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A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation

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A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation

BENJAMIN MEANS*

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INTRODUCTION

Investing in a closely held corporation is a risky proposition unless you hold the controlling stake or have bargained for additional protections. Your investment is likely to be a large percentage of your total wealth,¹ and, although you may rely upon family relationships or friendships, those are not legal protections. Indeed, family quarrels and soured friendships often lead to punitive business consequences. You may be removed from the board of directors; if you are an employee, you may be fired. Dividends may be withheld while the majority takes compensation in the form of salary. Under the business judgment rule, ordinary personnel and dividend decisions are not subject to judicial review. So consider your options. You could try to sell your stock, in order to exit the corporation, but who would step into your shoes, and at what price?² You might advocate for your interests, using your voice to improve your circumstances, but who would listen?³

1. Mary Siegel, *Fiduciary Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 384 (2004).

2. See *Donahue v. Rodd Electrotape Co. of New Eng.*, 328 N.E.2d 505, 515 (Mass. 1975) (“No outsider would knowingly assume the position of the disadvantaged minority. The outsider would have the same difficulties.”).

3. See *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984) (stating that the minority shareholder “may be without either a voice in protecting his or her interests or any reasonable means of withdrawing his or her investment”). In a public corporation, shareholders can always take the “Wall Street walk” and sell stock, a power that, in aggregate, gives managers reason to keep shareholders content. See generally ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS AND STATES* 4–5 (1970) (identifying economic pressure (“exit”) and political influence (“voice”) as the two primary mechanisms a firm’s members or customers may have available to protect their interests).

Despite these risks, most corporations are closely held.⁴ The close corporation form of business organization offers a winning combination of stability, structure, and limited liability while also permitting direct and relatively informal management.⁵ Yet, the very features that appeal to investors—a locked-in structure⁶ and centralized control⁷—enable the majority to deprive the minority of a return on its investment.⁸

The potential for minority shareholder oppression should be understood, therefore, as an inherent structural characteristic of the close corporation form.⁹ This characteristic creates a dilemma for courts and state legislatures, as well as for legal commentators who hope to offer guidance. The question is whether it is possible to adjust, *ex post*, the relationship of shareholders to remedy shareholder oppression while preserving the aspects of the close corporation form that investors value *ex ante*.¹⁰

4. See F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLCs: LAW AND PRACTICE § 1:2, at 1-7 (rev. 3d ed. 2004) [hereinafter O'NEAL & THOMPSON, CLOSE CORPORATIONS] (noting absence of "reliable figures" but citing one estimate "that 95% of all corporations have 10 or fewer shareholders" (citing Alfred F. Conrad, *The Corporate Consensus: A Preliminary Exploration*, 63 CAL. L. REV. 440, 458-59 (1975))). For most such small firms, it would not be realistic or advisable to become publicly traded. The decision for investors is whether to incorporate or operate instead as a partnership or limited liability company.

5. In several states, shareholders may affirmatively choose close corporation status, but "courts recognize the special needs of close corporations even in the absence of statute." JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 384 (2d ed. 2003); see also *Rexford Rand Corp. v. Ancel*, 58 F.3d 1215, 1217 n.1 (7th Cir. 1995) (stating that corporation "qualifies as a close corporation because it is a family-run business with only three shareholders" even though it "was not organized under the Illinois Close Corporation Act"). Unlike public corporations, close corporations have no publicly traded stock, and their shareholders usually manage the business directly as directors, officers, and employees.

6. Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387 (2003); Edward B. Rock & Michael L. Wachter, *Waiting for the Omelet To Set: Match-Specific Assets and Minority Oppression in Close Corporations*, 24 J. CORP. L. 913, 916 (1999) [hereinafter Rock & Wachter, *Waiting for the Omelet To Set*] ("The lack of a public market causes the parties to be locked into their investments to a much greater extent than in either the partnership or the publicly traded corporation.").

7. Cf. REVISED UNIF. P'SHIP ACT (RUPA) § 401(f) (1997) ("Each partner has equal rights in the management and conduct of the partnership business."); UNIF. P'SHIP ACT (UPA) § 24 (1914) (defining "property rights of a partner" to include the "right to participate in the management"). Close corporation shareholders have no established right of participation.

8. See F. HODGE O'NEAL & ROBERT B. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 3:1, at 3-2 (rev. 2d ed. 2005) [hereinafter O'NEAL & THOMPSON, OPPRESSION].

9. See Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699, 699 (1993) [hereinafter Thompson, *The Shareholder's Cause of Action*] ("The statutory norms of centralized control and majority rule, when combined with the lack of a public market for shares in a close corporation, leave a minority shareholder vulnerable in a way that is distinct from the risk faced by investors in public corporations.").

10. See O'NEAL & THOMPSON, CLOSE CORPORATIONS, *supra* note 4, § 1:5, at 1-16 ("The close corporation statutes and cases described in this treatise have provided a rich environment for working out issues at the intersection of contract (including the parties choice of a business form), the statutory norms, and the role of *ex post* judicial relief in contexts where the lack of a market and the combination of entity permanence and centralized control work to frustrate the expectations of investors in closely held businesses."); MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 1011 (1995) (observing that while "it seems reasonable to assume that most people who want to invest both human and

None of the three principal judicial approaches to the problem of minority shareholder oppression is satisfactory. Some courts, reluctant to upset the balance of corporate control to provide "special" un-bargained-for protection to minority shareholders, judge shareholder disputes in close corporations by the same standards applicable to public corporations.¹¹ This overly deferential view, referred to herein as a "Bad Faith" approach, treats the close corporation as if it were a public corporation, effectively ignoring the salient differences (including lack of liquidity) that make oppression possible. Minority shareholders are presumed not to value, or else to have priced-in before investing, any protections that might otherwise appear to be missing.

Other courts focus on the vulnerability of minority shareholders, and, with little regard for ex ante motivations for incorporation, hold majority shareholders to the enhanced fiduciary duties expected of partners, treating the close corporation as a partnership "clothed" in corporate form.¹² This "Fiduciary Duty" approach elides the differences between partnerships and corporations, creating uncertainty as to whether the corporate form will be respected or whether the majority must run the corporation to serve the interests of the minority.¹³

Increasingly, courts have adopted a "Reasonable Expectations" approach

financial capital in a particular enterprise would choose to organize as a general partnership because the default rules supplied by that body of law are most conducive to a consensus model of governance[.] ... considerations of limited liability, organizational stability and, in some cases, taxes may tip the balance in favor of incorporation" (footnote omitted)); Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence from LLCs*, 73 WASH. U. L.Q. 369, 375 (1995) ("Close corporations, whose disputes occur in nonrepeating end-game situations, may prefer flexible judicial decision-making to rigid legislative rules.").

11. See, e.g., *Nixon v. Blackwell*, 626 A.2d 1366, 1380 (Del. 1993) ("It would do violence to normal corporate practice ... to fashion an ad hoc ruling which would result in a court-imposed stockholder buy-out for which the parties had not contracted."); *Richards v. Bryan*, 879 P.2d 638, 648 (Kan. Ct. App. 1994) ("[D]irectors have the power to control and direct the affairs of the corporation, and in the absence of fraud, courts will generally not interfere on behalf of a dissatisfied stockholder with the discretion of the directors" (internal quotation marks and citation omitted) (emphasis in original)). A number of scholars share the view "that the oppression 'cure' is worse than the disease." John H. Matheson & R. Kevin Maler, *A Simple Statutory Solution to Minority Oppression in the Closely Held Business*, 91 MINN. L. REV. 657, 660 n.14 (2007) (citing scholarship without endorsing view). For a thorough discussion and a qualified endorsement, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 228-43 (1991).

12. See *Donahue v. Rodd Electrotype Co. of New Eng.*, 328 N.E.2d 505, 598 (Mass. 1975). Many legal commentators contend that minority shareholders deserve additional protection. See, e.g., Matheson & Maler, *supra* note 11, at 662 (proposing automatic right of exit); Thompson, *The Shareholder's Cause of Action*, *supra* note 9, at 702 ("Traditional corporate norms, oriented as they are toward publicly held corporations, proved unsuitable for close corporations.").

13. For an argument that default fiduciary duties should be applied only to relationships where one party delegates complete control to another, see Larry E. Ribstein, *Are Partners Fiduciaries?*, 2005 U. ILL. L. REV. 209, 212 ("Broad delegation means management power that is not subject to limitations or constraints such as the purported owner's active monitoring or approval power ..."). Professor Ribstein observes that, in this paradigm situation, "managers are subject to a duty of *unselfishness*" and "have a legal duty to forego gain from the relationship exceeding agreed compensation." *Id.* at 216 (emphasis in original). Ribstein contends that the duty of good faith is better suited to partnership-type firms because it "does not demand foregoing self-interested conduct, but rather only refraining from the

which measures oppression by asking whether minority shareholders have been deprived of some benefit that they were reasonably entitled to expect.¹⁴ To the extent courts seek to ascertain and enforce the parties' true bargain, rather than simply requiring controlling shareholders to abide by a norm of unselfishness, Reasonable Expectations invites a more careful and context-based adjudication. However, the approach is circular because whether a given expectation is "reasonable" depends upon whether the court holds that shareholders owe one another the limited duties of shareholders in a corporation (the Bad Faith approach), the enhanced obligations of partnership law (the Fiduciary Duty approach), or perhaps, some other set of rights and obligations.¹⁵ Reasonable Expectations analysis, then, begs the question of what is reasonable. Also, litigation concerning the nature of a bargain as originally envisioned (and as it has evolved over time) can embroil shareholders in protracted and expensive litigation and consume substantial judicial resources.

Rather than insisting upon strained comparisons to public corporation or partnership models of governance, courts should minimize deterrents to minority investment by preventing majority shareholders from taking unfair advantage of their power while also recognizing the majority shareholders' right to benefit from control in order to encourage their investment.¹⁶ Ultimately, the question is straightforward: do the controlling shareholders have a legitimate business purpose, or are they acting from a selfish desire to exclude the minority from the benefits of ownership in order to enjoy those benefits on a non-pro-rata basis?¹⁷ That question can and should be asked under any of the three existing

particular sort of self-interested conduct that is proscribed by the parties' contract, broadly construed." *Id.* at 222.

14. See Douglas K. Moll, *Reasonable Expectations v. Implied-in-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C. L. REV. 989, 1002 (2001) [hereinafter Moll, *Reasonable Expectations*] (stating that "the 'reasonable expectations' standard garners the most approval, and courts have increasingly used it to determine whether oppressive conduct has taken place").

15. Douglas K. Moll, *Shareholder Oppression & Dividend Policy in the Close Corporation*, 60 WASH. & LEE L. REV. 841, 844 (2003) [hereinafter Moll, *Shareholder Oppression & Dividend Policy*] (observing that defining shareholder oppression in terms of "reasonable expectations" does little more than "simply rephrase[] the fundamental question").

16. To the extent a tradeoff must be made between investment value and basic notions of fairness, sympathy for the disadvantaged minority shareholder will come at the expense of the overall value of the close corporation form. However, if the goal is to maximize total investment, and if we further assume that potential minority and majority shareholders are equally responsive to changes in legal doctrine, there is no reason to assume that any safeguards against minority shareholder oppression will reduce the value of the firm. The majority may be indifferent to a standard that prevents it from opportunistically grabbing the minority's investment; the minority may require such protection as a condition of investment, and, given transaction cost considerations, the existence of judicial discretion to police the parties' conduct ex post may determine whether socially valuable investment takes place.

17. To be sure, there are decisions that, by their terms, appear to require the majority to respect the minority's interests apart from any business justifications. See, e.g., *Meiselman v. Meiselman*, 307 S.E.2d 551, 564 (N.C. 1983) (defining reasonable expectations as analysis of minority's "rights and interest," not majority's conduct, but also holding that minority's responsibility for any frustration of expectations must be taken into account). Courts may differ in principle as to whether an action that harms minority shareholders can be legitimate—whether it is appropriate to investigate the majority's

approaches to minority shareholder oppression.

The key to improving the adjudication of shareholder disputes in close corporations, consistent with current law, is recognizing the procedural dimension of the problem: courts must determine the level of scrutiny to apply in deciding whether a claim of shareholder oppression has merit.¹⁸ Apparent doctrinal differences may be overstated, and they obscure the critical issue of judicial review.¹⁹ In large part, current approaches to identifying shareholder oppression can be understood as embodying points along a range of possible scrutiny.²⁰ What matters is not just what courts look for in evaluating claims of minority shareholder oppression, but the extent to which they defer to the controlling shareholders' business judgment.

This Article contends that courts should (1) embrace the principle that the appropriate level of judicial scrutiny may vary and (2) use minority shareholder participation in governance to determine the proper level of scrutiny. If the minority lacks a voice in the business, courts should apply enhanced scrutiny, accepting general pleadings and requiring controlling shareholders to show a legitimate business purpose for challenged conduct.²¹ When adjudicating claims of shareholder oppression in close corporations with substantial minority participation—paradigmatically, representation on the board of directors—courts should apply more relaxed scrutiny, giving substantial deference to the majority's business judgment absent evidence of self-dealing or bad faith.²²

rationale for the decision—but few courts would in practice require a business to go bankrupt to cater to minority shareholders or, conversely, would permit majority shareholders to reduce the value of the minority's interest to zero. *See infra* section III.A.

18. Cf. Robert B. Thompson, *Mapping Judicial Review: Sinclair v. Levien*, in *THE ICONIC CASES IN CORPORATE LAW* 79, 79 (Jonathan R. Macey ed., 2008) ("The intensity of judicial review of corporate decisions is the central issue of corporate law.").

19. *See* DOOLEY, *supra* note 10, at 1057 ("How many of these apparent differences reflect real disagreements about substance and how many are merely rhetorical differences is debatable . . ."). Many courts recognize that majority shareholders control the corporation and hold them to (at least) the same fiduciary obligations applicable to directors of public corporations. The fiduciary duty follows control. *See, e.g.,* Welch v. Via Christi Health Partners, Inc., 133 P.3d 122, 137 (Kan. 2006) ("[A] director of a corporation owes a high fiduciary duty to the other stockholders of the corporation.").

20. The extent to which a court is willing to defer to the majority's proffered justification may often be outcome determinative. In most cases, the majority will be able to offer a facially plausible business explanation for challenged conduct, and the minority will assert that the justifications are a pretense and that the majority's true purpose was to extract improper benefits from the corporation, to disadvantage the minority, or the like. As discussed *infra* section III.A, the intensity of judicial review matters greatly in any case where the factors relevant to an assessment of business purpose can legitimately be disputed.

21. As used in this Article, the concept of minority "voice" includes a meaningful opportunity to review information relevant to important corporate governance decisions and to participate in the decisionmaking process. When the minority's voice has been obstructed, judicial scrutiny should be at its most intense. However, as discussed *infra* section III.B.1, minority voice need not include any ability to alter the outcome through voting power or veto rights.

22. Even relaxed scrutiny of oppression claims would be more searching than the business judgment rule, which is so deferential that some scholars have described it as, essentially, a doctrine of abstention. *See* STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 243 (2002). Despite judicial reluctance to substitute a court's judgment concerning business matters for those charged with managing the

The recommended model accommodates a range of current approaches to shareholder oppression, improving upon them in a number of respects. First, variable scrutiny based on voice would avoid the systematic under- or over-protection of minority shareholders that can result from rigid application of existing Bad Faith and Fiduciary Duty approaches. Indeed, the recommended procedural flexibility can be defended as a formalization of the case-specific analysis many courts already apply.²³ In jurisdictions that follow a Reasonable Expectations approach, initial consideration of minority shareholder voice would help focus the court's inquiry, reducing the cost and uncertainty of litigation.

Second, by giving explicit priority to minority shareholder voice, the voice-based framework remedies an oversight in current doctrine.²⁴ Exit-focused approaches can have unhappy consequences: courts may either state the obvious, that close corporations are not conducive to exit, and leave the minority no better off, or they may create exit rights that undermine one of the fundamental characteristics of the close corporation. Voice deserves attention as an alternative mechanism for satisfying minority shareholder interests.²⁵ Voice matters to minority shareholders not only as a procedural protection, but often as, in itself, a central benefit of the investment.²⁶

Third, the proposed model would be more efficient. The cheapest lawsuits are

business, minority shareholders could present evidence of a lack of legitimate business purpose, and the legitimacy of corporate action could perhaps be assessed, in part, by considering its impact on minority shareholders. Minority shareholders cannot, however, escape the business judgment rule in all circumstances solely by virtue of their minority status. The rule would still protect the majority from allegations that it violated its fiduciary duty of care to the detriment of the corporation as a whole. *See, e.g., Alaska Plastics, Inc. v. Coppock*, 621 P.2d 270, 278 (Alaska 1980) (affirming dismissal of derivative claim brought by minority shareholder that alleged majority failed to procure adequate insurance and to invest corporate funds in interest-bearing accounts).

23. *See, e.g., Cooke v. Fresh Express Foods Corp.*, 7 P.3d 717, 722 (Or. 2000) ("[A]ttempts to define what oppressive conduct is . . . have proved elusive, and cases of this sort depend heavily on their specific facts."); *Kiriakides v. Atlas Food Sys. & Servs., Inc.*, 541 S.E.2d 257, 266 (S.C. 2001) (finding that "the definition of oppression has been left to judicial construction on a case-by-case basis"). The available parameters of scrutiny would vary state by state, depending on whether the state has adopted a heightened fiduciary standard, requires bad faith conduct on the part of the majority, or has moved in the direction of an approach based on reasonable minority expectations.

24. *See, e.g., Matheson & Maler, supra* note 11, at 661 (observing that "the development of [minority shareholder oppression] law involves a desire by courts and legislatures to provide an exit strategy for minority owners in closely held businesses").

25. *See HIRSCHMAN, supra* note 3, at 4-5.

