Against Contractual Formalism in Shareholder Oppression Law

Benjamin Means[†*] *& Douglas K. Moll*[**]

In closely held corporations, shareholder oppression law provides an equitable alternative to contract law for minority shareholders. However, the noncontractual nature of oppression law can be overstated. Two types of contractual analysis appear frequently in oppression cases: (1) pragmatic efforts to ascertain the minority's reasonable expectations based on evidence of shared understandings between the parties; and (2) formalistic insistence that contract law rules curtail the minority's reasonable expectations.

These two approaches conflict with each other and have created confusion. There is a crucial difference between using contractual analysis to assess the parties' reasonable expectations and allowing formalistic contract rules to substitute for a full evaluation of the parties' bargain. This Article argues that contractual formalism repositions the chief criticism of the shareholder oppression doctrine — that a corporation's shareholders could have negotiated adequate protection before investing — as the doctrine itself. By contrast, a pragmatic interpretation of reasonable expectations serves the equitable purpose of shareholder oppression law and empowers courts to achieve justice between the parties.

 We are grateful to Cathy Hwang, Susan S. Kuo, and James D. Nelson for comments on earlier drafts.

* Professor of Law and John T. Campbell Chair in Business and Professional Ethics, University of South Carolina School of Law. A.B. 1995, Dartmouth College; J.D. 1999, University of Michigan Law School.

** Beirne, Maynard & Parsons, L.L.P. Professor of Law, University of Houston Law Center. B.S. 1991, University of Virginia; J.D. 1994, Harvard Law School.

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INTRODUCTION

Courts that refuse to provide relief for shareholder oppression insist that minority shareholders are not helpless and must bargain for themselves before investing.[1] In closely held corporations, however, participants often rely on interpersonal trust and informal norms rather than arm's-length contract.[2] Sometimes, that trust is misplaced.[3] When relationships between shareholders break down, the majority can use its control to freeze the minority out of any ability to participate in the business or to receive financial returns.[4] Consequently, most

[1] *See* Nixon v. Blackwell, 626 A.2d 1366, 1380 (Del. 1993) ("The tools of good corporate practice are designed to give a purchasing minority stockholder the opportunity to bargain for protection before parting with consideration. It would do violence to normal corporate practice and our corporation law to fashion an ad hoc ruling which would result in a court-imposed stockholder buy-out for which the parties had not contracted."); Richards v. Bryan, 879 P.2d 638, 648 (Kan. Ct. App. 1994). For a scholarly defense, see 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) (arguing that when confronted with allegations of oppression, "courts should not do anything except enforce the participants' contracts and vigorously prevent non pro rata distributions to shareholders").

[2] *See* Jonathan M. Barnett, *Hollywood Deals: Soft Contracts for Hard Markets*, 64 DUKE L.J. 605, 607 (2015); Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J. LEGAL ANALYSIS 561, 562 (2015); Robert C. Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 STAN. L. REV. 623, 628, 677 (1986); Gillian K. Hadfield & Iva Bozovic, *Scaffolding: Using Formal Contracts to Support Informal Relations in Support of Innovation*, 2016 WIS. L. REV. 981, 987, 1017 (2016); Cathy Hwang, *Collaborative Intent*, 108 VA. L. REV. 657, 662 (2022) (noting the power of "informal sanctions, such as loss of reputation").

[3] *See* Benjamin Means, *Solving the "King Lear Problem,"* 12 U.C. IRVINE L. REV. 1241, 1257 (2022) ("A mix of aging incumbents who are loathe to cede power, hard-to-divide family wealth, miscommunication, and greed too often ends in tragedy."); Robert B. Thompson, *The Shareholder's Cause of Action for Oppression*, 48 BUS. L. 699, 705 (1993) [hereinafter *The Shareholder's Cause of Action*] ("Investors often fail to anticipate the failure of their enterprise, or demonstrate an overly optimistic trust in those with whom they are undertaking the venture.").

[4] This Article focuses on shareholder oppression in the corporate context, but most of the same arguments would apply in limited liability companies and other business forms in which majority owners exert control over decision making and the minority investors lack the practical ability to exit the investment at fair value. *See* Douglas K. Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) from Close*

jurisdictions offer a safety net for minority shareholders who have failed to negotiate contractual protections in advance.[5] As an alternative to contract, the shareholder oppression doctrine protects minority investors in closely held corporations from the improper exercise of majority control.[6]

Although shareholder oppression law provides an equitable, noncontractual remedy for abuses of majority power, contractual analysis remains relevant because courts in most jurisdictions evaluate oppression claims by seeking to identify the parties' "reasonable expectations."[7] For an expectation to be reasonable, it cannot be an idiosyncratic view held by one party when there is no basis for believing that other parties have assented to it.[8] The question, therefore, is not whether contract law affects shareholder oppression law, but how it does so. As this Article demonstrates, two types of contractual analysis appear frequently in oppression cases: (1) *pragmatic* attempts to ascertain the minority's reasonable expectations based on evidence of shared understandings between the parties; and (2) *formalistic* insistence that contract law rules place sharp limits on the minority's

Corporation History, 40 WAKE FOREST L. REV. 883, 887 (2005) [hereinafter *Minority Oppression*].

[5] *See, e.g.*, DOUGLAS K. MOLL & ROBERT A. RAGAZZO, CLOSELY HELD CORPORATIONS § 7.01(D) (2022) (stating that "[m]ost jurisdictions have developed special common-law doctrines (often aided by statutes) that are designed to protect minority shareholders in closely held corporations from oppressive majority conduct").

[6] *See infra* note 30.

[7] *See* Douglas K. Moll, *Reasonable Expectations v. Implied-in-Fact Contracts: Is the Shareholder Oppression Doctrine Needed?*, 42 B.C. L. REV. 989, 1002 (2001) [hereinafter *Reasonable Expectations v. Implied-in-Fact Contracts*] (stating that "the 'reasonable expectations' standard garners the most approval, and courts have increasingly used it to determine whether oppressive conduct has taken place").

[8] *See, e.g.*, Meiselman v. Meiselman, 307 S.E.2d 551, 563 (N.C. 1983) ("In order for plaintiff's expectations to be reasonable, they must be known to or assumed by the other shareholders and concurred in by them. Privately held expectations which are not made known to the other participants are not 'reasonable.' Only expectations embodied in understandings, express or implied, among the participants should be recognized by the court."); *see also In re* Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984) (stating that courts must "investigate what the majority shareholders knew, or should have known, to be the petitioner's expectations in entering the particular enterprise"); *id.* (noting that unfulfilled "subjective hopes and desires in joining the venture" are insufficient to establish an oppression claim).

reasonable expectations.[9] By pragmatism, we mean theories that prioritize flexibility in the application of law to avoid injustice in the disposition of individual cases.[10] By formalism, we mean methodological approaches that place greater weight on the *ex ante* values of consistency and certainty and that, accordingly, call for an application of law to fact without concern for fairness *ex post*.[11]

This Article argues against contractual formalism as a method for judging claims of shareholder oppression. Notably, formalism repositions the chief criticism of the shareholder oppression doctrine — that a corporation's shareholders could have bargained for adequate protection before investing — as the doctrine itself.[12] Courts that adopt

[9] As a concept, "formalism" best captures this contractarian approach because it insists on decisions based solely on the rules of contract law. *See* Frederick Schauer, *Formalism*, 97 YALE L.J. 509, 510 (1988) ("At the heart of the word 'formalism,' in many of its numerous uses, lies the concept of decisionmaking according to *rule*."). Necessarily, this approach achieves its objective by "screening off from a decisionmaker factors that a sensitive decisionmaker would otherwise take into account." *Id.*

[10] In legal philosophy, pragmatism refers to a "radical empiricism" that eschews abstract, deductive theories and focuses on what can be observed and measured. *See* Richard A. Posner, *Legal Pragmatism*, 35 METAPHILOSOPHY 147, 148 (2004). Our use of the term pragmatism is broader because the flexibility we advocate is not limited to propositions that can be ascertained via a quasi-scientific, empirical methodology. Pragmatism, as we use the concept, could also encompass moral reasoning about what justice requires in a given situation. For example, feminist and other critical theories of law could, in our view, be sources of pragmatic arguments about corporate law. For a recent collection of feminist critiques of corporate law decisions, see FEMINIST JUDGMENTS: CORPORATE LAW REWRITTEN (Anne M. Choike, Usha R. Rodrigues & Kelli Alces Williams eds., 2023).

[11] Formalists frequently assert that their decisions are required by the law and that additional equitable considerations are not relevant. *See* Schauer, *supra* note 9, at 510 ("The formalism in *Lochner* inheres in its *denial* of the political, moral, social, and economic choices involved in the decision, and indeed in its denial that there was any choice at all."); *supra* note 9 (discussing formalism); *infra* note 18 (same).

[12] *See, e.g.*, MJC Ventures LLC v. Detroit Trading Co., No. 19-cv-13707, 2020 WL 3542091, at *3 (E.D. Mich. June 30, 2020) (rejecting an oppression claim that was based in part on a plaintiff's removal from the board of directors because "[n]owhere do Plaintiffs specifically allege that these actions by [the majority] shareholders and newly installed Board of Directors were inconsistent with the company's articles of incorporation or bylaws, nor do Plaintiffs dispute that they were taken pursuant to written agreements by a majority of company shareholders, and the Board"); *infra* Part III.B.1 (discussing *MJC Ventures*).

a formalistic approach substitute an easier question for a harder one.[13] Instead of asking whether an expectation was reasonable under the circumstances, they ask whether contract law principles preclude the plaintiff's complaint. This wrongly converts the reasonable expectations standard into a limited, bright-line inquiry.[14]

We further contend that a proper assessment of reasonable expectations should require consideration of all relevant evidence concerning the parties' social or familial connections and the economic context of their venture.[15] For example, if investors incorporate a business, divide its profits via salary in lieu of dividends, and proceed with that arrangement for years, a court should not need evidence of an employment contract to recognize that the investors have developed a reasonable expectation of employment as the vehicle for a return on their investment.[16] Nor should contract rules foreclose minority

[13] For an explanation of how people make this substitution, often without realizing the difference, see DANIEL KAHNEMAN, THINKING, FAST AND SLOW 97-105 (2011).

[14] Our critique of formalism is limited to the context of shareholder oppression law. While we contend that adequate protection for minority shareholders in closely held corporations calls for a pragmatic approach to reasonable expectations, we do not offer a general critique of methodological formalism. For a classic argument against formalism, see Roberto Mangabeira Unger, *The Critical Legal Studies Movement*, 96 HARV. L. REV. 561, 567-73 (1983). *Cf.* Ernest J. Weinrib, *Legal Formalism: On the Immanent Rationality of Law*, 97 YALE L.J. 949 (1988) (observing that "[f]ormalism is like a heresy driven underground, whose tenets must be surmised from the derogatory comments of its detractors").

[15] *See* Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 FORDHAM L. REV. 1161, 1196 (2010) [hereinafter *A Contractual Approach*] (stating that closely held businesses "are quintessential relational contracts" and that they are often characterized by "an evolving, flexible bargain governed more by good faith than by specific contract terms"). In other areas of the law, courts have used contract principles for general guidance rather than construing them strictly. *See, e.g.*, Bridget A. Fahey, *Federalism by Contract*, 129 YALE L.J. 2326, 2331 (2020) (focusing on inter-government agreements between the federal government and the states or among individual states, and arguing the following: "In some cases, courts understand the agreements to be literal contracts. In others, they veer analogical, concluding that intergovernmental agreements are 'in the nature of a contract,' reflect 'a contractual relationship,' or have a 'contractual aspect.'" (citations omitted)).

[16] *Cf.* Franchino v. Franchino, 687 N.W.2d 620, 627 (Mich. Ct. App. 2004) (acknowledging plaintiff's argument that "individuals generally join close corporations not for dividends but for employment and a share of the profits, which are often paid through salaries and bonuses"). However, because the Michigan statute at issue limited

shareholders from asserting an expectation based on how the parties' relationship has evolved over time.[17] There is a crucial difference between using contractual analysis to inform the court's understanding of the parties' reasonable expectations and allowing formalistic contract rules to substitute for a full evaluation of the parties' bargain.[18]

The argument proceeds as follows. Part I reviews the evolution of shareholder oppression law and identifies a recurring theme: a shift toward pragmatism over formalism. Part II argues that the reasonable expectations standard that has been adopted in most jurisdictions is contractual and calls for a pragmatic assessment of the parties' economic, social, and family relationships. Yet, Part III contends that a resurgent formalism has led some courts to conflate "contractual" with "contract," forcing oppression claims to satisfy an inappropriate formalistic filter. This cannot be right. If contracts are the sole basis for creating reasonable expectations in closely held corporations, and if the shareholders' relationships are to be ignored, then there is no longer a meaningful difference between courts that accept the shareholder oppression doctrine and those that reject it.[19]

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the concept of oppression to conduct "that substantially interferes with the interests of the shareholder *as a shareholder*," *see* MICH. COMP. LAWS ANN. § 450.1489(3) (2006) (emphasis added), the court refused to consider the merits of plaintiff's argument and affirmed the judgment in favor of defendants. *See Franchino*, 687 N.W.2d at 629. In so holding, the court found that "there is no basis in current Michigan law for applying the reasonable expectations test for shareholder oppression." *Id.*

[17] *Cf.* Meiselman v. Meiselman, 307 S.E.2d 551, 563 (N.C. 1983) ("These 'reasonable expectations' are to be ascertained by examining the entire history of the participants' relationship. That history will include the 'reasonable expectations' created at the inception of the participants' relationship; those 'reasonable expectations' as altered over time; and the 'reasonable expectations' which develop as the participants engage in a course of dealing in conducting the affairs of the corporation.").

[18] Adherents of formalism in contract law prioritize doctrinal integrity over the achievement of underlying policy objectives. *See* Felipe Jiménez, *A Formalist Theory of Contract Law Adjudication*, 2020 UTAH L. REV. 1121, 1124 (2020) ("[F]ormalism recommends applying the . . . literal meaning of the legal rules and doctrines of contract law and their settled doctrinal construction, without directly considering the instrumental purposes of contract law.").

[19] In other words, if contracts are the sole basis for creating reasonable expectations in closely held corporations, then the result is the same whether (a) courts accept the shareholder oppression doctrine but require reasonable expectations to satisfy contract law principles, or (b) courts reject the shareholder oppression doctrine because the

I. SHAREHOLDER OPPRESSION LAW AS PRAGMATISM

In a closely held corporation, there are relatively few shareholders, the stock is not traded on public markets, and, typically, the principal shareholders take an active role in management.[20] Without control rights or exit rights, minority shareholders are inherently vulnerable to mistreatment.[21] With respect to control rights, the majority elects the board of directors.[22] Once elected, the board appoints corporate officers, sets their salaries, decides whether to distribute profits to shareholders, and has the authority to make nearly every business decision.[23] Under standard corporate law principles, the board's

shareholders could have contracted for protection. Under either approach, compliance with contract law is required before any relief is offered.

[20] *See, e.g.*, 2 JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS § 14.01, at 816 (2d ed. 2003) (distinguishing key characteristics of public and private corporations); 1 F. HODGE O'NEAL, ROBERT B. THOMPSON & HARWELL WELLS, CLOSE CORPORATIONS AND LLCS: LAW AND PRACTICE §§ 1:2, 1:9 (rev. 3d ed. 2010) [hereinafter CLOSE CORPORATIONS & LLCS] (same).

[21] *See* Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 GEO. L.J. 1207, 1209 (2009) [hereinafter *A Voice-Based Framework*] (arguing that the risk of "minority shareholder oppression should be understood . . . as an inherent structural characteristic of the close corporation form"); Thompson, *The Shareholder's Cause of Action*, *supra* note 3, at 699 ("The statutory norms of centralized control and majority rule, when combined with the lack of a public market for shares in a close corporation, leave a minority shareholder vulnerable in a way that is distinct from the risk faced by investors in public corporations.").

[22] *See, e.g.*, 1 F. HODGE O'NEAL, ROBERT B. THOMPSON & DOUGLAS K. MOLL, OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 1:2, at 1-3 (rev. 2d ed. 2004) [hereinafter OPPRESSION OF MINORITY SHAREHOLDERS] (explaining that majority shareholders wield power indirectly by electing directors); *infra* note 223 and accompanying text (stating that final authority to make decisions rests with the board of directors). Often, the majority shareholders elect themselves to the board. *See* 1 O'NEAL ET AL., OPPRESSION OF MINORITY SHAREHOLDERS, *supra*, § 1:2, at 3-38 (stating that "in most closely held corporations, majority shareholders elect themselves and their relatives to all or most of the positions on the board").

[23] *See* MODEL BUS. CORP. ACT § 8.01(b) (1993) (AM. BAR ASS'N, amended 2016) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors . . . ."); GRANT M. HAYDEN & MATTHEW T. BODIE, RECONSTRUCTING THE CORPORATION: FROM SHAREHOLDER PRIMACY TO SHARED GOVERNANCE 51 (2021) ("The firm is controlled by a board of directors, who in turn select the officers who run the day-to-

decisions are not normally reviewable in court.[24] The majority's control over the board, therefore, effectively gives it control over the corporation. Correspondingly, the minority lacks the power to make company decisions.

