

# The Need for Empirical Analysis of Shareholder Oppression Disputes

Douglas Moll & Benjamin Means

## Douglas Moll:

I appreciate the College of Law's invitation to the annual Connecting the Threads Conference. I have attended each one, and I always like to start with my terrible joke. I think we started this joke at the third Connecting the Threads Conference. Nobody asked me but I decided to subtitle it, "Haven't we Connected These Already?". Then we got to the fourth Connecting the Threads Conference, and again, no one asked me but I think I subtitled it just on my own: "We have made a whole quilt." And I have now decided my subtitle for the fifth Connecting the Threads Conference is going to be, "Always be Sewing." That's what I think Connecting the Threads Conference five is all about.

Our project that we want to talk to you about today involves shareholder oppression in a closely held corporation. Some of you are probably sick of hearing me talk about this because I talk about it quite a lot. But let me just spend a few moments before I turn it over to my colleague Professor Means to tell you more specifically about the project.

Let me give you five minutes' worth of background on shareholder oppression. What is a closely held corporation? A closely held corporation is a business organization that is, not surprisingly, a corporation. It is typified by a small number of shareholders, substantial owner participation in the management of the business, and most importantly, the absence of a market for the company's stock.<sup>1</sup>

In a public corporation, most shareholders are passive investors.<sup>2</sup> This means they do not contribute any labor to the corporation or take part in any management responsibilities for the corporation.<sup>3</sup> Generally speaking, shareholders in public corporations simply invest money and hope to receive a return on that money. These returns can be through dividends or capital appreciation – when the stock price goes up and they then sell the stock. The difference with closely held corporations is that the shareholders typically have participatory expectations as well.<sup>4</sup>

Shareholders in closely held corporations expect to have an active participatory role in the company, usually through employment and some

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<sup>1</sup> See Douglas K. Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VAND. L. REV. 749, 756 (2000).

<sup>2</sup> See DOUGLAS K. MOLL & ROBERT A. RAGAZZO, CLOSELY HELD CORPORATIONS § 7.01[A], at 7-3 (LexisNexis 2020 ed.).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

meaningful role in management.<sup>5</sup> Of course, shareholders in closely held corporations invest money into the venture and hope to receive a return on that money.<sup>6</sup> But by definition, the problem in a closely held corporation is that there is no market for the corporation's stock, so shareholders are not going to get any return by selling on the market.<sup>7</sup> Any investment return in a closely held corporation, short of selling the whole business, is going to be provided by employment compensation and dividends, rather than by sales of stock at an appreciated value.<sup>8</sup>

The problem is not too hard to understand. We have conventional corporate law norms of majority rule and centralized control, and those two concepts can lead to serious problems for minority investors in closely held corporations. Traditionally, most corporate power is centralized in the hands of a board of directors who make the decisions for the company.<sup>9</sup> Directors are elected by shareholder vote, so the board of a closely held corporation is typically controlled by the majority shareholder or the majority shareholder group.<sup>10</sup>

The board controls the corporation, and the composition of the board is controlled by the majority shareholder or the majority shareholder group. Of course, exercising control in some genuine effort to benefit the company and its owners is perfectly legitimate, even if that control necessarily prejudices what a minority shareholder would prefer to do. That's what it means to be in the majority. There's nothing wrong with being in the majority, and there's nothing wrong with exercising control. The problem is that the power to control also encompasses the power to abuse.

Whether that abuse springs from greed, spite, family conflicts, or whatever else, the minority shareholder in a closely held corporation does not have a viable escape route. You can't just sell your shares on the market, cash out your investment, and move on down the road to wherever you want to productively deploy that cash. There is no market. When the majority engages in these abusive actions, they are usually designed to restrict, or deny altogether, both the financial and participatory rights of the minority shareholder.<sup>11</sup> We collectively refer to these abusive

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<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 7-3 to 7-4.

<sup>8</sup> *Id.* at 7-4.

<sup>9</sup> *Id.* at 7-5.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

tactics as “oppressive conduct” or “oppression.”<sup>12</sup> That's what we mean when the majority abuses its control.

What are some examples of oppressive conduct in the case law? Courts have found oppression in cases involving termination of the employment of minority shareholders, their removal from management positions, cutting them off from dividends, cutting them off from information, and engaging in conflict of interest transactions involving the majority.<sup>13</sup> A very common example is excessive compensation. In other words, the majority will use compensation or other tactics to divert a disproportionate amount of the company's income to it.<sup>14</sup> Again, the underlying problem is there is no exit for the minority. There is no easy market exit like you would have in a public corporation.<sup>15</sup>

What have states done in response to this oppression problem? For our purposes, I want to focus on what I would call the statutory cause of action for oppression. Approximately 40 states in this country have a statute that allows a shareholder to ask the court to dissolve the corporation or give some less drastic remedy, like a buyout, on the grounds of oppressive conduct.<sup>16</sup> Not surprisingly, courts in jurisdictions with such statutes have to confront the question of “what in the world is oppressive conduct?” There are two primary definitions of oppressive conduct that have developed in the case law, and I just want to mention them because they segue nicely into what Professor Means is going to talk about and what our project covers.