26. *See, e.g., O'NEAL & THOMPSON, CLOSE CORPORATIONS, supra* note 4, § 1:9, at 1-36 ("[T]he shareholder in a close corporation considers himself or herself as a co-owner of the business and wants the privileges and powers that go with ownership."). Recent proposals for increasing shareholder voice in the public-corporation context reject the idea that there is any inherent value in shareholder voice or that political ideas might inform corporate governance. *See, e.g., Lucian A. Bebchuk, The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 678 (2007) ("[I]ncreased shareholder power to replace directors would be desirable if and only if such a change would improve corporate performance and value. . . . I do not view 'shareholder voice' and 'corporate democracy' as ends in themselves . . ."). Indeed, Bebchuk states that his "support for reforming corporate elections is not motivated by political ideas but rather by the goal of making a market institution—the modern publicly traded company—function better." *Id.* By contrast, this Article's advocacy of minority shareholder voice in close corporation governance does rely upon the political benefits of participation, because close corporations

the ones that never happen; creating an incentive for close corporations to respect minority shareholder voice would reduce the number of governance breakdowns that lead to litigation.²⁷ Even if the amount of litigation stayed constant, a voice-based framework would still offer efficiency benefits. Courts could reserve the most time-consuming, intense scrutiny—setting aside the business judgment rule and undertaking a detailed analysis of all contested facts—for those corporations without minority participation. A corporation that excludes minority voice is less likely to take into account minority shareholder interests, and, because the minority will have only limited access to information, majority shareholders are best positioned to justify a contested decision that harms minority shareholders.²⁸

Although some scholars may object that voice-based scrutiny would disregard the choice of business form made by the parties,²⁹ altering the bargain they thought they had, that objection is misplaced. The proposed framework does not change substantive doctrine or impose a new fiduciary obligation; rather, to the extent controlling shareholders are already subject to mandatory fiduciary duties preventing them from appropriating the value of the minority's investment, this Article contends that courts need not judge claims of shareholder oppression using a one-size-fits-all standard of review and should place the burden on the

are, in some respects, non-market organizations. For example, to describe a family run business strictly in market terms is to miss much of what motivates its shareholders.

27. By applying stricter scrutiny to those close corporations that dispense with important procedural opportunities for minority shareholder participation (such as annual shareholder meetings) or that deliberately shut out minority voice, this Article's proposal would create an incentive for close corporations to adopt inclusive governance models. An economist might object to the supposed benefits of a proposal that could be implemented by market participants without coercion. Arguably, an efficient market would already supply that form of governance arrangement if it were desirable. This possible objection overstates the efficiency of markets, especially in the close corporation context where business relationships may intertwine with family relationships. Also, the market for close corporation governance may not internalize the cost to society of strain on the judicial system or the potential societal benefits that shareholder participation may create. *See infra* section II.C.

28. When minority shareholders have substantial voice, courts can reasonably require more detailed factual allegations because minority shareholders have already had an opportunity to influence decisions before they are made and should have access to evidence of any majority misconduct in the decisionmaking process. Litigation costs can also be seen as an aspect of minority shareholder voice in that the litigation mechanism is an important expressive mechanism of last resort, given the difficulty minority shareholders have exiting close corporations.

29. In a series of articles, Professor Larry Ribstein has argued that choice of business form is an aspect of contractual freedom and that courts that impose additional fiduciary duties may undercut the parties' ability to bargain for their preferred set of rights. *See, e.g.,* Larry E. Ribstein, *Why Corporations?* 1 BERKELEY BUS. L.J. 185 (2004) [hereinafter Ribstein, *Why Corporations?*]; Larry E. Ribstein, *Uncorporating the Large Firm* (Univ. Ill. Law & Econ. Research Paper Series, Research Paper No. LE08-016, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1138092. Ribstein commented online in response to an earlier draft of this Article, raising the concern that "[t]he proposal would in effect invite courts to decide for the parties that they want voice, and give relief according to whether they've provided for it." Posting of Larry Ribstein to Ideoblog, <http://busmovie.typepad.com/ideoblog/2009/01/mandatory-rules-for-closely-held-firms.html> (Jan. 13, 2009, 07:29 CST).

party best able to meet it.³⁰

Even if the proposal could be understood to restrict the ability of parties to customize control arrangements, because minority voice determines the level of judicial review, the choice-of-form objection would remain unconvincing.³¹ One of the distinguishing features of corporate law is the mandatory fiduciary duty of loyalty owed by controlling shareholders to the corporation—directly or by dint of their control of the board of directors. If investors want to sharply limit fiduciary duties, perhaps in favor of enhanced, contractual exit rights, the choice-of-form theory indicates that they should pick a partnership or limited liability company form more amenable to contractual modification.³²

The Article proceeds as follows. Part I describes minority shareholder oppression as a problem of exit and voice and criticizes the three principal doctrinal responses. Part II argues that minority shareholder voice is far more important than courts and commentators have generally recognized and contends that

30. Controlling shareholders might invite minority participation in order to benefit from more relaxed review in the event of litigation, but they would remain free to run the corporation however they think best.

31. Although fiduciary duties are mandatory in that they cannot be waived in their entirety, shareholders would remain free to bargain explicitly concerning the structure of their relationship, including issues of voice. As a practical matter, though, minority shareholder voice may prove difficult to address through *ex ante* bargaining. Board membership is probably the best proxy, but the actual governance of a small business can easily shift from a consensus-based to an authoritarian model depending on the personalities involved. Short of voting rules that require consensus, which, of course, invite problems of deadlock, minority voice will substantially depend on the controlling shareholders' attitude toward the minority. This link between majority attitude and minority voice further supports using voice to determine the level of judicial review. For an earlier version of this point, see this author's online dialogue with Professor Stephen Bainbridge. Posting of Stephen Bainbridge to Professor-Bainbridge.com, <http://www.professorbainbridge.com/Lists/Posts/Post.aspx?ID=1967> (Jan. 4, 2009, 16:00 PST) (quoting email from this author to Professor Bainbridge); Posting of Stephen Bainbridge to ProfessorBainbridge.com, <http://www.professorbainbridge.com/Lists/Posts/Post.aspx?ID=1975> (Jan. 12, 2009, 16:00 PST) (quoting email from this author to Professor Bainbridge).

32. See, e.g., Ribstein, *Why Corporations?*, *supra* note 29, at 210 (arguing that corporate form is outliving its usefulness for large, modern firms and that "partnership-type firms offer an agreement-centered approach to centralized management that provides flexibility and adaptability"). Unlike partnerships, "[c]orporations originated as state-created monopolies" and, because corporations are still seen as a creation of the state, there exists "a presumption in favor of regulating corporations that does not apply to other business associations or contracts." *Id.* at 208. Whether minority investors in contract-based LLCs should be taken to have contracted for a locked-in voiceless status if they fail to modify default rules to avoid that problem is beyond the scope of this Article. Arguably, importing corporate law fiduciary duties would undermine the independent significance of the LLC form and inhibit contractual freedom. On the other hand, one might argue that any long-term, complex business contract is likely to be incomplete in fairly significant respects and that, to avoid inefficiently expensive *ex ante* bargaining, the courts should enforce fiduciary norms of conduct. See Melvin A. Eisenberg, *The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 835–36 (1999). For purposes of the argument advanced in this Article, the existence of alternate, contract-based forms of business investment only serves to highlight that gap-filling fiduciary duties are part of the choice made by investors who choose to do business by incorporating. With decades of shareholder-oppression doctrine as backdrop, one might argue that the choice of close corporation form amounts to a decision for enhanced fiduciary obligation among the shareholders. Thus, the availability of new, hybrid business forms only makes the argument for protection of minority shareholders in close corporations stronger.

voice should be central to judicial analysis of minority oppression claims. Part III offers an alternative model for adjudication that varies the level of judicial scrutiny based upon minority shareholder voice.³³ Part IV demonstrates that courts in most jurisdictions can apply a voice-based framework in conjunction with existing doctrine. A more flexible, voice-centered model of judicial scrutiny would better serve the interests of minority shareholders and the close corporations to which they belong.

I. THE PROBLEM OF MINORITY SHAREHOLDER OPPRESSION

Public corporations dominate the headlines and get far more attention from courts, legislatures, and commentators, but most corporations are closely held.³⁴ Minority shareholder oppression, therefore, has the potential to impact the "vast majority of American businesses."³⁵ Consistent with common usage, the term "oppression" as used in this Article encompasses all lawsuits brought by minority shareholders against controlling shareholders, regardless of the specific cause of action or the remedy sought.³⁶

33. This Article's twin arguments—that courts should apply varied scrutiny and that the level of scrutiny should be based upon minority shareholder voice—are, it should be noted at the outset, conceptually severable. The possibility of varying judicial scrutiny does not logically depend upon acceptance of the importance of minority shareholder voice. Likewise, one can accept that minority shareholder voice deserves greater weight in judicial analysis in shareholder oppression cases without implementing that insight through changes in the level of judicial review.

34. See O'NEAL & THOMPSON, CLOSE CORPORATIONS, *supra* note 4, § 1:2, at 1-7. For one well-known definition of the close corporation, see *Donahue v. Rodd Electrotape Co. of New Eng.*, 328 N.E.2d 505, 511 (Mass. 1975) ("We deem a close corporation to be typified by: (1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management . . . of the corporation."); cf. O'NEAL & THOMPSON, CLOSE CORPORATIONS, *supra* note 4, § 1:2, at 1-12 (contending that only the absence of shares traded on a securities market is critical to the definition of a close corporation). "In contrast with the close corporation, larger corporations . . . necessarily involve substantial separation of ownership and control, have a form of representative government-by-the-majority, with management delegated to a board of directors, following rather formal procedures," and "[t]he transfer of shares is usually not only free from transfer restrictions but is facilitated by securities exchange listing or an active over-the-counter market." HARRY G. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES 507 (2d ed. 1970).

35. Siegel, *supra* note 1, at 378 (citations omitted).

36. See DOOLEY, *supra* note 10, at 1042 ("Although the term 'oppression' originated in involuntary dissolution statutes, in many states it has now evolved to designate a separate cause of action for dissident minorities in close corporations, regardless of the form of relief sought . . ."); Thompson, *The Shareholder's Cause of Action*, *supra* note 9, at 700 (stating that the "purposes and effects" of statutory and common law approaches "are so sufficiently similar that it makes sense to think of them as two manifestations of a minority shareholder's cause of action for oppression"). For early use of "oppression" language in the common law context, see *Miner v. Belle Isle Ice Co.*, 53 N.W. 218, 223 (Mich. 1892):

It cannot be denied that minority stockholders are bound hand and foot to the majority in all matters of legitimate administration of the corporate affairs; and the courts are powerless to redress many forms of oppression, practiced upon the minority under a guise of legal sanction, which fall short of actual fraud.

A. CAUSES OF MINORITY SHAREHOLDER OPPRESSION: EXIT AND VOICE

The close corporation structure lends itself to abuse of minority shareholders. One way of describing the inherent structural potential for oppression of minority shareholders is as a problem of “exit” and “voice”—terms that represent economic and political mechanisms for the expression and resolution of shareholder grievances.³⁷

1. Exit

In economic terms, minority shareholder oppression in close corporations turns on one critical fact: minority shareholders have no practical ability to sell their shares and exit without the majority’s consent.³⁸ By definition, a close corporation’s shares do not trade on a public market.³⁹ Moreover, many close corporations impose additional transfer restrictions designed to exclude strangers to the business.⁴⁰ Unlike a partnership, the close corporation form is permanent; minority shareholders cannot ordinarily dissolve the corporation or require the corporation to repurchase their stock.⁴¹

37. HIRSCHMAN, *supra* note 3, at 4–5. The use of “exit” and “voice” to frame the analysis builds upon Albert Hirschman’s famous observation that any organization’s deterioration in quality can be counteracted by “exit,” “voice,” or a combination of the two. For instance, an unhappy customer can purchase goods from a competing firm (the “exit” option) or complain about the perceived lack of quality and seek improvement (the “voice” option). Declining sales and customer complaints may both serve to spur change. Depending upon the circumstances, either exit or voice may be effective as a mechanism of recuperation, and one can affect the other in a variety of ways. Where exit is impossible as a practical matter—for example, from a family or a state—voice automatically becomes more important. Yet, the lack of a credible threat of exit may in some circumstances diminish the effectiveness of voice. As discussed *infra* section I.A.2, these considerations are of direct relevance in the context of a close corporation, where structural exit limitations increase the importance of voice.

38. See, e.g., *Nixon v. Blackwell*, 626 A.2d 1366, 1379 (Del. 1993) (noting that “there is no market and no market valuation” and stating that “[i]t is not difficult to be sympathetic, in the abstract, to a stockholder who finds himself or herself in that position”). This, of course, assumes that the shareholders have not previously entered into a shareholders’ agreement creating a right of liquidity.

39. It should be noted, however, that the ability to exit from a public corporation through sale of stock does not offer perfect protection for shareholders, who may be forced to take losses in order to sell. See *Bebchuk*, *supra* note 26, at 716 (“[F]or shareholders concerned that poor board performance is reducing the value of their investment, the freedom to sell their shares is hardly an adequate remedy.”); Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789, 795 (2007) (“Although a single shareholder may be able to sell a small number of shares easily, when exploited shareholders try to sell en masse, the result is a predictable loss of value.”).

40. See O’NEAL & THOMPSON, CLOSE CORPORATIONS, *supra* note 4, § 1:9, at 1-36 (explaining that “shareholders in a close corporation commonly are greatly concerned about the identity of their associates and have a strong desire to gain and hold the power to choose future shareholders”).

41. It is important to recognize that limited exit is not accidental but part of the close corporation’s design. Share transfer restrictions show that shareholders value participation in a shared venture with known members and do not want changes to upset balanced ownership. *Id.* (noting that shareholders “are reluctant to run the risk of having the harmony and balance of their business organization disturbed . . . by the unwelcome intrusion of strangers”). Fundamentally, the decision to incorporate rather than operate as a partnership is itself evidence that shareholders disfavor exit. Where possible, shareholders should negotiate a buy-sell agreement in advance that enables shareholders, under defined circumstances, to sell stock to the corporation at a price set by a specified formula. However, as discussed *infra* section III.D.2, the appropriate terms for a buy-out will vary from business to business.

The minority's inability to exit the investment—through either market or legal means—enables a hostile majority to “freeze out” the minority from the benefits of ownership, for instance by excluding minority shareholders from salaried employment while refusing to declare dividends. Minority shareholders have no market for their shares if they believe that the business is being mismanaged or that they are being unfairly deprived of its benefits.⁴² As a consequence, a close corporation's decision not to declare dividends can have a large impact, such that “financially-starved minority shareholders may feel pressure to sell their stock for a low value.”⁴³

Although the threat of takeover can constrain abuse by the managers of a public corporation, in that sale of stock by minority shareholders renders the corporation vulnerable, no such market discipline exists in the close corporation context.⁴⁴ Thus, in an immediate sense, shareholder oppression stems from lack of exit.⁴⁵

2. Voice

Equally important, although less often discussed, minority shareholder oppression is a problem of voice. In broad terms, voice can be understood “as any attempt at all to change, rather than to escape from, an objectionable state of affairs.”⁴⁶ Yet, minority shareholders often lack a meaningful ability to participate in the governance of a close corporation and may be excluded entirely from the decisionmaking process. Depriving minority shareholders of voice poses an especially severe problem because of the absence of reasonable exit options: “Where exit is precluded, dissatisfied constituencies of an organization must resort to voice; that is, because they cannot escape from the unsatisfactory situation, they must seek to change it through internal governance mecha-

42. *Donahue v. Rodd Electrotype Co. of New Eng.*, 328 N.E.2d 505, 514 (Mass. 1975) (“In a large public corporation, the oppressed or dissident minority stockholder could sell his stock in order to extricate some of his invested capital. By definition, this market is not available for shares in the close corporation.”); see Douglas K. Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VAND. L. REV. 749, 757 (2000) [hereinafter Moll, *The Unanswered Question*]. By contrast, “[i]n the traditional public corporation, the shareholder is normally a detached investor who neither contributes labor to the corporation nor takes part in management responsibilities.” Moll, *The Unanswered Question*, *supra*, at 756–57; see also Siegel, *supra* note 1, at 384.

43. Siegel, *supra* note 1, at 384.

44. O'NEAL & THOMPSON, CLOSE CORPORATIONS, *supra* note 4, § 1:9 at 1-40. This is not to suggest that close corporations are indifferent to product, labor, and capital markets, but that those market incentives do not protect minority shareholders adequately from the possibility of oppression.

45. See *Donahue*, 328 N.E.2d at 514 (“[T]he true plight of the minority stockholder in a close corporation becomes manifest. He cannot easily reclaim his capital.”); Charles B. Blackmar, *Partnership Precedents in a Corporate Setting—Exit from the Close Corporation*, 7 J. CORP. L. 237 (1982) (proposing robust exit rights consistent with partnership law); Matheson & Maler, *supra* note 11, at 661 (“We contend that the development of this area of law involves a desire by courts and legislatures to provide an exit strategy for minority owners in closely held businesses.”); Rock & Wachter, *supra* note 6, at 916 (identifying the “difficulty of exit” as the “intuition that lies at the heart of the evolution of minority shareholders’ remedies for ‘oppression’”).

46. HIRSCHMAN, *supra* note 3, at 30.

nisms.”⁴⁷ Minority shareholders may depend upon having a voice concerning corporate decisions that affect the value of their investment.

To move from a conception of exit to voice is to move from an economic to a political understanding of the firm.⁴⁸ Given the intimate relationships involved in many close corporations, and the restrictions of exit,⁴⁹ a nuanced political approach may be more appropriate than an economic one.⁵⁰ By viewing shareholder relationships in terms of the broader conception of voice, we can also situate close corporations within “a whole gamut of human institutions, from the state to the family, [where] voice, however ‘cumbrous,’ is all their members normally have to work with.”⁵¹ Economics, and, by extension, the economic analysis of law, has “a blind spot” where voice is concerned.⁵²

Exit and voice should not, however, be viewed in isolation; the two mechanisms interact in a dynamic fashion. Thus, the lack of a credible threat of exit may diminish the effectiveness of minority voice even as it increases its importance. However, as discussed *infra* in Part II, the value of minority shareholder voice as a political mechanism does not depend on strong exit rights. Voice represents a nuanced process involving a reasoned exchange of views, not simply a vote tally. To the extent leverage matters, this Article’s use of voice as the trigger for intensified judicial scrutiny would partly restore the implicit threat of exit, potentially bolstering the impact of minority voice.⁵³

47. BAINBRIDGE, *supra* note 22, at 798.

48. HIRSCHMAN, *supra* note 3, at 30 (“[V]oice is nothing but a basic portion and function of any political system, known sometimes also as ‘interest articulation.’”).

49. See Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal’s Role in Corporate Law*, 84 GEO. L.J. 1, 2 (1995) [hereinafter Thompson, *Exit, Liquidity*]:

[O]ur willingness to accept a different balance of majority and minority rights is affected by the shareholder’s ability to exit from a corporation when there is a market for its shares. Within Albert Hirschman’s structure of exit, voice, and loyalty, corporate participants have greater exit opportunities than do political participants.

For a different perspective, see Anupam Chander, *Minorities, Shareholder and Otherwise*, 113 YALE L.J. 119, 122 (2003) (arguing that corporate law does not insist on an unrealistic conception of neutrality but offers additional appropriate protections for minorities: “Oppression is a cause of action found not in constitutional law, but in corporate law.”).

