

## **CHAPTER EIGHT**

### **SHAREHOLDER SUITS**

#### **Section 8.01 Shareholder Actions Against Corporation**

##### **A. Generally**

There are five basic types of lawsuits between a shareholder and the corporation or between the shareholders themselves:

A. The first occurs when a shareholder seeks to enforce a personal right against the corporation. In such a case, the shareholder may sue the corporation in his/her individual capacity and any remedy accrues to the shareholder's personal benefit. Such actions include lawsuits to require inspection of corporate records, lawsuits to recover dividends already declared, and lawsuits to enforce contractual rights between a shareholder and a corporation. Individual suits are discussed in Section 8.02 of this Chapter.

B. The second occurs in the context of close corporations. There has been a trend toward permitting shareholders to file individual lawsuits against each other on a breach of fiduciary duty theory. These lawsuits are discussed in Section 8.03 of this Chapter.

C. The third type of shareholder lawsuit is brought because the corporation has oppressed its minority shareholder or because there is voting deadlock. Oppression has been interpreted generally to include claims for breach of fiduciary duty. These lawsuits have historically been brought pursuant to judicial dissolution statutes, although the courts have generally refused to order dissolution and instead fashion some other remedy. In 2002, Oregon enacted a statute covering non-public corporations which sets out some of these alternative remedies and which gives the corporation and non-complaining shareholders the right to force the complaining shareholder to sell his/her stock at its "fair value" and on such terms as set by the court. These types of lawsuits and remedies are discussed in Section 8.04 of this Chapter.

D. The fourth type of shareholder lawsuit occurs when a shareholder sues a third party seeking to enforce a right held by the corporation or all shareholders, as a group. In such a case, after demand, the shareholder sues the third party –

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including the corporation as a nominal defendant. Such lawsuits are known as "derivative" lawsuits. Derivative lawsuits are discussed in Section 8.05 of this Chapter.

C. The fifth type of lawsuit between a shareholder and the corporation is a judicial appraisal action arising out of a shareholder's right to dissent pursuant to ORS 60.554. Such lawsuits must be initiated by the corporation. Judicial appraisal actions are discussed in Section 8.06 of this Chapter.

### **B. Right to jury trial**

Whether a shareholder bringing a lawsuit against the corporation or another shareholder has a right to a jury trial (and whether or not the appellate court will review de novo) will depend on the nature of the lawsuit (at law or in equity) and the remedy sought. In *Kollman v. Cell Tech Int'l, Inc.*, 250 Or App 163, 279 P3d 324 (2012), the Court of Appeals said:

With that foundation in mind, we address Carpenter's assertion that the trial court should have tried the direct breach of fiduciary duty claim in equity rather than submitting it to the jury. Carpenter relies on decisions in which claims involving a breach of fiduciary duty were tried in equity to the court. Kollman responds by citing cases in which claims involving breaches of fiduciary duty were tried in an action at law. However, those cases are not particularly helpful, because they do not explain why a particular case was tried in equity or at law. The answer, however, is clear from other case law:

"To determine whether a claim is legal or equitable, the court looks to the pleadings. See *Thompson v. Coughlin*, 329 Or 630, 637-38, 997 P2d 191 (2000) (test for determining whether jurisdiction is in law or equity generally turns on the nature of the relief sought in the pleadings); *Huebener v. Chinn*, 186 Or 508, 519, 207 P2d 1136 (1949) (in deciding whether Article I, section 17, jury trial right applies, court must 'determine whether the pleadings present a cause of equitable [or legal] cognizance'). The label that a party places on a claim is not necessarily dispositive. See *Thompson*, 329 Or at 638 (so holding). For example, the plaintiff in *Thompson* sought an accounting to resolve a dispute among partners, which is ordinarily an equitable claim that would not entitle a party to a jury trial. However, in determining whether the plaintiff's claim should have been tried to a jury, this court explained that it had long recognized that, when 'adequate relief may be obtained in law, \* \* \* equitable jurisdiction will not be invoked.' *Id.*"

*McDowell Welding & Pipefitting v. US Gypsum Co.*, 345 Or 272, 279-80, 193 P3d 9 (2008) (brackets in original). The nature of the relief sought generally determines whether a claim is based on law or equity. See generally *Assn. of Unit Owners v. Far West Federal Bank*, 120 Or App 125, 134, 852 P2d 218 (1993). In general, a claim for monetary damages inheres at law. See, e.g., *Wakeman v. Paulson*, 264 Or 524, 529-30, 506 P2d 683 (1973) (claim against corporate directors seeking payment of wages owed by dissolved corporation was an action at law: "The prayer asks only for a money judgment against defendants with no request for equitable relief of any kind."). With respect to the only claim on which Kollman prevailed against Carpenter, Kollman alleged that Carpenter had caused him to suffer "economic damages in an amount of \$55,000,000.00," and he sought to recover that amount. In light of the nature of the relief sought, the trial court correctly tried that claim at law rather than in equity.

*Kollman v. Cell Tech Int'l, Inc.*, 250 Or App 163, 170-171, 279 P3d 324 (2012).

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On the other hand, actions for breach of fiduciary duty seeking remedies other than purely monetary damages remain equitable actions. *See for example Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 7 P3d 717 (2000); *Tifft v. Stevens*, 162 Or App 62, 987 P2d 1 (1999).

An appraisal action filed under ORS 60.591 (dissenter's rights) is a legal action, not an equitable proceeding. *Gl Joe's, Inc. v. Nitzam*, 183 Or App 116, 123, 50 P3d 1282 (2002). This contrasts with actions for oppression or for breach of fiduciary duty – actions which also sometimes result in the valuation of the minority shareholder's shares – which are equitable proceedings. *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 21 P3d 178 (2001); *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 7 P3d 717 (2000); *Tifft v. Stevens*, 162 Or App 62, 987 P2d 1 (1999). There are no reported cases on whether there is a right to a jury trial in an appraisal action in the forced buyout action under ORS 60.952(6)(f) (oppression in a non-public corporation). But since the statute uses the terms "equitable" or "equity" eight times, it seems that the proceeding would be equitable rather than at law. *But see Hickey v. Hickey*, 269 Or App 258, 265, 344 P3d 512 (2015) (reviewed remedy under ORS 60.952 as a matter of law); *Kollman v. Cell Tech Int'l, Inc.*, 250 Or App 163, 279 P3d 324 (2012) (discussing whether a breach of fiduciary duty claims is legal or equitable).

A derivative lawsuit is an equitable action. *Schultz v. Highland Gold Mines Co.*, 158 F 337 (D Or 1907); *Barrett v. Southern Connecticut Gas Co.*, 172 Conn 362, 374 A2d 1051 (1977); *Rebstock v. Lutz*, 39 Del Ch 25, 158 A2d 487 (1960). This is true even though the only relief sought on behalf of the corporation is money damages and even though the corporation – if it had brought the lawsuit itself – would have brought the case as an action at law. *Griffin v. Carmel Bank & Trust Co.*, 510 NE2d 178 (Ind App 1987). However, there may be a right to a trial by jury if the corporation's claim against the "true" defendant in the case is an action at law. *Ross v. Bernhard*, 396 US 531 (1970); *Roberts v. Triquint Semiconductor, Inc.*, 358 Or 413, 429 n 14, 364 P3d 328 (2015)

### Section 8.02 Individual Claims

#### A. **General rule - shareholders may not sue individually to enforce rights of corporation or of all shareholders, as a group.**

As a general rule, a shareholder may not sue a third party directly to enforce a right held by the corporation.

All authorities agree that a stockholder, as such, cannot maintain an action against a third party, either for a breach of contract between such third party and the corporation of which he is a stockholder, or for an injury to the corporation or its property. All such wrongs must be redressed by the corporation itself and in the

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corporate name. *Ninneman v. Fox*, 43 Wash 43, 45, 86 P 213, 213 (1906).

Generally, a shareholder may only sue a third party to enforce an individual right, not a corporate right.

Whenever a cause of action exists primarily in behalf of the corporation against directors, officers, and others, for wrongful dealing with corporate property, or wrongful exercise of corporate franchises, so that the remedy should regularly be obtained through a suit by and in the name of the corporation, and the corporation either actually or virtually refuses to institute or prosecute such a suit, then, in order to prevent a failure of justice, an action may be brought and maintained by a stockholder, or stockholders, either individually or suing on behalf of themselves and all others similarly situated, against the wrongdoing directors, officers, and other persons; but it is absolutely indispensable that the corporation, itself, should be joined as a party, usually as a co-defendant. That the plaintiff should allege and prove that application was made to the directors or managing body, and a reasonable notice, request, or demand that they institute proceedings on the part of the corporation against the wrongdoers, and their refusal to do so after such reasonable request or demand, is but a statement of a general rule. (citations & internal quotations omitted) *Wills v. Nehalem Coal Co.*, 52 Or 70, 87, 96 P 528, 534 (1908).

See also *Dant & Russell, Inc. v. Ostlind*, 148 Or 204, 35 P2d 668 (1934); *Smith v. Bramwell*, 146 Or 611, 31 P2d 647 (1934); *Stewart v. King*, 85 Or 14, 166 P 55 (1917); *Goodwin v. Castleton*, 19 Wash 2d 748, 144 P2d 725, 732 (1944).

A shareholder who seeks to recover for corporate waste or for the misappropriation of corporate funds may not do so individually, but may do so only derivatively. *Munson v. Valley Energy Inv. Fund, US, LP*, 264 Or App 679, 705, 333 P3d 1102 (2014) (interpreting Colorado law); *Smith v. Bramwell*, 146 Or 611, 31 P2d 647 (1934).

There are at least four reasons underlying this basic rule:

In the instant case, the reasons requiring derivative suits do not exist. The reasons underlying the general rule are that 1) it prevents a multiplicity of lawsuits by shareholders; 2) it protects corporate creditors by putting the proceeds of the recovery back in the corporation; 3) it protects the interests of all shareholders by increasing the value of their shares, instead of allowing a recovery by one shareholder to prejudice the rights of others not a party to the suit; and 4) it adequately compensates the injured shareholder by increasing the value of his shares. (citations omitted) *Thomas v. Dickson*, 250 Ga 772, 774, 301 SE2d 49, 51 (1983).

Even though a shareholder owns substantially all of a corporation's stock, the shareholder still may not bring an individual action, but instead, must assert such claims in a derivative lawsuit. *Zimmerman v. Kyte*, 53 Wash App 11, 765 P2d 905 (1988); *Dale v. City Plumbing & Heating Supply Co.*, 112 Ga App 723, 146 SE2d 349 (1965).

This is true even when the injury to the corporation has brought about a decrease in the value of the shareholder's shares. *Lee v. Mitchell*, 152 Or App 159, 953 P2d 414 (1998); *Weiss v. Northwest Acceptance Corp.*, 274 Or 343, 546 P2d

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1065 (1975); *Smith v. Bramwell*, 146 Or 611, 31 P2d 647 (1934). *But see Wills v. Nehalem Coal Co.*, 52 Or 70, 96 P 528 (1908).

Under Delaware law, "whether a claim is direct or derivative is a question of law for the court." *Kollman v. Cell Tech Int'l, Inc.*, 250 Or App 163, fn 8, 279 P3d 324 (2012),

### **B. Individual contract claims against corporation.**

A shareholder may enter into a contract with, or loan money to, the corporation in the shareholder's individual capacity in much the same manner as may any other corporate creditor. *Knecht v. Mandek Corp.*, 281 NJ Super 439, 658 A2d 317 (1995); *Bellaire Securities Corporation v. Brown*, 124 Fla 47, 168 So 625 (1936); *Belcher v. Webb*, 176 Wash 446, 29 P2d 702 (1934). When a shareholder sues to enforce the contract or to foreclose on corporate property, the shareholder does so in an individual capacity. *Myers v. Indiana Mining Co.*, 86 Or 664, 168 P 719 (1917). However, a corporation's debt to a shareholder may sometimes be subordinated to the corporation's third party debts. *Stumbo v. Paul B. Hult Lumber Co.*, 251 Or 20, 44, 444 P2d 564 (1968); *Knecht v. Mandek Corp.*, 281 NJ Super 439, 658 A2d 317 (1995); *Taylor v. Standard Gas Co.*, 306 US 307 (1939); *Gannett Co. v. Larry*, 221 F2d 269 (2<sup>nd</sup> Cir 1953); H.W. BALLANTINE, BALLANTINE ON CORPORATIONS § 129 (1946). *See also* 11 USC § 510 (bankruptcy).

### **C. Claims when third party owes direct duty to both corporation & shareholder.**

If a third party owes a direct duty the shareholder, the shareholder has an individual claim against that third party – rather than a derivative claim – even though the third party may also owe a duty to the corporation.

It is well-settled that only a corporation and not its shareholders can complain of an injury sustained by, or a wrong done to, the corporation. However, this general principle has no application where the wrongful acts are not only against the corporation but are also violations of a duty arising from contract or otherwise owed directly by the wrongdoer to the shareholder. A suit brought by a shareholder on a personal claim is distinguishable from a proceeding to recover damages or other relief for the corporation. (citations omitted) *Adair v. Wozniak*, 23 Ohio St3d 174, 492 NE2d 426, 428 (1986).

*See also Wills v. Nehalem Coal Co.*, 52 Or 70, 96 P 528 (1908).

"It is well settled that an individual cause of action can be asserted when the wrong is both to the stockholder as an individual and to the corporation." *Far West Federal Bank, SB v. Office of Thrift Supervision-Director*, 119 F3d 1358, 1364 (9<sup>th</sup> Cir 1997)(permitting a direct action by shareholders against third party).

A third party's breach of duty to the corporation may also give rise to a claim by an individual shareholder when the third party owes some "special duty" to the shareholder or if the shareholder sustains a "special injury."

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While a stockholder cannot generally sue as an individual for damages arising from a contract between the corporation and a third party, a stockholder may sue individually when the injury resulted from the violation of a special duty to the stockholder that was independent from his status as a stockholder, even when the corporation may have a similar cause of action. (citation omitted) *Hanson v. Shim*, 87 Wash App 538, 551, 943 P2d 322, 329 (1997).

Delaware courts have addressed the issue of "special injury" on several occasions.

In *Elster v. American Airlines, Inc.*, Del Ch, 100 A2d 219 (1953), this Court held that an individual action may be maintained if the stockholder sustained a "special injury" and in *Moran* the standard was articulated as follow:

To set out an individual action, the plaintiff must allege either an injury which is separate and distinct from that suffered by other shareholders, or a wrong involving a contractual right of a shareholder, such as the right to vote, or to assert majority control, which exists independently of any right of the corporation.

*Moran v. Household International, Inc.*, 490 A2d at 1070. Most recently, the Delaware Supreme Court explained:

In comparing the two-prong test of *Moran* with the definition of the term "special injury" in *Elster*, it appears that the term encompasses both prongs of the *Moran* test. That is, a plaintiff alleges a special injury and may maintain an individual action if he complains of an injury distinct from that suffered by other shareholders or a wrong involving one of his contractual rights as a shareholder. Moreover, while *Moran* serves as a quite useful guide, the case should not be construed as establishing the only test for determining whether a claim is derivative or individual in nature. Rather, as was established in *Elster*, we must look ultimately to whether the plaintiff has alleged "special injury" in whatever form.

*Rabkin v. Philip A. Hunt Chemical Corp.*, 547 A2d 963, 968-9 (Del Ch 1986)(also quoting *Lipton & Ceasar v. News International*, 514 A2d 1075, 1078).

The issue of whether a shareholder has a "special injury" under Delaware law – thus entitling the shareholder of a Delaware corporation to bring an individual claim – is discussed at length in *Kollman v. Cell Tech Int'l, Inc.*, 250 Or App 163, 279 P3d 324 (2012). In applying Oregon law, the Oregon courts have **not** used "special injury" language in cases allowing close corporation shareholders to sue individually. See for example *Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682, 687 (1992).

A shareholder may have an individual claim when both the corporation and the shareholder are parties to a contract with a third party and the third party breaches that contract. *Sacks v. American Fletcher National Bank and Trust Co.*, 258 Ind 189, 279 NE2d 807 (1972); *Fleming v. Reed*, 77 NJL 563, 72 A 299 (1909). This may also be true when the shareholder guarantees a corporate debt. *Knauf Fiber Glass, GmbH v. Stein*, 622 NE2d 163 (Ind 1993).

As an exception to the general rule, a stockholder may maintain an action in his own right against a third party (although the corporation may likewise have a cause of action for the same wrong) when the injury to the individual resulted from the

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violation of some special duty owed to the stockholder but only when that special duty had its origin in circumstances *independent* of the stockholder's status as a stockholder. *Hunter v. Knight, Vale & Gregory*, 18 Wash App 640, 571 P2d 212, 216 (1977).

In some situations, the shareholder and the corporation may each have a claim against a third party. *But see Weiss v. Northwest Acceptance Corp.*, 274 Or 343, 546 P2d 1065 (1975)(confirming the general rule but holding that a shareholder who guaranteed a corporate loan agreement did not have a direct action against the lender when the basis for the claim was that the lender allegedly fraudulently induced the corporation to surrender the loan's security).

### **D. Individual claims for declared dividends.**

Generally, a shareholder has no right to force a corporation to declare a dividend. *Zidell v. Zidell, Inc.*, 277 Or 413, 560 P2d 1086 (1977); *Baillie v. Columbia Gold Mining Co.*, 86 Or 1, 166 P 965, 167 P 1167 (1917). Yet, if a shareholder has a contract right to require the corporation to declare a dividend, the shareholder's claim is an individual action. *Walters v. Center Electric, Inc.*, 8 Wash App 322, 506 P2d 883 (1973).

Once a dividend is declared by the board, the right to payment is a personal right in the person who owned the stock on the date that the dividend was declared. ORS 60.181(6); *McJannet v. Strehlow Supply Co.*, 25 Wash 2d 468, 171 P2d 173 (1946).

[A] dividend properly declared by the directors of a corporation cannot subsequently be revoked; and that persons who are shareholders at the time the dividend is declared have a legal claim against the company for the payment of the amount of the dividend; and that, after profits have been set apart and appropriated to the payment of the dividends, they belong to the shareholders, and cannot be recalled, even though the company should suffer losses and become insolvent before the dividend is actually paid. *Albany Fertilizer & Farm Improvement Co. v. Arnold*, 103 Ga 145, 148, 29 SE 695, 696 (1897).

*See also In re Wilson's Estate*, 85 Or 604, 167 P 580 (1917); *Cowin v. Bresler*, 741 F2d 410 (DC Cir 1984); *Mann-Paller Foundation, Inc. v. Econometric Research, Inc.*, 644 F Supp 92 (1986); *Cowin v. Bresler*, 741 F2d 410 (DC Cir 1984); *Cole Real Estate Corp. v. Peoples Bank and Trust Co.*, 160 Ind App 88, 310 NE2d 275 (1974).

### **E. Inspection of corporate records.**

Actions brought under ORS 60.781(2) to compel a corporation to allow a shareholder to inspect records may be brought as an individual action in the shareholder's own name. *Babbitt v. Pacco Investors Corp.*, 246 Or 261, 425 P2d 489 (1967). Shareholder inspection rights are discussed in Section 4.06 of this book.

Historically, a common law action brought to compel a corporation to permit shareholder inspection was brought as a mandamus action. *Bernert v. Multnomah*

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*Lumber & Box Co.*, 119 Or 44, 247 P 155, 248 P 156 (1926); *State ex rel Great Fidelity Life Insurance Co. v. Circuit Court of Posey County*, 259 Ind 441, 288 NE2d 143 (1972); *State ex rel Paschall v. Scott*, 41 Wash 2d 71, 247 P2d 543 (1952). See also *Huson v. Portland & Southeastern Railway Co.*, 107 Or 187, 211 P 897, 213 P 408 (1923)(court has no power to call corporate meetings except by mandamus). This may no longer be true.

#### **F. Action seeking judicial dissolution.**

Another action which may be brought individually – rather than derivatively – is an action pursuant to ORS 60.661(2) and/or 60.952 which seeks the judicial dissolution of the corporation, the appointment of a receiver, the repurchase of shares, the removal of a director, or other relief specified in these statutes. See Section 8.04.

#### **G. Action to compel stock transfer.**

If a shareholder seeks to compel a corporate officer to register a stock transfer, the shareholder may bring a mandamus action against the officer. *Hern v. Looney*, 90 Wash App 519, 959 P2d 1116 (1998); *Faro v. Simplex Medical Systems, Inc.*, 748 So2d 342 (Fla App 1999).

### Section 8.03 Special Case – Closely Held Corporations

#### **A. Oregon.**

In the special case of closely held corporations, Oregon courts are increasingly inclined to permit individual actions by minority shareholders against controlling shareholders when the majority shareholders have breached their fiduciary duty to the minority.

