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THE VACUITY OF WILKES

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THE VACUITY OF *WILKES*

BENJAMIN MEANS*

INTRODUCTION

In the United States, corporate governance remains mostly a matter of state law.¹ Accordingly, to understand how a court will resolve a claim of minority shareholder oppression in a closely held corporation, we have to know which state's law applies.² Depending upon where a business has been incorporated, any of fifty different legal regimes will govern the rights and obligations of its shareholders and other stakeholders.³

However, too much attention to differences among states may cause us to lose sight of common themes in shareholder oppression law. As an initial matter, the basic definition of a close corporation is substantially similar across jurisdictions—a limited number of shareholders, an absence of publicly traded shares, and, typically,

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1. See, e.g., William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 668 (1974) (describing competition among states for corporate charters, with Delaware the clear winner). Some scholars have called for increased federal oversight of corporate law rules. See, e.g., Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1499-1508 (1992); see also Richard A. Booth, *The Fall and Rise of Federal Corporation Law*, 2 J. BUS. & TECH. L. 161, 161 (2007) ("It is quite remarkable that corporation law remains the province of the states." (emphasis omitted)).

2. In general, shareholder oppression law "attempts to safeguard the close corporation minority investor from the improper exercise of majority control." Douglas K. Moll, *Shareholder Oppression & Dividend Policy in the Close Corporation*, 60 WASH. & LEE L. REV. 841, 844 (2003) [hereinafter Moll, *Shareholder Oppression & Dividend Policy*].

3. See, e.g., John H. Matheson & R. Kevin Maler, *A Simple Statutory Solution to Minority Oppression in the Closely Held Business*, 91 MINN. L. REV. 657, 700-09 (2007) (surveying the law of all fifty states). As Matheson and Maler observe, "[e]ach state has a unique regime for addressing minority shareholder oppression in closely held businesses—a surprising state of affairs for such an important area of corporate law." *Id.* at 661.

direct shareholder involvement in management.⁴ Minority shareholders in close corporations, unlike their counterparts in public corporations, have little practical ability to exit and to recover the value of their investment.⁵ Consequently, minority shareholders are particularly vulnerable to mistreatment by controlling shareholders.⁶ The problem of shareholder oppression follows from these basic features of the close corporation form.⁷

Not surprisingly, given the shared dimensions of the problem, states have developed similar legal responses that can be grouped into representative categories.⁸ In some states, for instance, oppression is couched in the language of tort law: whether the majority shareholders acted “harshly and wrongfully” toward the minority.⁹ Elsewhere, courts ask whether the minority shareholders have been deprived of the benefit of their contractual bargain.¹⁰ Other courts take a “fiduciary approach” to claims of oppression and insist that shareholders in close corporations are essentially partners who owe each other stronger fiduciary obligations than corporate law would ordinarily require.¹¹

4. See 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, *CLOSE CORPORATIONS AND LLCs: LAW AND PRACTICE* §§ 1:2, 1:9 (rev. 3d ed. 2010).

5. See, e.g., *Nixon v. Blackwell*, 626 A.2d 1366, 1379 (Del. 1993) (noting that “there is no market and no market valuation”); *Donahue v. Rodd Electrotpe 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.”).

6. *Donahue*, 328 N.E.2d at 513 (“The minority is vulnerable to a variety of oppressive devices, termed ‘freezeouts,’ which the majority may employ.”).

7. Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 GEO. L.J. 1207, 1218 (2009) [hereinafter Means, *A Voice-Based Framework*].

8. See, e.g., Douglas K. Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VAND. L. REV. 749, 754 (2000) [hereinafter Moll, *The Unanswered Question of Perspective*] (contending that “majority and minority perspectives” give us a method for sorting state approaches to oppression).

9. See Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. LAW. 699, 711–12 (1993) [hereinafter Thompson, *The Shareholder's Cause of Action for Oppression*] (“Some courts describe *oppression* as ‘burdensome, harsh and wrongful conduct . . . 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.’” (alteration in original) (quoting *Fix v. Fix Material Co.*, 538 S.W.2d 351, 358 (Mo. Ct. App. 1976))).

10. For a narrow version of this contractual approach, see *Nixon v. Blackwell*, 626 A.2d 1366, 1380 (Del. 1993), contending that it is incumbent upon minority shareholders to negotiate for explicit contractual protections and that there is no role for courts to create additional, “special” protections.

11. See *Donahue*, 328 N.E.2d at 515. Although breach of fiduciary duty may also be tortious, this Article contends that much of the animating force of fiduciary duty can be understood in contractual terms. For further discussion of contract law and share-

Yet, broad categories can mislead. Individual state approaches to shareholder oppression have distinct characteristics; even when identical terms are used, they may have different meanings. Fiduciary duty, for instance, is a famously varied concept,¹² and noteworthy differences exist from state to state regarding the scope of the duty, available defenses, and appropriate remedies.¹³ The danger of relying upon analytic categories—a generic “fiduciary approach,” for one—is that we will oversimplify, leaving out important doctrinal details and nuances. If we hope to evaluate shareholder oppression law, we must first understand how courts actually resolve claims of shareholder oppression.

This Symposium offers a welcome corrective to reliance on general categories, inviting us to reflect critically upon the thirty-five-year legacy of a leading Massachusetts case, *Wilkes v. Springside Nursing Home, Inc.*¹⁴ The venerable *Wilkes* decision is ideally suited to serve as a focal point for evaluation of shareholder oppression law.¹⁵ *Wilkes* defines the Massachusetts approach to shareholder oppression, and Massachusetts has had an indelible influence on the development of a robust, fiduciary-based response to

holder oppression, see Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 FORDHAM L. REV. 1161 (2010) [hereinafter Means, *A Contractual Approach*]; see also Douglas K. Moll, *Reasonable Expectations v. Implied-in-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C. L. REV. 989, 1073 (2001) [hereinafter Moll, *Reasonable Expectations v. Implied-in-Fact Contracts*] (“[I]t is fair to assert that oppression law is doing what contract law should be doing if contract law took a broader perspective when identifying and enforcing bargains.”); Robert B. Thompson, *The Law’s Limits on Contracts in a Corporation*, 15 J. CORP. L. 377, 394 (1990) (“A close corporation is like a long-term relational contract in which benefits for all parties necessarily depend on unstated assumptions. A fully contingent contract cannot be drafted, so some *ex post* settling up by courts is used to support these assumptions.” (footnote omitted)).

12. See, e.g., Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 879 (“Fiduciary obligation is one of the most elusive concepts in Anglo-American law.”).

13. Even Delaware, which has refused to recognize “special” protections for minority shareholders in close corporations, places a fiduciary duty on controlling shareholders that requires them to demonstrate the entire fairness of any self-dealing transactions. See STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 822 (2002) (noting that under Delaware law “standard corporate law fiduciary duty principles constrain the conduct of both directors and controlling shareholders”).

14. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976).

15. The Westlaw database reflects, as of October 6, 2010, that *Wilkes* has been cited 776 times. KEYCITE CITING REFERENCES: *Wilkes v. Springside Nursing Home, Inc.*, Westlaw, www.westlaw.com (search for *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 and following the “Citing References” link) (last visited Oct. 6, 2010).

shareholder oppression nationwide.¹⁶ Just as the study of public corporations often begins with Delaware corporate law, Massachusetts law frames the analysis of shareholder oppression in closely held corporations.¹⁷ Even jurisdictions that reject the fiduciary approach to shareholder oppression must engage with it,¹⁸ and *Wilkes* represents the most prominent and most complete statement of the fiduciary approach.

Wilkes was decided only a year after the Massachusetts Supreme Judicial Court first held, in *Donahue v. Rodd Electrottype Co.*,¹⁹ 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.”²⁰ To meet the required standard, according to *Donahue*, shareholders must treat each other with the “utmost good faith and loyalty.”²¹ The *Wilkes* court recognized that *Donahue*’s absolutist formulation, although appealing rhetorically, needs clarification.²²

Unfortunately, *Wilkes* does not deliver the guidance it promises. *Wilkes* instead offers a list of competing considerations. We are told that controlling shareholders “may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders”²³ but that they “concededly, have certain rights to what has been termed ‘selfish ownership’ in the corporation” and that these inconsistent concepts must be “balanced.”²⁴ So far, for better or worse, *Wilkes* provides an ordinary, common law standard through which courts might attempt to rec-

16. See, e.g., *Hollis v. Hill*, 232 F.3d 460, 468-70 (5th Cir. 2000); *G & N Aircraft, Inc. v. Boehm*, 743 N.E.2d 227, 240 (Ind. 2001); *Moore v. Me. Indus. Servs., Inc.*, 645 A.2d 626, 628 (Me. 1994); *Berremans v. West Publ’g Co.*, 615 N.W.2d 362, 370 (Minn. Ct. App. 2000); *Long v. Atl. PBS, Inc.*, 681 A.2d 249, 256 n.8 (R.I. 1996).

17. Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L. Q. 1099, 1099–1101 (1999).

18. *Riblet Prods. Corp. v. Nagy*, 683 A.2d 37, 39 (Del. 1996); *Lerner v. Lerner Corp.*, 750 A.2d 709, 721 (Md. Ct. Spec. App. 2000).

19. *Donahue v. Rodd Electrottype Co. of New England, Inc.*, 328 N.E.2d 505 (Mass. 1975).

20. *Id.* at 515 (footnotes omitted).

21. *Id.*

22. Unless controlling shareholders must run the corporation in the best interests of the minority shareholders, regardless of their own needs and interests, the fiduciary duty of loyalty cannot be one of entire selflessness. See *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976) (expressing “concern[] that untempered application of the strict good faith standard enunciated in *Donahue* . . . will result in the imposition of limitations on legitimate action by the controlling group”).

23. *Id.* at 662.

24. *Id.* at 663.

oncile competing values.²⁵ The court, though, fails to adequately explain the key concepts it identifies.

The court held that controlling shareholders may act in ways that disadvantage minority owners, if the controlling group can show a “legitimate business purpose,” and if the minority cannot establish a less harmful option that would achieve that purpose.²⁶ However, the court neither made clear what counts as “legitimate” nor how close an approximation the minority’s less-harmful option must represent.²⁷ Also, without explaining the relevance of shareholder expectations to its standard, the court observed that adverse action could “frustrate the minority stockholder’s purposes in entering . . . the corporate venture.”²⁸ The court’s two-part balancing test leaves the most important questions unanswered. In short, the *Wilkes* test is vacuous.

And yet, if *Wilkes* has correctly identified the values at stake in a shareholder-oppression case, and if those values really do conflict with each other, what methodology would better reconcile them?²⁹ How would we improve upon *Wilkes*? Unless we can appeal to some overarching principle when the minority’s interests are jeopardized by the pursuit of otherwise legitimate business purposes, we cannot claim that such disputes have a single, correct answer.³⁰ Acceptable reasons could be adduced for any outcome. Still, courts must in the end decide cases, vindicating certain values at the expense of others. The binary structure of legal decision-making requires a result—either the majority has oppressed the minority under the relevant legal standard, or it has not.

25. See, e.g., RICHARD A. COSGROVE, *OUR LADY THE COMMON LAW: AN ANGLICAN LEGAL COMMUNITY, 1870-1930* 39 (1987) (“The common law is not a body of rules; it is a method. It is the creation of law by the inductive process.” (citation and internal quotation marks omitted)).

