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Guest Article

Unmoored: How Minority Shareholder Oppression Litigation Has Gone Too Far

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This article further discusses the topic of shareholder oppression which was previously highlighted in a Spring 2014 SRR Journal article, "Shareholder Oppression, Fiduciary Duty, and Partnership Litigation in Closely Held Companies", written by Gerard Mantese.

Introduction

Much has been written suggesting the ready availability of the cause of action of "minority shareholder oppression" based upon any number of potential acts.[1] While typically noting there is no single standard for oppression across the country, there often are crucial distinctions between the laws of various states (and holdings in particular cases) which are broad-brushed in order to make generalized conclusions; all of which suggest an oppression remedy for all minority shareholders who "believe" they are victims.[2]

There is deceptive truth in the overall buoyant tone of such articles and their suggestion of judicial remedies ripe for the picking for any oppressed-feeling minority shareholder. At least with certain jurisdictions, the rise of minority shareholder oppression statutes and lawsuits cannot be denied. Twenty-five years ago, Professor F. Hodge O'Neal, ever an advocate for the minority shareholder, complained loudly about and cataloged various oppressive techniques.[3] Yet the predominate tools for addressing those issues—such as shareholder derivative suits or fiduciary duty claims—were existing causes of actions (albeit sometimes with newfangled paradigms, like "reasonable expectations") and, as such, provided various protections to the majority, such as derivative demand requirements and the business judgment rule.

The worm began to turn with the adoption of the 1984 Revised Uniform Business Corporation Act, and its Close Corporation Supplement, in to the statutes of several states (with a few states adopting statutes even before then). That provision accelerated states' recognition of the "close corporation,"[4] which was recognized as operating more as a partnership than a corporation. As noted by academics, "Much of the clamor for special close corporation legislation appears to be a reaction to heavy-handed decisions in cases in which courts denied oppressed minority shareholders equitable relief such as the dissolution of the corporation."[5] Soon, another solution arose: minority shareholder oppression statutes.

These statutes departed from the Model Act and expressly gave courts latitude to order a host of remedies for oppressive acts.

[1] Gerard Mantese & David Hansma, Shareholder Oppression, Fiduciary Duty, and Partnership Litigation in Closely Held Companies, SRR Journal Spring 2014 (available at http://www.srr.com/article/shareholder-oppression-fiduciary-duty-and-partnership-litigation-closely-held-companies#sthash.h9OGKsLM.dpuf).

[2] For example, the Mantese article concludes by stating that termination of a minority shareholder's employment from a closely held corporation "is likely to constitute oppression," but no case so holds and one of the footnoted cases held this quite opposite opinion: "We recognize that there are times when a majority shareholder may terminate a minority shareholder with impunity." *Knights' Piping, Inc. v. Knight*, 123 So. 3d 451, 459 (Miss. Ct. App. 2012).

[3] See, e.g., F. Hodge O'Neal, Oppression of Minority Shareholders: Protecting Minority Rights, 35 Clev. St. L. Rev. 121 (1987).

[4] For the evolution and early history of close corporation statutes, see Dennis Karjala, *An Analysis Of Close Corporation Legislation In The United States*, 21 Ariz. St. L.J. 663 (Fall 1989).

[5] *Id.*

For example, in Michigan, "willfully unfair or oppressive conduct" gave the court flexibility to do anything from dissolve the company to order a buyout to reform the bylaws.[6]

As it stands today, courts—using close corporation statutes, minority shareholder oppression statutes, and common law fiduciary duty theories—have greatly broadened the litigation options available to a minority shareholder. And boy have minority shareholders stepped up to the plate. Take Michigan, for example: in the first 11 years of the minority shareholder oppression statute, six appellate cases referenced it. In the next 10 years: 46.

So in one sense, the horn blowing and bell ringing announcing the malleable oppression remedy is accurate in so much as aggressive parties and aggressive lawyers are pushing the bounds of the law in various jurisdictions. But one should not take such zealous advocacy as simply an objective statement on the expansion of the law. Indeed, we've all been here before. The 1980s saw the high water mark of the shareholder derivative action (its subsequent decline not unrelated to the rise of minority shareholder oppression statutes and remedies). As courts and parties endured those waves of litigation, it was recognized that "derivative actions brought by minority shareholders could, if unrestrained, undermine the basic principle of corporate governance that the decisions of a corporation … should be made by the board of directors … "[7] Moreover, shareholder claims were recognized as often being brought for harassment purposes, and/or "more with a view to obtaining a settlement resulting in fees to the plaintiff's attorney than to righting a wrong to the corporation (the so-called 'strike suit')."[8] In response, states passed derivative demand requirements and imposed business judgment rule protection to the decisions of the majority.

