BEST PRACTICES

Shareholder oppression and business divorces

BY GERARD V. MANTESE AND BRIAN P. MARKHAM

The big and powerful don't always win. See, e.g., *David v. Goliath; Rocky v. Creed; Skywalker v. Vader; Brockovich v. PG&E.* This is no different in the world of closely held businesses, where the minority shareholder is often seemingly powerless.

Minority shareholders are particularly vulnerable to abuse at the hands of those in control of a corporation.[1] When majority shareholders resort to unfair or oppressive tactics, whether out of spite or greed, the minority can find themselves in a position where they are unable to defend themselves and, with no ready market for their shares, unable to escape.[2]

Accordingly, minority shareholders need a powerful weapon to deter and remedy majority abuse. Shareholder oppression law provides that weapon; it is David's slingshot for minority owners facing Goliath.

WHAT IS SHAREHOLDER OPPRESSION?

Courts have recognized and remedied the abuse of minority shareholders for well over a century. But courts, practitioners, and scholars still debate: just *what* is shareholder oppression? Is it unfair treatment? Is it a fiduciary breach? Is it defeated expectations? Is it fraud? Is it a single action or a course of actions?

The answer varies by state, but oppressive conduct typically falls into one of two categories that focus on either the majority's conduct (the "fair dealing" approach) or the minority's expectations (the "reasonable expectations" approach).[3] The approach that applies in a particular state derives from the statute, caselaw, or both. Michigan's law is an example of a statutory "fair dealing" approach that provides for an action against directors or those in control who engage in conduct that is "willfully unfair and oppressive," defined as "a continuing course of conduct or a significant action or series of actions that substantially interferes with the interests of the shareholder as a shareholder."[4] Conversely, for example, while New York's oppression action is statutory, its "reasonable expectations" approach comes from the caselaw, under which "oppression should be deemed to arise only when the majority conduct substantially defeats expectations that ... were central to the petitioner's decision to join the venture."[5]

How to oppress a minority shareholder: A quick guide to achieving oppression liability

With shareholder oppression being an equitable matter, courts have wide latitude when considering whether the majority's conduct amounts to actionable oppression[6] and a finding of oppression depends heavily on the facts before the court.[7] Accordingly, practitioners representing oppressed shareholders must have a keen eye to spot the majority's various methods of oppression — to paraphrase fomer U.S. Supreme Court Justice Potter Stewart, practitioners must know oppression when they see it.[8]

Thankfully, caselaw provides a handy guide. If you're a majority shareholder looking to oppress your minority shareholders (and assume the accompanying liability), you can try these tactics, all of which Michigan appellate courts have found to be evidence of oppression:

- dividend starvation (arbitrarily refusing to declare dividends);[9]

"Best Practices" is a regular column of the Michigan Bar Journal, edited by Georger Strander for the Michigan Bar Journal Committee. To contribute an article, contact Mr. Strander at gstrander@ingham.org.

- taking *de facto* dividends (taking compensation, such as bonuses, not made available to minority shareholders);[10]
- unfair redemption offers;[11]
- taking exorbitant salaries;[12]
- self-dealing;[13]
- withholding information (often to conceal the majority's oppressive conduct);[14]
- siphoning profits (diverting money to the majority's outside ventures);[15]
- terminating employment (salary is often the main source of value for close corporation owners);[16]
- and the list goes on ...[17]

Often, oppression is not just one or two of these methods, but instead is a game of synergies. A series of actions that look innocent in isolation can together achieve maximum oppressive effect.[18] For example, the majority may cease issuing dividends and instead stockpile cash. Knowing that the minority owner is now receiving no benefit from his investment, the majority will offer to purchase the minority's shares at a grossly low price; the minority must accept if he wishes to realize any value at all. This is where the law of shareholder oppression steps in.

A BRIEF HISTORY OF PROTECTING MINORITY SHAREHOLDERS

Fiduciary duties and early caselaw

At the root and heart of shareholder oppression law is the ancient and inveterate concept of the fiduciary duty — the idea that a person owes the utmost fidelity ("the punctilio of an honor most sensitive"[19]) to another who has reposed trust in him.[20] A fiduciary owes the duties of loyalty, honesty and good faith, full disclosure, and due care.[21] Michigan courts have long recognized that directors owe shareholders these fiduciary duties.[22] It is also well-established in Michigan caselaw that majority shareholders owe these same duties to minority shareholders.[23]

Prior to the enactment of the oppression statutes, these fiduciary concepts gave courts the tools to provide equitable remedies to minority shareholders harmed by oppressive conduct. More than 130 years ago in *Miner v. Belle Isle Ice Co*, for instance, the Michigan Supreme Court declared that majority shareholders "assume the trust relation occupied by the corporation towards its stockholders"[24] and therefore must act with the "utmost good faith in the control and management of the corporation as to the minority."[25] The Court accordingly exercised its equitable powers and ordered a full accounting and disgorgement to remedy the majority's fiduciary breaches including siphoning profits and dividend starvation — both classic oppression techniques.[26]

