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Book Reviews: Oppression of Minority Shareholders

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OPPRESSION OF MINORITY SHAREHOLDERS. By F. Hodge O'Neal.* Callaghan & Company, Chicago, Illinois. 1975. Pp. 647. $42.50. Reviewed by John J. Ghingher, III.†

Because of its uniqueness among the various business forms employed in American commerce, the closely held corporation confronts the corporate attorney with perhaps his most difficult challenge. More like a partnership in the mode of its daily operations, yet clothed with the formality of corporate status to the same extent as public corporations, the close corporation is a hybrid of sorts. In spite of its common usage, it receives a surprisingly small amount of specific attention in the corporate statutes, and many of the solutions and protections offered by those statutes appear ill-suited to its particular needs. As a result, close corporations enjoy little of the legal flexibility inherent in the legislation governing partnerships, but produce problems which cannot be resolved properly by the more formal approaches offered by most corporate statutes.

In *Oppression of Minority Shareholders*, Professor O'Neal has focused once again on the special realities of the close corporation,[1] this time illustrating in exhaustive fashion the plight of those who find themselves holding a minority interest in such a corporation with the majority interests aligned against them. As pointed out in great detail, minority shareholders can be subjected to a number of techniques, unique to the close corporation context, which, when employed by the unfriendly majority, can result in the depletion of the value of the minority interest, a denial of participation in corporate prosperity, and, sometimes, eventual defeat or surrender in the form of a constrained sale of shares at less than their true value. Professor O'Neal's shorthand for the use of these majority weapons is the term "squeeze-out," which he employs to describe not only those actions which are specifically designed to eliminate minority shareholders, but also those oppressive actions which may fall short of complete elimination.

The major theme of this book is the author's conviction that the courts generally have not kept abreast of the times in their consideration of the rights and remedies of minority shareholders. He suggests that the courts' exececssive reliance on the principle of majority control[2] and the business judgment rule[3] has too often

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1. *See* F. O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE (1971).

2. The principle of majority control expresses the judicial rule that the majority of a corporation's shareholders has the right to manage its affairs so long as they operate within the corporation's chartered powers and the provisions of corporate law.

3. The business judgment rule provides that a corporation's directors have full discretion to determine business policy and to conduct the affairs of the corporation.

obscured the legitimate claims of minority shareholders whose interests have suffered at the hands of the majority. The author believes that, by awarding relief only where majority conduct is clearly fraudulent or in bad faith, the courts have neglected to redress situations in which the minority has been dealt with unfairly. He points out that some courts abdicate their equitable responsibilities altogether when majority action triggers the dissenting shareholders' statutory right to have their shares judicially appraised and liquidated.

Professor O'Neal is undoubtedly accurate in his conclusion that the plight of minority shareholders deserves more aggressive judicial attention. He is equally correct when he observes that most corporate statutes do not provide the courts with sufficient guidance and flexibility in dealing with arbitrary majority conduct. However, conflicts between majority and minority shareholders of closely held corporations involve numerous complexities which are not subject to easy judicial or statutory formulae. These complexities are apparent from Professor O'Neal's highly detailed illustration of the diverse origins of squeeze-outs and the myriad squeeze-out techniques employed by majorities, but his less detailed suggestions for ameliorative legislation highlight the true difficulty of reaching any general solution to these complex problems.

The fundamental difficulty in reaching fair judicial or legislative solutions to squeeze-out situations arises primarily in gray areas where the line between the interests of the corporation and those of the minority shareholders is hazy and hard to discern. For example, one squeeze-out technique mentioned by the author is the dismissal of a minority shareholder as an employee of the corporation. Dismissal would certainly be proper if it arose from the minority shareholder's deficiencies as an employee, but dismissal merely to impose financial hardship on that shareholder, perhaps to pave the way for a bargain redemption, should create a cause of action appropriate for judicial remedy. Unfortunately, however, the situations are rarely so clear cut; in most cases, the majority shareholders will be able to assert cogent arguments that the dismissal was in the best interests of the corporation, while the minority shareholder will bring to bear equally believable claims of majority oppression. Subjective questions such as these do not submit readily to objective judicial and legislative standards and do not lend themselves to resolution by sweeping legislative proposals.

Another gray area exists with respect to the technique of withholding dividends, which Professor O'Neal places high on his list of squeeze-out methodology. The author goes so far as to suggest that the enactment of mandatory dividend legislation, permitting minority shareholders to require payment of dividends in the absence of concrete evidence that all earnings must be retained for business purposes, would be supported by "sound policy considerations." There are several basic problems with this proposal which Professor O'Neal fails to note. First, there is no general objective standard by which to measure the amount of working capital required by a small business. Most closely held corporations are under-capitalized initially and suffer from tight cash flows throughout their existences. It is rare that such a corporation will be able to accumulate large cash surpluses for the payment of dividends. Consequently, management in most cases will be able to present persuasive arguments that all earnings must be retained for working capital needs. In addition, a statute mandating payment of dividends would require courts to determine whether excess accumulations should be paid out as dividends, as demanded by minority interests, or used to further expand the corporation's business, as recommended by management. It is the reluctance of the courts to make these difficult subjective judgments that has led them to fall back on the traditional business judgment rule.

Still another problem arises from the income tax implications of a mandatory dividend. The cardinal principle of tax planning for close corporations is that dividends are to be avoided at all costs. Rather than subject corporate earnings to the dreaded two-level tax which results from dividends, most small corporations choose to reward their shareholders in the form of deductible salaries and corporate fringe benefits. Investors who voluntarily participate in such corporations as silent partners normally do so with full awareness that, because of the tax structure, their return on investment will come through appreciation in the value of their stock rather than through a steady stream of dividends. Such investors may even prefer to forego dividends when the applicable corporate and individual income tax brackets would siphon off considerably more than half of each original earnings dollar. Of course, as the author points out, there are many situations in which minority shareholders find themselves as involuntary silent partners, without the employment relationship necessary to produce income from the corporation in tax deductible form. Situations such as this can arise, for example, from the inheritance of stock or from a termination of employment. Even in these situations there may be a substantial question whether the minority shareholder should be permitted to force the majority shareholders to accept double-taxed dividends by exercising his rights under a mandatory dividend statute.

Solutions do not come easily to the subjective problems inherent in disputes between majority and minority shareholders in the close corporation context, and the only real weakness in this book stems from the author's attempts to advocate guidelines for statutory reform in this difficult area. Professor O'Neal has, however, exhaustively explored the various situations that create potential squeeze-outs and the numerous techniques at the disposal of an aggressive majority bent upon eliminating minority shareholders. His illustrations of these situations and techniques are both imaginative and well-documented, and will be of great value to attorneys who are faced with, or hope to avoid, squeeze-out problems. Unfortunately, the organization of the book into short, choppy subsections and the author's extensive footnoting, although helpful from a reference standpoint, make the book less readable and tend to interrupt the continuity of the author's theme.

These deficiencies become less important, however, in light of what this reviewer believes to be the real value of this book, that is, the stimulation of a new awareness among practicing corporate lawyers of the serious implications of majority-minority relationships and the precautions which can be taken to prevent these relationships from deteriorating into squeeze-out situations.