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Help from Across the Pond: Applying the U.K. Law Commission's Presumption That Exclusion from Management in a Private Company Is Unfairly Prejudicial as a Guide to Assessing Claims of Minority Shareholder Oppression in U.S. Closely Held Corporations

Lindsey M. Heger

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HELP FROM ACROSS THE POND:
APPLYING THE U.K. LAW COMMISSION'S
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MANAGEMENT IN A PRIVATE COMPANY IS
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ASSESSING CLAIMS OF MINORITY
SHAREHOLDER OPPRESSION IN U.S.
CLOSELY HELD CORPORATIONS

Lindsey M. Heger

INTRODUCTION

Investing in a closely held corporation¹ without protecting one's management expectations or ability to divest, namely by negotiating a controlling interest or buyout agreement, is an immodest gamble. The outcome of the investment may depend not only upon the success of the business venture but also on personal relationships with the other investors. When shareholders find themselves at odds, the minority is at a significant disadvantage.

The problem of minority shareholder oppression² arises from the majority shareholder's ability to control corporate decision-making coupled with the minority shareholder's inability to exit the investment.³ This dynamic creates a conundrum for the minority

¹ See generally, *Donahue v. Rodd Electrotype Co.*, 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 corporate stock; and (3) substantial majority stockholder participation in the management . . . of the corporation."); Cf. F. HODGE O'NEAL & ROBERT B. THOMPSON, CLOSE CORPORATIONS AND LLCs §1.2, at 1-7 (rev. 3d ed.) (2006) [hereinafter O'NEAL AND THOMPSON, CLOSE CORPORATIONS] (asserting that the illiquidity of the investment is the sole characteristic essential to the meaning of a close corporation).

² For purposes of this paper, the term "oppression" refers broadly to all lawsuits brought by a minority shareholder against the majority, irrespective of the particular cause of action or remedy sought.

³ See Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699, 699 (1993) ("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

shareholder should dissension arise among the shareholders.⁴ Subject to the whim of majority rule with no escape hatch, a minority shareholder faces significant economic deprivation⁵ as well as a diminished ability to participate in corporate affairs.⁶

Despite the inherent risks posed to an investor in a close corporation, most U.S. and U.K. corporations are structured as closely held.⁷ Close corporations provide several attractive features, including stability, fewer formalities, and limited shareholder liability. Unfortunately, these same characteristics contribute to the problem of minority shareholder oppression and allow the majority shareholder to exclude the minority from the benefits of ownership.⁸

The problem of minority shareholder oppression is not unique to close corporations in the United States.⁹ While minority shareholder

vulnerable in a way that is distinct from the risk faced by investors in public corporations.”).

⁴ See 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) (“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.”).

⁵ See Mary Siegel, *Fiduciary Duty Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 384 (2004) (noting that investors in a close corporation invest a “disproportionately high percentage of their wealth in their corporation.”).

⁶ See F. HODGE O’NEAL & JORDAN DERWIN, *EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES: “SQUEEZE-OUTS” IN SMALL ENTERPRISES* § 1.04, at 6-7 (Duke University Press) (1961) [hereinafter O’NEAL & DERWIN] (noting that the “losses and injustices” resulting from a minority shareholder’s squeeze-out include his expulsion from participation in corporate affairs).

⁷ For a discussion of the popularity of the close corporate form in the United States, see O’NEAL & THOMPSON, *CLOSE CORPORATIONS*, *supra* note 1, §1.2, at 1-7 (estimating that approximately “95% of all corporations [in the U.S.] have 10 or fewer shareholders.”). For a discussion of the abundance of private companies in the United Kingdom, see HARRY G. HENN & JOHN R. ALEXANDER, *LAWS OF CORPORATION AND OTHER BUSINESS ENTITIES* §257, n.5 (3d ed. 1983) (observing that private companies far outnumber public companies in the U.K.).

⁸ See Donahue, *supra* note 1, at 513 (“Although the [close] corporate form provides . . . advantages for the stockholders . . . it also supplies an opportunity for the majority stockholders to oppress or disadvantage minority stockholders. The minority is vulnerable to a variety of oppressive devices, termed ‘freezeouts,’ which the majority may employ.”).

⁹ The minority shareholder oppression problem is international in scope, as evidenced by claims of oppression arising in various countries throughout

oppression may take one of many forms,¹⁰ disputes among shareholders remain "part of the fabric of modern business organization law on a global scale."¹¹ The vulnerability of the minority shareholder in a close corporation is a universal trend among private companies across the globe; this trend suggests the need for more effective measures to redress shareholder disputes should they arise.

The United States and the United Kingdom have addressed the problem of minority shareholder oppression in a broadly similar manner. "Oppression" and "unfair prejudice"¹² are flexible yet elusive concepts at the core of a variety of common law and statutory causes of action that protect a minority shareholder's expectations. Although the law of both countries provides minority shareholders with causes of action to redress their grievances, substantial uncertainty remains

the world and by the remedies developed by such countries in seeking to address the problem. *See, e.g.,* Brian Cheffins, *The Oppression Remedy in Corporate Law: The Canadian Experience*, 10 U. PA. J. INT'L BUS. L. 305, 307-312 (1988) (discussing the reform of minority shareholder protections in Canada as a way to remedy the shareholder oppression problem); Francisco Reyes, *Corporate Governance in Latin America: A Functional Analysis*, 39 U. MIAMI INTER-AM. L. REV. 207, 235-36 (2008) (discussing the adoption of legislation as a solution to the minority shareholder oppression problem in Latin America); Cindy A. Schipani & Junhai Liu, *Corporate Governance in China: Then & Now*, 2002 COLUM. BUS. L. REV. 1, 36-38 (2002) (noting that "[o]ppression of minority shareholders is a serious issue" in China); Lorenzo Segato, *A Comparative Analysis of Shareholder Protections in Italy and the United States: Parmalat as a Case Study*, 26 NW. J. INT'L L. & BUS. 373, 390-408 (2006) (discussing the existing protections afforded to minority shareholders alleging oppression and suggesting reform towards more protective measures).

¹⁰ Among the most common allegations of oppression include "squeeze-out" techniques such as the withholding of dividends, the mismanagement of corporate assets, and the exclusion of the minority from management positions, employment positions, or both. *See* O'NEAL & DERWIN, *supra* note 6, §3.01-3.06, at 41-60.

¹¹ John H. Matheson & R. Kevin Maler, *A Simple Statutory Solution to Minority Oppression in the Closely Held Business*, 91 MINN. L. REV. 657, 658-59 (2007).

¹² For purposes of this paper, the terms "unfair prejudice" and "oppressive conduct" refer to the specific grounds for statutory action available to a minority shareholder claiming oppression, in the U.K. and in the U.S., respectively. "Oppression" broadly refers to all claims brought by a minority shareholder against the majority. *See supra* note 2.

regarding the extent to which a minority shareholder's expectations are to be protected. Additionally, shareholder litigation can prove costly and burdensome to both the involved parties and to the judicial systems of each country,¹³ thus calling for a more efficient and effective means to handle such disputes.

As a matter of statutory reform and in an effort to more effectively manage claims of oppression in the U.K., the U.K. Law Commission proposed a presumption of unfair prejudice arising from the minority's exclusion from management. A presumption of oppression in the U.S. may improve the U.S. oppression doctrine for the following reasons. First, the existing U.S. approaches to oppression fail to provide sufficient guidance to courts in determining whether an action constitutes oppression, but a presumption based upon structural factors may more clearly define the circumstances warranting a finding of oppression. Second, a presumption of oppression in the U.S. would foster judicial efficiency by encouraging parties to settle and by limiting the facts presented to courts to those occurring immediately before the minority shareholder's exclusion. Third, a presumption of oppression recognizes the unique nature of the close corporation, safeguards against the majority's abuse of control, and encourages minority shareholder participation.

This paper proceeds as follows: Part I describes the various causes of action and remedies available to a minority shareholder alleging oppression in the U.S. and in the U.K. Part II provides an overview of the U.K. Law Commission's recommendation to codify a presumption of unfair prejudice in U.K. law and further outlines the basis for the presumption's rejection and ultimate abandonment in the U.K. Part III argues that a presumption of oppression in the U.S. would improve the U.S. oppression doctrine. Part IV illustrates that U.S. courts, in conjunction with existing doctrinal approaches, can apply a presumption of oppression that will assist in defining situations where oppression arises while retaining the flexibility necessary to fashion an equitable remedy between the parties.

¹³ See *In re Elgindata, Ltd.*, 2 B.C.L.C. 354 (Eng. Ch. 1994) (illustrating the expensive and burdensome nature of shareholder litigation because it involves a claim of unfair prejudice requiring a forty-three day hearing and producing court costs of £320,000 (roughly equivalent to 473,400 U.S. dollars), where the shares at issue were initially purchased for £40,000 (59,180 U.S. dollars) and ultimately valued at £24,600 (36,395 U.S. dollars.)).

I. MINORITY SHAREHOLDER REMEDIES IN THE UNITED
KINGDOM AND IN THE UNITED STATES

The U.K. and the U.S. have developed several statutory and common law causes of action to provide minority shareholders with avenues of redress for their claims of oppression. Many U.S. states have adopted dissolution statutes, typically modeled after the *Revised Model Business Corporation Act*,¹⁴ that provide for involuntary corporate dissolution upon shareholder deadlock or a showing of the majority's "illegal, oppressive, or fraudulent conduct."¹⁵ Similarly, U.K. corporate law recognizes a statutory cause of action for oppression upon "unfairly prejudicial" conduct,¹⁶ which serves as the counterpart to the U.S. statutory remedy for dissolution upon a showing of oppressive conduct.¹⁷ While the phrasing of the statutory causes of action and a court's interpretation thereof may vary, both the U.S. and the U.K. statutory actions generally provide for a broad range of remedies available to a complaining minority shareholder upon a showing of the majority's acts of oppression.

¹⁴ See MODEL BUS. CORP. ACT § 14.30(2) (2005) (providing that a court may order involuntary dissolution where a shareholder has petitioned the court, and where the directors are deadlocked or where "the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent").

¹⁵ See, e.g., ALA. CODE § 10-2B-14.30 (2006); ARIZ. REV. STAT. ANN. § 10-1430 (2006); IDAHO CODE ANN. § 30-1-1430 (2005). While many states have adopted dissolution statutes modeled after the *Revised Model Business Corporation Act*, the pertinent standard of liability as developed through case law varies among states. For a state-by-state survey of the type of dissolution statute adopted, the pertinent standard of liability, and other important nuances, see Matheson & Maler, *supra* note 11, at 700.