50. See generally Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 924 (1984) (“[P]olitical ideas constrain or influence the form of business organizations.”).

51. HIRSCHMAN, *supra* note 3, at 17; cf. JOHN HART ELY, *DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW* 179 (1980) (arguing, in political context, that “a dissenting member for whom the ‘voice’ option seems unavailing should have the option of exiting and relocating in a community whose values he or she finds more compatible”).

52. HIRSCHMAN, *supra* note 3, at 17 (identifying the economist’s bias against voice and in favor of market-based exit as a tool of remediation and observing that political scientists similarly have a “trained incapacity” when it comes to recognizing the usefulness of exit).

53. If voice cannot substitute for stronger medicine—judicially ordered buyouts and dissolution, for example—it may make those remedies rarer. However, the fact that a lawsuit has been filed should not count as evidence of a lack of minority voice. Otherwise, the majority would have less incentive to provide voice to the minority in the first place. Further, to preserve the prerogative of majority rule, courts should not assume that an unhappy minority is an oppressed minority or conflate voice with outcome.

B. INADEQUATE RESPONSES TO MINORITY SHAREHOLDER OPPRESSION

Each state has its own method of resolving conflicts between majority and minority shareholders in close corporations, and the approaches vary along a number of dimensions: the nature of duties owed, whether statutory protections are available, and the scope of remedies available.⁵⁴ Nevertheless, with some simplification, current doctrine can be grouped into three distinct categories: Bad Faith, Fiduciary Duty, and Reasonable Expectations.⁵⁵ None is adequate to the task of identifying and remedying minority shareholder oppression.

1. Bad Faith: The Public Corporation Model

The Bad Faith approach emphasizes the fact that the owners of a close corporation, like any other corporation, are free at the outset to negotiate for corporate governance provisions that suit their needs.⁵⁶ As Delaware's Supreme Court explained:

The tools of good corporate practice are designed to give a purchasing minority stockholder the opportunity to bargain for protection before parting with consideration. It would do violence to normal corporate practice and our corporation law to fashion an ad hoc ruling which would result in a court-imposed stockholder buy-out for which the parties had not contracted.⁵⁷

In order to recover, the plaintiff cannot simply allege that a decision was "unfair."⁵⁸ The controlling shareholders are entitled to deference under the business judgment rule unless the plaintiff can show that the majority's conduct was fraudulent⁵⁹ or conflicted.⁶⁰ Yet, "[t]he actions that most directly impact the

54. For state-specific analysis, see Matheson & Maler, *supra* note 11, app. at 700–09. The trend has been toward greater flexibility in remedying oppression. *Id.* at 679.

55. *See id.* at 675 ("Courts have settled on three primary approaches."). For a different descriptive claim concerning the existing doctrinal approaches to minority shareholder oppression, see Moll, *The Unanswered Question*, *supra* note 42, at 752, 754 (contending that courts view shareholder oppression either by examining "the propriety of the majority's conduct" or "the effect that majority conduct has on the minority" and advocating a "modified minority perspective" as "the only approach that enforces the likely understandings that reasonable investors would have reached if, at the venture's inception, they had bargained over the protection of their investments and the prerogatives of the majority"). Using the categories Professor Moll offers, this Article advocates a modified majority perspective—the emphasis squarely on the legitimacy of the business purpose but informed by consideration of the effect on the minority, especially abrogation of minority shareholder voice.

56. *Nixon v. Blackwell*, 626 A.2d 1366, 1379–80 (Del. 1993); *Richards v. Bryan*, 879 P.2d 638, 648 (Kan. Ct. App. 1994). Even to the extent corporation statutes afford close corporation shareholders greater flexibility in modifying the ordinary principles of corporate governance, such "self help" provisions . . . by themselves, neither create nor alter any rights or obligations among the corporate actors." Siegel, *supra* note 1, at 385.

57. *Nixon*, 626 A.2d at 1380.

58. *Id.* at 1373, 1381 (noting that the basis for the lower court's ruling was that defendants' conduct was "inherently unfair" and reversing).

59. *Richards*, 879 P.2d at 648 ("[D]irectors have the power to control and direct the affairs of the corporation, and in the absence of fraud, courts will generally not interfere on behalf of a dissatisfied

minority shareholder—his or her termination and the failure to declare dividends—do not involve a conflict of interest transaction between the majority owners and the corporation.”⁶¹ If the defendants “are on both sides of the transaction,” the “defendants have the burden of showing the entire fairness of those transactions.”⁶² However, the concept of “fairness” is narrowly construed and does not appear to require the majority to provide any unbargained-for benefits to minority shareholders.⁶³

Thus, courts that adopt the Bad Faith approach place their faith in private ordering and leave it to the parties to tailor the rules to suit their circumstances. Because courts following the Bad Faith approach view close corporations as subject to the ordinary principles of corporations law, they ask, rhetorically, “[w]hether there should be any *special*, judicially-created rules to ‘protect’ minority stockholders of closely-held . . . corporations.”⁶⁴

One problem with the Bad Faith approach is that many close corporations

stockholder with the discretion of the directors on questions of corporate management, policy or business.” (quoting *Sampson v. Hunt*, 665 P.2d 743, 755 (Kan. 1983)) (emphasis removed)).

60. A related approach that might fall within the Bad Faith category defines oppression as “burdensome, harsh and wrongful conduct, or . . . a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.” *Fix v. Fix Material Co.*, 538 S.W.2d 351, 358 (Mo. Ct. App. 1976) (internal citations and quotation marks omitted). On the one hand, that standard clearly focuses attention on the conduct of the majority and appears to set a high bar for recovery. On the other hand, it permits a plaintiff to recover if the majority’s conduct is deemed sufficiently “harsh” by the finder of fact and permits the plaintiff to make that case without first having to demonstrate the inapplicability of the business judgment rule. *Id.*

61. Franklin A. Gevurtz, *Squeeze-Outs and Freeze-Outs in Limited Liability Companies*, 73 WASH. U. L.Q. 497, 499–500 (1995). As Professor Gevurtz observes, “under the traditional rule, courts would apply a highly deferential level of review; for example, they might require the complaining shareholder to prove the board’s decision was in bad faith or irrational.” *Id.* at 500. Yet, “[w]ithout a job and in the absence of dividends, the minority shareholder may face an indefinite future with no return on the capital he or she contributed to the enterprise.” Thompson, *The Shareholder’s Cause of Action*, *supra* note 9, at 703.

62. *Nixon*, 626 A.2d at 1375–76. For instance, “the majority owners’ receipt of salaries and perquisites involves a conflict of interest” but “courts find a substantial range of compensation to be fair and, at best, such a challenge will give the squeezed-out shareholder only limited leverage in obtaining some benefit from the corporation.” Gevurtz, *supra* note 61, at 500.

63. In *Nixon*, for example, the court approved a series of majority actions, including the creation of a stock option plan and the funding of “key man” life insurance that guaranteed liquidity for the controlling shareholders and held that, as passive investors, the minority shareholders were “entitled to be treated fairly but not necessarily to be treated equally.” *Nixon*, 626 A.2d at 1379. The court did not endeavor to explain what, if anything, fair treatment might require.

64. *Id.* at 1379 (emphasis added). Of course, characterizing shareholder oppression doctrine as “special” telegraphs the answer, and the court treated the comparison of close corporation to public corporation as dispositive, conflating the metaphor with reality. In *Nixon*, the court noted that the shareholders had chosen not to elect statutory close corporation status, but, as the court effectively acknowledged, that was a distinction without a difference, because the statutory provisions offered nothing more than flexibility in the initial formation of the corporation and provided no default protections for minority shareholders frozen out by a hostile majority. *Id.* at 1380 n.19 (“We do not intend to imply that, if the Corporation had been a close corporation under Subchapter XIV, the result in this case would have been different.”). Close corporation statutes like Delaware’s that offer flexibility may be useful for planning purposes (though counsel can usually accomplish the same result under general corporate statutes) but offer little or no help in resolving claims of shareholder oppression.

arise out of a family context, or else involve close friendships.⁶⁵ There is often no arms-length negotiation involved and investors may systematically underestimate the likelihood of future conflict.⁶⁶ To the extent the Bad Faith approach assumes that minority investors price-in the possibility of oppression, because they will internalize the harm, it relies upon a thin conception of the economically rational person and ignores the insights of behavioral economics.⁶⁷ Moreover, to the extent the corporation has few initial assets, there may also be rational impediments to incurring the bargaining costs necessary for a more fully developed contractual relationship.⁶⁸

A second difficulty is that, by placing the onus on minority shareholders to demonstrate egregious majority misconduct, the Bad Faith approach can lead courts to adopt too deferential a posture, even when there is evidence of self-dealing. This is particularly true when courts ignore issues of minority voice. If the minority is excluded from decisionmaking, it is also unlikely to have concrete evidence of wrongdoing.

For example, in *Stuparich v. Harbor Furniture Manufacturing*,⁶⁹ a California appellate court applied the traditional corporate law norm that the business judgment of those managing a corporation deserves substantial deference and failed to give sufficient weight to aspects of the close corporation context that suggested the majority's judgment might be conflicted.

Among other disagreements, plaintiffs (who were sisters of the defendant) alleged that the corporation continued to operate a money-losing furniture business because it enabled defendant, his wife, and his son to "draw salaries

65. Thompson, *The Shareholder's Cause of Action*, *supra* note 9, at 702.

66. See, e.g., Manuel A. Utset, *A Theory of Self-Control Problems and Incomplete Contracting: The Case of Shareholder Contracts*, 2003 UTAH L. REV. 1329, 1333–35 (reviewing strategic explanations for incomplete agreements, as well as explanations based on shareholder ignorance, and contending that psychological limitations that prevent shareholders from choosing according to their own preferences offer a more convincing explanation).

67. For a collection of important work in this area, see CHOICES, VALUES, AND FRAMES (Daniel Kahneman & Amos Tversky eds., 2000). Empirical investigation concerning price discounts for minority investment might reveal the extent to which minority shareholders conform to the classical model of economic rationality. For instance, it would be interesting to know whether non-controlling shareholders receive larger discounts in jurisdictions that offer less protection against opportunistic behavior by the majority. (Indeed, it would be instructive to know how often minority shareholder investors in family corporations ask for any discount to reflect their lack of control). In this vein, one commentator suggests that pricing information could be used to resolve particular shareholder disputes. See Robert C. Illig, *Minority Investor Protections as Default Norms: Using Price To Illuminate the Deal in Close Corporations*, 56 AM. U. L. REV. 275 (2006).

68. See EASTERBROOK & FISCHER, *supra* note 11, at 34 (stating that "[c]orporate law—and in particular the fiduciary principle enforced by courts—fills in the blanks and oversights with the terms that people would have bargained for had they anticipated the problems and been able to transact costlessly in advance"); Moll, *Reasonable Expectations*, *supra* note 14, at 993, 995 (contending that many elements of a shareholder relationship are implied and that "when the oppression doctrine safeguards reasonable expectations, oppression law is effectively stepping in for contract law and is accomplishing what contract law itself should be doing").

69. *Stuparich v. Harbor Furniture Mfg.*, 100 Cal. Rptr. 2d 313 (Ct. App. 2000).

and other compensation well exceeding \$200,000 per year.”⁷⁰ The court held that “[a]s holders of a minority of the voting shares, plaintiffs are not entitled to substitute their business judgment for their brother’s with respect to viability of the furniture operations.”⁷¹

The court noted, correctly, that the minority shareholders held part of their interest in non-voting shares, “[p]erhaps the most traditional way of allocating control of a corporation.”⁷² Despite acknowledging that “[o]ut of frustration, and perhaps out of fear, plaintiffs have chosen not to participate further in the meetings of the board of directors,” the court concluded there was “no evidence of bad faith conduct” by the majority shareholder, plaintiffs’ brother.⁷³ This conclusion was reached notwithstanding the court’s awareness of “a serious argument between” the shareholders “which resulted in physical injuries” to one of the sisters.⁷⁴

The court appeared to accept, as had the trial court, the corporation’s contention that plaintiffs should “elect someone other than themselves to represent their interests on the board of directors” as if that were an adequate response to outright intimidation.⁷⁵ (Presumably these substitute directors would need to be more physically imposing.) The court gave no weight to the notion that the sisters, as substantial shareholders, might have an interest in participating directly.

Given the serious impediments to plaintiffs’ exercise of their rights as shareholders, and the specific allegations of self-dealing, the court should have scrutinized the plaintiffs’ allegations more closely. The majority shareholder should have been required to provide evidence substantiating the existence of a legitimate business purpose for maintaining a furniture operation that consistently lost money. The problem was not the substantive standard, but the relaxed scrutiny applied by the court even though it was clear that the minority shareholders had no voice.

2. Fiduciary Duty: The Partnership Model

The Fiduciary Duty approach holds that majority shareholders owe a heightened fiduciary duty akin to the duty partners owe to each other, restricting even

70. *Id.* at 315.

71. *Id.* at 320.

72. *Id.* at 318. The court was also right to observe that plaintiffs had received regular and substantial dividends from their share ownership. *See id.* at 315, 319.

73. *Id.* at 320 (emphasis added). Indeed, the court discounted plaintiffs’ allegations because “plaintiffs removed themselves from participation in the board meetings.” *Id.*

74. *Id.* at 315. The court does not describe the specific circumstances of the altercation. However, whether or not the physical violence was itself connected to the business dispute, the court does recognize that the fear of violence may have precluded the sisters from further direct involvement with the business. *See id.*

75. *Id.* at 316, 319 (quoting trial court’s findings).

otherwise legitimate business decisions that harm minority shareholders.⁷⁶ In one influential, if vague, formulation, minority shareholders may insist upon scrupulously "equal treatment."⁷⁷ On this approach, the partnership aspects of a close corporation take precedence: "[t]he stockholders 'clothe' their partnership 'with the benefits peculiar to a corporation, limited liability, perpetuity and the like.'"⁷⁸ However, apart from expressing the general sentiment that majority shareholders should not mistreat minority shareholders, the standard provides little useful guidance to courts.⁷⁹

For an enhanced fiduciary standard to have content, we would need some definite idea of what the fiduciary duty might require, beyond what corporate fiduciary duties of care and loyalty already require. If the majority must sometimes put the minority's interests ahead of its own, or those of the corporation, the standard is unhelpfully vague, risks empowering minority shareholders to demand disproportionate benefits from the corporation, and treats the decision to incorporate a business (or to invest in an incorporated entity) as inconsequential. Indeed, taken to its logical conclusion, the approach thwarts the majority's ability to manage the business at all.⁸⁰

76. The idea that closely held corporations are akin to partnerships is not a new one. *See, e.g.,* *Miner v. Belle Isle Ice Co.*, 53 N.W. 218, 224 (Mich. 1892) ("Corporations of this kind are in truth little more than private partnerships" (citing *Foss v. Harbottle*, 67 Eng. Rep. 189, 202 (High Ct. Ch. 1843))).

77. *See* *Donahue v. Rodd Electrotype Co. of New Eng.*, 328 N.E.2d 505, 518 (Mass. 1975).

78. *Id.* at 512 (citation omitted) (emphasis added). Through the clothing metaphor, the court conveys its view that the partnership is the essence and the corporate law differences mere trappings. *Id.* The "incorporation benefits are clothes" metaphor establishes a relation between the source domain of "clothing a human being" to the target domain of "incorporating a partnership." The metaphor carries over, as one of its entailments, the concept that clothes may enhance or disguise the human form, but they are accessories and cannot fundamentally change the person underneath. *See also* O'NEAL & THOMPSON, *CLOSE CORPORATIONS*, *supra* note 4, § 2:3 at 2-18 (using a similar metaphor in discussing "ill-fitting governance norms").

79. Arguably, the difference is in the application of those duties to the relationships among shareholders. Some courts adhere to the traditional view that corporate fiduciary duties belong to the corporation. *See, e.g.,* *Schautteet v. Chester State Bank*, 707 F. Supp. 885, 888 (E.D. Tex. 1988) ("Officers and directors owe fiduciary duties only to the corporation."). The better view is that controlling shareholders, through control and operation of the board, owe fiduciary duties to the minority even in a public corporation. *See, e.g.,* *S. Pac. Co. v. Bogert*, 250 U.S. 483, 487-88 (1919) ("The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority."); *Riblet Prods. Corp. v. Nagy*, 683 A.2d 37, 40 (Del. 1996) ("To be sure, the Majority Stockholders may well owe fiduciary duties to Nagy as a minority stockholder.").

80. Moreover, one reason for choosing a corporate rather than partnership form is to guard against the possibility of rent-seeking tactics by minority shareholders who could otherwise threaten to dissolve the business or to veto important decisions. *See* Charles R. O'Kelley, Jr., *Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis*, 87 Nw. U. L. REV. 216, 240-41 (1992) ("[T]he corporation law preference for majority adaptability combines with the lack of a unilateral minority withdrawal right to insulate the majority from the threat of minority opportunism."). While investors might once have chosen the corporate form in order to obtain the benefits of limited liability, even when partnership governance norms would otherwise be more desirable, *see id.* at 241, the newer LLC form (which permits limited liability and greater investor liquidity) may offer a better set of default rules for some closely-held firms, *see* Charles R. O'Kelley, *Foreword: Understanding the Place of Limited Liability Companies in the Spectrum of Business Forms*, 73 OR. L. REV. 1, 3 (1994); *see also* Gevurtz, *supra* note 61 at 537 (describing the ability of a majority to amend an operating agreement). The extent

Massachusetts usefully illustrates the difficulty of applying uncompromising fiduciary duties when the fiduciaries also directly participate and benefit from ownership.⁸¹ In *Donahue v. Rodd Electrottype Co.*, the Massachusetts Supreme Court announced that close corporation shareholders “owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.”⁸² The court described the standard as “the duty of the finest loyalty.”⁸³ Applying that standard, the court concluded that the majority had violated its fiduciary duties to the minority by refusing to offer a share repurchase plan on the same terms as had been offered to an aging majority shareholder who wished to retire from the business. The unequal treatment was, according to the court, an abuse of the majority’s power.⁸⁴

Yet, within a year, the Massachusetts Supreme Court in *Wilkes v. Springside Nursing Home*⁸⁵ substantially softened the fiduciary duty analysis without actually repudiating *Donahue*. Under the revised analysis, courts first ask whether the majority can offer a reasonable business justification for a challenged corporate decision.⁸⁶ If so, then the minority must establish that the result could have been accomplished in some other manner that would not have caused harm to the minority shareholder.⁸⁷ The court recognized that the majority’s interest in selfish ownership does not, per se, violate a fiduciary duty owed to the minority.⁸⁸

to which the common law and statutory responses to minority shareholder oppression in the close corporation will be applied in the LLC context remains uncertain. See generally Sandra K. Miller et al., *An Empirical Glimpse into Limited Liability Companies: Assessing the Need To Protect Minority Investors*, 43 AM. BUS. L.J. 609, 627–35 (2006).