The first definition is called “frustration of reasonable expectations,” and it occurs when the minority shareholder's reasonable expectations are frustrated by the majority.<sup>17</sup> The second test is even more vague to some extent: “burdensome, harsh and wrongful conduct, a lack of probity and fair dealing . . . .”<sup>18</sup> This tees up our project because if you look at those definitions of oppressive conduct they seem quite vague. They seem quite amorphous. What are the reasonable expectations of a minority shareholder? How does a majority frustrate those expectations? When does a majority's conduct cross the line from a legitimate exercise of control to a lack of probity and fair dealing?

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<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 7-6.

<sup>14</sup> *Id.* at 7-6 to 7-7.

<sup>15</sup> *Id.* at 7-7 to 7-8.

<sup>16</sup> *Id.* § 7.01[D][1][b][i], at 7-78 to 7-80 & n.192.

<sup>17</sup> *Id.* at 7-83 to 7-84.

<sup>18</sup> *Id.* at 7-82.

This is probably the biggest criticism of the oppression doctrine: it's vague and indeterminate. With this project, we wanted to test this in the trenches, so to speak. What is going on in oppression cases? Is it the Wild West where it appears to be totally haphazard and outcomes are random? Or are there patterns that we see in the case law, perhaps suggesting that there is more predictability in the doctrine than one might have thought? Let me pass the baton to Professor Means to talk a little bit more about how we plan on exploring these questions.

**Benjamin Means:**

Thank you. It is great to be here. I'm delighted to have a chance to work with Professor Moll on a scholarly project. I went back and looked, and it turns out I have known him since 2008. At the time, I was a baby law professor. I had just joined the profession and I was put in touch via email with Professor Moll to see if he might be willing to serve as a mentor for me. His response was, "I'd be happy to talk to him so long as he agrees with all of my positions 100%, as I will tolerate no difference of opinion."

**Douglas Moll:**

That was a joke, Benjamin, that was a joke! I just had to throw that in.

**Benjamin Means:**

In the original email, he said it was a joke. I thought it would be more fun here to quote it without the caveat. Professor Moll has been a terrific mentor to me, so this is an incredibly exciting experience. It's like getting pulled on stage at a rock concert; working together on this project is like getting to jam with my idols. My assigned role today is to explain to you what we are trying to accomplish with this project. Professor Moll has already introduced you to some of the difficulties in this area. We have a legal standard that is highly equitable and very fact specific, and yet the statutory standard in different jurisdictions is different.

To some extent, it should not be surprising that seemingly similar cases may be decided differently by different judges, in different courts, and in different jurisdictions. We recognize that equity contains a certain amount of inherent flexibility. But even if we concede that different jurisdictions have their own statutory approaches, there are still some deep, important questions that remain unanswered. What is the relationship between shareholder oppression and the fiduciary duty of loyalty? How can courts reconcile the concept of employment-at-will with

the notion that a shareholder should not be frozen out of any return on their investment? When the majority takes action that disadvantages the minority, what counts as a legitimate business purpose? If the court is going to view these questions through a contractual framework, how should the court interpret the contract that governs the parties' relationship? Should we apply the direct versus derivative distinction in these closely held business disputes? As a practical matter, whatever benefits the corporation or harms the corporation almost does not matter because the majority stands in for the corporation. I could go on and on.

Most of the questions about shareholder oppression are unresolved conceptually. Between the two of us, Professor Moll and I have written at least a dozen law review articles on various aspects of shareholder oppression, and yet to us it often seems that a particular case could go either way. You can see the court in one case say, "this shareholder was fired and that was part of a scheme to freeze the shareholder out of any return on her investment, and that is shareholder oppression." And then the same court, in a similar case, might say "you have to understand that employment is separate from share ownership. These are different things, and you cannot complain that you've been fired as a shareholder. That is not shareholder oppression."

That is not to say that the courts are wrong or that these standards are arbitrary or unjust, but rather that it is difficult to gain any conventional understanding of how the courts will apply the law. So, rather than tilting at these same issues again, Professor Moll and I decided to go back and try to understand how the courts are making these fundamental category distinctions. With that information, we might be able to recommend some appropriate reforms to help the courts better understand what they are doing and how to apply the standard uniformly.