In other jurisdictions, the invocation of fiduciary duties to remedy oppressive conduct goes back even further. Take the 1834 New York case of *Muir v. Throop*, which concerned an overt freeze-out of a minority shareholder and director from all participation in decision making — the majority wrote a bylaw specifically excluding the plaintiff (and only the plaintiff) "from all knowledge of their business transactions."[27] Though the statute gave the majority the power to make bylaws concerning corporate governance and management, the court held that because of the "trust reposed in [a director] by the stockholders," bylaws "must be reasonable [and] must not be unequal, oppressive, or vexatious."[28] The court found that the bylaw was unequal and oppressive and ordered the defendants to allow the plaintiff to inspect the company's books and records.[29]

Statutory protections

Soon enough, legislatures began recognizing minority shareholders' need for protection. Early state statutes codified the dramatic remedy of dissolution as the solution when the majority engages in oppressive conduct. The earliest of those laws appears to be a 1931 California statute which provided for dissolution where "the directors or those in control of the corporation have been guilty of persistent fraud or mismanagement or abuse of authority, or persistent unfairness toward minority shareholders."[30]

Illinois and Pennsylvania followed with their own dissolution statutes in 1933.[31] An oppression action was included in the 1950 Model Business Corporation Act,[32] and from there it was off to the races as states began codifying their own oppression actions.[33] Today, 40 states have statutes that provide protections for minority shareholders against the actions of an unfair majority.[34] Minority shareholders in states that do not provide such a cause of action must still turn to breach of fiduciary duty claims when seeking relief from an oppressive majority.[35]

THE VAST EQUITABLE POWERS OF THE COURTS TO REMEDY SHAREHOLDER OPPRESSION

Because shareholder oppression is an equitable cause of action,[36] the full panoply of equitable remedies is available to rectify the majority's wrongdoing.[37] A court sitting in equity has vast powers to fashion a remedy. As the U.S. Supreme Court recognized, the "flexibility inherent in equitable procedure enables courts to meet new situations [that] demand equitable intervention, and to accord all the relief necessary to correct ... particular injustices."[38] Stated more simply, "[e]quity will not suffer a wrong without a remedy."[39]

In some states, a court's broad equitable ability to provide justice as it sees fit is enshrined in the oppression statute. Michigan's statute provides that a court "may make an order or grant relief *as it considers appropriate*, including, *without limitation*," and thereafter is an enumerated list of remedies, including injunctive and declarato-

ry relief, damages, and a buyout remedy (emphasis added).[40] Even in states where the oppression statute provides only for dissolution, courts often recognize that less drastic remedies are also available, often on the theory that the greater power includes the lesser.[41]

The statutory and equitable remedies available to courts are wide ranging, including damages and injunctive relief, but at the end of the day, courts often favor the remedy of a buyout, by which the court orders the corporation or the oppressors to purchase the oppressed shareholders' interests at fair value.[42] Indeed, it has been said that in business disputes "[t]here must be a 'divorce,'" as the problems that led the parties to litigation "are inherent in their relationship."[43] They cannot be fixed "by an order attempting to modify or control their actions while they remain 'married' to each other. The conflict will remain, and its symptoms will reappear in what will inevitably be a continuing war between the two."[44] Separating the warring parties allows the company to move forward, avoids future litigation, and provides the oppressed shareholders with a reasonable measure of justice.

CONCLUSION

Minority shareholders in close corporations face a unique problem in the business world. Without special protection under the law, they are particularly vulnerable to a host of abusive tactics by those in control of a corporation. The law of shareholder oppression offers special protection by providing minority shareholders with a cause of action against oppressive conduct. And where oppression is found, a court has broad discretion to grant whatever remedy is appropriate to rectify the injustice, with a buyout remedy offering the best way forward for the parties to be free of persistent litigation and entanglements.

Gerard V. Mantese is a trial attorney at Mantese Honigman P.C., where he handles shareholder litigation in courts across the country. He also handles public interest cases, including advocating for children with autism (*Potter v Blue Cross*, No. 10-cv-14981 (2013 ED Mich) (summary judgment holding insurer arbitrarily denied behavioral therapy as "experimental"); combatting housing abuses (*James v. Detroit Property Exchange*, No. 18-cv-13601 (2018 ED Mich)); and advocating for the disabled to have equal access to public services (*Jones v City of Detroit*, No. 21-1292 (2021 US Supreme Court, certiorari petition pending.))

Brian P. Markham is an associate at Mantese Honigman P.C. He focuses his practice on complex business litigation, including business divorces and environmental litigation, and appeals to the United States Supreme Court and the Michigan Supreme Court. He is a 2020 graduate of Wayne State University Law School and a graduate in accounting at Wayne State University.