81. Of course, a similar argument could be made that the extension by analogy of fiduciary duties from the traditional trustee context to co-venturers in a partnership is itself problematic.

82. *Donahue*, 328 N.E.2d at 593.

83. *Id.* at 516 (quoting *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928) (Cardozo, J.)). In *Meinhard*, then-Judge Cardozo defined the concept of fiduciary duty for partners in famously florid prose: “Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.” 164 N.E. at 546. Interestingly, the very act of identifying Cardozo’s rhetorical excess seems to create in commentators an irresistible urge to join the fun. See, e.g., Barbara Ann Banoff, *Company Governance Under Florida’s Limited Liability Company Act*, 30 FLA. ST. U. L. REV. 53, 59 (2002) (labeling Cardozo’s rhetoric “galloping Meinhardism” (internal quotation marks omitted)); Geoffrey P. Miller, *A Glimpse of Society Via a Case and Cardozo: Meinhard v. Salmon*, in *THE ICONIC CASES IN CORPORATE LAW*, *supra* note 18, at 12, 23 (“Cardozo, a virtuoso stylist, outdid himself in *Meinhard v. Salmon*, serving up a spicy bouillabaisse of metaphor and allusion . . .”).

84. *Donahue*, 328 N.E.2d at 518.

85. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976).

86. See *id.* at 663.

87. See *id.* (“When an asserted business purpose for their action is advanced by the majority, however, we think it is open to minority stockholders to demonstrate that the same legitimate objective could have been achieved through an alternative course of action less harmful to the minority’s interest.”).

88. For a more recent Massachusetts case acknowledging that tension in the context of fashioning an appropriate remedy, see *Brodie v. Jordan*, 857 N.E.2d 1076, 1080 (Mass. 2006) (“The remedy . . . should attempt to reset the proper balance between the majority’s ‘concede[d] . . . rights to what has been termed selfish ownership,’ . . . and the minority’s reasonable expectations of benefit from its

The two cases illustrate the difficulty in articulating and applying an enhanced partnership-like fiduciary duty in the corporate context. The fiduciary standard announced in *Donahue* appeared to prohibit any corporate action, regardless of its business purpose, unless the benefits were made available to all shareholders on an equal basis.⁸⁹ That rule would frustrate the close corporation's ability to repurchase shares of retiring members unless the close corporation had sufficient funds to repurchase all outstanding shares.⁹⁰ Moreover, it was unclear how a fiduciary standard of "utmost loyalty" could co-exist with the corporate governance principle of majority rule without making the acquisition of control a pointless, if not treacherous, accomplishment.⁹¹

The modified *Wilkes* approach allows Massachusetts courts to consider legitimate corporate purposes, but cannot easily be squared with the notion of a fiduciary duty that requires more, substantively, of controlling shareholders than ordinary corporate fiduciary duties of care and loyalty.⁹² However, from a procedural perspective, *Wilkes* does place the onus on controlling shareholders to show a business purpose, even if a minority shareholder has had a full, fair opportunity to participate in the business decision and simply disagrees with the majority's judgment.⁹³

3. Reasonable Expectations: A Tailored Approach with Uncertain Foundations

Evaluation of minority shareholder "reasonable expectations" constitutes a

shares." (second ellipsis in original) (citation omitted)). It is unclear why the *Brodie* court believed that the majority's interests deserved attention at the remedy phase but not in determining liability. As to liability, Massachusetts Supreme Court affirmed the lower court's finding that the majority shareholders breached their fiduciary duty to the minority shareholder by "hindering her ability to sell her shares in the open market." *Id.* This notwithstanding the fact that the majority shareholders "gave the plaintiff full permission to sell her stock to a third party" and fell short of their fiduciary obligation "by refusing to perform a valuation of the company" which "prevented the plaintiff from determining the value of her shares." *Id.* at 1080 n.4. The idea that the minority, holding an illiquid investment, could demand (and reasonably expect) that the corporation perform a valuation exercise at its own expense solely for the minority's benefit is astounding.

89. See *Donahue*, 328 N.E.2d at 516.

90. See Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 298-99 (1986) ("Most firms could not survive if the purchase of the interest of a retiring member required that everyone else be given the opportunity to sell out at the same price.").

91. See *id.* at 295; Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1688 (1990) ("The application of strict fiduciary standards to close corporations deprives controlling shareholders of the ability to manage the corporation—to use their own property—as they see fit.").

92. See, e.g., *Brodie*, 857 N.E.2d at 1082, discussed *supra* note 88.

93. On its facts, it appears there were restrictions of minority voice in *Wilkes* that warranted enhanced scrutiny. One of the four equal participants in a nursing home business venture was forced out by the other shareholders and deprived of his salary. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 661 (Mass. 1976). Applying the reformulated fiduciary duty standard, the *Wilkes* court concluded that the majority had "not shown a legitimate business purpose for severing Wilkes from the payroll of the corporation or for refusing to reelect him as a salaried officer and director." *Id.* at 663. The court relied on the trial court's finding that Wilkes had not sought to harm the corporation but, rather, "had always accomplished his assigned share of the duties competently, and that he had never indicated an unwillingness to continue to do so." *Id.* at 664.

third method of adjudicating shareholder oppression cases.⁹⁴ Reasonable Expectations analysis recognizes that close corporations have characteristics “that distinguish them from the typical public corporation.”⁹⁵ Also, by focusing on shareholder expectations, the approach can be used to identify different types of close corporations; for example, shareholder relationships in a family corporation may be quite different than those in a venture capital-funded start up. When applying a Reasonable Expectations approach, a court will protect certain minority interests—sometimes assessed, hypothetically, as what the minority would have bargained for—thereby limiting the majority’s right of selfish ownership. The majority, in effect, owes additional duties to the minority; those duties are defined by an account of what it is reasonable for the minority to expect from the majority.

Although the approach defines oppression in terms of minority expectations, it does not necessarily require strong protection of minority shareholders. The Reasonable Expectations approach depends on the meaning of the word “reasonable” and, therefore, requires a deeper theory of shareholder rights and obligations. For example, if minority shareholders are entitled to expect only that the majority will not act in bad faith to deprive the minority of the value of its investment, then we have simply replicated the Bad Faith approach.⁹⁶ A further interpretive difficulty is that a minority’s objectively reasonable expectation may vary over time, expanding or contracting based upon decisions in other shareholder litigations.

Compounding these difficulties, in order to assign a clear meaning to the term “reasonable,” we must identify the nature of the expectation. To the extent courts set aside what the parties actually agreed or understood and focus upon what objectively reasonable parties would have contracted for, Reasonable Expectations turns on a hypothetical expectation and becomes a fictional device for courts to adjust the parties’ relationship after the fact. This approach may well facilitate appropriate resolution of shareholder disputes concerning matters

94. See, e.g., Matheson & Maler, *supra* note 11, at 679 (“[C]ourts in at least twenty-one states have applied the language in some form.”); Moll, *Shareholder Oppression & Dividend Policy*, *supra* note 15, at 853 (identifying minority shareholder expectations as one of “three principal approaches to defining oppression”). Yet, as Professor Moll observes, defining shareholder oppression in terms of “reasonable expectations” does little more than “simply rephrase[] the fundamental question.” Moll, *Shareholder Oppression & Dividend Policy*, *supra* note 15, at 844. The “doctrine provides no guidance on whether an asserted expectation is ‘reasonable,’ and thus enforceable, in the particular circumstances before a court.” *Id.*

95. Thompson, *The Shareholder’s Cause of Action*, *supra* note 9, at 717. The Reasonable Expectations standard “has become an easily accessible label to identify the special nature of close corporations.” *Id.* at 716.

96. New York’s measured use of minority shareholder expectations is probably closer to a Bad Faith approach than a Fiduciary Duty standard and reflects concern that the minority may use litigation as a coercive tool. See *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1180 (N.Y. 1984) (“It would be contrary to [the statute’s] remedial purpose to permit its use by minority shareholders as merely a coercive tool.” (citations omitted)); *In re Dubonnet Scarfs, Inc.*, 105 A.D.2d 339, 343 (N.Y. App. Div. 1985) (rejecting notion that shareholder in close corporation “can demand to be bought out . . . and that if such demand is not complied with, then such shareholder can seek the dissolution of that corporation”).

the parties never contemplated, but describing a court's insertion of new terms into the parties' bargain as a matter of "reasonable expectations" disguises what the court is actually doing.⁹⁷

If, on the other hand, courts seek to take into account the parties' actual understandings, whether at the time of investment or as they may have evolved, then Reasonable Expectations employs a quasi-contractual analysis to decide whether alleged expectations should be honored.⁹⁸ The analysis is not constrained by ordinary principles of contract interpretation, however, because the terms at issue are implicit.⁹⁹ Thus, Reasonable Expectations analysis relies upon material too shaky to support an ordinary contract while leaving courts discretion to go beyond mere restitution once liability has been determined.¹⁰⁰ While perhaps less open-ended and paternalistic than hypothetical-bargain analysis, because there must at least be some evidence of a bargain, this version of Reasonable Expectations analysis seems to invite protracted and expensive litigation over contested issues of fact that may be very difficult to prove or disprove.¹⁰¹ If shares have been passed down from the first generation, through gift or inheritance, consideration of expectations becomes even more attenuated.

Despite these difficulties, the Reasonable Expectations approach has facilitated more careful judicial analysis of close corporations as distinctive entities. In particular, a focus on shareholder expectations leads naturally to consideration of minority shareholder voice because minority shareholders often expect

97. See, e.g., *Brodie v. Jordan*, 857 N.E.2d 1076, 1080 n.4 (Mass. 2006) (assessing minority shareholder expectations in context of claim for breach of fiduciary duty and affirming lower court's ruling that minority shareholder had reasonable expectation that corporation would not only permit her to sell her shares to a third party, but would perform a valuation at its expense to facilitate the sale).

98. In North Carolina, for example, "[o]nly expectations embodied in understandings, express or implied, among the participants should be recognized by the court." *Meiselman v. Meiselman*, 307 S.E.2d 551, 563 (N.C. 1983). In New York, courts are to "investigate what the majority shareholders knew, or should have known to be the petitioner's expectations in entering the particular enterprise." *Kemp & Beatley, Inc.*, 473 N.E.2d at 1179. This approach makes the fundamental corporate agreement subject to an after-the-fact judicial determination based upon, inter alia, witness credibility and assumes that it may have been reasonable for minority shareholders to expect unbargained-for benefits.

99. See F. Hodge O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 886 (1978) ("In a close corporation, the corporation's charter and bylaws almost never reflect the full business bargain of the participants.").

100. See Moll, *Reasonable Expectations*, *supra* note 14, at 1073 (defending those features of the doctrine and stating that "it is fair to assert that oppression law is doing what contract law should be doing if contract law took a broader perspective when identifying and enforcing bargains." (emphasis in original)).

101. At some point, though, the line between analysis of what a minority shareholder would, hypothetically, have bargained for and what the parties' actual understanding might have been becomes hopelessly blurred. See Moll, *Reasonable Expectations*, *supra* note 14, at 1012 ("Courts may be willing to find reasonable expectations based on a broader pattern and thin specific evidence because they understand the economics behind an investor's commitment of capital to a close corporation. In other words, courts seem to appreciate that a rational minority stockholder would not invest in a close corporation without reaching a shared understanding of continued employment and management participation with the majority stockholder.").

to have a role in the management of the close corporation.¹⁰² For example, an influential early New York trial court decision explained that “[n]ot uncommonly a participant in a closely held enterprise invests all his assets . . . with an expectation, often reasonable under the circumstances . . . that he will be a key employee in the company and will have a voice in business decisions.”¹⁰³

New York’s Court of Appeals adopted that reasoning four years later.¹⁰⁴ The court noted the connection between exit and voice: “As the stock of closely held corporations generally is not readily salable, a minority shareholder at odds with management policies may be without either a voice in protecting his or her interests or any reasonable means of withdrawing his or her investment.”¹⁰⁵ The court recognized that share ownership in a close corporation is more than a financial investment because a “shareholder in a close corporation is a co-owner of the business and wants the privileges and powers that go with ownership.”¹⁰⁶ While we need to know more than what a close corporation shareholder “wants” in order to assign specific content to “reasonable” expectations, given the absence of a contractual basis for those expectations, the *Kemp & Beatley* court correctly identified voice as an important alternative to exit.

In sum, none of the existing approaches to minority shareholder oppression is satisfactory. The Bad Faith approach proceeds as if close corporations were public corporations; the Fiduciary Duty approach assumes that they are, essentially, partnerships. Reasonable Expectations avoids reductive reasoning only to fall into the trap of circular reasoning: the approach depends upon an external standard to define what is “reasonable.”

II. THE VALUE OF VOICE

To improve upon existing responses to minority shareholder oppression, we need a better account of voice in the close corporation. This Part argues that robust minority shareholder voice is vital to the health of close corporations. First, corporate decisions based on transparent, open discussion will more often serve the interests of all shareholders, and the minority will more likely accept the results of an inclusive, deliberative process as fair. Second, minority shareholders ought to participate in the management of what will often be their largest investment.

A. INSTRUMENTAL BENEFITS OF DELIBERATION

The minority’s participation in governance—its voice—enables the minority

102. See, e.g., *McCallum v. Rosen’s Diversified, Inc.*, 153 F.3d 701, 703 (8th Cir. 1998) (“Often-times, a shareholder’s reasonable expectations include a significant voice in management and an opportunity to work.” (citation omitted)).

103. See *In re Topper*, 433 N.Y.S.2d 359, 365 (Sup. Ct. 1980) (quoting F. Hodge O’Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 884 (1978)).

104. See *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1178–79 (N.Y. 1984).

105. *Id.* at 1179.

106. *Id.* at 1178.

to advance its interests and to be heard on important issues, a process protection lost when close corporations fail to hold shareholder meetings and lacking when the minority has no active role in management. Enhanced minority participation would improve close corporation governance by increasing the range of perspectives brought to bear on any given problem.¹⁰⁷

The exercise of voice is, or can be, more than the casting of votes. Indeed, the mere ability to vote may be of little consequence for a minority shareholder if the controlling shareholders are in the majority.¹⁰⁸ Formal studies indicate that groups have important cognitive advantages over sole decisionmakers,¹⁰⁹ a finding consistent with arguments at least as old as Aristotle.¹¹⁰ Many heads are better than one.¹¹¹ When minority shareholders participate in decisionmaking,

107. See Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1 (2002) (arguing that a range of perspectives is a cognitive advantage of group decisionmaking that supports a model of director primacy in corporate decisionmaking). Professor Bainbridge opposes enhanced shareholder participation in public corporations. See Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006). However, in close corporations, the cognitive advantages of group decisionmaking he identifies would seem to support robust minority shareholder participation, especially when there is a single majority shareholder.

108. See Thompson, *Exit, Liquidity*, *supra* note 49, at 8 (“[I]f those in control already have a majority, voting becomes an empty vessel.”). For a recent exploration of the value of voting in the corporate context, see Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129 (2009). The authors focus on public corporations, where shareholders typically sell “when they disagree with a decision made by the corporation’s managers.” *Id.* at 130. Accordingly, the authors contend that voting should be viewed not in terms of “democratic theory and legitimacy” but within “a framework based on information theory, which treats voting as a means of error correction for decisions.” *Id.* They observe, correctly, that “[v]oting within close corporations or by controlling shareholders is the mechanism to implement the property rights that follow from acquiring the controlling interest,” and so “[t]he likelihood of the correct decision when there is a vote with a majority shareholder is exactly the likelihood of the majority shareholder alone getting the right answer; voting does not improve accuracy.” *Id.* at 151. What follows, however, is not that minority shareholder participation is useless, but that voice must mean more than voting for it to matter.

109. See, e.g., Gary Charness, Edi Karni & Dan Levin, *Individual and Group Decision Making Under Risk: An Experimental Study of Bayesian Updating and Violations of First-order Stochastic Dominance*, 35 J. RISK UNCERTAINTY 129, 129 (2007) (“The violation rate when groups make decisions is substantially lower, and decreasing with group size, suggesting that social interaction improves the decision-making process.”).

110. See ARISTOTLE, POLITICS 1281b2, reprinted in THE POLITICS OF ARISTOTLE 1, 123 (Ernest Baker trans., 1962) (“Feasts to which many contribute may excel those provided at one man’s expense. In the same way, when there are many who contribute to the process of deliberation each can bring his share of goodness and moral prudence . . .”). Aristotle’s argument is an example of the metaphor that ideas are food. See GEORGE LAKOFF & MARK JOHNSON, METAPHORS WE LIVE BY 46–47 (1980) (arguing that “metaphors partially structure our everyday concepts and that this structure is reflected in our literal language” and providing examples: “I just can’t swallow that claim. . . . Now there’s a theory you can really sink your teeth into. . . . That’s food for thought. . . . We don’t need to spoon-feed our students. He devoured the book.” (emphases removed)). For a thorough discussion of conceptual metaphor and law, see STEVEN L. WINTER, A CLEARING IN THE FOREST: LAW, LIFE, AND MIND (2001).

111. Best Buy recently put this principle into practice by establishing a “prediction market” through which its 115,000 U.S. employees place bets as to whether “a new product or idea is likely to succeed.” Phred Dvorak, *Best Buy Taps “Prediction Market”: Imaginary Stocks Let Workers Forecast Whether Retailer’s Plans Will Meet Goals*, WALL ST. J., Sept. 16, 2008, at B1. The collective wisdom of Best Buy’s employees “has often proved to be more accurate than the company’s official forecasts.” *Id.*

the majority may benefit from the presentation of opposing arguments and will be pressed to defend its own preferences.¹¹² If, for instance, payment of dividends depends upon the corporation's expected need for cash in the coming year, reviewing the corporation's financial outlook together with minority shareholders will make it more likely that a reasonable consensus will emerge. If the corporation does not truly need to retain earnings, controlling shareholders will find it harder to withhold or reduce dividends.