When the majority shareholders of a closely held corporation use their control over the corporation to their own advantage and exclude the minority from the benefits of participating in the corporation, absent a legitimate business purpose, the actions constitute a breach of their fiduciary duties of loyalty, good faith and fair dealing. Because actions such as those alleged in this case result in both derivative and individual harm, an action brought by minority shareholders may proceed as a derivative or a direct action. *Noakes v. Schoenborn*, 116 Or App 464, 472, 841 P2d 682, 687 (1992).

See also *Wulf v. Mackey*, 135 Or App 655, 899 P2d 755 (1995); *Chiles v. Robertson*, 94 Or App 604, 767 P2d 903, *reconsideration allowed in part, opinion modified*, 96 Or App 658, 774 P2d 500 (1989). *But see Wilcox v. Stiles*, 127 Or App 671, 873 P2d 1102 (1994); *Stringer v. Car Data Systems, Inc.*, 314 Or 576, 841 P2d 1183 (1992).

This liberal policy of permitting a minority shareholder in a close corporation to bring a direct action against a controlling shareholder may not apply where a corporation has a large number of shareholders or is a public corporation, *Loewen*



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*v. Galligan*, 130 Or App 222, 882 P2d 104 (1994); *Kahn v. Sprouse*, 842 F Supp 423 (D Or 1993); *Guenther v. Pacific Telecom, Inc.*, 123 FRD 341 (D Or 1987). It also may not apply where the minority shareholder seeks to enforce some corporate right against a non-shareholder. *Lee v. Mitchell*, 152 Or App 159, 953 P2d 414 (1998); *Hampton Tree Farms, Inc. v. Jewett*, 125 Or App 178, 865 P2d 420 (1993), *affirmed*, 320 Or 599, 892 P2d 683 (1995); *Johnson v. Con-Vey/Keystone, Inc.*, 814 F Supp 931 (D Or 1993). *But see Far West Federal Bank, SB v. Office of Thrift Supervision-Director*, 119 F3d 1358 (9<sup>th</sup> Cir 1997)(permitting a direct action by shareholders against third party).

**NOTE:** Often, controlling shareholders will also control the corporation in their capacity as officers and directors. When control persons transfer corporate assets to themselves for inadequate consideration, it may be difficult to discern whether they acted in their capacity as controlling shareholders (giving rise to a direct action) or in their capacity as officers and directors (giving rise to a derivative action only). In such cases, Oregon courts give weight to whether the corporation is closely held or public. *Compare: Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682 (1992)(direct action permitted in close corporation) and *Loewen v. Galligan*, 130 Or App 222, 882 P2d 104 (1994)(only derivative action permitted in public corporation). *But see Wilcox v. Stiles*, 127 Or App 671, 873 P2d 1102 (1994).

**NOTE:** Direct actions by minority shareholders against those in control of the corporation should be pled as actions against controlling shareholders in their "shareholder" capacity; actions pled against control persons in their capacity as officers or directors will almost always be construed as a derivative claim only. *See for example Lee v. Mitchell*, 152 Or App 159, 953 P2d 414 (1998).

Persons who assist shareholders in breaching their fiduciary duties to the other shareholders may also be liable for the breach. *Granewich, II v. Harding*, 329 Or 47, 945 P2d 1067 (1999). For public policy reasons, this rule generally does not apply to attorneys acting within the scope of an attorney-client relationship. *Reynolds v. Schrock*, 341 Or 338, 142 P3d 1062 (2006).

### **B. Other states.**

Like in Oregon, many other states now permit shareholders in close corporations to bring direct actions against each other, rather than forcing the minority shareholder to bring the case derivatively.

Where majority or controlling shareholders in a close corporation breach their heightened fiduciary duty to minority shareholders by utilizing their majority control of the corporation to their own advantage, without providing minority shareholders with an equal opportunity to benefit, such breach, absent legitimate business purpose, is actionable. Where such breach occurs, the minority shareholder is individually harmed.

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Accordingly, we hold that claims of a breach of fiduciary duty alleged by minority shareholders against shareholders who control a majority of shares in a close corporation, and use their control to deprive minority shareholders of the benefits of their investment, may be brought as individual or direct actions and are not subject to the provisions of [the civil court rules related to derivative lawsuits]. *Crosby v. Beam*, 47 Ohio St3d 105, 548 NE2d 217, 221 (1989).

See also *Steelman v. Mallory*, 110 Idaho 510, 716 P2d 1282 (1986).

Some courts reject attempts to apply separate rules to close corporations and require that all such lawsuits be filed derivatively, unless the minority shareholder has suffered a "special injury" or can allege a "special duty."

Ohio, like a few other states, has expanded the "special injury" doctrine into a general exception for closely held corporations, treating them as if they were partnerships. The American Law Institute recommends that other states do the same. *Principles of Corporate Governance* § 7.01(d) and pp. 22-25 (comment), 30-36 (reporter's note). The premise of this extension may be questioned. Corporations are *not* partnerships. Whether to incorporate entails a choice of many formalities. Commercial rules should be predictable; this objective is best served by treating corporations as what they are, allowing the investors and other participants to vary the rules by contract if they think deviations are warranted. So it is understandable that not all states have joined the parade.

Delaware, for one, has not. When the controlling stockholder of a family corporation transferred its assets for independent consideration, Delaware required the minority investors to pursue derivative litigation, observing that the value of the minority shares went down only to the extent the corporation as an entity was worth less. When the owner of 95% of a closely held firm's stock proposed to liquidate the corporation at what the minority thought was an inadequate price, Delaware again required the minority to bring the objection derivatively. In neither case did the Chancellor think it important that the wrong alleged involved the controlling stockholder enriching itself at corporate expense, or that the corporation was closely held. The author of the leading treatise treats [the second Delaware case cited] as establishing the proposition that the closely held nature of the corporation is irrelevant to the distinction between direct and derivative actions. (citations omitted) *Bragdon v. Bridgestone/Firestone, Inc.*, 916 F2d 379, 383-4 (7<sup>th</sup> Cir 1990).

See also *Frank v. Hadesman & Frank, Inc.*, 83 F3d 158 (7<sup>th</sup> Cir 1996).

The issue of whether a shareholder has a "special injury" under Delaware law – thus entitling the shareholder of a Delaware corporation to bring an individual claim – is discussed at length in *Kollman v. Cell Tech Int'l, Inc.*, 250 Or App 163, 279 P3d 324 (2012). In applying Oregon law, the Oregon courts have not used "special injury" language in cases allowing close corporation shareholders to sue individually. See for example *Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682, 687 (1992).

Individual actions in close corporations are generally limited to intracorporate disputes – not to claims by a shareholder against an outside party. *Mathis v. Era Franchise Systems, Inc.*, 25 So3d 298, 302 (Miss 2009).

## Section 8.04      Actions Arising Out of Oppression & Deadlock

ORS 60.661(2) has long permitted a shareholder to seek judicial

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dissolution of a corporation when the majority's conduct is "illegal, oppressive or fraudulent" or when there is a voting deadlock.

In 2001, ORS 60.952 took effect. The new statute applies only to non-public corporations. It mirrors ORS 60.661(2) in listing the same triggering events (oppression, voting deadlock, corporate waste) giving rise to a claim, but sets out a long, but non-exclusive, list of possible remedies that a court might apply—remedies previously applied by the courts under their equitable powers. The new statute also gives the corporation the right to buy-out the complaining shareholder, but gives the court the ability to set the price and terms of the sale.

ORS 60.661 continues to be applicable to all corporation; ORS 60.952 is applicable only to non-public corporations. It is likely that much of the case law interpreting the older ORS 60.661 will apply to the ORS 60.952 as well.

### **A. Statutory triggering events.**

Both ORS 60.661 and 60.952 are triggered, and a shareholder may seek court intervention, if:

- (a) The directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock and irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally, because of the deadlock;
- (b) The directors or those in control of the corporation have acted, are acting or will act in a manner that is illegal, oppressive or fraudulent;
- (c) The shareholders are deadlocked in voting power and have failed, for a period that includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired; or
- (d) The corporate assets are being misapplied or wasted.

Most cases brought under this statute allege acts which are "illegal, oppressive or fraudulent." Such cases are generally referred to as "shareholder oppression" cases.

A breach of the fiduciary duty owed by controlling shareholders to minority shareholders likely also constitutes "oppressive" conduct. *Naito v. Naito*, 178 Or App 1, 20-1, 35 P3d 1068 (2001).

Although there is not, and probably cannot be, a definitive definition of oppressive conduct under the statute, at least in a closely held corporation conduct that violates the majority's fiduciary duties to the minority is likely to be oppressive. *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 108, 7 P3d 717 (2000).

### **B. Dissolution as a remedy.**

Although the only remedy mentioned in ORS 60.661 is dissolution, courts have usually fashioned other remedies for oppressive conduct – relying on their traditional equitable power to protect minority owners. *Browning v. C & C Plywood*

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*Corp.*, 248 Or 574, 434 P2d 339 (1968); *Baker v. Commercial Body Builders, Inc.*, 264 Or 614, 507 P2d 387 (1973); *Delaney v. Georgia-Pacific Corp.*, 278 Or 305, 564 P2d 277, *supplemented*, 279 Or 653, 569 P2d 604 (1977), *appeal after remand*, 42 Or App 439, 601 P2d 475 (1979).

Although not mentioned as a remedy under ORS 60.661, the most common remedy in oppression cases is an order for the controlling shareholders to purchase the shares of the oppressed minority. “Often the appropriate remedy has been a court-ordered share purchase, which is now provided for in ORS 60.952(5).” *Hickey v. Hickey*, 269 Or App 258, 273, 344 P3d 512 (2015).

Under ORS 60.661, the trial court had the authority to choose a remedy for defendants' actions; we agree with it that requiring defendants to purchase plaintiff's shares is the preferable option. A purchase will disentangle the parties' affairs while keeping the corporation a going concern; dissolution would not benefit anyone, and plaintiff did not seek it at trial. *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 114, 7 P3d 717 (2000).

*See also Tiffit v. Stevens*, 162 Or App 62, 78, 987 P2d 1 (1999).

Although ORS 60.952(2) sets out a number of possible remedies which a court may impose other than dissolution, “ORS 60.952 was not intended to institute a menu of remedies irrespective of Oregon case law but was enacted to reflect judicial practice.” *Hickey v. Hickey*, 269 Or App 258, 270, 344 P3d 512 (2015).

ORS 60.661 applies to all corporations – close corporations, publicly-held corporations, and everything in-between. That said, all of the cases in Oregon on judicial dissolution – and maybe all cases elsewhere as well – involve close corporations.

### **C. *Illegal, oppressive or fraudulent conduct.***

“The legislature has not defined “oppression” for present purposes. . . Rather, courts must determine on a case-by-case basis whether the conduct complained of rises to the level of oppression.” *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 265, 21 P3d 178 (2001). “‘Minority shareholder oppression’ is not defined by statute, and the case law indicates that the concept is rather nebulous, such that a definitive definition may not be possible.” *Davis v. Brockamp & Jaeger, Inc.*, 216 Or App 518, 530, 174 P3d 607 (2007).

In interpreting the similarly-worded, former ORS 57.595, the Oregon Supreme Court held that the terms “illegal,” “oppressive,” and “fraudulent” are to be read in the disjunctive:

In considering the meaning and application of the term “oppressive” conduct it is first to be noted that by the very terms of [the statute] conduct need not be fraudulent or illegal to be “oppressive” within the meaning of that statute.

While general definitions of “oppressive” conduct are of little value for application in a specific case, perhaps the most widely quoted definitions are that “oppressive conduct” for the purposes of such a statute is:

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"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."

We agree, however, that the question of what is "oppressive" conduct by those in control of a "close" corporation as its majority stockholders is closely related to what we agree to be the fiduciary duty of a good faith and fair dealing owed by them to its minority stockholders.

Thus, an abuse of corporate position for private gain at the expense of the stockholders is "oppressive" conduct. Or the plundering of a "close" corporation by the siphoning off of profits by excessive salaries or bonus payments and the operation of the business for the sole benefit of the majority of the stockholders, to the detriment of the minority stockholders, would constitute such "oppressive" conduct as to authorize a dissolution of the corporation under the terms of ORS 57.595. (footnotes omitted) *Baker v. Commercial Body Builders, Inc.*, 264 Or 614, 628-9, 507 P2d 387, 393-4 (1973).

See also *Iwasaki v. Iwasaki Bros., Inc.*, 58 Or App 543, 649 P2d 598 (1982).

A breach of the fiduciary duty owed by controlling shareholders to minority shareholders likely also constitutes oppressive conduct. *Naito v. Naito*, 178 Or App 1, 20-1, 35 P3d 1068 (2001).

Although there is not, and probably cannot be, a definitive definition of oppressive conduct under the statute, at least in a closely held corporation conduct that violates the majority's fiduciary duties to the minority is likely to be oppressive. *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 108, 7 P3d 717 (2000).

"Diversion of a corporate opportunity is a breach of fiduciary duty." *Davis v. Brockamp & Jaeger, Inc.*, 216 Or App 518, 537, 174 P3d 607 (2007). "When a corporate opportunity is usurped by the majority shareholder of a closely held corporation, that breach may constitute minority shareholder oppression." *Id*; *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 266, 21 P3d 178 (2001).

But where there are both fiduciary duty breaches and oppressive conduct and the remedy imposed is the buy-out of the minority, the breach of fiduciary duty claim "is essentially subsumed under the oppression claim" and there is not a separate remedy for the fiduciary claim. *Tiff v. Stevens*, 162 Or App 62, 78, 987 P2d 1 (1999).

Conduct which constitutes "oppressive conduct" is necessarily fact dependent and summary judgment on this issue is usually inappropriate. *Weiner Investment Co. v. Weiner*, 105 Or App 339, 804 P2d 1211 (1991).

### **D. Reasonable expectations.**

In the context of close corporations, "oppression" has often been construed to include frustrating the "reasonable expectations" of founding shareholders, including expectations of employment and involvement in management decisions. Law Professor Robert Art, who chaired the Oregon State Bar committee that drafted

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ORS 60.952, later wrote:

The reasonable expectations approach focuses on the special characteristics of close corporations, that a managerial role and employment are central to the decision to invest, and that economic return (if the business is successful) is expected to be largely, or entirely, in the form of salary and other employment benefits, not dividends. Profitability of the corporate entity, which is calculated after payment of salaries and benefits, is not critical if the employee-shareholders receive their due as compensation. The controlling shareholders inherently agree to forego, to some extent, the managerial discretion typical in non-close corporations. The business judgment rule, or other deference given to decisions of those in control, is not warranted in this situation.

Removing an employee-shareholder in a close corporation from a position of influence and employment, in this view, is not accurately viewed as a managerial decision within the ordinary discretion of those in control. Instead, it is a breach of the basic bargain among the business' owners, depriving the minority shareholder of all present return on investment. Moreover, because the terminated employee-shareholder has no realistic opportunity to sell the shares at a fair value to anyone else, the owner is deprived of the investment principal. No recourse is available except for the judicial action for oppression.

Under this perspective, importantly, oppression can be found even though the conduct that frustrates the minority's expectations does not entail a breach of fiduciary duty by the controlling shareholder. Conduct can be oppressive even though it does not include typical "squeeze-out" techniques, such as absence of dividends or payment of excessive salaries to the controlling shareholders. An assertion by those in control that the challenged conduct enhances corporate profitability can be rejected on the grounds that economic benefits to the business owners, rather than profitability of the business entity, was the basis of the bargain among the owners. An assertion that conduct such as terminating employment is legal, in the sense that directors are empowered by the statutes and articles of incorporation or other documents to take such action, is similarly flawed under this perspective. If those in control exercise their power in a manner that breaches the reasonable expectations of the minority, they must in some other manner fulfill the expectations.

Robert C. Art, *Shareholder Rights and Remedies in Close Corporations: Oppression, Fiduciary Duties, and Reasonable Expectations*, 28 J Corp L 371, 389-90 (2003).

The New York Court of Appeals has said:

A shareholder who reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, a place in corporate management or some other form of security would be oppressed in a very real sense when others in the corporation seek to defeat those expectations and there exists no effective means of salvaging the investment. *In the Matter of the Judicial Dissolution of Kemp & Beatley, Inc.*, 64 NY2d 63, 484 NY S2d 799, 805, 473 NE 2d 1173, 1179 (1984) (citations omitted).

In applying Colorado law, the Oregon Court of Appeals said:

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 [plaintiff's] decision to join the venture. *Munson v. Valley Energy Inv. Fund, US, LP*, 264 Or App 679, 709, 333 P3d 1102 (2014) (interpreting Colorado law and quoting *In re Kemp & Beatley, Inc.*, 64 N.Y.2d 63, 73, 484 N.Y.S.2d 799, 473 N.E.2d 1173, 1179 (1984)).

The Maryland Court of Appeals has said:

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“oppressive conduct,” a concept we defined in *Edenbaum* as turning on the objectively reasonable expectations of the shareholder going into the enterprise: conduct is oppressive if it “substantially defeats expectations that, objectively viewed were both reasonable under the circumstances and were central to the [minority shareholder’s] decision to join the venture.” (citations omitted) *Bontempo v. Lare*, 217 Md App 81, 90 A3d 559, 579 (2014).

One Washington case discusses “reasonable expectations” as follows:

Washington cases have not addressed the question of what constitutes “oppressive” action against a shareholder. A number of courts in other states have found oppression in minority shareholder settings. The court in *Gimpel v. Bolstein*, 125 Misc 2d 45, 477 NYS 2d 1014 (1984) attempted to set a standard for determining the existence of oppression, stating that “[t]he most prominent definition of oppression stems from the writings of F. Hodge O’Neal, which define “oppression” as a violation by the majority of the “reasonable expectations” of the minority.” “Reasonable Expectations” are those spoken and unspoken understanding on which the founders of a venture rely when commencing the venture.

The Court in *Gimpel* did not use the reasonable expectations test because the corporation was 53 years old, the current shareholders were not the original shareholders, and the plaintiff had stolen from the corporation, thereby breaking all bargains. The court thus applied a secondary definition, describing oppression as

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 visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.

Under either of these test, the factual findings support the legal conclusion that [defendant] did not oppress [plaintiff] as a minority shareholder. (citations omitted) *Robblee v. Robblee*, 68 Wash App 69, 76, 841 P2d 1289, 1293 (1992).

*See also Baur v. Baur Farms, Inc.*, 832 NW2d 663, 671 (Iowa 2013); *Stefano v. Coppock*, 705 P2d 443, 446 n 3 (Alaska 1985); *Fox v. 7L Bar Ranch Co.*, 198 Mont 201, 645 P2d 929, 933–34 (1982); *Brenner v. Berkowitz*, 134 NJ 488, 634 A2d 1019, 1028–29 (1993); 2 F. Hodge O’Neal & Robert B. Thompson, *Oppression of Minority Shareholders and LLC Members* § 7:11, at 7–105 to 7–108 (rev 2d ed 2012); Douglas K. Moll, *Shareholder Oppression & Dividend Policy in the Close Corporation*, 60 Wash & Lee L Rev 841, 853–58 (2003).

Some courts have held that “reasonable expectations” must be objective, not merely the mental impressions of the shareholder claiming oppression. corporation.

a complaining shareholder’s “rights or interests” in a close corporation include the “reasonable expectations” the complaining shareholder has in the corporation. 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. The interests and views of the other participants must be considered in determining “reasonable expectations.” The key is “reasonable.” 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

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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. Also, only substantial expectations should be considered and this must be determined on a case-by-case basis. (citation omitted) *Meiselman v. Meiselman*, 563 309 NC 279, 307 SE2d 551 (1983).

**NOTE:** The term "reasonable expectations" appears in the remedies section – ORS 60.952(4) – not in the triggering event section – ORS 60.952(1). This author served on the committee that drafted ORS 60.952 and Oregon case law was silent on whether Oregon would follow the reasonable expectation test applied by some other courts. The committee decided to let Oregon case law develop on this issue rather than take a position in the statute. Since then, no Oregon appellate decision has addressed this issue other than the *Munson* case which applied Colorado law. *Munson v. Valley Energy Inv. Fund, US, LP*, 264 Or App 679, 709, 333 P3d 1102 (2014).

### **E. Oppression usually involves pattern of conduct.**

But not all conduct which negatively impacts the minority will give rise to a remedy under ORS 60.661 and 60.952.

The existence of one or more of these characteristic signs of oppression does not necessarily mean that the majority has acted oppressively within the meaning of ORS 60.661(2)(b). Courts give significant deference to the majority's judgment in the business decisions that it makes, at least if the decisions appear to be genuine business decisions. As we have noted, attempts to define what oppressive conduct is, instead of what it is not, have proved elusive, and cases of this sort depend heavily on their specific facts. See *Weiner Investment Co. v. Weiner*, 105 Or App 339, 342-43, 804 P2d 1211 (1991). The court must evaluate the majority's actions, keeping in mind that, even if some actions may be individually justifiable, the actions in total may show a pattern of oppression that requires the court to provide a remedy to the minority. *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 110, 7 P3d 717 (2000).