¹⁶ See U.K. Companies Act, 2006, pt. 30, § 994(1).

¹⁷ See Sandra K. Miller, *How Should U.K. and U.S. Minority Shareholder Remedies for Unfairly Prejudicial or Oppressive Conduct be Reformed?*, 36 AM. BUS. L.J. 579, 581-82 (1999) (noting that the U.K. and U.S. "have developed some-what similar legal remedies for the minority shareholder of a private company" and that an action for corporate dissolution is the U.S. counterpart to the U.K. remedy for "unfair prejudice").

*A. UNITED KINGDOM: THE STATUTORY PROVISIONS
REGARDING DISSOLUTION AND UNFAIR PREJUDICE*

In the U.K., a complaining minority shareholder may pursue one of many routes to recovery. At common law, a complaining minority shareholder might seek to stand in the shoes of the corporation and initiate a derivative action for wrongs allegedly done to the corporation, such as waste of corporate assets, mismanagement, or breach of fiduciary duties owed. But, because the English rule of *Foss v. Harbottle*¹⁸ restricted minority shareholders from bringing such actions,¹⁹ minority shareholders attempting to redress their grievances through this procedure faced difficulty maintaining their claims, particularly where their claims rested on harm caused to their interest as shareholders. Today, minority shareholders in the U.K. more often pursue statutory causes of action; such statutory causes have become a “bypass” to the derivative action that allows minority shareholders to bring direct actions addressing “personal grievances.”²⁰ Under current U.K. corporate law, a minority shareholder is likely to seek relief through either the statutory mechanism for the “just and equitable winding up” of the company²¹ or through the statutory cause of action

¹⁸ *Foss v. Harbottle*, (1843) 2 Hare 461.

¹⁹ The English rule of *Foss v. Harbottle* dictates that, in an action involving an alleged wrong done to the company, the proper claimant is the corporation itself. By classifying minority shareholders as disfavored litigants, the effect of *Foss* was generally to bar minority shareholder actions, unless the claim met one of *Foss*’s delineated exceptions. One such exception included the derivative action; however, a minority shareholder was prevented from bringing suit against the majority where the alleged action was legally capable of ratification under the article of incorporation or otherwise by law. See generally A.J. BOYLE, *MINORITY SHAREHOLDERS’ REMEDIES* 1-23 (Barry Rider ed., Cambridge Univ. Press)(2002). For a complete discussion and critique of the rule of *Foss* and its exceptions, see *id.* at 1-59.

²⁰ *Id.* at 22-23 (“It is a commonplace observation of company law textbooks that minority shareholders today tend to seek relief by means of a section 459 [the predecessor to section 994 of the Companies Act 2006 and identical in language] petition for unfair prejudice rather than by common law actions under the ‘exceptions’ to *Foss v. Harbottle*”). Additionally, Professor Boyle notes that a minority shareholder more frequently resorts to an unfair prejudice petition where he seeks to remedy “personal grievances.” *Id.* at 23.

²¹ See BOYLE, *supra* note 19, at 91-92 (noting that while the court’s involuntary judicial dissolution power has been long recognized in U.K. law, the latest codification of the “just and equitable winding up” remedy is set forth in the Insolvency Act of 1986 and serves as the modern basis for analyzing the propriety of judicial dissolution); see also U.K. Insolvency Act, 1986, §122(1)(g) (providing that a court may order dissolution of a company where

protecting minority shareholders from oppression, originally adopted and codified in the Companies Act of 1980 as the "unfair prejudice" remedy.²²

1. THE STATUTORY REMEDY OF "JUST AND EQUITABLE WINDING UP"

Pursuant to the statutory power to order a just and equitable winding up, courts retain the broad discretion to order dissolution of a company consistent with equitable principles.²³ In *Ebrahimi v. Westbourne Galleries, Ltd.*,²⁴ the leading case to address the nature and scope of the just and equitable winding up power, the House of Lords²⁵ stated that, even in the absence of an agreement dictating legal rights among shareholders, equitable considerations enable a court to consider whether the circumstances warrant dissolution.²⁶ While the House of Lords in *Ebrahimi* indicated that providing a comprehensive definition of the equitable grounds for dissolution was impossible, it provided guidelines as to when conduct may justify a dissolution based in

"the court is of the opinion that it is just and equitable that the company should be wound up").

²² See BOYLE, *supra* note 19, at 90 ("The Cohen Committee, as long ago as 1945, designed what was to become a statutory remedy against the oppression of minority shareholders in the form of section 210 of the Companies Act 1948. . . . The Jenkins Committee's [later] proposals for a new 'unfair prejudice' remedy were, after a long delay, implemented by section 75 of the Companies Act 1980."). For the operative provision of the unfair prejudice remedy in the latest re-enactment of the Companies Act, see U.K. Companies Act, 2006, pt. 30, § 994.

²³ See BOYLE, *supra* note 19, at 92 ("The effect of section 122(1)(g) of the Insolvency Act 1986 is to enable the court to subject the exercise of legal rights to equitable considerations . . .").

²⁴ *Ebrahimi v. Westbourne Galleries, Ltd.* [1973] A.C. 360 (H.L.).

²⁵ The House of Lords forms the upper house of the U.K. Parliament and the highest court in the U.K. The core legislative duties of the House of Lords include making, debating, and passing all laws, scrutinizing the work of other governmental bodies, and providing a forum of independent expertise comprised of specialist committees. See U.K. Parliament, *Parliament's Role*, <http://www.parliament.uk/about/how/role.cfm> (last visited May 13, 2009).

²⁶ *Ebrahimi*, *supra* note 24, at 379-80.

equity.²⁷ Because courts consider dissolution an extreme remedy to be granted only sparingly, minority shareholders more often pursue their claims under the statutory remedy for unfair prejudice.²⁸ Notably, courts have applied the *Ebrahimi* factors for granting dissolution based in equity to define unfair prejudice.²⁹

2. THE STATUTORY CAUSE OF ACTION FOR UNFAIR PREJUDICE

Under section 994 of the U.K. Companies Act of 2006, a shareholder may petition the court on the basis that the company's affairs have been or are currently being conducted in an "unfairly prejudicial" manner.³⁰ The provision is a re-enactment of section 459 of the Companies Act of 1985.³¹ Upon a showing of unfairly prejudicial conduct, a court may impose one of a wide range of remedies, including regulating the corporation's future conduct through injunctions, permitting the shareholder to proceed with a derivative action, or providing for a buyout of the complainant's shares.³²

The act neither describes unfairly prejudicial conduct nor provides any examples thereof.³³ A court's finding of unfair prejudice initially involved a flexible standard based on case-by-case court

²⁷ As set forth in *Ebrahimi*, the equitable factors justifying dissolution, in the absence of a shareholder agreement documenting legal rights, include the following: (1) an association, formed or continued on the basis of a personal relationship, involving mutual confidence; (2) an agreement or understanding that all or some of the shareholders shall participate in the conduct of the business; and (3) restriction upon the transfer of the members' interest in the company. As noted in *Ebrahimi*, an order of dissolution based in equity would seemingly require the satisfaction of one or more of these elements. *Id.*

²⁸ See *id.* at 103 (noting the significant effect of the "alternative" remedy provision of the just and equitable winding up remedy on shareholder claims and further noting that the unfair prejudice remedy has become a "more inclusive remedy both substantively and in terms of the remedial orders that might be made").

²⁹ *Id.* at 91 (noting that the *Ebrahimi* principles "have been employed to illuminate the meaning of the concept of 'unfair prejudice,' as it applies to small private companies"); Additionally, as discussed *infra* Part II.A, the U.K. Law Commission relied on the *Ebrahimi* factors in its initial proposal for reform of the unfair prejudice remedy.

³⁰ See U.K. Companies Act, 2006, pt. 30, § 994(1).

³¹ Compare U.K. Companies Act, 2006, pt. 30, §§ 994-996, with U.K. Companies Act, 1985, pt. 17, §§ 459-461.

³² See U.K. Companies Act, 2006, pt. 30, § 996.

³³ See *id.* § 994.

determinations of what types of conduct warranted judicial intervention.³⁴ Thus, prior to the House of Lords' decision in *O'Neill v. Phillips*, discussed *infra* Part II.B, British courts had developed an imprecise notion of unfair prejudice while retaining broad discretion in finding unfairly prejudicial conduct.³⁵ Accordingly, uncertainty often arose in defining what conduct constituted unfair prejudice. In determining whether conduct is unfairly prejudicial for purposes of the current provision, U.K. courts have emphasized both commercial conduct in light of the actual agreement between the parties and the parties' "reasonable expectations" in the corporate undertaking.³⁶

*B. STATES: OPPRESSION AND THE STATUTORY REMEDY OF
DISSOLUTION*

Like the U.K. and many other countries, U.S. law in most jurisdictions provides relief to complaining minority shareholders either by statute or as a matter of common law.³⁷ *The Revised Model Business Corporation Act*, which has been adopted in whole or in part by a majority of U.S. jurisdictions,³⁸ prescribes a U.S. counterpart to

³⁴ See BOYLE, *supra* note 19, at 94 (noting that the notion of unfair prejudice might be best described as a "general standard to guide the court as to what kind or degree of misbehaviour or mismanagement should justify the court, on hearing a petition under section 459 [the predecessor to section 994 of Companies Act 2006], in exercising its powers of intervention under section 461 [the predecessor to section 996 of Companies Act 2006]").

³⁵ See *id.* at 94-95.

³⁶ See Miller, *supra* note 17, at 605 (noting that while the unfair prejudice statute does not provide a comprehensive definition of "unfairly prejudicial conduct," British courts have looked to commercial conduct in light of any actual agreement between the parties and the reasonable expectations arising out of any agreement to define such conduct).

³⁷ See Matheson & Maler, *supra* note 11, at 662-63 (noting that the development of relief for minority shareholder oppression in the U.S. can be divided into roughly three groups: states developing relief as a "matter of common law jurisprudence;" states whose legislatures have adopted "comprehensive statutes," which provide for relief upon oppression and also "describe the behavior that triggers such a cause of action;" and states which have "declined to create a judicially imposed doctrine of shareholder oppression for closely held corporations").