The minority's inherent vulnerability is exacerbated in a corporation because the default rules provide no right to exit.[25] If minority shareholders are unhappy with their position in the corporation, they cannot demand that the corporation or other shareholders repurchase their stock.[26] In publicly traded corporations, by contrast, the minority could sell at arm's length to a third party via the stock market.[27] Taken together, the minority's lack of control and lack of liquidity empower

day business of the operation. This board is elected by shareholders."). Majority shareholders may elect themselves to the board, *see supra* note 22, but their power to control the corporation remains the same whether they act directly or through designated proxies.

[24] *See* STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 242 (2002) ("[T]he business judgment rule says that courts must defer to the board of directors' judgment absent highly unusual exceptions."); *infra* note 102 and accompanying text (describing the business judgment rule).

[25] *See* Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 684-85 (2016) ("Many states have developed a doctrine of shareholder oppression in closely held corporations because the lack of a public market leaves minority shareholders particularly vulnerable to the majority's actions.").

[26] *See, e.g.*, Goode v. Ryan, 489 N.E.2d 1001, 1004 (Mass. 1986) ("In the absence of an agreement among shareholders or between the corporation and the shareholder, or a provision in the corporation's articles of organization or by-laws, neither the corporation nor a majority of shareholders is under any obligation to purchase the shares of minority shareholders when minority shareholders wish to dispose of their interest in the corporation.").

Even if there is no stock-transfer restriction in the bylaws or a shareholders' agreement, the prospect of an outside sale in a closely held corporation is severely limited as well. *See, e.g.*, Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 515 (Mass. 1975) ("No outsider would knowingly assume the position of the disadvantaged minority."); Balvik v. Sylvester, 411 N.W.2d 383, 386 (N.D. 1987) (noting the "natural reluctance of potential investors to purchase a noncontrolling interest in a close corporation that has been marked by dissension"). It should also be noted that the minority's investment is often a substantial percentage of its net worth. *See* Mary Siegel, *Fiduciary Duty Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 384 (2004).

[27] *See* Rock & Wachter, *supra* note 1, at 916 ("The lack of a public market causes the parties to be locked into their investments to a much greater extent than in either the partnership or the publicly traded corporation.").

majority shareholders to freeze out the minority owners from any return on their investment. Compounding the unfair treatment, the majority may then offer to repurchase the minority's stock at pennies on the dollar, knowing that the minority has no choice but to capitulate.[28]

As explained in the Sections that follow, two pragmatic responses emerged to protect minority shareholders from the majority's abusive conduct. First, courts created equitable exceptions to mandatory corporate law rules, permitting shareholders to alter the structure of the corporation by contract, even in ways that limited the statutory authority of the board of directors. Second, most jurisdictions offered additional noncontractual protection for minority shareholders' financial and participatory interests in a corporate venture. Whether by common law or statutory provision,[29] these jurisdictions provide a remedy for minority shareholders who can establish "oppression."[30]

[28] *See, e.g.*, Franks v. Franks, 944 N.W.2d 388, 393 (Mich. Ct. App. 2019) (finding evidence of possible oppression due to a lowball offer for the minority's stock based in part on the majority owner's admission "that [the corporation's accountant] wrote [the majority] and stated that [the majority's lowball] offer was 'a good plan' because the nonvoting members were astute enough to realize that their shares had no value unless a different buyer were to offer them more"); *id.* (noting that the accountant "said that he made that statement . . . because, 'if no dividends are being paid and there are no redemptions being made, then nobody else is going to buy the stock'"); *see also* Thompson, *The Shareholder's Cause of Action*, *supra* note 3, at 703-04 (stating that a freezeout is accomplished when "the majority first denies the minority shareholder any return and then proposes to buy the shares at a very low price").

[29] For a fifty-state survey of oppression laws, see 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). A similar fifty-state survey of oppression statutes and related case law is provided in MOLL & RAGAZZO, *supra* note 5, at § 7.01(D).

[30] The law of shareholder oppression "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).

A. Enforcing Shareholder Bargains

Courts and commentators who reject special legal protections for minority shareholders invoke contract law.[31] According to this view, courts should not allow themselves to be influenced by broader equitable considerations. Either the minority has negotiated a contract that protects its interests, or else it must accept the consequences.[32] When considered in historical context, however, the present-day connection between formalism and contract law appears ironic. Modern corporate law statutes authorize shareholder agreements that alter fundamental corporate governance rules, but those governance rules were once understood to be mandatory.[33]

As this Section explains, contract law only became available as a tool for minority shareholders to use because courts in the mid-twentieth century were willing to address what they rightly perceived to be the distinctive needs of minority shareholders in closely held corporations. Three classic cases, *McQuade v. Stoneham*,[34] *Clark v. Dodge*,[35] and *Galler v. Galler*,[36] illustrate how contractual bargains among shareholders gradually became accepted as a legitimate method for adjusting the rights of minority owners in closely held corporations, even when the contracts at issue encroached on the role of the board of directors.

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[31] Contract law may be raised directly to foreclose the oppression argument altogether, or, as we show in Part III, indirectly by defining the minority's reasonable expectations as largely synonymous with contract.

[32] *See* BAINBRIDGE, *supra* note 24, at 830 (stating that "parties who want liberal dissolution rights may bargain for them . . . before investing"); Rock & Wachter, *supra* note 1, at 915 ("[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.").

[33] *See* MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 1016 (1995) (noting a "general trend toward more enabling general corporation statutes in which previously mandatory governance procedures have been transformed into default provisions that may be altered by the charter").

[34] 189 N.E. 234 (N.Y. 1934).

[35] 199 N.E. 641 (N.Y. 1936).

[36] 203 N.E.2d 577 (Ill. 1964).

For an example of reluctant formalism, consider the *McQuade* case. Francis McQuade was a minority shareholder who negotiated a shareholders' agreement that guaranteed his position and salary. Yet, after a personal falling out with the majority shareholder, he lost his job and no longer received any return on his investment.[37] The New York Court of Appeals acknowledged that McQuade had been "shabbily treated."[38] The court further acknowledged that McQuade had insisted upon contractual protection as a condition of his investment in the corporation, and that such bargains were understandable: "We do not close our eyes to the fact that such agreements, tacitly or openly arrived at, are not uncommon, especially in close corporations where the stockholders are doing business for convenience under a corporate organization."[39] Nevertheless, despite the court's awareness of the reasons for the bargain and the unfairness of allowing the majority to make supposedly contractual promises, only to violate them at his later convenience, the justices refused to enforce the shareholders' agreement. What mattered was that the agreement contravened the ultimate authority of the corporation's board of directors.[40]

Two years later, the same court arrived at a different conclusion. In *Clark v. Dodge*,[41] the plaintiff was a minority shareholder who divulged a secret formula crucial to the business, but only after entering into a shareholders' agreement with the majority shareholder giving the minority job protection and a guaranteed share of the profits.[42] Once the majority shareholder had the formula, he fired the minority and refused to honor the agreement. The issue before the court was whether to

[37] The court accepted the trial court's finding that "plaintiff was removed because he had antagonized the dominant Stoneham [the majority shareholder] . . . and for no misconduct on his part." *McQuade*, 189 N.E. at 236.

[38] *Id.*

[39] *Id.*

[40] *See id.* at 237 ("We are constrained by authority to hold that a contract is illegal and void so far as it precludes the board of directors, at the risk of incurring legal liability, from changing officers, salaries, or policies or retaining individuals in office, except by consent of the contracting parties."). The court may also have been influenced by the fact that McQuade's involvement in the business appeared to have been political patronage. *See id.* at 237-38.

[41] 199 N.E. 641 (N.Y. 1936).

[42] *See id.* at 642.

adhere to its decision in *McQuade* and leave the minority shareholder without a remedy.[43] The court quoted the relevant corporate law statute, which provided that "[t]he business of a corporation shall be managed by its board of directors."[44] Despite that language, the court was reluctant to adhere to the principle of board primacy in a case involving egregious bad faith.[45] Instead, the court relied upon its inherent equitable power and held that the shareholders' agreement should be enforced because it was a minor and harmless "invasion" of the board's powers. According to the court, *McQuade* would henceforth be limited to its facts.[46]

Decades after *Clark v. Dodge*, the Illinois Supreme Court addressed the enforceability of shareholder agreements in a well-known decision that more fully articulated a rationale for pragmatism. The *Galler v. Galler*[47] decision concerned two brothers who were shareholders of a corporation and who, "on the advice of their accountant, decided to enter into an agreement for the financial protection of their immediate families and to assure their families, after death of either brother, equal control of the corporation."[48] When the surviving brother refused to honor the agreement, the legal issue was whether the shareholders' agreement was valid. The appellate court followed a formalistic approach and held that the agreement was void because it conflicted with board prerogatives under state corporate law.[49]

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[43] *See id.*

[44] *Id.* (quoting N.Y. GEN. CORP. LAW § 27 (1936).

[45] The court asked, rhetorically, "Are we committed by the McQuade Case to the doctrine that there may be no variation, however slight or innocuous, from that norm [of board primacy], where salaries or policies or the retention of individuals in office are concerned?" *Id.*

[46] *See id.* at 643 ("If there was any invasion of the powers of the directorate under that agreement, it is so slight as to be negligible; and certainly there is no damage suffered by or threatened to anybody. The broad statements in the McQuade opinion, applicable to the facts there, should be confined to those facts.").

[47] 203 N.E.2d 577 (Ill. 1964).

[48] *Id.* at 579. The court noted that the "evidence is undisputed that defendants had decided prior to [plaintiff's husband's] death [that] they would not honor the agreement." *Id.* at 580.

[49] *See id.* at 581 ("The Appellate Court found the 1955 agreement void because 'the undue duration, stated purpose and substantial disregard of the provisions of the

The Illinois Supreme Court saw that resolving the case required a choice between formalism and pragmatism. On the one hand, the court summarized the advantages of formalism: "It would admittedly facilitate judicial supervision of corporate behavior if a strict adherence to the provisions of the Business Corporation Act were required in all cases without regard to the practical exigencies peculiar to the close corporation."[50] On the other hand, the court noted that "shareholder agreements similar to that in question here are often, as a practical consideration, quite necessary for the protection of those financially interested in the close corporation."[51] The court further observed that "courts have long ago quite realistically, we feel, relaxed their attitudes concerning statutory compliance when dealing with close corporate behavior, permitting 'slight deviations' from corporate 'norms' in order to give legal efficacy to common business practice."[52] Citing scholarly commentary, the court upheld the validity of the agreement and concluded that "[n]ew needs compel fresh formulation of corporate 'norms.'"[53] Pragmatism prevailed.

To summarize, corporate law statutes did not authorize shareholder bargains that shifted power away from the board of directors. Nevertheless, courts sympathetic to the vulnerability of minority shareholders refused to be boxed in by legal constraints that had not been developed with closely held corporations in mind.[54] Instead, these courts enforced shareholder contracts based on a realistic assessment of what was needed. Although courts have no power to rewrite statutes, the judiciary was, in effect, challenging lawmakers to clarify their intentions with respect to closely held corporations. Overwhelmingly, corporate law statutes were amended to expand freedom of contract and to clarify that board control is only a default rule. The Model Business

Corporation Act outweigh any considerations which might call for divisibility' and held that 'the public policy of this state demands voiding this entire agreement.'").

[50] *Id.* at 584.

[51] *Id.* at 583.

[52] *Id.* at 584.

[53] *Id.* at 585 (quoting George D. Hornstein, *Shareholders' Agreements in the Closely Held Corporation*, 59 YALE L.J. 1040, 1056 (1950)).

[54] As one commentator has observed, "[C]orporation statutes fail to take [the distinctive characteristics of closely held corporations] into account." BAINBRIDGE, *supra* note 24, at 799.

Corporation Act, for example, states that a shareholders' agreement is enforceable, even if it "eliminates the board of directors or restricts the discretion or powers of the board of directors."[55] Today, the centrality of freedom of contract in corporate affairs is widely accepted.[56]

For an additional example of how modern courts prioritize contractual agreements among the parties over technical rules of corporate governance, consider a recent New York decision in which the plaintiff sought to enforce a shareholders' agreement providing that the company's certificate of incorporation "will not be amended or repealed except by written Agreement of all of the Shareholders."[57] The trial court granted summary judgment in favor of defendants because New York's Business Corporation Law states, to the contrary, that "a certificate of incorporation may be amended by a simple majority vote of the shares present at a meeting of the shareholders."[58] Although the New York statute allowed the parties to enter into a supermajority voting provision in their certificate of incorporation, it was undisputed that such a provision was in a shareholders' agreement and not the certificate. Thus, the trial court sided with the defendants, not because it concluded that altering the default "majority vote" rule was impermissible, but because, in the court's judgment, a collateral shareholders' agreement was not the proper vehicle for doing so.[59] In

[55] MODEL BUS. CORP. ACT § 7.32(a)(1) (AM. BAR ASS'N 2016).

[56] *See* COX & HAZEN, *supra* note 20, § 14.02, at 818 ("Participants may use some kind of contractual arrangement to set up a control pattern for the corporation that differs from the traditional corporation control structure."). Indeed, the shift to a contract paradigm was so successful that some scholars now assert that corporations are best understood as a set of interlocking contracts. As Professors Grant Hayden and Matthew Bodie explain, "[t]he nexus of contracts theory, in its purest form, holds that a corporation is merely a central hub for a series of contractual relationships." HAYDEN & BODIE, *supra* note 23, at 52 (citing Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976)).

[57] Salansky v. Empric, 173 N.Y.S.3d 376, 378 (App. Div. 2022). For a further discussion of the *Salansky* case, see Peter Mahler, *Summer Shorts: LLC Dissolution and Other Recent Decisions of Interest*, N.Y. BUS. DIVORCE BLOG (Aug. 15, 2022), https://www.nybusinessdivorce.com/2022/08/articles/summer-shorts/summer-shorts-llc-dissolution-and-other-recent-decisions-of-interest/ [https://perma.cc/9U7G-GZAE].

[58] *Salansky*, 173 N.Y.S.3d at 378 (citing N.Y. BUS. CORP. § 803(a) (2023)).

[59] *See id.*

other words, the trial court took a formalistic view of how corporate law allocates voting rights and was not swayed by evidence of the parties' different intentions.

The appellate court reversed the trial court's ruling, as it concluded that the statute "does not prohibit parties from entering into a *separate* agreement that requires unanimity among the shareholders to amend a certificate of incorporation."[60] Thus, plaintiff's objections to defendants' conduct were not precluded by the fact that the certificate itself had not changed the default "majority vote" rule. Indeed, even though the certificate of incorporation was adopted pursuant to New York's Business Corporation Law, the court perceived "no conflict between the Business Corporation Law and the shareholder agreement."[61] In the spirit of pragmatism, the court was apparently more concerned with what the parties had agreed to rather than where they had agreed to it.

B. Shareholder Fiduciary Duties

Once the right to contract in closely held corporations was established, the next issue courts considered was whether to intervene equitably on behalf of minority shareholders who had not bargained for contractual protection. Some courts stated that minority shareholders should only be permitted to assert rights in court that they had insisted upon before investing.[62] Most notably, the Delaware Supreme Court in *Nixon v. Blackwell*[63] opined that "[t]he tools of good corporate practice . . . give a purchasing minority stockholder the opportunity to

[60] *Id.* (emphasis added).

[61] *Id* at 378-79. We note, however, that there would be a conflict between the corporation's certificate of incorporation and the separate shareholders' agreement. Without a copy of the shareholders' agreement, an external party reviewing the corporation's certificate of incorporation would falsely conclude that the majority has the power to amend or alter the certificate.

[62] Even the default rules of corporate law can be treated as contractual choices because (1) the parties can select from various business forms in any one jurisdiction; and (2) the parties can incorporate using the laws of any U.S. jurisdiction, regardless of where the business plans to operate. *See* Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 675 (2008).

[63] 626 A.2d 1366 (Del. 1993).

bargain for protection before parting with consideration."[64] Delaware's position on shareholder oppression draws support from neoclassical law and economics.[65] The economists' model of rational behavior posits that a minority shareholder would not invest without appropriate contractual protections.[66] Put differently, the price the minority paid for its stock must be presumed to include all risks, including the possibility that the majority might later appropriate the value of the minority's stake in the business.[67]

Ironically, in this replay of the contest between formalism and pragmatism, contract law marches under formalism's flag. Instead of being celebrated for the flexibility it permits, contract law has been invoked as a paragon of the virtues of formalism — clear rules to follow, predictable results, and the avoidance of unresolvable policy disputes.[68] In some cases, admittedly, minority shareholders might suffer unfair treatment, but those consequences could have been avoided. At any rate, according to proponents of formalism, abstract questions of fairness should not change the result when a rule provides for a specific outcome.[69] Moreover, if experience is the best teacher, formalists can

[64] *Id.* at 1380.

[65] *See* Paula J. Dalley, *The Misguided Doctrine of Stockholder Fiduciary Duties*, 33 HOFSTRA L. REV. 175, 197 (2004); Rock & Wachter, *supra* note 1, at 915.

[66] *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 237 (1991) ("Investors in close corporations often put a great deal of their wealth at stake, and the lack of diversification (compared with investors in publicly held firms) induces them to take care.").