The current wave of minority shareholder oppression litigation is arguably starting to create a similar backlash. Consider Texas; in 1988, the Texas Court of Appeals held in *Davis v. Sheerin* that minority shareholders in close corporations are entitled to a buyout of their shares if they are "oppressed" by the majority shareholders.[9] The *Davis* court acknowledged that minority shareholders in close corporations are particularly vulnerable to oppression, as they cannot freely exit an enterprise in the same manner as a member of a partnership or a shareholder of a public corporation.[10] As noted by one commentator, "The test set out in *Davis*—which has rightly been described as 'seminal'—became the prevailing approach in Texas, influenced case law in a number of other states, and earned a prime place in black-letter corporations law."[11] In June 2014, the Texas Supreme Court flatly overruled *Davis* and gutted the cause of action for shareholder oppression in Texas in *Ritchie v. Rupe*. The decision has been met with mouths agape across the nation, and it is beyond the scope of this article to dissect the opinion. But it is not wild speculation to query whether the decision comes, having watched the lower courts struggle to apply numerous amorphous standards for "oppression" without consistency or success, as a ringing indictment of the cause of action and its impact on both litigants and courts.

The status of civil litigation in this country generally is at a crossroads. The Federal Rules of Civil Procedure are being revised in an attempt to reign in out-of-control discovery, which has been the bane of litigants and courts, and to formally introduce the concept of "proportionality." Is there any room for "proportionality" when it comes to shareholder rights?

Regardless of how one views the issue normatively, history suggests that the oppression remedy has, to a certain extent, gone beyond its intended and worthy purposes. When adopted, it was not designed to constitute a litigation gun in the hand of every minority shareholder, yet that is what it has become in some jurisdictions. Surely there are truly oppressed shareholders (whatever definition one might employ) in need of judicial relief. But the sense is that the vagueness of the law combined with the lax and expensive civil litigation system has combined to provide minority shareholders with a means for extortion and strike suits just as were seen by courts with shareholder litigation in the 1970s and 1980s. With the benefit of avoiding the procedural and substantive hurdles of derivative actions, coupled with ill-defined standards for what constitutes oppression, a single shareholder can now sue the company and all of its executives *personally* and likely force them through invasive and expensive litigation before there is a real chance of a court addressing a dispositive motion. The result is that a shareholder pleading oppression stands little risk of dismissal on the basis of an initial motion, meaning that he can thus engage in broad, expansive discovery, with its attendant distractions to management, before a post-discovery motion for summary disposition can be heard. Even then, courts construing the statute have most often found such murkiness in the statutory definitions that factual issues are found to exist, leading to trial.

What has been lost in the evolution of the oppression claim is the balance that has always existed in corporate law. Perhaps the ruling in Texas is simply the loudest reaction to date to an area of the law governed by fuzzy standards, expensive discovery, and inconsistent legal opinions. While perhaps not a panacea, one solution is immediately available: strict statutory interpretation.

[6] MCL 450.1989. Legislatures in other states, have done the same; see, e.g., 805 ILL. COMP. STAT. 5/12.56(a) (1983).
[7] *Daily Income Fund, Inc v. Fox*, 464 US 523, 531; 104 S Ct 831, 78 L Ed 2d 645 (1984) (citing *Hawes v. Oakland*, 104 US 450; 26 L Ed 827 (1882)).
[8] MODEL BUSINESS CORP. ACT § 7.4, Introductory Comment (1994).
[9] 754 S.W.2d 375, 381-82 (Tex. App. 1988).
[10] Id at 381. See also commentary at James Dawson, *Ritchie v. Rupe and the Future of Shareholder Oppression*, 124 Yale L.J. F. 89 (2014), http://www.yalelawjournal.org/forum/ritchie-v-rupe.
[11] Dawson, supra n. 9 (footnotes omitted).
[12] No. 11-0447, 2014 WL 2788335 (Tex. June 20, 2014).

This is, arguably, all that was being done in Texas; the Supreme Court expressly stated that it was for the legislature, not it, to craft a broad remedy for oppression if one was needed, but one could not be divined from either the common law or the current statute.