26. *Wilkes*, 353 N.E.2d at 663.

27. *Id.* (“If called on to settle a dispute, our courts must weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative.”).

28. *Id.*

29. As Professor Larry Ribstein observes, by incorporating the parties in *Wilkes* created “the structural dissonance of a ‘partnership’ in corporate form.” Larry E. Ribstein, *Close Corporation Remedies and the Evolution of the Closely Held Firm*, 33 W. NEW ENG. L. REV. 531 (2011).

30. The difficulty I am describing is by no means unique to shareholder oppression doctrine. See, e.g., Pierre Schlag, *Hiding the Ball*, 71 N.Y.U. L. REV. 1681, 1682 (1996) (identifying conflicting constitutional interpretations and stating that “one could repeat this exercise in the plurality of legal meaning with just about any interesting piece of common or statutory law”).

Given the constraints of the judicial role, *Wilkes* deserves credit for resisting the temptation to simplify shareholder oppression disputes, even if its time-honored legal response—the deployment of a balancing metaphor—leaves too many issues underexplored.³¹ This Article contends that a more developed theory of reasonable expectations would help clarify the *Wilkes* approach by offering an appropriate threshold inquiry. To decide whether a minority shareholder's expectation is reasonable, courts should ask whether there exists a shared understanding among shareholders (even if unwritten and unspoken) that the majority has violated.³² A contractual approach to shareholder oppression, building on *Wilkes*'s acknowledgment of the importance of reasonable shareholder expectations,³³ would advance the task *Wilkes* set for itself: the articulation of a powerful but fair standard for protecting minority shareholders that does not prevent controlling shareholders from pursuing legitimate business purposes.³⁴

This Article proceeds in five parts. Part I argues that *Wilkes* fails to provide a clear standard for assessing claims of shareholder

31. In his contribution to this Symposium, Professor Lyman Johnson notes that *Wilkes*'s approach is consistent with the methodology courts have long used to resolve disputes concerning our most fundamental values. See Lyman Johnson, *Enduring Equity in the Close Corporation*, 33 W. NEW ENG. L. REV. 313 (2011) (“Balancing, of course, is a longstanding mainstay of constitutional law analysis, where competing interests are weighed against each other and the relative strengths of each are assessed.”).

32. In many disputes, asking what the shareholders' actual bargain was will go a long way toward determining whether there has been a breach of fiduciary duty. See, e.g., *Merola v. Exergen Corp.*, 668 N.E.2d 351, 355 (Mass. 1996). However, not all claims of shareholder oppression turn on the nature of the parties' bargain; the majority can abuse its control even as to matters entirely beyond the parties' contemplation. One might still consider what the parties would have bargained for had they considered the issue, but “[h]ypothetical contract is a welfare norm asserted by an academic. It is not a transactional artifact.” William W. Bratton, *The Economic Structure of the Post-Contractual Corporation*, 87 NW. U. L. REV. 180, 192 (1992).

33. *Wilkes*, 353 N.E.2d at 664. Massachusetts courts have increasingly used expectations analysis. See *infra* Part III.C.

34. See *Wilkes*, 353 N.E.2d at 663. Fiduciary duty and contractual norms are (or can be) related concepts. See LARRY E. RIBSTEIN, *THE RISE OF THE UNINCORPORATION* 166 (2010) (“[C]ontrolling shareholders should not have *fiduciary* duties to noncontrolling shareholders [T]he law need only constrain opportunism by holding the controller to its express or implied contractual obligations, including the duty of good faith”); LARRY E. RIBSTEIN & JEFFREY M. LIPSHAW, *UNINCORPORATED BUSINESS ENTITIES* 219 (4th ed. 2009) (“Fiduciary and good faith duties may be difficult to distinguish in practice.”); see also Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J. L. & ECON. 425, 427 (1993) [hereinafter Easterbrook & Fischel, *Contract and Fiduciary Duty*] (“[A] ‘fiduciary’ relation is a contractual one characterized by unusually high costs of specification and monitoring. The duty of loyalty replaces detailed contractual terms”).

oppression. Part II uses the facts of *Donahue* to illustrate *Wilkes*'s indeterminacy. Part III contends that the Massachusetts courts, even with the benefit of more than three decades of experience, have not satisfactorily answered the questions that *Wilkes* left open. Part IV contends that reasonable expectations analysis could give the *Wilkes* test more specific content by encouraging the courts to evaluate the legitimacy of the controlling shareholders' purpose in the context of the parties' actual bargain.³⁵ Part V concludes, however, that not all values at stake in a shareholder oppression claim are contractual. *Wilkes*'s engagement with complexity is a signal contribution.

I. THE ROAD TO *WILKES*

Most jurisdictions protect minority shareholders from oppression,³⁶ notwithstanding the opposition of commentators who fault shareholders who failed to negotiate adequately before investing.³⁷ Some courts use common law doctrines to protect minority shareholders;³⁸ elsewhere, there are specific statutory provisions in the

35. Unlike the you-made-your-bed-now-you-must-lie-in-it approach advocated by some scholars, see, for example, Paula J. Dalley, *The Misguided Doctrine of Stockholder Fiduciary Duties*, 33 *HOFSTRA L. REV.* 175 (2004), this kind of contractual analysis would take account of the parties' ongoing relationship and the necessary incompleteness of any long-term contract. See Means, *A Contractual Approach*, *supra* note 11. At the same time, the analysis would require something more than "the minority's reasonable expectations of benefit from their ownership of shares." *Brodie v. Jordan*, 857 N.E.2d 1076, 1080 (Mass. 2006) (finding liability without inquiring as to whether minority shareholder had any specific expectation with respect to the matter at issue—that the corporation would provide a valuation of its shares at its own expense).

36. Douglas K. Moll, *Minority Oppression and the Limited Liability Company: Learning (or not) from Close Corporation History*, 40 *WAKE FOREST L. REV.* 883, 883 (2005) ("[J]udicial precedents and statutory provisions in many jurisdictions afford some protection to the close corporation minority investor from the improper exercise of majority control."); see also Sandra K. Miller, *Should the Definition of Oppressive Conduct by Majority Shareholders Exclude a Consideration of Ethical Conduct and Business Purpose?*, 97 *DICK. L. REV.* 227 (1993) ("Many states have adopted remedial legislation to address the special needs of the minority shareholder of a closely-held corporation." (footnote omitted)).

37. See, e.g., BAINBRIDGE, *supra* note 13, at 830 ("[P]arties who want liberal dissolution rights may bargain for them . . . before investing."); Edward B. Rock & Michael L. Wachter, *Waiting for the Omelet to Set: Match-Specific Assets and Minority Oppression in Close Corporations*, 24 *J. CORP. L.* 913, 915 (1999) ("[T]he question [is] what, if anything, the courts should do for the minority shareholders in cases where the parties have not provided for the problem by contract. Our basic answer is that courts should not do anything except enforce the participants' contracts and vigorously prevent non pro rata distributions to shareholders." (footnote omitted)).

38. See Matheson & Maler, *supra* note 3, at 662 (noting that "some states have developed relief for minority oppression as a matter of common law jurisprudence").

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corporate code that enable oppressed shareholders to seek dissolution as a remedy.³⁹ At the heart of the Massachusetts common law approach to shareholder oppression is the view that shareholders owe each other a fiduciary duty of loyalty akin to that owed by partners. Part I.A contends that the fiduciary approach, first articulated in *Donahue*, appeared to nullify the majority's ability to make necessary business decisions. Part I.B shows that the court's effort in *Wilkes* to better define the parameters of fiduciary duty was a mixed success, limiting the reach of fiduciary duty at the expense of the doctrine's internal coherence.

A. *The Duty of Utmost Good Faith and Loyalty*

In *Donahue*, the Massachusetts Supreme Judicial Court described the minority shareholder's predicament.⁴⁰ Under basic rules of corporate law, the majority shareholders elect the board of directors.⁴¹ In turn, the directors have the power to decide whether value will be returned to shareholders through dividends and who will be employed by the business.⁴² These powers can be used to freeze out minority shareholders, so that they receive no benefit from their stock ownership.⁴³ Unlike their public corporation

39. *See id.* at 665-69 (describing evolution of the statutory approach to shareholder oppression). Depending on the jurisdiction, the dissolution statute may also give courts the flexibility to award other kinds of equitable relief. *See, e.g.*, N.J. STAT. ANN. 14A:12-7(1)(c) (West 2003) (authorizing equitable remedies short of dissolution).

40. *Donahue v. Rodd Electrotape Co.*, 328 N.E.2d 505, 511 (Mass. 1975). The court held that "a close corporation [is] typified by: (1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management . . . of the corporation." *Id.*

41. DOUGLAS K. MOLL & ROBERT A. RAGAZZO, *THE LAW OF CLOSELY HELD CORPORATIONS* § 3.01, at 3-3 (2009) ("According to [the traditional model of corporate governance], shareholders vote for directors but otherwise have little role in managing the corporation."); *see also* MODEL BUS. CORP. ACT § 2.05 (1984).

42. BAINBRIDGE, *supra* note 13, at 192-94 ("Under all corporation statutes, the board of directors is the key player in the formal decisionmaking structure."); MOLL & RAGAZZO, *supra* note 41, § 7.01[A], at 7-4 ("Traditionally, most corporate power is centralized in the hands of a board of directors."); *see also* MODEL BUS. CORP. ACT § 8.01(b).

43. *Donahue*, 328 N.E.2d at 514. An authoritative study of such "freeze-outs" enumerates some of the possibilities:

"The squeezers [those who employ the freeze-out techniques] may refuse to declare dividends; they may drain off the corporation's earnings in the form of exorbitant salaries and bonuses to the majority shareholder-officers and perhaps to their relatives, or in the form of high rent by the corporation for property leased from majority shareholders . . . ; they may deprive minority shareholders of corporate offices and of employment by the company . . ."

Id. at 513 (alterations in original) (citation omitted) (quoting F.H. O'NEAL & J. DERWIN, *EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES*, 42 (1961)).

counterparts, minority shareholders in close corporations are locked in with no practical ability to exit by selling their shares and investing elsewhere.⁴⁴

The court further reasoned that a close corporation often resembles a partnership⁴⁵ and that the stockholders in a close corporation “‘clothe’ their partnership ‘with the benefits peculiar to a corporation, limited liability, perpetuity and the like.’”⁴⁶ Therefore, to address the problem of shareholder oppression, the court imported partnership concepts into corporate law for the protection of minority shareholders.⁴⁷ While shareholders in corporations do not ordinarily owe one another fiduciary duties, the *Donahue* court held that shareholders in close corporations owe a fiduciary duty of “utmost good faith and loyalty.”⁴⁸

According to the court, the majority shareholders violated their fiduciary duty because they refused to repurchase the shares of a minority shareholder on the same terms made available to a former majority shareholder who wished to retire.⁴⁹ Euphemia Donahue, the plaintiff, was the widow of a former vice president of the corporation and a minority shareholder.⁵⁰ The former majority shareholder had already given the bulk of his stock to his children, and they caused the corporation to repurchase the remaining stock in connection with his resignation as a director.⁵¹ The court held

44. See Rock & Wachter, *supra* note 37, at 916; Thompson, *The Shareholder's Cause of Action for Oppression*, *supra* note 9, at 699 (observing that minority shareholders are “vulnerable in a way that is distinct from the risk faced by investors in public corporations”). In a close corporation, there is no active secondary market for stock, making it more difficult to locate a willing buyer and to ascertain the market value. An outside investor will hesitate to accept a minority position in a corporation owned by strangers, especially if it appears that shareholder relations have broken down. See Paul G. Mahoney, *Trust and Opportunism in Close Corporations*, in CONCENTRATED CORPORATE OWNERSHIP 177, 180 (Randall K. Morck ed., 2000) (observing that a minority shareholder “may sell to a third party, of course, but, if his desire to exit stems from opportunistic behavior by the minority, the purchase price will reflect the behavior and therefore provide neither recompense nor deterrence”).