[67] The cost of mistreatment is priced in because investors select whichever form of business association offers the best mix of risks and opportunities. *See* Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 272 (1985) ("Each organizational form presents its own problems, for which people have designed different mechanisms of control. At the margin, the problems must be equally severe, the mechanisms equally effective . . . .").

[68] *See* Jiménez, *supra* note 18, at 1160 ("A coherent and predictable body of law allows individuals to plan with confidence, and to settle their disputes without the need to recur to litigation."). In this sense, the appeal of formalism is the appeal of all rule-based systems: clarity and certainty. For an evaluation of rules and standards, see Kathleen M. Sullivan, *The Supreme Court, 1991 Term — Foreword: The Justices of Rules and Standards*, 106 HARV. L. REV. 22, 58-59 (1992).

[69] *See* Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175, 1182 (1989) ("[W]e should recognize that, at the point where an appellate judge says that the remaining issue must be decided on the basis of the totality of the circumstances, or by

comfort themselves that a hapless minority shareholder's misfortune may then serve as a warning, motivating other investors to use the available contractual tools rather than expecting courts to save them from their own lack of planning.[70]

The arguments for exclusive reliance on contract law have been challenged by courts and commentators who contrast the behavior of a purely hypothetical economically rational actor with the parties' actual bargaining situation in closely held businesses.[71] For example, scholars have argued that it is unrealistic to expect tailored agreements when closely held businesses are built on trust and shareholders are often connected by kinship ties.[72] In addition, bespoke deals can be expensive for the parties at the outset of an uncertain venture.[73] Moreover, even

a balancing of all the factors involved, he begins to resemble a finder of fact more than a determiner of law."); *cf.* Schauer, *supra* note 9, at 535 (explaining that formalism exalts rules and that "it is exactly a rule's rigidity, even in the face of applications that would ill serve its purpose, that renders it a rule").

[70] *See* EASTERBROOK & FISCHEL, *supra* note 66, at 237-38 ("[The] process of learning (through counsel) from the mistakes of others works reasonably well in assuring intelligently specialized contractual terms for closely held corporations."). The effort to conform behavior to law is a classic hallmark of formalism. *See* PIERRE SCHLAG & AMY J. GRIFFIN, HOW TO DO THINGS WITH LEGAL DOCTRINE 93 (2020) ("To display practicality, a legal distinction must track with the social, technological, or economic divisions already inscribed in the field of application (the realist strategy), or it must be sufficiently powerful to impose itself on the field (the formalist strategy)."). Consequently, "to use the formalist strategy well, one needs to know the relevant factual context well enough to recognize that a formalist strategy is likely to work — that the parties are likely to be induced to conform their behavior to a formalist conceptual architecture." *Id.* at 90.

[71] *See, e.g.*, Means, *A Contractual Approach*, *supra* note 15, at 1172 ("It is no secret that minority shareholders in close corporations tend not to bargain for adequate protection, a problem that has been evident for decades.").

[72] Family members who are vulnerable within the structure of the family will not always be able to insist upon contractual protections as a precondition to their participation in a shared business venture. *See* Elizabeth Sepper & James D. Nelson, *Adolf Berle's Corporate Conscience*, 45 SEATTLE U. L. REV. 97, 124-25 (2021) ("[T]he hierarchical norms of family are often reproduced within the corporate form. Those who traditionally lack power within the family often become minority shareholders, without the power to replace company managers or to sell their shares for fair value." (citing Benjamin Means, *Nonmarket Values in Family Businesses*, 54 WM. & MARY L. REV. 1185, 1209-10 (2013))).

[73] *See* Matheson & Maler, *supra* note 29, at 679; Moll, *Minority Oppression, supra* note 4, at 916 n.112 (noting that "ex ante contracting is expensive," and observing that "[t]his

granting the assumption of law and economics that individuals always act rationally in their own interests, minority shareholders may lack the legal sophistication to perceive problems in the business relationship that could arise decades in the future.[74]

If contract law is insufficient to the task, then adequate protection of minority shareholders appears to require a noncontractual solution. To that end, some courts have concluded that shareholders in closely held corporations should be treated as partners and entitled to the strong fiduciary protections of partnership law.[75] As fiduciaries, majority shareholders would be prevented from mistreating minority shareholders because the duty of loyalty prohibits placing one's own interests above the interests of others to whom the fiduciary duty is owed. A fiduciary duty, in other words, requires more than the commercial reasonableness expected of contractual counterparties.[76]

Partnerships and corporations are distinct forms of business association, but closely held corporations arguably present a hybrid

level of expense may be prohibitive for many small businesses, especially at their inception").

[74] *See* Means, *A Contractual Approach*, *supra* note 15, at 1211 (contending that "shareholders live in the real world, not in the pages of a game theory treatise, and the ties of family and friendship, the social norms of business, and the constraints imposed by transaction costs all impact the likelihood that the parties will negotiate adequate protections against possible future discord"); Moll, *Minority Oppression*, *supra* note 4, at 912-13 (noting that "[c]ommentators have also argued that close corporation owners are often unsophisticated in business and legal matters such that the need for contractual protection is rarely recognized," and stating that "it is quite difficult to foresee all (if not most) of the situations that may require contractual protection").

[75] *See, e.g.*, Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 515 (Mass. 1975) (stating 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" (footnotes omitted)); *see also* Hollis v. Hill, 232 F.3d 460, 468-69 (5th Cir. 2000) (applying Nevada law and concluding that "courts have equitable powers to fashion appropriate remedies where the majority shareholders have breached their fiduciary duty to the minority by engaging in oppressive conduct").

[76] *See, e.g.*, Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928) ("Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.").

situation.[77] That is, a relatively small group of investors may incorporate to obtain limited liability and favorable tax treatment, but still view themselves as partners who expect to share equally in the successes and failures of the business.[78] If so, judicial enforcement of the fiduciary norms of partnership law will more closely resemble the parties' own expectations than strict adherence to the rules of corporate law. This approach does not preclude the parties from bargaining to adjust the terms of their relationship, but it situates the bargain within a context defined principally by the duty of loyalty.[79]

Two important cases setting forth the fiduciary approach, *Donahue v. Rodd Electrotype Company*[80] and *Wilkes v. Springside Nursing Home, Incorporated*,[81] were both decided within a year of each other by the Massachusetts Supreme Judicial Court. In *Donahue*, a "landmark decision,"[82] the court held 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."[83] The plaintiff, Euphemia Donahue, was the widowed spouse of the corporation's former vice president.[84] She sued because she was not permitted to sell her shares to the corporation on the same terms extended to a majority shareholder who wished to retire.[85] Deciding in her favor, the court created a rule of equal opportunity: "[I]f the stockholder whose shares

[77] *See* Larry E. Ribstein, *Close Corporation Remedies and the Evolution of the Closely Held Firm*, 33 W. NEW ENG. L. REV. 531, 533 (2011) (arguing that the availability of limited liability motivated small business owners who wanted to do business as partners to choose the corporate form but that "this was an unhappy compromise that necessitated judicial intervention into the parties' contracts").

[78] *See id.*

[79] *See* Means, *A Voice-Based Framework*, *supra* note 21, at 1223-24 ("The Fiduciary Duty approach holds that majority shareholders owe a heightened fiduciary duty akin to the duty partners owe to each other, restricting even otherwise legitimate business decisions that harm minority shareholders.").

[80] 328 N.E.2d 505 (Mass. 1975).

[81] 353 N.E.2d 657 (Mass. 1976).

[82] COX & HAZEN, *supra* note 20, § 14.16, at 874.

[83] *Donahue*, 328 N.E.2d at 515 (footnotes omitted).

[84] *See id.* at 508-09.

[85] *See id.* at 511. The transaction involving the majority shareholder was apparently part of a family succession plan; the exiting shareholder had already given the bulk of his stock to his children. *See id.* at 510.

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."[86]

A year later, in *Wilkes*, the court reaffirmed the fiduciary approach but clarified that decisions disadvantaging the minority were not per se unlawful if the majority could establish a "legitimate business purpose" for its actions.[87] The plaintiff, Stanley Wilkes, was one of four founding investors in a nursing home.[88] He and the other shareholders took equal salaries, which represented their return on investment, and allocated operational responsibilities among themselves equally.[89] Wilkes sued after the other three shareholders fired him, cutting off his salary and keeping the value of the business for themselves.[90] There was no evidence that Wilkes failed to perform his job properly; instead, the events precipitating his removal seem to have involved his negotiation of a better deal for the corporation to the disadvantage of another shareholder.[91] The defendants, therefore, were not able to show any legitimate business purpose for their conduct.[92] Still, the court emphasized that controlling shareholders "must have some room to

[86] *Id.* at 518. Some commentators have argued that this strict fiduciary approach (and its accompanying equal opportunity rule) comes at too high of a cost with respect to the ordinary governance needs of a corporation. *See, e.g.*, 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.").

[87] *Wilkes*, 353 N.E.2d at 663; *see also infra* text accompanying notes 104–107 (discussing *Wilkes*).

[88] Wilkes was the one who had identified the investment opportunity in the first place. *See Wilkes*, 353 N.E.2d at 659.

[89] *See id.* at 659-60.

[90] *See id.* at 661.

[91] *See id.* at 660 ("Wilkes was successful in prevailing on the other stockholders of Springside to procure a higher sale price for the [corporation's] property than Quinn [another stockholder] apparently anticipated paying or desired to pay.").

[92] *See id.* at 661 ("The severance of Wilkes from the payroll resulted not from misconduct or neglect of duties, but because of the personal desire of [the other three stockholders] to prevent him from continuing to receive money from the corporation.").

maneuver in establishing the business policy of the corporation."[93] By integrating a legitimate business purpose framework into the fiduciary approach, the *Wilkes* court sought to reconcile fiduciary duty protections with the ordinary governance needs of a corporation.

Whether applied strictly or tempered by some deference for the majority's control rights, the application of a fiduciary standard promises to protect minority shareholders from overreaching. Unlike the contract-based approach exemplified by *Nixon v. Blackwell*, the absence of explicitly bargained-for contractual rights is not tantamount to acquiescence by the minority to whatever abuse the majority might decide to dish out. A heightened fiduciary standard of behavior would still apply.[94] Thus, the fiduciary approach captures the pragmatic insight that some judicial oversight is needed to temper the majority's control and to ensure that a closely held corporation operates for the benefit of all shareholders.

II. THE MINORITY SHAREHOLDER'S REASONABLE EXPECTATIONS

Broadly speaking, pragmatism has won the day.[95] Although a few jurisdictions continue to reject the doctrine of shareholder oppression,

[93] *Id.* at 663 (citing dividends, salary, and employment as issues ordinarily committed to the majority's discretion).

[94] The fiduciary approach has been applied in other jurisdictions as well. *See, e.g.*, Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 276 (Alaska 1980) (defining relationship among shareholders in closely held corporations as fiduciary); Melrose v. Capitol City Motor Lodge, Inc., 705 N.E.2d 985, 991 (Ind. 1998) (citation omitted) ("[W]e have held that 'shareholders in a close corporation stand in a fiduciary relationship to each other, and as such, must deal fairly, honestly, and openly with the corporation and with their fellow shareholders.'"); Boatright v. A&H Techs., Inc., 296 So. 3d 687, 697 (Miss. 2020) (noting that state law recognizes the vulnerability of minority shareholders and provides them with special protections against freeze-outs); Whitehorn v. Whitehorn Farms, Inc., 195 P.3d 836, 843 (Mont. 2008) (stating that shareholders in closely held corporations owe one another a fiduciary duty of "utmost good faith and loyalty" (citation omitted)); Clark v. Lubritz, 944 P.2d 861, 865 (Nev. 1997) (defining content of fiduciary duty among partners); Crosby v. Beam, 548 N.E.2d 217, 220-21 (Ohio 1989) (holding that majority shareholders have a fiduciary duty not to abuse their power at the expense of minority shareholders).

[95] *Cf.* Anupam Chander, *Minorities, Shareholder and Otherwise*, 113 YALE L.J. 119, 122 (2003) ("Despite scholarly commentary to the contrary, the watchwords of corporate law include not only *wealth maximization*, but also *fairness*." (emphasis in original)).

most jurisdictions have created common law or statutory remedies for minority shareholders that offer relief in the absence of a formal contract.[96] As a result, the availability of protection for minority shareholders in a particular case is more likely to depend on how broadly the concept of oppression is defined than on whether it is recognized. Courts in some states, including Massachusetts, continue to describe oppression in fiduciary terms. In many states, however, courts define oppression as conduct that frustrates the minority's reasonable expectations.[97]

Unlike fiduciary duty, the concept of reasonable expectations is not so much a rejection of contract law as it is a pragmatic version of it. Reasonable expectations are contractual because courts consider the nature of the parties' bargain when deciding whether the minority's expectations are reasonable in a given case. This analysis may involve the inclusion of implied terms, an assessment of background relationships among the parties, and a heightened scrutiny of contract terms that appear to contravene the parties' purposes. Consequently, although reasonable expectations need not have been reduced to writing in a formal contract, they are consistent with pragmatic principles of contract law.[98]

A. The Limits of a Fiduciary Standard for Oppression

Courts have sometimes stated that the cause of action for shareholder oppression in a closely held corporation is essentially identical to an action for breach of fiduciary duty.[99] A fiduciary-based definition of

[96] *See supra* note 5 and accompanying text.

[97] *See* MOLL & RAGAZZO, *supra* note 5, at § 7.01(D)(1)(b)(i) (stating that "many courts tie oppression to majority conduct that frustrates a minority shareholder's 'reasonable expectations,'" noting that "[t]he highest courts in several states have adopted the reasonable expectations approach," and further observing that "[a] number of intermediate appellate courts in other states have adopted the reasonable expectations standard as well"); *supra* note 7 and accompanying text.

[98] In some situations, a reasonable expectations analysis may call for a pragmatic extension of contract law principles. *See infra* Part II.D.

[99] *See, e.g.*, Baur v. Baur Farms, Inc., 832 N.W.2d 663, 673-74 (Iowa 2013) ("Management-controlling directors and majority shareholders of such [closely held] corporations have long owed a fiduciary duty to the company and its shareholders. . . .

shareholder oppression, however, can be difficult to administer. The problem is applying the fiduciary standard to remedy oppressive conduct without undermining the essential nature of the corporate form. On the one hand, if restricted to paradigmatic cases of self-dealing in which a controlling shareholder takes value out of a corporation at the expense of other shareholders, the fiduciary standard is duplicative of duties owed by directors and controlling shareholders in all corporations, even those that are publicly traded.[100] This approach would respect the corporate form but at the cost of reading the concept of oppression too narrowly.

On the other hand, assuming that the shareholder oppression doctrine is meant to sweep more widely than classic self-dealing,[101] courts must reconcile fiduciary duty with majority control. One of the most fundamental principles of corporate law, known as the "business judgment rule," provides that a corporation's directors are presumed to act in the best interest of the corporation and its shareholders.[102] The deference that directors can expect pursuant to the business judgment

The fiduciary duty . . . mandates that controlling directors and majority shareholders conduct themselves in a manner that is not oppressive to minority shareholders.").

[100] *See* MOLL & RAGAZZO, *supra* note 5, §§ 6.03(A), 6.07(B) (observing that directors, officers, and controlling shareholders of all corporations owe a duty of loyalty that regulates self-dealing transactions).

[101] One commentator has argued that self-dealing, construed broadly, is at the heart of all shareholder oppression disputes. *See* Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L.Q. 1099, 1146 (1999) ("Moreover, the problem of self-dealing (broadly understood) in a closely held corporation is omnipresent. Almost every decision made by the majority that affects the minority's employment, participation, or dividends has a potential freezeout effect and the potential to grant the majority a disproportionate share of the corporation's income stream. The majority is usually employed, which makes every compensation decision a self-dealing problem.").

[102] *See, e.g.*, BAINBRIDGE, *supra* note 24, at 242 and accompanying text (describing the business judgment rule); Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87 (2004) (stating that the business judgment rule "creates a strong presumption against judicial review of duty-of-care claims," and noting that "[c]ourts following this [abstention] approach to the rule will abstain from reviewing the substantive merits of the directors' conduct unless the plaintiff can carry the very heavy burden of rebutting that presumption"); Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 721 (2019) (describing the business judgment rule as "the normal standard of deference for directors' decision-making").

rule is totally different from the level of scrutiny that would apply when fiduciary duties are at issue.[103] Too broad an application of fiduciary duty might protect minority shareholder interests but would turn the business judgment rule into a dead letter in closely held corporations.

The doctrinal apparatus that has developed around fiduciary law in Massachusetts illustrates the difficulty. Courts seeking to create a general limitation on the discretion of majority owners must navigate the doctrinal thicket left by *Wilkes*, which sought to qualify *Donahue*'s unnuanced proclamation that the duty of loyalty defines the shareholder relationship in closely held corporations.[104] As the *Wilkes* court recognized, any realistic fiduciary standard would need to somehow accommodate the majority's right of "selfish ownership."[105] Consequently, the *Wilkes* test for oppression involves two steps. First, if the minority can plausibly allege mistreatment, the majority has the burden of demonstrating a legitimate business purpose for its conduct.[106] Second, if such a legitimate business purpose has been established, the minority must then show that practicable alternatives were available that would have accomplished the same legitimate corporate purpose while causing less harm to the minority's interests.[107]

One could fault the *Wilkes* court for creating too much complexity while providing too little guidance, but the problem is more fundamental than that. Regardless of how the fiduciary standard is described, there is an inherent tension in declaring that majority shareholders owe a heightened fiduciary duty of loyalty to the minority shareholders, while, at the same time, admitting that majority shareholders are permitted to act self-interestedly for their own benefit (i.e., "selfish ownership"). The concept of fiduciary duty, classically described as "relentless and supreme,"[108] is best suited to drawing

[103] *See* Bernard S. Sharfman, *The Importance of the Business Judgment Rule*, 14 N.Y.U. J.L. & BUS. 27, 29 (2017) (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993)).