³⁸ See Stephen M. Bainbridge, CORPORATION LAW AND ECONOMICS 2, 16 (2002) (noting that at least twenty-four states have adopted the *Revised Model*

the U.K. cause of action based on the majority's unfairly prejudicial conduct.³⁹ This statutory cause of action allows a shareholder to petition for judicial dissolution upon shareholder or director deadlock or upon "illegal, oppressive, or fraudulent conduct" of the directors or those in corporate control.⁴⁰ Similar to the U.K. unfair prejudice remedy, the *Revised Model Business Corporation Act* and state legislatures adopting the act generally have not defined what types of acts constitute oppressive conduct.⁴¹

Courts reluctant to resort to the extreme measure of judicial dissolution but increasingly sympathetic to the vulnerability of the minority shareholder have enlarged the rights of minority shareholders by broadly interpreting oppressive conduct and by providing a wide range of remedies upon a finding of oppression.⁴² Although a limited number of state dissolution statutes broadly set forth what acts constitute oppressive conduct,⁴³ courts are typically faced with the

Business Corporation Act in whole and that many other states have adopted it in part).

³⁹ See MODEL BUS. CORP. ACT § 14.30(2) (2005).

⁴⁰ *Id.* While many state dissolution statutes provide for involuntary judicial dissolution upon a showing of the majority's "oppressive conduct," some state dissolution statutes contain a variation of this language. Other state statutes may permit a minority shareholder to bring an action for involuntary dissolution, but do not expressly use the term "oppressive conduct." For a state-by-state survey of the various types of dissolution statutes adopted among U.S. states, see Matheson & Maler, *supra* note 11, at 700.

⁴¹ Compare U.K. Companies Act, 2006, pt. 30, § 994(1), with MODEL BUS. CORP. ACT § 14.30(2) (2005), and Matheson & Maler, *supra* note 11, at 662-63.

⁴² See Matheson & Maler, *supra* note 11, at 674-75 (noting that courts would not traditionally order dissolution in the absence of extreme circumstances, but as courts have become "somewhat more sympathetic to minority claims," the rights bestowed on minority shareholders have broadened); see also Thompson, *supra* note 3, at 707-08 (noting that because "the statutory grounds for judicial dissolution now are substantially broader," and because "state legislation authorizes more remedies as alternatives to dissolution" than previously warranted, state statutes providing for involuntary dissolution have become broader grounds for claiming minority shareholder oppression).

⁴³ These "comprehensive statutes" establish a cause of action for minority shareholders claiming oppression, and also attempt to "describe the behavior that triggers such a cause of action." See Matheson & Maler, *supra* note 11, at 663. For example, the New Jersey Corporations Act provides for a range of remedies, including dissolution, upon certain types of director or majority shareholder behavior, including fraudulent or illegal conduct, mismanagement, abuse of authority, or upon oppressive or unfair actions towards the minority.

challenge of defining oppressive conduct without any guidance from the dissolution statute.

State courts have developed various standards for defining oppressive conduct within a particular jurisdiction.⁴⁴ One standard involves assessing whether the majority has defeated the minority shareholder's "reasonable expectations."⁴⁵ Recently, this approach received increased recognition.⁴⁶ Some state legislatures, such as those in Minnesota and North Dakota, have explicitly directed in their dissolution statutes that courts consider the minority shareholder's

Id. at 666. While state legislatures adopting "comprehensive statutes" attempt to provide some guidance to courts in defining oppressive conduct, a presumption of oppression grounded in structural factors, as discussed *infra* Part III.A., may provide more appropriate and helpful guidance in the U.S.

⁴⁴ See Robert C. Art, *Shareholder Rights and Remedies in Close Corporations: Oppression, Fiduciary Duties, and Reasonable Expectations*, 28 J. CORP. L. 371, 376 (2003) ("Judicial interpretation of the term 'oppressive' may be divided into three broad approaches, though the demarcations among them are not distinct."). The three approaches to defining oppression for purposes of the statutory remedy for dissolution upon "oppressive conduct" include the following: (1) oppression as "wrongful conduct," (2) oppression as breach of a fiduciary duty, and (3) oppression as breach of the minority's "reasonable expectations." *Id.* These approaches to defining "oppressive conduct" roughly mirror the approaches followed by states developing remedies for oppression primarily as a matter of common law jurisprudence. See Matheson & Maler, *supra* note 11, at 674-89. These common law approaches include the "Bad Faith" or Delaware approach, the "Fiduciary Duty" or Massachusetts approach, and the "Reasonable Expectations" approach. See *id.*

⁴⁵ See generally Art, *supra* note 44, at 389-90 (noting that the "reasonable expectation" approach to defining oppression, discussed *infra* Part III.A., examines the minority's expectations with respect to the majority's challenged action).

⁴⁶ See Matheson & Maler, *supra* note 11, at 679 ("While the reasonable expectations model may not yet fully represent a majority rule, courts in at least twenty-one states have applied the language in some form. Courts in several states have adopted the reasonable expectations test without 'enabling' language from the [involuntary dissolution] statute itself; that is, courts have applied the test even when the statute only provides that dissolution is available when conduct is 'oppressive.'").

reasonable expectations in determining whether the majority acted in an oppressive manner.⁴⁷

Other jurisdictions, recognizing the unique nature of the close corporation, impose judicially created fiduciary duties on shareholders in a close corporation and define oppressive conduct as a breach of such duty.⁴⁸ Yet other states treat shareholders in a close corporation no differently than investors in a public corporation and find oppression only in the event of the majority's "wrongful conduct."⁴⁹ However, as discussed *infra* Part III.A, regardless of the particular approach a state may follow in defining oppression, the approach alone cannot provide adequate guidance to a court handling claims of minority shareholder oppression in the U.S.

II. PRESUMING OPPRESSION: PROPOSED REFORM OF THE UNFAIR PREJUDICE REMEDY IN THE U.K.

In an effort to more effectively manage claims of unfair prejudice arising in U.K. private companies, the U.K. Law Commission,⁵⁰ prior

⁴⁷ See MINN. STAT. § 302A.751 (2004) (providing for involuntary judicial dissolution where the directors or those in control of the corporation acted in an "unfairly prejudicial" manner, and further directing that the "reasonable expectations of all shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other" is one consideration that a court must take into account in granting relief); N.D. CENT. CODE § 10-19.1-115(4) (2005) (providing for court-ordered relief upon the majority's oppressive conduct and further providing that the court must consider the reasonable expectations of the corporation's shareholders both at the time of the corporation's formation and as developed during the course of the business relationship).

⁴⁸ This approach, also known as the Massachusetts or "Fiduciary Duty" approach, defines oppression as breach of a fiduciary duty owed to the minority and, as discussed *infra* Part III.A, depends on what duties the majority owes. See Art, *supra* note 44, at 377-78; see also Matheson & Maler, *supra* note 11, at 675.

⁴⁹ This third approach, also known as the Delaware or "Bad Faith" approach, defines oppression as "wrongful conduct." See Art, *supra* note 44, at 376-77; see also Matheson & Maler, *supra* note 11, at 683.

⁵⁰ The U.K. Law Commission is the independent advisory body created by the Law Commissions Act of 1965. The Law Commission's primary tasks, as prescribed by statute, include reviewing laws and recommending reform where the Commission deems it necessary. One other duty assigned to the Law Commission includes receipt of proposals for reform of the law. The Commission examines and adopts a particular view before transferring the

to the re-enactment of the Companies Act in 2006, recommended codifying a presumption of unfair prejudice following the minority's exclusion from management and the fulfillment of other factors. However, the proposal was hastily dismissed during the consultation phase. Despite its rejection as a matter of U.K. statutory law, such a presumption could serve as a helpful guide for U.S. courts handling claims of shareholder oppression.

Part II.A provides a background and overview of the presumption of unfair prejudice, as proposed in U.K. law. Part II.B discusses the basis for the ultimate dismissal of the Law Commission's recommendation to codify the presumption as part of the unfair prejudice remedy.

A. BACKGROUND AND MECHANICS OF THE PRESUMPTION OF UNFAIR PREJUDICE

Before the adoption of the Companies Act of 2006, the U.K. Law Commission set forth several recommendations for reform of U.K. minority shareholder remedies. In its *Consultation Paper*, the Law Commission proposed the adoption of a second statutory cause of action to supplement the existing provision under section 459.⁵¹ The proposed cause of action was intended to "provide a more streamlined procedure" for handling certain disputes commonly brought under section 459, whose broad wording usually resulted in time-consuming, complicated, and expensive litigation.⁵²

The determination of which cases to shift from the original provision to the proposed cause of action was based on a study showing three trends: (1) most companies involved in unfair prejudice proceedings under section 459 were private companies with five or fewer shareholders; (2) the most commonly pleaded allegation was

proposed reform to another agency for examination. See Law Commission, <http://www.lawcom.gov.uk> (last visited Apr. 3, 2009).

⁵¹ U.K. Law Commission, *Shareholder Remedies: A Consultation Paper* (Consultation Paper No. 142), 1996, pt. 18. [hereinafter *Consultation Paper*].

⁵² See U.K. Law Commission, *Shareholder Remedies* (Law Commission Report No. 246), 1997, pt. 3, para. 3.1 [hereinafter Report No. 246] ("The aim of such a remedy would be to provide a more streamlined procedure for dealing with some of the most common disputes which are currently brought under section 459, thereby reducing the time and costs spent on such disputes.").

exclusion from management; and (3) most petitioners sought a buyout of their shares.⁵³ Accordingly, the proposed cause of action was designed to allow minority shareholders in private companies of two to five shareholders to petition the court based primarily on their exclusion from management, that is, without first establishing unfair prejudice as required under section 459.⁵⁴ Additionally, the proposed cause would have required a showing that the corporate association was formed on the basis of a “personal relationship” and that before the minority shareholder’s exclusion, all shareholders agreed that the complaining shareholder would participate in the company’s management.⁵⁵

Absent a showing of the minority shareholder’s gross misconduct, the separate unfair prejudice procedure would allow a court to order the limited remedy of a buyout of the minority’s shares, either by the company or by other shareholders, at a fair value.⁵⁶ However, in a later version of its report,⁵⁷ the Law Commission expressed concern over adopting an additional remedy for unfair prejudice in small companies. Factors such as potential arbitrariness in its application,⁵⁸ possible duplication of claims, possible complication

⁵³ *Id.* at app. E.

⁵⁴ See BOYLE, *supra* note 19, at 119 (“Without the usual burden in a section 459 [unfair prejudice] petition of establishing unfair prejudice, the petitioner in the envisaged procedure could apply to the court for an order on the grounds of exclusion from participation in management . . .”).