To start our process, we decided "Let's just go read a dozen years' worth of cases and see what they say." At that point, we could test our descriptive claim against what the courts themselves were telling us they were doing. Neither Professor Moll nor I have any training as empirical researchers. We are not doing anything sophisticated, like regression analyses. Our methodology here is simple: we count. How many cases did the plaintiffs win? What arguments did they make? What defenses were raised? We thought that by doing that, by counting the cases, we would be able to perceive patterns.

As an inspiration for this approach, we looked to Professor Bob Thompson, a law professor who wrote about veil piercing a number of

years ago.<sup>19</sup> Professor Thompson's approach was basically to count veil piercing cases. How many of them involved contracts? How many of them involved torts? Did that make any difference in terms of whether the court was willing to pierce the veil or not? Professor Thompson's work was our inspiration. We wanted to apply his methodology to the shareholder oppression context.

If we discovered that, for example, oppression claims are much less likely to be successful in family owned businesses, that would be interesting. If we see that marketability discounts are applied to certain causes of action, but not others, that also would be noteworthy. So we are interested to look and see what we find out. Before I hand the microphone back over to Professor Moll, who will show us in a little more detail what this project is going to look like, I should concede that there are limitations to our methodology. There are three concessions I will make.

First, we can only count the cases that we find in Westlaw. We cannot count what we do not see, so we cannot assert anything about the overall pool of closely held businesses. I think that is an important concession.

Second, to avoid drawing unwarranted conclusions, we are being very careful to restrict our analysis to what the court says it is doing. If the court does not tell us its underlying rationale, we are not going to go look it up. Even if that information is accessible elsewhere, the only evidence Professor Moll and I are looking at is the language found in the decision.

The third concession, which is much broader, is that we are essentially trying to code the un-code-able. These cases involve highly fact-specific, equitably driven analyses. It is a tall order to think that Professor Moll and I will ever be able to come up with a list of factors that can be coded to capture everything the courts are doing.

Professor Moll and I spent a good part of the last summer on hours-long phone calls trying to figure out how to achieve our goal. It was quite a learning experience. We would be reading fifteen or twenty cases at a time and trying to break them down into yes or no questions—to the extent such a task is even possible. Every time we thought we had it figured out, we would read one more case and discover a whole new set of possibilities that did not fit into our coding form. So we would have to go back and try to retrofit the coding form with the new information and end up starting all over again.

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<sup>19</sup> Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991).

Having spent the summer arguing with Professor Moll over these substantive shareholder oppression issues, one thing I have learned is that he was really onto something in that first email he sent me way back in 2008. He was actually being incredibly prescient when he told me that the best course of action was to agree with him 100%, because far more often than not, that is where we would end up: Professor Moll is correct, Professor Means is not correct. With that, let me hand this presentation back over to Professor Moll, and he can go into greater detail into what our coding project will be like.

**Douglas Moll:**

Let me say, that is absolutely false, and Professor Means has changed my mind several times. However, if we are counting, he has been wrong more than myself.

I must tip my cap to Professor Means because we were on the phone talking about something, and I said “I have always wanted to do a project like Professor Bob Thompson's where I read several cases and code them.”<sup>20</sup> He asked me, “Why don't we do that?” I responded that I had thought about doing oppression cases, but it seemed like such a pain because it is a gigantic, equitable, fairness issue, and it seemed hard to try to capture that. He replied, “Well, if you are ever interested in doing it, I would be interested.” I thought it would be fun to work with Ben, and that conversation was the genesis for how this project got started.

What you have in your materials is exactly what Ben described. We kept revising the form because every time we read a case, it would present some new aspect that we wanted to capture. This is now the latest version of the form. It is very similar to what you have in your materials, but it is not the same. Let me just talk about some of the things that we are trying to capture. The general idea is simple – what is the conclusion of any particular court and what factors contributed to that conclusion? That is a very simple and easy sentence to say. Trying to actually write questions to capture all of those things in a way that we could code proved to be harder than certainly I thought.

We have four sections of this form. The goal of Section One is mostly background material. We have several students helping us who code the following basic information: information about the parties, the year of the decision, the court, the level of the court, the jurisdiction, and whether the opinion is published or unpublished. Maybe the last category

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<sup>20</sup> *Id.*



will turn out to be nothing, but I could imagine scenarios where perhaps unpublished opinions come out in a different way.

Oppression can occur in LLCs as well. There are several cases involving oppression in LLCs, but we are sticking with closely held corporations for now. Our query does not actively search for LLC cases, but sometimes they will be captured when we search for corporate cases. For this reason, we try to identify what entity we are dealing with, even though we are mostly looking for corporation cases.