[104] *See supra* text accompanying notes 80–94 (discussing the *Donahue* and *Wilkes* decisions).

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

[106] *See id.*

[107] *See id.*

[108] Meinhard v. Salmon, 164 N.E. 545, 548 (N.Y. 1928).

strong lines between permissible and impermissible conduct, not to navigating grey areas in shareholder relationships.[109]

B. The Reasonable Expectations Approach

The fiduciary duty of loyalty, however, represents only one possible method for protecting minority shareholders from the majority's abuses of control. In most U.S. jurisdictions, shareholder protection is codified in statutory provisions that allow minority shareholders who can establish "oppressive" or "unfairly prejudicial" conduct to seek corporate dissolution.[110] Courts typically define oppression as the frustration of the minority's reasonable expectations.[111] This approach is informed by evidence of the parties' business relationship and avoids much of the *post hoc* quality of fiduciary analysis.

The New York Court of Appeals, which was one of the first courts to develop the reasonable expectations approach, described it as follows:

> A court considering a petition alleging oppressive conduct must investigate what the majority shareholders knew, or should have

[109] *See* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 879 (1988) ("Fiduciary obligation is one of the most elusive concepts in Anglo-American law."); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1400 (2002) ("Fiduciary law is messy.").

[110] *See infra* note 196. Such provisions were adopted in a handful of jurisdictions by the mid-1930s and then promoted more broadly by the 1946 Model Business Corporation Act. *See* Thompson, *The Shareholder's Cause of Action*, *supra* note 3, at 709 (noting that 37 states have now adopted similar oppression statutes). Until relatively recently, the statutes were rarely invoked, "in part because of . . . the traditional unwillingness of courts to dissolve an ongoing business." *Id.* at 709-11. According to one early critic, the oppression cause of action "confers a drastic remedy by way of involuntary dissolution in very vague and general terms which will make it easy for a single obstreperous shareholder . . . to interfere with the management of the majority by creating a cash nuisance value." Henry Winthrop Ballantine, *A Critical Survey of the Illinois Business Corporation Act*, 1 U. CHI. L. REV. 357, 392 (1934).

[111] *See supra* note 97 and accompanying text. In some jurisdictions, courts look instead for evidence of "burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members; or a visual 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." Baker v. Com. Body Builders, Inc., 507 P.2d 387, 393 (Or. 1973); *see also infra* notes 116–117 and accompanying text (discussing the "burdensome, harsh, and wrongful" test).

> known, to be the petitioner's expectations in entering the particular enterprise. Majority conduct should not be deemed oppressive simply because the petitioner's subjective hopes and desires in joining the venture are not fulfilled. Disappointment alone should not necessarily be equated with oppression. Rather, oppression should be deemed to arise only when the majority conduct substantially defeats expectations that, objectively viewed, were both reasonable under the circumstances and were central to the petitioner's decision to join the venture.[112]

This definition of oppression replaces the fiduciary framework with a contractual lens; reasonable expectations do not include the minority's subjective "hopes and desires" unless they were part of the understanding between the parties.[113]

In a recent case of first impression, *Manere v. Collins*,[114] a Connecticut appellate court adopted reasonable expectations as the standard for evaluating claims of oppression in the LLC setting.[115] The court's rationale for doing so is illuminating. Surveying the law in the analogous corporate context, the court noted that while most jurisdictions use the reasonable expectations test to identify shareholder oppression, some jurisdictions define oppression as "burdensome, harsh, and wrongful"

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

[113] *See, e.g.*, Gimpel v. Bolstein, 477 N.Y.S.2d 1014, 1019 (Sup. Ct. 1984) ("[T]he 'reasonable expectations' test is indeed an examination into the spoken and unspoken understanding upon which the founders relied when entering into the venture."); Meiselman v. Meiselman, 307 S.E.2d 551, 563 (N.C. 1983) ("In order for plaintiff's expectations to be reasonable, they must be known to or assumed by the other shareholders and concurred in by them. Privately held expectations which are not made known to the other participants are not 'reasonable.' Only expectations embodied in understandings, express or implied, among the participants should be recognized by the court.").

[114] 241 A.3d 133 (Conn. App. Ct. 2020).

[115] The statute at issue provided that a member can seek dissolution of the LLC on the grounds that the controlling managers or members "have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant." CONN. GEN. STAT. ANN. § 34-267(a)(5) (2017). The court found that LLC members are in most respects equivalent to closely held corporation shareholders. As a consequence, the court determined that corporate law interpretations of the concept of oppression would be relevant. *See Manere*, 241 A.3d at 152.

conduct by the majority.[116] This latter approach looks past the parties' bargain and instead focuses on the motivation for and propriety of the majority's conduct. The *Manere* court favored the reasonable expectations alternative because it did not require a court to decide if majority conduct that negatively affected the minority was nevertheless permissible because it served a legitimate business purpose (and was therefore not "burdensome, harsh, and wrongful").[117] As the court recognized, any effort to balance the majority's control rights with fiduciary or other status-based obligations to the minority creates a wide area of uncertainty.[118]

The reasonable expectations approach avoids this problem. While a reasonable expectations analysis requires a close look at the facts of each case, it is more than merely an after-the-fact conclusion about what is fair and equitable under the circumstances.[119] Unlike the "burdensome, harsh, and wrongful" approach, which imposes an external standard, reasonable expectations arise from the parties' bargain. Thus, the reasonable expectations approach is preferable to either a fiduciary standard or the burdensome-harsh-and-wrongful definition of oppression — not because reasonable expectations are

[116] *Manere*, 241 A.3d at 153.

[117] *See id.* (noting that the "burdensome, harsh, and wrongful" test "has been described as a focus 'on preserving the majority's discretion to make decisions in furtherance of a legitimate business purpose — a standard that is typically satisfied when majority actions benefit the corporation'" (quoting Douglas K. Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VAND. L. REV. 749, 762 (2000))).

[118] In this regard, a former Chief Justice of the Delaware Supreme Court has argued that "courts need to be mindful of the distinction between status relationships and contractual relationships." Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 9 (2007). Justice Steele argued that greater emphasis should be placed on contractual analysis in dispute resolution. *See id.* at 25.

[119] The clarity of the reasonable expectations approach might allay the concerns of commentators who have worried about injecting arbitrariness into the law of closely held corporations. *See* Larry E. Ribstein, *The Closely Held Firm: A View from the United States*, 19 MELB. U. L. REV. 950, 955 (1994) (contending that shareholder oppression claims are a "wild card").

always easy to measure, but because an inquiry into such expectations appropriately focuses on the shared understandings of the parties.[120]

The *Manere* decision is also instructive in its explanation of how a reasonable expectations analysis might proceed. Following the official commentary to the Revised Uniform Limited Liability Company Act, the Connecticut court identified several important factors for assessing reasonable expectations from a bargain-focused perspective:

> [W]hether the expectation: (i) contradicts any term of the operating agreement or any reasonable implication of any term of that agreement; (ii) was central to the plaintiff's decision to become a member of the limited liability company or for a substantial time has been centrally important in the member's continuing membership; (iii) was known to other members, who expressly or impliedly acquiesced in it; (iv) is consistent with the reasonable expectations of all the members, including expectations pertaining to the plaintiff's conduct; and (v) is otherwise reasonable under the circumstances.[121]

These factors highlight that the concept of reasonable expectations is rooted in the parties' own business dealings. On the one hand, a reasonable expectation may exist even if it was not reduced to writing in a shareholders' agreement or other formal contract.[122] Nor must a reasonable expectation have existed at the time of investment; the parties' later conduct can provide evidence of the expectation.[123] On the

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[120] *See, e.g.*, *supra* text accompanying note 113 (noting descriptions of "reasonable expectations" in case law); MOLL & RAGAZZO, *supra* note 5, § 7.01(D)(1)(b)(ii)(A) (stating that "[c]ourts and commentators have observed that reasonable expectations are based on mutual understandings between the shareholders of a closely held corporation").

[121] *Manere*, 241 A.3d at 156-57 (citing REV. UNIF. LTD. LIAB. CO. ACT § 701 cmt. (2006) (UNIF. L. COMM'N, amended 2013)).

[122] *See* Gimpel v. Bolstein, 477 N.Y.S.2d 1014, 1019 (Sup. Ct. 1984) ("[T]he 'reasonable expectations' test is indeed an examination into the spoken and unspoken understanding upon which the founders relied when entering into the venture."); Robert B. Thompson, *Corporate Dissolution and Shareholders' Reasonable Expectations*, 66 WASH. U. L.Q. 193, 217 (1988) [hereinafter *Corporate Dissolution*] ("Courts permit expectations to be established outside of formal written agreements, but the minority shareholder retains the burden of proving the existence of the expectations.").

[123] *See infra* Part III.B.2 (discussing whether reasonable expectations must exist at the time of investment).

other hand, the reasonableness of the alleged expectation may be contested when it is in tension with the terms of the negotiated provisions of any written contracts.[124] Further, reasonable expectations cannot be secret expectations unknown to the majority.[125] Finally, because equity plays a role, reasonable expectations can be lost because of the minority's own misconduct.[126]

Thus, the reasonable expectations approach to evaluating claims of minority shareholder oppression is contractual in that it turns on the parties' bargain. As discussed in the Sections that follow, the reasonable expectations approach is consistent with existing pragmatic contract doctrines such as implied-in-fact contract, relational contract, and the "objectively reasonable expectations" interpretive principle that is sometimes applied when interpreting contracts of adhesion. Moreover, even if a shareholder's reasonable expectations would not meet the requirements of contract law in a particular jurisdiction, the contractual inquiry called for under a reasonable expectations approach need not be synonymous with a jurisdiction's contract law doctrine.

C. Reasonable Expectations as Contractual Bargain

Although contract law has been invoked by formalists to oppose minority shareholder protections, the extent to which contract law embodies formalistic principles is debatable. Indeed, for the past century, a tug-of-war between formalism and pragmatism has touched nearly every aspect of contract law. The pragmatic approach, most fully captured in the Uniform Commercial Code's provisions concerning the sale of goods, seeks to understand the parties' behavior and then conform the law to what most people would naturally expect.[127] Courts

[124] *See infra* note 227 (discussing conduct authorized by contract).

[125] *See, e.g.*, Meiselman v. Meiselman, 307 S.E.2d 551, 563 (N.C. 1983) ("Privately held expectations which are not made known to the other participants are not 'reasonable.'").

[126] *See, e.g.*, *Manere*, 241 A.3d at 161 (finding that "the plaintiff's misappropriation of . . . funds would render any expectation of continuing employment . . . unreasonable"). The court stated that "[a]lthough those expectations may have, at one point, been reasonable, it must be recognized that 'reasonable expectations' do not run only one way." *Id.* (internal quotation omitted).

[127] *See* SCHLAG & GRIFFIN, *supra* note 70, at 80 ("In the realist strategy, the law 'tracks' an already existing division in the field of application. In other words, the law simply

that adhere to a more formalistic view believe that the law sets standards which individuals must meet.[128]

The reasonable expectations approach to defining shareholder oppression aligns nicely with a pragmatic view of contract law. Instead of setting traps for the unwary, pragmatism's overriding goal is to identify what the parties themselves intended.[129] Accordingly, "judicial determination of the contractual obligation serves as a fallback mechanism for vindicating the parties' intent whenever a court determines that the formal contract terms fall seriously short of achieving the parties' purposes."[130] Depending on the circumstances, courts might imply contractual terms or recognize that relationships between the parties affect the interpretation of a contract. In limited situations, courts might also conclude that a party's reasonable expectations counsel against interpretations of the language in a contract that would cut against the manifest purpose of entering into the bargain in the first place.

follows whatever distinctions are already marked out in the social, technological, or economic realm . . . .").

[128] *See id.* at 81 ("The formalist strategy is to create legal distinctions with the kinds of incentives (carrots) and/or deterrents (sticks) that will induce parties to conform their behavior to the distinction set forth."). A deeper objection to a formalistic approach is that it can validate outcomes that conflict with contract law's basic purpose of enhancing individual freedom. *See* Hanoch Dagan & Michael Heller, *Why Autonomy Must Be Contract's Ultimate Value*, 20 JERUSALEM REV. LEGAL STUD. 148, 151 (2019) (contending that "there is no 'autonomy gain' in enforcing contracts that go beyond the parties' own basic assumptions").

[129] That intention may be interpreted to include certain norms of treatment, as when a court found that a female shareholder had a reasonable expectation that she would be "be treated with equal dignity and respect as the male shareholders forming the majority." Straka v. Arcara Zucarelli Lenda & Assocs., 92 N.Y.S.3d 567, 570 (Sup. Ct. 2019) (cited in Meredith R. Miller, *Challenging Gender Discrimination in Closely Held Firms: The Hope and Hazard of Corporate Oppression Doctrine*, 54 IND. L. REV. 123, 126 (2021)); *see also* Peter Mahler, *Minority Shareholder Oppression in the #MeToo Era*, N.Y. BUS. DIVORCE BLOG (Jan. 28, 2019), https://www.nybusinessdivorce.com/2019/01/articles/grounds-for-dissolution/minority-shareholder-oppression-metoo-era/ [https://perma.cc/22DL-3W37].

[130] Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1025 (2009).

1. Implied-in-Fact Contracts

One way to align the concept of shareholder expectations with contract law is to assert that evidence of shareholder expectations establishes an implied-in-fact contract between the parties, even if that alleged agreement is not found in any writing.[131] A contractual term may be implied if there is objective evidence of a contractual bargain that was never formalized orally or in writing.[132] An implied-in-fact contract, therefore, is "grounded in the parties' agreement and tacit understanding" and its "existence and terms are inferred from the conduct of the parties."[133] Instead of invoking the maxim, "you made your bed, now you must lie in it," courts that take a pragmatic view of contract law will enforce the parties' understood bargain.[134]

For example, in *Wood v. Lucy, Lady Duff-Gordon*,[135] Justice Cardozo, writing for the New York Court of Appeals, held that the element of consideration was satisfied because an obligation of "reasonable efforts" should be implied based upon the context of the parties' relationship.[136] Lady Duff-Gordon was a clothing designer who had allegedly given an exclusive marketing and endorsement deal to the plaintiff. She then broke her promise by dealing directly with stores to

[131] *See* Moll, *Reasonable Expectations v. Implied-in-Fact Contracts*, *supra* note 7, at 992 ("When courts attempt to define a 'reasonable expectation' in the shareholder oppression context, the language used is nearly identical to the conventional description of an implied-in-fact contract.").

[132] *See* Commerce P'ship 8098 v. Equity Contracting Co., 695 So. 2d 383, 385 (Fla. Dist. Ct. App. 1997) ("A contract implied in fact is not put into promissory words with sufficient clarity, so a fact finder must examine and interpret the parties' conduct to give definition to their unspoken agreement."); J. Wilson Parker, *At-Will Employment and the Common Law: A Modest Proposal to De-Marginalize Employment Law*, 81 IOWA L. REV. 347, 354 (1995) ("A court's willingness to find implied-in-fact terms in [employment] contracts by examining the parties' objective behavior is rooted in fundamental contract principles.").

[133] Kennedy v. Forest, 930 P.2d 1026, 1029 (Idaho 1997).

[134] In some cases, courts will look past what the parties actually negotiated and consider, based on the circumstances, what it is logical to assume the parties would have agreed to had the issue arisen for discussion. *See* Lisa Bernstein, *Social Norms and Default Rules Analysis*, 3 S. CAL. INTERDISC. L.J. 59, 62-63 (1993).

[135] 118 N.E. 214 (N.Y. 1917).

[136] *See id.* at 214-15.

market her wares.[137] She argued that the plaintiff, although obligated to account to her for any sales, had never committed to attempt to make those sales in the first place.[138] Accordingly, she argued that plaintiff's promise was illusory and that the alleged contract was not supported by consideration.[139]

The court rejected Lady Duff-Gordon's argument. As Cardozo put it, "[t]he law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal."[140] Instead, looking at the totality of the bargain, including the promise of exclusivity, Cardozo concluded that the plaintiff, Wood, was bound to make reasonable efforts on behalf of Lady Duff-Gordon. Wood's promise, when evaluated in context, was not illusory, and it followed that the contract did not fail for lack of consideration.[141]

Similarly, in a closely held corporation, courts may enforce terms that were not explicitly negotiated by the parties but that arise by implication. For example, it will often be clear from the circumstances that a minority shareholder invested in the business to share in its profits via salary and to participate in management.[142] Thus, a court

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[137] *See id.* at 214.

[138] *See id.*

[139] *See id.*

[140] *Id.*

[141] *See id.* at 215.