Conversely, where the majority can articulate an objective basis for its own view, the minority may disagree but will see that there are countervailing considerations and will more likely accept the outcome as fair.¹¹³ Sometimes, it is valuable to be heard on an issue, even when ultimate decisionmaking authority rests elsewhere.¹¹⁴ For example, shareholders in public corporations have increasingly demanded the ability to cast nonbinding votes concerning executive compensation.¹¹⁵ Although the board sets compensation, shareholders want a voice in the process. Among other things, they believe that compensation committees will act with greater deliberation if their work is subject to en-

Other companies using or experimenting with internal prediction markets include Google Inc., General Electric Co., Intel Corp. and Microsoft Corp. *Id.*

112. See RONALD M. MASON, PARTICIPATORY AND WORKPLACE DEMOCRACY: A THEORETICAL DEVELOPMENT IN CRITIQUE OF LIBERALISM 35 (1982) (observing that a crucial first step for effective governance is the identification of problems and that "[p]articipation is thus an indispensable aid to improve input to government"). Although the author describes his work as non-liberal, he does not reject, and appears to accept, the central tenets of liberalism: individual liberty and equality. *Id.* at 32 (describing liberty and equality as preconditions for effective participation). Certainly, he does not identify any illiberal consequences he would be prepared to accept. It would appear more accurate, then, to describe the work as a criticism of certain conceptions of liberalism and not, as the author posits, a "break from liberal thought." *Id.* at 201.

113. The difference between an opportunity to participate and total exclusion is well illustrated by the following testimony of a minority shareholder:

My brother had the majority of stock . . . before this management contract. As to whether he had the final say in the control of [the corporation], that is the point. He might have been the final say, but when [the new corporation] started, I lost all say-so because he wouldn't listen to anybody.

Meiselman v. Meiselman, 307 S.E.2d 551, 555 (N.C. 1983). The connection between voice and legitimacy is that "participation increase[s] acceptance of decisions." MASON, *supra* note 112, at 38 (citing Jean-Jacques Rousseau's political theory and more contemporary social science research).

114. Indeed, it is important to distinguish between deliberation and ultimate decision power. In addition to making a correct decision, a corporation must have the ability to decide at all. A deliberative mechanism that required consensus, whether unanimous or supermajority, would risk deadlock. See James A. Gardner, *Shut Up and Vote: A Critique of Deliberative Democracy and the Life of Talk*, 63 TENN. L. REV. 421, 430 (1996) (identifying the "commitment to consensus" as "the most problematic feature of deliberative democracy"). Even assuming scrupulous good faith on the part of all participants, substantive disagreement is always possible. See *id.* Giving minority shareholders veto power would also create a danger of opportunism, where minority shareholders might threaten to hold out in order to extract a non-pro-rata share of profits.

115. See Claudia H. Deutsch, *Say on Pay: A Whisper or a Shout for Shareholders?* N.Y. TIMES, Apr. 6, 2008, at Bus. 9 ("Last year, investors filed 60 resolutions asking for a say on pay This year, there were more than 90 such resolutions filed").

hanced scrutiny and meaningful, if nonbinding, feedback from shareholders.¹¹⁶ In two foreign jurisdictions, “say on pay” appears to have had an impact on compensation.¹¹⁷

That deliberation—speech—is desirable and produces better, more legitimate outcomes than the alternative is a contestable claim but also one that is fundamental to our representative form of government.¹¹⁸ Advocates of deliberative democracy argue for greater levels of participation and hold that legitimacy depends upon discussion, not just voting—and that we owe one another reasons.¹¹⁹ On this view, the goal of deliberation is to improve collective understanding and to reach decisions that all can regard as fair.¹²⁰

The argument that an inclusive deliberation is more legitimate and more likely to lead to a correct outcome need not be limited to the political realm.¹²¹ In *Hoschett v. TSI International Software, Ltd.*,¹²² Chancellor Allen cited the value of deliberation in holding that a corporation’s annual shareholder meeting is mandatory, even when the majority has enough votes to elect a new slate of directors on written consent:

116. *Id.* (“Shareholders are recognizing that, when chairmen of compensation committees understand that their decisions will be subject to a vote of confidence, they try harder to get it right.” (quoting Stephen M. Davis, project director at the Millstein Center for Corporate Governance and Performance at Yale)).

117. *Id.* (“In one sense, American investors are coming late to the party. Say-on-pay resolutions have been common in Britain and Australia for several years, and governance experts say they have most likely reined in compensation in those countries.”). Of course, public corporation shareholders also have the ability to exit, which places some weight behind even informal resolutions.

118. See CASS R. SUNSTEIN, *DEMOCRACY AND THE PROBLEM OF FREE SPEECH* 241 (1993) (stating that the “American constitutional system” is designed “to ensure discussion and debate among people who are genuinely different in their perspectives and position, in the interest of creating a process through which reflection will encourage the emergence of general truths”). The alternative to deliberation is tallying existing preferences. See AMY GUTMANN & DENNIS THOMPSON, *WHY DELIBERATIVE DEMOCRACY?* 13 (2004) (rejecting aggregative theories, which take preferences as given and seek fair methods of translating individual preferences into collective judgment, and advocating a deliberative conception of governance, which assumes that preferences can be reexamined); David M. Estlund, *Who’s Afraid of Deliberative Democracy? On the Strategic/Deliberative Dichotomy in Recent Constitutional Jurisprudence*, 71 TEX. L. REV. 1437, 1452 (1993) (“Many people think democratic inputs are mere expression of preference, not judgments at all.”).

119. See GUTMANN & THOMPSON, *supra* note 118, at 4 (“The reasons are meant both to produce a justifiable decision and to express the value of mutual respect.”). The importance of giving reasons may depend in part on whether we view the goals of participants as achieving self-interest, defined in terms of fixed preferences on a rational choice model, or whether we believe that human behavior, viewed from a political perspective, can escape the reductive power of classical economic reasoning.

120. See *id.* at 12 (“Through the give-and-take of argument, participants can learn from each other, come to recognize their individual and collective misapprehensions, and develop new views and policies that can more successfully withstand critical scrutiny.”).

121. See GUTMANN & THOMPSON, *supra* note 118, at 34 (“Corporations are another . . . example of an institution that should be subject to more deliberation.”); Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J.L. BUS. & FIN. 334, 335 (2008) (“Writing on civic republicanism and on corporate law rarely overlaps, but republican ideas can offer a very useful perspective on corporate law.”).

122. *Hoschett v. TSI Int’l Software, Ltd.*, 683 A.2d 43 (Del. Ch. 1996).

The theory of the annual meeting includes the idea that a deliberative component of the meeting may occur. Shareholders' meetings are mandated and shareholders authorized by statute to transact proper business because we assume that at such meetings something said may matter. Obviously these meetings are very far from deliberative convocations, but a keen realization of the reality of the degree of deliberation that is possible, should make the preservation of residual mechanisms of corporate democracy more, not less, important.¹²³

Chancellor Allen observed that "while the model of democratic forms should not too strictly be applied to the economic institution of a business corporation," the shareholders' meeting facilitates "a form of discourse (i.e., oral reports, questions and answers and in rare instances proxy contests) among investors and between shareholders and managers."¹²⁴

Some might question the value of voice for locked-in minority shareholders because majority shareholders ultimately decide all contested questions, but voice is a political mechanism and need not be synonymous with control. A person's ability to participate and to be heard on issues important to a shared enterprise, whether family, business organization, or nation-state, does not turn on the final tally of votes.¹²⁵ Voice is not as crude a mechanism as exit; its value lies in its nuance, as a means of shaping the goals of a close corporation to better accommodate the interests of all shareholders.¹²⁶

Of course, since the majority still controls the outcome, the participants are not substantively equal, even if there is formal equality of participation.¹²⁷ In addition, there will not always be a "right" decision, because the majority and minority may have different interests, neither one of which impacts the efficient operation of the business, only the distributive effects.¹²⁸ Although voice is not

123. *Id.* at 46.

124. *Id.* at 45–46. In a closely held corporation with relatively few shareholders, Chancellor Allen's vision of a deliberative process is more feasible and more usual.

125. Indeed, the imbalance of power makes participation all the more important if we are to reduce the frequency of shareholder litigation. *Cf.* GUTMANN & THOMPSON, *supra* note 118, at 6–7 (noting that full consensus may be impossible to achieve but that those who "disagreed with the original decision are more likely to accept it if they believe they have a chance to reverse or modify it in the future").

126. *See* MASON, *supra* note 112, at 39 ("That participation can even transform an individual's conceptualization of his interests indicates that participation is a potent agent as well as medium of socialization. Through participation in any system, support will develop for that system.").

127. *Hoschett*, 683 A.2d at 46 (noting that, unlike democracies, "votes are weighted by the size of the voter's investment"); Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1391 (2006) ("By virtue of the one-vote-per-share principle, larger shareholders inevitably have a greater say in corporate governance than do smaller shareholders."). For an exception, where the shareholders had agreed, in effect, that no corporate action could be taken over the objection of any shareholder, see *Smith v. Atlantic Props., Inc.*, 422 N.E.2d 798, 801–02 (Mass. App. Ct. 1981) (finding, in an unusual application of shareholder oppression doctrine, that the minority shareholder had oppressed the majority by using his veto to block the payment of dividends).

128. In those situations, it may be especially difficult to distinguish opportunistic behavior from the right of selfish ownership.

a panacea for the problem of minority shareholder oppression, enhanced participation will improve close corporation governance overall by fostering a transparent, cooperative mode of decisionmaking, and so it is reasonable to expect that close corporations that invite minority participation will, on the whole, be less likely to behave oppressively toward the minority.¹²⁹ Because minority voice serves these ameliorative purposes, and signifies them, we should view its presence or absence as an important proxy for oppression.¹³⁰

B. NORMATIVE REASONS FOR PARTICIPATION

In addition to the benefits enhanced minority shareholder voice may offer for the quality of deliberation and governance in close corporations, minority shareholders with a substantial stake ought to participate and take responsibility for the success or failure of the business.¹³¹

As a general matter, minority shareholders welcome this responsibility. By investing in a close corporation, minority shareholders make a deliberate choice to link their fortune with their own efforts and to exercise control over their working lives.¹³² For those shareholders, participating in a close corporation may represent a fundamental life choice, a commitment to work together with family or friends to build a business consistent with their values.¹³³ The close corporation may also be chosen as a vehicle for innovators to bring a new product or service to market, and it is natural to expect that they will be deeply invested, emotionally as well as economically.¹³⁴

129. Cf. ELY, *supra* note 51, at 80.

130. The value of minority shareholder voice does not depend upon achieving, in every case, a perfect deliberative process. Indeed, even if we assume cynically that majority shareholders will invite minority participation only as an empty formality, and not because they take the minority's views seriously, minority participation remains important. The formal mechanism may itself operate as a restraint on the majority's decision whether to exclude the minority from the benefits of ownership. See *Hoschett*, 683 A.2d at 45 (acknowledging that requirement of a meeting could be viewed as "a pointless exercise" but concluding that "knowing that such an occasion [the shareholders' meeting] is necessarily to be faced annually may itself have a marginally beneficial effect on managerial attention and performance. . . . [I]t provides a certain discipline and an occasion for interaction and participation of a kind"). Admittedly, as Chancellor Allen points out, the effects will be felt at the margin. For further discussion of the importance of minority access to information, see *infra* section III.C.

131. For an analogous argument that corporate law should give greater weight to employee input, in part to capture the benefits of deliberation, see McDonnell, *supra* note 121, at 336.

132. See, e.g., *Pedro v. Pedro*, 463 N.W.2d 285, 289 (Minn. Ct. App. 1991) ("[T]he primary expectations of minority shareholders include an active voice in management of the corporation and input as an employee." (citation omitted)).

133. See Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L.Q. 1099, 1110 (1999) ("[T]he employee may simply derive satisfaction from working in a business that he himself takes a substantial part in managing."). Further evidence that the investment is more than a matter of wealth maximization is that "[h]olding stock in a closely held corporation, viewed purely as an investment decision, seems almost irrational from an economic perspective. Small businesses are exceedingly risky enterprises with high failure rates." *Id.* at 1109.

134. This is not to suggest that innovators insist upon control. To the contrary, sophisticated financial investors usually condition their investment on the ability to make decisions and, if necessary, remove the original developers of the idea. See Jeffrey M. Leavitt, *Burned Angels: The Coming Wave of*

A news article entitled “Family Hands off Its Business, and Its Philosophy” provides an interesting illustration of a closely held business that is, for its owners, more than an opportunity to make money.¹³⁵ The third-generation, self-described liberal owners of a family scrap metal company were reluctant to hand over the reins of their business to local managers who were politically conservative and perceived to be less worldly.¹³⁶ The family views the business as an important part of the community with a philanthropic mission in addition to making money.¹³⁷ So concerned were the owners over the future “soul” of the business, they have—according to the *Times*—required their managers to read Thoreau, Sophocles, and Freud and to attend cultural events, including a Shakespeare play.¹³⁸ They have also provided each manager with a subscription to the *Sunday New York Times*.¹³⁹ These are matters of perhaps indirect relevance to the effective management of a scrap metal company and show that the goals of shareholders in a close corporation are not always identical to the profit motive of investors in a public corporation.

Just as the instrumental argument for participation can be framed in terms of a deliberative conception of democracy, the non-instrumental argument also can draw upon political theories of participation for support.¹⁴⁰ In fact, the shift in emphasis from the instrumental to the normative roughly tracks the difference between deliberative democracy and certain strands of civic republican thought. Contemporary civic republicans, such as Frank Michelman and Cass Sunstein, have argued for deliberative, inclusive decisionmaking, contending that the

Minority-Shareholder Oppression Claims in Venture Capital Start-up Companies, 6 N.C. J.L. & TECH. 223, 226 (2005) (observing that venture capital firms “will often seek to structure the terms of investments so as to maximize their control of, and thus reward from, their portfolio companies”). Nothing in this Article is intended to overturn the basic principle of contractual freedom. However, some commentators contend that “[i]t is almost impossible to deal adequately with [the] potential for ex post opportunism by ex ante contracting.” Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1465 (1989). Consequently, “although the purpose of enforcing bargains is to protect expectations, the full enforcement of bargained-out structural and distributional rules in a closely held corporation may actually violate fair expectations.” *Id.* at 1465–66. That is why corporate law enforces certain mandatory fiduciary duties, even at the risk of interfering with private ordering. Also, as discussed *supra* note 16, to the extent minority shareholders are aware of “the difficulty of predicting and planning for future events and their impact on a business enterprise,” *id.* at 1465, the existence of judicial discretion as a mandatory background to the corporate bargain may foster socially valuable investment that would otherwise not take place.

135. See Jeff Bailey, *Family Hands off Its Business, and Its Philosophy*, N.Y. TIMES, Feb. 24, 2007, at A1.

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.*

140. See Cass R. Sunstein, *Beyond the Republican Revival*, 97 YALE L.J. 1539, 1541 n.8 (1988) (“Some of those who value civic virtue emphasize the improvement of individual character . . .”). Sunstein identifies this view with classic republicanism and emphasizes a more modern variant, in which civic virtue is the willingness to deliberate toward a conception of the public good. *Id.* at 1544 (“Private-regarding reasons are an insufficient basis for legislation. Political actors must justify their choices by appealing to a broader public good.”).

process itself has normative benefits for society—fostering good-faith steps toward consensus and community—even when the minority view does not prevail.¹⁴¹ Adopting a more classical view of civic republicanism, we might further contend that participation is inherently valuable for the participant.¹⁴² Someone with a large stake in an enterprise *ought* to take some responsibility for that enterprise.¹⁴³

In addition to improving close corporation governance, a more deliberative decisionmaking process can be viewed as a way of inculcating the habits and temperament of an engaged, informed citizenry.¹⁴⁴ Empirical research suggests that participation in one sphere may have spillover benefits in other spheres.¹⁴⁵ Although some academics dispute the utility of analogies between corporate and democratic governance, much of that debate has centered upon the public corporation.¹⁴⁶ By contrast, close corporations serve their members' varied interests, not necessarily limited to profit maximization. Also, the owners of a

141. See SUNSTEIN, *supra* note 118, at 244 ("Most ambitiously, we might hope that a well-functioning system of free expression will ultimately encourage a degree of public virtue and produce high levels of participation and genuine deliberation"). See generally Frank Michelman, *Law's Republic*, 97 YALE L.J. 1493 (1988) (arguing that inclusive decisionmaking enhances everyone's political freedom); Sunstein, *supra* note 140, at 1545 ("The requirement of appeal to public-regarding reasons may make it more likely that public-regarding legislation will actually be enacted.").

142. See McDonnell, *supra* note 121, at 347 (arguing in favor of employee participation in governance on the ground that "active involvement in affairs that affect one's life have a bearing on one's personal happiness and sense of well-being").

143. This notion can be traced to Aristotle's virtue ethics, defining morality in terms of the virtuous characteristics of the actor more than the consequences of his actions or the moral precepts obeyed. See ARISTOTLE, *ETHICS*, bk. II, reprinted in *THE PHILOSOPHY OF ARISTOTLE* 306, 334 (Renford Bambrough ed., J.L. Creed & A.E. Wardman trans., 2003) ("The virtues, then, are neither innate nor contrary to nature. They come to be because we are fitted by nature to receive them; but we perfect them by training or habit.").

144. See GUTMANN & THOMPSON, *supra* note 118, at 35 ("Because most citizens live most of their lives in civil society outside of conventional politics, deliberative theories seek to structure civil society so as to better equip citizens to deliberate in politics."). Indeed, "[w]ithout a civil society that provides rehearsal space for political deliberation, citizens are less likely to be politically effective." *Id.*; see also MASON, *supra* note 112, at 79 (contending that an "individual's involvement in *organized* social activities" is a "crucial cause[] of political participation"); MASON, *supra* note 112, at 187 ("[P]articipation in the workplace most clearly approximates participation in government.").

145. See McDonnell, *supra* note 121, at 370 (reviewing literature and concluding that a majority of researchers "have found a positive correlation between workplace participation and political participation"); Stephen C. Smith, *Political Behavior as an Economic Externality*, in 1 *ADVANCES IN THE ECONOMIC ANALYSIS OF PARTICIPATORY AND LABOR-MANAGED FIRMS: A RESEARCH ANNUAL* 123 (Derek C. Jones & Jan Svejnar eds., 1985) (reviewing survey results finding a strong correlation between decisionmaking participation within the firm and community). Of course, as Professor McDonnell acknowledges, more would be needed to demonstrate a causal relationship. McDonnell, *supra* note 121, at 370.