See also *Davis v. Brockamp & Jaeger, Inc.*, 216 Or App 518, 174 P3d 607 (2007).

Usually, to trigger a remedy under ORS 60.661, the controlling shareholder must engage either in some pattern of wrongful conduct or in a single instance of wrongful conduct which is particularly egregious.

### **F. Deadlock.**

ORS 60.661 and 60.952(1) also permit a court to intervene and dissolve a corporation (or fashion another remedy) in the event of shareholder or director deadlock.

"Deadlock is the inaction which results when two equally powerful factions stake out opposing positions and refuse to budge." (footnote omitted) *Wilcox v. Stiles*, 127 Or App 671, 678, 873 P2d 1102, 1105 (1994). If one shareholder owns a majority of the shares, the corporation is not necessarily deadlocked simply because its board of directors is deadlocked since ORS 60.661(2)(a) also requires



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that "the shareholders are unable to break the deadlock." See also *Gregory v. J. T. Gregory & Son, Inc.*, 176 Ga App 788, 338 SE2d 7 (1985).

Likewise, even though the shareholders are deadlocked, a corporation is not necessarily deadlocked if the board itself is not deadlocked or if the shareholder deadlock has not lasted through at least two consecutive annual meeting dates. ORS 60.661(2)(c) & 60.952(1)(c); *Jackson V. Nicolai-Neppach Co.*, 219 Or 560, 348 P2d 9 (1959).

### **G. Court's power to dissolve is discretionary.**

A court's power to dissolve a corporation under ORS 60.661 is a discretionary power, one which the courts are most hesitant to exercise. For instance, after a lengthy discussion of the evolution of this power, the court in *Jackson V. Nicolai-Neppach Co.*, 219 Or 560, 348 P2d 9 (1959) stated:

The shareholder deadlock provisions of the Illinois Business Corporation Act, of the Model Business Corporation Act, and of the Oregon Business Corporation Law are clearly couched in language of permission. It is incredible that the many able lawyers who worked from time to time on these three identical acts would have used such phraseology to express a mandate. The statute contemplates that the court of equity shall take jurisdiction once a requisite showing of fact is made and contemplates further that having taken jurisdiction it will bring its discretion to bear in granting or refusing to grant equitable relief. The very fact that the legislature has made the remedy of liquidation a matter of discretion for the courts is a mandate to us to use discretion, and we would not be carrying out the legislative will by simply decreeing liquidations as a matter of course once the jurisdictional facts and nothing more are proven. The common law rule was thought to be an insufficient safeguard of the rights of the half-owner of a corporation who happened to be out of power. As we read the statute its intent is to obligate the courts to thread their way from case to case without the assistance of sweeping generalizations. *Jackson V. Nicolai-Neppach Co.*, 219 Or 560, 574-5, 348 P2d 9, 16 (1959).

The *Jackson* case is discussed in a casenote: 39 OR L REV 382 (1960). See also *McMunn v. ML&H Lumber, Inc.*, 247 Or 319, 429 P2d 798 (1967); *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wash App 502, 728 P2d 597 (1986).

In *Baker v. Commercial Body Builders, Inc.*, 264 Or 614, 507 P2d 387 (1973), the court again noted that the power granted by the judicial dissolution statute was a discretionary power and pointed out that this statutory power did not limit the court's more general equitable power to protect minority shareholders by fashioning remedies other than dissolution.

Historically, courts have been disinclined to intervene to dissolve a corporation, even in cases involving deadlock or oppressive conduct.

At common law, many courts refused to intervene in shareholder disputes since the State licensed the corporation, and as such the State and not the courts had the authority to dissolve the corporation. In a few jurisdictions, courts of equity began to carve out areas in which they would use the powers of the chancellors to liquidate the assets and business of the corporation. A few courts asserted the power to liquidate on a showing of irreparable injury to the shareholders and the corporation due to gross or fraudulent mismanagement.

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More recently, many states have adopted statutory provisions granting courts of equity power to dissolve corporations in suits brought by shareholders where irreparable injury to the shareholders or the corporation occurred or was threatened. Some states adopted legislation permitting liquidation and dissolution because of deadlocks among the owners or the directors of the corporation. In determining whether to grant dissolution under either the common law or statute, the principal inquiry appears to be whether dissolution would be beneficial to the shareholders and not injurious to the public.

Under the predecessor statutes to RCW 23A.28.170, the Washington courts permitted dissolution based on shareholder dissension or deadlock only under the most egregious circumstances. (citations omitted) *Henry George & Sons, Inc. v. Cooper-George, Inc.*, 95 Wash 2d 944, 632 P2d 512, 514 (1981).

This author has been unable to find any Oregon appellate decision in which judicial dissolution was ordered.

Courts will usually not intervene even in the case of alleged director incompetence and mismanagement. *Beeler v. Standard Investment Co.*, 107 Wash 442, 181 P 896 (1919). One decision recognized the right of the board of directors to shift the balance of voting power, stating that "directors . . . may in the exercise of their honest business judgment adopt a valid method of eliminating what appears to them a clear threat to the future of their business by any lawful means." *Hendricks v. Mill Engineering & Supply Co.*, 68 Wash 2d 490, 495, 413 P2d 811, 813-4 (1966).

The Oregon Supreme Court said in an older case:

In the absence of a fraudulent or coercive design or purpose on the part of the management neither the judgment of the court nor that of a minority stockholder can properly be substituted for the judgment of the majority of the directors and stockholders of a corporation. *Horner v. Pleasant Creek Mining Corp.*, 165 Or 683, 699, 107 P2d 989, 995, 109 P2d 1044 (1941).

Another court put it more bluntly:

No principle of law is more firmly fixed in our jurisprudence than the one which declares that the courts will not interfere in matters involving merely the judgment of the majority in exercising control over corporate affairs. *Regenstein v. J. Regenstein Co.*, 213 Ga 157, 159 97 SE2d 693, 695 (1957).

See also *Davis v. Brockamp & Jaeger, Inc.*, 216 Or App 518, 174 P3d 607 (2007).

Usually, either bad faith or fraud must be present for a court to intervene in internal corporate affairs.

Under ORS 60.661, a court may find inequitable conduct, but order relief short of dissolution. *Browning v. C & C Plywood Corp.*, 248 Or 574, 434 P2d 339 (1968); *Delaney v. Georgia-Pacific Corp.*, 278 Or 305, 564 P2d 277, *supplemented*, 279 Or 653, 569 P2d 604 (1977), *appeal after remand*, 42 Or App 439, 601 P2d 475 (1979); *Agronic Corporation of America v. deBough*, 21 Wash App 459, 585 P2d 821 (1978).

"While [Maryland's corporation statute] only mentions dissolution as a remedy

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for oppressive conduct, we join other courts today ‘which have interpreted their similar statutory counterparts to allow alternative equitable remedies not specifically stated in the statute.’” *Edenbaum v. Schwarcz-Osztreicherne*, 165 Md App 233, 885 A2d 365, 380 (2005).

**NOTE:** Despite language in many earlier cases that indicates courts are reluctant to intervene in internal corporate disputes, there has been an increased tendency for the Oregon Court of Appeals to intervene and fashion some remedy to protect minority shareholders. See *Tiffit v. Stevens*, 162 Or App 62, 78, 987 P2d 1 (1999); *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 108, 7 P3d 717 (2000) *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 265, 21 P3d 178 (2001). *But see Davis v. Brockamp & Jaeger, Inc.*, 216 Or App 518, 174 P3d 607 (2007). When the court does intervene, the remedy chosen is usually the forced buy-out of the minority’s shares.

### **H. 2002 statutory provisions for non-public corporations.**

The remedy for oppressive conduct set out in ORS 60.661 is the dissolution of the corporation. This author knows of no Oregon cases where this statutory remedy was actually imposed, although in one recent Multnomah County case, the court ordered the corporation split up between the two warring factions.

In recent years, shareholder lawsuits alleging illegal, oppressive or fraudulent conduct have become increasingly common. Although courts have frequently found that those in control of the corporation have acted in a manner which is “illegal, oppressive or fraudulent,” courts rarely, if ever, order the drastic remedy of dissolution of the corporation. Rather, most courts have disregarded the statutory remedy of dissolution and instead exercised their equitable power to fashion some other remedy.

In response to this increase in litigation, the OSB Business Law Section set up a task force to make proposals for oppression cases in the context of non-public corporations. The task forces’ recommendations were enacted into law as ORS 60.952 and took effect on January 1, 2002.

ORS 60.952 applies a new procedure for non-public corporations, while leaving ORS 60.661 unchanged for public corporations and non-public corporations which choose to use it. The highlights of this new statute are:

The threshold statutory issue of “illegal, oppressive or fraudulent” conduct remains unchanged and is left for further judicial development.

Under the statute, in the event a court finds threshold oppressive conduct, the statutory remedies available to the court are expanded beyond the drastic remedy of dissolution. The statute lists 12 other permissive statutory remedies – including

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appointment or removal of directors, appointment of a custodian to manage the business, submission of the dispute to mediation, award of damages and the forced purchase of shares. All of these statutory remedies have previously been applied by various courts – in Oregon and elsewhere – exercising their equitable power to regulate corporations. ORS 60.952(3) provides that the listed remedies are not exclusive of other legal and equitable remedies a court may impose.

By means of an agreement entered into before the oppressive conduct and described in ORS 60.265, the shareholders may agree to limit or eliminate any of the listed remedies – except for the remedies of an accounting, damages or dissolution.

ORS 60.952(4) provides that in fashioning a remedy, a court may take into account the “reasonable expectations of the corporation’s shareholders as they existed at the time the corporation was formed and developed during the course of the shareholders’ relationship with the corporation and with each other.” The statute goes on to say: “the court shall endeavor to minimize the harm to the business of the corporation.”

The concept that a remedy can accommodate benefits particular to the circumstances of a close corporation, such as a salary from employment, is captured in ORS 60.952(4), which provides that, in determining the appropriate remedy under the statute, the court has discretion to “take into consideration the reasonable expectations of the corporation’s shareholders as they existed at the time the corporation was formed and developed during the course of the shareholders’ relationship with the corporation and with each other.” *Hickey v. Hickey*, 269 Or App 258, 274 n.9, 344 P3d 512 (2015).

If the court orders the purchase of the complaining shareholder’s stock, it can apply either what the parties could reasonably expect or the fair value. *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 114, 7 P3d 717 (2000). No penalty applies regardless of wrongdoing.

In considering appropriate relief, judicial practice **avoided penalizing** controlling shareholders’ ownership interests in a manner that significantly departed from what was required to relieve minority shareholders from the oppressive conduct, and also **avoided increasing any value** or benefit from a minority shareholders’ interest beyond what minority shareholders **could reasonably expect or the fair value** of the shares. (emphasis added) *Hickey v. Hickey*, 269 Or App 258, 274-75, 344 P3d 512 (2015).

Courts often look to shareholder agreements or operating agreements to aid in determining rights in a buyout of ownership interests. See *Cox v. C & H Reforesters, Inc.*, 239 Or App 101, 245 P3d 139 (2010) (looking to the Shareholder Agreement to set buy-out terms in an oppression action under ORS 60.952); *Stone v. REAL Health, PC*, CV98-41 49 72, 29 Conn L Rptr 219 (Superior Ct Conn New Haven Nov 15, 2000) (setting fair value as book value because that valuation method was provided in the shareholder agreement); *Maschmeier v. Southside Press, Ltd.*, 435 NW 2d 377 (Iowa App 1988) (requiring that the manner of payment

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for the share buyout be consistent with the bylaws because the court should not “rewrite” bylaws or other shareholder agreements).

**NOTE:** There has been a trend for some states to look to the “reasonable expectations” of the shareholders at formation in determining whether a triggering event of oppression has occurred. For example, whether at formation the shareholders had a “reasonable expectation” of employment throughout the existence of the corporation. In such states, employment termination might be a triggering event giving rise to a suit for oppression. See Section 8.04(D) above. The only Oregon case to adopt the reasonable expectations test did so applying Colorado law. See *Munson v. Valley Energy Inv. Fund, US, LP*, 264 Or App 679, 709, 333 P3d 1102 (2014).

The task force which proposed ORS 60.952 (a task force on which this author served as a member) rejected efforts to include “reasonable expectation” language in the triggering event provisions of ORS 60.952 – leaving this issue to further development by the Oregon courts. However, the task force did include “reasonable expectation” language in the remedy section. Thus as written, a corporate act which disregards the subjective expectations of the shareholders **may** not be a triggering event for an oppression suit, but ORS 60.952(4) requires the court to take these expectations into account in fashioning a remedy. This may be consistent with prior case law. See *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 7 P3d 717 (2000)(which took into account the lost wages of the oppressed shareholder in awarding damages).

If a court orders either the corporation or its controlling shareholders to purchase the minority’s shares, ORS 60.952(5) provides that the court shall determine the “fair value” of the shares (with or without the assistance of appraisers), a value which shall take “into account any impact on the value of the shares resulting from the actions giving rise to the preceding.” The court is also required to “consider any financial or legal constraints on the ability of the corporation or the purchasing shareholder to purchase the shares.”

In *Marker v. Marker*, 238 Or App 65, 242 P3d 638 (2010), the plaintiff prevailed at trial on his oppression claim and the court entered a judgment ordering the defendant to purchase his shares at a value to be set by an appraiser. After the appraiser determined fair value, the trial court denied plaintiff’s request for a hearing on the appraiser’s report and adopted the appraiser’s determination of fair value. The plaintiff unsuccessfully appealed only on the issue of whether he was entitled to a hearing on the appraisal report.

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### **I. ORS 60.952(6): forced buy-out.**

ORS 60.952(1) - (5) contains no significant departure from existing case law. The only radically new provision – ORS 60.952(6) – provides that within 90 days after a minority shareholder initiates an oppression-type lawsuit, either the corporation or one or more of the controlling shareholders may force the minority shareholder to sell his/her shares. Should the corporation or its controlling shareholders make such an election, the minority’s lawsuit for oppressive conduct is suspended and the court need only determine the “fair value” of the minority’s shares. “The legislative history of ORS 60.952(6) shows that the legislature intended to discourage litigation between shareholders, with its potential for acrimony and harm to the firm and others, by providing an incentive for shareholders to resolve their disputes in some way other than a “proceeding under subsection (1).” *Graydog Internet, Inc. v. Giller*, 362 Or 177, 198, \_\_\_ P3d \_\_\_ (2017).

**NOTE:** This forced buy-out provision is drawn from § 14.34 (2001) of the Model Business Corporation. Several other state oppression statutes contain provisions giving the corporation and/or controlling shareholders the option of staying the original proceeding while the court sets a price for the forced buy-out of the complaining shareholder – although the actual mechanism for doing so varies widely. See Ala Code § 10-2B-14.34 (1999); Alaska Stat § 10.06.630 (West 2010); Ariz Rev Stat § 10-1434 (1999); Cal Corp Code § 2000 (2000); Conn Gen Stat § 33-900 (1999); Fla Stat Ann § 607.1436 (West 2010); Idaho Code § 30-1-1434 (West 2010); 805 Ill Comp Stat Ann 5/12.56(f) (West 2010); Minn Stat Ann § 302A.751, subd 2 (West 2010); Miss Code Ann § 79-4-14.34 (1999); Mont Code Ann § 35-1-939 (1999); Neb Rev Stat Ann § 21.20,166 (West 2009); NH Rev Stat Ann § 293-A:14.34 (1999); NJ Stat Ann § 14A:12-7(8)(c) (West 2010); NY Bus Corp Law § 1118 (McKinney 1999); RI Gen Laws § 7-1.2-1315 (2009); Utah Code Ann § 16-10a1434 (1999); W Va Code § 31D-14-1434.

Shareholders invoking ORS 60.661 must plead the statutory remedy of corporate dissolution. ORS 60.952 is not so limited.

ORS 60.952 applies when the plaintiff invokes the statute itself or conduct that falls within the statute.

ORS 60.952 may be invoked when claims are asserted within a derivative lawsuit if such claim assert “illegal, oppressive or fraudulent” conduct. *Scallon ex rel. Henry Enters. Inc. v. Scott Henry's Winery Corp.*, Case No. 15-35952 (9<sup>th</sup> Cir April 11, 2017).

ORS 60.952 may not be invoked in response to a third party claim where allegations in that claim do not either invoke the statute itself or assert “illegal, oppressive or fraudulent” conduct. *Graydog Internet, Inc. v. Giller*, 362 Or 177, \_\_\_ P3d \_\_\_ (2017).

Whether less drastic claims of “illegal” conduct (e.g., failing to call a

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shareholder meeting, failing to permit inspection of corporate records) give rise to the ORS 60.952(6) forced buy-out right is an open question.

### **J. Steps to invoke forced-buy out provisions.**

Within 90 days of the filing of the proceeding under subsection (1), either the corporation or one or more of the non-complaining shareholders may elect to purchase all of the shares owned by the complaining shareholder. This election must be in writing and contain the amount the electing party will pay for the shares. ORS 60.952(6). This election to purchase is usually irrevocable. ORS 60.952(6)(a).

If the election is made by shareholders (rather than the corporation), the corporation must give notice of the election and give these other shareholders notice of their right to join in the irrevocable offer. ORS 60.952(6)(b).

If the parties are unable to reach agreement after 30 days (which agreement must be approved by the court), then upon application of any party, the court shall stay the proceeding and determine the fair value and terms of the purchase. ORS 60.952(6)(f). The court is not bound by the original irrevocable offer, but is charged with determining the fair value of the shares. The value is normally set as of the day before the date the proceeding was filed. *Id.*

The court may value the shares with or without the assistance of appraisers. ORS 60.952(5)(a)(A) & ORS 60.952(7).

In setting the terms of the purchase, the court is to consider any financial or legal constraints on the ability of the corporation or purchasing shareholder to purchase the shares and may specify the terms of the purchase, including installment payments, interest rate, subordination to rights of other corporate creditors, security and covenants not to compete. ORS 60.952(5)(a)(B) & (C).

### **K. Scope of trial.**

In theory, an action for a forced buy-out under ORS 60.952(6) only involves the issues of the fair value of the minority's shares and the terms of the purchase (e.g., lump sum vs. payment over time; imposition of a noncompetition requirement). It is not clear whether evidence of the oppressive conduct is admissible to prove the value of the minority's shares. Case law in some states indicates that such evidence is not admissible. For example, in a New York case, the court said that the test to be applied to determining "fair value" was the same in both dissenter rights cases (§623) and oppression cases (§1118):

there is no difference in analysis between stock fair value determinations under Business Corporation Law § 623, and fair value determinations under Business Corporation Law § 1118. The latter provision governs the rights of minority stockholders when the corporation has elected to purchase their interests, also at "fair value", following their petition for corporate dissolution under Business Corporation Law § 1104-a for oppressive majority conduct. The corporations' opposing argument is that considerations of the oppressive conduct of the majority stockholders enter into fair value considerations conducted under Business

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Corporation Law § 1118; therefore, the cases decided under that section are distinguishable and not authoritative for fair value considerations under Business Corporation Law § 623. **The corporations' position in this regard is untenable because their basic underlying assumption--that oppressive majority conduct enters into the court's fair value equation under section 1118--is in error. As we stated in Matter of Pace Photographers (Rosen), 71 N.Y.2d 737, 530 N.Y.S.2d 67, 525 N.E.2d 713, once the corporation has elected to buy the petitioning stockholders' shares at fair value, "the issue of [majority] wrongdoing [is] superfluous \* \* \* [fixing blame is material under [Business Corporation Law s] 1104-a, but not under [Business Corporation Law s] 1118".**

Thus, we apply to stock fair value determinations under section 623 the principle we enunciated for such determinations under section 1118 that, in fixing fair value, courts should determine the minority shareholder's proportionate interest in the going concern value of the corporation as a whole, that is, "a willing purchaser, in an arm's length transaction, would offer for the corporation as an operating business' ".

Consistent with that approach, we have approved a methodology for fixing the fair value of minority shares in a close corporation under which the investment value of the entire [87 N.Y.2d 169] enterprise was ascertained through a capitalization of earnings (taking into account the unmarketability of the corporate stock) and then fair value was calculated on the basis of the petitioners' proportionate share of all outstanding corporate stock. (emphasis added) *Friedman v. Beway Realty Corp.*, 87 NY2d 161, 638 NYS2d 399, 403 (1995).

*See also G & G Fashion Design, Inc. v. Garcia*, 870 So2d 870 (Fla App 2004); *Go v. Pacific Health Services, Inc.*, 179 Cal App4th 522, 101 Cal Rptr3d 736 (2009).