⁵⁵ See *Consultation Paper*, *supra* note 51, pt. 18 (noting the Law Commission’s guidelines for determining “unfairly prejudicial” conduct for purposes of the proposed additional remedy mirror two of the equitable factors set forth in *Ebrahimi*, which the House of Lords suggested were sufficient to warrant an order for judicial dissolution). See *supra* notes 24-29 and accompanying text (in its *Consultation Paper*, the Law Commission suggested that a minority shareholder petitioning the court under the additional remedy for unfair prejudice must ordinarily demonstrate the satisfaction of the first two factors – that the business association was formed and continued on the basis of a “personal relationship,” and the existence of an agreement, or understanding, that all or some of the shareholders will participate in the affairs of the business).

⁵⁶ See *Consultation Paper*, *supra* note 51, pt. 18.

⁵⁷ See Report No. 246, *supra* note 52, pt. 3.

⁵⁸ The Law Commission noted that several respondents to their initial report expressed the belief that drawing the line at two to five shareholders required before a minority shareholder may petition under the new remedy was arbitrary. *Id.* pt. 3, para. 3.18.

of shareholder proceedings,⁵⁹ and debate over the degree of flexibility to be achieved by the new remedy⁶⁰ led the Law Commission to disfavor the proposed cause of action.⁶¹ Nevertheless, after noting the need for a “rough and ready” remedy to handle shareholder disputes,⁶² the Law Commission ultimately revised its initial proposal and advanced an “alternative approach.”⁶³

The Law Commission’s “alternative approach” sought to achieve the same objectives as the initially proposed remedy while avoiding its flaws, namely the duplication of proceedings.⁶⁴ In a report issued subsequent to its *Consultation Paper*, the Law Commission proposed amending the existing unfair prejudice remedy to raise the presumption of unfairly prejudicial conduct upon a showing of the minority shareholder’s exclusion from management, *inter alia*.⁶⁵ Additionally,

⁵⁹ The Law Commission believed that there would be circumstances where permitting a minority shareholder to bring a claim under a new unfair prejudice remedy would “simply extend the length of proceedings and add to the costs.” *Id.* pt. 3, para. 3.22.

⁶⁰ Some respondents suggested that, to achieve flexibility, the new remedy should allow courts to order more than a buyout of the minority’s shares upon a successful petition. On the other hand, the Law Commission believed that if the remedy were made more flexible, “it would largely defeat its purpose and would add little to the existing provisions.” *Id.* pt. 3, para. 3.25.

⁶¹ *Id.* (“For these reasons we do not favour the introduction of a new unfair prejudice remedy for smaller companies along the lines proposed . . .”).

⁶² *See id.* pt. 3, para. 3.23.

⁶³ *See id.* pt. 3, paras. 3.26-3.31.

⁶⁴ The Law Commission stated that the “alternative approach” embodied by the presumptions would further the policy objectives of the originally proposed additional remedy for unfair prejudice, including certainty, judicial efficiency, and providing a “speedy and economical exit route” for petitioning shareholders, which would prove beneficial to both the minority and majority shareholders while also avoiding duplication of remedies and retaining flexibility in fashioning a remedy. *See id.* pt. 3, paras. 3.19 & 3.26-3.29.

⁶⁵ The Law Commission’s proposed presumption of unfair prejudice upon the minority’s exclusion reads as follows:

Accordingly, we recommend that there should be legislative provision for presumptions in proceedings under sections 459-461 [the predecessors to sections 994-996 of Companies Act 2006] that, in certain circumstances, (a) 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

where the respondent company failed to rebut the presumption of unfairly prejudicial conduct and the court found that a buyout was proper, the court was to apply a second presumption that a pro rata valuation was proper.⁶⁶ While the Law Commission recognized that the presumption would not flawlessly handle all shareholder disputes, it believed a presumption of unfair prejudice would “do substantial justice between the parties.”⁶⁷

In an effort to steer away from highly fact-driven disputes, the Law Commission based the conditions triggering the presumption on “structural factors”⁶⁸ rather than the expectations of the parties.⁶⁹ The presumption would apply to private companies limited by shares⁷⁰ and upon the complaining minority shareholder’s exclusion from

exclusion; and (b), if the presumption is not rebutted and the court is satisfied that it ought to order a buy out of the petitioner’s shares, it should do so on a pro rata basis. *Id.* pt. 3, para. 3.30.

⁶⁶ The paper states that where “the presumption is not rebutted and the court is satisfied that it ought to order a buyout of the petitioner’s shares, it should do so on a pro rata basis.” *Id.* This in-artful drafting makes unclear whether the presumption refers to the appropriateness of a buyout or the appropriateness of a pro rata valuation upon a finding that a buyout is proper. Nevertheless, the former possibility is illogical because it would arise only after the court finds it ought to order a buyout. Further, para. 3.60 states, “[T]he court may provide for the presumption to be displaced if the only shares to be purchased are for example preference shares with limited rights to receive dividends and capital. The court may consider that some simpler method of valuation would be appropriate.”

⁶⁷ *Id.* pt. 3, paras. 3.23 & 3.26-3.29.

⁶⁸ *Id.* pt. 3, para. 3.32 (“The circumstances giving rise to the presumptions need to be as easily ascertainable as possible. . . . [T]he presumptions should not, so far as possible, rely on arbitrary factors; rather they should be based on clear principles.”).

⁶⁹ *Id.* pt. 3, para. 3.37 (“We [the U.K. Law Commission] consider that the presumptions should be based on ‘structural’ factors . . . rather than the expectations of the parties. Clearly, these matters are less open to factual disputes than conditions derived from *Ebrahimi*. They have the advantage of being readily ascertainable by reference to the current . . . state of affairs.”).

⁷⁰ *Id.* pt. 3, para. 3.39 (noting that the proposed presumptions target owner-managed companies, which are far more likely to be subjected to unfair prejudice claims than other types of companies). In the U.K., a private company limited by shares, as statutorily defined, is a non-public company whose shareholders enjoy limited liability, and whose shares may not be offered to the general public. See U.K. Companies Act, 2006, pt. 1, §§ 3.1-3.2; U.K. Companies Act, 2006, pt. 1, §4.1; U.K. Companies Act, 2006, pt. 20, § 755(1).

management.⁷¹ Acts constituting exclusion from management would include removal as a director or other actions preventing the carrying out of a director's duties.⁷² Further, the complaining shareholder would be required to show that, immediately before the exclusion, two circumstances existed: first, the shareholder held no less than 10% of the voting rights at general meetings on all or substantially all matters;⁷³ and second, all or substantially all of the corporation's members served as directors.⁷⁴ These last two requirements reflected the Commission's specific targeting of "owner-managed" companies.⁷⁵

Once the above conditions were met, the respondent company could rebut the presumption of unfair prejudice by showing that the petitioner's conduct justified his removal or that the petitioner had no legitimate expectation of continued participation in company management.⁷⁶ Where the respondent failed to rebut the presumption and the court found that ordering a buyout would be appropriate, a

⁷¹ Report No. 246, *supra* note 52, pt. 3, para. 3.40 ("The presumptions should apply where the petitioner has been excluded from participating in the management of the company.").

⁷² *Id.* pt. 3, paras. 3.40-3.43. For purposes of the presumption, exclusion from management includes situations where the petitioning shareholder has been formally removed from his position as director, or where he is prevented from carrying out his duties as directors. A petitioning shareholder is prevented from carrying out his duties as director in a variety of situations, including where the respondent fails to consult with him on major decisions, fails to invite him to board meetings, or fails to supply him with other pertinent information. *See id.* pt.3, para. 3.41.

⁷³ *Id.* pt. 3, para. 3.53 ("We recommend that the presumption should apply where, immediately before the exclusion from participation in the management . . . the petitioner held shares in his sole name giving him not less than 10% of the rights to vote at general meetings of the company on all or substantially all matters . . .").

⁷⁴ *Id.* ("We recommend that the presumption should apply where, immediately before the exclusion from participation in the management . . . all, or substantially all of the members of the company were directors.").

⁷⁵ *Id.* pt. 3, para. 3.44 (noting that the conditions triggering the presumption based on the make-up of the company immediately before the petitioning shareholder's exclusion reflect an effort to target "owner-managed companies").

⁷⁶ *Id.* pt. 3, para. 3.54.

second presumption was to arise that a pro rata rather than discounted valuation of the minority's shares was proper.⁷⁷

B. ULTIMATE FATE OF THE PROPOSED PRESUMPTION

During the consultation process, the Department of Trade & Industry (DTI) Company Law Review Steering Group⁷⁸ met the Law Commission's proposed presumption of unfair prejudice with resistance.⁷⁹ After expressing its concerns with the presumption in a later report,⁸⁰ the Steering Group ultimately rejected the codification of a presumption of unfair prejudice in its *Final Report*.⁸¹ In a later re-enactment of the U.K. Companies Act, U.K. lawmakers followed the Steering Group's recommendation and reinstated the unfair prejudice remedy without any amendment to codify the presumption.⁸²

⁷⁷ *Id.* pt. 3, paras. 3.57-3.62. Valuation of a petitioner's shares on a pro rata basis entails valuing the company as a whole, and then apportioning that value "rateably to the individual shareholdings." *Id.* pt. 3, para. 3.59.

⁷⁸ The former Department of Trade and Industry (DTI), subsumed by the Department for Business, Enterprise & Regulatory Reform, was the government department responsible for Company Law, and other various areas. As discussed *supra* note 50, one of the responsibilities of the U.K. Law Commission includes recommending reform of the law. The Law Commission's proposal for reform is then sent to another governmental agency for review in a consultation process. The Law Commission solicited comments from the legal, academic, and business fields, and prepared a formal report on the unfair prejudice remedy, which was then issued to the DTI. See *Consultation Paper*, *supra* note 51. The DTI then reviewed the report and made its own recommendation regarding the proposal for reform.

⁷⁹ Department of Trade & Industry (DTI) Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (DTI, URN 00/656, March 2000) [hereinafter *Developing the Framework*] (affirming the rejection of the Law Commission's proposed presumption of unfair prejudice).

⁸⁰ See Department of Trade & Industry (DTI) Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Completing the Structure* (DTI, URN 00/1335, November 2000) [hereinafter *Completing the Structure*] (confirming the rejection of the Law Commission's proposed presumption of unfair prejudice).