ENDNOTES

1. *Darvin v Belmont Industries*, 40 Mich App 672, 677–678; 199 NW2d 542 (1972) (discussing the "special problems inherent in the close corporation").
2. *Id.*
3. Mantese & Bolyea, *Shareholder Oppression Litigation—A National Perspective*, 40 Mich Bus L J 38, 38–39 (Fall 2020).
4. MCL 450.1489(3).
5. *Matter of Kemp & Beatley (Gardstein)*, 64 NY2d 63, 73; 473 NE2d 1173 (1984).
6. *Madugula v Taub*, 496 Mich 685, 711–15; 853 NW2d 75 (2014) (characterizing an action under MCL 450.1489 as an equitable claim).
7. *Kemp*, 64 NY2d at 73.
8. *Jacobellis v State of Ohio*, 378 US 184, 197; 84 S Ct 1676; 12 L Ed 2d 793 (1964) (Stewart, J., concurring) (declining to define exactly what content is obscene and instead declaring, "I know it when I see it").
9. *Miller v Magline, Inc*, 76 Mich App 284; 256 NW2d 761 (1977).
10. *Erdman v Yolles*, 62 Mich App 594; 233 NW2d 667 (1975).
11. *Schimke v Liquid Dustlayer, Inc*, unpublished per curiam opinion of the Court of Appeals, issued September 24, 2009 (Docket No 282421).
12. *Berger v Katz*, unpublished per curiam opinion of the Court of Appeals, issued July 28, 2011 (Docket Nos 291663 and 293880).
13. *Thompson v Walker*, 253 Mich 126; 234 NW 144 (1931).
14. *Madugula v Taub*, unpublished per curiam opinion of the Court of Appeals, issued October 25, 2012 (Docket No 298425), p 2 (rev'd on other grounds, *Madugula v Taub*, 496 Mich 685).
15. *Lozowski v Benedict*, unpublished per curiam opinion of the Court of Appeals, issued February 7, 2006 (Docket No 257219).
16. Moll, *Shareholder Oppression & Dividend Policy in the Close Corporation*, 60 Wash & Lee L Rev 841, 848 (2003).
17. Generally, Mantese & Williamson, *Litigation Between Shareholders in Closely Held Corporations*, 1 Wayne St U J Bus L 1 (2018).
18. *Shareholder Oppression*, 60 Wash & Lee L Rev at 848–50.
19. *Meinhard v Salmon*, 249 NY 458, 464; 164 NE 545 (1928).
20. Mantese, *The Fiduciary Duty—Et Tu Brute?* 99 Mich Bar J 52 (2020).
21. *Id.*
22. *Murphy v Inman*, ___ Mich ___, issued April 5, 2022 (Docket No 161454) (citing cases).
23 *Veeser v Robinson Hotel Co*, 275 Mich 133, 138; 266 NW 54 (1936).
24. *Miner v Belle Isle Ice Co*, 93 Mich 97, 114; 53 NW 218 (1892).
25. *Id.* at 117.
26. *Id.* at 117–18. Though it did not go so far, the Court recognized that it had the power to dissolve the corporation to remedy such wrongs. Dissolution would go on to become a prevalent feature in oppression statutes.
27. *People ex rel Muir v Throop*, 12 Wend 183, 186 (1834).
28. *Id.* at 185–86 and *Berger*, unpub op at 4 (holding that a general grant of authority in the bylaws cannot justify oppressive conduct).
29. *Muir*, 12 Wend at 186–87.
30. O'Neal, Thompson & Moll, *Oppression of Minority Shareholders and LLC Members* (Rev 2d) (2022), § 7:11 n 1, quoting Cal Civ Code § 404 (1931).
31. *Id.*
32. *Id.*
33. Matheson & Maler, *A Simple Statutory Solution to Minority Oppression in the Closely Held Business*, 91 Minn L Rev 657, 665 (2007). Oppression law in our sister nations of the United Kingdom and Canada followed similar paths, with oppression remedies being codified in the U.K. in 1948 and in Canada in 1975, Ben-Ishai & Puri, *The Canadian Oppression Remedy Judicially Considered: 1995-2001*, 30 Queen's L J 79 (2004).
34. O'Neal, *Oppression of Minority Shareholders and LLC Members*, § 7:11. The remaining states provide minority protections in a more limited set of circumstances, such as against illegal and fraudulent (but not oppressive) behavior (e.g., Florida) or only when there is a 50/50 deadlock (e.g., Ohio), *Id.* at § 7:11 n.4.
35. *Id.* at § 7:11.
36. *Madugula*, 496 Mich at 711–15.
37. *Id.* at 708–09.
38. *Holland v Florida*, 560 US 631, 649–50; 130 S Ct 2549; 177 L Ed 2d 130 (2010).
39. *Cannon v Bingman*, 383 SW2d 169, 174 (Mo App, 1964).
40. MCL 450.1489(1).
41. See, e.g., *Kemp*, 64 NY2d at 74 ("A court has broad latitude in fashioning alternative relief, but . . . should not hesitate to order dissolution [when appropriate]") and *Robinson v Langenbach*, 599 SW3d 167, 182 (Mo, 2020).
42. *Shareholder Oppression Litigation*, 40 Mich Bus L J at 41–42.
43. *Bonavita v Corbo*, 300 NJ Super 179, 198–99; 692 A 2d 119 (1996).
44. *Id.* at 199.