On the other hand, the Illinois Act required the trial court to determine the fair value of the plaintiffs' shares "taking into account any impact on the value of the shares resulting from the actions giving rise to a petition under this Section." The court was thus obliged to consider the statutory allegations of oppression and waste that formed the basis for the first two counts of the complaint. *Jahn v. Kinderman*, 351 Ill App3d 158, 14 NE2d 116, 123 (2004). Interpreting Florida law, the 11<sup>th</sup> Circuit has said that "fair value still ought to take into account any effect thereupon of corporate asset waste or other harm caused by mismanagement." *Cox Enterprises, Inc. v. News-Journal Corp*, 510 F3d 1350 (11<sup>th</sup> Cir 2007).

This issue is an open one in Oregon.

### **L. Fair value.**

ORS 60.952(6)(f) provides that the court is to determine the "fair value" of the shares, but does not define this term. Both the Comments to the Model Business Corporation Act and case law indicate that the court should look to the dissenter rights statute for guidance in determining "fair value." *See* Comment to Model Business Corporation Act § 14.34; *Friedman v. Beway Realty Corp.*, 87 NY2d 161, 638 NYS2d 399, 403 (1995).

"Fair value" is defined in Oregon's dissenter rights statute, ORS 60.551(4), as follows:



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"Fair value," with respect to a dissenter's shares, means the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable.

In the context of the dissenter rights statute, "fair value" has been discussed by the Oregon courts. *Stringer v. Car Data Systems, Inc.*, 314 Or 576, 587-8, 841 P2d 1183, 1189 (1992); *Columbia Management Co. v. Wyss*, 94 Or App 195, 765 P2d 207 (1988). See Section 8.06 herein.

### **M. Discounts.**

In determining fair value, a court must determine whether to apply a "minority" and/or a "marketability" discount.

A "minority discount" is a reduction in value "which recognizes that controlling shares are worth more in the market than are noncontrolling shares." *Columbia Management Co. v. Wyss*, 94 Or App 195, 204, 765 P2d 207, 213 (1988); *Tyron v. Smith*, 191 Or 172, 229 P2d 251 (1951); *Congel v. Malfitano*, 2016 NY Slip Op 3845, 141 AD3d 64, 32 NYS3d 264 (NY App Div 2016).

A "marketability discount" is a reduction in value which recognizes that "interests in closely held business enterprises cannot readily be sold, they are less marketable and, therefore, less valuable than equivalent interests in companies whose securities are regularly traded in a recognized market." Haynesworth, *Valuation of Business Interests*, 33 MERCER L REV 457, 489 (1982). A "marketability discount adjusts for a lack of liquidity in one's interest in an entity. Even controlling interests in nonpublic companies may be eligible for marketability discounts, as the field of potential buyers is small, regardless of the size of the interest being sold." *Balsamides v. Protameen Chemicals*, 160 NJ 352, 734 A2d 721, 733 (1999).

Under the dissenter rights statute, "fair value" is usually determined applying a marketability discount, but without applying a minority discount. *Columbia Management Co. v. Wyss*, 94 Or App 195, 204, 765 P2d 207, 213 (1988).

But if the majority's acts are oppressive or a breach of fiduciary duty, neither the minority discount nor the marketability discounts will usually apply. *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 276, 21 P3d 178 (2001); *Chiles v. Robertson*, 94 Or App 604, 767 P2d 903, *reconsideration allowed in part, opinion modified*, 96 Or App 658, 774 P2d 500 (1989).

Finally, because defendants must purchase plaintiff's shares as a remedy for their misconduct, and the price for plaintiff's shares is therefore based on their fair value rather than their fair market value, either a minority or marketability discount would be inappropriate. *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 115, 7 P3d 717 (2000).

It is unclear whether the Oregon courts will apply both discounts in a forced

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buy-out under ORS 60.952(6) or whether the issue of wrongdoing would affect the discount issue. In a law review article published soon after the adoption of this statute, the Chair of the task force who wrote this new provision assumed – without analysis – that the marketability discount would not apply in the forced-buyout context. Robert Art, *Shareholder Rights and Remedies in Close Corporations: Oppression, Fiduciary Duties, and Reasonable Expectations*, 28 J Corp L 371, 416-7 (Spring 2001). Another commentator argues forcefully against applying marketability discounts. Rabbit, *Application of Share-Price Discounts and Their Role in Dictating Corporate Behavior: Encouraging Elected Buy-Outs Through Discount Application*, 43 Willamette L Rev 107 (2007).

Some states apply a marketability discount under their forced buy-out statutes. *Blake v. Blake Agency, Inc.*, 107 AD2d 139, 486 NYS2d 341, *appeal denied*, 65 NY2d 609, 484 NE2d 671, 494 NYS2d 1028 (1985). Other states do not. *Charland v. Country View Golf Club, Inc.*, 588 A2d 609 (RI 1991).

For a more detailed discussion of discounts, see Section 8.06(C) herein.

### **N. Equitable or legal claim; burden of proof.**

An action under ORS 60.661 – and presumably under ORS 60.952 – is an equitable action. *Gl Joe's, Inc. v. Nitzam*, 183 Or App 116, 123, 50 P3d 1282 (2002); *Naito v. Naito*, 178 Or App 1, 4, 35 P3d 1068 (2001). It is not clear whether a forced buy-out action under ORS 60.952(6) is equitable or legal in nature. On one hand, the statute itself uses the terms “equity” or “equitable” eight times. But in *Hickey v. Hickey*, 269 Or App 258, 265, 344 P3d 512 (2015), the court said it was reviewing the trial court’s remedy as a matter of law. In *Kollman v. Cell Tech Int'l, Inc.*, 250 Or App 163, 279 P3d 324 (2012), the court discusses whether a breach of fiduciary duty claims is legal or equitable.

While it would seem that the corporation or shareholder seeking to force the sale of the plaintiff’s stock would have the burden of proof on the value of the stock, this is not certain. In the context of appraisal actions, cases have held that both sides bear this burden. See Section 8.06(D) of this book.

**NOTE:** It also unclear which party presents evidence first – the defendant seeking to force the stock sale or the plaintiff. In one case tried in 2010 by this author in Washington county before Judge Marco Hernandez, the ruled that plaintiff presented evidence first. *Mar v. Fadden/Mar Co*, Wash Co Cir Ct Case No.: C097225CV.

### **O. Attorney fees.**

Neither ORS 60.661 nor 60.952 provide for the award of attorney fees. At least in Oregon, there does not appear to be a common law right to attorney fees in breach of fiduciary duty or oppression actions.

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Attorney fees may be awarded in derivative lawsuits. *Crandon Capital Partners v. Shelk*, 342 Or 555, 157 P3d 176 (2007).

### **P. Derivative lawsuits.**

In an unpublished opinion, the Ninth Circuit has held that the forced buy-out provisions of ORS 60.952(6) may be invoked by the corporation upon the filing of a derivative lawsuit alleging wrongful acts encompassed by ORS 60.952. *Scallon v Scott Henry's Winery Corp.*, Case No: 15-35952 (9<sup>th</sup> Cir April 11, 2017).

## **Section 8.05 Derivative Lawsuits**

### **A. Generally.**

As a general rule, a shareholder may not sue a third party directly to enforce a right held by the corporation. Such a claim must be brought derivatively.

[A] derivative action \* \* \* is a mechanism used in the corporate context by shareholders to sue on behalf of a corporation when those in control of a corporation decide not to pursue a claim belonging to the organization." *Curtis v. Nevens*, 31 P.3d 146, 151 (Colo.2001). Shareholders may use derivative suits to file an action "in the name of the organization against alleged wrongdoers, naming the board of directors as defendants." *Id.* Corporate shareholders may not, however, "assert individual claims based on wrongs to the corporation where they did not suffer injuries separate and distinct from the injury to other shareholders." *Adams v. Land Services, Inc.*, 194 P.3d 429, 434 (Colo.App. 2008). Rather, shareholders "may sue corporate officers and directors only when they have sustained a loss which is separate and distinct from that of other stockholders"; where the "loss, if any, was to all shareholders," the "right to sue belongs to the corporation and may be brought by individual shareholders only as a derivative action." *Buechner v. Rouse*, 538 P.2d 117, 120 (Colo.App. 1975). Whether a claim is derivative rather than direct in nature is determined by evaluating, from the facts alleged in the complaint, who suffered the alleged harm and who would receive the benefit of a remedy. *Kim v. Grover C Coors Trust*, 179 P.3d 86, 89–90 (Colo.App. 2007).

*Munson v. Valley Energy Inv. Fund, US, LP*, 264 Or App 679, 703-4, 333 P3d 1102 (2014) (applying Colorado law).

Another court has said:

All authorities agree that a stockholder, as such, cannot maintain an action against a third party, either for a breach of contract between such third party and the corporation of which he is a stockholder, or for an injury to the corporation or its property. All such wrongs must be redressed by the corporation itself and in the corporate name. *Ninneman v. Fox*, 43 Wash 43, 45, 86 P 213, 213 (1906).

A shareholder may not bring an individual action in such circumstances, even if the shareholder owns substantially all of the corporation's stock. *Zimmerman v. Kyte*, 53 Wash App 11, 765 P2d 905 (1988). A shareholder may not enforce a corporate right by means of a lawsuit brought in an individual capacity – all such actions must be brought derivatively.

Whenever a cause of action exists primarily in behalf of the corporation against directors, officers, and others, for wrongful dealing with corporate property, or wrongful exercise of corporate franchises, so that the remedy should regularly be

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obtained through a suit by and in the name of the corporation, and the corporation either actually or virtually refuses to institute or prosecute such a suit, then, in order to prevent a failure of justice, an action may be brought and maintained by a stockholder, or stockholders, either individually or suing on behalf of themselves and all others similarly situated, against the wrongdoing directors, officers, and other persons; but it is absolutely indispensable that the corporation, itself, should be joined as a party, usually as a co-defendant. That the plaintiff should allege and prove that application was made to the directors or managing body, and a reasonable notice, request, or demand that they institute proceedings on the part of the corporation against the wrongdoers, and their refusal to do so after such reasonable request or demand, is but a statement of a general rule. *Wills v. Nehalem Coal Co.*, 52 Or 70, 87, 96 P 528, 534 (1908).

See also *Dant & Russell, Inc. v. Ostlind*, 148 Or 204, 35 P2d 668 (1934); *Smith v. Bramwell*, 146 Or 611, 31 P2d 647 (1934); *Stewart v. King*, 85 Or 14, 166 P 55 (1917); *Goodwin v. Castleton*, 19 Wash 2d 748, 763, 144 P2d 725, 732 (1944).

"In general, claims of waste and mismanagement of corporate assets are claims which allege injury to the corporation and, thus, can only be raised by the corporation itself or by the stockholders in a derivative suit." *Munson v. Valley Energy Inv. Fund, US, LP*, 264 Or App 679, 705, 333 P3d 1102 (2014) (interpreting Colorado law and quoting from *River Management Corp. v. Lodge Properties, Inc.*, 829 P2d 398, 403 (Colo App 1991)). See also *Smith v. Bramwell*, 146 Or 611, 31 P2d 647 (1934).

Typically, a derivative lawsuit is brought by a shareholder because the corporation has not, and will not, bring a lawsuit against a third party on its own behalf. *Davis v. Harrison*, 25 Wash 2d 1, 167 P2d 1015 (1946). If a shareholder demands that the corporation itself bring a lawsuit – and the corporation agrees and files the demanded lawsuit against the third party in the corporation's own name – no derivative lawsuit is necessary or permitted.

Thus, in order for a complaint to state a cause of action entitling the stockholder to relief, it must allege two distinct wrongs: The act whereby the corporation was caused to suffer damage, and a wrongful refusal by the corporation to seek redress for such act. *James Talcott, Inc. v. McDowell*, 148 Fla 2d 36, 38 (Fla App 1962).

But when a shareholder makes demand and the corporation refuses to bring a lawsuit – and that refusal is itself improper – the shareholder is permitted to pursue a "derivative" action.

In a derivative lawsuit, a shareholder sues both the corporation and a third party. The third party is the "real" defendant – the corporation is included in the lawsuit only as a nominal defendant or nominal plaintiff.

**NOTE:** In Oregon, some cases are brought with the corporation as a nominal plaintiff; others include the corporation as a nominal defendant. Where the plaintiff shareholder brings both derivative and individual claims, some attorneys will include the corporation both as a nominal plaintiff and as a

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defendant. This author believes the corporation should be included as a defendant – not as a plaintiff.

In a derivative lawsuit, the plaintiff-shareholder seeks a remedy against the third party defendant only – the plaintiff does **not** seek damages from the corporation, even though the corporation may be included as a defendant. In fact, the plaintiff shareholder usually is not personally entitled to any of the damages awarded – any funds recovered from the “true” defendant are usually payable only to the corporation.

Even though the corporation is the real party in interest, as a practical matter the corporation ordinarily is named first as a defendant, then, if appropriate, realigned as a plaintiff. While as a general rule, realignment often is appropriate, it is not, as defendant suggests, automatic or required. The corporation should remain as a defendant if corporate management is “antagonistic” to the plaintiff shareholder. (citations omitted) *Trabucco v. Carlile*, 57 F Supp2d 1074 (D Or 1999).

This issue can be important when a derivative claim is brought in federal court under diversity jurisdiction. In such circumstances, the federal court may realign the corporation to reflect whether it is a true plaintiff or defendant, rather than rely upon the plaintiff’s characterization of the corporation.

Although the plaintiff is generally the master of his complaint, diversity jurisdiction “cannot be conferred upon the federal courts by the parties’ own determination of who are plaintiffs and who defendants.” *City of Indianapolis v. Chase Nat’l Bank of City of New York*, 314 U.S. 63, 69, 62 S.Ct. 15, 86 L.Ed. 47 (1941). Instead, a court must realign the parties in order to protect our judgments against artful pleading and ensure an actual “collision of interest.” *Id.* (quoting *Dawson v. Columbia Ave. Sav. Fund, Safe Deposit, Title & Trust Co.*, 197 U.S. 178, 181, 25 S.Ct. 420, 49 L.Ed. 713 (1905)); *Dolch v. United Cal. Bank*, 702 F.2d 178, 181 (9th Cir.1983). The court should determine the “collision of interest” by reference to the “principal purpose of the suit” and not mere “mechanical rules.” *Chase*, 314 U.S. at 69-70, 62 S.Ct. 15.

Because a derivative lawsuit brought by a shareholder is “not his own but the corporation’s,” the corporation “is the real party in interest” and usually properly aligned as a plaintiff. *Koster v. Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 522-23, 67 S.Ct. 828, 91 L.Ed. 1067 (1947). There is an exception, however, when a corporation’s officers or directors are “antagonistic” to the interests of the shareholder plaintiff(s). *Smith v. Sperling*, 354 U.S. 91, 95-96 n. 3, 77 S.Ct. 1112, 1 L.Ed.2d 1205 (1957) (citing *Doctor v. Harrington*, 196 U.S. 579, 587, 25 S.Ct. 355, 49 L.Ed. 606 (1905) (“The ultimate interest of the corporation made defendant may be the same as that of the stockholder made plaintiff, but the corporation may be under a control antagonistic to him, and made to act in a way detrimental to his rights.”)). To determine whether antagonism exists, the court should look to “the face of the pleadings and ... the nature of the controversy,” *id.* at 96, 77 S.Ct. 1112, because “the very individuals who have a stranglehold over the corporation are the people against whom suit is sought to be brought and, therefore, in any sense that has any meaning they are the defendants for that reason,” *id.* at 103, 77 S.Ct. 1112 (Frankfurter, J., dissenting).

A corporation is generally antagonistic to a shareholder plaintiff where “management is aligned against the stockholder and defends a course of conduct which he attacks,” *Smith*, 354 U.S. at 95, 77 S.Ct. 1112, or merely where “management—for good reasons or for bad—is definitely and distinctly opposed to the institution of [the derivative] litigation,” *Swanson*, 354 U.S. at 116, 77 S.Ct. 1116. For example, where

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management "refuses to take action to undo a business transaction or whenever ... it so solidly approves [of the transaction] that any demand to rescind would be futile," a court should find antagonism. *Smith*, 354 U.S. at 97, 77 S.Ct. 1119.

*In re Digimarc Corp. Derivative Litigation*, 549 F3d 1223, 1234-35 (9<sup>th</sup> Cir 2008).

Most cases hold that in a derivative suit, the corporation is a necessary party. *Howell v. Fisher*, 49 NC App 488, 272 SE2d 19 (1980); *Rose v. Schantz*, 56 Wis2d 222, 201 NW2d 593, 598 (1972).

It is settled beyond dispute that in a derivative suit on behalf of a corporation against third persons or against officers or directors of the corporation, the corporation is a necessary party. It is, in fact, inherent in the nature of the suit itself that it is the corporation whose rights are being redressed rather than those of the individual plaintiff. It follows that the corporation is regarded as the real party in interest. *Morgan v. Robertson*, 271 Ark App 461, 609 SW2d 662, 663 (1980).

Another court has said:

Primarily the right of action for wrongs suffered by the corporate interests is in the corporation, and an action for such wrongs cannot be maintained by a stockholder, however injuriously it may affect him, unless he alleges such fraud on the part of the corporation and complicity in the alleged wrongs as would seriously affect his interest; and, in such a case, it is indispensable that the stockholder make the corporation a party defendant to such a proceeding. This is to say that, where the corporation refuses to sue, a stockholder may, by complying with the conditions prescribed in Code § 22-711, bring such an action for the benefit of the corporation, but to the stockholder's action the corporation is not merely a proper party, but is an essential, indispensable party, and a failure to make the corporation a party is not a mere defect of parties, but leaves the stockholder without a cause of action and the court without jurisdiction. (citations omitted) *Smyly v. Smith*, 216 Ga 529, 529, 118 SE2d 188, 189 (1961).

**NOTE:** Some cases hold that joinder of the corporation may not be required when it is not pragmatic to do so, such as, when the corporation has ceased to exist or when it has been liquidated. *LaHue v. Keystone Investment Co.*, 6 Wash App 765, 496 P2d 343 (1972).

In a legal sense, the shareholder and corporation stand in the position of guardian ad litem and ward.

As frequently expressed judicially, a stockholder bringing a derivative action occupies a strictly fiduciary relationship to the corporation whose interests he assumes to represent, and his position in the litigation is in a legal sense the precise equivalent of that of a guardian ad litem, while the position of the corporation is the equivalent of the status of a ward or beneficiary. *Goodwin v. Castleton*, 19 Wash 2d 748, 144 P2d 725, 732 (1944).

Another case states that in a derivative action, "the corporation is the real party in interest and the minority stockholder who brings the action is at best only a nominal plaintiff seeking to enforce the right of the corporation against a third party." *Walters v. Center Electric, Inc.*, 8 Wash App 322, 506 P2d 883, 888 (1973). See also *Cohen v. Beneficial Industrial Loan Corp.*, 337 US 541 (1949).

A derivative claim is a claim of the corporation. *Haberman v. Public Power*

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*Supply System*, 109 Wash 2d 107, 744 P2d 1032 (1987), *amended*, 750 P2d 1032 (1988). In one case, a derivative claim was barred when – after being apprised of the claim – the corporation sold all of its assets to a third party. The court found the corporation had sold all its assets – even the claim which was the subject of the derivative lawsuit. *Lewis v. Chiles*, 719 F2d 1044 (9<sup>th</sup> Cir 1983).

The development of derivative lawsuits is discussed in *Ross v. Bernard*, 396 US 531 (1970), in *Davis v. Harrison*, 25 Wash 2d 1, 167 P2d 1015 (1946), and in Prunty, *The Shareholders' Derivative Suit: Notes on Its Development*, 32 NYU L REV 980 (1957).

### **B. Equitable action; extraordinary remedy.**

A derivative lawsuit is an equitable action. *Serbick v. Timpco-Pacific, Inc.*, 88 Or App 633, 635 n5, 746 P2d 1167 (1987); *Schultz v. Highland Gold Mines Co.*, 158 F 337 (D Or 1907); *Haberman v. Public Power Supply System*, 109 Wash 2d 107, 744 P2d 1032 (1987), *amended*, 750 P2d 1032 (1988); *Barrett v. Southern Connecticut Gas Co.*, 172 Conn 362, 374 A2d 1051 (1977); *Florik v. Florida Land Sales Board*, 206 So2d 41 (Fla App 1968); *Rebstock v. Lutz*, 39 Del Ch 25, 158 A2d 487 (1960). This is true even though the only relief sought on behalf of the corporation is money damages and even though the corporation – if it had brought the lawsuit itself – would have brought the case as an action at law. *Griffin v. Carmel Bank & Trust Co.*, 510 NE2d 178 (Ind App 1987). However, there may be a right to a trial by jury if the corporation's claim against the “true” defendant in the case is an action at law. *Ross v. Bernhard*, 396 US 531 (1970).