45. *Donahue*, 328 N.E.2d at 512 (“Just as in a partnership, the relationship among the stockholders must be one of trust, confidence and absolute loyalty if the enterprise is to succeed.”).

46. *Id.* (quoting *In re Surchin v. Approved Bus. Mach. Co.*, 286 N.Y.S.2d 580, 581 (Sup. Ct. 1967)).

47. *Id.* at 515.

48. *Id.* at 515, 518.

49. *Id.* at 520. The corporation had repurchased the shares of a departing stockholder, negotiated in connection with his departure from the business and his transfer of control to his children. *Id.* at 511.

50. *Id.* at 508.

51. *Id.* at 510.

that “if the stockholder whose shares were purchased was a member of the controlling group, the controlling stockholders must cause the corporation to offer each stockholder an equal opportunity to sell a ratable number of his shares to the corporation at an identical price.”⁵²

Under the *Donahue* rule of equal opportunity, it does not matter if the corporation has a good reason for repurchasing only some of its outstanding stock.⁵³ Nor does it matter whether the minority had any bargained-for expectation of selling its stock to the corporation at fair value.⁵⁴ According to one commentator, “*Donahue* used language so broad as to imply that the majority must always subordinate their interests to those of the minority.”⁵⁵

The *Donahue* court distinguished its approach from the “somewhat less stringent standard of fiduciary duty to which directors and stockholders of all corporations must adhere in the discharge of their corporate responsibilities.”⁵⁶ In an effort to describe “[t]he more rigorous duty of partners and participants in a joint adventure,” the court quoted extensively from Justice Cardozo’s famous articulation of fiduciary duty in *Meinhard v. Salmon*:

“Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.”⁵⁷

However, strict fiduciary duties create a dilemma: in a corporation, let alone in a partnership, it is hard to know what “the punctilio of an honor the most sensitive” requires when difficult business decisions must be made.⁵⁸ Without the ability to adapt to unforeseen circumstances, a business cannot survive; without the right to

52. *Id.* at 518.

53. *Id.*

54. *Id.* at 515 (“When the minority stockholder agrees to sell out at less than fair value, the majority has won.”).

55. BAINBRIDGE, *supra* note 13, at 818; *see also* Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1688 (1990) (“The application of strict fiduciary standards to close corporations deprives controlling shareholders of the ability to manage the corporation—to use their own property—as they see fit.”).

56. *Donahue*, 328 N.E.2d at 515-16 (footnote omitted).

57. *Id.* at 516 (quoting *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (alteration in original)).

58. *Id.* (quoting *Meinhard*, 164 N.E. at 546) (internal quotation marks omitted).

benefit from ownership, investors would have no incentive to take a controlling stake in a business venture.

Commentators were quick to identify the vagueness inherent in the *Donahue* approach to fiduciary duty. As the editors of the *Harvard Law Review* noted in a review of recent cases for 1975-1976:

The court's exhortation makes it clear that Massachusetts courts can be expected to supervise more carefully at least some business decisions of close corporations; but which decisions those may be cannot readily be determined because of the abstract nature of the court's announced principle.⁵⁹

The Massachusetts Supreme Judicial Court acknowledged this criticism, and, as discussed in the next section, the court responded in *Wilkes* by more carefully describing its views concerning the nature of fiduciary duty.⁶⁰

B. *The Legitimate Business Purposes of Selfish Owners*

The facts set forth in *Wilkes* are straightforward: four equal shareholders owned and operated a nursing home, all were founding investors, all shared profits equally through salary and divided work responsibilities evenly.⁶¹ After a falling out, three of the shareholders decided to fire the fourth, Wilkes, and to keep the value of the investment for themselves.⁶² No messy family complications were involved, and the court does not mention any offsetting bad behavior on the part of the minority shareholder.⁶³ Further augmenting the aura of disloyalty is the fact that Wilkes

59. *Recent Cases: Corporations—Close Corporations—Stockholders' Duty of "Utmost Good Faith and Loyalty" Requires Controlling Shareholder Selling a Close Corporation its Own Shares to Cause the Corporation to Offer to Purchase a Ratable Number of Shares from Minority—Donahue v. Rodd Electrotype Co.*, 75 Mass. Adv. Sh. 1295, 328 N.E.2d 505 (1975), 89 HARV. L. REV. 423, 428 (1976) [hereinafter *Recent Cases*].

60. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976) ("Therefore, when minority stockholders in a close corporation bring suit against the majority alleging a breach of the strict good faith duty owed to them by the majority, we must carefully analyze the action taken by the controlling stockholders in the individual case."). *Wilkes* does not address the further criticism "that a relationship of 'trust and confidence' does not in fact exist in all corporations that are closely held" and that "imposition of a citizenship concept may be contrary to the intentions of the shareholders." *Recent Cases*, *supra* note 59, at 427-28.

61. *Wilkes*, 353 N.E.2d at 659-60.

62. *Id.* at 661.

63. Indeed, the falling out seems to have involved Wilkes's negotiation of a better deal for the business, limiting a co-owner's ability to self-deal. *See id.* at 660 ("Wilkes was successful in prevailing on the other stockholders of Springside to procure a higher

devised the plan for a nursing-home business, and he brought the other three shareholders on board as investors and participants; they had shut him out of a business that would not have existed without his efforts and creative vision.⁶⁴

Given those facts, the court might have applied *Donahue*'s "utmost good faith and loyalty" test and concluded without much trouble that terminating the employment of the person who founded the business, and who continued to do his part, falls well short of the required standard of utmost loyalty.⁶⁵ Instead, although the court reaffirmed *Donahue*,⁶⁶ it also took the opportunity to clarify the fiduciary duty standard. The court acknowledged a "concern[] that untempered application of the strict good faith standard" might "unduly hamper" the majority's ability to manage the business and stated that "[t]he majority, concededly, have certain rights to what has been termed 'selfish ownership' in the corporation."⁶⁷

Specifically, in order to "temper" the application of good faith, *Wilkes* invented a two-part test that balances the majority's right of selfish ownership "against . . . their fiduciary obligation to the minority."⁶⁸ The *Wilkes* test first asks "whether the controlling group can demonstrate a legitimate business purpose for its action."⁶⁹

sale price for the property than Quinn apparently anticipated paying or desired to pay.").

64. *Id.* at 659. This is a recurring issue for venture capital financing. See Robert Sprague & Karen L. Page, *The Private Securities Litigation Reform Act and the Entrepreneur: Protecting Naive Issuers from Sophisticated Investors*, 8 WYO. L. REV. 167, 167 (2008) ("There is evidence suggesting . . . that in the sphere of new ventures, the balance of power may be tipped in favor of the investors and away from the issuers. Indeed, it is often the case that entrepreneurs, though expert in their substantive field, tend to be naïve in financial and business matters. Investors, particularly venture capitalists, on the other hand, tend to be experienced and knowledgeable in financial matters.").

65. See BAINBRIDGE, *supra* note 13, at 818 ("Under *Donahue*, this is an easy case."). The fact that an individual is a founding shareholder does not guarantee employment, however, particularly where the parties have explicitly contracted for a different arrangement. See M. Todd Henderson, *The Story of Dodge v. Ford Motor Company: Everything Old is New Again*, in CORPORATE LAW STORIES 46 (J. Mark Ramseyer ed., 2009) ("A good product can survive mismanagement precisely because investors have control rights that give them the power to change management, even when the manager is the entrepreneur without whom the company would not even exist.").

66. *Wilkes*, 353 N.E.2d at 661-62.

67. *Id.* at 663.

68. *Id.* (citing Alfred Hill, *The Sale of Controlling Shares*, 70 HARV. L. REV. 986, 1013-15 (1957)).

69. *Id.*

Then, if the majority meets its burden, “it is open to minority stockholders to demonstrate that the same legitimate objective could have been achieved through an alternative course of action less harmful to the minority’s interest.”⁷⁰ The court’s role is to “weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative.”⁷¹

Central to *Wilkes*’s analytic framework is the requirement that controlling shareholders demonstrate a “legitimate business purpose” for challenged conduct that disadvantages minority shareholders.⁷² The *Wilkes* court did not offer a definition but “acknowledge[d] the fact that the controlling group in a close corporation must have some room to maneuver in establishing the business policy of the corporation.”⁷³ As examples, the court mentioned business decisions concerning dividends, salary, and employment.⁷⁴

Applying this standard, the court found that there was no legitimate business purpose for terminating Wilkes and that “[t]he severance of Wilkes from the payroll resulted not from misconduct or neglect of duties, but because of the personal desire of [his fellow shareholders] to prevent him from continuing to receive money from the corporation.”⁷⁵ Because the majority lacked a legitimate business purpose, there was no need to consider alternatives to the minority shareholder’s termination.⁷⁶ Of crucial importance for the court was the fact that the majority’s actions “assured that Wilkes would receive no return at all from the corporation.”⁷⁷ Thus, *Wilkes* set forth a novel approach to evaluating claims of minority shareholder oppression, but it did so in a case involving facts that did not require the court to reach the second step of its own analysis.

Wilkes fails to explain what makes a business purpose legitimate, leaving even the first step’s application uncertain in future cases. For instance, can there be a business purpose for terminating the minority’s employment based on personal or family disagreements? One might interpret *Wilkes* to hold that shareholder per-

70. *Id.*

71. *Id.*

72. *See id.*

73. *Id.*

74. *Id.*

75. *Id.* at 661.

76. *See id.* at 663-64.

77. *Id.* at 664.

sonality conflicts do not warrant adverse actions against a minority shareholder, unless the minority shareholder intends to damage the business through disruptive conduct.⁷⁸ On the other hand, personality disputes can interfere with normal business operations as much as any other conflict; squabbling shareholders can cripple a corporation even if no shareholder desires that result and all shareholders seek only to advance their own view of how best to advance the business.⁷⁹

The remainder of the *Wilkes* test also lacks specific content. Courts are instructed to balance business purposes with alternative courses of action but are given no guidance in identifying reasonable alternatives or in assigning weights to different possible courses of action.⁸⁰ Finally, *Wilkes* included discussion of the parties' expectations⁸¹ but did not formally connect the expectations of shareholders to the two-part test it developed. We know that shareholder expectations may matter, but not when they matter or how.

II. DONAHUE REVISITED

One way to highlight unresolved issues in *Wilkes* is to apply the two-part test to more difficult facts—those of *Donahue*, for instance. Setting aside the fact that *Wilkes* reaffirmed *Donahue*, and thus appeared to endorse *Donahue*'s equal opportunity rule, at least in the context of selective share repurchase arrangements, the *Wilkes* test could be used to argue for a different outcome. Unlike the equal opportunity rule, the *Wilkes* test does not dictate a result.