146. See Rodrigues, *supra* note 127 (reviewing and critiquing scholarship); Alan R. Palmiter, *Public Corporation as Private Constitution* (Wake Forest Legal Studies, Research Paper Series 2, 2008), available at <http://papers.ssrn.com/abstract=1111773> ("My thesis is that our notions of republican government (and its democratic ideals and practices) inform our notions of corporate governance. And thus to understand the modern public corporation—and to set its agenda—compels us to understand and dissect its republican impetus.").

close corporation manage their business without significant mediation.¹⁴⁷ Finally, just as in a nation-state, the possibility of exit is radically limited, which means that differences must be addressed and resolved within the context of a continuing enterprise.¹⁴⁸

The point is not that any particular set of political norms should be adopted across the government/corporate divide, nor that the purposes of a political community and a profit-oriented corporation are fundamentally similar. Rather, the suggestion is that self-governance itself is a shared concept and that more robust, inclusive governance in the corporate context could have side-benefits for the public realm.¹⁴⁹ Because these normative benefits are externalities, we would not expect their value to be reflected in the choice of governance structure. Thus, even if one believed that the market would already supply inclusive governance, if it were efficient, non-market rationales would also support a system of judicial scrutiny calculated to enhance the use of voice.¹⁵⁰

Political theories that advocate greater deliberation in the public sphere face a number of serious objections, but those objections do not counsel against this Article's proposed enhancement of voice in the close corporation. Take as emblematic the following critique:

[W]hat is missing from the republican revival is an appreciation of the frightening power of man to subvert the offices of government It is this gap that deprives pure republicanism of any prospect of serving as a viable constitutional theory. Thus, my argument is not that Sunstein's aspirational appeal to civic virtue is always wrong; my claim is only that it is not always

147. See Sunstein, *supra* note 140, at 1556 ("[R]epublican systems should be small and decentralized. A large republic threatens to diminish the connection between rules and ruled and decrease opportunities for participation."); cf. GUTMANN & THOMPSON, *supra* note 118, at 8 (noting that deliberative theories "can be traced to fifth-century Athens" and that "the Athenian democracy of Pericles and Aristotle was quite different from ours").

148. See HIRSCHMAN, *supra* note 3, at 17 ("In a whole gamut of human institutions, from the state to the family, voice, however 'cumbrous,' is all their members normally have to work with.").

149. Much commentary concerning corporations, especially large public corporations, has assumed that their impact on democratic society is, if anything, pernicious. See, e.g., RALPH NADER, CUTTING CORPORATE WELFARE (2000). The argument that close corporation governance can support democracy, then, would represent a cheerful counter-tendency. Further work would be required to specify the ways that close corporation (or other small business) participation may impact matters of public governance. In this regard, one interesting question would be the extent to which small-scale businesses operate in closed societies and whether modest economic reforms that enable localized capitalism may have larger, unintended consequences for those societies.

150. In any case, because the process of incorporating a small business with family and close friends may depart substantially from the model of economic rationality, it is not clear what weight economic analysis of the choice of governance terms should be given. Venture capital investors bargain for exactly what they want (at least as to matters that can be anticipated), but this only highlights the disparity between what sophisticated parties would negotiate at arms length and what close corporation shareholders may leave to trust.

right. And constitutional rules become most important when compassion and civic virtue are on the wane, not when they are on the rise.¹⁵¹

Even if deliberation is imperfect, an overall increase in “civic virtue” in the close corporation context would be an unmitigated good. Improved governance need not eliminate the problem of minority shareholder oppression to be worthwhile; courts would retain the ability to remedy abuses when they arise.

Thus, minority shareholder voice has value, for reasons both pragmatic and moral. As discussed in the next Part, courts should vary the degree of scrutiny they apply to claims of oppression based on the presence or absence of minority voice. Through varied scrutiny, courts would better account for minority voice and would create incentives for more inclusive governance models.

III. VARIABLE SCRUTINY BASED UPON MINORITY SHAREHOLDER VOICE

As a practical matter, substantive doctrines tend to entail corresponding commitments to a level of judicial scrutiny. None of the existing approaches to minority shareholder oppression has recognized that the level of scrutiny might be independent of the substantive standard applied.¹⁵² An injection of flexibility would remedy deficiencies of the Bad Faith or Fiduciary Duty approaches because close corporations resemble corporations *and* partnerships to varying degrees, with different consequences for shareholder relationships. By providing a relatively clear basis for courts to apply relaxed or intensified review, the proposed model uses minority shareholder voice to avoid the rigidity of current doctrine without sacrificing rigor or predictability.¹⁵³

Section III.A explains why scrutiny matters. Section III.B describes the

151. Jonathan R. Macey, *The Missing Element in the Republican Revival*, 97 YALE L.J. 1673, 1673 (1988). In a similar vein, see Russel Hardin, *Deliberation: Method, not Theory*, in DELIBERATIVE POLITICS: ESSAYS ON DEMOCRACY AND DISAGREEMENT 103, 117 (Stephen Macedo ed., 1999) (“Deliberation is . . . a method for discovery and, sometimes but not always, a method for mollifying losers by giving them the sense of at least being heard. These are good things, but they fall far short of being a general theory of democratic politics.”).

152. Nor have commentators assessed different possible levels of scrutiny. Commentators have observed merely that any doctrine of minority shareholder oppression involves enhanced judicial review, requiring something more than a possible business justification for challenged majority conduct. See, e.g., Easterbrook & Fischel, *supra* note 90, at 293 (noting that “[i]t makes sense . . . to have greater judicial review of terminations of managerial (or investing) employees in closely held corporations than would be consistent with the business judgment rule” and that “[t]he same approach could be used with salary, dividend, and employment decisions”). The business judgment rule, as applied in public corporations under ordinary circumstances, amounts to almost no judicial review. See Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 100 (2004) (“[A] rational business purpose requires only the *possibility* that the decision was actuated by a legitimate business reason . . .” (emphasis added)).

153. A truly ad hoc approach would invite arbitrary decisions that fail to guide future litigants and create economic uncertainty. See Larry E. Ribstein, *The Rise of the Uncorporation* 5 (Illinois Law and Economics Research Paper No. LE07-026, 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1003790 (arguing that, among other things, non-contractual fiduciary standards have driven investors to more predictable entity forms like the LLC).

proposed model, including possible methods for assessing voice and for using that assessment to set an appropriate level of judicial scrutiny. Section III.C contends that varied scrutiny along the lines recommended herein offers important advantages over existing approaches. Section III.D briefly addresses two possible responses: (1) if voice is so important, we should require it; and, conversely, (2) rather than finding ways to enhance voice, we should create a more robust right of exit.

A. SUBSTANCE OR SCRUTINY: REEVALUATING THE DOCTRINAL APPROACHES

Some commentators contend that the apparent differences in substantive doctrine are overstated and that most decisions would be identical, regardless of the approach.¹⁵⁴ One might even question the extent to which shareholder oppression doctrine imposes different substantive standards than those applicable to controlling shareholders in a public corporation.¹⁵⁵ The law, after all, already provides certain core protections to minority shareholders in both public and close corporations, including the prohibition of non-pro-rata distributions, waste, and the taking of corporate opportunities.¹⁵⁶ Officers and directors owe the corporation and its shareholders fiduciary duties of care and loyalty; when

154. For identification of a number of proponents of that view, see BAINBRIDGE, *supra* note 22, at 823 (contending that, on the facts, the result in *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993), where Delaware's Supreme Court refused to extend "special" protections to minority shareholders, would have been identical under Massachusetts' fiduciary duty approach as articulated in *Wilkes*); O'NEAL & THOMPSON, CLOSE CORPORATIONS, *supra* note 4, § 9.29, at 9-132-33; O'NEAL & THOMPSON, OPPRESSION, *supra* note 8, § 7:13, at 7-80; Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285, 322 (1990) ("Although courts focusing on the majority's duty of utmost good faith and loyalty and courts focusing on the minority's reasonable expectations do take different approaches, in practice, there is little difference."); Moll, *The Unanswered Question*, *supra* note 42, at 753 n.14; see also Gimpel v. Bolstein, 477 N.Y.S.2d 1014, 1019 (App. Div. 1984) (asserting that different approaches to oppression "will frequently be found to be equivalent"). But see Siegel, *supra* note 1, at 382-83 ("disabusing any notion that the majority and minority rules are coalescing").

155. To some extent, any definition of oppression will limit the majority shareholders' right of selfish ownership, which remains the background norm in public corporations. See BAINBRIDGE, *supra* note 22, at 336 (stating that "shareholders qua shareholders are allowed to act selfishly in deciding how to vote their shares"). However, even in public corporations, shareholder directors have fiduciary duties to other shareholders, and, to the extent that they control the board, controlling groups of shareholders also owe fiduciary duties. *Id.*; see also Gatz v. Ponsoldt, 925 A.2d 1265, 1281 (Del. 2007) (en banc) (permitting direct action by public shareholders where controlling shareholder allegedly violated fiduciary duty by arranging scheme to take personal profit through recapitalization of company and dilution of ownership interest of other shareholders).

156. Edward Rock & Michael Wachter, *Corporate Law as a Facilitator of Self Governance*, 34 GA. L. REV. 529, 535 (2000) [hereinafter Rock & Wachter, *Corporate Law*] ("[T]he corporate form handles potential opportunism by the controlling shareholders toward the non-controlling shareholders. Here the critical mechanism is the prohibition on non-pro-rata distributions."); Rock & Wachter, *Waiting For the Omelet To Set*, *supra* note 6, at 922 ("So long as the majority shareholders cannot prefer themselves in distributions, minority shareholders can depend on the majority to protect [their] interests."). The duty of loyalty rules extend further "to prevent enough instances of self-dealing from slipping through so that the overall incentive compatibility of the form is preserved." Rock & Wachter, *Corporate Law*, *supra* at 536.

majority shareholders act as officers and directors, they assume certain fiduciary obligations in those capacities, which can be understood as an assumption of ordinary, pre-existing corporate responsibilities.¹⁵⁷

Of course, even if substantive standards do overlap to a considerable degree, with each other and with corporation law generally, we still need to have a method for resolving hard cases.¹⁵⁸ In addition, the difference between jurisdictions may be greater than those commentators have recognized because substantive doctrines are translated into substantial divergences concerning the appropriate level of judicial scrutiny.

Consider, for example, the decision of the Oregon Supreme Court in *Zidell v. Zidell*.¹⁵⁹ One commentator cites the case as a clear example of what he terms the "pure majority perspective."¹⁶⁰ *Zidell* concerned a passive minority shareholder investor who complained that dividends were "unreasonably small" and that the controlling shareholders were taking a disproportionate share of the wealth through salary and bonuses.¹⁶¹ The court affirmed the award of summary judgment in favor of the defendant, stating that "[i]f there are plausible business reasons supportive of the decision of the board of directors, and such reasons can be given credence, a Court will not interfere with a corporate board's right to make that decision."¹⁶²

While *Zidell* stands as an example of an approach that "concerns itself solely with the propriety of the majority's conduct,"¹⁶³ it also illustrates the importance of the degree of scrutiny applied by a court. On the bare allegations—sharply reduced dividends, increased salary, and bonuses—there are grounds to suspect that the majority was acting deliberately to increase its wealth at the expense of the minority. The plaintiff, moreover, had "shown that the corporations could afford to pay additional dividends" and that there was "hostility" among the shareholders.¹⁶⁴ The court's apparent willingness to accept "plausible business reasons" followed from its allocation of the burden of proof to the minority and its insistence on strong evidence of wrongdoing.¹⁶⁵

Accordingly, even though the court "recognized that those in control of corporate affairs have fiduciary duties of good faith and fair dealing toward the minority shareholders,"¹⁶⁶ the court was, as a practical matter, unwilling to look

157. See, e.g., *Miner v. Belle Isle Ice Co.*, 53 N.W. 218, 223 (Mich. 1892) ("When a number of stockholders combine to constitute themselves a majority in order to control the corporation as they see fit, they become, for all practical purposes, the corporation itself, and assume the trust relation occupied by the corporation toward its stockholders.").

158. See Moll, *The Unanswered Question*, *supra* note 42, at 753.

159. *Zidell v. Zidell*, 560 P.2d 1086 (Or. 1977).

160. Moll, *The Unanswered Question*, *supra* note 42, at 766.

161. *Zidell*, 560 P.2d at 1088.

162. *Id.* at 1089.

163. Moll, *The Unanswered Question*, *supra* note 42, at 766.

164. *Zidell*, 560 P.2d at 1089.

165. *Id.* ("Plaintiff had the burden of proving bad faith . . .").

166. *Id.* (citation omitted).

behind the majority's explanation and to scrutinize the compensation and dividend decisions with care. To understand the court's decision, the important point is not the existence of a fiduciary duty imposed on the majority but the relaxed scrutiny of the majority conduct at issue. To prevail, the minority shareholder would have had to establish "fraud, bad faith or an abuse of discretion," given the court's insistence that "the burden . . . rests on the party seeking judicial mandatory relief respecting the declaration of dividends."¹⁶⁷

To be sure, not every shareholder oppression case turns on the question of scrutiny. However, broadly speaking, doctrinal differences from jurisdiction to jurisdiction reflect differences in procedure as well as substance. For example, if the *Zidell* case arose in Massachusetts, the burden of proof would have been reversed, and the majority would have had to provide an adequate business justification for the apparent disparity in compensation.¹⁶⁸ Massachusetts has adopted a substantive doctrine of enhanced fiduciary duty, but that duty is put into place and made a reality through a procedural mechanism of shifting presumptions requiring the controlling shareholders in the first instance to show a legitimate business purpose.¹⁶⁹

B. TOWARD A VOICE-CENTERED MODEL OF SCRUTINY

This section addresses two matters necessary for a voice-based framework: (1) a process for identifying minority shareholder voice; and (2) sufficiently defined levels of scrutiny corresponding to voice. As the word "toward" in the heading indicates, this section does not offer conclusive answers to these questions because the specific implementation would vary depending upon the existing approach in each jurisdiction.¹⁷⁰ However, it is possible to identify important parameters.

1. Identifying Minority Shareholder Voice

Under the proposed model, minority participation in close corporation gover-

167. *Id.* (quoting *Bates Street Shirt Co. v. Waite*, 156 A. 293, 298 (Me. 1931)) (internal quotation marks omitted).

168. *See Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976).

169. *See id.* This Article's focus on levels of scrutiny rather than substantive standards for liability should not be seen as an attempt to replace one with the other. In order for a court to apply a procedural standard—for example, enhanced or relaxed scrutiny—the court must also have a substantive doctrine to apply. In most jurisdictions, as *Zidell* and *Wilkes* illustrate, courts consider whether the majority has a legitimate business purpose consistent with its fiduciary obligation to the corporation and to non-controlling shareholders. *Zidell*, 560 P.2d at 1089; *Wilkes*, 353 N.E.2d at 663. Courts to a greater or lesser degree also take into account any direct harm suffered by the minority. This Article does not take a position concerning whether harm to minority shareholders should itself trigger liability, except that a total deprivation of value should be actionable absent extremely compelling circumstances. *See, e.g., Royals v. Piedmont Elec. Repair Co.*, 529 S.E.2d 515, 520 (N.C. Ct. App. 2000) (stating, with regard to shareholder fired for sexual harassment, that "[a]lthough [his] conduct did warrant some penalty with respect to his presence and participation in management . . . any penalty should not have extended to his realization of a fair return on his equity in the company").

170. *See infra* Part IV.

nance determines the level of judicial scrutiny and is, accordingly, the threshold issue a court would address.¹⁷¹ First, courts would consider whether the challenged majority action has itself obstructed the minority's voice, depriving the minority of access to information and an opportunity to participate in governance discussions. If so, the court would apply enhanced scrutiny placing the burden of justification on the majority.

For example, if the majority removed a minority shareholder from the board of directors, the majority's conduct would warrant higher-level scrutiny in a lawsuit challenging the majority's conduct. The question would be closer if the minority sought to participate to a greater extent than it had previously—a situation where it might be said that there is no “reasonable expectation” of active participation.¹⁷² However, any substantial limitation imposed upon the minority's participation should be reviewed to ensure the existence of a legitimate business purpose.¹⁷³

Second, even if the challenged conduct is itself participation-neutral, the court should assess whether the minority has a substantial right of participation overall, formally or informally. Factors would include board representation and whether the corporation holds annual shareholder meetings, keeps adequate books and records, and otherwise observes corporate formalities.¹⁷⁴ Decisions made by majority shareholders should be treated with more deference if the minority has had a substantial ability to participate.¹⁷⁵

Most states provide shareholders opportunities for voice, including a right to

171. To the extent there are disputed issues of fact, the court would consider testimony and other evidence gathered during discovery. Few shareholder disputes can be resolved on the pleadings, and so judicial analysis will usually be in the context of motions for summary judgment.

172. So long as the corporation continues to hold shareholder meetings and follow other formalities, a minority shareholder who chose to resign voluntarily before filing suit should not be heard to complain that her voice in the business has been reduced.

173. The minority's involvement as an employee may be of importance, in terms of the minority's ability to earn a return on the investment, but is less likely to implicate issues of voice. As agents of the business, employees have no assigned role in management or governance.

174. Board representation will often be of particular importance but does not guarantee the effectiveness of minority voice. *See, e.g., Davis v. Sheerin*, 754 S.W.2d 375, 382 (Tex. App. 1988) (affirming finding of oppression where minority shareholder was a director and officer of the corporation but was deliberately excluded from decisionmaking and where minutes of board meeting stated that his “opinions or actions would have no effect on the Board's deliberation”). This Article does not attempt to identify the degree of access and participation necessary for adequate minority shareholder voice, in part because a precise definition would be more subject to manipulation and in part because close corporation governance is often informal, making it difficult to identify specific requirements.

175. While the minority should have a voice in close corporation management, it is not entitled to control the business. Also, in some cases, relaxed scrutiny may be applied if the minority shareholder did not take an active role in governance, so long as the opportunity was available. A minority shareholder should not benefit from a refusal to assume responsibilities for managing a business. *See, e.g., Allchin v. Chemic, Inc.*, No. 14-01-00433-CV, 2002 WL 1608616, at *9 (Tex. App. 2002) (“An employee who voluntarily leaves the employment of the corporation presents a less persuasive case for concluding the majority shareholders oppressed him.” (citations omitted)); Joseph Edward Olson, *A Statutory Elixir for the Oppression Malady*, 36 MERCER L. REV. 627, 657 (1985) (“If the complaining shareholder has himself caused the frustration of his reasonable expectations, the court may deny relief altogether or limit the remedy accordingly.”).

be heard at annual shareholder meetings and the right to vote concerning certain fundamental matters. However, the board of directors and the officers of public corporations make the vast majority of decisions without shareholder input.¹⁷⁶ In a close corporation, by contrast, shareholders typically serve as the directors and officers of the corporation,¹⁷⁷ and shareholders often share bonds of friendship, family, or other personal connection. As a practical matter, so long as the participants operate in good faith, it is much easier for any shareholder to be heard, at least informally.¹⁷⁸

Close corporations also may adopt additional governance mechanisms designed to enhance minority voice. For instance, a group of founding shareholders may follow a governance model based on consensus and may agree to formal mechanisms, such as supermajority voting or guaranteed minority representation on the board of directors. Although shareholder agreements allocating control were once treated with suspicion by courts, wary of undue limitations on the power of the board of directors,¹⁷⁹ such agreements are now widely accepted.¹⁸⁰

Indeed, courts should take account of any shareholder agreements regarding minority shareholder participation rights. The elevated importance of minority voice represents a default position, which the parties are free to modify contractually, subject only to the usual objections to enforcement of a contract and to limitations on the ability of the shareholders to eliminate fiduciary duties.¹⁸¹ By agreement, shareholders might explicitly provide for minority shareholder board representation, or, conversely, they might state that a minority shareholder intends to make a passive investment.¹⁸² However, an agreement regarding the allocation of control does not itself specify an understanding concerning fidu-

176. Cf. BAINBRIDGE, *supra* note 22, at 242 (“[T]he business judgment rule says that courts must defer to the board of director’s judgment absent highly unusual exceptions.”).