A derivative lawsuit is an extraordinary remedy which generally is available to shareholders only when they have no other right to redress. *LaHue v. Keystone Investment Co.*, 6 Wash App 765, 496 P2d 343 (1972); *Bell v. Arnold*, 175 Colo 277, 487 P2d 545 (1971); *Winter v. Farmers Educational & Cooperative Union of America*, 259 Minn 257, 107 NW2d 226, 233 (1961).

Courts tend to disfavor derivative lawsuits. *See for example Labovitz v. Washington Times Corp.*, 900 F Supp 500 (D DC 1995); *Haberman v. Public Power Supply System*, 109 Wash 2d 107, 744 P2d 1032 (1987), *amended*, 750 P2d 1032 (1988); *Good v. Getty Oil Co.*, 514 A2d 1104, 1106 (Del Ch 1986). This is true, in part, due to the strong judicial tendency to defer to the business judgment of corporate management and, in part, due to perceived abuses which may occur in a derivative suit – particularly derivative lawsuits against public corporations. Consequently, courts impose a number of procedural requirements regarding derivative lawsuits, some of which have been codified in ORS 60.261. *See also* Federal Rules of Civil Procedure Rule 23.1.

**NOTE:** There is no comparable provision to FRCP 23.1 in the Oregon Rules

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of Civil Procedure.

### **C. Who may bring suit: contemporaneous ownership of shares.**

In order to bring a derivative lawsuit, the plaintiff must have been a shareholder of the corporation at the time of the allegedly improper transaction. ORS 60.261(1); *Borne v. Gonstead Adv. Tech.*, 266 Wis2d 253, 2003 WI App 135, 667 NW2d 709 (2003); *Bank of Santa Fe v. Petty*, 116 NM 761, 867 P2d 431 (NM App 1993); *Davis v. Harrison*, 25 Wash 2d 1, 167 P2d 1015 (1946); *The Contemporaneous Ownership Rule in Shareholders' Derivative Suits*, 25 UCLA L Rev 1041 (1978).

Further, the person bringing the derivative lawsuit must continue to be a shareholder throughout the course of the lawsuit. *Grosset v. Wenaas*, 42 Cal 4th 1100, 72 Cal Rptr3d 129, 175 P3d 1184 (2008); *Timko v. Triarsi*, 898 So2d 89 (Fla App 2005) (noting that allowing a plaintiff to retain standing despite the loss of stock ownership would produce "the anomalous result that a plaintiff with absolutely no 'dog in the hunt' is permitted to pursue a right of action that belongs solely to the corporation").

Although there are no statutes governing standing in a derivative action, "general principles of standing require that, in order to bring a derivative suit, a shareholder must own stock at the time of the alleged wrong and retain ownership for the duration of the litigation." *Loewen v. Galligan*, 130 Or App 222, 232, 882 P2d 104 (1994)(quoting *Metal Tech Corp. v. Metal Techniques Co.*, 74 Or App 297, 302, 703 P2d 237 (1985).

A person who became a shareholder by operation of law from one who was a shareholder at the time of the allegedly improper transaction may also bring suit.

Whether the case is considered in the light of the Federal Rule or the Georgia Statute is immaterial because in each the allegation that the petitioner was a stockholder at the time of the transaction of which he complains, or that his shares have devolved upon him by operation of law, is required. *Hurt v. Cotton States Fertilizer Co.*, 145 F2d 293, 295 (5<sup>th</sup> Cir 1944).

A person need not be a shareholder of record in order to bring a derivative suit. An equitable interest may be sufficient. *Rosenthal v. Burry Biscuit Corp.*, 60 A2d 106 (Del Ch 1948); *Parfi Holding Ab v. Mirror Image Internet*, 954 A2d 911, fn 105 (Del Ch 2008).

A widow's community property interest in stock has been held sufficient to enable her to bring a derivative lawsuit. *LaHue v. Keystone Investment Co.*, 6 Wash App 765, 496 P2d 343 (1972). Likewise, a wife who acquired her ex-husband's stock through divorce may bring a derivative suit. *Kaplus v. First Continental Corp.*, 711 So2d 108 (Fla App 1998). A person with a security interest in the corporation's stock may bring suit either individually or derivatively. *Gustofson v. Gustofson*, 47 Wash App 272, 734 P2d 949 (1987).



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ORS 60.261(4) specifically includes within the definition of shareholder: "a beneficial owner whose shares are held in a voting trust or held by a nominee on behalf of the beneficial owner." Oregon law is silent on whether a beneficiary of a trust, other than a voting trust, may initiate a derivative lawsuit. Some courts hold that a beneficiary of a trust that owns shares may initiate a derivative lawsuit. *Housman v. Albright*, 857 NE2d 724 (Ill App 2006)(ESOP beneficiaries); *Edgeworth v. First National Bank of Chicago*, 677 F Supp 982 (SD Ind 1988). Other courts have held that beneficiaries lack standing to bring a derivative lawsuit. *Matties v. Seymour Manufacturing Co.*, 270 F2d 365 (2<sup>nd</sup> Cir 1959).

One older case indicates that despite not owning the shares at the time of the wrongdoing, a shareholder may bring a derivative lawsuit if "the wrongful acts were effectually concealed, and it appeared that the effects of the mismanagement continued to the stockholder's injury." *Davis v. Harrison*, 25 Wash 2d 1, 11, 167 P2d 1015, 1019 (1946).

Several cases hold that a former shareholder or member of a dissolved corporation or limited liability company could bring a derivative lawsuit. *Price v. Upper Chesapeake Health*, 192 Md App 695, 995 A2d 1054 (2010); *Independent Investor Protective League v. Time, Inc.*, 50 NY2d 259, 428 NYS2d 671, 406 NE2d 486, 488-89 (1980); *Striker v. Chesler*, 217 A2d 31, 35 (Del Ch1966); *Castner v. First National Bank of Anchorage*, 278 F2d 376 (9th Cir1960).

A shareholder who purchases all of the stock owned by an officer or director – with knowledge of the selling officer/director's wrongdoing – cannot cause the corporation to sue the selling officer/director for the misconduct which occurred before the sale. *Damerow Ford Co. v. Bradshaw*, 128 Or App 606, 876 P2d 788 (1994). One court held that a shareholder who purchased shares knowing of a wrong could not later bring a derivative suit even though the wrongs continued to occur after the purchase. *Blum v. Morgan Guaranty Trust Co. of New York*, 539 F2d 1388 (5<sup>th</sup> Cir 1976).

In a theoretical sense, this ownership requirement exists because the person who acquires stock after the alleged wrongdoing has presumably paid a price for that stock which reflects the wrongful act. See *Colville Valley Coal Co. v. Rogers*, 123 Wash 360, 212 P 732 (1923). In a practical sense, courts (and now legislatures) imposed this requirement to prevent a person from "buying" a derivative lawsuit. *Rosenthal v. Burry Biscuit Corp.*, 60 A2d 106, 111 (Del Ch 1948).

Not only must a person be a shareholder at the time that the allegedly improper transaction occurred, that person must usually be a shareholder at the time the derivative lawsuit is filed and continue on as a shareholder throughout the course of the lawsuit. *Loewen v. Galligan*, 130 Or App 222, 882 P2d 104 (1994); *Metal Tech*

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*Corp. v. Metal Techniques Co., Inc.*, 74 Or App 297, 703 P2d 237 (1985); *Zauber v. Murray Savings Ass'n*, 591 SW2d 932 (Texas Civil App 1980).

One reason for this rule is that a shareholder who voluntarily sells his/her stock after the allegedly wrongful act is perceived to no longer adequately represent the interest of similarly situated shareholders. In part, this is also true because the person bringing the lawsuit must have a proprietary interest in the lawsuit. *Haberman v. Public Power Supply System*, 109 Wash 2d 107, 744 P2d 1032 (1987), *amended*, 750 P2d 1032 (1988).

There are exceptions. For instance, the Ninth Circuit has permitted a former shareholder to maintain a derivative lawsuit – at least where the rights of creditors and other shareholders are not prejudiced – when the former shareholder parted "with his shares without knowledge of prior wrongful misappropriation of corporate assets by the directors" and where "the misappropriation had reduced the value of his prior shareholdings." *Watson v. Button*, 235 F2d 235, 237 (9<sup>th</sup> Cir 1956). Likewise, a shareholder whose shares were foreclosed by a bank whose alleged wrongdoing formed the basis of the derivative claim was permitted to sue. *Eastwood v. National Bank of Commerce, Altus, Okl.*, 673 F Supp 1068 (WD Okla 1987).

As a general rule, a person who ceases to be a shareholder due to the merger of a corporation lacks standing to bring a derivative action. *Loewen v. Galligan*, 130 Or App 222, 882 P2d 104 (1994); *Lewis v. Ward*, 852 A2d 896 (Del 2004); *Sound Infiniti Inc v. Snyder*, 169 Wash 2d 199, 237 P3d 241 (2010). However, under some circumstances, if the shareholder of the extinguished corporation becomes a shareholder of the surviving corporation, that shareholder may bring a double derivative action. *Lambrecht v. O'Neal*, 3 A3d 277 (Del 2010).

In some situations – such as in a freeze-out merger involving improper conduct – the improper conduct itself causes the shareholder to lose ownership status. In such circumstances, some courts have relaxed the requirement of contemporaneous ownership.

The Delaware courts have recognized at least two exceptions to the contemporaneous ownership rule.

The two recognized exceptions to the rule are: (1) where the merger itself is the subject of a claim of fraud; and (2) where the merger is in reality a reorganization which does not affect plaintiff's ownership of the business enterprise. *Lewis v. Anderson*, 477 A2d 1040, 1046 n 10 (1984).

See also *Lewis v. Ward*, 852 A2d 896 (Del 2004); *Blasband v. Rales*, 971 F2d 1034 (3<sup>rd</sup> Cir 1992); *Schreiber v. Carney*, 447 A2d 17, 22 (1982).

In an Oregon case, the court permitted a former shareholder of a dissolved corporation to bring a derivative claim, stating that "an otherwise eligible shareholder who has been involuntarily eliminated should be permitted to bring and continue the

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corporate cause of action if unjust enrichment otherwise seems likely to result.” *Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682, 686 (1992). *But see Loewen v. Galligan*, 130 Or App 222, 882 P2d 104 (1994).

In interpreting statutory language similar to the language in Oregon’s statute, the California Court of Appeals allowed a derivative lawsuit to proceed because the lawsuit alleged wrongful conduct in a merger transaction. *Gaillard v. Natomas Co.*, 173 Cal App 3d 410, 219 Cal Rptr 74 (1985).

In a case which alleged that a freeze-out merger had occurred to insulate directors from a derivative lawsuit, the Indiana Supreme Court held that the derivative lawsuit could proceed stating:

But, since no wrong should be without a remedy a Court of Equity may grant relief, pro rata, to a former shareholder, of a merged corporation, whose equity was adversely affected by the fraudulent act of an officer or director and whose means of redress otherwise would be cut off by the merger, if there is no shareholder of the surviving corporation eligible to maintain a derivative action for such wrong and said shareholder had no prior opportunity for redress by derivative action against either the merged or the surviving corporation. *Gabhart v. Gabhart*, 267 Ind 370, 370 NE2d 345, 358 (1977).

Other courts have refused to permit persons frozen-out as shareholders to maintain a derivative action. *See for example Loewen v. Galligan*, 130 Or App 222, 882 P2d 104 (1994); *Guenther v. Pacific Telecom, Inc.*, 123 FRD 341 (D Or 1987); *Bronzaft v. Caporali*, 162 Misc2d 281, 616 NYS2d 863 (1994); *Yanow v. Teal Industries, Inc.*, 178 Conn 263, 422 A2d 311 (1979).

### **D. Who may bring suit: representative plaintiff.**

Rule 23.1(a) of the Federal Rule of Civil Procedure requires that a person bringing a derivative lawsuit in federal court “fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association.”

Neither the Oregon Business Corporation Act nor the Oregon Rules of Civil Procedure impose such a requirement on a person filing a derivative lawsuit.

**NOTE:** Oregon does impose a requirement that a party filing a class action lawsuit “fairly and adequately protect the interests of the class.” ORCP 32(A)(4). Generally, derivative lawsuits are not filed as class actions. Some lawsuits, however, combine both a derivative claim filed by a single shareholder and individual shareholder claims filed as a class action. This may occur in a merger where directors allegedly breached their duty to the corporation in evaluating the value of the merger (a derivative claim) and then allegedly made false representations to the shareholders in recommending favorable action on the merger (an individual securities claim).

The requirements of FRCP 23.1 will apply to derivative lawsuits filed in federal

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court – even lawsuits involving Oregon corporations. See for example *Rothenberg v. Security Management, Inc.*, 667 F2d 958 (5<sup>th</sup> Cir 1982).

The rationale for the rule that a shareholder-plaintiff in a derivative lawsuit be representative of the other shareholders is set out in *Cohen v. Beneficial Industrial Loan Corp.*, 337 US 541 (1949):

Likewise, a stockholder who brings suit on a cause of action derived from the corporation assumes a position, not technically as a trustee perhaps, but one of a fiduciary character. He sues, not for himself alone, but as representative of a class comprising all who are similarly situated. The interests of all in the redress of the wrongs are taken into his hands, dependent upon his diligence, wisdom and integrity. And while the stockholders have chosen the corporate director or manager, they have no such election as to a plaintiff who steps forward to represent them. He is a self-chosen representative and a volunteer champion. The Federal Constitution does not oblige the state to place its litigating and adjudicating processes at the disposal of such a representative, at least without imposing standards of responsibility, liability and accountability which it considers will protect the interests he elects himself to represent. *Id.* at 549-50.

A corporate director may qualify as a representative shareholder. *Dotlich v. Dotlich*, 475 NE2d 331 (Ind App 1985). The most important consideration is whether or not the shareholder bringing the derivative lawsuit has an economic interest antagonistic to innocent shareholders. *Newell Co. v. Vermont American Corporation*, 725 F Supp 351 (ND Ill 1989). “Courts have found inadequacy of representation based on conflict of interest when the shareholder plaintiff had personal entanglements adverse to the interest of the other shareholders.” *Sonkin v. Barker*, 670 F Supp 249, 251 (SD Ind 1987). Whether or not a plaintiff is an adequate representative “is firmly committed to the discretion of the trial court, reviewable only for abuse.” *Smith v. Ayres*, 977 F2d 946, 948 (5<sup>th</sup> Cir 1992). See also *Larson v. Dumke*, 900 F2d 1363 (9<sup>th</sup> Cir 1990).

### **E. Demand requirement.**

Demand is another important procedural precondition to filing a derivative lawsuit.

Before initiating a derivative lawsuit, a shareholder must first make demand on the corporation that the corporation itself institute proceedings against the wrongdoers on its own behalf. *North v. Union Savings & Loan Ass'n*, 59 Or 483, 117 P 822 (1911).

By its very nature, the derivative action impinges on the managerial freedom of directors. Hence, the demand requirement \* \* \* exists at the threshold, first to insure that a stockholder exhausts his intracorporate remedies, and then to provide a safeguard against strike suits. Thus, by promoting this form of alternative dispute resolution, rather than immediate recourse to litigation, the demand requirement is a recognition of the fundamental precept that directors manage the business and affairs of corporations. *Bernards v. Summit Real Estate Management*, 229 Or App 357, 365, 213 P3d 1 (2009) (quoting *Crandon Capital Partners v. Shelk*, 219 Or App 16, 31, 181 P3d 773, that case quoting *Aronson v. Lewis*, 473 A2d 805, 811-12 (Del1984).

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The "demand requirement is intended to allow the corporation the opportunity to take over a suit brought on its behalf." *Haberman v. Public Power Supply System*, 109 Wash 2d 107, 153, 744 P2d 1032, 1063 (1987), *amended*, 750 P2d 1032 (1988).

That the plaintiff should allege and prove that application was made to the directors or managing body, and a reasonable notice, request, or demand that they institute proceedings on the part of the corporation against the wrongdoers, and their refusal to do so after such reasonable request or demand, is but a statement of a general rule. *Wills v. Nehalem Coal Co.*, 52 Or 70, 87, 96 P 528, 534 (1908).

If the corporation accedes to such demand and files a lawsuit against the alleged wrongdoer, no derivative lawsuit is necessary or permitted.

ORS 60.261(2) provides:

A complaint in a proceeding brought in the right of a corporation must allege with particularity the demand made, if any, to obtain action by the board of directors and either that the demand was refused or ignored or why a demand was not made. Whether or not a demand for action was made, if the corporation commences an investigation of the charges made in the demand or complaint, the court may stay any proceeding until the investigation is completed.

***Business Judgment Rule.*** Even though it may have a valid claim against a third party, a corporation may decide not to sue. "Thus, the demand requirement implements `the basic principle of corporate governance that the decision of a corporation - including the decision to initiate litigation - should be made by the board of directors or the majority of shareholders.'" (citations omitted) *Kamen v. Kemper Financial Services, Inc.*, 500 US 102 (1991).

By its very nature, the derivative action impinges on the managerial freedom of directors. Hence, the demand requirement of Chancery Rule 23.1 exists at the threshold, first to insure that a stockholder exhausts his intracorporate remedies, and then to provide a safeguard against strike suits. Thus, by promoting this form of alternative dispute resolution, rather than immediate recourse to litigation, the demand requirement is a recognition of the fundamental precept that directors manage the business and affairs of corporations. *Crandon Capital Partners v. Shelk*, 219 Or App 16, 30, 181 P3d 773 (Or App 2008)(quoting *Aronson v. Lewis*, 473 A2d 805, 811-12 (Del 1984).

If the decision not to sue is one supportable by the business judgment rule, a shareholder may not pursue the derivative claim. *Bernards v. Summit Real Estate Management*, 229 Or App 357, 213 P3d 1 (2009); *but see Gleason v. International Multifoods Corp.*, 282 Or 253, 577 P2d 931 (1978).

*Also see When Should Courts Allow the Settlement of Duty-of-Loyalty Derivative Suits?*, 109 HARV L REV 1084 (1996); Kinney, *Stockholder Derivative Suits: Demand and Futility where the Board Fails to Stop Wrongdoers*, 78 MARQ L REV 172 (1994).

If the corporation's decision not to sue is a decision supportable by the business judgment rule, many courts will not permit a shareholder to override this

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decision and proceed with a derivative lawsuit.

The mere failure or refusal of the directors of a corporation to bring a suit does not give the right to do so to minority stockholders. The wisdom and expediency of a suit by a corporation must be left to the discretion of the directors. They may believe that a suit would not be productive, or that a satisfactory settlement can be secured, or that the publicity of a suit would be damaging to the future interest of the corporation. As said in the Albright case, *supra* [Albright v. Fulton County Home Builders, 15 Ga 485, 107 SE 335], 'they necessarily have a large discretion in that matter.' 'In order for a minority stockholder to maintain an action of this character, it is imperative that fraud and complicity on the part of the directors must be shown. Even conversion of the property of the corporation by a third person gives no right of action to the stockholders, in the absence of an allegation of fraud or collusion on the part of the directors.' *Peeples v. Southern Chemical Corp.*, 194 Ga 388, 394, 21 SE2d 698, 701 (1942).

Another court has said:

It does not follow from what has been said in this connection, however, that a stockholder or a minority group of stockholders may impose their unbridled wills upon the officers or directors of a corporation by launching the corporation into litigation for the purpose of obtaining for it certain benefits which the complaining parties deem to belong or be due to the corporation. Business policy may dictate that, under certain circumstances, it would be unwise or unprofitable to insist upon one's rights, and accordingly the directors of a corporation or the majority of its stockholders may decline to bring or maintain a suit which a single stockholder or a minority group believes should be instituted. *Goodwin v. Castleton*, 19 Wash 2d 748, 762, 144 P2d 725, 732 (1944).

Upon receipt of a shareholder demand, the board of directors may refer the demand to a committee of disinterested directors. If this committee decides that it is not in the best business interest of the corporation to sue, courts will uphold this business judgment.

In a leading case, New York's highest court upheld the business judgment of a committee of disinterested directors not to pursue a lawsuit against management involved in foreign bribes and kickbacks, finding that the committee believed that in relation to the likelihood of success that such a lawsuit would be too costly and disruptive to management and that the adverse publicity would damage the corporation's business. The court said that "[w]hile the court may properly inquire as to the adequacy and appropriateness of the committee's investigative procedures and methodologies, it may not under the guise of consideration of such factors trespass in the domain of business judgment." *Auerbach v. Bennett*, 47 NY2d 619, 634, 419 NYS 2d 920, 393 NE2d 994 (1979).