⁸¹ See Department of Trade & Industry (DTI) Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Final Report* [hereinafter *Final Report*] (DTI, URN 01/942 and URN 01/943, July 2001), vol. I, para. 7.41.

⁸² Compare U.K. Companies Act, 2006, pt. 30, §§ 994-996, with U.K. Companies Act, 1985, §§459-461. The operative provision of the unfair prejudice remedy codified in the U.K. Companies Act 2006 reads as follows:

In *Developing the Framework*,⁸³ the Steering Group responded to the Law Commission's recommendation.⁸⁴ After labeling the results of the consultation process concerning the presumptions as "mixed and inconclusive," the Steering Group stated that at that time it was "inclined to doubt whether the case for the presumptions has been made."⁸⁵ The Steering Group's skepticism stemmed from beliefs that the presumptions would encourage litigation and were open to abuse because presuming unfairness merely upon exclusion from management would be inequitable and unreasonable.⁸⁶ Also, the Steering Group questioned whether the presumptions were consistent with the House of Lords' opinion in *O'Neill v. Phillips* decided one year earlier.⁸⁷

In *O'Neill v. Phillips*, the House of Lords examined the scope of the unfair prejudice provision for the first time.⁸⁸ Recognizing that several sources, including the articles of incorporation and other shareholder agreements, regulated the affairs of the corporation, Lord Hoffman concluded that a complaining shareholder would not

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- (1) A member of a company may apply to the court by petition for an order under this Part on the ground—

- (a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or
- (b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.

U.K. Companies Act, 2006, pt. 30, § 994(1).

⁸³ See *Developing the Framework*, *supra* note 79, ch. 4.

⁸⁴ See *id.* paras. 4.102-4.111 ("Law Commission Proposals on Section 459").

⁸⁵ *Id.* para. 4.104.

⁸⁶ See *id.*

⁸⁷ *Id.* para. 4.110 ("[I]t seems that it may now be more difficult to adopt the Commission's proposal to create a statutory presumption that unfair prejudice has been suffered. In the light of *O'Neill v. Phillips*, it is difficult to see how the facts proposed by the Commission as sufficient to give rise to such a presumption could now be regarded as *prima facie* indication of unfair prejudice . . . ") (citation omitted).

⁸⁸ *O'Neill v. Phillips*, (1999) B.C.C. 600 (H.L.) (U.K.).

ordinarily have cause to complain absent a breach of the terms of an agreement by which the company's affairs were to be conducted.⁸⁹ However, drawing a parallel to the analysis in *Ebrahimi*, in which the court set forth factors justifying the equitable dissolution of a corporation,⁹⁰ Lord Hoffman further stated that there will be cases in which equity demands a finding of unfair prejudice, even if the majority's actions were otherwise legal.⁹¹ While Lord Hoffman recognized that it would be impossible to define all the circumstances in which equity would warrant a finding of unfairness, he noted that existing equitable principles could sufficiently guide courts.⁹²

In dicta, Lord Hoffman provided one example of circumstances warranting a finding of unfairness: in the absence of a contractual understanding between the parties, if an event ends the basis on which the parties entered the shareholder relationship, unfairness arises where the majority uses its legal powers "to maintain the association in circumstances to which the minority can reasonably say it did not agree."⁹³ According to Lord Hoffman, unfairness also inevitably arises out of the minority's exclusion without a reasonable offer to buy out his shares or for some other special arrangement, and that a presumption of unfair prejudice "does not seem . . . very different in practice from the present law."⁹⁴ However, Lord Hoffman's example of an equitable

⁸⁹ *Id.* at 607 ("[A] member of a company will not ordinarily be entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted.").

⁹⁰ *Id.* at 607-08 (citing *Ebrahimi*, (1973) A.C. at 379-80) (stating that an approach to unfair prejudice which considers equitable principles in assessing unfairness "runs parallel" to the "concept of 'just and equitable' as a ground for winding up").

⁹¹ *Id.* at 607 ("[T]here will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith.").

⁹² *Id.* As articulated by the Steering Group, such equitable considerations include well-establish equitable principles and others developed by courts. See generally *Developing the Framework*, *supra* note 80, para. 4.106.

⁹³ *O'Neill*, *supra* note 88, at 609 ("I do not suggest that exercising rights in breach of some promise or undertaking is the only form of conduct which will be regarded as unfair for purposes of section 459. For example, there may be some event that puts an end to the basis upon which the parties entered the association with each other, making it unfair that one shareholder should insist upon the continuance of the association.").

⁹⁴ *Id.*

principle sufficient to warrant a finding of unfairness⁹⁵ and the view that a presumption of unfair prejudice was, in essence, no different than the existing state of law⁹⁶ appear in dicta. While the *O'Neill* decision appeared to limit the grounds for bringing an unfair prejudice petition to allegations based on breach of an agreement or a well-established equitable principle, its parameters are far from clear.⁹⁷

Ultimately, the Steering Group rejected the presumption of unfair prejudice based in part on the presumption's claimed inconsistency with *O'Neill*. According to the Steering Group, the scope of the unfair prejudice provision after *O'Neill* was more restrictive than indicated by the Law Commission in its proposals.⁹⁸ To make out a claim of unfairness after *O'Neill*, the Steering Group stated that a complaining shareholder could not base his claim on "general notions of unfairness" or solely on his reasonable expectations;⁹⁹ instead, he must rely on a breach of an agreement or "a situation which permits or requires [e]quity to intervene."¹⁰⁰ Further, the Steering Group concluded that viewing the structural conditions triggering the presumption as prima facie evidence of unfair prejudice would be difficult where these conditions do not involve breach of an agreement or a specific equitable principle warranting a finding of unfairness.¹⁰¹ After the

⁹⁵ *Id.* (noting that unfairness arising out of an event which makes it unfair for one shareholder to insist on continuing the relationship "does not arise in this case").

⁹⁶ *Id.* at 614.

⁹⁷ See BOYLE, *supra* note 19, at 127 ("*O'Neill* may well prove no more than a method of 'theorizing' the concept of unfair prejudice. Its remedially polymorphous character may survive the apparent 'contractual' straitjacket.").

⁹⁸ *Developing the Framework*, *supra* note 79, para. 4.106 (noting that the scope of section 459 is "of more restricted effect than indicated" by the Law Commission's proposals). Cf. BOYLE, *supra* note 19, at 127 ("*O'Neill* provides much more leeway than the Steering Group's terse account of its reasoning reveals.").

⁹⁹ *Developing the Framework*, *supra* note 79, para. 4.108.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* para. 4.110. It is worth noting, however, that in his *O'Neill* opinion, Lord Hoffman suggested that, upon an event which puts an end to the business association and where a minority is excluded without an offer to buy out his shares, unfairness inevitably arises, and a presumption of unfair prejudice would do no more than achieve a similar result under present law. See *O'Neill*, *supra* note 88, at 614. A codification of the presumption, however, might more firmly ingrain Lord Hoffman's belief into present U.K. law.

Steering Group expressed doubts over the presumption's consistency with *O'Neill*, it invited responses from practitioners and other members of the lawmaking bodies as to whether *O'Neill* should be reversed.¹⁰²

Subsequently, in *Completing the Structure*, the Steering Group noted that responses to whether *O'Neill* should be reversed or maintained were "very mixed."¹⁰³ Most favored removing *O'Neill*'s "contractual" limitation to permit complaining shareholders to bring an action under the unfair prejudice provision without first proving the breach of some agreement.¹⁰⁴ However, the Steering Group took a "hard[] line against any change to existing law," deciding that *O'Neill* should not be reversed and dismissing the proposed presumptions altogether.¹⁰⁵ The Steering Group ultimately decided that allegations of unfair prejudice should be limited to cases where an action deviates from an agreement between the parties, as broadly defined and identified by words and conduct.¹⁰⁶

The Steering Group's *Final Report* confirms the rejection of the proposal to amend the unfair prejudice remedy to raise the presumptions.¹⁰⁷ Accordingly, in the recent re-enactment of the Companies Act in 2006, the unfair prejudice remedy found in section 994 remains identical to the prior section 459.¹⁰⁸

Despite its formal rejection as a matter of statutory reform in the U.K., the presumption has been the focus of several commentators promoting reform of minority shareholder remedies, both in the U.K. and other countries.¹⁰⁹ While commentators suggest that the Steering

¹⁰² See *id.* para. 4.111.

¹⁰³ *Completing the Structure*, *supra* note 80, paras. 5.77-5.79.

¹⁰⁴ *Id.* para. 5.77.

¹⁰⁵ BOYLE, *supra* note 19, at 126; see also *Completing the Structure*, *supra* note 80, para. 5.76 ("We expressed views against presumptions and the winding-up remedy and no responses supported either of those.").

¹⁰⁶ *Completing the Structure*, *supra* note 80, para. 5.79. This stance adopted by the Steering Group might reflect application of "contractarian" theory to the unfair prejudice remedy, a trend which has influenced U.K. law in the past two decades. See generally BOYLE, *supra* note 19, at 112-18.

¹⁰⁷ See *Final Report*, *supra* note 81.

¹⁰⁸ Compare U.K. Companies Act, 2006, pt. 30, §§ 994-996, with U.K. Companies Act, 1985, pt. 17, §§459-461. For the current text of the operative provision of the unfair prejudice remedy, see *supra* note 82.

¹⁰⁹ See, e.g., BOYLE, *supra* note 19, at 126 (contending that the Steering Group's rejection of the presumption as proposed by the Law Commission is "regrettable" and "does not auger well for a constructive reform of the unfair prejudice remedy in general or for a better procedure in the case of owner-

Group's dismissal of the Law Commission's proposed presumptions was premature and without careful consideration,¹¹⁰ some have gone so far as to recommend the adoption of the presumption in other countries as an appropriate means for both resolving relevant shareholder conflicts and reducing shareholder oppression litigation.¹¹¹

Whether the case for adopting the presumption of unfair prejudice has been made in the U.K. remains a subject of contention, but at a minimum, the Steering Group's review of the presumption was arguably not as careful as it ought to have been. Given the uncertainty of the scope of the unfair prejudice provision in light of *O'Neill*, the proposed presumption would enhance the predictability of determinations of unfair prejudice while preserving the flexibility, as intended since the inception of the unfair prejudice provision, to fashion an appropriate remedy. The presumption would provide enhanced guidance to courts in analyzing claims of unfair prejudice, thus resulting in more effectively managed claims.

managed companies" in the U.K.); Rita Cheung, *The Statutory Minority Remedies of Unfair Prejudice and Just and Equitable Winding Up: The English Law Commission's Recommendations as Models for Reform in Hong Kong*, 19(5) INT'L CO. & COM. L. REV. 156, 162-63 (2008) (recommending consideration of the adoption of the presumption of unfair prejudice in Hong Kong as a means to "reduce the incidence of protracted and expensive litigation by providing a more predictable procedure"); John H. Farrar & Laurence Boulle, *Minority Shareholder Remedies: Shifting Dispute Resolution Paradigms*, 13(2) BOND L. REV. Article 3 (2001) (recommending consideration of the adoption of the presumption of unfair prejudice in Australia as part of an alternative dispute resolution paradigm in assessing minority shareholder complaints).