Beyond statutory interpretation, interpreting the oppression remedy in tandem with other recognized pillars of corporate law might help leave it as a tool for fighting proper oppression while squelching its potential for mayhem. The manner in which oppression has become unhinged from the rest of corporate law is exemplified by the muddled path of the shareholder oppression remedy in Michigan. Solely as a case study, consider the history and evolution of oppression litigation in Michigan.[13] Until 1989, the Michigan Business Corporation Act ("MBCA") had traditional derivative shareholder provisions with a demand requirement. This pre-suit demand requirement was designed to respect the decisions of the corporation and limit judicial interference because "[w]hether to sue or not to sue is ordinarily a matter for the business judgment of directors, just as is a decision that the corporation will make bricks instead of bottles."[14] Shareholders also had the right to bring "direct" actions. The definition of an action that is direct and not derivative has not always been crystal clear, but there was a good body of case law on the topic both in Michigan and elsewhere. Direct actions relate to injuries that have happened to the shareholder not because he or she is a shareholder, but as a result of a distinct, independent duty "owed directly to him [or her]."[15]

Michigan also had an oppression statute, but it was in the dissolution section of the act, leading courts and attorneys to believe that dissolution was the sole remedy. In 1989, the Michigan legislature adopted a formal oppression statute, MCL 450.1489, by moving that statute within the act and clarifying that courts had flexibility as to remedies. At the very same time, it also overhauled the MBCA's provisions concerning derivative actions, mandating written demand, providing mechanisms for determining whether an action is in the corporation's best interests, and allowing the court to stay or dismiss a derivative proceeding.[16]

The fact that these two steps were taken together—a careful revision of the derivative shareholder remedy and adoption of an express oppression statute—is a coupling that has not much informed subsequent judicial analysis. Rather, the oppression statute took on a life of its own, with the predictable issues of attempting to interpret what the statute actually was attempting to brand as "oppression." The terminology—conduct that is "illegal, fraudulent, or willfully unfair and oppressive to the corporation or its shareholder"—presented a host of potential interpretive issues. In 2001, the Legislature amended MCL 450.1489(3) to define "willfully unfair and oppressive conduct" as follows:

> *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. The term does not include conduct or actions that are permitted by an agreement, the articles of incorporation, the bylaws, or a consistently applied written corporate policy or procedure.*[18]

Michigan courts began to be confronted with cases in which minority shareholders attempted to use § 489 to seek redress for a broad away of alleged wrongdoing. The alternative paths were highlighted by a spate of appellate cases decided in 2006. On one hand, the Michigan Court of Appeals (albeit in unpublished cases) rejected attempts to expand the scope of § 489.[19] On the other, in *Bromley v. Bromley*,[20] the U.S. District Court for the Eastern District held that shareholders pursing what would normally be considered derivative claims—they were founded upon allegations of inappropriate corporate spending, self-dealing, and general mismanagement and resulted in harm to *the corporation* rather than the shareholders—could be brought pursuant to § 489. While the court seized upon the clear statutory language of improper acts *"to the corporation or to the shareholder"* in making this ruling, commentators have rightly questioned whether the opinion went too far and whether there is a middle ground wherein traditional derivative actions are preserved but conduct over a higher threshold—"willfully unfair and oppressive"—opens the door to an oppression action.[21]

This statute's evolution led to considerable commentary in 2007.[22] Even then, the core question—what constitutes "willfully unfair and oppressive" conduct—remained largely unanswered by courts. But the flow of litigation by this point seemed clear. Since 2002, not one opinion had been issued in the Court of Appeals dealing with the direct vs. derivative distinction. Rather, a spate of lawsuits have arisen by adopting the easy end-run—oppression under §1489. Plaintiffs' lawyers have self-servingly noted that "the trend

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13 For a more thorough analysis of Michigan law, see D. Quick & E. Pawlowski, "Tyranny of the Minority," ABA Section of Litigation (2014)(available at http://apps.americanbar.org/litigation/committees/commercial/articles/winter2014-0214-tyranny-of-minority.html).

14 *In re Consumers Power Co*, 132 FRD 455, 465 (ED Mich 1990) (internal quotation omitted); see also *Kamen v. Kemper Fin Servs, Inc*, 500 US 90, 96; 111 S Ct 1711; 114 L Ed 2d 152 (1991) ("The purpose of the demand requirement is to 'afford the directors an opportunity to exercise their reasonable business judgment and waive a legal right vested in the corporation in the belief that its best interests will be promoted by not insisting on such right'" and the demand process protects "the directors' prerogative to take over the litigation or to oppose it." (internal quotation omitted)).