177. O’NEAL & THOMPSON, CLOSE CORPORATIONS, *supra* note 4, § 1:9, at 1-35.

178. See, e.g., *Nelson v. Anderson*, 84 Cal. Rptr. 2d 753, 763 n.8 (Ct. App. 1999) (rejecting minority shareholder’s claims, in part, because “[a] minority shareholder has a wide range of statutory rights to help her participate in the management of the corporation,” and “[t]here was no allegation made . . . that [the shareholder] attempted to avail herself of any of them”). The court observed, to the contrary, that the plaintiff’s “habit in corresponding with [the majority shareholder] was to be ‘polite’ and ‘nicer’ by reporting only positive opinions about the progress of the marketing effort.” *Id.*

179. See BAINBRIDGE, *supra* note 22, at 806; Thompson, *The Shareholder’s Cause of Action*, *supra* note 9, at 703 (“Traditionally . . . [i]f minority shareholders attempted to contract for protection against [oppression], such as by agreements that the minority shareholder would retain a corporate office and a salary, courts . . . struck down the agreement as an unlawful interference with the unfettered discretion required for directors.”).

180. BAINBRIDGE, *supra* note 22, at 810. The freedom to bargain away from the default rules of corporate law remains subject to significant limitations; under the Model Act, for instance, shareholder agreements must be unanimous, limited to ten years, and noted in the stock certificates, so that any stock purchaser who is not informed of the agreement is entitled to rescission. *Id.*

181. See *id.*

182. A lawyer advising a passive investor should insist upon inclusion of provisions guaranteeing some kind of liquidity, preferably through a buy-sell arrangement, but possibly through mandatory distributions. Where different roles are anticipated from the outset, such bargaining is more likely to occur. See Gevurtz, *supra* note 61, at 510. Thus, “[t]he typical squeeze-out occurs after some ownership

ciary obligations.

In *Meiselman v. Meiselman*,¹⁸³ North Carolina's Supreme Court addressed disputed issues of minority shareholder participation in a fashion consistent with this Article's recommended approach.¹⁸⁴ The case concerned an action for dissolution brought pursuant to a statute authorizing trial courts "to order dissolution or another more appropriate remedy when 'reasonably necessary' for the protection of the 'rights or interests' of the complaining shareholder."¹⁸⁵

Assessing the relationship of the plaintiff and defendant, who were brothers, the court noted a sharp disagreement about the nature of the plaintiff's participation in the business. According to the defendant, the plaintiff "'was never denied participation in the management of the corporate defendants,' that, on the contrary, [he] 'voluntarily limited his participation in their affairs.'"¹⁸⁶ The plaintiff countered "that 'theaters are being sold without my knowledge and theaters are being built without my knowledge'; and that 'my brother solely and without my consent, not only develops but closes, sells, does anything he wants with all of the properties.'"¹⁸⁷

To resolve the matter, the court examined the evidence in the record and found that it was apparent that the plaintiff's ability to participate had been substantially reduced, if not entirely eliminated.¹⁸⁸ The court noted that, based on family arguments—one concerning a girlfriend from a different religion, the other over an invitation to a football game—the defendant claimed his brother suffered "from crippling mental disorders."¹⁸⁹ The court also gave weight to a pre-litigation letter from defendant's lawyer discouraging plaintiff's efforts to secure board representation:

We have no desire to see the productive efforts of the boards be affected by possibly allowing them to function as a forum for airing personal hurts and slights; and we all recognize that the course of business activity for the companies is not going to be altered by [plaintiff]'s representation.¹⁹⁰

interests, which started as active, become passive—perhaps . . . involuntarily at the behest of the majority . . . or often because of changing life circumstances . . ." *Id.*

183. *Meiselman v. Meiselman*, 307 S.E.2d 551 (N.C. 1983).

184. In other respects, the court's expectations-based approach differs significantly from this Article's recommended framework, because the court held that shareholder participation is significant only if there is an actual expectation of participation and, equally important, treated that expectation (once established) as an absolute entitlement. For criticism of those aspects of the decision, see *supra* notes 177–81 and accompanying text.

185. *Meiselman*, 307 S.E.2d at 553 (citing N.C. GEN. STAT. § 55-125(a)(4) (currently located at § 55-14-30(2)(ii))). Notably, and significant to the court's analysis, the North Carolina dissolution statute does not appear to require a finding of oppression or other majority misconduct.

186. *Id.* at 555 (quoting testimony).

187. *Id.* (quoting testimony).

188. *Id.* at 555–56.

189. *Id.* at 556 (internal quotation marks omitted).

190. *Id.* at 555 (internal quotation marks omitted).

Counsel could hardly have made it clearer that there would be no meaningful opportunity for plaintiff to participate in governance, despite plaintiff's nearly one-third ownership of the businesses at issue. Finally, the court observed that defendant's contention that "two corporate decisions were made or changed on the basis of objections [plaintiff] had lodged" was at best misleading—the defendant's primary response to one of those objections was to terminate plaintiff's employment.¹⁹¹

The court's analysis of the participation issue in *Meiselman* shows that courts are capable of identifying the presence or absence of minority shareholder participation, even when the issue is disputed. In some cases, it may be more difficult to assess the nature of minority participation; in others, it may be easier. Undoubtedly, there will be close cases. The point is simply that this is the kind of factual analysis courts are well equipped to make.

2. Setting an Appropriate Level of Scrutiny

A court's next task, once it has assessed the minority's voice in the corporation, is to decide how closely to scrutinize the legitimacy of the challenged corporate activity. The most straightforward approach is binary: if the minority shareholder lacks voice, the court applies elevated scrutiny; otherwise, the court applies relaxed scrutiny. Procedurally, scrutiny could be adjusted through allocation of the burden of proof.¹⁹² For example, borrowing the *Wilkes* test from Massachusetts,¹⁹³ courts might hold that the usual version of that test (which requires the majority to first demonstrate the legitimacy of the challenged conduct) applies whenever the minority lacks voice. If the minority has substantial voice, then a reverse-*Wilkes* test applies instead, and the minority has the burden of demonstrating that the majority's conduct was not legitimate.¹⁹⁴

The burden could be imposed at the pleading stage—to allege specific facts supporting a finding that the majority acted without legitimate business purpose—

191. *Id.* at 556.

192. For purposes of this discussion, we need not make fine-grained distinctions between burdens of proof, production, and persuasion.

193. See *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976).

194. This Article's proposed framework bears some similarity to a recommendation made by a Law Commission charged with recommending changes to the English unfair prejudice remedy (an equivalent of U.S. shareholder oppression doctrine). The Law Commission proposed, among other things, a presumption that "where a shareholder has been excluded from participation in the management of the company, the conduct will be presumed to be unfairly prejudicial by reason of the exclusion" with a court ordered buy-out to follow unless the majority rebuts the presumption. See A.J. BOYLE, MINORITY SHAREHOLDERS' REMEDIES 122–23 (2002) (quoting Law Commission, *Shareholder Remedies* (Law Commission Report No. 246, Cm 3769, Stationery Office, 1997), Part 3). The proposal was later rejected by the Company Law Review Steering Group and has never been adopted. *Id.* at 126. Notably, the Law Commission's presumption of unfair prejudice would appear to go significantly beyond this Article's more modest suggestion that heightened scrutiny is warranted when the minority shareholders lack voice. Under the voice-based framework proposed here, the majority might be required to supply reasons, but the court would not apply any additional presumption that those reasons are false. To the contrary, the operating presumption under any level of scrutiny should be that controlling shareholders have a right to operate the business as they see fit.

or, at the close of discovery, to be able to identify evidence that sustains an issue of fact. It is also possible that differences in the level of scrutiny might impact whether a claim of shareholder oppression would be considered ripe for adjudication at the pleading stage, at summary judgment, or whether a full airing of the evidence at trial would be required.¹⁹⁵

However, binary analysis would put pressure on the determination of voice and, in close cases, could lead to unpredictable results. Therefore, even if courts used a binary method, rather than defining voice and scrutiny along a range of possibilities, it would be important to remain sensitive in the application of the standard to actual differences in voice. As an alternative, a court might apply scrutiny on a sliding scale from minimal to enhanced depending on the quality of minority shareholder voice.¹⁹⁶ Ultimately, the specific method for setting the level of scrutiny would likely depend on existing doctrine in each state. As discussed *infra* Part IV, a voice-based framework can be applied in the context of any of the three major doctrinal approaches to adjudicating shareholder oppression claims.

A recent decision from the Oregon Court of Appeals offers an illustration of what elevated scrutiny might look like in a case where the minority shareholders lacked voice.¹⁹⁷ The decision, issued after a bench trial, contains an extensive review of the evidence relating to the minority shareholder's allegations, *inter alia*, of unfairness in corporate bonus policy.¹⁹⁸ The court did not simply defer to the majority, which, as the court noted, had denied the minority the opportunity to participate in the management of the business.¹⁹⁹

Yet, after careful review of the corporation's dividend policy, detailing each year's bonus for each shareholder and the business justifications offered by the controlling shareholder, the court concluded that there was a substantial, well-documented business justification for each bonus:

[D]efendant's determination of each shareholder's contribution and effort was not entirely subjective or arbitrary. Defendant based his determinations primarily on an objective measure: the profits generated by the construction projects that each shareholder had managed. It is true that defendant made some adjustments to the objective figures on a subjective basis. However, those

195. Obviously, the uncertainty and expense of trial would create strong incentives to settle.

196. Such an approach would be consistent with this Article's recommended approach, but the greater procedural complexity of a sliding scale might create difficulties in application that would outweigh any greater precision it might offer in theory over a simpler, binary division. Also, it would represent a further departure from current doctrinal approaches.

197. See *Davis v. Brockamp & Jaeger, Inc.*, 174 P.3d 607, 617 (Or. Ct. App. 2007) ("The record indicates that, with respect to many decisions, defendant merely informed the minority shareholders after having made the decisions."). The court found that denial of participation was not, in itself, oppressive: "Unless a corporation's articles of incorporation or bylaws (or some other agreement) specifically give minority shareholders the right to participate in such decisions—which they did not in this case—that right does not exist." *Id.* at 618.

198. See *id.* at 610–12.

199. *Id.* at 617–18.

adjustments accounted for only a small fraction of the total bonuses. Furthermore, in at least one year, defendant's subjective adjustments included a downward adjustment to his own "contribution and effort" figure, which he made in order to boost the bonuses for [two minority shareholders]. That fact belies plaintiff's assertion that defendant's bonus determinations were motivated by greed.²⁰⁰

The court's analysis constitutes elevated scrutiny—requiring that the majority offer business reasons for its conduct and undertaking a searching review of those reasons—and also underscores the point that the minority shareholder may still lose.²⁰¹

C. ADVANTAGES OF A VOICE-CENTERED MODEL FOR ADJUDICATION

In addition to the benefits of deliberation for close corporation governance, discussed *supra* Part II, the voice-based framework would improve the quality of judicial analysis and the efficiency of litigation. Attention to voice encourages flexible application of existing standards and provides a better descriptive account of what courts have already recognized to be a fact-intensive analysis. A more flexible standard for judicial scrutiny would also improve the efficiency of shareholder litigation because it would reserve higher scrutiny for corporations in which the minority has less ability to protect its own interests and would allocate pleading or evidentiary burdens to better reflect the parties' access to information.

1. Avoiding Rigid Application of Existing Standards

The voice-centered model offers a formal methodology to help guide the case-specific analysis many courts and commentators have recognized is crucial in close corporation shareholder disputes. By varying the intensity of judicial review based on minority voice, courts can protect minority shareholder interests without undermining majority rule.²⁰² Applied without nuance, any of the existing doctrines for resolving shareholder litigation can lead to the formalistic protection of either majority or minority shareholder interests. The danger is perhaps greater for the Bad Faith and Fiduciary Duty approaches, which tend to

200. *Id.* at 616.

201. Enhanced scrutiny, then, is not the same thing as strict scrutiny in Constitutional law, a standard reserved for laws that discriminate based upon race or national origin and that is almost never met. See Gerald Gunther, *The Supreme Court, 1971 Term—Foreword: In Search of Evolving Doctrine on a Changing Court: A Model for a Newer Equal Protection*, 86 HARV. L. REV. 1, 8 (1972) (describing standard as "'strict' in theory and fatal in fact"). But see Adam Winkler, *Fatal in Theory and Strict in Fact: An Empirical Analysis of Strict Scrutiny in the Federal Courts*, 59 VAND. L. REV. 793, 795 (2006) (questioning the conventional wisdom concerning strict scrutiny).

202. As a kind of representation-reinforcement, the voice-based approach is very loosely analogous to John Hart Ely's famous, process-oriented approach to constitutional adjudication and the countermajoritarian difficulty. See ELY, *supra* note 51, at 87 (arguing that the Constitution "ensur[es] broad participation in the processes and distributions of government").

align with public corporation or partnership models of the close corporation, but overly rigid analysis can also be found in jurisdictions that use Reasonable Expectations analysis.

For example, when North Carolina's Supreme Court adopted a version of the Reasonable Expectations approach and emphasized the significance of a minority shareholder's "meaningful participation" in management, it appeared to reject wholesale the basic norms of corporation law.²⁰³ The court cited extensive scholarly authority for the proposition that close corporations are "little more than 'incorporated partnerships'"²⁰⁴ and stated, "when courts apply the principle of majority rule in close corporations, they often disappoint the reasonable expectations of the participants."²⁰⁵

In effect, the court held that the decisions of the controlling shareholders, as well as their judgment concerning the best course of action for the business, deserved no weight. The trial court's finding—that there was "no evidence to support a finding of fact that there was oppression, overreaching on the part of management, the taking of any unfair advantage of the minority stockholder by the majority stockholder or any other wrongful conduct on the part of the majority stockholder"—was, accordingly, irrelevant.²⁰⁶ On remand, the trial court was instructed to consider only what the "rights or interests" of the minority shareholder might be and whether they "are in need of protection."²⁰⁷

It is possible to recognize the importance of minority shareholder voice, as the *Meiselman* court did, without excluding from the analysis the business legitimacy of the decisions at issue. The choice need not be between total deference under some version of a business judgment rule and total protection of the minority's established interests in the corporation. Using voice as a proxy for the minority's ability to advocate effectively for its own interests (and to identify with specificity any wrongful conduct by the majority) would help courts better tailor the level of review to the case at hand.

203. *Meiselman v. Meiselman*, 307 S.E.2d 551, 559 (N.C. 1983). The court identified those norms as follows: "'(1) the principle of majority rule in corporate management and (2) the business judgment rule.'" *Id.* at 559 (quoting F. O'NEAL, *OPPRESSION OF MINORITY SHAREHOLDERS* § 9.04, at 582 (1975)).

204. *Id.* at 557 (citations omitted).

205. *Id.* at 559. Thus, in its effort to respect functional differences between publicly held and closely held corporations, the court failed to also distinguish partnerships from closely held corporations.

206. *Id.* at 567 ("These findings indicate that the trial court applied incorrect legal standards . . .").

207. *Id.* The court's instructions track the language of the North Carolina statute, which refers only to the "rights and interests" of the minority shareholder and does not require a showing of oppression or other majority misconduct. See N.C. GEN. STAT. § 55-14-30(2)(ii). Nevertheless, this simply restates the question of what makes an expectation "reasonable." The court seems to adopt implicitly the view that a minority shareholder's expectations need not be limited—at all—by the usual expectation that majority shareholders have the right to control the business. However, the court did observe that the expectation must have been "known or assumed by the other participants" and "the frustration [of the expectation] was without fault of plaintiff and was in large part beyond his control." *Meiselman*, 307 S.E.2d at 564; see also *Royals v. Piedmont Elec. Repair Co.*, 529 S.E.2d 515, 520 (N.C. Ct. App. 2000) (noting that "a shareholder with an expectation in management cannot seek dissolution based upon a frustration of this expectation if he never learns the business nor attends corporate management meetings").

2. Efficiency Justifications for Varied Scrutiny

A voice-based framework also would be more efficient than current doctrine because varied scrutiny places the burden of production (or elevated pleading) on the party best able to meet it.²⁰⁸ When the minority lacks an active role in the management of the corporation, the majority has better, if not sole, access to information relevant to the litigation. If a legitimate business reason exists, the majority should be able to provide it. If a decision rests on improper grounds but could conceivably be legitimate, an inactive minority shareholder may have nothing beyond circumstantial evidence to offer the court.

Minority shareholders who participate in the meetings where decisions are made and who review the information relevant to those decisions are better able to challenge the majority's conduct in court and to offer the court evidence that the majority's conduct lacks a legitimate business purpose. Courts can expect, and may require, a higher level of pleading from a minority shareholder with voice. Participation thus enables the oppressed minority shareholder to proceed to court armed with evidence and protects the corporation from the minority shareholder who is simply disgruntled.²⁰⁹

Problems can result when a court ignores the issue of access to information. For example, in a case concerning failure of several related close corporations to declare adequate dividends, Oregon's Supreme Court placed the burden of proof on the plaintiff, even though the plaintiff had been excluded from participation.²¹⁰ Indeed, the court went further and rejected the plaintiff's evidence of lack of proper business purpose precisely because the majority shareholders were the insiders with direct knowledge of the true situation:

In rebuttal, plaintiff contends that the directors did not really make their decisions on the basis of these factors, pointing to testimony that they did not rely on any documented financial analysis to support their dividend declarations. This is a matter for consideration, but it is certainly not determinative. All of the directors of these corporations were active in the business on a day-to-day basis and had intimate first-hand knowledge of financial conditions and present and projected business needs. In order to substantiate their testimony that the above factors were taken into consideration, it was not

208. As discussed above, *supra* notes 29–32 and accompanying text, it might be objected that there is an efficiency cost associated with any judicial intervention, and that the choice of form—with locked-in status for minority shareholders—should be presumed deliberate. In other words, courts should not seek to rewrite the parties' bargain. This is a complex issue, and a full analysis is beyond the scope of this Article, but the availability of newer, contract-based LLC business forms would seem to indicate a continuing role for court oversight of shareholder oppression, even from a choice-of-form perspective. Investors who select the close corporation form do so against a background of judicial protection of minority shareholder interests.