Many courts follow the *Auerbach* rule and give great deference to the business judgment of the board. See *Burgess ex rel. Bancorpsouth, Inc. v. Patterson*, 188 So3d 537 (Miss 2016); *Seidl v. Am. Century Cos.*, 799 F3d 983 (8<sup>th</sup> Cir 2015); *Sojitz Am. Capital Corp. v. Kaufman*, 141 Conn App 486, 61 A3d 566 (2013); *Millsap v. American Family Corporation*, 208 Ga App 230, 430 SE2d 385 (1993); *Will v. Englebretson & Co.*, 213 Cal App3d 1033, 261 Cal Rptr 868, 872-3

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(1989); *Black v. NuAire, Inc.*, 426 NW2d 203, 209-10 (Minn App 1988); *Genzer v. Cunningham*, 498 F Supp 682, 686-9 (ED Mich 1980).

Not all states so apply the business judgment rule. One commentator notes there “are at least five different standards being applied by various jurisdictions across the country.” Ferrell, *A Hybrid Approach: Integrating the Delaware and the ALL Approaches to Shareholder Derivative Litigation*, 60 OHIO ST L J 241, 251, n 36 (1999).

Other courts have applied a “modified business judgment rule.”

we shall apply a modified business judgment rule that imposes an initial burden on a corporation to demonstrate that in deciding to reject or terminate a shareholder’s suit the members of the board (1) were independent and disinterested, (2) acted in good faith and with due care in their investigation of the shareholder’s allegations, and that (3) the board’s decision was reasonable. *In re PSE&G Shareholder Litigation*, 173 NJ 258, 801 A2d 295, 312 (2002).

See also *Lewis v. Boyd*, 838 SW2d 215 (Tenn App 1992); *Houle v. Low*, 407 Mass 810, 556 NE2d 51 (Sup Jud Ct 1990); *Alford v. Shaw*, 320 NC 465, 358 SE2d 323 (1987).

The business judgment rule may not be strictly applied with respect to claims between shareholders in close corporations. See discussion in Section 7.12E of this book.

In a case involving a limited liability company, the disinterested members decided not to sue and the Oregon Court of Appeals upheld that decision by ruling that the dissatisfied member’s complaint failed to allege demand or the futility of that demand, stating:

The mere fact that a corporation has a cause of action for an injury does not always make it incumbent upon it to sue, any more than in the case of an individual. If, in the opinion of the directors or a majority of the stockholders, the best interests of the company do not require it to sue, it need not do so. The matter ordinarily is within their discretion, and if they act in good faith, their refusal to sue violates no right of dissenting stockholders, so as to entitle them to maintain a suit in their own behalf. *Bernards v. Summit Real Estate Management*, 229 Or App 357, 370, 213 P3d 1 (2009)(quoting *Gleason v. International Multifoods Corp.*, 282 Or 253, 259-60, 577 P2d 931 (1978)).

A discussion of the role of special litigation committees appears in Murdock, *Corporate Governance – The Role of Special Litigation Committees*, 68 WASH L REV 79 (1993) and in Crain, *Decisions of Special Litigation Committees: Solving the Problem of Control Under Texas Law*, 44 BAYLOR L REV 171 (1992).

One law review article argues the Delaware courts have heightened their scrutiny of director decisions to ignore shareholder demands to sue in response to the corporate scandals of 2001 and 2002. Horn, *Delaware Courts’ Delicate Response to the Corporate Governance Scandals of 2001 and 2002: Heightening Judicial Scrutiny on Directors of Corporations*, 41 WILL L REV 207 (2005);

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If the business judgment rule does not support a board's decision not to pursue corporate claims against a third party, a shareholder may sue derivatively. Such derivative lawsuits often involve allegations of wrongdoing by the corporation's directors, management and controlling shareholders.

### ***No demand required if demand would be futile.***

ORS 60.261(2) provides:

A complaint in a proceeding brought in the right of a corporation **must allege with particularity** the demand made, if any, to obtain action by the board of directors and either that the demand was refused or ignored **or why a demand was not made**. Whether or not a demand for action was made, if the corporation commences an investigation of the charges made in the demand or complaint, the court may stay any proceeding until the investigation is completed.

In *Crandon Capital Partners v. Shelk*, 219 Or App 16, 181 P3d 773 (Or App 2008), the court embarked on a lengthy analysis of whether the allegations of the complaint contained sufficient particularity to justify why demand was not made.

Many courts have held that demand is not required if such demand would be futile. *North v. Union Savings & Loan Ass'n*, 59 Or 483, 117 P 822 (1911). "[D]emand typically is deemed to be futile when a majority of the directors have participated in or approved the alleged wrongdoing, or are otherwise financially interested in the challenged transactions." (citations omitted) *Kamen v. Kemper Financial Services, Inc.*, 500 US 102 (1991).

Demand is excused either where (1) the board is not disinterested or independent, or (2) the challenged transaction was not the product of a valid exercise of business judgment.

To excuse noncompliance with the prelitigation demand requirement, a plaintiff must be able to articulate particularized facts showing that there is a reasonable doubt either that (1) the directors are disinterested and independent for purposes of responding to the demand or (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. If either prong is satisfied, demand is excused. *Crandon Capital Partners v. Shelk*, 219 Or App 16, 30, 181 P3d 773 (Or App 2008)(citing *Brehm v. Eisner*, 746 A2d 244, 256 (Del 2000)).

The Delaware courts have held:

This Court, in determining whether a pre-suit demand would have been futile, must decide:

[W]hether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.

*Aronson v. Lewis*, 473 A2d 805 (1984). To successfully maintain a stockholder derivative claim where pre-suit demand was not made, a plaintiff must plead particularized facts sufficient to create a reasonable doubt that the business judgment rule protects the challenged corporate transaction. A plaintiff may adequately plead demand futility by satisfying either prong of the two-prong test of *Aronson*. (some citations omitted) *Kahn v. Roberts*, [1993-4 Transfer Binder] FED



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SEC L RPTR (CCH) ¶ 98,201 (Del Ch Ct February 28, 1994).

A director is not “interested” merely because the director will be personally impacted by the decision (if the director is a shareholder, all decisions that effect shareholders will also effect that director), but rather whether the director will be effected in a way not shared by all shareholders generally.

Director interest exists where the director “will receive a personal financial benefit from a transaction that is not equally shared by the stockholders [or] where a corporate decision will have a materially detrimental impact on a director, but not on the corporation and the stockholders.” (citation omitted) *In Re Bidz. Com Inc. Derivative Litigation* (CD Cal Case No. CV 09-4984, 2-24-2011). (quoting *Rales v. Blasband*, 634 A2d 927 (Del Supr 1993).

**Form of demand.** ORS 60.261 does not specify the form of demand. Some cases have held that “demand need not assume any particular form or recite any specific language.” *Syracuse Television, Inc. v. Channel 9, Syracuse, Inc.*, 51 Misc2d 188, 273 NYS2d 16, 24 (1966). In 1990, amendments to the Revised Model Business Corporation Act – not adopted in Oregon – included a requirement that demand be in writing. RMBCA § 7.40(1). See 45 BUS LAW 1241 (1990).

Other cases require that the demand contain sufficient information so that the board of directors can properly evaluate the claim. *Renfro v. Federal Deposit Insurance Corp.*, 773 F2d 657 (5<sup>th</sup> Cir 1985). See also Official Comment to RMBCA § 7.42. “At a minimum, a demand must identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused to the corporation, and request remedial relief.” *Allison on behalf of General Motors Corp. v. General Motors Corp.*, 604 F Supp 1106, 1117 (D Del 1985). See also *Vanessa Simmonds v. Credit Suisse Securities (USA) LLC*, 638 F3d 1072, n 14 (9<sup>th</sup> Cir 2010); *Nemazee v. Premier, Inc.*, 232 F Supp 2d 172, 180 (SDNY 2002); *Stoner v. Walsh*, 772 F Supp 790 (SDNY 1991).

### **F. Recovery belongs to corporation, not plaintiff-shareholder.**

A derivative lawsuit is filed on behalf of the corporation. If the lawsuit is successful and damages recovered, these funds belong to the corporation – not the shareholder/plaintiff. *American Timber & Trading Co. v. Niedermeyer*, 276 Or 1135, 558 P2d 1211 (1977); *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wash App 502, 728 P2d 597 (1986); *Lynch v. Patterson*, 701 P2d 1126 (Wyo 1985); *Ross v. Bernhard*, 396 US 531 (1969).

Under exceptional circumstances, however, a court will permit direct recovery by the shareholders. For instance, if the majority shareholder participated in the wrongful act, the court may conclude that recovery by the corporation would be unjust because the majority shareholder would be rewarded by a pro rata distribution of the derivative lawsuit proceeds. *American Timber & Trading Co. v. Niedermeyer*,

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276 Or 1135, 558 P2d 1211 (1977).

The general rule is that in a shareholder derivative action to enforce a corporate cause of action, the judgment belongs to the corporation rather than the individual stockholders. Nevertheless, a direct recovery to the stockholders may be permitted under exceptional circumstances, notwithstanding that such recovery amounts to a forced distribution of corporate assets to the stockholders.

If awarding a recovery to a corporation would result in a stockholder's receiving a portion thereof to which he was not entitled, then a court of equity will look beyond the corporation and award the recovery to the individual stockholders entitled thereto. However, when third-party rights of higher priority, such as those of corporate creditors or claimants, are involved, then a judgment in favor of the stockholders, which would prejudice such rights, would be improper. (citations omitted). *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wash App 502, 519-520, 728 P2d 597, 608-9 (1986).

See also *LaHue v. Keystone Investment Co.*, 6 Wash App 765, 496 P2d 343 (1972).

### **G. Settlement.**

At common law, the plaintiff-shareholder could continue, compromise, abandon or discontinue a derivative lawsuit at pleasure until another shareholder was joined as a party or until an interlocutory judgment was entered. *Goodwin v. Castleton*, 19 Wash 2d 748, 765, 144 P2d 725, 733 (1944); *Albrecht v. Bauman*, 130 F2d 452 (DC Cir 1942)(interpreting Delaware law).

In *Goodwin v. Castleton*, 19 Wash 2d 748, 144 P2d 725 (1944), the court held that since the claim actually belonged to the corporation, the corporation retained the right to compromise or abandon the lawsuit at any time – subject to court approval.

Today by statute, once a derivative lawsuit is filed, any compromise or settlement of the lawsuit by anyone requires court approval.

A proceeding commenced under this section may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interest of the corporation's shareholders or a class of shareholders, the court shall direct that notice be given the shareholders affected. ORS 60.261(3).

In determining whether to approve such settlement, the court need not try all of the issues raised in the plaintiff-shareholder's complaint in order to evaluate each issue's likelihood of success.

The court may approve or it may disapprove the settlement. In either event, it is the action of the court and is binding on the parties concerned. Nor is the court under such circumstances required first to try out all the issues presented by the plaintiffs in the derivative action; on the contrary, the court may confine itself to the question as to whether the matters involved in such suit have, in good faith and for adequate consideration, been settled and compromised. This, in our opinion, constitutes the orderly manner of procedure, for, otherwise, the fruits of an advantageous settlement might be lost, the corporation exposed to the expense and embarrassment of protracted litigation, and the rights and property of the majority stockholders seriously jeopardized. *Goodwin v. Castleton*, 19 Wash 2d 748, 764, 144 P2d 725, 733 (1944).

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In approving a settlement, the court need only determine whether the parties acted in good faith and whether the payment offered is adequate.

### **H. Attorney fees.**

Neither ORS 60.261 – nor § 7.40(d) of the Revised Model Act from which it was taken – mention the award of attorneys fees. However, the Comments to RMBCA § 7.40(d) state:

Section 7.40(d) does not refer to the award of expenses, including attorneys' fees, to successful plaintiffs. The right of successful plaintiffs in derivative suits to this recovery is so universally recognized, both by statute and on the theory of a recovery of a fund or benefit for the corporation, that specific reference was thought to be unnecessary. The intention is to preserve fully these nonstatutory rights of reimbursement. Therefore, no negative inference should be drawn from section 7.40(d) as to the rights of plaintiffs to reimbursement. Official Comment to RMBCA § 7.40.

A shareholder's right to attorney fees is supported by two important policies. First, non-plaintiff/shareholders would be unjustly enriched by the plaintiff's efforts if they recovered without contributing to the litigation expenses. Second, the reimbursement of attorney fees and expenses encourages meritorious derivative lawsuits by shareholders whose expenses in bringing such lawsuits would normally exceed any increase in the value of their stock brought about by the lawsuit. *Neese v. Richer*, 428 NE2d 36, 39 (Ind App 1982).

Even prior to adoption of the current Act, Oregon courts held that a plaintiff-shareholder is entitled to attorney fees chargeable against the corporation if the derivative lawsuit benefits the corporation. *Hoekstre v. Golden B. Products, Inc.*, 77 Or App 104, 712 P2d 149 (1985). This is true even if the outcome means that the corporation will likely dissolve and liquidate. *Krause v. Mason*, 272 Or 351, 537 P2d 105 (1975). “An exception to the general rule exists when there is no benefit, or only nominal benefit, to the corporation.” *Serbick v. Timpte-Pacific, Inc.*, 88 Or App 633, 637, 746 P2d 1167 (1987).

In *Crandon Capital Partners v. Shelk*, 342 Or 555, 157 P3d 176 (2007), the Oregon Supreme Court affirmed the right of plaintiffs in derivative lawsuits to recover their reasonable attorney fees if the filing of the lawsuit conferred a benefit on the corporation – even a benefit that occurred outside the lawsuit itself. In *Crandon*, the plaintiffs sued to remove a merger target's takeover defenses, alleging that they were unlawful measures to entrench existing management, and to force that corporation's board to engage in negotiations with the other corporation. Before trial, the target stopped resisting the merger and the merger occurred.

In reversing the trial court's refusal to award attorney fees to the plaintiffs, the Supreme Court reviewed the history supporting awards of attorney fees in derivative cases and noted that a long line of cases have held that courts have the equitable

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power to award attorney fees to a shareholder who brings litigation that confers a common benefit on others, such as a corporation or its shareholders.

Under the common fund doctrine, plaintiffs who is legal efforts create, discover, increase, or preserve a fund of money to which others also have a claim, they recover the costs of their litigation, including their attorney fees, from the created or preserved fund. \* \* \* [T]he doctrine is primarily employed to realize the broadly defined purpose of recapturing unjust enrichment. \* \* \* in other words, the doctrine is used to spread litigation expenses among all beneficiaries of a preserved fund so that litigant-beneficiaries are not required to bear the entire financial burden of the litigation while in active beneficiaries receive the benefits at no cost. *Crandon Capital Partners v. Shelk*, 342 Or 555, 566, 157 P3d 176 (2007) (quoting *Strunk v. PERB*, 341 Or 175, 181, 139 P3d 956 (2006)).

The Court also looked to a related equitable basis for an award of attorney fees – the “substantial benefit” theory – which originated in the idea that fees may be awarded when the benefit that was conferred was nonpecuniary, thus providing no fund from which to award fees.

Litigation which results in correcting abuses of [the union democratic] process frequently may not give rise to an ascertainable pecuniary benefit. But the fact that no money or property is involved does not detract from the importance of litigation. Those members of the union who in good faith seek to preserve internal democracy of their union should not have to bear the expense of a successful suit. *Crandon*, *supra* 342 at 566 (quoting *Gilbert v. Hoisting & Port. Engrs.*, 237 Or 130, 138, 384 P2d 136, 390 P2d 320 (1963)).

The Court held that the plaintiffs’ claim for attorney fees did not become moot when the underlying substantive claims became a moot. It therefore reversed.

On remand, the Court of Appeals stated:

It is well settled under Delaware law that to be entitled to fees under the substantial benefit doctrine, a party must demonstrate, as a preliminary matter, that “(1) the suit was meritorious when filed; (2) the action producing benefit to the corporation was taken by the defendants before a judicial resolution was achieved; and (3) the resulting corporate benefit was causally related to the lawsuit.” *United Vanguard Fund v. TakeCare, Inc.*, 693 A2d 1076, 1079 (Del 1997) (cited with approval in *Crandon II*, 342 Or at 567-68, 157 P3d 176). As the Delaware Supreme Court has explained:

“The reason for allowing an award of attorneys’ fees to plaintiff’s counsel where a defendant corporation takes steps to settle or moot a case and in so doing produces the same or similar benefit sought by the shareholder’s litigation is to prevent frustration of the remedial policy of providing professional compensation for such suits when meritorious. This rule insures that, even without a favorable adjudication, counsel will be compensated for the beneficial results they produced, provided that the action was meritorious and had a causal connection to the conferred benefit.” *Allied Artists Pictures Corp. v. Baron*, 413 A2d 876, 878 (Del 1980) (citations omitted).

The meaning of the “meritoriousness” requirement was fully explored in *Chrysler Corporation v. Dann*, 223 A2d 384 (Del 1966). There the court observed that to allow the award of fees upon the mere filing of a derivative action would encourage the filing of many baseless actions solely for the purpose of obtaining counsel fees — a clearly undesirable result. *Id* at 386-87. Rather, to justify an award of fees,

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"the action in which they are sought must have had merit at the time it was filed. It may not be a series of unjustified and unprovable charges of wrongdoing to the disadvantage of the corporation. The plaintiff must have some factual basis at least for the making of the charges." *Id* at 387.

On the other hand, the court expressly rejected the notion that the rule was so demanding as to require that the action, to be meritorious, must be capable of surviving a motion for summary judgment. *Id*. Rather, the court concluded:

"A claim is meritorious within the meaning of the rule if it can withstand a motion to dismiss on the pleadings if, at the same time, the plaintiff possesses knowledge of provable facts which hold out some reasonable likelihood of ultimate success. It is not necessary that factually there be absolute assurance of ultimate success, but only that there be some reasonable hope." *Id*; see also *Kahan v. Rosenstiel*, 424 F2d 161, 167 (3d Cir), *cert den*, 398 US 950, 90 S Ct 1870, 26 L Ed2d 290 (1970) (noting that "[i]n several cases which became moot, courts have said suits were 'meritorious' if they could have survived a motion to dismiss").

We agree with the rationale expressed by the Delaware court and adopt its standard for determining the "meritoriousness" of the predicate litigation as applicable to "substantial benefit"-based attorney fee claims in Oregon. *Crandon Capital Partners v. Shelk*, 219 Or App 16, 27-29, 181 P3d 773 (2008).

Other cases hold that attorney fees may not be recoverable when a lawsuit's most substantial benefit inures to the benefit of the shareholder/plaintiff – rather than to the corporation itself. *Serbick v. Timpte-Pacific, Inc.*, 88 Or App 633, 746 P2d 1167 (1987); *Delaney v. Georgia-Pacific Corp.*, 279 Or 653, 569 P2d 604 (1977); *Interlake Porsche & Audi, Inc. v. Buchholz*, 45 Wash App 502, 728 P2d 597 (1986).

Likewise, attorney fees may not be recoverable when a lawsuit is a direct action by the shareholder, rather than a derivative one. *Chiles v. Robertson*, 96 Or App 658, 774 P2d 500 (1989).

### ***I. Oregon does not require plaintiff to post security.***

Unlike some state derivative statutes, the Oregon Business Corporation Act does not require a shareholder to post security with the court when filing a derivative claim.

### ***J. Oregon does not require verification of complaint***

Federal Rule of Civil Procedure 23.1(b) requires that a derivative lawsuit complaint must be verified. This is also true in many other states, including Washington. See Wash Civil Rule 23.1.

"Verification is the confirmation of the correctness, truth or authenticity of the pleadings." *RCL Northwest, Inc. v. Colorado Resources, Inc.*, 72 Wash App 265, 271, 864 P2d 12 (1993). Failure to verify may usually be cured, but if not cured before dismissal, the dismissal should be with "leave to replead or conditioned on a failure to cure within a reasonable period of time." *Id*.

The Oregon Rules of Civil Procedure do not contain a specific rule for derivative actions. Therefore, no verification is required for derivative lawsuits filed

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in the Oregon state courts.

### **K. Equitable defenses.**

A derivative lawsuit is an equitable action. *Serbick v. Timpte-Pacific, Inc.*, 88 Or App 633, 635 n5, 746 P2d 1167 (1987); *Schultz v. Highland Gold Mines Co.*, 158 F 337 (D Or 1907); *Barrett v. Southern Connecticut Gas Co.*, 172 Conn 362, 374 A2d 1051 (1977); *Florik v. Florida Land Sales Board*, 206 So2d 41 (Fla App 1968); *Rebstock v. Lutz*, 39 Del Ch 25, 158 A2d 487 (1960). As such, certain equitable defenses may apply.

A defense of unclean hands may be available. *Roles v. Roles Shingle Co.*, 147 Or 365, 31 P2d 180 (1934); *Straight v. Goss*, 383 SC 180, 678 SE2d 443 (2009); *Foy v. Klapmeier*, 992 F2d 774, 779 (8<sup>th</sup> Cir 1993)(applying Minnesota law); *Gaudiosi v. Mellon*, 269 F2d 873, 882 (3<sup>rd</sup> Cir 1959); *Dobry v. Dobry*, 324 P2d 534 (Okla 1958); *Rosenfeld v. Zimmer*, 116 Cal App2d 719, 254 P2d 137, 139 (1953); *Liken v. Shaffer*, 64 F Supp 432, 442 (ND Iowa 1946).