Under the first step of the *Wilkes* analysis, the controlling shareholders in *Donahue* could have argued that there was a legitimate business purpose for the share repurchase plan—removing a semi-retired member who had the ability to influence corporate policies and to block efforts to build for the future.⁸² Acquiring his

78. *Id.* (“There was no showing of misconduct on Wilkes’s part as a director, officer or employee of the corporation which would lead us to approve the majority action as a legitimate response to the disruptive nature of an undesirable individual bent on injuring or destroying the corporation.”).

79. For conflicting court opinions, see *infra* Part III.A.

80. See *infra* Part III.B.

81. See *Wilkes*, 353 N.E.2d at 662-63.

82. O’NEAL & THOMPSON, *supra* note 4, § 7:3, at 7-16 (“A buyout agreement tied to a shareholder’s retirement or withdrawal from the business can work to insure that the corporation will continue to be owned by those who are actively involved in the business and thereby reduce potential conflict between active and passive shareholders.”).

shares would set the foundation for stable management of the corporation. The problems for corporate governance posed by retired shareholders are well understood, and it is not uncommon for close corporations to have mandatory repurchase agreements in place.⁸³ Some commentators have argued that the majority's stated purpose was legitimate and justified its actions.⁸⁴

On the other hand, the plaintiff, Ms. Donahue, might have responded that arranging special liquidity for an exiting shareholder who was the father of the next generation of managers was more about family loyalty than business justification. Also, if the controlling shareholders owed her a duty of the utmost loyalty, and if the definition of fiduciary duty adopted in *Donahue* and affirmed in *Wilkes* explicitly rejects the sort of arm's length "conduct permissible in a workaday world,"⁸⁵ she might have argued that something more than a mere commercial purpose would be necessary to justify the repurchase of only a majority shareholder's stock. Arguments along these lines expose a conflict between the values of efficient governance and shareholder loyalty. *Wilkes* recognizes the importance of both values, but does not explain how they are to be reconciled in determining whether the majority has established a legitimate business purpose for its actions.

Nor is it clear how the second step of the *Wilkes* analysis would apply to *Donahue*. On what basis do we decide whether a less harmful alternative is reasonably available? One can imagine many approaches to this problem.⁸⁶ Perhaps the issue is whether buying out all shareholders who wished to tender their shares would cause the corporation to go bankrupt or to lose out on important business

83. 2 F. HODGE O'NEAL & ROBERT B. THOMPSON, *OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS* § 6:11, at 6-35 (rev. 2d ed. 2005) ("Restrictions are commonly placed on the transferability of stock in close corporations . . . and are often accompanied by buyback agreements permitting or requiring the purchaser of a shareholder's stock triggered by . . . retirement. . . ."); Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 *STAN. L. REV.* 271, 294 (1986) ("Buy-out arrangements on contingencies such as retirement are common in closely held corporations.").

84. See Easterbrook & Fischel, *supra* note 83, at 295 ("The purchase appears to have been nothing more than an attempt to facilitate the retirement of a manager who, by virtue of advancing age and poor health, could no longer contribute.").

85. *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 516 (Mass. 1975) (quoting *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928)).

86. See, e.g., Moll, *The Unanswered Question of Perspective*, *supra* note 8, at 773 (noting that the import of the *Wilkes* test "depends upon what the courts will consider a less harmful alternative" and that a cost-insensitive approach would be very different than one that required the alternative to be "equally feasible and cost-effective to the corporation").

opportunities; or maybe a less serious but still significant economic difficulty would suffice.⁸⁷ Even if the standard were clear, a court would have to inform itself about the corporation's financial position and its future prospects in order to evaluate the appropriateness of a complex business judgment.

In sum, although *Wilkes* explicitly affirms *Donahue*, its own analytic framework would seem to permit a finding for either the plaintiff or the defendants.⁸⁸ Certainly, the defendants could have made facially plausible arguments that the share repurchase was supported by a valid business purpose and that the alternative of repurchasing everyone's shares was not reasonably practicable. *Wilkes* holds that legitimate business interests must be balanced with reasonably available alternatives,⁸⁹ but it does not say how these concepts are to be identified or how the balancing should be performed.

III. THE AFTERMATH OF *WILKES*

Despite its reworking of *Donahue*'s vague fiduciary command, *Wilkes* has itself engendered uncertainty, and the Supreme Judicial Court's more recent decisions have not resolved fundamental questions of interpretation. To be clear, this is not a criticism of the outcome in any particular case. Nor do I mean to insist upon a standard that can be applied mechanically. In a common law system it is not unusual for courts to consider all relevant facts and to allow the legal principles to reveal themselves over time, as when a sculptor carves away everything that does not belong in the finished image.⁹⁰ Rather, the question is whether Massachusetts's approach to shareholder oppression law satisfies the requirement that law

87. Notably, the majority shareholders did inform Ms. Donahue "that the corporation would not purchase the shares and was not in a financial position to do so." *Donahue*, 328 N.E.2d at 511.

88. Indeed, we have not even touched upon the variety of arguments that might be made about the shareholders' expectations, since the *Wilkes* test does not formally include expectations analysis.

89. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976).

90. See, e.g., Wayne R. Barnes, *Contemplating a Civil Law Paradigm for a Future International Commercial Code*, 65 LA. L. REV. 677, 692 (2005) ("The common law system has been described as the process of applying rules derived from case precedents, to new factual situations, all for the purpose of producing uniform, consistent, and certain results." (citing ARTHUR R. HOGUE, *ORIGINS OF THE COMMON LAW* 245 (1966))).

“be intelligible to law enforcers and law subjects and that justifications be public.”⁹¹ Put more simply, what does *Wilkes* mean?

A satisfactory interpretation would need to resolve three difficulties: the absence of a clear standard for identifying a legitimate business purpose; the absence of any standard for evaluating less-harmful alternatives; and, more recently, varying approaches to reasonable expectations analysis.

A. *What is a Legitimate Business Purpose?*

Under the *Wilkes* standard, majority shareholders might assume that they have the ability to fire a manager for poor performance, even if the manager also owns shares in the corporation. The right of selfish ownership, if it is to have substance, necessarily includes latitude to take reasonable steps to protect the value of the majority’s investment in the corporation. Yet, *Wilkes*’s acknowledgment that the majority “must have some room to maneuver”⁹² does not indicate whether a minority shareholder can be terminated for poor performance, even in an at-will employment jurisdiction. After all, as the court noted in *Wilkes*, permitting the majority to terminate a shareholder employee may “effectively frustrate the minority stockholder’s purposes in entering on the corporate venture and also deny him an equal return on his investment.”⁹³

Taking a narrow view, the Supreme Judicial Court held in *Pointer v. Castellani* that it was a breach of fiduciary duty to remove the president of a corporation, even though he had twice violated the terms of a loan covenant with the corporation’s principal lender, thereby exposing the corporation to the risk of bankruptcy, and notwithstanding the fact that the other shareholders had lost faith in his ability to manage the business on a profitable basis.⁹⁴ On one occasion, the president had caused another business he co-owned to lend money to the corporation at very high interest rates.⁹⁵ Moreover, he had failed to disclose information about side

91. Kenneth W. Simons, *Justification in Private Law*, 81 CORNELL L. REV. 698, 741 (1996) (reviewing ERNEST J. WEINRIB, *THE IDEA OF PRIVATE LAW* (1995)). To avoid the problem of indeterminacy, it is not necessary to enable a court to “mechanically derive detailed norms from more general ones. Still, one would expect a justifying theory of law to give considerable guidance.” *Id.* at 739.

92. *Wilkes*, 353 N.E.2d at 663.

93. *Id.* at 662-63.

94. *Pointer v. Castellani*, 918 N.E.2d 805, 813-14 (Mass. 2009). Although the case involved an LLC, Massachusetts does not appear to distinguish between LLCs and close corporations for purposes of shareholder oppression analysis. *Id.* at 815.

95. *Id.* at 813.

real-estate ventures before recommending that the corporation sell its property to his other venture at what turned out to be a low value.⁹⁶

To be sure, there was another side to the story in *Pointer*. The plaintiff had plausible explanations for all the actions that led to his removal. For instance, the parties had agreed that they had the right to conduct competing business and, as the lower court found, “no one . . . other than [plaintiff] had any interest in real estate development.”⁹⁷ But the question relevant to step one of the *Wilkes* analysis is not whether the majority’s actions were indisputably correct, or whether some course of action less harmful to the minority’s interests might have been pursued, but whether the majority shareholders could articulate a legitimate business purpose for the challenged conduct.⁹⁸ The majority shareholders wanted to put a manager in place that they trusted, yet the court found that this violated their fiduciary duty to the minority shareholder.⁹⁹

By contrast, in *Holland v. Burke*, a Massachusetts Superior Court Judge recently held that, notwithstanding a minority shareholder’s “expectation that he would continue to participate in corporate decisions,” there was “credible evidence [that] established a breakdown over time of the relationship between [plaintiff] on the one hand and the other three shareholders with respect to the day-to-day operations of the two inns and the long-term goal of the venture.”¹⁰⁰ Although there was no showing that plaintiff was unwilling to perform his job,¹⁰¹ or that he intended to damage the business in any way, a personality conflict with the other shareholders warranted his removal.¹⁰²

96. *Id.* at 811-12.

97. *Id.* at 818.

98. *Wilkes*, 353 N.E.2d at 663.

99. *Pointer*, 918 N.E.2d at 816-17; *see also* *Leslie v. Boston Software Collaborative, Inc.*, No. 010268BLS, 2002 WL 532605, at *8 (Mass. Super. Ct. Feb. 12, 2002) (holding that although plaintiff “was hardly a model employee” his termination was not justified because, “as a founder and a nearly one-third minority shareholder, he was entitled to the utmost good faith and fair dealing”). The plaintiff in *Leslie* had been known to carry a licensed firearm to the office and his termination followed an e-mail message interpreted by the defendants as a threat of violence. *Id.* at *4 (referencing e-mail message describing plaintiff’s wife’s statement that “[s]he reserves the right to shoot Bob and (or) Mark at a moments [sic] notice or at a minimum to severely injure them for what they are putting her through” (second alteration in original)).

100. *Holland v. Burke*, No. BACV2005-00122A, 2008 WL 4959050 (Mass. Super. Ct. June 18, 2008).

101. *Id.* The court observed that the plaintiff “was an articulate and principled individual who had a different philosophy on how a business should be run.” *Id.*

102. *Id.*

The *Holland* court distinguished *Wilkes*, stating that the majority's primary goal did not appear to be "to prevent [plaintiff] from continuing to receive money from the corporations."¹⁰³ However, there were also striking similarities. First, the alleged freeze-out in both cases occurred after the plaintiff had proposed that the other shareholders buy out his interest in the business.¹⁰⁴ Second, in *Holland* and *Wilkes*, the termination of the plaintiff's employment meant that he received no value going forward for his "25% interest."¹⁰⁵ Third, the dispute in both cases had to do as much with clashing personalities as with any disagreement regarding business objectives.¹⁰⁶ The court in *Wilkes* emphasized that "[t]here was no showing of misconduct on Wilkes's part as a director, officer or employee of the corporation which would lead us to approve the majority action as a legitimate response to the disruptive nature of an undesirable individual bent on injuring or destroying the corporation."¹⁰⁷ Likewise, the record in *Holland* did not suggest any improper motive or conduct on the part of the plaintiff.¹⁰⁸

In both *Pointer* and *Holland*, then, one could as easily use the *Wilkes* analysis to support the opposite result. The legitimacy of a business purpose depends upon the court's judgment, and, as these cases suggest, that judgment may vary substantially from case to case. The central problem is not factual ambiguity, but rather the

103. *Id.*

104. *Id.* ("Holland proposed that he would surrender all of his shares for a total price of \$750,000."); *cf.* *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 660-61 (Mass. 1976) ("Wilkes . . . gave notice of his intention to sell his shares for an amount based on an appraisal of their value.").