¹¹⁰ See BOYLE, *supra* note 19, at 133 ("The over-cautious views expressed in Developing the Framework seem to be regrettably negative and hesitant. The level of argument is rather superficial compared with that in the Law Commission's Consultation Paper and Report."); Cheung, *supra* note 109, at 158 (contending that the Law Commission's basis for rejecting the presumption of unfair prejudice was not "entirely convincing" and was "based on certain rudimentary and unchallenged assumptions").

¹¹¹ See Cheung, *supra* note 109, at 156-164 (contending that the Steering Group's rejection of the presumption overstated its defects and that it provides a useful model for reform of minority shareholder remedies in Hong Kong); Farrar & Boulle, *supra* note 109, at 2 (recommending consideration of the U.K. Law Commission's presumption of unfair prejudice in Australia as device "designed to prevent and limit disputes involving minority shareholders").

III. OPPRESSIVE CONDUCT IN THE U.S.: A PRESUMPTION TRIGGERED BY THE MINORITY'S EXCLUSION FROM MANAGEMENT

Professor Miller has stated that a presumption of oppressive conduct upon a minority shareholder's exclusion from management—though rejected by U.K. lawmakers—has relevance in the U.S.¹¹² Nevertheless, she argues that a presumption of oppressive conduct should not be adopted in the U.S. because it would not effectively assist the resolution of U.S. shareholder disputes since disputes in the U.S. involve varied types of factual allegations that do not always fulfill the conditions triggering the presumption.¹¹³ Further, Miller argues that presuming oppressive conduct in all cases of exclusion, particularly those in which the minority shareholder precipitated his own exclusion from management, would be unfair.¹¹⁴

However, the concerns raised over the presumption's usefulness in the U.S. are misguided. First, a presumption of oppression arising from the minority's exclusion from management and other structural conditions would correct vagueness in defining oppression, which makes existing U.S. approaches to resolving minority shareholder disputes difficult to apply with any consistency or degree of certainty. Second, the presumption promotes judicial efficiency and functions as a practical, predictable procedural device for effectively handling shareholder disputes based on allegations of exclusion while retaining the flexibility necessary for awarding appropriate remedies on a case-by-case basis. Third, the presumption, tailored to the context of the owner-managed company, recognizes the unique nature of the close corporation and safeguards against the majority's abuse of control, which further encourages minority shareholder participation.

¹¹² See Miller, *supra* note 17, at 622 (noting that, given the similarities in the statutory remedies for unfair prejudice and oppressive conduct in the U.K. and U.S., respectively, the U.K. Law Commission's proposed presumptions "should be of great interest to the U.S. legal community"). Cf. Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 GEO. L.J. 1207 (2009) (proposing an alternative approach to minority shareholder oppression in the U.S. where the level of judicial scrutiny is dependent upon minority shareholder voice).

¹¹³ See Miller, *supra* note 17, at 624.

¹¹⁴ *Id.*

*A. THE INADEQUACIES OF U.S. APPROACHES TO MINORITY
SHAREHOLDER OPPRESSION: THE NEED FOR EFFECTIVE
GUIDANCE IN DEFINING OPPRESSION*

As discussed in Part I.B, U.S. courts and legislatures have developed various statutory and common law remedies to address the problem of minority shareholder oppression. Most states have adopted dissolution statutes modeled after the *Revised Model Business Corporation Act*, which provide for involuntary judicial dissolution upon the majority's illegal, oppressive, or fraudulent conduct.¹¹⁵ While some state legislatures have attempted to define by statute what types of conduct warrant a finding of oppression,¹¹⁶ most state dissolution statutes do not define such conduct, leaving the task to courts and common law jurisprudence.¹¹⁷

Thus, courts face the difficulty of defining with some precision what constitutes oppression without defining it so narrowly as to impede the equitable goal of protecting a minority shareholder's investment. While no all-encompassing definition for oppression exists, courts typically define oppression in one of three ways: oppression as breach of the minority shareholder's "reasonable expectations," oppression as breach of a fiduciary duty, and oppression as "wrongful conduct" or "bad faith."¹¹⁸ However, as discussed below, none of these definitions standing alone provides a court with sufficient guidance in determining oppressive conduct while permitting the flexibility necessary to equitably remedy oppression on a case-by-case basis.

Many U.S. state courts follow the "reasonable expectations" approach which recognizes that members of a closely held corporation typically invest with the expectation of being an employee or helping to manage the corporation, even in the absence of an express agreement illustrating those expectations.¹¹⁹ As typically described, the

¹¹⁵ See *supra* notes 38-41 and accompanying text.

¹¹⁶ See *supra* note 43.

¹¹⁷ See *supra* note 44 and Part I.B.

¹¹⁸ Art *supra* note 44, at 376. See also Means, *supra* note 112, at 1220 (noting that current oppression doctrine can be grouped into three distinct categories: "reasonable expectations," "fiduciary duty," and "bad faith").

¹¹⁹ See Douglas K. Moll, *Reasonable Expectations v. Implied-in-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C. L. REV.

reasonable expectations approach emphasizes the minority's management-related interests—i.e., what the minority shareholder “reasonably expected”—viewed objectively, over the majority's challenged conducts.¹²⁰

However, the reasonable expectations approach is not seamless for two related reasons. As a general matter, the approach involves establishing a party's expectations either by an actual agreement or in the absence of any actual agreement between the parties or in a case in which the court has to disregard an actual agreement between the parties. A court must determine what expectations are “reasonable.” Thus, commentators first criticize that in defining the parties' reasonable expectations as what objective parties would have agreed to, courts are merely superimposing judicially-defined expectations.¹²¹

Second, commentators criticize that identifying the relevant expectations by an actual agreement between the parties reduces the predictability of current and future determinations by relying on particular, subjective facts rather than a generally applicable, objective rule. Thus, handling claims of oppression in this case-by-case manner

989, 1002 (2001) (contending that, of the three primary approaches to oppression, the reasonable expectations standard “garners the most approval, and courts have increasingly used it to determine whether oppressive conduct has taken place”); *see also* Matheson & Maler, *supra* note 11, at 679 (noting that U.S. states have increasingly employed the reasonable expectations approach to define whether majority conduct is oppressive). In addition, some U.K. courts have employed the reasonable expectations approach to define unfairly prejudicial conduct for purpose of the provision. Miller, *supra* note 17, at 581. *See, e.g., In re Topper*, 433 N.Y.S.2d 359, 365 (quoting F. Hodge O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 884 (1978)).

¹²⁰ Matheson & Maler, *supra* note 11, at 677 (“Under this [the reasonable expectations] approach, a court could find oppression by focusing on how the actions of the majority interfered with what the minority shareholder reasonably expected would happen when she invested in and joined the enterprise.”).

¹²¹ *See* Miller, *supra* note 17, at 615 (“[I]n the United States and the United Kingdom[,] courts are not merely interpreting the parties' actual express or implied agreement. Rather, courts seem to be superimposing a set of expectations that the parties will conduct themselves in a judicially defined manner.”); *cf.* Christopher A. Riley, *Contracting Out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts*, 55 MOD. L. REV. 782, 796-98 (1992) (contending that rather than ascertaining the expectations of the parties, courts employing the reasonable expectation analysis are “developing their [the court's] own mandatory judicial paradigm”).

leaves parties, practitioners, and courts with little guidance for determining what acts will constitute oppression in the future.¹²²

Two other approaches to defining oppressive conduct exist in the U.S. One approach defines oppressive conduct as the breach of a fiduciary duty.¹²³ Defining oppression as breach of a fiduciary duty requires consideration of what duties shareholders owe one another. Some courts have likened the relationship between shareholders in a close corporation to that of members of a partnership, thus requiring majority shareholders to adhere to a heightened fiduciary standard.¹²⁴ However, it remains unclear exactly what the specific duties of a majority shareholder in a close corporation are.¹²⁵ For example, a court cannot generally require that a majority shareholder, like a partner, place the minority's interest above all else because this would overprotect the minority shareholder and substantially interfere with majority rule.¹²⁶ Since the nature of the fiduciary duties owed among shareholders determines the legitimacy of majority actions, the fiduciary duty approach requires more specific direction as to exactly what is required or prohibited of shareholders before it can provide effective guidance in assessing oppression.

¹²² See Miller, *supra* note 17, at 617 (noting the uncertainty caused by a vague reasonable expectations test and describing such confusion as "the necessary by-product of any case-by-case legal analysis").

¹²³ See Art, *supra* note 44, at 376.

¹²⁴ *Donahue v. Rodd Electrotape Co. of New Eng., Inc.*, 328 N.E.2d 505, 515 (Mass. 1975) ("[W]e hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another."). The *Donahue* court described the duties owed among partners in a partnership as the "utmost good faith and loyalty." *Id.* at 516 (quoting *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928)).

¹²⁵ Under the *Donahue* facts, it appeared that a minority shareholder could successfully allege that the majority breached a fiduciary duty owed where the minority is denied an "equal opportunity" or is otherwise treated unequally. *Id.* at 518. However, in a subsequent decision, the Massachusetts Supreme Court revised this analysis and, where the minority shareholder brings suit alleging a breach of fiduciary duty owed, placed the burden on the majority to demonstrate a legitimate business purpose for the action. See *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976).

¹²⁶ See Art, *supra* note 44, at 387-89 (noting that the parameters of the fiduciary duties imposed on controlling shareholders "are not precisely defined" and "exist in constant and avoidable tension" with the corporate concept of majority rule).