[142] *See, e.g.*, Gunzberg v. Art-Lloyd Metal Prods. Corp., 492 N.Y.S.2d 83, 85 (App. Div. 1985) ("As a result of their long history of taking an active part in the running of the corporation, petitioners demonstrated that they had a reasonable expectation that they would continue to be employed by the company, and have input into its management."); Muellenberg v. Bikon Corp., 669 A.2d 1382, 1388 (N.J. 1996) ("[I]t is reasonable to conclude that Burg's fair expectations were that should he give up his prior employment with a competitor company and enter this small corporation, he would enjoy an important position in the management affairs of the corporation."). Professors Moll and Ragazzo provide a further example:

> [A]ssume that all of the shareholders in a closely held corporation invest a substantial sum of capital in the business, quit their prior employment, and begin working for the corporation. The company pays no dividends and distributes all of its profits to shareholders as salary and other employment-related compensation. Even without an explicit agreement, it is a fair inference that all of the shareholders implicitly understood that their investments entitled them to continued employment with the company. Indeed, because

could find that the minority's employment and managerial role were part of an implicit bargain. However, there may not be anything in writing to support the shareholder's claims with respect to a specific mode of revenue distribution.[143] Especially when a background rule of law provides for employment at will, some courts are reluctant to imply a term providing for employment as a feature of a shareholder's investment.[144] Nevertheless, "courts seem to appreciate that a rational minority stockholder would not invest in a close corporation without reaching a shared understanding of continued employment and management participation with the majority stockholder."[145] To respect the reality of the parties' situation, a court might imply a promise to continue the plaintiff's employment. Alternatively, a court might imply a promise to declare dividends so that investors are able to realize a return even when they are not earning salary as employees of the business.

> the shareholders left their prior jobs, they all likely understood that employment with the corporation would become their primary (if not sole) sources of livelihood. Moreover, because of the absence of dividends, they all likely understood that employment with the corporation would be the only vehicle for distributing the returns of the business. Thus, the parties' own actions suggest an implicit understanding that shareholder status entitled one to continued employment with the company.

MOLL & RAGAZZO, *supra* note 5, § 7.01(D)(1)(b)(ii)(A); *see also supra* text accompanying note 16 (providing a similar example).

[143] *See* Moll, *Reasonable Expectations v. Implied-in-Fact Contracts*, *supra* note 7, at 1006 ("Although explicit evidence of mutual understandings between the shareholders will occasionally be present — particularly where written documents exist that spell out those understandings — such explicit evidence is usually absent.").

[144] *See, e.g.*, Willis v. Bydalek, 997 S.W.2d 798, 803 (Tex. App. 1999) ("Texas law does not recognize a minority shareholder's right to continued employment without an employment contract."). The court qualified its holding somewhat by stating that "[w]e are not holding that firing an at-will employee who is a minority shareholder can never, under any circumstances, constitute shareholder oppression; we simply hold that under these particular facts, it does not." *Id.* at 802.

[145] Moll, *Reasonable Expectations v. Implied-in-Fact Contracts*, *supra* note 7, at 1012; *see also* Pedro v. Pedro, 463 N.W.2d 285, 289 (Minn. Ct. App. 1990) (stating that "the primary expectations of minority shareholders include an active voice in management of the corporation and input as an employee"); Ragazzo, *supra* note 101, at 1110 (arguing that a minority shareholder "often invests for the purpose of having a job").

The facts of a particular dispute, however, may indicate that implying a promise is inappropriate. In one case, the plaintiff was a minority shareholder and sued after his employment was terminated.[146] The court observed that the plaintiff's stock acquisition postdated his hiring, "[t]here was no general policy [in the corporation] regarding stock ownership and employment," and "there was no evidence that any other stockholders had expectations of continuing employment because they purchased stock."[147] Under the circumstances, therefore, the fact that minority shareholders typically consider salary to be a return on investment was insufficient to establish that this particular plaintiff had a reasonable expectation of employment.[148]

An implied right to employment or managerial participation may also be rebutted by the parties' actual contractual arrangement. For example, when the majority owner of a car dealership terminated the employment of the minority shareholder and exercised a contractual right to repurchase the minority's stock, the conduct was not found to be oppressive.[149] Even if there would otherwise be a reasonable expectation as a matter of implication, the parties' negotiated bargain to the contrary, if not dispositive, should weigh heavily against a finding that the majority has violated the minority's reasonable expectations.[150]

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[146] *See* Merola v. Exergen Corp., 668 N.E.2d 351, 351 (Mass. 1996).

[147] *Id.* at 354.

[148] *See* Moll, *Reasonable Expectations v. Implied-in-Fact Contracts*, *supra* note 7, at 1011 (concluding that the plaintiff's argument failed because he was "unable to prove that his particular dispute fit within the broader pattern of behavior in close corporations").

[149] *See* Ingle v. Glamore Motor Sales, Inc., 528 N.Y.S.2d 602, 604 (App. Div. 1988) ("The plaintiff was aware throughout his employment of the possibility that he could be discharged at the will of the defendants since he repeatedly signed agreements which provided for his discharge 'for any reason' and for the repurchase of his interest in the corporation at that time."). For a detailed critique of the *Ingle* decision, see Alyse J. Ferraro, Note, Ingle v. Glamore Motor Sales, Inc.*: The Battle Between Ownership and Employment in the Close Corporation*, 8 HOFSTRA LAB. & EMP. L.J. 193, 215 (1990) (arguing that an examination of the economic context in *Ingle* demonstrates that the plaintiff did have a reasonable expectation that he would be employed "until he chose to retire or to acquire his own Ford dealership").

[150] *See* Douglas K. Moll, *Shareholder Oppression v. Employment at Will in the Close Corporation: The Investment Model Solution*, 1999 U. ILL. L. REV. 517, 559-61 (1999); *see also infra* note 227 (citing cases where a contract permitted the allegedly oppressive conduct). In one recent case, a minority shareholder's allegation that a termination of

Thus, unlike a vague fiduciary standard, the reasonable expectations approach embodies an implied-in-fact contractual analysis. Such an approach gives courts the ability to protect minority shareholders while, at the same time, respecting the corporation's structure and any existing bargains between the parties.

2. Relational Contracts

The reasonable expectations standard for evaluating claims of shareholder oppression draws additional support from relational contract theory. The classical vision of contract law assumes that two parties have negotiated at arm's length for a discrete exchange of goods or services. In a very simple contract of this kind, there may be less excuse for the parties not to have addressed all important matters in advance. As many commentators have observed, most business relationships no longer fit this model, if they ever did.[151]

One possible response to the gap between the classical model and observed reality is to develop a separate concept of relational contract — a pragmatic concept that better accommodates contracts that may not be negotiated at arm's length and that are intended to guide the parties' dealings over an extended period of time.[152] Instead of limiting

employment was oppressive was rejected in large part because she had signed a shareholders' agreement stating that she was an at-will employee and that the end of her employment would be deemed an offer to sell stock back to the corporation or the majority shareholder. *See* Metro Com. Mgmt. Servs., Inc. v. Van Istendal, 197 A.3d 695, 700 (N.J. Super. Ct. App. Div. 2018) ("Here, the record contains ample evidence to support the judge's conclusion that the parties entered into the Agreement and stipulated that defendant was an at-will employee.").

[151] *See, e.g.*, Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOCIO. REV. 55, 55 (1963) (observing that business contracts typically fail to specify all details of the contemplated transaction and that the parties prefer to resolve issues informally when they arise).

[152] For a classic statement of relational contract theory, see generally Ian R. Macneil, *Contracts: Adjustments of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978). *Cf.* Melvin A. Eisenberg, *Why There Is No Law of Relational Contracts*, 94 NW. U. L. REV. 805, 817 (2000) (arguing that courts should take into account relational factors that may impact the proper interpretation of any contract). For our purposes, the label is not important so long as it is appreciated that contracts are often between parties with preexisting, intimate, and trusting

itself to the explicit terms of a written agreement, relational contract interprets the parties' obligations in light of their circumstances and can evolve as the relationships change.[153]

Closely held corporations, especially those that are family owned, represent a prototypical situation for relational contract.[154] The investors are likely to rely upon their prior relationships with each other and to assume that they can trust their co-investors not to take advantage of any vulnerabilities.[155] Moreover, even if they tried, it would be difficult for investors to anticipate every possible type of controversy that could arise in the life of a business relationship meant to last for years, if not decades.[156] A version of reasonable expectations analysis

relationships. Moreover, those parties may seek to establish an open-ended, long-term exchange governed more by principles than clear rules.

[153] Relational contract thus responds to what scholars have identified as one of the major challenges of contract theory. *See* Richard Holden & Anup Malani, *Renegotiation Design by Contract*, 81 U. CHI. L. REV. 151, 152-53 (2014) ("It is . . . assumed that the parties cannot foresee all possible future contingencies . . . and therefore a complete contract is not possible. Instead, the bulk of the contract-theory literature . . . asks: How can the environment, including the process under which renegotiation takes place, be structured to avoid or ameliorate holdup?"). Some commentators argue, however, that the social expectations captured by relational contract theory should not be enforced by courts — in other words, that contract law should be subject to formalistic constraints. *See* Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 852 (2000) ("All contracts are relational, complex and subjective. But contract law, whether we like it or not, is none of those things. Contract law is formal, simple, and . . . *classical*.").

[154] *See* Means, *A Contractual Approach*, *supra* note 15, at 1196 ("Close corporations are quintessential relational contracts."); Douglas K. Moll, *Shareholder Oppression & Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes*, 86 MINN. L. REV. 717, 756 (2002) (stating that "the investment bargains entered into by close corporation shareholders reflect the characteristics of relational contracts").

[155] *See* Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691, 751 (1974) ("[T]he creation of a new joint enterprise, such as a business partnership or close corporation, is normally preceded by other business relations giving rise to a willingness to go into a deeper relation."); Shannon Kathleen O'Byrne & Cindy A. Schipani, *Feminism(s), Progressive Corporate Law, and the Corporate Oppression Remedy: Seeking Fairness and Justice*, 19 GEO. J. GENDER & L. 61, 98 (2017) ("[T]he oppression action is empowered to treat as legally significant that certain kinds of shareholders — including those in the family firm — are connected to and rely on each other.").

[156] *See* Hwang, *supra* note 2, at 666 ("In many cases, it is impossible for parties to draft contracts that anticipate every contingency.").

that ignored significant relationships between the parties would produce results that fail to match the parties' expectations of mutual benefit and might allow one party to take advantage of the other.[157] Thus, by preventing opportunistic conduct, reasonable expectations, like relational contract theory, follows from the fundamental obligation of good faith that governs every contract.[158]

Although one might object that a focus on relationships rather than rules creates uncertainty that makes business dealings more expensive, too much clarity can also be costly if it breeds opportunistic behavior. According to one commentator, a certain amount of vagueness can be optimal as a mechanism for prompting deeper consideration of business ethics and fairness:

> I begin by questioning the consensus that, whatever their overall merits, it is a common defect of standards that they are hazy, unclear, and provide insufficient notice. Instead, I contend that these supposed defects may often operate as virtues. In some circumstances, these very features of standards serve . . . deliberative purposes. Rather than applying a rule by rote, citizens must ask themselves, for example, whether they are treating one another fairly, whether they are acting in good

[157] *Cf.* William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1400 (1993) ("Since the corporate contract governs an ongoing venture, there is much that cannot be specified before the relationship among the real persons involved commences. Thus, a corporation can be seen as a form of relational contract, in which rather large contractual gaps will necessarily exist.").

[158] *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. L. INST. 1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."); *see also* O'Byrne & Schipani, *supra* note 155, at 100 (arguing that "the oppression action's focus on reasonable expectations and fairness can be regarded as coalescing around broad notions of good faith"). That is, even when the majority's conduct does not violate an explicit term of a contract between the parties, the majority may be found to have violated the covenant of good faith and fair dealing. *See* Means, *A Contractual Approach*, *supra* note 15, at 1199 ("Conduct that is contrary to the reasonable expectations of the parties will also run afoul of the implied covenant of good faith and fair dealing . . . .").

> faith, whether they are taking due care, whether they are behaving reasonably, and the like.[159]

By building upon the contractual covenant of good faith and fair dealing, a relational approach to contractual obligation provides guidance for parties who seek to preserve important relationships with others over time.[160] The simple assumptions of economic rationality that might pertain to an exchange of goods for a price are far different than the interpersonal trust necessary to sustain a business venture.

Notably, this broader vision of contract law in a relational context is demanding and provides a response to those who have objected that "to rely on the contractual duty of good faith as a substitute for fiduciary duty is akin to replacing heavy cream with skim milk."[161] To the contrary, inquiring into the parties' bargain in order to assess their reasonable expectations offers a more effective tool for achieving justice. The inquiry reconciles the minority's inherent vulnerability to abuse with a structure in which the majority has the right to make decisions.[162] In such situations, hierarchy is an essential part of the bargain, but mistreatment is not.

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[159] Seana Valentine Shiffrin, Essay, *Inducing Moral Deliberation: On the Occasional Virtues of Fog*, 123 HARV. L. REV. 1214, 1217 (2010).

[160] *Cf. id.* at 1224 (contending that, unlike compliance with a simple rule, living up to a moral standard "demands active engagement and understanding of the situations of others").

[161] Daniel S. Kleinberger, Essay, *Two Decades of "Alternative Entities": From Tax Rationalization Through Alphabet Soup to Contract as Deity*, 14 FORDHAM J. CORP. & FIN. L. 445, 470 (2008); *see also* Sandra K. Miller, *The Role of the Court in Balancing Contractual Freedom with the Need for Mandatory Constraints on Opportunistic and Abusive Conduct in the LLC*, 152 U. PA. L. REV. 1609, 1654 (2004) ("A broad approach to fiduciary duties is arguably preferable to a . . . contractually oriented standard of good faith because it better reflects society's norms of ethical conduct, may be more effective in combating subtle freeze-out schemes, and does not rest on the assumption that the parties' relationship is governed by a highly negotiated and well-conceived contract.").

[162] *See* Means, *A Contractual Approach*, *supra* note 15, at 1166-67 ("Contract theory, in fact, better explains existing shareholder oppression doctrine than does the imprecise invocation of fiduciary duty. Rather than settle for simplified and unsatisfying assumptions, contract theory incorporates asymmetries, incompleteness, and relational rather than discrete exchanges." (citing PATRICK BOLTON & MATHIAS DEWATRIPONT, CONTRACT THEORY 2 (2005))).

3. Adhesion Contracts

More radically, the reasonable expectations standard for shareholder oppression could be analogized to the reasonable expectations exception to contracts of adhesion, which applies in a very narrow range of circumstances. To achieve justice between the parties, courts will occasionally set aside the language found within a contract when that language is inconsistent with the parties' actual expectations. Courts are most likely to invoke the reasonable expectations exception in situations characterized by a significant disparity in bargaining power, as when an insurance company issues a policy to an insured who may not realize that the exclusions undermine the policy's central purpose.[163]

For example, in *C&J Fertilizer, Incorporated v. Allied Mutual Insurance Company*,[164] the Iowa Supreme Court sided with the insured in a dispute concerning coverage under a burglary policy.[165] The plaintiff owned and operated a warehouse and purchased insurance for burglaries — a term defined by the court as follows:

> [T]he felonious abstraction of insured property . . . from within the premises by a person making felonious entry therein by actual force and violence, of which force and violence there are visible marks made by tools, explosives, electricity or chemicals upon, or physical damage to, the exterior of the premises at the place of such entry . . . .[166]

The purpose of the requirement of evidence of forced entry was plainly to exclude inside jobs from the scope of the insurance policy.[167]

The plaintiff's warehouse was later robbed and there was substantial evidence that the culprit was not an employee.[168] Thus, the insurance

[163] *See, e.g.*, Reliance Ins. Co. v. Moessner, 121 F.3d 895, 904 (3d Cir. 1997) (stating that the reasonable expectations test was "adopted . . . to combat the effects of the relatively unequal bargaining power exercised by insurer and insured").

[164] 227 N.W.2d 169 (Iowa 1975).

[165] *See id.* at 171.

[166] *Id.*

[167] *See id.* at 176-77.

[168] Notably, "[t]here were truck tire tread marks visible in the mud in the driveway leading to and from the plexiglass door entrance to the warehouse." In addition, a locked interior door had been forced open and "was physically damaged." *Id.* at 171.

claim was the kind of claim for which the insurance policy had been purchased. However, the incident did not meet the definition of burglary contained in the insurance policy because there were no visible marks on the warehouse exterior; accordingly, the defendant insurer argued that it was not obligated to pay.[169] According to the court, the reason there were no visible marks was likely because the plexiglass "door could be forced open without leaving visible marks or physical damage."[170]

Even though the policy language excluding the claim was unambiguous, the court concluded that the insurance company's defense should be rejected because it was asserted in bad faith. The court first observed that insurance contracts are contracts of adhesion in which the insured has no ability to negotiate terms.[171] Next, although the formal rules of contract law impose a duty to read on all contracting parties, the court stated that "[i]t is generally recognized the insured will not read the detailed, cross-referenced, standardized, mass-produced insurance form, nor understand it if he does."[172] Finally, the court summarized the reasonable expectations interpretive principle as follows: "'The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.'"[173] Applying that standard, the court concluded that the insurance company's refusal to pay was contrary to the insured's reasonable expectations.[174] Although the

[169] *See id.*

[170] *Id.*

[171] *See id.* at 174 ("The insurance company tenders the insurance upon a 'take it or leave it' basis . . . ." (quoting 7 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 900, at 29-30 (3d ed. 1963) (internal quotation marks omitted))).