105. *Holland*, 2008 WL 4959050 ("None of the entities has ever declared dividends."); *Wilkes*, 353 N.E.2d at 664 ("Most important is the plain fact that the cutting off of Wilkes's salary, together with the fact that the corporation never declared a dividend . . . assured that Wilkes would receive no return at all from the corporation." (internal citation omitted)).

106. *Holland*, 2008 WL 4959050 (identifying as "a legitimate business purpose for removing Holland as a director and officer . . . credible evidence [that] established a breakdown over time of the relationship between Holland on the one hand and the other three shareholders with respect to the day-to-day operations of the two inns and the long-term goal of the venture"); *Wilkes*, 353 N.E.2d at 661 ("Despite a continuing deterioration in his personal relationship with his associates, Wilkes had consistently endeavored to carry on his responsibilities to the corporation in the same satisfactory manner and with the same degree of competence he had previously shown.").

107. *Wilkes*, 353 N.E.2d at 664.

108. *Holland*, 2008 WL 4959050. If anything, the dispute arose as a result of alleged mismanagement on the part of the other shareholders. *See id.* ("He was at odds with the other shareholders with respect to [their] company sponsored trips to Mexico, inattention and accountability issues, and a general distaste for the others' collective approach to running a business.").

legal standard's indeterminacy. According to *Wilkes*, legitimacy involves the perceived needs of the business, the selfish ownership rights of the majority, and the duty of utmost loyalty, which is sometimes described expansively as a principle of equal return on investment. Not all of these interests can be vindicated at the same time in every case.

B. *What Alternatives Must the Majority Consider?*

Even if courts could satisfactorily define the parameters of a legitimate business purpose, *Wilkes* charges them with the additional task of evaluating the suitability of alternative courses of action.¹⁰⁹ The *Wilkes* court left open whether cost is no object, of some import, or whether an alternative must be "equally feasible and cost-effective to the corporation."¹¹⁰ Further complicating matters, *Wilkes* separated the threshold business purpose analysis from the identification of alternatives, even though the two analyses intertwine.¹¹¹ It is hard to decide in a vacuum whether a business decision was legitimate, and alternative choices may inform our understanding of the majority's actual decision. Obviously, if an equally affordable and effective means of achieving the majority's stated purpose is eschewed in favor of a course of action that causes harm to the minority, that foregone option is strong circumstantial evidence that the majority intended to harm the minority or was indifferent to the prospect.

However, there are countless alternatives that might be posited in hindsight to any particular business decision. In many cases, a suggested alternative will involve additional expense for the corporation,¹¹² and it will be unclear whether the alternative would have successfully accomplished the business purpose. The business judgment rule, which insulates most corporate decisions from shareholder challenge, recognizes that this kind of second-guessing invites litigation and reduces the value of the corporate enterprise

109. *Wilkes*, 353 N.E.2d at 663. This difficulty will be felt, not only by courts, but also by well-intentioned majority shareholders seeking to manage their businesses without oppressing minority shareholders in violation of Massachusetts law.

110. Moll, *The Unanswered Question of Perspective*, *supra* note 8, at 773.

111. *Wilkes*, 353 N.E.2d at 663. Under the *Wilkes* test, defendants bear the burden of showing a legitimate business purpose; then, and only then, does plaintiff have the burden of showing reasonably practicable alternatives. *Id.*

112. See Moll, *The Unanswered Question of Perspective*, *supra* note 8, at 774 (discussing hypothetical situation where minority shareholder challenges withholding of dividends by pointing out that immediate business needs could have been satisfied by borrowing money).

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for all investors; timid, risk-averse management is in no one's best interest.¹¹³ Although the business judgment rule has limited applicability to shareholder disputes in close corporations, given the myriad ways that controlling shareholders can line their own pockets at the expense of minority shareholders,¹¹⁴ the alternative to deference need not be the interposition of courts as after-the-fact business managers.

A recent Massachusetts Superior Court case illustrates the problem. In *O'Connor v. United States Art Co.*, the minority shareholder was "charged with poor bookkeeping practices that left receivables unaccounted for and payables outstanding" and he was terminated.¹¹⁵ Even assuming that "these sloppy practices" had been established, the court found that "[t]here clearly were less harmful alternatives to firing" the plaintiff and described those alternatives as follows:

For example, [the corporation's] controlling group could have . . . hired a competent bookkeeper and made [the minority shareholder] vice president of marketing, with an adjustment in compensation to a modified salary-plus-commission based compensation. Or the company treasurer, who from day one always was [the majority shareholder], could have acted in a treasurer's function, not simply as a title holder. Or the stockholders could have called a real meeting and discussed among the four of them ways and means to correct the bookkeeping issues and still preserve a role for [plaintiff] in the international sales aspects of the business, in which no one said his skills were lacking. Indeed, there are, this Court is confident, numerous other rational busi-

113. See Stephen M. BAINBRIDGE, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 787 (2006) (contending that the business judgment rule "is precisely the rule for which shareholders would bargain because they would conclude that the systemic costs of judicial review exceed the benefits of punishing director misfeasance and malfeasance").

114. Controlling shareholders have a conflict of interest with respect to decisions—including salaries paid to themselves as employees of the corporation, or director's fees they collect, or other transactions they may cause the corporation to engage in—that benefit themselves individually. In the fiduciary language of corporate governance, these kinds of decisions implicate the duty of loyalty. Stephen M. BAINBRIDGE, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 580 N.162 (2003) ("Preventing directors from pursuing their self-interest, of course, is the reason corporate law contains a duty of loyalty.").

115. *O'Connor v. U.S. Art Co.*, No. 031728BLS, 2005 WL 1812512, at *9 (Mass. Super. Ct. June 27, 2005), *aff'd* 66 Mass. App. Ct. 1118 (2006).

ness means for solving the bookkeeping issues short of firing [the minority shareholder] and shutting down the business.¹¹⁶

When courts speculate about alternative choices, and how those choices would have worked out, while conceding that the majority's actual choice advanced a legitimate business purpose, we have more than a departure from the business judgment rule—there is a total obliteration of the concept.¹¹⁷ It is one thing to recognize a duty of loyalty issue and to require the majority to defend the entire fairness of a particular decision; it is another to decide liability based upon a universe of other possibilities that, viewed after the fact, might also have advanced the majority's purpose.¹¹⁸

C. *What is the Role of Reasonable Expectations?*

Further complicating the application of the *Wilkes* standard is the court's observation that firing a shareholder employee or "severing him from a position as an officer or director" might "frustrate the minority stockholder's purposes in entering . . . the corporate venture."¹¹⁹ Although *Wilkes* indicates that shareholder expectations are relevant, the court does not make reasonable expectations a formal part of its two-part shareholder oppression analysis.¹²⁰ The Supreme Judicial Court has suggested recently that reasonable expectations analysis is, in fact, a separate inquiry: "A breach of

116. *Id.* My critique here concerns the undefined nature of the *Wilkes* analysis, not the court's judgment in this case concerning a situation where the parties' negotiations through counsel toward an amicable separation ended abruptly when the majority shareholder decided instead to use its control to terminate the minority's involvement in the business. *See id.* For a more questionable result, see *Leslie v. Boston Software Collaborative, Inc.*, No. 010268BLS, 2002 WL 532605, at *8 (Mass. Super. Ct. Feb. 12, 2002), in which the court found that less harmful alternatives for dealing with a shareholder who had alienated coworkers and clients, and who arguably had threatened violence, included modifying his job description "such that he could have been insulated from direct contact with . . . employees" and helping plaintiff "becom[e] more extensively involved in off-site, time-and-materials billing projects."

117. *See* BAINBRIDGE, *supra* note 13, at 242 ("[T]he business judgment rule says that courts must defer to the board of director's judgment absent highly unusual exceptions.").

118. In this issue, Professor Kleinberger defends the value of *Wilkes*'s second step, because it gives courts the ability to analyze claims of oppression in situations where neither party is without fault. *See* Daniel Kleinberger, *Donahue's Fils Aîné: Reflections on Wilkes and the Legitimate Rights of Selfish Ownership*, 33 W. NEW ENG. L. REV. 405 (2011) ("*Wilkes* is most important when both sides can justifiably point fingers at each other.") However, this judicial flexibility comes at the cost of considerable uncertainty in the legal standard.

119. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 662-63 (Mass. 1976).

120. *Id.* at 663-64.

fiduciary duty through a freeze-out *also* occurs when the reasonable expectations of a shareholder are frustrated.”¹²¹

If reasonable expectations analysis matters but is not actually part of the *Wilkes* test, then what happens if the reasonable expectations analysis and the *Wilkes* analysis point in different directions? In general, Massachusetts courts seem to require that a plaintiff establish oppression under both theories.¹²² Accordingly, after a minority shareholder uses the reasonable expectations theory to allege “a breach of fiduciary duty, the court must allow the controlling group to demonstrate a ‘legitimate business purpose for its action.’”¹²³ However, if the plaintiff cannot establish a reasonable expectation, then the court will find for the defendant. As a practical matter, reasonable expectations may have become a dispositive, threshold analysis. Thus, it is important to know what counts as a reasonable expectation.

In some cases, the Massachusetts courts have relied upon a careful assessment of the parties’ actual, bargained-for expectations.¹²⁴ For example, in *Merola v. Exergen Corp.*,¹²⁵ the Supreme Judicial Court used reasonable expectations analysis to preclude liability even though the plaintiff might have had a colorable argument for breach of duty under the *Wilkes* standard.¹²⁶ The court held that the majority shareholder had not violated a fiduciary duty by firing the minority shareholder.¹²⁷ Rather than apply the *Wilkes*

121. *Pointer v. Castellani*, 918 N.E.2d 805, 816 (Mass. 2009) (emphasis added).

122. *See, e.g., Murphy v. Grey*, No. 051951B, 2007 WL 3014730, at *6 (Mass. Super. Ct. Sept. 7, 2007) (“There can be little doubt that being terminated from the corporation of which he was a co-owner and co-founder would frustrate Murphy’s expectations of the benefits of ownership. However, to establish that the defendants are liable Murphy must show that the defendants acted improperly in some way—i.e., they did not have any legitimate business purpose—when they terminated him.”). One court reviewed plaintiff’s claim under both theories, without deciding which analysis controls, simply because it could not be sure what Massachusetts law requires. *See Keating v. Keating*, Nos. 00749, 00748 2003 WL 23213143, at *15 (Mass. Super. Ct. Oct. 3, 2003) (“In the wake of the Supreme Judicial Court’s decision in *Merola*, the proper analytical framework for this Court to employ in passing on the merits of [the] freeze-out claim is not entirely clear.”).

123. *Pointer*, 918 N.E.2d at 816.

124. *See, e.g., Merola v. Exergen Corp.*, 668 N.E.2d 351, 354 (Mass. 1996); *Holland v. Burke*, No. BACV200500122A, 2008 WL 4514664, at *7 (Mass. Super Ct. June 18, 2008) (holding that plaintiff had not “established that he had a reasonable expectation of continued employment . . . , that a guaranty of employment was a major reason for his investment of capital, or that he was relying on employment by the LLC and two corporations for his livelihood”).