A third interpretation of oppression defines the term as arising from "wrongful conduct." Courts following this approach recognize no special, judicially-created protections for minority shareholders in close corporations, aside from bargained-for protections.¹²⁷ These courts treat minority shareholders like shareholders in a public corporation and stress that minority shareholders remain free to negotiate for protections at the outset of the business relationship.¹²⁸ In essence, a complaining minority shareholder under this third approach must overcome the business judgment rule not by making general allegations of unfairness but by showing that the majority's conduct was otherwise fraudulent¹²⁹ or conflicted.¹³⁰ However, where the complaining minority shareholder challenges the majority's action as oppressive and the transaction at issue is one in which the majority is not entitled to the protection of the business judgment rule, the burden lies with the majority to prove the inherent fairness of the transaction.¹³¹

One criticism of the bad faith approach is that it fails to recognize the unique nature of the close corporation. Many close corporations are based on familial or personal relationships. When parties form a corporation expecting these business relationships to remain intact,

¹²⁷ *Nixon v. Blackwell*, 626 A.2d 1366, 1379 (Del. 1993).

¹²⁸ *Nixon*, 626 A.2d at 1380 ("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 buyout for which the parties had not contracted."); *Richards v. Bryan*, 879 P.2d 638, 648 (Kan. Ct. App. 1994).

¹²⁹ *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 stockholder with the discretion of the directors on questions of corporate management, policy or business.") (quoting *Sampson v. Hunt*, 665 P.2d 743 (Kan. 1983)) (emphasis removed).

¹³⁰ One articulation of "wrongful conduct" sufficient to warrant a finding of oppression under this approach describes the term 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 corporation is entitled to rely." See Art, *supra* note 44, at 376-77 (quoting *Fix v. Fix Material Co.*, 538 S.W.2d 351, 358 (Mo. Ct. App. 1976)). However, this articulation may provide little help to courts in defining oppressive conduct, as the definition is "plainly vague" and arguably rephrases the standard rather than defining with any precision what type of conduct is oppressive and the basis for finding such. *Id.* at 377.

¹³¹ *Nixon*, 626 A.2d at 1375-76.

insisting that the parties bargain for protections may be unrealistic because admitting that a shareholder might need protection may undermine the business relationship. Thus, a focus on the minority shareholder's bargained-for protections is not helpful in situations where the minority would not ordinarily have bargained for protections. A second problem with the bad faith approach is that it sets too high a burden on minority shareholder complainants. By requiring a minority shareholder to establish the majority's flagrant, wrongful conduct, the approach, in combination with the business judgment rule, creates a potential for courts to adopt an overly deferential stance to the majority's action. This problem is exacerbated where the minority shareholder does not retain access to the information necessary to meet the burden of demonstrating the majority's misconduct.¹³²

In sum, the various approaches courts in the U.S. have used to define oppression fail to provide the guidance necessary to determine with any precision whether particular acts constitute oppression. In addition to its unpredictable nature, the reasonable expectations approach requires courts to identify each shareholder's pertinent expectations and determine whether those expectations are reasonable without any particularized test for reasonableness. The fiduciary duty approach fails to offer meaningful guidance as to the heightened duties owed among shareholders. Finally, the bad faith approach fails to recognize the unique nature of the close corporation and further imposes a high burden on complaining minority shareholders.

*B. PRESUMING OPPRESSION UPON EXCLUSION: PROMOTING
JUDICIAL EFFICIENCY*

Shareholder litigation embroils parties in disputing highly factual matters, expending judicial time and resources, while also working a detriment to the continuation of the business relationship. The U.K.

¹³² See O'NEAL & DERWIN, *supra* note 6, §1.04, at 6 (noting that one common effect resulting from the "squeeze-out" of a minority shareholder in a close corporation is the majority's withholding of "information on the affairs of the business and on policies being adopted and decisions being made"); Means, *supra* note 112, at 1249 (noting that one of the justifications for a "voice-based" trigger for enhanced judicial scrutiny is that the minority shareholder lacking voice will not possess the information necessary to challenge the majority's action).

Law Commission's recommendation to codify a presumption of unfair prejudice upon the minority's exclusion from management reflects an effort to direct courts to employ more effective case management techniques, to reduce costly and time-consuming litigation, and to minimize the highly factual nature of the circumstances surrounding the dispute. In light of the similarities between private companies in the U.S. and in the U.K.,¹³³ a presumption of oppression in the U.S. would produce similar benefits. Specifically, it would encourage settlement among parties involved in shareholder oppression litigation. Secondly, a presumption arising upon the fulfillment of certain structural conditions would permit courts assessing oppression claims to scrutinize limited factual circumstances and to retain the flexibility necessary to fashion an equitable remedy between the parties.¹³⁴

A presumption of oppressive conduct in the U.S. would provide courts with a procedural mechanism to encourage settlement and foster judicial efficiency. As proposed by the U.K. Law Commission, the presumption of oppression would arise upon fulfillment of certain "structural factors."¹³⁵ Because these factors expressly narrow the scope of facts purported to constitute oppression to certain incidents arising immediately before the exclusion, a presumption based on such factors "has the advantage of being readily ascertainable by reference to the current or recent state of the company's affairs."¹³⁶ The adoption of a similar presumption in the U.S. would provide parties and their

¹³³ U.K. "private companies" possess many of the same characteristics as closely held corporations in the U.S. Investors in the U.K. private company and in the U.S. closely held corporation enjoy limited shareholder liability. Additionally, both corporate forms are subjected to fewer formalities, including relaxed capital requirements and centralized management. For a comprehensive discussion of U.K. private companies, see Simon Goulding, *The Private Company in the United Kingdom*, in *THE EUROPEAN PRIVATE COMPANY?* 55, 59-62 (Harm-Jan De Kluiver & Walter Van Gerven eds., 1995).

¹³⁴ Because one factor triggering the presumption requires the exclusion of the minority from management, the presumption would call for more exacting judicial scrutiny upon the minority shareholder's diminished ability to participate in the affairs of the corporation. The presumption is consistent with a "voice-based" approach to evaluating claims of minority shareholder oppression that recommends employing flexible judicial scrutiny depending on the presence or absence of minority shareholder participation in governance. See Means, *supra* note 112. Where the challenged exclusion of the minority has diminished the minority shareholder's ability to participate in business affairs, this "voice-based" framework would lead courts to apply enhanced judicial scrutiny. *Id.*

¹³⁵ See *supra* notes 68-9 and Part II.A.

¹³⁶ BOYLE, *supra* note 19, at 123; *supra* note 68.

counsel the opportunity to assess the substance of oppression claims and to predict a court's likely response at an early stage. Because the presumption would enable parties to predict the outcome of litigation with some level of certainty, the parties may be more likely to settle, thus avoiding the burdens of extensive litigation altogether. As one British commentator favoring the presumption has suggested, the use of the presumption in the U.K. "might encourage more of such claims [the common case of expulsion from management in owner-managed companies] to be settled either out of court or before a hearing."¹³⁷

Where parties forego settlement and instead pursue litigation, a presumption of oppression may promote judicial efficiency by narrowing the factual issues presented to the court to those facts occurring immediately before the exclusion. This allows courts to more carefully scrutinize the particular facts giving rise to the minority's exclusion and reduces the time and expense associated with litigation. As noted in the U.K. Law Commission's drafting of the presumption, litigation among shareholders creates "the potential for complex factual disputes of a historical nature."¹³⁸ However, the use of structural elements in triggering a presumption of oppression permits a more objective determination of oppression based on fewer disputable circumstances. Rather than focusing on the reasonable expectations of the parties, more rigid criteria provide a readily workable, less fact-intensive means of analyzing the substance of the claim. Instead of deciphering whether the parties manifested any actual or implied agreement, or merely substituting judicially crafted expectations in lieu of the parties' agreement, courts can more carefully scrutinize the specific incident giving rise to the minority's expulsion from management. Accordingly, where courts focus on the immediate circumstances giving rise to the current claim, they can avoid the problems presented by the reasonable expectations test discussed in Part III.A.

While a presumption of oppression triggered upon certain ascertainable criteria provides a more predictable and efficient alternative to assessing claims of minority shareholder oppression, the operation of the presumption retains flexibility for minority shareholders pursuing claims of oppression in which the conditions

¹³⁷ BOYLE, *supra* note 19, at 125-26.

¹³⁸ See Report No. 246, *supra* note 52, para. 3.35.

triggering the presumption are unsatisfied.¹³⁹ In such a case, petitioning shareholders may still pursue their claims of oppression by proving that the majority's actions constituted oppression under an existing approach to defining the term.

A presumption of oppressive conduct upon the minority's exclusion from management also retains the flexibility necessary to achieve an equitable remedy between the parties and to prevent unfairness to the majority shareholder respondent. The U.K. Law Commission drafted its presumption of unfair prejudice with the intent that it be rebuttable.¹⁴⁰ Thus, a respondent would have the opportunity to demonstrate that the exclusion of the minority shareholder from management did not amount to oppressive conduct. Where the majority shareholder proves to the court's satisfaction that the exclusion did not amount to oppressive conduct, the court retains the flexibility in ruling against the minority shareholder. However, where the majority shareholder fails to rebut the presumption, the court retains the broad discretion to impose one of a wide range of equitable remedies, meaning that the drastic remedy of dissolution would not be a necessary consequence of a finding of oppression.

In sum, a presumption of oppression based on the U.K. Law Commission's model would maintain flexibility for both complaining shareholders and for courts in fashioning equitable remedies; it would avoid an overly deferential approach to the majority's action; and it would result in a more efficient and predictable procedure.

*C. PRESUMING OPPRESSION UPON EXCLUSION: A
PROTECTION AGAINST THE MAJORITY SHAREHOLDER'S ABUSE
OF CONTROL*

As discussed in the Introduction, a minority shareholder in a closely held corporation exposes himself to an inherent risk of oppression caused by the unique nature of the closely held corporate form. At least one of the U.S. approaches to analyzing claims of minority shareholder oppression, namely the bad faith approach which recognizes no special protections for minority shareholders beyond

¹³⁹ Cf. BOYLE, *supra* note 19, at 123 (noting that the presumption would provide a minority shareholder flexibility in pursuing unfair prejudice claims because, where the factors necessary to trigger the presumption are unsatisfied, a minority shareholder may still pursue an unfair prejudice petition by otherwise showing that the majority's conduct was unfairly prejudicial); Report No. 246, *supra* note 52, para. 3.37.

¹⁴⁰ See *supra* note 65 and Part II.A.

those negotiated for, fails to adequately adapt to the specialized nature of the close corporation. On the other hand, to impose a presumption of oppressive conduct when the majority has excluded the minority from management is to recognize that closely held corporations are unique entities and that the exclusion of the minority from participation in corporate affairs may reflect the majority's scheme to squeeze-out the minority shareholder. In fact, a presumption of oppression would operate to safeguard against the majority's abuse of control.