[S]hareholder derivative actions are inventions of courts of equity, and even though [plaintiff] is merely a nominal plaintiff bringing suit on behalf of [the corporation], equity requires that a shareholder derivative action cannot be maintained if the nominal plaintiff has unclean hands in connection with the transactions which are the bases for the litigation or has participated or acquiesced in, or benefitted from the conduct of which he now complains. (citations omitted) *Forkin v. Cole*, 192 Ill Ap3d 409, 548 NE2d 795, 805 (1989).

*But see Hilpert v. Yarmosh*, 77 App Div 2d 608, 430 NYS2d 112, 113 (1980)(“The ‘dirty hands’ rationale therefore is inapplicable to plaintiff’s representative capacity since the lawsuit is for the benefit of the corporation”).

A defense of laches may also be available if the shareholder bringing suit delays too long after learning of the claim. *Parker v. Richards*, 43 Or App 455, 602 P2d 1154 (1979); *Wills v. Nehalem Coal Co.*, 52 Or 70, 96 P 528 (1908); *Teren v. Howard*, 322 F2d 949 (9<sup>th</sup> Cir 1963); *Gascue v. Saralegui Land & Livestock Co.*, 70 Nev 83, 255 P2d 335 (1953); *Gallup v. Pring*, 116 P2d 202 (Colo 1941). But laches does not apply until the shareholder learns of the claim. *Moore v. Los Lugos Gold Mines*, 172 Wash 570, 601, 21 P2d 253 (1933). However, laches as to one shareholder may not apply to another shareholder who only recently learned of the claim. *Liken v. Shaffer*, 64 F Supp 432, 442 (ND Iowa 1946).

The underlying claim may also be subject to a statute of limitations. *Teren v. Howard*, 322 F2d 949 (9<sup>th</sup> Cir 1963). Thus, if the statute of limitations would bar a corporation from bringing the lawsuit itself, the claim is not revived merely because a shareholder brings the claim as a derivative lawsuit. But if the wrongdoer is one or more of the directors themselves, the statute of limitations may be tolled until at least some innocent director knows of the wrongdoing.

There are competing rules on who needs to know of the wrongdoing before

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the statute of limitations begins to run: some courts have only required that a single disinterested director acquire knowledge of the wrongdoing; other courts require a majority of disinterested directors have such knowledge before the statute begins to run. Oregon follows the more liberal of these two views – the disinterested majority version of the rule.

Under the disinterested majority version, a plaintiff benefits from a presumption that the cause of action does not accrue or the statute of limitations does not run so long as the culpable directors remain in the majority, *i.e.*, until the corporation has a disinterested majority of nonculpable directors. *FDIC v. Smith*, 328 Or 420, 427, 980 P2d 141 (1999).

A shareholder who, with knowledge of the material facts, consents to, concurs in, acquiesces in or ratifies wrongful conduct cannot later bring a derivative lawsuit over that conduct. *Swafford v. Berry*, 382 P2d 999, 1002 (Colo 1963); *Dobry v. Dobry*, 324 P2d 534, 536 (Okla 1958); *Elster v. American Airlines, Inc.*, 100 A2d 219, 221 (Del Ch 1953).

Some state statutes dealing with derivative lawsuits contain specific provisions addressing the period in which such lawsuits may be brought. See for example OCGA § 14-2-831(b)(Georgia's four-year period); *Norris v. Osburn*, 243 Ga 483, 254 SE2d 860 (1979).

### **L. Forced buyout provisions of ORS 60.952(6) may apply.**

In an unpublished opinion, the Ninth Circuit has held that the forced buy-out provisions of ORS 60.952(6) may be invoked by the corporation upon the filing of a derivative lawsuit alleging wrongful acts encompassed by ORS 60.952. *Scallon v Scott Henry's Winery Corp.*, CA No: 15-35952 (9<sup>th</sup> Cir, April 11, 2017).

### **M. Benefit companies.**

In a benefit company, a derivative lawsuit may be filed by a shareholder, a governor, the company itself and any “person identified in the benefit company’s bylaws, articles of incorporation . . . as having a right to commence a proceeding under this section.” ORS 60.766(2). For benefit companies, a “governor” serves much the same function as a member of the board of directors in a traditional business corporation.

## **Section 8.06 Dissenters' Rights**

At common law, the merger of one solvent corporation with another solvent corporation required unanimous shareholder approval. *Shawnee Telecom Res., Inc. v. Brown*, 354 SW3d 542 (Ky 2011); *Pomierski v. W. R. Grace & Co.*, 282 F Supp 385, 394 (ND Ill 1967); *Reynolds Metals Co. v. Colonial Realty Corp.*, 41 Del Ch 183, 190 A2d 752, 755 (1963); *Shaffer v. General Grain, Inc.*, 133 Ind 598, 182 NE2d 461 (1962). By statute, all or nearly all states have abandoned this common

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law rule and now permit a merger by vote of less than all shareholders.

This true in Oregon. A majority of the shares of each voting group entitled to vote separately on a plan of merger may vote to merge a corporation with another corporation, unless the articles or bylaws requires a greater vote. ORS 60.487(5). See Section 12.02 of this book.

As a trade-off, shareholders who oppose the merger may require the corporation to repurchase their shares.

At common law, unanimous shareholder consent was a prerequisite to fundamental changes in the corporation. This made it possible for an arbitrary minority to establish a nuisance value for its shares by refusal to cooperate. To meet the situation, legislatures authorized the making of changes by majority vote. This, however, opened the door to victimization of the minority. To solve the dilemma, statutes permitting a dissenting minority to recover the appraised value of its shares, [sic] were widely adopted. *China Products North America, Inc. v. Manewal*, 69 Wash App 767, 773, 850 P2d 565, 568 (1993) (quoting from *Voeller v. Nielston Warehouse Co.*, 311 US 531, 535 n 6 (1940)).

This right to recover the shares' appraised value is known as "the right to dissent" and as "dissenters' rights."

'Dissenting shareholders' rights' is a term of art that describes the right of dissenting minority shareholders in a merger to seek judicial appraisal of their shares, instead of being forced to accept the merger offer price that the majority of shareholders has accepted. *Shlens v. Egnatz*, 508 NE2d 44, 47 (Ind App 1987).

Dissenters' and appraisal rights are governed by the laws of the state creating the corporation, and if so required by that state's statutes, the shareholders may need to file suit in that state's courts to seek appraisal of their shares. *Wilson v. Celestial Greetings, Inc.*, 896 SW2d 759 (Mo App WD 1995); *Meade v. Pacific Gamble Robinson Co.*, 21 Wash 2d 866, 153 P2d 686 (1944); *Grant v. Pacific Gamble Robinson Co.*, 22 Wash 2d 65, 154 P2d 301 (1944). But this view as to the exclusive jurisdiction of the state of incorporation is not uniformly held. See *In re IMO Daniel Kloiber Dynasty Trust*, 98 A3d 924, 940 n6 (Del Ch 2014).

Merger is not the only event which creates dissenters' rights. ORS 60.554 grants a shareholder the right to dissent when any of the following extraordinary events occur: the consummation of certain plans of merger and plans of share exchange; the consummation of a sale of substantially all corporate assets; and enactment of certain amendments of the articles of incorporation which materially affect the rights of the dissenters' shares. Modifying preemptive rights may also trigger the right to dissent. ORS 60.554(1)(d)(A); *Waters v. Double L, Inc.*, 114 Idaho 256, 755 P2d 1294 (Idaho App 1987).

Not all mergers trigger to a right to consent. For instance, the right to dissent does not apply to a merger occurring solely to change the corporation's state of incorporation. *China Products North America, Inc. v. Manewal*, 69 Wash App 767,



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775-6, 850 P2d 565, 569 (1993).

The right to dissent gives a dissenting shareholder the right to give up his/her stock in the corporation and, in exchange, receive payment equal to the "fair value" of the shares. ORS 60.554(1).

The effect of dissenter's rights "is to change the status of a dissenting shareholder to that of a creditor at least superior to the distributive rights of the remaining shareholders." *Flarsheim v. Twenty Five Thirty Two Broadway Corp.*, 432 SW2d 245, 253 (Mo 1968).

ORS 60.181(6) appears to place the debt to the dissenting shareholder at parity with the debts of the corporation's general, unsecured creditors – as long as the creation of the debt to the dissenting shareholder does not render the corporation insolvent. But such debts may be treated as a preference under 11 USC § 547.

Dissenters' rights do not apply to holders of shares of most public companies. Dissenters' rights do not apply to any class or series of shares registered on a national securities exchange. ORS 60.554(3).

### **A. Steps required by statute.**

If a corporation proposes to take a corporate action which will give rise to dissenters' rights and the action requires a shareholder vote, the corporation must notify its shareholders of the right to dissent before the shareholder meeting when the vote will occur. ORS 60.561(1). In order to dissent under such circumstances, a dissenting shareholder must deliver a written notice to the corporation before the vote is taken. The written notice must include a demand for payment in exchange for the shareholder's shares in the event the action is effectuated. ORS 60.564(1).

If the shareholders fail to take the proposed action, the corporation need do nothing more with regard to any dissenting shareholder.

But if the shareholders then vote and authorize an action giving rise to dissenters' rights, the corporation must send a "dissenters' notice" to all shareholders who previously dissented. The corporation must send the "dissenters' notice" within ten days of the shareholder vote authorizing the act. This notice must: (i) state where the shareholder must send a payment demand; (ii) state where and when the shareholder's stock certificates must be deposited; (iii) describe any transfer restrictions applicable to uncertificated shares; (iv) supply a form for demanding payment which must include certain information; and (v) set a date by which the corporation must receive the payment demand (no less than 30 and no more than 60 days after the date the dissenters' notice is delivered to the dissenters). ORS 60.567(2).

If the proposed action is taken without a shareholder vote, the corporation is

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required to inform its shareholders of the action taken and to deliver a "dissenters' notice," described above, to all shareholders entitled to assert dissenters' rights. ORS 60.561(2).

**EXAMPLE:** In the merger between a parent corporation and a subsidiary, 90% of which is owned by the parent corporation, neither shareholders of the parent nor shareholders of the subsidiary are entitled to vote on the merger. ORS 60.491(1). Shareholders of the subsidiary – but not the parent – have the right to dissent. ORS 60.554(1)(a). In such case, shareholders of the subsidiary would be entitled to receive a "dissenters' notice" after the subsidiary's board of directors voted to merge.

Dissenters desiring payment are then required to demand payment and deposit their shares. ORS 60.571.

Upon receipt of a proper demand for payment, the corporation is required to pay each such dissenter the amount the corporation estimates to be the "fair value" of the dissenters' shares, plus accrued interest. ORS 60.577(1). Payment must be accompanied by the corporation's balance sheet, a statement of the corporation's estimate of fair value, an explanation of how interest was calculated, a statement of the dissenters' rights under ORS 60.587, and a copy of ORS 60.551 through 60.594. ORS 60.577(2).

If a dissenter disagrees with the corporation's estimate of "fair value," the dissenter may notify the corporation in writing of the dissenters' own estimate of fair value and demand payment of this (presumably higher) amount. ORS 60.587(1). Unless the dissenter does so within 30 days, however, the dissenter waives the right to demand an amount higher than was originally offered by the corporation. ORS 60.587(2).

Even though the dissenter notifies the corporation of a higher value, the shareholder can cash the corporation's check and argue for the higher value should appraisal litigation ensue, as described below. Linda O. Smiddy, *Reform of Vermont's Corporate Law: A Call For Much Needed Reform*, 17:3 Vermont L Rev 3, 48-9 (1992); Donald J. Brown & M. Daniel Waters, *Dissenters' Right and Fundamental Changes Under the New Iowa Business Corporation Act*, 40 Drake L Rev 733, 748-9 (1991).

The premise underlying the 1978 change is that since the dissenter is no longer treated as a corporate shareholder subsequent to the corporate act in question (whatever triggers the dissent), that dissenter should have immediate access to the corporately acknowledged value of the dissenters' shares.

By providing the dissenter with immediate funds, litigation may well be fostered rather than discouraged. In simple terms, a minority shareholder, believing he has been treated unfairly, would be given the necessary financing to pursue a cause of action for fraud, illegality, or breach of fiduciary duty. Henry F. Johnson & Paul

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Bartlett, *Is a Fistful of Dollars the Answer? A Critical Look at Dissenters' Rights Under the Revised Model Business Corporation Act*, 12 JL & Com 211, 220 (Spring 1993).

Once a dissenting shareholder sends a proper demand for the dissenter's estimate of "fair value," the corporation may either: (i) pay the amount demanded; or (ii) commence a proceeding in circuit court for the appraisal of the shares. ORS 60.591. If a corporation fails to commence such a proceeding within 60 days of receiving the dissenters' estimate of fair value, the corporation is required to pay each dissenter the amount previously demanded by the dissenter. ORS 60.591(1).

### **B. Fair value.**

As discussed above, once a shareholder dissents and demands payment for his/her shares, the corporation is required to pay "fair value" in exchange for the shareholder's shares. If, using the procedures discussed above, the corporation and the shareholder are unable to agree on an amount constituting "fair value," the corporation must file an appraisal action asking the circuit court to determine fair value within a specified time.

"Fair value" is not the same as "fair market value." Fair market value – what a willing buyer and willing seller will pay – is only one factor in determining fair value. *Columbia Management Co. v. Wyss*, 94 Or App 195, 199, 765 P2d 207, 210 (1988). But in many circumstances, "fair market value" will equal "fair value," but with minority and marketability discounts applied. *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 188, 21 P3d 178 (2001). Fair value is

a term that does not have a commonly accepted meaning in ordinary usage, much less in the business community. *Shawnee Telecom Res., Inc. v. Brown*, 354 SW3d 542, 551 (Ky 2011) (quoting *Pueblo Bancorporation v. Lindoe, Inc.*, 63 P3d 353, 359 (Colo 2003)).

There is no "one size fits all" method for determining fair value. *Matter of Seagroatt Floral, Co., Inc.*, 78 NY2d 439, 583 NE2d 287, 290 (1991). Rather, there are several methods and the circumstances of each case will determine the weight given to each method. In a case involving dissenters' rights, the Washington Supreme Court has noted:

No universal formula for determining the value of shares of a corporation can be stated. No two corporations are precisely alike, and a consideration that may be very influential in evaluating the shares of one may be meaningless with reference to another. *In re West Waterway Lumber Co.*, 59 Wash 2d 310, 320, 367 P2d 807, 813 (1962).

"Fair value" is defined in ORS 60.551(4) as follows:

"Fair value," with respect to a dissenter's shares, means the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable.

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The language of ORS 60.551(4) is taken from Revised Model Act § 13.01(3), the Comment to which states in relevant part:

The definition of "fair value" in section 13.01(3) leaves to the parties (and ultimately to the courts) the details by which "fair value" is to be determined within the broad outlines of the definition. This definition thus leaves untouched the accumulated case law about market value, value based on prior sales, capitalized earnings value, and asset value. It specifically preserves the former language excluding appreciation and depreciation in anticipation of the proposed corporate action, but permits an exception for equitable considerations. The purpose of this exception ("unless exclusion would be inequitable") is to permit consideration of factors similar to those approved by the Supreme Court of Delaware in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), a case in which the court found that the transaction did not involve fair dealing or fair price: "In our view this includes the elements of rescissory damages if the Chancellor considers them susceptible of proof and a remedy appropriate to all the issues of fairness before him." Consideration of appreciation or depreciation which might result from other corporate actions is permitted; these effects in the past have often been reflected either in market value or capitalized earnings value.

"Fair value" is to be determined immediately before the effectuation of the corporate action, instead of the date of the shareholder's vote, as is the case under most state statutes that address the issue. This comports with the plan of this chapter to preserve the dissenter's prior rights as a shareholder until the effective date of the corporate action, rather than leaving him in a twilight zone where he has lost his former rights, but has not yet gained his new ones.

A leading commentator has said that no one factor governs the determination of fair value, but speculative factors should not be considered. FLETCHER, CYC CORP § 5906.12 (Perm Ed).

The "fair value" of shares is not to be measured by any unique benefits that will accrue to the acquiring corporation, but rather is to be determined on the basis of what a reasonable and objective observer would consider to be a price that reflects the intrinsic value of the right of stock ownership, without regard to any subjective mental processes of the dissenting shareholders or any special benefits to be derived by the acquiring corporation. Also, the valuation must be made without consideration of the merger transaction which prompted the appraisal proceeding. (footnotes omitted) FLETCHER, CYC CORP § 5906.12 (Perm Ed).

In order to determine fair value, several methods or values are usually considered: market value, net assets value, and a third value, varyingly referred to as the earnings value, investment value, or enterprise value. "[T]he relative weight given each will depend on the circumstances of the case." *Columbia Management Co. v. Wyss*, 94 Or App 195, 199, 765 P2d 207, 210-1 (1988).

In an appraisal action, the investment value will often be the value given the most importance by the courts.

The most important factor in most cases, it pointed out, is investment or enterprise value, because that value reflects the business' worth as a going concern. The purpose of the appraisal statute is to ascertain what the dissenter actually loses because of his or her unwillingness to go along with the controlling shareholders' desires. The court refused to accept a minority discount because it would be a departure from that purpose. Such a discount affects market value more than investment value. The statute allows the majority to override the minority so long as

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it adequately protects the minority's interests. There would be no protection if the minority could be squeezed out for less than the real value of its interest. *Columbia Management Co. v. Wyss*, 94 Or App 195, 201-2, 765 P2d 207, 212 (1988) (discussing *Woodward v. Quigley*, 257 Iowa 1077, 133 NW2d 38 (1965)).

ORS 60.551(4) provides that fair value is to be determined "immediately before the effectuation of the corporate action to which the dissenter objects." Factors which might be relevant to fixing fair value include, but are not limited to, the following:

the price at which the shares had been selling; the amount, if any, of present share value increase or decrease because of anticipated future earnings of the corporation; corporate assets; corporate earnings or losses; corporate reputation; anticipated competition. ORS 60.551(4) excludes consideration of appreciation or depreciation in anticipation of the corporate action, unless it would be inequitable to exclude such appreciation or depreciation. *Stringer v. Car Data Systems, Inc.*, 314 Or 576, 587-8, 841 P2d 1183, 1189 (1992), *reconsideration denied*, 315 Or 308, 844 P2d 905 (1993).

In determining fair value, the Eleventh Circuit held that fair value required an examination of "net asset value, investment value and market value in determining a stock's worth." *Multitex Corporation of America v. Dickinson*, 683 F2d 1325, 1328 (11<sup>th</sup> Cir 1983). This court went on to state:

Turning to the jury instructions actually given by the court below, we find them to be a proper statement of Georgia law. The district court instructed the jury that fair value represented

the price at which a willing seller and a willing buyer will be tried, both having original knowledge of the facts. Now a willing seller is one who desires, but is not obligated to sell, and a willing buyer is one who wishes to buy, but is under no obligation, compulsion or necessity to buy. Determination of the fair value of stock owned by Mr. Dickinson in Colormasters, Inc., as of the close of business on April 10, 1978, is necessarily based somewhat on assumption rather than absolute fact.

The jury was also instructed that it should determine fair value "using as a guideline any and all evidence that [it] determined to accept which was legally presented . . . in Court."

The willing seller/willing buyer standard has been found by Georgia courts to provide proper guidance to a jury when determining the "fair market value" of real property in condemnation proceedings. The standard has, however, also been recognized by the Georgia Supreme Court to "permit the proof of the varied elements of value; that is all the facts which the owner would properly and naturally press upon the attention of a buyer to whom he is negotiating a sale, and all other facts which would naturally influence a person of ordinary prudence desiring to purchase." Because all evidence of a stock's worth, whether compiled under a market value, investment value or net asset value approach, would naturally influence a buyer of stock, the jury was properly guided in its consideration of all such evidence under a willing seller/willing buyer standard. (citations & footnote omitted) *Id* at 1329.

Hard and fast rules do not apply. Fair value is a question of fact, and as such, it "will depend upon the circumstances of each case; there is no single formula for mechanical application." *Matter of Seagroatt Floral, Co., Inc.*, 78 NY2d 439, 583

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NE2d 287, 290 (1991).

Additional discussion of "fair value" is contained in Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L J 613 (1998); Shishido, *The Fair Value of Minority Stocks in Closely Held Corporations*, 62 FORDHAM L REV 65 (1993); Edwards, *Dissenters' Rights: The Effect of Tax Liabilities on the Fair Value of Stock*, 6 DEPAUL BUS L J 77 (1993); Schlyer, "Fair Value" Determination In Corporate "Freeze-outs," *And In Security And Exchange Act Suits: Weinberger, Other, And Better Methods*, 19 VAL U L REV 521 (1985); *Valuation of Close Corporation Shares in Oregon*, 57 OR L REV 309 (1978).

