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Minority Shareholder Oppression in the Private Company in the European Community: A Comparative Analysis of the German, United Kingdom, and French "Close Corporation Problem"

Sandra K. Miller*

The purpose of the European Community is to remove barriers to the free movement of goods, persons, services, and capital in the European Community.1 With regard to company law, the Treaty calls for "safeguards . . . for the protection of the interests of members and others," and authorizes the coordination of company rules throughout the Community.2 Significant progress has been made in the harmonization of corporate safeguards involving public filings, financial reporting, auditing, capitalization, and mergers.3 However, several areas have not been successfully harmonized, including matters regarding corporate governance and remedies for resolving disputes among shareholders of

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1. Article 2 of The Treaty of Rome mandates that a common market be established. It provides in part that:

"The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.


2. EEC Treaty art. 54(3)(g).

3. For an excellent survey of these areas, see Alfred F. Conard, The European Alternative To Uniformity In Corporation Laws, 89 Mich. L. Rev. 2150 (1991) (discussing the Communities' development of minimum standards in such areas as public recording, financial disclosure, mergers, takeovers, and shareholder and employee powers).

30 CORNELL INT'L L.J. 381 (1997)
private companies.4

While a great deal of attention has focused on the problems of shareholder squeeze outs, deadlocks, and disputes in the close corporation in the United States, little attention has focused on the same issues which arise in other countries, and in particular, in the European Community.5 In fact, the "close corporation problem"6 is universal—regardless of the country of domicile, shareholders of the private company typically lack liquidity in their investments.7 If a dispute arises among shareholders, the shareholders are frequently locked into the company. Minority shareholders in particular are vulnerable to the conduct of the majority owners.8

The primary purpose of this Article is to explore the different ways in which selected countries within the European Community address the "close corporation problem." The corporate structure and shareholder dispute mechanisms in the private company under German, United Kingdom (UK), and French law are considered. The Article suggests that members of the Community consider the modification of company statutes to require or otherwise encourage shareholders to contractually address shareholder disputes in advance of their occurrence. Part I of this Article identifies the "close corporation problem" as a universal dilemma found in the United States as well as in other countries. Part II analyzes the corporate structure of German, UK, and French public and private corporations. Each country's remedies for shareholder disputes in the private company are considered. Part III explores the burdens and benefits of existing judicial discretion in resolving close corporation shareholder disputes, focusing on: 1) the potential for abuse of judicial discretion; 2) the confusion fostered by vague legal standards in an international context; 3) the rationale for judicial discretion in the dispute resolution process; and 4) the extent to which contractual arrangements can effectively address the close corporation problem. Part IV explores the


6. For the purposes of this Article, the term "close corporation problem" refers to the judicial and practical difficulties raised by shareholder disputes among members of a close corporation. A close corporation is defined in accordance with PRINCIPLES OF CORPORATE GOVERNANCE § 1.06 (1994) as a corporation whose equity securities are owned by a small number of persons, and whose securities do not have an active trading market.

7. F. Hodge O'Neal identified the unique issues faced by the U.S. close corporation and identified the close corporation problem or dilemma. He also proposed remedies for the minority shareholder. See F. Hodge O'Neal, Close Corporations: Existing Legislation and Recommended Reform, 33 Bus. Law. 873 (1978).

8. See discussion infra Part I.
feasibility of harmonizing the laws governing close corporation shareholder disputes within the European Community. Part V recommends strategies to improve existing approaches to close corporation shareholder dispute resolution.

I. The Universal Nature of the "Close Corporation Problem"

Generally, a close corporation is a corporation whose stock is not publicly traded. The stock of the close corporation is typically owned by a small number of shareholders. The directors, officers, and shareholders may in some cases be the same individuals. In the United States, most businesses are closely-held corporations and a large percentage of these entities are family-owned. Approximately fifty percent of the U.S. population is employed by close corporations. In the industrialized countries, small and medium-sized companies comprise a major segment of business. Although close corporations are clearly an important part of the economy in the European Union, relatively little attention has focused on the special problems faced by such entities.

Shareholder disputes present one of the most difficult and potentially destructive problems which arise in the context of the close corporation. A U.S. study conducted in Chicago, Illinois revealed that shareholder dis-
sension was a major cause of business failures for the close corporation.16
Shareholder disputes are responsible for a wide variety of business
problems including loss of management time and increased
costs.17 The problem of shareholder dissension is not unique to the United States.18
Several countries within the European Community have witnessed similar
problems in connection with the European limited liability company—the
private business entity which most closely parallels the U.S. close
corporation.19