Because the majority holds a controlling share of voting rights, the majority can elect and control directors. By way of these positions of control and influence in corporate decision-making, majority shareholders possess powers that enable them to "squeeze-out"¹⁴¹ the minority. One common squeeze-out technique, typically used in conjunction with various others, includes the expulsion of minority shareholders from directorial or other employment positions.¹⁴² This technique often forms part of a broader plan to rid the corporation of its most vulnerable members. Upon exclusion and in the absence of any shareholder agreement to the contrary, the minority shareholder essentially becomes helpless in retaining his directorial position.¹⁴³ In addition to the diminished ability to participate in company affairs, the minority shareholder faces other detrimental consequences flowing from the squeeze-out.¹⁴⁴ While the minority shareholder may seek

¹⁴¹ One definition of "squeeze-outs," also known as "freeze-outs," describes the term as "the use [of strategic position, inside information, or powers of control, or the utilization of some legal device or technique] by some of the owners or participants in a business enterprise . . . to eliminate from the enterprise one or more of its owners or participants." O'NEAL & DERWIN, *supra* note 6, §1.01, at 3.

¹⁴² See *id.* §3.05, at 52-54 ("Eliminating minority shareholders from directorate and excluding them from company employment").

¹⁴³ *Id.* § 3.05, at 54 (noting that, upon his squeeze-out from the company and in the absence of a shareholder agreement so providing, a minority shareholder can neither "compel the majority shareholders to elect him a director or the directors to make him an officer," nor can he institute a claim for dissolution unless "in cases of extreme abuse").

¹⁴⁴ The "losses and injustices" a minority shareholder suffers as a result of a squeeze-out are "catastrophic." *Id.* §1.04, at 6. Such losses include the deprivation of "any effective voice in the making of business decisions"; the majority's withholding of information relating to the affairs, policies, and decisions of the business; the loss of expected employment; and the economic deprivation of his investment. *Id.*

relief by asserting a claim for oppression, given the difficulties presented by U.S. oppression doctrine, the minority shareholder might find the outcome unsatisfying.

In formulating its proposed presumption of unfair prejudice upon a minority shareholder's exclusion from management, the U.K. Law Commission explicitly noted that the conditions triggering the presumption would target the "owner-managed" company.¹⁴⁵ Accordingly, the Law Commission proposed that the presumption apply only to private companies limited by shares and to cases in which, immediately before the exclusion, all or substantially all shareholders occupied director positions.¹⁴⁶ These measures represented a conscious effort to tailor the presumption of unfair prejudice to the owner-managed company, a corporate structure prone to shareholder disputes, particularly when the majority abuses its control and exerts its power and influence to the minority's detriment.

In the U.S., a presumption of the majority's oppressive conduct upon the minority's expulsion from management and the fulfillment of a few other conditions would safeguard against the majority's abuse of control by requiring proof of the legitimacy of its action. Importantly, the presumption also places the burden on the party most able to carry it.¹⁴⁷ Arguing that the presumption may be inappropriate in the U.S., one commentator believes that it would be unfair to presume that majority misconduct caused the minority shareholder's exclusion, particularly where the minority shareholder precipitated the expulsion.¹⁴⁸ However, any argument of "unfairness" overlooks the vulnerability of the minority shareholder in the closely held corporation and the considerable likelihood that the minority's expulsion was the product of an effort to thwart the minority's participation and to deprive him of the financial benefit flowing from his original investment.

When the majority has excluded the minority for sound, legitimate reasons, the majority can rebut the presumption of unfair conduct. Thus, the presumption accounts for the squeeze-out scenario and properly places the onus on the majority shareholder respondent to

¹⁴⁵ See *supra* note 75 and Part II.A.

¹⁴⁶ See *supra* Part II.A.

¹⁴⁷ Because squeezed-out minority shareholders often lack the information necessary to establish a claim of oppression in the actual event of the majority's abuse of control, the majority possesses the requisite information to rebut the allegation and can do so if the minority's exclusion was truly a legitimate decision.

¹⁴⁸ See Miller, *supra* note 17, at 624.

show that the exclusion does not amount to an abuse of control. Accordingly, the presumption would likely have the effect of deterring exclusion of minority shareholders for illegitimate reasons, thus fostering minority shareholder participation in management.

IV. APPLYING THE PRESUMPTION IN THE UNITED STATES

While the U.K. Law Commission's proposed codification of a statutory presumption of unfair prejudice was not adopted in the re-enactment of the Companies Act in 2006, U.S. courts can incorporate a presumption of oppression into a framework including existing approaches and treat the presumption as a procedural mechanism to help define oppression and assess shareholder disputes. To rebut the presumption of oppression, the respondent majority shareholder can demonstrate that his conduct was not oppressive under the jurisdiction's particular approach to defining the term. This Part illustrates the applicability of the presumption by considering the facts of two classic U.S. cases in which the minority shareholder alleged oppression following exclusion from management in the close corporation.

In *Wilkes v. Springside Nursing Home, Inc.*, four investors – Riche, Wilkes, Quinn, and Pipkin – formed a closely held corporation as an investment vehicle for purchasing property to build and operate a nursing home.¹⁴⁹ Each of the four owners initially invested \$1,000 in the business, and each owner held equal interest in the corporation.¹⁵⁰ At the outset of the business venture, each owner expected to serve as a director and to participate actively in the management and affairs of the corporation.¹⁵¹ However, after dissension arose between Quinn and Wilkes affecting the relationship among all four owners, the other owners did not re-elect Wilkes either as a director or officer of the

¹⁴⁹ *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976). The business was incorporated in Massachusetts, a state following the Fiduciary Duty approach to minority shareholder oppression as first set forth in the *Donahue* decision. See *supra* Part III.A.

¹⁵⁰ *Wilkes*, 353 N.E.2d at 659-60.

¹⁵¹ *Id.* ("At the time of incorporation it was understood by all of the parties that each would be a director of Springside and each would participate actively in the management and decision making involved in operating the corporation.") (footnote omitted).

corporation.¹⁵² After his exclusion from management, Wilkes brought suit against the other owners and the corporation alleging that the owners breached fiduciary duties owed to him as a minority shareholder in the corporation.¹⁵³

The *Wilkes* facts would trigger the presumption of oppression and would require the respondent shareholders to rebut the presumption. The majority shareholder excluded the complaining minority shareholder from the management of a privately held corporation, and immediately before such exclusion, all of the owners held director positions, and the complaining shareholder held more than 10% of the voting rights. The respondent owners could rebut the presumption by demonstrating a legitimate business purpose for their actions or by otherwise proving that their conduct was not oppressive under the fiduciary duty approach to defining oppression. However, under the court's analysis and in light of the facts, it was apparent that the majority shareholders could not prove a non-oppressive, legitimate purpose for their action.¹⁵⁴ Thus, the outcome under a presumption of oppression would likely be the same as the actual outcome.

A second case involving exclusion of a minority shareholder from managerial decision-making also illustrates the applicability of the presumption. In *Pedro v. Pedro*, three brothers – Alfred, Carl, and Eugene Pedro – owned equal interests in a Minnesota closely held corporation.¹⁵⁵ Each of the brothers was also a long-time employee of the corporation, and each received equal compensation.¹⁵⁶ After Alfred discovered a discrepancy with the financial records of the business, which he brought to the attention of his brothers, his brothers placed him on a temporary leave of absence and therefore froze him out of management before ultimately firing him from his employment position with the company.¹⁵⁷ Alfred later brought suit against his brothers under the Minnesota state dissolution statute, alleging that the brothers engaged in oppressive conduct.¹⁵⁸

¹⁵² *Id.* at 660-61.

¹⁵³ *Id.* at 659.

¹⁵⁴ *Id.* at 663 (“[I]t is apparent that the majority stockholders in Springside have not shown a legitimate business purpose . . . for refusing to reelect him as a salaried officer and director.”).

¹⁵⁵ *Pedro v. Pedro*, 463 N.W.2d 285, 287 (Minn. Ct. App. 1991).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

While the *Pedro* case involves the discharge of an owner-employee rather than removal of an owner-director, a presumption of oppression could still apply. In drafting the presumption of unfair prejudice, the U.K. Law Commission suggested that actions other than a minority's formal removal as director could "constitute exclusion from management of the company for the purposes of the presumption[]." ¹⁵⁹ Examples of such conduct include the majority's failure either to consult the minority on major decisions, to invite the minority to board meetings, or to supply the minority with other pertinent information. ¹⁶⁰ These actions constitute various techniques employed to squeeze-out the minority. Likewise, the squeeze-out technique of firing a minority shareholder from a position of employment, particularly when the majority then distributes profits in the form of exorbitant salaries, might constitute exclusion for purposes of the presumption.

Assuming, for purposes of applying the presumption to the *Pedro* facts, that Alfred's discharge from a position of employment constitutes exclusion from management, the *Pedro* facts would trigger the presumption of oppressive conduct. Immediately before the exclusion, Alfred held a one-third interest in the closely held corporation in which all of the owners served as long-time employees involved in the management of the company. However, once the presumption arose, the respondent shareholders could rebut the presumption by arguing that the firing of Alfred did not constitute oppressive conduct for purposes of the state dissolution statute because Alfred had no reasonable expectation to maintain his position of employment in perpetuity or to otherwise participate in the company's management. Ultimately, given the facts, this argument would likely be unsuccessful because Alfred's brothers had no legitimate reason for firing him, and the outcome would likely be the same as the actual decision of the *Pedro* court.

While these two cases illustrate that a presumption of oppression may produce outcomes similar to those decided under existing U.S. oppression doctrine, the presumption would arrive at these decisions in a more efficient manner because it would limit the facts a court

¹⁵⁹ See Report No. 246, *supra* note 52, para. 3.41 (noting that "a shareholder could be excluded from participating in the management of the company without any need to be formally removed as director").

¹⁶⁰ *Id.*

examines in finding oppression and would place the burden on the party most apt to meet it.

CONCLUSION

A presumption of oppression upon the minority shareholder's exclusion from management and the fulfillment of certain other conditions, first proposed as a matter of statutory reform in the U.K., is a useful procedural device that would provide U.S. courts with a more predictable and efficient alternative in handling claims of minority shareholder oppression. Operating within a framework that incorporates the current approaches to defining oppression, the presumption would improve existing U.S. oppression doctrine.