[172] *Id.*

[173] *Id.* at 176 (quoting Rodman v. State Farm Mut. Auto. Ins. Co., 208 N.W.2d 903, 906 (Iowa 1973)).

[174] *See id.* at 177 ("The exclusion in issue, masking as a definition, makes insurer's obligation to pay turn on the skill of the burglar, not on the event the parties bargained for: a bonafide third party burglary resulting in loss of plaintiff's chemicals and equipment."). Four justices took a more formalistic perspective on contract law and dissented. *See id.* at 183 (LeGrand, J., dissenting) ("We may not — at least we should not

court's decision involved the interpretation of a contract, the mode of analysis was pragmatic, not formalistic.

Similarly, when evaluating lawsuits involving alleged majority overreaching, courts have sometimes refused to enforce terms in a shareholders' agreement or bylaws on equitable grounds. For example, in *Haley v. Talcott*,[175] the parties were equal co-owners of an LLC and had negotiated a buy-sell provision in their operating agreement. This provision specified how their ownership units would be valued and the process for completing a sales transaction if one party wished to exit the venture.[176] The provision further provided that "upon written notice of election to 'quit' the company, the remaining member may elect, in writing, to purchase the departing member's interest for fair market value."[177] The agreement appeared to prevent one member from unilaterally seeking dissolution of the company, stating that "[o]nly if the remaining member fails to elect to purchase the departing member's interest is the company to be liquidated."[178]

Rather than invoking the buy-sell agreement, however, Haley petitioned for dissolution based on deadlock. Talcott responded that "it is reasonably practicable for the LLC to continue to carry on business in conformity with its LLC Agreement because the [buy-sell] mechanism creates a fair alternative that permits Haley to get out, receiving the fair market value of his share of the property as determined in accordance with procedures in the LLC Agreement, while allowing the LLC to continue."[179] Unlike a situation in which the parties had not specifically addressed an issue, in this case the parties had anticipated and dealt with the question of exit contractually.[180]

There was, however, a significant flaw: the buy-sell provision failed to deal with a personal guaranty that both Haley and Talcott had entered

— by any accepted standard of construction meddle with contracts which clearly and plainly state their meaning simply because we dislike that meaning . . . .").

[175] 864 A.2d 86 (Del. Ch. 2004).

[176] *See id.* at 87-88. The LLC owned the real estate on which the parties operated, as a separate venture, the Redfin Grill restaurant. *See id.*

[177] *Id.* at 91.

[178] *Id.* at 92.

[179] *Id.* at 88.

[180] Notably, however, the buy-sell provision did not state that it was exclusive or that it precluded suits for dissolution of the company. *See id.* at 92.

into as part of a loan to the company.[181] The exit right was useless, practically speaking, because the departing member would remain financially responsible for the company's loan but would no longer have the ability to monitor the company's operations.[182] For this reason, the Vice Chancellor concluded that the "exit mechanism is not a reasonable alternative" to dissolution.[183] He further determined that the plaintiff should not be "limited to the contractually-provided exit mechanism in the LLC Agreement."[184] Thus, even though the parties' had negotiated a specific contractual provision, pragmatic considerations remained relevant to interpreting the provision.[185]

To summarize, pragmatic contract principles can explain many aspects of shareholder oppression law. Such principles provide a basis

[181] More specifically, each of the parties had personally guaranteed the LLC's mortgage. *See id.* at 88.

[182] The court observed that an exit "would leave Haley with no upside potential, and no protection over the considerable downside risk that he would have to make good on any future default by the LLC (over whose operations he would have no control) to its mortgage lender." *Id.* at 98.

[183] *Id.* at 88.

[184] *Id.* at 87. If not for the buy-sell agreement, the case for dissolution would have been clear. *See* DEL. CODE ANN. tit. 6, § 18-802 (1995) ("On application by or for a member or manager the Court of Chancery may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement."); *Haley*, 864 A.2d at 88 (stating that "it is factually undisputed that it is not reasonably practicable for the LLC to carry on business in conformity with a limited liability company agreement . . . that calls for the LLC to be governed by its two members, when those members are in deadlock"). Unlike a buyout, dissolution would have protected the interests of plaintiff Haley because "[s]uch an end will force the sale of the LLC's real property, which is likely worth, at current market value, far more than the mortgage that the LLC must pay off if it sells." *Haley*, 864 A.2d at 88.

[185] According to two commentators, the *Haley* decision should be understood as an example of equitable reformation. *See* David A. Hoffman & Cathy Hwang, *The Social Cost of Contract*, 121 COLUM. L. REV. 979, 996 (2021) (stating that "Delaware state courts, easily the most influential for business contract disputes, have long decided cases using equitable principles that amount to reformation" (citing *Haley*, 864 A.2d at 98)). For a recent case reaching the same conclusion, see *In re Dissolution of T & S Hardwoods KD, LLC*, C.A. No. 2022-0782-MTZ, 2023 WL 334674 (Del. Ch. Jan. 20, 2023), ordering dissolution based on deadlock and holding that the parties' negotiated buy-sell provision was inequitable and therefore unenforceable. Just as in the *Haley* case, the complaining member would have remained a guarantor of the LLC's debts. *Id.* at *9.

for implying terms to protect the minority's interests, for recognizing the significance of shareholder relationships, and for accepting evidence of the parties' actual intent even when language in a contract might otherwise foreclose such inquiries.

D. Reasonable Expectations as an Alternative to Contract

To assert that shareholder oppression involves a frustration of the minority's reasonable expectations does not, without more, establish what counts as reasonable under the circumstances.[186] The previous Section argued that pragmatic approaches to contract law should inform our understanding of shareholder oppression law. To be clear, however, we do not assert that the standard for evaluating reasonable expectations in oppression cases is contingent on the content of a jurisdiction's general contract law.

Accordingly, even if a particular jurisdiction has adopted a more formalistic view of contract law,[187] the reasonable expectations approach would nevertheless require a pragmatic evaluation of the parties' bargain.[188] Claims brought pursuant to an oppression statute are distinct from common-law contract claims.[189] For example, in

[186] *See* Means, *A Voice-Based Framework*, *supra* note 21, at 1227 ("The Reasonable Expectations approach depends on the meaning of the word 'reasonable' and, therefore, requires a deeper theory of shareholder rights and obligations.").

[187] For an argument that formalism should be rejected in all areas of contract law, see Shawn J. Bayern, *Rational Ignorance, Rational Closed-Mindedness, and Modern Economic Formalism in Contract Law*, 97 CALIF. L. REV. 943, 945-46 (2009).

[188] *See* O'Byrne & Schipani, *supra* note 155, at 99 (contending that "the oppression action is expressly designed to sideline the literalist approach to the shareholder relationship which egregiously eschews both context and the possibility of implied terms").

[189] *See infra* note 239 (citing cases recognizing a distinction between oppression claims and contract claims). In *Litle v. Waters*, Civ. A. No. 12155, 1992 WL 25758 (Del. Ch. Feb. 11, 1992), for example, the plaintiff shareholder complained that the defendant's refusal to distribute sufficient profits to cover the plaintiff's tax liability was oppressive. The court found that any such agreement would be too vague and indefinite to enforce as a contract. *See id.* at *6. However, the court also found that the allegations stated a cause of action for shareholder oppression because they suggested that the defendant might have violated the plaintiff's reasonable expectations. *See id.* at *8 ("As far as whether plaintiff makes an adequate argument that defendants violated his reasonable expectations, it is only reasonable to believe that when [defendant] and [plaintiff]

jurisdictions that recognize the doctrine of employment at will, employees have no contractual protection against termination unless they negotiated an employment contract that specifies the term of employment or requires a cause-based termination.[190] If courts treated the "at-will" contractual default as dispositive of oppression claims, then minority shareholders could be fired with impunity even if they earned their return on investment solely via salary.[191] As an additional example, a minority shareholder's claim might rely on unstated understandings that, when violated, are too indefinite to enforce in a breach of contract action. If such understandings (general or otherwise) can be established through circumstantial evidence, however, they are likely sufficient for an oppression claim.[192]

In sum, although pragmatic approaches to contract law overlap substantially with oppression law, the oppression statutes proceed on the assumption that existing contract law principles will not suffice in all circumstances to protect minority shareholders from abuses of majority control. In jurisdictions that apply a reasonable expectations test for shareholder oppression, that statutory authority leaves open the possibility of enforcing bargains between the parties notwithstanding

entered into these ventures that neither expected that the other would use their power so as to make the stock a liability when the company was making money in order to effectuate a squeeze out.").

[190] *See* MOLL & RAGAZZO, *supra* note 5, § 7.01(B)(3) (discussing the employment at will doctrine).

[191] *Cf.* Moll, *Reasonable Expectations v. Implied-in-Fact Contracts*, *supra* note 7, at 1024 ("[C]ontract law will likely be unable to protect the reasonable expectations of close corporation shareholders because, in practice, courts tend to apply contract law in a narrow manner. Put differently, because of indefiniteness, employment at will, and statute of frauds problems, courts are likely to conclude that the oppression doctrine's reliance on pattern, conduct, and economic evidence is insufficient to establish an implied-in-fact contract.").

[192] *See id.* at 1029 ("Many courts have been willing to find that . . . circumstantial evidence suffices to create an enforceable reasonable expectation. As a matter of contract law, however, such a minimal amount of proof is problematic." (footnote omitted)); *id.* ("Although the circumstantial evidence in close corporation disputes typically establishes very general understandings of employment and management participation, there is rarely any further evidence allowing a court to flesh out the details of these generic understandings."); *see also supra* note 189 (discussing the *Little* decision).

any limitations that contract doctrine might otherwise impose.[193] By attending to evidence of the parties' relationship and mutual expectations, courts can protect minority shareholders from abuse using contractual oppression concepts, even if those concepts would not otherwise meet the strictures of the jurisdiction's contract law.

III. THE TROUBLING RETURN OF FORMALISM

In previous Parts, we have explained that both corporate law and contract law have shifted toward pragmatism over formalism in many respects.[194] The reasonable expectations standard, in particular, embodies a pragmatic approach to resolving shareholder disputes.[195] Nevertheless, in recent years, several judicial decisions reflect a resurgent formalism — one that reflexively applies contract law doctrines with little or no consideration of the closely held setting at issue.

To some extent, this formalistic revival is not surprising. After all, a potential disadvantage of equating shareholder oppression with a violation of the minority's reasonable expectations is that courts may conclude that, by definition, minority shareholders cannot have any reasonable expectations beyond what they have specifically negotiated. In other words, once oppression has been described as the violation of a bargain between the parties, it is only a few small steps to describe the bargain as a contract and to use contract law doctrine to filter claims.

When viewed formalistically in this manner, however, the reasonable expectations standard becomes indistinguishable from the contractarian model it was meant to supplant. Such an approach violates

[193] *See infra* note 239 (citing cases recognizing a distinction between oppression claims and contract claims). For example, relational contracts among parties are usually enforced through informal reputational sanctions. *See* Hwang, *supra* note 2, at 677 (stating that "contracting parties enter into incomplete contracts because they know that they can rely on norms and informal sanctions to fill the gap with provisions that they expect"). If such sanctions are unavailable because a relationship of trust among the parties no longer exists, a minority shareholder might not have recourse under contract law. For further analysis of the interplay between trust and contract, see Kathryn Hendley, *Coping with Uncertainty: The Role of Contracts in Russian Industry During the Transition to the Market*, 30 NW. J. INT'L L. & BUS. 417, 419-20 (2010).

[194] *See supra* Parts I, II.

[195] *See supra* Part II.

basic principles of statutory interpretation. Moreover, because it offers only the pretense of protection for minority shareholders, a formalistic interpretation of reasonable expectations can lead to unjust judicial outcomes — ones that fail to identify or remedy oppressive conduct by the majority.

A. Statutory Interpretation

Formalistic interpretations of reasonable expectations turn the standard into a rule-based inquiry that asks whether the minority shareholders bargained for specific financial or control rights. This approach is misguided for several reasons. First, as a matter of textual analysis, it is implausible to suppose that legislatures addressing the problem of shareholder oppression meant to duplicate existing common-law causes of action for breach of contract, much less strip away pragmatic analysis of the parties' relationship. Had that been their intent, lawmakers would have used the term "contract" in statutes rather than "oppressive" or "unfairly prejudicial" conduct.[196] Therefore, any interpretation of shareholder oppression law that conflates it with formal contract doctrine should be rejected because it fails to give independent meaning to the statutory language.

Second, and relatedly, jurisdictions with statutes that provide relief for "oppressive" or "unfairly prejudicial" conduct are typically contrasted with jurisdictions that provide no special relief to minority shareholders who fail to negotiate contractual protections before investing.[197] It is logical to assume that these statutes were enacted despite objections that protecting minority shareholders from abusive majority behavior would reward shareholders who failed to contract for

[196] *See, e.g.*, 2 O'NEAL ET AL., OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 22, § 10:8, at 10-34 (stating that "more than three-fourths of the states now list oppression as a ground for dissolution," and noting that "[i]n some states the statute uses unfairly prejudicial conduct as an alternative or additional phrasing").

[197] *See, e.g.*, MOLL & RAGAZZO, *supra* note 5 (noting that "most jurisdictions have developed special common-law doctrines (often aided by statutes) that are designed to protect minority shareholders . . . from oppressive majority conduct," contrasting jurisdictions that "have refused to develop special common-law rules to protect minority shareholders," and stating that "[i]n these [refusal] jurisdictions, an oppressed investor can attempt to rely on . . . traditional corporate or contract law doctrines . . . but no additional common-law safeguards are provided").

protection in advance. The statutory enactments recognize, in other words, that reliance on contract law alone is insufficient in the context of shareholder disputes in closely held corporations.[198] A formalistic interpretation of shareholder oppression law as no different from ordinary contract doctrine, therefore, is problematic. Not only the language of the statutes, but also the context of their enactment counsels against such a narrow interpretation.

Third, even setting aside the context and considering only the plain meaning of "reasonable expectations,"[199] a narrow, rule-based interpretation remains untenable. The word "reasonable" appears in various other legal contexts and always denotes the use of a standard rather than a rule — in other words, some assessment of a parties' expected behavior under the circumstances.[200] The relevant factors may

[198] Arguably, no legislation would have been warranted if the legislature merely intended to continue existing contract law protections. On the other hand, to the extent oppression statutes authorize remedies, such as dissolution and buyouts, the statutes also need to specify what type of misconduct will trigger the provision of a remedy. A legislature could decide that a majority's breach of contractual obligations to the minority is, or can be, oppressive.

[199] Some jurisdictions codify the reasonable expectations standard. *See, e.g.*, MINN. STAT. ANN. § 302A.751 subdiv. 3a (2011) ("In determining whether to order equitable relief, dissolution, or a buy-out, the court shall take into consideration . . . the reasonable expectations of all shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other."). Even in jurisdictions that do not codify the standard, we still consider it a statutory interpretation issue because the courts interpret the statutory term "oppressive" in conjunction with common-law precedents that define the term as conduct that frustrates the minority's reasonable expectations. Thus, even if the reasonable expectations standard is not an explicit statutory concept, its interpretation is effectively part of a statutory analysis.

[200] *See, e.g.*, Alena M. Allen, *The Emotional Woman*, 99 N.C. L. REV. 101, 104 (2021) ("In criminal law, proving reasonable provocation, reasonable mistake, reasonable force, or reasonable doubt is the difference between freedom and incarceration." (citations omitted)); Larry A. DiMatteo, *The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment*, 48 S.C. L. REV. 293, 336, 350 (1997) (stating that contract formation is judged from the perspective of a "reasonable person" who "can be seen as a synthesis of legal and community values"); Robert J. Rhee, *The Tort Foundation of Duty of Care and Business Judgment*, 88 NOTRE DAME L. REV. 1139, 1171 (2013) ("The inquiry in corporation law focuses on the demonstrable effort and the quality of decisionmaking as the measure of reasonableness, and thus an error in judgment is not a wrong."). In addition, "[t]he reasonable person is . . . omnipresent in workplace sexual

be carefully delineated or left relatively open ended, but the word "reasonable" calls for the application of judgment. To pretend otherwise because it is convenient, or because, as a matter of policy, one believes that shareholder expectations not memorialized in contract are unworthy of protection, is to reason backwards from preferred results.

B. Consequences of Formalism

The formalistic interpretation of reasonable expectations produces unjust judicial outcomes because the court's resolution can have little or nothing to do with what the investors themselves may have understood,[201] much less whether those understandings were reasonable under the circumstances. If the central purpose of contract law is to identify and uphold the parties' intentions,[202] mischaracterizing the bargaining process between the parties is unhelpful. Consequently, a formalistic application of contract law can lead courts astray.