The procedural posture of the case turns out to be somewhat important. If the judge is reviewing a motion to dismiss versus reviewing trial findings, the precedential value of that case will be different. One thing to ask is, “did the court say that X is oppressive in this context, or is the court just saying that there were sufficient allegations of oppression?” You will see in a moment that this is a very important question. We also must ask, “what does the court conclude?” For that question we have five answers that are all assuming the case is about liability in some way. Some other oppression cases are purely about the remedy, because in some jurisdictions, you can skip the whole liability phase and simply elect to buy out the complaining shareholder. Some cases might be “junk” and just mention shareholder oppression as an aside. We have a coding option for “junk” cases as well.

Next, family businesses. Ben has written a lot about family businesses, so we try to code to see if there is a family business at issue. We ask, “what is the actual family relationship between the plaintiff and the defendant?”

Next, we ask how many owners does the principal company have? There are many kinds of statutory differences these days. Some jurisdictions allow owners to bring an oppression claim in a company that has 35 or fewer shareholders. Others allow owners to bring an oppression claim against any corporation. Some allow a claim against any corporation that is not publicly traded. We are trying to capture disputes even in the smallest of the small companies. Imagine two to four owners. Are some family companies bigger? Could they be 50-shareholder companies or 100-shareholder companies? We are trying to capture both the small and the large.

If buy-sell agreements exist, we try to capture them and look at the language. We are not sure what to do with that information, but we want to know whether those agreements are involved.

At the end of every section we have what we call “narrative questions.” They are the fail-safe. If there is something from the opinion that the coding does not capture, the narrative questions tell us. Most of



the time we try to be a bit more specific about what we want, but that is the idea. Ben has convinced me that the more we can code and keep out of the narrative questions, the better. Reading 800 input forms is not much better than reading 800 cases. The more cases we can get coded the better, but there is still a need for narratives. We have students involved in this project, and we want to see people showing their work. For example, “here is why I coded what I coded,” or “here is the language from the opinion supporting what I coded.”

Section Two we call “Liability Questions.” These are questions or arguments that presumably would favor the plaintiff and that we think are likely to lead to a positive result on an oppression claim. Most of these questions are Ben and I applying what we have learned about oppression cases over the past 15 or 20 years of researching and writing in this area.

For example, if terminations of employment were mentioned by the court, were there other factors mentioned? Did those factors contribute to the court’s conclusion that was coded back in section one? Courts will often mention various factors, but some are not relevant to the court’s oppression analysis. Thus, we don’t want to say that a termination did not contribute to the court’s finding because that would suggest that the court actually thought about the termination issue and rejected it as being relevant to the oppression conclusion. We want to say that a termination was mentioned, but the court did not consider that factor in its analysis, and we have an “N/A” option to capture that.

Here are some other factors: if you were not terminated, were there other adverse changes in your job circumstances? Were you removed from management or otherwise excluded from business operations, such as not getting notice of meetings? Were you excluded from company information? Were dividends suppressed? Were there conflict of interest transactions present? What about low-ball offers, such as offering to purchase the minority’s shares for a very low price? Were there manipulations of financial information? In essence, we are trying to code things that we have seen in cases. We also ask, “Are there other miscellaneous oppressive actions?” It is difficult to capture them all because you can act unfairly, or oppress someone, in an unlimited number of ways. The miscellaneous question allows us to code that.

In Section Three, we have all the arguments that would presumably favor the defendant in these cases. Is the plaintiff’s fault mentioned as a defense? Does the business judgment rule or some legitimate business purpose defense come up? Does employment-at-will come up? Is there a contract that says we are permitted to do the things that you claim are oppressive? Those arguments are what we cover in

Section Three. Again, anything that we think would typically result in a defendant's outcome in the case.

Finally, Section Four of the form focuses on remedies. We do have a question here for those of you who teach in the area and remember cases like *Donahue*.<sup>21</sup> Some jurisdictions handle their oppression claims under a fiduciary duty framework and not under statute. In this project, we are not actively seeking out those cases, but if we happen to capture one while looking for statutory oppression claims, we will try to code it here. That said, this section is mostly about remedies, and the questions reflect that. What court imposed the remedy? We also want to know about remedies that might have been rejected. For example, if it is a buyout, we want all the details about the buyout. Were discounts applied or were discounts rejected? Who was ordered to effectuate the buyout? Were there installment payments? If discounts were applied, what percentage was used? What was the valuation date? These are the types of questions that we cover in this section.

At this point we have already coded about 40 to 50 cases. We think the form is working, even though we are literally trying to code a doctrine that polices unfairness in its many forms. However, it appears that we have identified most of the major issues and have figured out how to capture the relevant factors. We are cautiously optimistic, and we hope to come back in the next year or two with some written product addressing our findings.

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<sup>21</sup> See generally *Donahue v. Rodd Electrottype Co.*, 328 N.E.2d 505 (Mass. 1975).