Commentary on How Not to End Up Like "King Lear:" A Family-Business Succession Case Study[1]

Douglas K. Moll[2]

I want to start with a question and a confession. The question is: Will there be a Don Carlos Sharp the Fifth? I was impressed with that lineage. The confession, which I've been hesitant to tell Professor Means, is that I never read *King Lear*. The story is new to me, but that's okay because that's not why I'm here today. Professor Means wanted me to talk about the dark side of not planning for family business succession. We can sum up the dark side very quickly, which is litigation.[3] That's at least, from the lawyer's standpoint, what we really are going to worry about. Of course, you have the deterioration in your family which, don't get me wrong, is perhaps an even bigger problem. But from the standpoint of sitting here in a room of lawyers or lawyers to be, litigation is what one could expect if you don't do your planning. I feel like I've been here a million times talking about this, but perhaps with a different audience.

A few quick words about what is likely to happen if you don't plan for succession and if you start having dissension between the family members who are owners of the business. Let me start by saying that about 40 states in this country have a cause of action called shareholder oppression.[4] This claim allows a shareholder to ask the court to dissolve the corporation or to provide some less drastic remedy on the grounds of oppressive conduct.[5]

Tennessee has a statute just like that in the corporation setting.[6] On the screen here, you'll see an example from the Model Business Corporation Act, but this is very representative of most states.[7] You'll notice it says the court may dissolve a corporation in a proceeding by a shareholder. You don't have to own a substantial amount of stock, and you don't have to be a shareholder for a certain period of time. You just have to be "a" shareholder. You'll notice the grounds there: The directors

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[1] Benjamin Means, *How Not to End Up Like "King Lear:" A Family-Business Succession Case Study*, 24 TRANSACTIONS: TENN. J. BUS. L. 391 (2023).

[2] Professor Douglas K. Moll, The University of Houston Law Center. Comment in response to Benjamin Means' *How Not to End Up Like "King Lear:" A Family-Business Succession Case Study*.

[3] *See generally* DOUGLAS K. MOLL & ROBERT A. RAGAZZO, CLOSELY HELD CORPORATIONS chs. 6–7 (2022) (discussing causes of action for breach of fiduciary duty and shareholder oppression in closely held corporations).

[4] *See id.* § 7.01[D][1][b][i], at 7–80 n. 192 ("Forty states have statutes providing for dissolution or other relief on the grounds of 'oppressive actions' (or similar term) by 'directors or those in control.'").

[5] *See id.*

[6] *See* TENN. CODE ANN. § 48-24-301(2)(B) (2022).

[7] *See* MODEL BUS. CORP. ACT § 14.30 (AM. BAR ASS'N 2023).

or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent. In this country, when things go south in a family business, oppression is usually the cause of action used by the minority owner who feels like he or she has been wronged in some way.

The statute of course has this term "oppressive" conduct. The courts have to wrestle with the idea of what that term means. How are we supposed to decide whether we should grant dissolution or some other relief? There's two primary definitions of "oppression" that have come up in the courts. One is what we call frustration of reasonable expectations. In other words, it is oppressive if the majority frustrates the minority's reasonable expectations.[8] The second definition is really a fancy way of saying unfairness—

> burdensome, harsh and wrongful conduct, a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members, or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.[9]

You'll see at the end there a mention of a "departure from the standards of fair dealing and a violation of fair play." When I talk to plaintiff's lawyers, they say they wish there was just a cause of action called "unfairness" because they just want to come into court and say what happened to their client was unfair. Oppression is pretty close—I mean, that's basically an unfairness cause of action.

Aside from the jurisdictions that allow statutory actions for dissolution or some other remedy, we also have states that describe the protection given to minority shareholders as a breach of fiduciary duty. In some states, either in conjunction with the statute or by itself, if you're a minority shareholder, you feel like you've been wronged, and you're in a family business where somebody has screwed you over in some way, you can bring an action for breach of fiduciary duty.[10] In those jurisdictions, as long as you can claim that you have been harmed individually, you can seek judicial relief via the rubric of breach of fiduciary duty. This is from a famous Massachusetts case, but you can see in the bolded text there, "we

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[8] *See, e.g.*, *In re* Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984).

[9] Fix v. Fix Material Co., 538 S.W.2d 351, 358 (Mo. Ct. App. 1976) (footnote omitted) (internal quotations omitted).

[10] *See, e.g.*, MOLL & RAGAZZO, *supra* note 3, § 7.01[D][1][a], at 7–57 to 7–79.

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."[11] Again, you'll have to trust me that in most states in this country, if you're in a family business and there's been no planning for succession, maybe you'll be fine. But if things start going south, as Professor Means explained, litigation is a possible result. That result in most states is going to lead to some cause of action, which we generically call oppression, either via statute or via a breach of fiduciary duty claim.

Let me point out some very common examples of oppressive conduct, including things that you might not normally think of as harming a shareholder. One example, terminating the employment of a shareholder in the company, comes up in a lot of oppression cases. Other examples include removing a shareholder from a management position, either as a director or an officer; cutting off dividends; denying access to information; and draining the earnings of the company to the majority shareholder to the exclusion of the minority through perhaps excessive salaries.[12]

Of course, the oppression doctrine largely arises in the context of a closely held corporation. That is important because, by definition, in a closely held corporation there is no market.[13] This is not Apple. You can't just go on your e-trade account, place a quick trade, and say "I'm out of here." I'm getting my money out and I'm moving on down the road. By definition, there is no market. So, you're stuck in this family business where you didn't do your planning.