1. Treating the Corporate Structure as a Bargained-For Choice

Courts that formalistically apply contract law to oppression disputes may treat the legal structure of the corporation as, itself, a contractual bargain. According to this approach, by investing in a corporation a minority shareholder has consented to majority rule and cannot complain, at least so long as the majority's decisions are not

harassment cases where courts rely on the reasonable person standard to measure whether the behavior was sufficiently 'severe or pervasive' to constitute a hostile working environment." Allen, *supra*, at 104. Some feminist scholars have argued that a reasonableness inquiry prioritizes the male perspective and should be reformed to reflect women's experiences, see Naomi R. Cahn, *The Looseness of Legal Language: The Reasonable Woman Standard in Theory and in Practice*, 77 CORNELL L. REV. 1398, 1431 (1992), or abolished. *See* Allen, *supra*, at 109.

[201] Two scholars describe the centrality of mutual assent as follows: "Regardless of one's normative theory of contract, the central focus of justification is on the enforcement of common terms that parties agree to when they form contracts. Without the presence of an actual agreement freely reached, the state is not easily justified in enforcing a contract, because instead of enhancing the parties' freedom of contract, the legal system would be limiting it." Robin Bradley Kar & Margaret Jane Radin, *Pseudo-Contract and Shared Meaning Analysis*, 132 HARV. L. REV. 1135, 1138 (2019).

[202] *Cf.* RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 158, § 201 cmt. c (stating that "the primary search is for a common meaning of the parties").

independently unlawful. Formalism thus limits oppression claims by taking the rules of the legal structure and whatever legal documentation may exist as conclusive evidence of the parties' reasonable expectations. As one court put it, "the parties' reasonable expectations are to be inferred from their written agreements; the meanings of the agreements are not to be inferred from the parties' expectations, reasonable or otherwise."[203] In many cases, however, the opposite will be true: it will not be possible to ascertain the meaning of a written agreement without considering the context of the business relationship.[204]

For example, in *Knobloch v. Home Warranty, Inc.*,[205] a district court held that the dilution of plaintiff's stock interest from forty-eight percent to 18.87% could not have been a violation of the plaintiff's reasonable expectations because he had not bargained for preemptive rights in the company's articles of incorporation.[206] The court acknowledged that preemptive rights "give existing stockholders a means of maintaining their relative equity position in a corporation

[203] Drewitz v. Motorwerks, Inc., No. A12-0604, 2012 WL 5476148, at *7 (Minn. Ct. App. Nov. 13, 2012).

[204] For lawyers and academics in the United States, a court's statement that its hands are tied by one document or another and that it simply cannot consider evidence that might be probative of the parties' real intentions will usually be understood to signify only that the court preferred a different result:

> American lawyers, to one degree or another, all subscribe to the notion that in many litigated cases — especially those that get to the Courts of Appeals and form the foundation of our casebooks — traditional legal materials (i.e., statutes and case law) rarely suffice to determine the outcome. We identify a gap between those materials and a case's result that is not filled by logical deduction, regardless of how a court ultimately explains the outcome. In nearly all interesting cases, we teach and believe that there is enough slack that a court can come out either way. In casebooks, cases with similar fact patterns but different outcomes are often paired. We typically teach these cases as illustrations of the manipulability of doctrine, rather than as opportunities for fine-grained distinctions.

Edward B. Rock, *Corporate Law Doctrine and the Legacy of American Legal Realism*, 163 U. PA. L. REV. 2019, 2021 (2015).

[205] No. C15-4239-MWB, 2016 WL 6662709 (N.D. Iowa Nov. 10, 2016).

[206] *See id.* at *6.

when new shares of stock are issued."[207] Without those rights, the minority's position is vulnerable.

Despite the possibility of abuse, and without considering other evidence that the plaintiff had an expectation of maintaining his forty-eight percent share of the corporation's earnings going forward, the entirety of the court's analysis of reasonable expectations was a statement that the plaintiff had not bargained for preemptive rights before investing:

> I agree with [defendant's] position that [plaintiff] did not have a preemptive right to acquire unissued corporate shares because no such right was provided him in the Articles of Incorporation. [Plaintiff] does not point to any portion of [defendant's] Articles of Incorporation that would provide him with such a preemptive right. Therefore, he has not generated a genuine issue of material fact on his [oppression] claim and this portion of [defendant's] Motion for Summary Judgment is granted.[208]

The court treated the unmodified background rules of the corporation structure (i.e., no preemptive rights unless provided for in the articles) as constituting the parties' bargain; moreover, it did not even attempt to defend its assumption that those rules adequately reflected a minority shareholder's reasonable expectations.[209] In fact, such an assumption seems unwarranted. Although corporate law once protected shareholders against dilution, the law changed because *public* corporations needed greater flexibility.[210] A public corporation cannot

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[207] *Id.* (quoting Kelly v. Englehart Corp., No. 99-1907, 2001 WL 855600, at *4-5 (Iowa Ct. App. July 31, 2001) (internal quotation omitted)).

[208] *Id.*

[209] Indeed, as one commentator has observed, contract law rules diverge from ordinary morality and may sometimes operate at cross-purposes. *See* Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708, 710 (2007) ("Some aspects of U.S. contract law not only fail to support the morally decent person, but also contribute to a legal and social culture that is difficult for the morally decent person to accept."). For a classic argument that contract law should be founded on the morality of promising, see CHARLES FRIED, CONTRACT AS PROMISE 14 (1981).

[210] 1 O'NEAL ET AL., OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 22, § 3:16, at 3-174 to 3-175 ("The change reflect[ed] the needs of a publicly held corporation where a requirement to provide thousands of shareholders with preemptive rights would hamstring a corporation's efforts to raise additional capital.").

easily bargain with its large number of shareholders every time it needs to adjust its capital structure. In other words, the default rules of corporate law with respect to preemptive rights are not set with closely held corporations in mind. Yet the court in *Knobloch* equated the minority shareholder's expectations with the background rules of the corporation structure and rejected the plaintiff's arguments out of hand.

If a perfunctory assessment of the rules of the legal structure and whatever written documentation may exist between the parties is all that a reasonable expectations analysis requires, then the standard is not an alternative to formalistic, contractarian analysis — it is the same thing.[211] Perhaps because a case-by-case investigation of reasonable expectations based on all facts and circumstances can be difficult,[212] courts sometimes choose to answer an easier question: whether the allegedly oppressive conduct violates a contract between the parties. In cases like *Knobloch*, it will often be simpler to decide whether the plaintiff has a contract than whether the plaintiff's asserted expectation was reasonable under all the circumstances.[213] Although they may be confused for one another, these are different questions.

The decision of *MJC Ventures LLC v. Detroit Trading Company*[214] goes even further than *Knobloch* by effectively concluding that minority shareholders cannot have any reasonable expectations that conflict with

[211] Notably, the court in *Knobloch* also rejected a claim that the defendants violated the plaintiff's reasonable expectations by paying themselves excessive salaries. *See Knobloch*, 2016 WL 6662709, at *6-7. The court rejected the claim because plaintiff had not introduced expert evidence that would support a finding that the defendants' salaries were objectively unreasonable. *See id.* at *7. Thus, although the distinction is not defended in the opinion, it appears that the court viewed the issue of preemptive rights as contractual — such that no reasonable expectation could arise in the absence of a contractual provision — and treated the question of salary amounts as a discretionary judgment subject to review.

[212] *See* Means, *A Voice-Based Framework*, *supra* note 21, at 1228 (arguing that "Reasonable Expectations analysis seems to invite protracted and expensive litigation over contested issues of fact that may be very difficult to prove or disprove").

[213] *See* Jiménez, *supra* note 18, at 1154 (stating that "formalism might be epistemically less demanding than other approaches that require more attention to the specific case, such as pragmatism"). Or, more simply, "[a]ccuracy is costly." *Id.* at 1155.

[214] No. 19-cv-13707, 2020 WL 3542091 (E.D. Mich. June 30, 2020).

the majority-rule principle baked into the corporation structure.[215] *MJC* concerned allegations of oppression brought by Mark Campbell, a shareholder and former CEO of Detroit Trading Company, based on his removal from leadership and the termination of his "lucrative consultancy agreement with the company."[216] Shareholders owning a majority of the corporation's stock had entered into a written consent that removed Campbell from the board of directors.[217] The directors had then entered into their own written consent that removed Campbell from his CEO position and terminated his consulting arrangement.[218]

As part of its rationale for dismissing Campbell's oppression action for failure to state a claim, the court noted that § 450.1489(3) of the Michigan oppression statute "excludes from the definition of 'willfully unfair and oppressive conduct' any 'conduct or actions that are permitted by an agreement, the articles of incorporation, the bylaws, or a consistently applied written corporate policy or procedure.'"[219] According to the court, this statutory provision doomed Campbell's oppression claim:

> Here, there is no dispute that Campbell was removed from the Board of Directors by written agreement of a majority of Detroit Trading's shareholders . . . . That same Board of Directors then resolved, in writing, to terminate Campbell's . . . association with Detroit Trading. Nowhere do Plaintiffs specifically allege that these actions by Detroit Trading's shareholders and newly installed Board of Directors were inconsistent with the company's articles of incorporation or bylaws, *nor do Plaintiffs dispute that they were taken pursuant to written agreements by a majority of company shareholders, and the Board*. . . . Plaintiffs have not alleged facts showing how the challenged shareholder and Board decisions — which are set forth in writing —

[215] *See, e.g.*, Moll, *Minority Oppression*, *supra* note 4, at 905 (stating that "[t]raditional corporate law . . . defaults to norms of majority rule and centralized control").

[216] *MJC Ventures*, 2020 WL 3542091, at *1. Technically, the "lucrative consultancy agreement" was between Campbell's wholly owned limited liability company (MJC Ventures LLC) and Detroit Trading. *See id.*

[217] *See id.*

[218] *See id.* at *2.

[219] *Id.* at *3 (quoting MICH. COMP. LAWS ANN. § 450.1489(3) (2006)).

> constitute "willfully unfair and oppressive conduct" as defined by the plain language of Mich. Comp. Laws § 450.1489(3). These claims for shareholder oppression will accordingly be dismissed.[220]

In Michigan, decisions made by written consent are fully valid if entered into by a majority of the corporation's voting shares (shareholder written consents)[221] or by all of the members of the company's board of directors (director written consents).[222] Given that a majority shareholder, by definition, owns a majority of the corporation's voting stock and has sufficient voting power to elect all of its board members,[223] a majority shareholder under a Michigan-like statute will be able to enter into shareholder and director written consents to do whatever the majority wishes. According to the *MJC* court, such consents will be characterized as "agreements" and the decisions taken pursuant to them cannot be challenged as oppressive.[224] By applying the statute in a rote fashion without any consideration of the oppression context at issue, the *MJC* court exemplifies a formalistic approach by effectively immunizing oppressive conduct from challenge so long as the majority's abusive decisions are carried out by written consent. Given that actions permitted by the bylaws also fail to meet the definition of "willfully unfair and oppressive conduct,"[225] it is not much

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[220] *Id.* (emphasis added); *see also id.* at *2 ("In this case, however, because Plaintiffs acknowledge the Defendant Directors were elected by a majority of shareholders and acted pursuant to written consents in terminating Campbell's and MJC's relationships with Detroit Trading, by the terms of the statute there can be no claim for shareholder oppression.").

[221] *See* MICH. COMP. LAWS ANN. § 450.1407(1) (2018) (permitting written consents by a majority of the corporation's voting shares if the articles of incorporation so provide).

[222] *See id.* § 450.1525(1) (2018).

[223] *See, e.g.*, O'NEAL & THOMPSON, CLOSE CORPORATIONS & LLCS, *supra* note 20, § 3:8, at 3-38 ("Under a system of 'straight voting' [for the election of directors], each shareholder is entitled to one vote per share and can cast that number of votes for as many candidates as there are seats to be filled. If there is a majority shareholder, each of the candidates supported by the majority will have more votes than any of the minority-supported candidates. Thus, even a bare majority of shares can elect the entire board of directors."). *See supra* note 22 and accompanying text (noting that the majority elects the board of directors).

[224] *See supra* note 220 and accompanying text.

[225] *See supra* note 219 and accompanying text.

of a stretch to assume that the *MJC* court would similarly treat majority-rule statements in the bylaws (which are ubiquitous)[226] as defeating any reasonable expectations to the contrary.

Despite our criticism, we are sympathetic to the difficulty faced by the *MJC* court. The Michigan statute it confronted required a nuanced inquiry to distinguish oppressive conduct from conduct authorized by contract, but surely deferring to language that simply acknowledges generic majority-rule governance is an insufficient analysis.[227] Taken literally, the court's reasoning would seem to foreclose shareholder oppression actions, rendering the statute a nullity.

To be sure, the background legal structure has probative value, and the formation of a corporation comes with different consequences than a partnership or other form of business association.[228] In addition,

[226] *See, e.g.*, DOUGLAS K. MOLL, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: STATUTES, RULES, AND FORMS 957, 959 (2021) (providing "form bylaws" specifying that shareholder decisions (other than elections) "shall be determined by a majority of the votes cast" and director decisions "shall be determined by a majority vote of the directors present"); *supra* note 215 and accompanying text (referencing the majority-rule principle of the corporation).

[227] Indeed, in oppression disputes that have been decided on the basis of contractual language, the language at issue tends to be much more specific and directly applicable to the reasonable expectation asserted by the plaintiff. *See, e.g.*, Metro Com. Mgmt. Servs., Inc. v. Van Istendal, 197 A.3d 695, 698, 701 (N.J. Super. Ct. App. Div. 2018) (concluding that a shareholder had no reasonable expectation of continuing employment when she signed a Shareholders Agreement providing that she was an at-will employee who "can be terminated by the Corporation at any time for any reason"); *In re* Apple, 637 N.Y.S.2d 534, 535 (App. Div. 1996) (noting that a buyout agreement explicitly bound each shareholder to sell "after ceasing for any reason, either voluntarily or involuntarily, to be in the employ of the corporation," and stating that the terminated shareholder-employee "cannot be heard to argue that he had a reasonable expectation that he would be employed and would be a shareholder for life"); *cf.* Stile v. C-Air Customhouse Brokers-Forwards, Inc., 167 N.Y.S.3d 40, 45 (App. Div. 2022) ("The second cause of action alleges that defendants 'are guilty of shareholder oppression' because they refused to permit plaintiff to inspect the Companies' books and records and they refused to recognize her as a shareholder. To the extent this claim is based on defendants' refusal to allow plaintiff to inspect the books and records, it is dismissed. In the settlement, Stile agreed to not 'make any request or demand to inspect the records of the Companies.'").

[228] *See, e.g.*, LISA M. FAIRFAX, BUSINESS ORGANIZATIONS: AN INTEGRATED APPROACH 4 (2019) (noting the "benefits and drawbacks of choosing between the available business forms").

shareholders can further clarify their expectations by negotiating buy-sell agreements, dispute-resolution mechanisms, and other tailored legal instruments.[229] We do not mean to suggest that contracts are unimportant or that the choice of form should not count. However, as the cases reviewed above demonstrate, an insistence that the parties' expectations must be found only within the jurisdiction's corporate code and the four corners of the legal documents is not consistent with the reasonable expectations standard.[230]

2. Excluding Evidence of Implied Bargains

A second problem with a formalistic application of contract law to oppression disputes is that courts insisting on specific evidence of offer, acceptance, consideration, and the like may overlook evidence of an implicit bargain between the parties. That is, courts may use contract law to filter out relevant information concerning the parties' relationship. For example, courts typically insist that the parties'

[229] *See, e.g.*, MOLL & RAGAZZO, *supra* note 5, § 4.01(A)(3), (discussing buy-sell agreements); 2 O'NEAL ET AL., OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 22, § 9:8, at 9-20 to 9-21 (mentioning contractual arrangements for the arbitration of shareholder disputes). *See generally* MOLL & RAGAZZO, *supra* note 5, §§ 3.01-3.07 (considering the alteration of corporate norms by contract).

Whether there should be limits to the parties' ability to waive basic fiduciary protections is beyond the scope of this Article. For analysis of that issue in the context of LLC governance, see Peter Molk, *Protecting LLC Owners While Preserving LLC Flexibility*, 51 UC DAVIS L. REV. 2129, 2136 (2018) (arguing that the law should provide a mandatory structure to protect relatively unsophisticated LLC members but permit more sophisticated parties to bargain around fiduciary rules).

[230] Nor is the four-corners approach required as a matter of contract law. Although some courts continue to follow a classical, formalistic approach to contract interpretation, more progressive courts will consider external evidence that may shed light on the contract itself or suggest supplemental terms agreed to by the parties. *See* Stephen F. Ross & Daniel Tranen, *The Modern Parol Evidence Rule and Its Implications for New Textualist Statutory Interpretation*, 87 GEO. L.J. 195, 200 (1998) (explaining that the classical "view on the proper use and admissibility of parol evidence was replaced by the views of Arthur Corbin, Karl Llewellyn, and other scholars who advocated that parol evidence be admitted so that a writing could be interpreted according to the actual intention of the parties, notwithstanding the 'objective' meaning that a judge might attach to the words").

expectations must be set at the time of investment,[231] presumably because that is when consideration is provided for the shares. Such a requirement fails to respect the normal twists and turns in a relationship that persists over time and that is often founded on interpersonal trust.