125. *Merola*, 668 N.E.2d at 354.

126. *Id.* at 354.

127. *Id.* at 354-55.

test, the court focused instead upon the minority shareholder's lack of a reasonable expectation of employment.¹²⁸ The court acknowledged that the principle of employment at will may conflict with a majority shareholder's "fiduciary duty to the minority interest."¹²⁹ To the extent the majority is obligated to demonstrate a legitimate business purpose for conduct that disadvantages a minority shareholder, it would seem to follow that the employment-at-will doctrine is limited when an employee is a minority shareholder.

Yet, the court declined to apply *Wilkes* in this fashion and instead distinguished *Wilkes* on its facts.¹³⁰ Whereas the plaintiff shareholder in *Wilkes* depended "on his salary as the principal return on his investment,"¹³¹ the court found that "there was no evidence that the corporation distributed all profits to shareholders in the form of salaries."¹³² More significant, the court concluded that the plaintiff's stock ownership was separate from his employment status:

Here, although the plaintiff invested in the stock of Exergen with the reasonable expectation of continued employment, there was no general policy regarding stock ownership and employment, and there was no evidence that any other stockholders had expectations of continuing employment because they purchased stock. The investment in the stock was an investment in the equity of the corporation which was not tied to employment in any formal way. The plaintiff . . . testified that he was induced to work for Exergen with the promise that he could become a major stockholder. There was no testimony that he was ever required to buy stock as a condition of employment.¹³³

The court relied upon *Wilkes*'s statement that the majority "must have some room to maneuver in establishing the business policy of the corporation,"¹³⁴ and upheld the employment action even though "there was no legitimate business purpose for the termination of the plaintiff."¹³⁵ The court gave significant weight to

128. *Id.* The lower court had adopted the jury's finding that "there was no legitimate business purpose for not continuing the plaintiff's employment." *Id.* at 353.

129. *Id.* at 354.

130. *Id.*

131. *Id.* (quoting *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 662 (Mass. 1976)).

132. *Id.*

133. *Id.*

134. *Id.* at 355 (quoting *Wilkes*, 353 N.E.2d at 663).

135. *Id.* In other words, the defendant could not satisfy step one of the *Wilkes* test.

the fact that “[t]he plaintiff was terminated in accordance with his employment contract and fairly compensated for his stock.”¹³⁶

In other cases, the Supreme Judicial Court has taken a more expansive view of reasonable expectations, highlighting the minority’s general expectation of benefit from share ownership rather than a specific, bargained-for expectation. For example, in *Brodie v. Jordan*,¹³⁷ the plaintiff complained that the majority shareholders excluded her from participation and hindered her ability to sell her shares, in part by refusing to perform a valuation of the corporation that might have facilitated a sale of her stock to an outside party.¹³⁸ The Massachusetts Supreme Judicial Court affirmed the lower court’s judgment of liability and concluded that the court “properly analyzed the defendants’ liability in terms of the plaintiff’s reasonable expectations of benefit.”¹³⁹ The court did not consider whether the plaintiff had a reasonable expectation that the corporation

136. *Id.* If *Merola* has a flaw, it is that the court appears to give total priority to the absence of shareholder expectations, even where the defendants lack a business justification for their actions. As an initial matter, the *Merola* court’s refusal to give any weight to the lack of business justification could confuse lower courts into believing that the Supreme Judicial Court intended to remove whatever constraints *Wilkes* imposes on judicial discretion. See *Keating v. Keating*, Nos. 00749, 00748, 2003 WL 23213143, at *15 (Mass. Super. Ct. Oct. 3, 2003) (“In *Merola v. Exergen, Corp.*, the Supreme Judicial Court seemed to eschew the *Wilkes* ‘legitimate business purpose’ test in favor of an inquiry based more on fairness and equity.”). Also, regardless of the parties’ actual expectations, the lack of a legitimate business purpose can evidence oppressive conduct. See *supra* Part I.B. This is particularly true since trust is what makes closely held businesses possible, and, with no ability to specify all important contractual terms in advance, the minority is exposed to the majority’s opportunistic self-dealing. In other words, the fact that the minority shareholders never thought about a particular issue does not mean that they consented to the majority’s exploitation of its power to their disadvantage.

137. *Brodie v. Jordan*, 857 N.E.2d 1076, 1080 (Mass. 2006).

138. See *id.* at 1078-79 (“[T]he plaintiff asked [defendants] to perform a valuation of the company so that she could ascertain the value of her shares, but such a valuation was never performed.”).

139. *Id.* at 1080. In remanding the case, the court stated that the award of a buyout was not appropriate because “it placed the plaintiff in a significantly *better* position than she would have enjoyed absent the wrongdoing, and well exceeded her reasonable expectations of benefit from her shares.” *Id.* at 1081. Although the *Brodie* court held that reasonable expectations “analysis is useful at both the liability and remedy stages of freeze-out litigation,” *id.* at 1080, it appeared to assess those two kinds of expectations differently. For purposes of liability, what mattered was the plaintiff’s general expectation that she would benefit from owning stock. *Id.* In awarding a remedy, though, the court observed that there was “nothing in the background law, the governing rules of this particular close corporation, or any other circumstance that could have given the plaintiff a reasonable expectation of having her shares bought out.” *Id.* at 1081. Thus, the court studied the parties’ actual bargain to limit the remedy but not to decide liability. *Id.*

would, at its own expense, perform a valuation simply to allow her to sell her shares. Indeed, absent some explicitly bargained for provision, it is hard to see why a shareholder would expect the corporation to undertake such an expense.¹⁴⁰

In sum, a defendant's ability to avoid liability under reasonable expectations analysis may depend upon whether the court chooses to enforce the minority's general expectation that it will benefit from its stock ownership, regardless of the specific circumstances, or whether the court instead seeks to ascertain whether the parties' actual bargain governs the matter at issue. In particular, a focus on the parties' specific bargain will constrain the minority's ability to recover if the minority had no specific expectation one way or the other with respect to the matter at issue.¹⁴¹

As discussed in the next Part, reasonable expectations analysis has great promise for improving the fiduciary approach to claims of shareholder oppression. By assessing the parties' understood bargain, courts can prevent majority shareholders from opportunistically abusing their control to deprive minority shareholders of the reasonable expectations that motivated their investment. Also, consideration of the parties' bargain—interpreted broadly to encompass the overall structure of their relationship—would limit the minority's ability to use litigation to rewrite the terms of the deal in its own favor. Greater reliance on shareholder expectations analysis would advance *Wilkes*'s goal of providing a measured structure for fiduciary analysis, balancing the majority's right to pursue legitimate business purposes with a strong duty of loyalty owed to vulnerable minority shareholders.¹⁴²

IV. PROTECTING THE PARTIES' BARGAIN

Despite *Wilkes*'s flaws, the Massachusetts Supreme Judicial Court is not likely to abandon the signature fiduciary approach to

140. Put in terms of the *Wilkes* test, there would appear to be a legitimate business purpose for declining to perform a valuation exercise solely for the benefit of a minority stockholder.

141. Conversely, if the parties have an actual bargain with respect to a particular issue, such as minority employment, the majority cannot contravene that understanding simply by citing a legitimate business purpose. For instance, even if it would be cheaper for the business to replace the minority shareholder with an employee willing to work for lower wages, those cost savings would not ordinarily justify the termination of the minority shareholder's employment.

142. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976) (stating that "courts must weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative").

shareholder oppression it has developed over the last thirty-five years; fortunately, no radical change is needed. *Wilkes* contains the DNA for a more bargain-focused approach to oppression because it highlights the problem that majority exclusion of the minority may “effectively frustrate the minority stockholder’s purposes in entering on the corporate venture.”¹⁴³ In more recent cases, like *Merola*, the court has used reasonable expectations analysis to identify and enforce the parties’ actual bargain.¹⁴⁴

By situating shareholder oppression analysis within the context of the parties’ contractual relationship, the reasonable expectations inquiry would help Massachusetts courts apply a more tempered version of fiduciary duty—consistent with *Wilkes*’s purpose—without resting liability judgments entirely on a see-saw between two under-defined concepts: legitimate business purpose and reasonable alternatives. Minority shareholder protection can be understood as an extension of contract theory, providing a constraint against opportunistic action by the majority that violates the parties’ reasonable expectations in entering into a long-term relationship.¹⁴⁵

Under *Wilkes*, the key question is whether the majority has a legitimate business purpose, but it should also matter whether the majority has acted in accord with the parties’ basic agreement—both to prevent the minority from claiming an entitlement to benefits it bargained away and to prevent the majority from violating mutually understood expectations in the name of business expedience. Thus, contract theory helps explain what makes an expectation “reasonable,” and reasonable expectations analysis can establish a boundary for fiduciary duty.¹⁴⁶

143. *Wilkes*, 353 N.E.2d at 663.

144. *Merola v. Exergen Corp.*, 668 N.E.2d 351, 354-55 (Mass. 1996).

145. Close corporations are quintessential relational contracts. The founding shareholders negotiate a long-term, open-ended relationship with each other for the general purpose of operating a profitable business. See Douglas K. Moll, *Shareholder Oppression & Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes*, 86 MINN. L. REV. 717, 756 (2002) (“[T]he investment bargains entered into by close corporation shareholders reflect the characteristics of relational contracts.”).

146. On some accounts, this version of reasonable expectations analysis may differ from a true fiduciary approach. See, e.g., LARRY E. RIBSTEIN, *THE RISE OF THE UNINCORPORATION* 166 (2010) (“[C]ontrolling shareholders should not have *fiduciary* duties to noncontrolling shareholders. . . . [T]he law need only constrain opportunism by holding the controller to its express or implied contractual obligations, including the duty of good faith . . .”). However, at least in Massachusetts, bargain analysis has become increasingly central to defining the shareholders’ fiduciary duty: *Wilkes* identi-

A. *The Contractual Approach*

Through the rubric of objectively reasonable expectations, courts can account for the interests of all shareholders. Accordingly, the parties' fiduciary duties to one another should be understood in context; they have chosen to enter a business venture and have voluntarily undertaken certain obligations. By its nature, a long-term agreement to own and operate a corporate venture cannot be fully specified in advance.¹⁴⁷ When the intention is to establish a relationship more than a discrete bargain, this open texture is, in fact, part of the agreement.¹⁴⁸ Through the mechanism of majority control, provided as part of the default rules of corporate law, the corporation retains the ability to adapt.¹⁴⁹ However, should the majority take opportunistic advantage of its control to exclude the minority from the value of the corporation—conduct that the minority would never have agreed to at a hypothetical bargaining table and that lies far outside the parties' objectively reasonable expectations at the time of investment—the majority would act in contravention of the equitable duty of good faith and fair dealing implied as a term in every contract.¹⁵⁰

Shareholder oppression law, therefore, involves the enforcement of the parties' reasonable expectations. Actions that violate the reasonable expectations of the parties will also breach the implied covenant of good faith and fair dealing implied in every contract.¹⁵¹ The enforcement of expectations is not limited to a narrow interpretation of the parties' literal contract. Rather, courts should identify and enforce the parties' central understanding, their bargain, even assuming the bargain is unwritten and would not be defi-

fied the importance of shareholder expectations and subsequent Massachusetts cases have focused upon the parties' actual bargain in assessing those expectations. *See supra* Parts I.B, III.A-C.