15 *Michigan Nat'l Bank*, 178 Mich App at 679 (emphasis omitted).

16 *Id.*

17 See Moscow and Ankers, *Oppression of Minority Shareholders*, 77 Mich B J 1088 (Oct 1998).

18 MCL 450.1489(3) (emphasis added).

19 See, e.g., *Haarer v. Vreba-Hoff Dairy Development, LLC*, unpublished opinion per curiam of the Court of Appeals, issued August 17, 2006 (Docket No. 260001) (affirming summary disposition under MCR 2.116(C)(8) for claims arising from the financial decline and bankruptcy of a corporation); *Wojcik v. William J. McNish & McNish's Sporting Goods & Trophies Inc.*, unpublished opinion per curiam of the Court of Appeals, issued July 25, 2006) (Docket No. 267005) ("Plaintiff's claims regarding breach of an employment contract and breach of a stock purchase agreement are not interests of plaintiff as a shareholder, and therefore, are not protected by § 489.").

20 *Bromley v. Bromley*, No. 05-71798, 2006 US Dist LEXIS 37022 (ED Mich June 7, 2006).

21 See Hauck and Kolozsvary, *Shareholder Oppression and the Direct/Derivative Distinction*, 27 MI Bus LJ 18 (Summer 2007).

22 See Hauck, *supra* note and Cambridge, *Minority Member Oppression*, 27 MI Bus LJ 11 (Spring 2007).

is toward a broad interpretation of what constitutes actionable conduct"—although that opinion is based upon some selective treatment of cases.[23] And while some cases have seemed to grasp the limited role of oppression in the greater constellation of the MBCA,[24] other opinions continue to create more questions than answers. For example, the line between a direct shareholder action and a derivative action was further greyed in the 2011 case of *Berger v. Katz*[25] and its less-than-clear analysis of issues were quickly seized upon by counsel to opine that § 489(3) casts a much broader net than the statutory language would infer and should be read to include general corporate mismanagement that harms the corporation, rather than injuries to rights unique to shareholders.[26]

The status of shareholder litigation generally, as told through the example of Michigan, provides a few ideas for a way forward. Both center on re-tying the oppression remedy back to its roots—statutorily (where applicable) and contextually.

First, the words of the statute must be applied. While one could disagree with the Texas Supreme Court's interpretation of that statute, the Court obviously felt it necessary to address a body of case law that had spread in numerous directions and far from the statute itself since the earlier *Davis* opinion. While legislatures could and sometimes do draft clear statutes, courts need not fabricate claims in the absence of such lawmaking. And even where courts employ common law standards, fuzzy and ill-defined concepts advance neither the cause of the truly injured shareholder nor that of the judicial system.

Second, courts should consider oppression relative to other provisions of corporate law lest the oppression statute completely subsume the co-equal derivative litigation structure. Similarly, the courts must recognize that most states' public policy values both a corporation's right to govern itself free from harassment from minority shareholders besetting the corporation with vexatious litigation as much as protection of minority shareholders against "oppression." In interpreting words like "unfair," this context is meaningful and appropriate. But what has happened, without either published or holistic guidance from the courts, is a free-for-all, where shareholders generically plead oppression and defendants are left without any threshold means to sort out cases that do not meet the statutory standard. That standard is intended to be high, not merely out of consideration of competing policy goals, but to make sure that the minority—which in the first instance is entering in to a corporate environment with known limited rights—does not wield disproportionate power over the corporation via litigation. While some courts have rejected expansive notions such as the "reasonable expectations" rubric, the absence of any other cohesive paradigm has left trial courts with simply letting cases proceed. This inaction is equivalent to taking sides given the time, burden, and expense of shareholder litigation. The statutory scheme, corporate law, and the civil litigation system all deserve more.

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[23] Mantese, Rossman & Williamson, *Shareholder and Corporate Oppression Actions*, 91 Mich B J 25 (2012).
[24] *Arevelo v. Arevelo*, unpublished opinion per curiam of the Court of Appeals, issued April 6, 2010 (Docket Nos. 285548, 286742).
[25] *Berger v. Katz*, unpublished opinion per curiam of the Court of Appeals, issued July 28, 2011 (Docket Nos. 291663, 293880).
[26] Mantese, Rossman, & Williamson, *Shareholder and Corporate Oppression Actions: Fixing Liability Against Those in Control of Closely Held Corporations*, 91 Mich B J 25 (Feb 2012).