To illustrate the point, consider that a number of shareholder oppression disputes involve minority owners who received their stock via gift or inheritance.[232] Because these shareholders did not commit any capital to the venture, a court that insists on expectations being set at the time of investment — i.e., when consideration is given in exchange for the shares — would presumably conclude that no reasonable expectations exist, leaving such shareholders vulnerable to abuse. In *Guerra v. Guerra*,[233] for example, a minority shareholder asserted that the majority shareholder had "engaged in shareholder oppression because he used Laredo Hardware [the corporation] for his personal gain,"[234] including by entering into self-dealing transactions with the corporation and using company funds for personal purposes.[235] The court noted that Texas law defined oppressive conduct, in part, as majority conduct that "substantially defeats the minority's expectations that . . . were both reasonable under the circumstances and central to the minority shareholder's decision to join the venture."[236] Under that definition, the court refused to even consider the minority's claim:

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[231] *See, e.g.*, *In re* Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984) ("The question has been resolved by considering oppressive actions to refer to conduct that substantially defeats the 'reasonable expectations' held by minority shareholders *in committing their capital to the particular enterprise*." (emphasis added)); Balvik v. Sylvester, 411 N.W.2d 383, 387 (N.D. 1987) ("Because of the predicament in which minority shareholders in a close corporation are placed by a 'freeze out' situation, courts have analyzed alleged 'oppressive' conduct by those in control in terms of . . . the 'reasonable expectations' held by the minority shareholders in committing their capital and labor to the particular enterprise.").

[232] *See, e.g.*, Kaplan v. First Hartford Corp., 484 F. Supp. 2d 131, 147 & n.48, 148-52 (D. Me. 2007) (inheritance); *In re* Schlachter, 546 N.Y.S.2d 891, 892 (App. Div. 1989) (gift); *In re* Smith, 546 N.Y.S.2d 382, 384 (App. Div. 1989) (inheritance); *In re* Gunzberg v. Art-Lloyd Metal Prods. Corp., 492 N.Y.S.2d 83, 86 (App. Div. 1985) (gift).

[233] No. 04-10-00271-CV, 2011 WL 3715051 (Tex. App. Aug. 24, 2011).

[234] *Id.* at *6.

[235] *See id.* at *1-2.

[236] *Id.* at *6.

> The first part of the definition relates to shareholders' expectations when investing in the corporation. Maria [the plaintiff minority shareholder] received all of her shares as gifts or as a bequest from her father. Therefore, there is no evidence of shareholder oppression under this prong.[237]

By requiring reasonable expectations to be established at the time of investment when consideration is given, the *Guerra* court avoids the need to examine the parties' relationship for evidence of any implicit bargains or shared understandings between them. Such a narrow and overly formalistic approach to identifying reasonable expectations is surely easier to administer,[238] but it comes at the expense of providing protection from majority wrongdoing.[239] Despite the absence of formal

[237] *Id.* The court proceeded to consider the oppression claim under a second definition of oppression that Texas courts had recognized — "burdensome, harsh, or wrongful conduct; a lack of probity and fair dealing in the company's affairs to the prejudice of some members; or a visible departure from the standards of fair dealing and a violation of fair play on which each shareholder is entitled to rely." *Id.* The minority shareholder's claim was rejected under that definition as well. *See id.* at *7.

[238] A formalist might argue that the desirability of a legal rule or standard cannot be determined solely by whether courts will reach the correct answer — the legal process itself may impose costs that outweigh the benefits. *See* Jiménez, *supra* note 18, at 1160 ("Even if courts were perfect . . . figures, incapable of mistakes, formalism still might be preferable because of its predictability, certainty, and the protection of legitimate expectations, all of which are crucial for contract law's valuable effects."). In that regard, the South Carolina Supreme Court has rejected reasonable expectations as the standard for shareholder oppression in order to avoid a tedious assessment of whether a plaintiff's reasonable expectations were met — otherwise, courts will be bogged down in endless family business disputes. *See* Kiriakides v. Atlas Food Sys. & Servs., Inc., 541 S.E.2d 257, 264 (S.C. 2001) ("To examine the 'reasonable expectations' of minority shareholders would require the courts of this state to microscopically examine the dealings of closely held family corporations, the intentions of majority and minority stockholders in forming the corporation and thereafter, the history of family dealings, and the like."); *see also* Mason v. Mason, 770 S.E.2d 405, 418 (S.C. Ct. App. 2015) (same). Although we appreciate the court's concern, expedience is a poor substitute for justice. When business and personal relationships intersect, the result can be complicated and messy.

[239] In contrast to *Guerra*, some courts correctly conclude that contract law doctrines should not necessarily prevent a full consideration of whether reasonable expectations have been established. *See, e.g.*, Orchard v. Covelli, 590 F. Supp. 1548, 1556, 1558 (W.D. Pa. 1984) (rejecting a shareholder-employee's wrongful discharge claim on several grounds, including the ground that there was "no evidence of the existence of a contract

consideration, shareholders receiving stock via gift or inheritance have at least the general reasonable expectations that all persons with the status of "shareholder" have in a corporation, including, among others, expectations of voting on shareholder issues and receiving a proportionate share of any distributed profits.[240] Moreover, a consideration of all evidence concerning the parties' social or familial connections and the economic context of their venture may reveal that understandings between the majority and the minority have been reached, albeit after the time of the original investment.[241] A more pragmatic approach to contract law permits parties to modify contracts in good faith without consideration,[242] and that same approach should

for employment, oral or written," but granting oppression-based relief by concluding that the termination was part of a breach of fiduciary duty); Litle v. Waters, Civ. A. No. 12155, 1992 WL 25758, at *1, 6-8 (Del. Ch. Feb. 11, 1992) (concluding that a shareholder's expectation that the company would distribute sufficient profits to cover the shareholder's tax liability was too indefinite to state a claim for breach of contract, but recognizing the same expectation as stating a cognizable oppression claim); *see also* Merola v. Exergen Corp., 648 N.E.2d 1301, 1305 (Mass. App. Ct. 1995) ("[A] stockholder's expectations may arise from an express or implied understanding that falls short of an enforceable contract. The rightful expectations of the parties, not contract law, are controlling."); *supra* note 189 (discussing the *Litle* decision).

[240] *See* MOLL & RAGAZZO, *supra* note 5, § 7.01(D)(1)(b)(ii)(A) (discussing general reasonable expectations); *id.* § 7.01(D)(1)(b)(ii)(B) ("After all, general reasonable expectations are expectations that go hand-in-hand with the status of shareholder. Any shareholder, including a shareholder who received his stock via gift or inheritance, is entitled to all of the rights and benefits that traditional corporate law associates with shareholder status." (footnote omitted)).

[241] *See id.* § 7.01(D)(1)(b)(ii)(B) (stating that "[a] transferee of shares . . . may be able to establish specific reasonable expectations on his own," and observing that "to the extent that a specific reasonable expectation is premised on a mutual understanding between the shareholders, such an understanding could theoretically be reached at any time (assuming a relaxation of the literal 'time of investment' *Kemp* standard)" (footnote omitted)); *see also* Robert W. Hillman, *The Dissatisfied Participant in the Solvent Business Venture: A Consideration of the Relevant Permanence of Partnerships and Close Corporations*, 67 MINN. L. REV. 1, 86 n.265 (1982) ("Ordinarily, expectations are personal and therefore would not be transferable . . . . Thus, an individual who acquires stock by gift or inheritance would not also take the expectations of the original owner. *However, an individual in such a position may develop mutual expectations with the other participants which should be recognized.*" (emphasis added)).

[242] *See, e.g.*, U.C.C. § 2-209(1) (AM. LAW. INST. & UNIF. LAW COMM'N 2002) ("An agreement modifying a contract within this Article needs no consideration to be binding.").

suffice in the context of establishing reasonable expectations in an oppression dispute.[243]

3. Rejecting Equitable Remedies

Even if a court finds that the majority has violated a reasonable expectation of the minority, the court may resurrect the formalistic approach and disallow remedies that traditional contract law would not otherwise provide. In contract law, the goal of remedies is typically to put the nonbreaching party in the position the party would have been in had the breach not occurred.[244] This approach would support compensatory damages or reinstatement for an oppressed minority shareholder, but would not support a court-ordered buyout of the minority's shares.[245] Under such a formalistic view of remedies for

[243] Indeed, some courts have recognized that an inquiry into reasonable expectations should not be limited to the time of investment. *See, e.g.*, Meiselman v. Meiselman, 307 S.E.2d 551, 563 (N.C. 1983) ("These 'reasonable expectations' are to be ascertained by examining the entire history of the participants' relationship. That history will include the 'reasonable expectations' created at the inception of the participants' relationship; those 'reasonable expectations' as altered over time; and the 'reasonable expectations' which develop as the participants engage in a course of dealing in conducting the affairs of the corporation."). *See* Thompson, *Corporate Dissolution*, *supra* note 122, at 218 ("Other courts, and legislatures too, have phrased the standard more broadly, looking to the shareholders' reasonable expectations as they existed at the inception of the enterprise and as they developed thereafter through a course of dealing."); *cf.* MINN. STAT. ANN. § 302A.751 subdiv. 3a (2011) ("In determining whether to order equitable relief, dissolution, or a buy-out, the court shall take into consideration . . . the reasonable expectations of all shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other.").

[244] *See, e.g.*, Interceramic, Inc. v. S. Orient R.R. Co., 999 S.W.2d 920, 927 (Tex. App. 1999) ("The general rule is that the victim of a breach of contract should be restored to the position it would have been in had the contract been performed."); *see also* 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.1, at 147 (2d ed. 1998) (noting that ordinarily "courts encourage promisees to rely on promises" by "attempting to put that party in as good a position as it would have been in had the contract been performed, that is, had there been no breach").

[245] The buyout remedy in shareholder oppression disputes has been described as follows:

> A buyout is the most common remedy for oppression and other forms of shareholder dissension. In operation, a buyout typically involves a court ordering the corporation or the controlling shareholders to purchase the

oppression, if minority shareholders desire a right to exit their investments, they should negotiate a buy-sell agreement before committing capital to a venture.

For example, in *Brodie v. Jordan*,[246] the plaintiff prevailed at trial on allegations that "the defendants had 'frozen her out' from participation in the company, refused her access to company information, and denied her any economic benefit from her shares."[247] On appeal, the Massachusetts Supreme Judicial Court observed that "[w]e have previously analyzed freeze-outs in terms of shareholders' 'reasonable expectations' both explicitly and implicitly."[248] The court referenced the lower court's conclusion that the defendants' actions violated the plaintiff's expectations of participation in the business venture and affirmed the defendants' liability.[249]

When reviewing the lower court's buyout order, however, the Supreme Judicial Court observed that a plaintiff in a closely held corporation has no expectation of liquidity because "[o]ne of the defining aspects of a close corporation is 'the absence of a ready market for corporate stock.'"[250] The problem with a buyout, therefore, is that it "placed the plaintiff in a significantly *better* position than she would have enjoyed absent the wrongdoing" by creating an "artificial market" for the plaintiff's shares.[251] The court reversed the buyout award, suggested

> shares of an aggrieved minority investor at a judicially-determined "fair value." The court, usually aided by experts, values the company and awards the minority shareholder his proportionate share of the corporation's value (subject to any applicable discounts). In effect, the buyout remedy provides a judicially created exit for an aggrieved shareholder by allowing the shareholder to recover the capital that he invested in the venture.

MOLL & RAGAZZO, *supra* note 5, § 8.02(B)(1) (footnotes omitted).

[246] 857 N.E.2d 1076 (Mass. 2006).

[247] *Id.* at 1078.

[248] *Id.* at 1079.

[249] *See id.* at 1080 ("The judge found that the defendants had interfered with the plaintiff's reasonable expectations by excluding her from corporate decision-making, denying her access to company information, and hindering her ability to sell her shares in the open market. In addition, the judge's findings reflect a state of affairs in which the defendants were the only ones receiving any financial benefit from the corporation." (footnote omitted)); *id.* at 1082 (affirming the lower court's liability finding).

[250] *Id.* at 1081 (quoting Goode v. Ryan, 489 N.E.2d 1001 (Mass. 1986)).

[251] *See id.*

that money damages or injunctive relief were more appropriate, and remanded for a remedy determination.[252]

By limiting oppression relief to traditional remedies for breach of contract, the formalistic approach of the *Brodie* court makes it difficult for courts to tailor the remedy to the disharmony present in most (if not all) oppression disputes. Indeed, there is a reason that the buyout has become the most common remedy for oppressive conduct[253] — it provides a needed separation of the parties. More specifically, the buyout is advantageous because it provides a mechanism for a shareholder to extricate his investment from the venture without having to dissolve the corporation.[254] The remaining shareholders continue to operate the business and to participate in the company's successes and failures, while the departing shareholder recovers the value of his invested capital and removes himself from the company's affairs.[255] This equitable "parting" avoids a number of practical problems that often arise when more conventional contract remedies are considered. Orders of reinstatement or related injunctive relief, for

[252] *See id.* at 1082-83.

[253] *See* O'NEAL & THOMPSON, CLOSE CORPORATIONS & LLCS, *supra* note 20, § 1:28, at 97 (noting that buyouts "are the most common remedy for dissension within a close corporation"); Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 470 (1990) ("The most common form of alternative remedy is the buy-out of the minority shareholder."); *supra* note 245.

[254] *See, e.g.*, Curran v. Curran, No. X04HHDCV126039298S, 2014 WL 1814266, at *3-4 (Conn. Super. Ct. Apr. 7, 2014) (stating that "[t]he buyout will also eliminate the need for a judicial dissolution and liquidation of the assets of Curran Volkswagen, Inc., allowing that company to continue without interruption in the business of selling and servicing new and used automobiles," and observing that "[f]or the many employees and customers of Curran Volkswagen, Inc. who depend on its continuing operation, avoiding a decree of judicial dissolution would serve an important public good"); *infra* note 255 (noting that a buyout allows a shareholder to recover his investment).

[255] *See, e.g.*, Kaplan v. First Hartford Corp., 522 F. Supp. 2d 275, 277 (D. Me. 2007) (stating that a "[b]uy-out makes sense because it allows an oppressed shareholder like Kaplan to escape the oppression and recover his investment, yet simultaneously allows this . . . corporation to continue for the benefit of its other shareholders"); *cf. In re* Levitt, 492 N.Y.S.2d 736, 740 (App. Div. 1985) (stating that "the buy-out remedy accommodates the interests of the respective parties in ensuring the continued functioning of the business, while also protecting the financial interest of the shareholders and creditors").

example, are often problematic because they force the acrimonious parties to continue working together and they may involve court supervision of a difficult ongoing relationship.[256] Damage awards can be similarly problematic because they "keep[] the investment of the aggrieved shareholder locked into the company and, relatedly, force[] the aggrieved shareholder to trust that a previously oppressive majority shareholder will not oppress again."[257]

Interestingly, the *Brodie* court seemed to recognize that its formalistic approach to remedies raised these issues:

> The remedy of a forced buyout may be an appealing one for a court of equity in that it results in a 'clean break' between acrimonious parties. Yet this rationale would require a forced share purchase in virtually every freeze-out case, given that resort to litigation is itself an indication of the inability of shareholders to work together.[258]

It is not clear that the court's slippery slope argument should be of any real concern if the buyout is sensible. More importantly, regardless of whether a business divorce would be merited in most oppression cases, the analysis should turn on what approach would best protect the reasonable expectations of the oppressed shareholders. To limit oppression remedies simply because they seem inconsistent with traditional contract remedies is yet another example of a modern court mistakenly conflating a shareholder oppression analysis with a formalistic contractarian analysis.

CONCLUSION

The law of shareholder oppression is viable today because, at every stage of the law's development, courts have prioritized concrete facts over abstract theories. In doing so, courts have had to weather formalistic objections. For example, when courts first began to enforce shareholder bargains, they did so despite mandatory corporate law rules

[256] *See, e.g.*, Moll, *Reasonable Expectations v. Implied-in-Fact Contracts*, *supra* note 7, at 1019 & n.119.

[257] *Id.* at 1021.

[258] *See* Brodie v. Jordan, 857 N.E.2d 1076, 1081-82 (Mass. 2006).

that, read literally and narrowly, seemed to preclude such bargains. Eventually, corporate statutes were revised to make clear that what was sensible was also lawful.

The same pragmatism has infused the judicial approach to evaluating claims of shareholder oppression in the absence of bargained-for contractual rights. Instead of affirming one-size-fits-all models of corporate governance that are easy to administer but insufficient for the needs of minority investors, most jurisdictions have promoted flexibility in the application of existing rules to ameliorate the inherent vulnerability of minority shareholders. The contractual formalism we critique in this Article is only the latest iteration of a longstanding dispute concerning the appropriate role of judicial oversight in closely held corporations.

When a question is difficult, we may be tempted to ask a different question, one that is easier to answer. We may not even realize that we are making the switch. For example, instead of asking who the best candidate for a position is, we might ask instead who seems to be more likeable. Unfortunately, the answer to the new question may turn out to have little bearing on the original question. And so it is with reasonable expectations in the context of shareholder oppression. A minority shareholder's reasonable expectations in a closely held corporation are not necessarily coincident with the terms of a shareholders' agreement and the background rules of corporate law. When courts equate reasonable expectations with contract, treating the terms of the contract as dispositive of the parties' expectations, they lose sight of the distinction between contract law and oppression law. The potential benefit of the reasonable expectations approach depends on how broadly it is interpreted. If given too little scope, the reasonable expectations analysis loses its pragmatic virtues and collapses back into the contractual formalism that it was meant to replace.