209. The participation-based and information-based arguments for voice are related. A rational majority must understand that the minority's access to information about a contested decision could form the basis for an eventual petition for judicial relief. Thus, the availability of judicial review should limit the majority's ability to erect an artifice of minority voice while studiously ignoring it.

210. *Zidell v. Zidell, Inc.*, 560 P.2d 1086, 1090 (Or. 1977).

necessary that they provide documentary evidence or show that formal studies were conducted. Their testimony is believable, and the burden of proof on this issue is on the plaintiff, not the defendants.²¹¹

The court's reliance on the credibility of insiders with no supporting objective evidence made plaintiff's burden all but insurmountable. As the court's opinion acknowledges, plaintiff was able to argue "that the change in compensation policy, coinciding as it did with his departure from active involvement in the business, [was] evidence of a concerted effort by the other shareholders to wrongfully deprive him of his right to a fair proportion of the profits" and that "each corporation had substantial retained earnings."²¹² The plaintiff was not on the board of directors, was not present when the decisions were made, and was not privy to the information on which they were based.

By contrast, a California appellate court was rightly skeptical of claims brought by a minority shareholder who had failed to bring her criticisms to the attention of the majority shareholder.²¹³ Despite believing that an infomercial critical to the product launch would not succeed, she told the majority shareholder a different story:

The infomercial was taped on October 26, 1993. As [the minority shareholder] watched the taping from a control booth, she could tell it was a "disaster" . . . and did not have a "snowball's chance" of successfully generating sales. However, she kept her opinion to herself. Instead, she sent . . . a memorandum in which she stated, "Now that we have completed our beautiful infomercial, and even before we go to air, I think we are all feeling the impending success we'll be realizing" ²¹⁴

The court held that the minority shareholder lacked standing to bring a direct action because the harm alleged was to the corporation and noted that it was unlikely that she could establish the prerequisites for a derivative claim in that "[a] minority shareholder has a wide range of statutory rights to help her participate in the management of the corporation. . . . [and t]here was no allegation made or evidence adduced that [the plaintiff] attempted to avail herself of any of them."²¹⁵ Even though the court's analysis of the minority shareholder's abdication of responsibility was specific to the context of a derivative claim, the same issue has relevance in the context of a direct claim as well. Enhanced scrutiny of corporate decisions that could have been addressed earlier would be

211. *Id.*

212. *Id.* at 1088.

213. See *Nelson v. Anderson*, 84 Cal. Rptr. 2d 753 (Ct. App. 1999). The business was formed "for the purpose of marketing skin care products," and the majority shareholder, Loni Anderson, was a television actress. *Id.* at 756. The minority shareholder, Nancy Nelson, was also a television personality. *Id.* at 757.

214. *Id.* at 758-59.

215. *Id.* at 763 n.8.

inefficient. Courts have a significant role to play when minority shareholders are unable to participate, not when they choose not to do so.

Under the proposed voice-based model, a controlling shareholder might choose to operate the corporation as a personal fiefdom but could not also demand judicial deference.²¹⁶ Those corporations that carefully observe corporate formalities can more reasonably ask courts to respect majority rule as well as the business judgment standard that gives latitude to managers of public corporations. Where close corporations fail to observe ordinary corporate procedures, or otherwise deny minority shareholders an opportunity to meaningfully participate in the decisionmaking process, there is more reason to worry that the majority may be misusing the corporate form to advance its own interests.

D. UNDESIRABLE ALTERNATIVES: MANDATED VOICE OR PURE EXIT

This Article's contention that minority shareholder voice merits careful judicial attention in the analysis of shareholder oppression claims might be criticized from at least two perspectives.²¹⁷ Some might argue that the argument does not go far enough and that minority shareholder voice should be required, not simply considered after the fact. Others have contended that the answer to minority shareholder oppression is exit, not voice.²¹⁸ Neither position undermines this Article's central claims.

1. Why Not Mandate Voice?

One might ask why courts or legislatures should not simply mandate minority shareholder voice if it is so important. While specific advance planning is extremely important, mandatory voice provisions would cause at least as many problems as they would solve.

For example, voting restrictions can impede efficient management, causing a risk of deadlocks, and majority shareholders may balk at handing disproportionate power to the minority.²¹⁹ In addition, abusive shareholders may forfeit the right of participation. It would be perverse to penalize corporations that investigate and take appropriate action to remedy sexual harassment or other improper conduct by a director, officer, or employee.

216. Like the risk of veil piercing, limitations on minority participation would be a factor for controlling shareholders to consider in deciding how to run the business.

217. A more fundamental objection, which, of course, applies to any doctrine of minority shareholder oppression, is that parties are free to bargain for all rights they value and should be presumed to have done so. As discussed, *supra* note 31 and accompanying text, that view is premised on an unrealistic view of the shareholder relationship and bargaining process, at least for family corporations. Also, given the delayed-harm aspect of the problem, it seems unsatisfying to declare, sternly, "you made your bed, now you must lie in it." The bed's occupant may be a generation or more removed from the misguided founder who put rocks in the pillows.

218. See, e.g., Blackmar, *supra* note 45; Matheson & Maler, *supra* note 11.

219. See Easterbrook & Fischel, *supra* note 90, at 284–85 (offering governance concerns as a reason not to adopt regulatory protections for minority shareholders that would enable them to disrupt the business and to extract disproportionate benefits).

The possibility of minority shareholder oppression appears to be an unavoidable side effect of the close corporation form.²²⁰ Mandatory voice provisions would not work, ultimately, because no solution is right for every corporation, and minority holdouts are no less serious a potential problem than majority abuse of control.²²¹ Accordingly, courts will have to evaluate claims of minority shareholder oppression on a case-by-case basis—as they already do.²²² Applying a level of judicial scrutiny inversely proportional to the amount of voice given the minority offers the best method for efficiently and predictably achieving a sound result.

2. Why Not Eliminate Fault and Create an Automatic Exit Right?

Rather than seek the impossible—designing rules for close corporations that preserve their essential features while making shareholder oppression impossible—some focus on the wasteful expense of the resulting litigation. In that vein, a significant body of scholarship advocates a statutory right of exit that would eliminate the need for minority shareholders to show fault and would guarantee the liquidity of their investment.²²³ The argument is sometimes positioned as an analogy to the no-fault divorce.²²⁴

The statutory approach, however, creates more problems than it solves. First, an automatic exit right undermines the significance of the close corporate form and the shareholders' interest in having a locked investment.²²⁵ From the ex ante perspective, it is not clear that any shareholders would benefit from a rule that left their investment exposed.²²⁶ Undermining the stability of the corporate

220. Indeed, the strong principle of majority rule evolved in part to avoid issues of minority dominance and the oppression of the majority which could result when unanimity was required. Matheson & Maler, *supra* note 11, at 659 (citing Thompson, *Exit, Liquidity*, *supra* note 49, at 11–14).

221. See BAINBRIDGE, *supra* note 22, at 823 (“[O]ne size does not fit all. Rules that work well for some [close corporation] investors will prove a straitjacket for others.”).

222. Indeed, some scholars believe that courts should deny minority shareholders protections that those shareholders could have bargained for. See, e.g., Easterbrook & Fischel, *supra* note 90, at 273. To the extent a doctrine of minority shareholder oppression creates non-binding default rules, however, this concern seems overstated. Sophisticated parties are free to allocate rights and responsibilities differently, all of which can be priced in to the valuation of majority and minority ownership stakes. There are many reasons why shareholders may not alter the default rules, even when they are undesirable. In close corporations, shareholders may lack sophistication, may avoid bargaining because of delicate family relationships, or may not be able to afford the investment of time and money required to modify the default rules for a fledgling business that has little or no current profitability.

223. See J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1 (1977); Matheson & Maler, *supra* note 11, at 662.

224. See, e.g., Matheson & Maler, *supra* note 11, at 691; Douglas K. Moll, *Shareholder Oppression and “Fair Value”: Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L.J. 293, 369 (2004) [hereinafter Moll, *Shareholder Oppression and “Fair Value”*].

225. By contrast, “[p]ublic corporations are built on, and defined by, exit rights.” Palmiter, *supra* note 146, at 12.

226. See Rock & Wachter, *Waiting For the Omelet To Set*, *supra* note 6, at 920 (emphasizing importance of locked-in investments—metaphorically, to permit the corporate omelet to set); Thompson, *The Shareholder’s Cause of Action for Oppression*, *supra* note 9, at 702 (stating that the traditional

form would also require creditors to worry about the potential consequences of “a relatively trivial falling out among the equity investors,” and this monitoring burden and uncertainty would reduce the attractiveness of the investment from the creditor’s perspective, “thus raising the cost of capital.”²²⁷

Second, because of the lack of an established market for shares, creating liquidity for close corporations creates considerable valuation difficulties.²²⁸ Litigation concerning exit rights would not necessarily be less costly than shareholder oppression lawsuits brought pursuant to existing doctrine, which requires some showing of harm before any remedy is available.

Third, the statutory approach dismisses the instrumental and normative value of minority shareholder voice and misses the complex interaction of exit and voice. As Hirschman persuasively argued, exit and voice are dynamic, potentially complementary mechanisms.²²⁹ While some boost in exit could enhance voice by backing it with credible threat, shareholder litigation may already serve that function. If the threat of exit becomes too strong, given the need for locked investment, then minority shareholder demands may overwhelm sensible decisionmaking.

Finally, to the extent the argument for a statutory right of exit presumes that the relationship of shareholders in close corporations is akin to that of partners and that the partnership right of exit should apply equally to close corporations, the argument overlooks important differences between shareholders and partners:

[I]t is obvious that close corporate shareholders do not have a relationship that even approaches the interdependency of partners. Shareholders are not agents of the corporation and therefore cannot cause the corporation to incur liabilities. Even more significant is that unlike partners, shareholders are not liable for the debts of their corporation. These marked differences eviscerate any claim that shareholders in a close corporation are in an “incorporated partnership,” or even that these two groups of investors are similarly situated.²³⁰

corporate norm of “permanence permits the board to make long-term plans and lessens the potential financial impact occasioned by minority shareholders opportunistically withdrawing or threatening to withdraw their money capital”); *id.* at 706 (“Withdrawal of an investor’s capital comes at a cost to the remaining participants—they may have to reduce the size of their business, take out a potentially costly loan, or seek a new shareholder.”).

227. BAINBRIDGE, *supra* note 22, at 831. Bainbridge also criticizes “liberal partnership-like dissolution rights” as “a significant negative externality” because of the impact on potential creditors. *Id.* at 830. Although this latter point may at first appear to be inconsistent with Bainbridge’s observation about the cost of capital—that is, that creditors will seek to pass along their risk in the form of higher loan costs to the corporation—Bainbridge’s larger point seems to be that the inefficient corporate governance rule would reduce the total amount of investment, impacting the wealth of both potential creditors and close corporations that would have welcomed additional capital.

228. See Moll, *Shareholder Oppression and “Fair Value,” supra* note 224, at 295.

229. HIRSCHMAN, *supra* note 3, at 4–5.

230. Siegel, *supra* note 1, at 437–38.

Unless bargained for in advance, therefore, exit rights should not be available on demand in the close corporation context. As discussed below, a voice-based framework would assist courts in evaluating on a case-by-case basis whether minority shareholders are entitled to relief.

IV. APPLYING THE VOICE-BASED FRAMEWORK

Courts can adopt a voice-based framework along the lines recommended in this Article within the context of a variety of existing approaches to shareholder oppression. In large part, this Article aims to provide a better descriptive account of existing law, emphasizing issues of voice and scrutiny, and its proposal can be thought of as a refinement of current law that would not require special authorizing legislation. However, consistent with the best interpretation of existing law, the proposal offers a basis for limiting prior decisions that too rigidly apply corporate or partnership norms inconsistent with the nature of close corporation governance. This Part illustrates the applicability of the voice-based framework to Bad Faith, Fiduciary Duty, and Reasonable Expectations approaches.

A. BAD FAITH

While Delaware has rejected the concept of an independent cause of action for oppression,²³¹ and has refused to offer any “special” protection to minority shareholders in close corporations²³² its courts enforce ordinary fiduciary duties and judge corporate decisions made by controlling shareholders, sometimes under a strict “entire fairness” approach.²³³ Professor Robert Thompson has recently observed that Delaware’s seemingly inconsistent approach to fiduciary duty in fact embodies the principle of varied scrutiny: “[A]ll of these apparently disparate standards fit within the same space for judicial review that can be defined between deference on one end (characterized by the business judgment rule) and more intensive judicial review on the other end (identified as ‘entire fairness’ or intrinsic fairness).”²³⁴

Delaware courts already consider various factors reflecting possible board self-dealing in assigning a level of scrutiny in public corporation litigation. To adopt this Article’s proposal, Delaware courts would add minority shareholder voice as a trigger for enhanced scrutiny in the close corporation context.²³⁵

231. See *Nixon v. Blackwell*, 626 A.2d 1366, 1380–81 (Del. 1993).

232. *Id.*

233. See Matheson & Maler, *supra* note 11, at 684 (“Typically, Delaware courts review corporate decisions under the deferential business judgment rule. However, as the court in *Nixon* explained, the entire fairness test is implicated when the directors are on both sides of the transaction.” (citation omitted)).

234. Robert B. Thompson, *Delaware’s Disclosure: Moving the Line of Federal-State Corporate Regulation*, 2009 U. ILL. L. REV. 167, 169.

235. See Matheson & Maler, *supra* note 11, at 684 (“The entire fairness analysis essentially requires ‘judicial scrutiny.’” (quoting *Nixon*, 626 A.2d at 1376)).

Board decisions concerning salary, employment, and dividends are ordinarily protected by the business judgment rule.²³⁶ When minority shareholders are excluded from participation, however, the controlling shareholders would be required to show the “entire fairness” of challenged corporate decisions, even for decisions concerning dividends or employment that do not necessarily involve self-dealing.²³⁷ In Delaware, then, a voice-based framework would extend the logic of varied scrutiny (and of bad faith) to permit Delaware courts to police possible abuses of majority shareholder discretion without undermining the close corporation form.

B. FIDUCIARY DUTY

The *Wilkes* test established in Massachusetts suggests one way that a Fiduciary Duty approach could be modified to take into account issues of minority voice.²³⁸ The existing test, which requires the majority shareholders to establish the legitimate business purpose of challenged decisions,²³⁹ overturns the business judgment rule’s presumption and is especially well suited to close corporations without substantial minority participation.

However, Massachusetts may provide too much protection to minority shareholders who already have voice and should be able to allege with specificity why any particular business decisions were improper. (To always place the burden on the controlling shareholder is to overturn the ordinary presumption of business judgment and to risk inserting courts into the middle of every business disagreement.) As a corollary to the *Wilkes* test, then, Massachusetts courts might implement this Article’s recommendation by requiring minority shareholders with full rights of participation to meet the burden of showing that the majority’s actions lacked justification.

Expanding the flexibility of the *Wilkes* test to reflect the nature of the close corporation at issue would reserve intensified review for those close corporations most likely to ignore the interests of minority shareholders. Courts should not simply protect minority interests, regardless of business justification, and should instead apply the scrutiny-based model advocated in this Article to achieve more business-sensitive results without abandoning minority shareholders.

236. See Thompson, *The Shareholder’s Cause of Action*, *supra* note 9, at 703 (observing that “[t]he majority may even be able to deny the minority shareholder any return in the long run by siphoning off corporate assets in the form of high salaries or rents, insulated from judicial review by the business judgment rule”).

237. Under existing Delaware law, only if minority shareholders can show that the majority has, in fact, taken a disproportionate benefit to the exclusion of minority shareholders will the majority be obligated to show the “entire fairness” of the transaction. See *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

238. See *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976).

239. See *id.* at 663.

C. REASONABLE EXPECTATIONS

Courts adopting a Reasonable Expectations approach in some respects come closest to the approach recommended in this Article, in that they already tend to give explicit priority to voice. In such jurisdictions, the voice-based framework might improve judicial analysis by making it *less* flexible and more predictable. Before attempting to evaluate the nature of the parties' bargain, which may involve conflicting testimony and an examination of years' worth of corporate records, an initial assessment of the minority's voice would usefully calibrate the intensity of the court's scrutiny. Given the costs and disruption of litigation for the corporation, as well as the judicial resources involved, courts should not aim to police shareholder relationships to identify and correct all instances of overreaching.

Accordingly, minority shareholders with voice would have the burden of establishing a clear violation of their objectively reasonable expectations and would as a result be less likely to use litigation to impose costs on majority shareholders, who are entitled to control the direction of the business.²⁴⁰ If minority shareholders have been deprived of voice, however, then the majority would be required to show that the challenged conduct is consistent with the minority's reasonable expectations. Ultimately, the court's aim should be to ensure that the majority has a business justification and not to enhance the value of the minority's investment at the expense of other shareholders. Placing the burden on the majority reflects nothing more than the fact that concentrated power without any check is likely to be abused.²⁴¹

CONCLUSION

Emphasis on the immediate problem of exit in the context of close corporation shareholder litigation causes courts and commentators to discount the continuing relevance of voice, both to identifying and remedying oppression. A voice-based model, applying enhanced scrutiny to close corporations that deprive minority shareholders of voice, creates appropriate incentives for inclusive governance of close corporations in the best interest of all shareholders.

240. See *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1180 (N.Y. 1984) ("It would be contrary to [the dissolution statute's] remedial purpose to permit its use by minority shareholders as merely a coercive tool." (citations omitted)); *In re Dubonnet Scarfs, Inc.*, 105 A.D.2d 339, 343 (N.Y. App. Div. 1985) (rejecting notion that shareholder in close corporation "can demand to be bought out . . . and that if such demand is not complied with, then such shareholder can seek the dissolution of that corporation").

241. See Moll, *The Unanswered Question*, *supra* note 42, at 757; Rock & Wachter, *Waiting for the Omelet To Set*, *supra* note 6, at 916; Siegel, *supra* note 1, at 383-84.