147. *See* Charles R. O'Kelley, Jr., *Filling Gaps in the Close Corporation Contract: A Transaction Cost Analysis*, 87 *Nw. U. L. Rev.* 216, 216 (1992) ("Viewed contractually, the typical closely held corporation is mostly gaps.")

148. When all important issues cannot be resolved ahead of time, rational parties may substitute equitable obligations for detailed contract terms. *See* Easterbrook & Fischel, *Contract and Fiduciary Duty*, *supra* note 34, at 427.

149. *See* O'Kelley, *supra* note 147, at 225 ("[W]hile contractual specification of rights and duties may provide protection against opportunistic withdrawal, the parties may also incur significant costs from lost flexibility.")

150. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979); O'Kelley, *supra* note 147, at 222 ("Opportunistic actors seek to extract an advantage which would be denied them if the party with whom they deal had full information.")

151. *See* Means, *A Contractual Approach*, *supra* note 11, at 41.

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nite enough to enforce under conventional contract doctrine.¹⁵² Fiduciary duty may prohibit other forms of overreaching—the prospects for self-dealing are limited only by the imagination of controlling shareholders—but “good faith” and other well-accepted equitable contract principles offer useful guidelines for the protection of minority shareholders in close corporations.

B. *Reasonable Expectations in Massachusetts*

Recent Massachusetts case law shows the utility of a contractual approach to shareholder oppression.¹⁵³ Compare, for example, the court’s use of reasonable expectations analysis in *O’Brien v. Pearson* with the court’s application of the standard *Wilkes* test.¹⁵⁴ In *O’Brien*, the court found that the majority had breached its fiduciary duty to the minority shareholder by failing to follow through on its promise to fund a development project.¹⁵⁵ The minority shareholder, O’Brien, was a builder and had solicited the majority shareholders’ participation in a venture that involved acquiring distressed properties from a bankrupt developer and completing the construction of the buildings in order to eventually bring them to the market for sale.¹⁵⁶ Although this was the parties’ original understanding, the majority shareholders decided to turn a quick and handsome profit by allowing a third party to satisfy the outstanding mortgages and to take on the risk of development.¹⁵⁷

On a broad expectation of benefit, everyone had done well, but the controlling shareholders had not held to the original business plan.¹⁵⁸ Therefore, the most direct way of assessing liability was to determine whether the parties had an enforceable bargain and, if so, whether the majority shareholders violated the bargain, depriving the minority shareholder of his objectively reasonable expectations.¹⁵⁹ Had the investors made their low risk tolerance known,

152. Douglas Moll points out that “[a]lthough both oppression precedents and contract precedents base their decisions on breached ‘agreements’ and ‘understandings’ between the parties, it is clear that different meanings are ascribed to these terms.” Moll, *Reasonable Expectations v. Implied-in-Fact Contracts*, *supra* note 11, at 1066. Moll concludes that “it is fair to assert that oppression law is doing what contract law should be doing *if* contract law took a broader perspective when identifying and enforcing bargains.” *Id.* at 1073.

153. *See, e.g.*, *Merola v. Exergen Corp.*, 668 N.E.2d 351 (Mass. 1996).

154. *See O’Brien v. Pearson*, 868 N.E.2d 118, 125-26 (Mass. 2007).

155. *Id.* at 126.

156. *Id.* at 121.

157. *Id.* at 123-24.

158. *Id.* at 126.

159. *Id.*

O'Brien might have found other backers; a quick profit for the investors may have meant the loss, from O'Brien's perspective, of a once-in-a-lifetime business opportunity.¹⁶⁰ Despite the lack of measurable damages,¹⁶¹ the majority's ignored promise to fund the development project arguably breached an agreement among the shareholders that the majority shareholders would provide funding until completion of the project.

The court provides just this kind of contractual analysis in rejecting the "argument that O'Brien could not compel [the defendants] to invest their own money."¹⁶² As the court observes, the defendants' objection "misses the point."¹⁶³ The parties had a bargain:

The defendants' breach did not arise from their failure to purchase the entire subdivision, but rather it occurred when they unilaterally decided, after promising to fund the project to the extent that it was economically feasible, to turn away from pursuit of the agreed-on objective in favor of their preferred alternative.¹⁶⁴

By analyzing the parties' reasonable expectations in terms of their actual bargain, the court can explain why O'Brien has a claim "despite over-all profits to the corporation and, derivatively, O'Brien."¹⁶⁵

160. *Id.*

161. *Id.* at 129. The minority shareholder suffered no damages because the eventual outcome of the development project was uncertain, while the majority's alternative course—obtaining an essentially risk free, four-fold return on its investment—was shared with him. *Id.* at 128-29.

162. *Id.* at 126.

163. *Id.*

164. *Id.*

165. *Id.* The calculation of damages is, of course, another matter. Having affirmed the liability judgment, however, the court rejected the award of \$900,000 in damages. *Id.* at 129. Instead, the court relied upon *Brodie's* holding "that the appropriate remedy 'should, to the extent possible, restore to the minority shareholder those benefits which [he] reasonably expected, but has not received because of the fiduciary breach.'" *Id.* at 128 (citing *Brodie v. Jordan*, 857 N.E.2d 1076, 1080 (Mass. 2006)). The court held that plaintiff had not established damages, because the profits that might have been achieved had the project been seen through to completion were too speculative. *Id.* at 128-29. O'Brien hoped that the project would succeed, but he could not reasonably expect as much. *Id.* at 129. Although the court remanded for further proceedings on the issue of damages, it sent a strong signal that plaintiff's recovery would be the "forty-eight per cent of the mortgage discharge proceeds" he would receive in the ordinary course, since he would have to forego that recovery in order to pursue a different damages theory. *See id.* at 130 n.13.

The court's holding that defendants were also liable under the two-part *Wilkes* test is much less convincing. Indeed, the *Wilkes* test makes it very difficult to capture the key point that the defendants promised to do one thing in order to join the venture and instead did something else entirely. Applying the *Wilkes* test, the court acknowledged that obtaining a relatively high, risk free return on an investment rather than gambling on a real estate venture's long-term success was a legitimate business purpose.¹⁶⁶

Because the defendants easily satisfied the first step of the *Wilkes* analysis, the court, if it meant to hold the defendants liable, had to find that there was "a reasonably practicable alternative course" that would have been less harmful to the minority's interests.¹⁶⁷ Yet, O'Brien suffered no financial injury—he shared in the profit from sale of the property and the possibility of greater profits was speculative.¹⁶⁸ The court reasoned that the "alternative course would have included a more open, communicative, and inclusive manner of engagement between the defendants and O'Brien"¹⁶⁹ but failed to offer any support for a finding that funding the development project would have improved O'Brien's financial position.¹⁷⁰

Thus, reasonable expectations analysis seems closer to our intuitions about why majority conduct may oppress the minority. As *O'Brien* also illustrates, there remains the issue of reconciling the reasonable expectations approach to shareholder oppression with the two-part *Wilkes* test. According to Professors Moll and Ragazzo, *Merola* stands for the proposition, applicable across jurisdictions, that there is a threshold test that a plaintiff's claim must satisfy:

When the minority asserts that he has been deprived of employment or some other non-traditional shareholder benefit, however, his burden of proving that his shareholder rights have been harmed is satisfied only by showing that, in the corporation at issue, the benefit was part of his rights *as a shareholder*.¹⁷¹

166. *Id.* at 126.

167. *Id.*

168. *Id.* at 128-29.

169. *Id.* at 126.

170. The only harm to weigh against the majority's legitimate business purpose was O'Brien's exclusion from participation, but it is awkward to characterize the process of making a decision as an alternative to the decision itself.

171. MOLL & RAGAZZO, *supra* note 41, at 7-64.

On this view, if a minority shareholder could not expect a benefit simply by virtue of share ownership, the minority must show that a bargain existed among the shareholders concerning that benefit.¹⁷²

Reasonable expectations analysis can also be extended beyond non-traditional benefits, since even core benefits, such as dividends, are subject to the discretion of the board of directors (and thus controlled by the majority shareholders). A minority shareholder has no automatic right to dividends but should be permitted to argue on the facts, including course-of-performance evidence, that the shareholders had an agreement to distribute corporate revenue as dividends. Perhaps, therefore, reasonable expectations should always be the threshold inquiry in a shareholder oppression case. In *Wilkes*, the plaintiff's expectation as a founding investor and full participant in a business idea he had generated was continued employment and an equal return.¹⁷³ In fact, the threshold, contractual inquiry seems conclusive.¹⁷⁴

V. *WILKES* REVISITED

If shareholder oppression law, properly understood, involves nothing more than identifying and enforcing the parties' actual bargain, then reasonable expectations analysis is more than a threshold inquiry—it comprehensively resolves any conceivable claim of oppression. For that to be true, though, it must be the case that all the values at stake in a claim of shareholder oppression are, at bottom, contractual values.¹⁷⁵ If so, then the *Wilkes* test is not just vacuous as a descriptive matter but also normatively undesirable and, indeed, irrelevant.

This single-value approach may explain why the Delaware Supreme Court dismissed the need for a doctrine of shareholder op-

172. In Massachusetts, notwithstanding Moll and Ragazzo's cogent analysis, it remains unclear whether expectations analysis constitutes a threshold inquiry, and, if so, whether it is dispositive or merely instructive.

173. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 660-61 (Mass. 1976).

174. See BAINBRIDGE, *supra* note 13, at 820 (“[T]his case could have been decided as a simple breach of contract.”).

175. This claim is consistent with the view that the corporation is a nexus of contracts. See Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266, 1266 (1999) (“[A]ccording to the law and economics perspective that the nexus-of-contracts approach to corporate law exemplifies, one should view the corporation as a ‘complex set of explicit and implicit contracts.’” (citation omitted)).

pression on the ground that “[t]he tools of good corporate practice . . . give a purchasing minority stockholder the opportunity to bargain for protection before parting with consideration.”¹⁷⁶ According to law and economics, market logic explains a wide variety of social choices, including those that have an explicitly ethical dimension; for example, how much environmental protection do we wish to purchase? Is the cost of preventing the accident cheaper than the harm prevented, accounting also for the likelihood of the harm?¹⁷⁷ And so on. The economic perspective is “monistic” because it posits one value—economic efficiency—as the measuring stick for social choice.¹⁷⁸ On this view, the only question we need to ask to resolve a shareholder oppression claim is whether the majority’s action violated either the background rules of corporate law or a bargained-for provision in the articles of incorporation, by-laws, or shareholder agreement.¹⁷⁹

For value pluralists, however, no single value exists against which all other ethical choices can be measured.¹⁸⁰ Rather, we are often forced to choose among values, not because we are maximizing some greater value (like economic efficiency), but because our most fundamental priorities are not consistent and cannot all be realized.¹⁸¹ The values are incommensurable. Even if we could assign a price to environmental protection, for instance by studying the “revealed preferences” of consumers’ willingness to pay more for environmentally friendly products, “the assumption of commensurability does a kind of conceptual violence to the underlying val-

176. *Nixon v. Blackwell*, 626 A.2d 1366, 1380 (Del. 1993); *see also* Dalley, *supra* note 35, at 222 (“Controlling stockholders’ fiduciary duties are a judicial invention stimulated by a desire to provide relief to minority stockholders who later regretted their own or their decedent’s bargains . . .”).

177. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 167–71 (7th ed. 2007).

178. *Id.* at 19 (“Economists can usually appeal to a generally accepted goal, such as maximizing the value of output, rather than having to defend the goal.”). According to standard economic reasoning, economic efficiency follows when individuals engage in non-coerced market transactions to satisfy their own preferences. *See, e.g.*, RICHARD A. EPSTEIN, *SKEPTICISM AND FREEDOM* 42 (2003).

179. *See, e.g.*, *Nixon*, 626 A.2d at 1380 (“One could bargain for definitive provisions of self-ordering permitted to a Delaware corporation through the certificate of incorporation or by-laws” or “enter into definitive stockholder agreements, and such agreements may provide for elaborate earnings tests, buy-out provisions, voting trusts, or other voting agreements.”).

180. *See* Isaiah Berlin, *Two Concepts of Liberty*, in *LIBERTY* 213 (Henry Hardy ed., 2002).

181. *Id.*

ues, converting genuine qualitative differences into merely quantitative ones.”¹⁸²

The initial payoff for applying value pluralism theory to shareholder oppression law is that it explains why Massachusetts courts might hold, despite the apparent contradiction, that majority shareholders have a right of selfish ownership *and* a duty of utmost loyalty. In Massachusetts (and elsewhere), courts appear to recognize conflicting values and, depending on the facts of particular cases, give fuller effect to certain values at the expense of other values at stake in a particular dispute.¹⁸³ To the extent shareholder oppression law is value pluralistic, it may be unfair to criticize *Wilkes* for giving weight to competing, sometimes irreconcilable values.¹⁸⁴ The shareholder oppression’s context-specific nature eludes easy categorization.

Value pluralism may also explain some subtler aspects of *Wilkes*’s efforts to accommodate inconsistent principles. On a value-pluralist view, for instance, the *Wilkes* court’s insistence that the majority at least “consider” that its action would “disregard . . . long-standing policy” is interesting because it places emphasis on the process of choosing rather than the choice itself.¹⁸⁵ Where plural values are at stake and there is no axiomatically correct way to proceed, one response is to focus instead on improving decision-making by ensuring that all relevant perspectives and values are

182. Bruce Chapman, *Law, Incommensurability, and Conceptually Sequenced Argument*, 146 U. PA. L. REV. 1487, 1488 (1998).

183. *Kiriakides v. Atlas Food Sys. & Servs., Inc.*, 541 S.E.2d 257, 266 (S.C. 2001) (“We find . . . that the terms ‘oppressive’ and ‘unfairly prejudicial’ are elastic terms whose meaning varies with the circumstances presented in a particular case.”). The point can be overstated, though. For example, enforcing the equitable duty of good faith and fair dealing can sometimes advance the parties’ autonomy interests in that it requires them to live up to the bargain they actually understood, even if opportunistic exploitation of contractual incompleteness later tempts the stronger party. See Means, *A Contractual Approach*, *supra* note 11. Even so, we cannot assume that vindicating autonomy interests in a particular case will always advance equitable good faith concerns and vice versa.

184. The problem of competing values has been recognized in other areas of law. For instance, a number of scholars have argued against unitary theories of tort law. See, e.g., Lawrence A. Cunningham, *Traditional Versus Economic Analysis: Evidence from Cardozo and Posner Torts Opinions*, 62 FLA. L. REV. 667, 676-77 (2010) (describing tension between “social wealth or utility maximization” and “corrective justice”); Christopher J. Robinette, *Torts Rationales, Pluralism, and Isaiah Berlin*, 14 GEO. MASON L. REV. 329, 330, 360 (2007) (advocating a value pluralistic approach to tort law); Gary T. Schwartz, *Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice*, 75 TEX. L. REV. 1801, 1802, 1818 (1997) (advocating, on practical grounds, that tort law accommodate conflicting values).

185. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 664 (Mass. 1976).

aired in a fully deliberative process.¹⁸⁶ In *Wilkes*, consistent with value pluralism, the focus on considered choice suggests that legitimacy cannot be assessed solely based on economic impact.

Subsequent Massachusetts courts have highlighted the presence or absence of a reasoned decision-making process. In *O'Brien*, for instance, the court noted that “pursuing a risk-averse effort to recoup the initial investment with some return” was a “narrower” objective than that originally contemplated by the parties but still within the range of “legitimate.”¹⁸⁷ However, in light of the minority’s strong objection, “[a] reasonably practicable alternative course would have included a more open, communicative, and inclusive manner of engagement between the defendants and O’Brien. Without such a dialogue, the corporate sea change that occurred . . . could be interpreted by the jury as a breach of fiduciary duty.”¹⁸⁸ In *Pointer*, the court approved the lower court’s finding that the other shareholders “owed [plaintiff], who was a forty-three per cent owner . . . , real substance and communication, including efforts to resolve *supposed* complaints by less drastic measures than termination. But such efforts never truly were attempted.”¹⁸⁹ Thus, the same decision might be acceptable if made after a properly noticed meeting and on the basis of full information, including minority shareholder participation.

Alternatively, courts might treat evidence that the minority was walled off from a decision as reason to worry about disingenuous business purposes advanced by the majority after the fact.¹⁹⁰ This seems more plausible than offering process as a direct alternative to a given business decision. I have previously argued that minority shareholder “voice” should matter in oppression cases, not as a substantive right—unless bargained for as such—but as possible evidence of the good faith of the controlling shareholders, and that

186. See CASS R. SUNSTEIN, *DEMOCRACY AND THE PROBLEM OF FREE SPEECH* 241 (1993) (stating that the “American constitutional system” is designed “to ensure discussion and debate among people who are genuinely different in their perspectives and position, in the interest of creating a process through which reflection will encourage the emergence of general truths”).

187. *O'Brien v. Pearson*, 868 N.E.2d 118, 126 (Mass. 2007).

188. *Id.*

189. *Pointer v. Castellani*, 918 N.E.2d 805, 818 (Mass. 2009) (internal quotation marks omitted); see also *O'Connor v. U.S. Art Co.*, No. 031728BLS, 2005 WL 1812512 (Mass. Super. Ct. June 27, 2005).

190. Of course, a savvy majority could use the appearance of process to provide cover for decisions it already intended to make, but that objection can be made with respect to any decision that relies upon deliberation among interested parties and that requires a modicum of good faith.

courts should more closely scrutinize cases where the minority shareholder has been cut out of the decision-making process.¹⁹¹ As in *O'Brien*, the exclusion of a participant may indicate that the controlling shareholders have decided to turn the venture to their own advantage, regardless of the expectations of the minority.¹⁹²

Also, if the values at stake in shareholder oppression litigation can be arranged logically according to relative priority, we can structure the court's decision sequence to reflect those priorities without excluding values or making a single value decisive. Professor Bruce Chapman has described this as a "conceptually sequenced" argument.¹⁹³ The *Wilkes* test establishes priorities—first, the majority must show a legitimate business purpose, second, the minority must establish reasonable alternatives—but does not give the first value absolute priority over the second.¹⁹⁴ If the majority cannot show a legitimate purpose, the court need not consider whether another, less-harmful approach was possible. However, if the parties can establish, respectively, a business purpose and some plausible alternatives, the court will assess the strength of the alternatives in light of the proffered purpose.¹⁹⁵

Understood as a conceptually sequenced analysis, *Wilkes* makes sense. If the controlling shareholders do not have a good business reason for what they have done, it seems odd to ask whether there was a less drastic way of doing it. Logic defers consideration of the alternatives until the appropriateness of the original choice has been established.¹⁹⁶ Thus, *Wilkes*'s conceptual sequencing can be defended as a rational response to incommensurability. To complete the *Wilkes* test, reasonable expectations should be considered a threshold, non-dispositive but shaping inquiry—giving us a three-part test. Reasonable expectations, in

191. See Means, *A Voice-Based Framework*, *supra* note 7, at 1218-19.

192. At the same time, majority shareholders have the right and the ability to decide contested questions as they see fit, so long as they do not oppress the minority.

193. Chapman, *supra* note 182, at 1515.

194. See *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976).

195. *Id.*

196. For much the same reason, the criminal law concept of "excuse" cannot be evaluated until it has been determined whether a crime was committed. See Chapman, *supra* note 182, at 1515 ("For the notion of an excuse is an essentially (conceptually) sequenced idea; without a prior act of wrongdoing, there is nothing for which the actor can be held responsible, and no issue, therefore, to which an excuse could possibly have any sensible application." (citing George P. Fletcher, *The Right and the Reasonable*, 98 HARV. L. REV. 949, 960 (1985))).

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other words, should not be accorded total, lexical priority over all other values identified in *Wilkes*.

Without overturning existing case law, the Massachusetts Supreme Judicial Court could clarify that shareholder expectations analysis is a threshold but non-dispositive inquiry.¹⁹⁷ If the minority shareholders can establish a particular expectation, then that expectation should only be defeasible upon a very strong showing of business need.¹⁹⁸ However, if the minority shareholders have no relevant expectation, then a correspondingly weaker business purpose would suffice.¹⁹⁹ Viewed this way, shareholder expectations analysis would neither be separate from the *Wilkes* test nor a replacement for it.

CONCLUSION

Imagine if Justice Cardozo had issued a second opinion for the New York Court of Appeals to explain what he meant when he stated in *Meinhard v. Salmon* that fiduciary duty demands the “punctilio of an honor the most sensitive.”²⁰⁰ If Cardozo had written a companion decision describing what the “punctilio” requires, and demystifying *Meinhard’s* other rhetorical chestnuts,²⁰¹ we might have something like the relation of *Donahue* and *Wilkes*—the spiritual leader and the pragmatic acolyte.

Yet, as this Article has demonstrated, pragmatism is hard won. The *Wilkes* test does not clarify *Donahue* so much as it raises new questions. Viewed skeptically, Massachusetts’ fiduciary standard contains many strands and offers support for almost any result. There is, however, no reason to doubt the sincerity with which Massachusetts courts have applied the *Wilkes* standard or that the courts believe that they are doing anything other than resolving

197. This diaphanous approach would help clarify the relationship of reasonable expectations and the *Wilkes* test as discussed *supra* Part III.C.

198. To be clear, I am not referring to explicit contractual arrangements, which would still be enforced subject to any equitable exceptions that might apply within contract law.

199. For instance, if second or third generation shareholders who had never worked for the business applied for a management position, the majority would need little reason to decline.

200. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

201. See, e.g., Robert B. Thompson, *The Story of Meinhard v. Salmon: Fiduciary Duty’s Punctilio*, in *CORPORATE LAW STORIES*, *supra* note 65, at 106, 120 (“The opinion is one of Cardozo’s most eloquent. He paints with a broad brush, setting out high moral aspirations.”).

shareholder oppression cases consistent with a principled view of fiduciary duty.

If Massachusetts' explication of the fiduciary approach appears to have serious shortcomings that can be traced back to *Wilkes*, it suggests that we either need a different approach to the problem of shareholder oppression or another way of understanding the work that courts do in these kinds of cases. Perhaps fiduciary duty in Justice Cardozo's grand style is too lofty and we should fix our gaze on something closer to home and more attainable, like an understanding of the parties' bargain rooted in relational contract theory. Or perhaps a non-reductive approach to minority-shareholder oppression will necessarily include a number of values that are in tension with one another, that cannot be arranged into a final framework, and that can only be adjusted case by case.