### C. Discounts.

In determining fair value, a court must determine whether to apply a "minority" and/or a "marketability" discount.

A "minority discount" is a reduction in value "which recognizes that controlling shares are worth more in the market than are noncontrolling shares." *Columbia Management Co. v. Wyss*, 94 Or App 195, 204, 765 P2d 207, 213 (1988); *Tyron v. Smith*, 191 Or 172, 229 P2d 251 (1951); *Congel v. Malfitano*, 2016 NY Slip Op 3845, 141 AD3d 64, 32 NYS3d 264 (NY App Div 2016).

A "marketability discount" is a reduction in value which recognizes that "interests in closely held business enterprises cannot readily be sold, they are less marketable and, therefore, less valuable than equivalent interests in companies whose securities are regularly traded in a recognized market." Haynesworth, *Valuation of Business Interests*, 33 MERCER L REV 457, 489 (1982). A "marketability discount adjusts for a lack of liquidity in one's interest in an entity. Even controlling interests in nonpublic companies may be eligible for marketability discounts, as the field of potential buyers is small, regardless of the size of the interest being sold." *Balsamides v. Protameen Chemicals*, 160 NJ 352, 734 A2d 721, 733 (1999).

Although not always true, most courts today do not apply a minority discount in the dissenters' rights context. *Brown v. Arp and Hammond Hardware Co.*, 141 P3d 673, 683 (Wyo 2006).

Most courts have also rejected applying marketability discounts in the dissenter rights context. *Id.*; *Shawnee Telecom Res., Inc. v. Brown*, 354 SW3d 542, 555 (Ky 2011); *First Western Bank Wall v. Olsen*, 621 NW2d 611 (SD 2001). But not all cases agree. *See for example Robblee v. Robblee*, 68 Wash App 69, 841 P2d 1289 (1992).

*Columbia Management Co. v. Wyss*, 94 Or App 195, 765 P2d 207 (1988) involved a corporate event which essentially squeezed-out a shareholder in a close corporation and gave him the right to dissent. The Court of Appeals upheld the trial

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court's decision to apply a marketability discount, but overturned the trial court's application of a minority discount.

[B]ecause a dissenting shareholder is exercising a right designed for his or her protection, and because the purchaser of the shares will be the corporation, not an outsider, this recognition of decreased market value may not be appropriate. "It is contrary to the purpose of the statute to discount the minority interest because it is a minority. This in effect would let the majority force the minority out without paying its fair share of the value of the corporation." (citation omitted) *Columbia Management Co. v. Wyss*, 94 Or App 195, 204, 765 P2d 207, 213 (1988).

*But see Perlman v. Permonite Manufacturing Co.*, 568 F Supp 222, 232 (ND Ind 1983), *affirmed*, 734 F2d 1283 (7<sup>th</sup> Cir 1984) (although discounts for minority interest, lack of marketability and lack of diversity are proper, a discount for capital gains tax liability is not).

A discount applied by the courts may be different in other contexts. For instance, in actions by minority shareholders for oppressive conduct and breach of fiduciary duty, courts sometimes force the corporation to buy-out the minority's shares. In several such cases, the court has declined to apply either minority or marketability discounts in determining value. *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 276, 21 P3d 178 (2001); *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 115, 7 P3d 717 (2000) *Chiles v. Robertson*, 94 Or App 604, 767 P2d 903, *reconsideration allowed in part, opinion modified*, 96 Or App 658, 774 P2d 500 (1989).

### **D. Legal action; burden of proof.**

An appraisal action filed under ORS 60.591 is a legal action, not an equitable proceeding. *Gl Joe's, Inc. v. Nitzam*, 183 Or App 116, 123, 50 P3d 1282 (2002). This contrasts with actions for oppression or for breach of fiduciary duty – actions which also sometimes result in the valuation of the minority shareholder's shares – which are equitable proceedings. *Id.*

ORS 60.591 requires the corporation to initiate the appraisal action and the burden of proof is arguably on the corporation to prove fair value. *Chrome Data Systems, Inc. v. Stringer*, 109 Or App 513, 517, 820 P2d 831 (1991).

Some courts hold that both sides bear the burden of proof saying that in "a statutory appraisal proceeding, both sides have the burden of proving their respective valuation positions by a preponderance of evidence." *M.G. Bancorporation, Inc. v. Le Beau*, 737 A2d 513, 520 (Del 1999); *see also Highfields Capital, Ltd. v. AXA Financial, Inc.*, 939 A2d 34, 42 (Del Ch 2007).

Elsewhere, the burden has been placed variously, on the corporation in a dissenting shareholder situation, *Multitex Corp. of America v. Dickinson*, 683 F.2d 1325 (11th Cir.1982); *Atlantic States Const. v. Beavers*, 169 Ga.App. 584, 314 S.E.2d 245 (1984) and on the petitioner in an appraisal proceeding, *Dofflemyer v. W.F. Hall Printing Co.*, 1980 WL 6414 (Del.Ch. No. CA5906), *aff'd*, 432 A.2d 1198 (Del.Supr.1981); *Campbell v. Caravel Academy*, 1988 WL 63492 (Del.Ch. No.

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CA7830), *aff'd* 553 A.2d 638 (1988). In Oregon one court observed that the burden of proof is not necessarily on the dissenters; but they are entitled to fair value even without putting forth any evidence in an appraisal proceeding. *Chrome Data Systems v. Stringer*, 109 Or.App. 513, 517, 820 P.2d 831, 833 n. 2 (1991). This position is close to one articulated by the Court of Appeals of Ohio, Hancock County in 1986: "The ultimate issue was fair cash value and neither the statute, nor practicality, placed the burden of proof on one party rather than another." *Price v. Marathon Oil Co.*, 1986 WL 807 (Ohio App.1986). In Ohio the primary objective is to provide all parties an opportunity to be heard on the question of fair value and, then, for the court "based on all of the relevant evidence without consideration of burden of proof, to make a finding as to fair cash value." (1986 WL 807, at 4, *supra*.) The most persuasive explanation for what can be called the "no burden" position is found in the Court of Chancery, New Castle County, Delaware. As in the New York scheme, it is the court that has the obligation to establish fair value in an appraisal. In this context, there is no occasion to approach the problem by analyzing who has the burden of proof and finding against that party if she or it fails to carry this burden.

"In an ordinary litigation, the matter might be resolved by applying traditional burden of proof rules. If the Court had found that neither side had adequately established a ... value ..., it could rule against the party having the burden of proof. However, that approach is not permissible in a [statutory] appraisal. The statute directs that the Court 'shall appraise' the fair value of the dissenting shareholders' shares." *Cavalier Oil Corp. v. Harnett*, 1988 WL 15816, *aff'd* 564 [168 Misc.2d 95] A.2d 1137 (Del.Supr.1989).

The same court, somewhat obversely, applied this concept by suggesting that both sides bore the burden to prove their respective valuation position by a preponderance of the evidence. *Pinson v. Campbell-Taggart, Inc.*, 1989 WL 17438, pp. 6-7.

However analyzed, the court at bar has a responsibility to "determine the fair value of petitioner's shares as of the day prior to the date on which such petition was filed." BCL § 1118. This formulation defies application of a burden-of-proof approach. That each party presented their views of the value of petitioner's shares through expert testimony does not require or even invite the court to measure value using or rejecting either or both opinions of value. Neither does it exonerate the court from formulating a value.

*Cohen, Matter of*, 636 NYS2d 994, 996-97, 168 Misc2d 91 (NYSup 1995) (emphasis added)

See *Chrome Data Systems v. Stringer*, 109 Or App 513, n 2, 517, 820 P2d 831, 833 (1991); *Am. Ethanol Inc. v. Fund*, 127 Nev Adv Op 13, 252 P3d 663 (2011).

"Even if one side fails to satisfy its burden of proving its valuation position, the court is not free to accept the competing valuation by default, but must use its own independent judgment to determine a fair value." 18 CJS Corporations § 394 (citing *Montgomery Cellular Holding Co., Inc.*, 880 A2d 206, 221 (Del 2005).

### **E. Attorney fees.**

ORS 60.594 permits a court to assess attorney fees against either the corporation or the dissenters if the court finds that such party acted arbitrarily, vexatiously or not in good faith. In the case of the corporation only, the court may



assess attorney fees if the corporation did not comply with the dissenters' rights provisions of the Act. *Chrome Data Systems, Inc. v. Stringer*, 109 Or App 513, 820 P2d 831 (1991).

**F. Appraisal actions – exclusive remedy?**

Many, if not most, courts will use their equitable powers to protect minority shareholders in a squeeze-out situation. Oregon is among the few states where the appraisal statute is likely the sole remedy for the minority. *Stringer v. Car Data Systems, Inc.*, 314 Or 576, 841 P2d 1183 (1992); Spencer, *The Oregon Supreme Court Grants Majority Shareholders in Close Corporations a License to Steal: Stringer v. Car Data Systems, Inc.*, 30 WILL L REV 373 (1994). *But see Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682 (1992).

Historically, fundamental corporate changes – such as mergers – could occur only with unanimous shareholder approval. Eventually, all states adopted statutes which permitted fundamental corporate change by a less than unanimous vote of the shareholders. Dissenters' rights were enacted to give an objecting shareholder the right to bail out of the fundamentally different corporation and the right to be paid the fair value of his/her shares. *McMinn v. Mbf Operating, Inc.*, 133 P3d 875, 879 (NM App 2006); *Gabhart v. Gabhart*, 267 Ind 370, 370 NE2d 345 (1977).

Even though these statutes allowed the majority the right to make fundamental changes over the objections of the minority, courts initially held that the majority shareholders could do so only for legitimate business reasons and in a manner consistent with the majority's fiduciary duty to the minority shareholders. See *Singer v. Magnavox Co.*, 380 A2d 969 (Del 1977).

a scheme by a majority stockholder to freeze out a minority shareholder, when the plan lacks any legitimate corporate purpose, is a breach of the majority shareholder's fiduciary obligation to deal fairly with minority shareholders, and is fraudulent as against them. *Corbin v. Corbin*, 429 F Supp 276, 280 (MD Ga 1977).

Courts in Delaware and in a majority of other states eventually abandoned this business purpose rule. Instead, these courts held that a majority could freeze-out the minority for any reason, as long as the majority did so in a lawful manner, free from fraud. *Weinberger v. UOP, Inc.*, 457 A2d 701 (Del 1983). An appraisal remedy would normally be the only remedy available to the disaffected minority.

While a plaintiff's monetary remedy ordinarily should be confined to the more liberalized appraisal proceeding herein established, we do not intend any limitation on the historic powers of the Chancellor to grant such other relief as the facts of a particular case may dictate. The appraisal remedy we approve may not be adequate in certain cases, particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved. Under such circumstances, the Chancellor's powers are complete to fashion any form of equitable and monetary relief as may be appropriate, including rescissory damages. (citations omitted) *Weinberger v. UOP, Inc.*, 457 A2d 701, 714 (Del 1983).

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The Revised Model Act adopted the *Weinberger* approach.

A shareholder entitled to dissent and obtain payment for his shares under this chapter may not challenge the corporate action creating his entitlement unless the action is unlawful or fraudulent with respect to the shareholder or the corporation. RMBCA § 13.02(b).

The Comment to Revised Model Act § 13.02(b) states:

But the prospect that shareholders may be "paid off" does not justify the corporation in proceeding unlawfully or fraudulently. If the corporation attempts an action in violation of the corporation law on voting, in violation of clauses in articles of incorporation prohibiting it, by deception of shareholders, or in violation of a fiduciary duty--to take some examples--the court's freedom to intervene should be unaffected by the presence or absence of dissenters' rights under this chapter. Because of the variety of situations in which unlawfulness and fraud may appear, this section makes no attempt to specify particular illustrations. Rather, it is designed to recognize and preserve the principles that have developed in the case law of Delaware, New York and other states with regard to the effect of dissenters' rights on other remedies of dissident shareholders. See *Weinberger v. UOP, Inc.*, 457 A2d 701 (Del 1983)(appraisal remedy may not be adequate "where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross or palpable overreaching are involved.") See also, Vorenberg, *Exclusiveness of the Dissenting Stockholders' Appraisal Right*, 77 HARV L REV 1189 (1964).

Numerous cases have held that courts retain their historic equitable power to protect minority shareholders from the majority's fraud and self-dealing, despite enactment of an appraisal statute. These cases have recognized equitable remedies other than appraisal. *Coggins v. New England Patriots Football Club*, 397 Mass 525, 492 NE2d 1112 (1986)(appraisal statute does not deprive courts of their equitable powers); *Bayberry Associates v. Jones*, 783 SW2d 553 (Tenn Sup Ct 1990)(despite appraisal statute, courts retain equitable right to assure fairness, including fair price and fair dealing); *Mullen v. Academy Life Ins. Co.*, 705 F2d 971 (8<sup>th</sup> Cir 1983)(appraisal not only remedy despite N.J. appraisal statute); *Joseph v. Shell Oil Co.*, 498 A2d 1117 (Del Ch 1985)(minority shareholders not limited to appraisal remedy which precludes imposition of adequate remedy for serious breaches of fiduciary duty); *Rabkin v. Philip A. Hunt Chemical Corp.*, 498 A2d 1099 (Del 1985)(allegations of bad faith manipulation and grossly inadequate price state claim for damages beyond appraisal); *Cede & Co. v. Technicolor, Inc.*, 542 A2d 1182 (Del Ch 1988)(damage claim and appraisal claim both permitted to go to trial).

In *Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc.*, 532 A2d 1324 (Del Ch 1987), the Delaware Court of Chancery held that the minority shareholders were entitled to a preliminary injunction enjoining a squeeze-out merger noting that:

As fiduciaries seeking to "cash out" the minority stockholders of a Delaware corporation in a non-arm's length merger, the defendants had a duty to be entirely and scrupulously fair to the plaintiffs in all respects. *Weinberger v. UOP, Inc.*, 457 A2d at 710. The majority stockholder was obliged not to time or structure the transaction, or to manipulate the corporation's values, so as to permit or facilitate the forced elimination of the minority stockholders at an unfair price. The corporation's directors were obliged to make an informed, deliberate judgment, in good faith, that

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the merger terms, including the price, were fair and that the merger would not become a vehicle for economic oppression. And finally, the directors (and the majority stockholder, to the extent that it involved itself in such matters) were obliged to disclose with entire candor all material facts concerning the merger, so that the minority stockholders would be able to make an informed decision as to whether to accept the merger price or to seek judicial remedies such as appraisals, an injunction, or a post-merger damage action.

None of these fiduciary obligations were satisfied in this instance. Indeed, if one were setting out to write a textbook study on how one might violate as many fiduciary precepts as possible in the course of a single merger transaction, this case would be a good model. *Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc.*, 532 A2d 1324, 1335 (Del Ch 1987).

The Washington Supreme Court has held that the *Weinberger* “fraud” exception is broader than common law actual fraud, but does not encompass the freeze-out itself, even though the minority shareholder may allege that the act of freezing out the shareholder constitutes a breach of fiduciary duty. *Sound Infiniti Inc v. Snyder*, 169 Wash 2d 199, 237 P3d 241 (2010).

Oregon, however, holds that the appraisal remedy is the sole remedy when the dispute is merely over price, even where the transaction involves self-dealing by the majority and the price offered is only a fraction of the true value of the shares.

Where the allegations show only a disagreement as to price, however, with no allegations that permit any inference of self-dealing, fraud, deliberate waste of corporate assets, misrepresentation, or other unlawful conduct, the remedy afforded by ORS 60.551 to 60.594 is exclusive. That is true even if the majority shareholders acted arbitrarily or vexatiously or not in good faith.

It may be that the \$0.002 offer was insulting to plaintiffs, and it may even have been motivated by bad faith. But, because the facts alleged in the complaint, if established, support no claim for damages apart from the fair value of the shares, we believe that the legislature intended that dissenting shareholders in the position of plaintiffs be limited to their remedies under the appraisal statutes. *Stringer v. Car Data Systems, Inc.*, 314 Or 576, 590-1, 841 P2d 1183, 1190-1 (1992), *reconsideration denied*, 315 Or 308, 844 P2d 905 (1993).

*See also Fleming v. International Pizza Supply Corp.*, 676 NE2d 1051 (Ind 1997) (appraisal action is exclusive remedy but minority can litigate fraud and breach of fiduciary duty claims in that action as effecting fair value); *Brandt v. Travelers Corp.*, 44 Conn Sup 12, 665 A2d 616 (1995) (minority could not enjoin merger because appraisal is exclusive remedy); *Stepak v. Schey*, 51 Ohio St3d 8, 553 NE2d 1072 (1990) (remedy for breach of fiduciary duty involving only price that a shareholder receives is limited to appraisal statute); *Schloss Associates v. C & O Ry.*, 73 Md App 727, 536 A2d 147 (1988) (appraisal remedy wholly adequate in dispute essentially over price); *Green v. Santa Fe Industries, Inc.*, 70 NY2d 244, 514 NE2d 105 (1987) (appraisal adequate in dispute over mere inadequacy of price); Spencer, *The Oregon Supreme Court Grants Majority Shareholders in Close Corporations a License to Steal: Stringer v. Car Data Systems, Inc.*, 30 WILL L REV

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373 (1994).

*But see McMinn v. MBF Operating Acquisition Corp.*, 142 NM 160, 164 P3d 41 (NM 2007); *Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682 (1992)(minority shareholder may have direct action against majority if squeeze-out constituted a breach of majority's fiduciary duty).

### **G. Reverse Stock Splits.**

Reverse stock splits are also a recognized method of cashing or squeezing out minority shareholders. *See for example Sound Infiniti Inc v. Snyder*, 169 Wash 2d 199, 237 P3d 241 (2010); *Wright v. Sutton*, Case No: 1:08-1431 (SD W Va July 5, 2017); *FGS Enterprises, Inc. v. Shimala*, 625 NE2d 1226 (Ind 1993); *Goldman v. Union Bank and Trust*, 765 P2d 638 (Colo App 1988); *Laird v. I. C. C.*, 691 F2d 147 (3<sup>rd</sup> Cir 1982).

There is broad consensus that a reverse stock split may validly be used for the sole purpose of removing minority shareholders, subject to the restriction that the removal of the minority shareholders must not constitute a breach of fiduciary duty on the part of the majority shareholders or directors of the corporation. *U.S. Bank N. A. v. Cold Spring Granite Co.*, 802 NW2d 363, 371 (Minn 2011).

In a reverse stock split, the corporation adopts a plan proportionately reducing the number of shares held by each shareholder, leaving the minority shareholders with less than one share each. The plan calls for the corporation to redeem all fractional shares for cash, forcing the minority shareholders to sell their fractional shares back to the corporation.

A reverse stock split which provides for cashing out of fractional shares gives rise to dissenter's rights under the Oregon Act. ORS 60.554(1)(a)(B). This is not true in all states. *See U.S. Bank N. A. v. Cold Spring Granite Co.*, 802 NW2d 363 (Minn 2011).

Most courts which have considered reverse stock splits have essentially applied the *Weinberger* [457 A2d 701 (Del 1983)] standard, that is, appraisal is the exclusive remedy unless there is "fraud, illegality, or fundamental unfairness." *Sound Infiniti Inc v. Snyder*, 169 Wash 2d 199, 237 P3d 241 (2010).

In our view, the fairness rule is the appropriate test under these circumstances, i.e., a reverse stock split in a closely held corporation with the effect of eliminating a minority stockholder, because it permits intervention on the facts of any given case when intervention is justified. As compared to business purpose, courts have a long history of assessing concepts of fairness. Moreover, in most cases, a plausible business purpose would not be difficult to demonstrate. *See Ralph A. Peebles, The Use and Misuse of the Business Judgment Rule in the Close Corporation*, 60 Notre Dame L. Rev. 456, 499 (1985)(citing F. Hodge O'Neal, O'Neal's Oppression of Minority Shareholders § 3.05 (1975)). As a result, the fairness rule, in many if not most instances, will provide courts with greater ability to fashion appropriate relief. *Lerner v. Lerner Corp.*, 132 MD App 32, 750 A2d 709, 722 (2000).

The subject of reverse stock splits is discussed in the following: Paul H.

Dykstra, *The Reverse Stock Split—That Other Means of Going Private*, 53 Chi-Kent L Rev 1 (1976); Michael J. Lawson, Comment, *Reverse Stock Splits: The Fiduciary's Obligations Under State Law*, 63 Cal L Rev 1226 (1975); and Michael R. Rickman, Note, *Reverse Stock Splits and Squeeze-outs: A Need for Heightened Scrutiny*, 64 Wash U L Q 1219 (1986).