I thought it would be interesting to talk about another family farm case. In this discussion of *Baur v. Baur Farms, Inc.*,[14] the upshot is that even with some planning, things can still go wrong. That's one way you can understand the discussion we're about to engage in. But I want to spin this in a more positive way. The theme here is that while incomplete planning may only be marginally better than no planning at all, there is a role here for good lawyers, for you folks who are going to graduate and become lawyers. There is a role here for good lawyers who can recommend good planning.

With that, let's just briefly talk about *Baur v. Baur Farms*. This is another family farm. It was formed in 1966 by these two brothers, Merritt

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[11] Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 515 (Mass. 1975).

[12] *See generally* MOLL & RAGAZZO, *supra* note 3, § 7.01[C], at 7–24 to 7–54 (discussing common acts of oppression).

[13] *See, e.g.*, Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 514 (Mass. 1975) ("In a large public corporation, the oppressed or dissident minority stockholder could sell his stock in order to extricate some of his invested capital. By definition, this market is not available for shares in the close corporation.")

[14] Baur v. Baur Farms, Inc., 832 N.W.2d 663 (Iowa 2013).

and Edward. They took ownership of about 1700 acres of land they had previously farmed as partners. They issued 2,450 shares. All you really need to understand is that Edward winds up with the majority. He's got 51% of the company.[15] Then we move to the second generation. Merritt has two sons, Jack and Dennis, and Edward has a son, Bob. Both Merritt and Edward transfer their shares to the second generation. Jack, who is the plaintiff in the case, works for the family farm for a bit, but he leaves relatively early to pursue a business career and he's pretty successful. I want you to understand that he's largely a passive owner. He owns stock in the company, but he doesn't work for the venture. Dennis was working for the company, but he had some health problems and had to stop working. So, the Merritt side of the family are really just passive owners at this point.

Bob is running things and is very active. He basically controls the board, works for the company, et cetera. Just because you may be curious, Dennis has a son, James, so now we're in the third generation. James is actually working for the family farm, but Jack is the plaintiff, and Bob is essentially the antagonist in this case. He is the main defendant. Jack winds up ultimately with 644 shares, but Bob is the majority shareholder. All you need to understand is that Jack and Bob have several disagreements over the years, mostly related to distributions. Jack is a passive owner who just wants some money. Bob says no, the farm needs to buy more land and we're not going to make any distributions. As a consequence, Jack has been lobbying since the 1990s to be bought out at a reasonable price. This case was decided in 2013, so Jack has been lobbying for a long time to be bought out at a reasonable price.

The parties did do some planning, as their 1984 bylaws had a buyout provision. It provided that if an owner wished to sell shares, the owner must first offer them to the corporation or the other shareholders,[16] which is fairly common. It's an option that you give to the corporation and the other shareholders. Only if they decline can you sell to someone else. Now, when you offer your shares to the company or the other shareholders, if you can't agree on a price, the bylaw provided that the purchase price of the stock is set at the "book value per share of the shareholders' equity interest in the corporation as determined by the Board of Directors . . . as of the close of the most recent fiscal year."[17] In 1984, when they passed this amendment, they decided that the book value would be $686 per share. Now that was in 1984. You probably can guess what's about to happen. They keep fighting over the value of Jack's shares. Jack finally sues the company, but the main defendant is Bob. Jack says that

[15] *See id.* at 665 (stating that Edward had 1262 of the 2450 shares of stock).
[16] *See id.*
[17] *Id.*

Bob has engaged in oppressive conduct because Jack won't buy Bob out at a reasonable price or make any distributions.

I want to highlight the main language from the opinion. For 20 years, Jack has been trying to sell his stock, but he has never officially tendered his shares under the buyout provision because he disagrees with the $686 share price. The company has never paid a dividend and it might never do so. Despite his persistent efforts for two decades, Jack has been unable to sell his stock at a reasonable price. The book value option is problematic from Jack's perspective because it has a price of $686. That valuation, which was approved in 1984, has never been formally revisited or revised, so that is a huge problem. They did some planning, and the parties presumably thought that they would update this number every year. It's 2013 by the time this gets to the Iowa Supreme Court, but the parties never did update the buyout price. This last paragraph from the Supreme Court of Iowa is important:

> The language of the book value buyout provision fails to address several important questions: (1) whether book value must be set by express resolution of the BFI board or may be determined from an inspection of the books of the corporation without formal action by the directors or shareholders; (2) whether annual determination of the book value for purposes of the bylaw provision was intended; and (3) whether the board, when setting the book value under the provision, must use asset values that are reasonably related to "actual" or "fair market" values and be based on generally accepted accounting principles.[18]

The court was left with these questions despite the planning that was done. It was great that the parties had a buyout provision, but the planning that was done did not address some seemingly simple questions that would've been relevant and important to resolving disputes.

Last little point here. This lawsuit started in 2007, and this case is 2013. It gets remanded and there's another appeal in 2016. Ultimately, Jack loses on his oppression claim, so who knows what's happening at this point to Jack's shares. He's been trying since the 1990s to get bought out at a reasonable price. God only knows what his relationship with his cousin is because they've been litigating for 20 years or more. This is the dark side of what Professor Means is talking about. If you don't do some planning for family succession, litigation is a possible result. But again, let's just look at it in a more positive light. There is a role for lawyers to come

[18] *Id.* at 674.

in and do some effective and thorough planning so that we can lessen (if not eliminate) these types of problems.