16. Bahls, supra note 13, at 287 (citing a major study by Professor John L. Ward of
Loyola University which indicated that “eighty percent of the Chicago area family-owned
corporations that were in existence in 1924 and had at least twenty employees were no
longer going concerns in 1984.”) Major reasons cited for business failure included fam-
ily problems, and competition between generations. Id.
17. Id. at 287.
18. See Deborah A. DeMott, Oppressed But Not Betrayed: A Comparative Assessment of
Canadian Remedies For Minority Shareholders and Other Corporate Constituents, 56 LAW
& CONTEMP. PROBS. 181 (1993) (including an analysis of Canadian remedies for minor-
ity shareholders); Greta M. Fung, A Common Goal From Two Different Paths: Protection of
Minority Shareholders in Delaware and Canada, 57 ALB. L. REV. 41 (1993) (comparing the
remedies for minority shareholders in Canada and the United States with a focus on the
public company). See Zipora Cohen, Fiduciary Duties of Controlling Shareholders: A
Comparative View, 12 U. PA. J. INT’L BUS. L. 379 (1991) (comparing fiduciary duties in
England, America, and Israel).
19. Most European nations draw a sharp distinction between the publicly-held cor-
poration and the closely-held limited liability company. Typically, the European limited
liability company possesses the corporate characteristics of limited liability, centralized
management, and continuity of life whereunder the entity continues even upon the
death or bankruptcy of a member. See also LEGAL ASPECTS OF DOING BUSINESS IN WEST-
ERN EUROPE 209-12 (Dennis Campbell ed., 1983). The German Gesellschaft mit
beschrankter Haftung (GmbH) provides the prototype for many limited liability com-
panies throughout the world. See Gesetz betreffend die Gesellschaften mit beschränkter
Haftung (Act on Limited Liability Companies), v.10.5.1994 (BGBl. I 2922) (F.R.G.),
translated in 1 BUSINESS TRANSACTIONS IN GERMANY App. 6 (Dennis Campbell et al., 1994).
The German GmbH bears many of the same characteristics as the U.S. close corporation.
Both the U.S. close corporation and the GmbH provide for centralized management,
although the shareholders may in some cases serve as members of the Board of Direc-
tors. Id. at Sec. 6. They possess continuity of life and do not dissolve upon death or
bankruptcy of the members. Further, they both enjoy limited liability. The typical lim-
ited liability company in the United States more closely resembles the European limited
partnership than the European limited liability company. Driven largely by tax-related
reasons, the U.S. limited liability company possesses the corporate characteristic of lim-
ited liability, but is structured to avoid other corporate characteristics such as continuity
of life, and free transferability of interests. Many U.S. LLCs also lack centralized man-
agement. The U.S. limited liability company has been deliberately structured to resem-
ble a partnership. Like partners, members of the LLC often have control of
management either because the limited liability company members choose to manage
the business themselves, or they employ managers to manage the entity. Some state
statutes vest management in proportion to capital contributions, while others defer to
the operating agreement with regard to management rights. See ARIZ. REV. STAT. ANN.
§ 29-682 (West 1995) (providing for management pursuant to the operating agreement);
CAL. CORP. CODE § 17001 (West 1996); COLO. REV. STAT. ANN. § 7-80-401 (West 1995)
(providing for management by a manager, except as otherwise provided); DEL. CODE
ANN. tit. 18, § 18-402 (West Supp. 1996) (providing for management vesting in its
members in proportion to the then current percentage or other interest in profits unless
otherwise provided in the operating agreement, and also permitting management by
managers chosen by the members in accordance with the operating agreement); FLA.
There are several key features of the limited liability company in Europe and the close corporation in the United States that create a foundation for shareholder dissension. Perhaps the most fundamental factor that gives rise to many private company problems is the absence of the influence of a market mechanism. A dissatisfied shareholder of a public corporation has a ready market where stock may be sold. Further, the marketplace provides an important incentive to maximize shareholder returns for the public entity. Further, the parties who are stockholders of the public company typically do not serve as Board members or managers. This segregation of ownership and management diminishes the opportunity for self-interested dealing on the part of management. Finally, European public corporations are subject to substantial formalities and accounting controls which provide increased scrutiny and accountabilit-

STAT. ANN. § 608.422 (West Supp. 1997) (providing for management vesting in members in proportion to their contributions to capital unless otherwise provided in the articles of organization, and also permitting management by annually elected manager); LA. REV. STAT. ANN. § 12-1312-13 (West 1996) (providing for management by members, except as otherwise provided, and also permitting management by managers); MINN. STAT. ANN. § 322B.67 (West 1995) (requiring that the limited liability company must have one or more natural persons exercising the functions of the offices however designated of chief manager and treasurer); NEV. REV. STAT. ANN. § 86.291 (Michie Supp. 1995) (vesting management in members in proportion to their contribution to capital, permitting annually elected managers); OKLA. STAT. ANN. tit. 13, §§ 2013-15 (West Supp. 1997) (permitting management by manager or member); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 2.09 (West Supp. 1997) (authorizing regulations of limited liability company to govern management and business); UTAH CODE ANN. § 48-2a-126 (1992) (providing for operating agreement for management and conduct of business); VA. CODE ANN. §§ 13.1-1023, 1024 (Michie Supp. 1996) (providing for operating agreement and management by manager or members); W. VA. CODE § 31-1A-18 (1996) (providing that unless otherwise provided, the members shall vote in proportion to their contributions, and management may be by members or by managers); WYO. STAT. ANN. §17-15-116 (Michie Supp. 1996) (providing for management by members in proportion to their contribution to capital, but also permitting management by manager). For an excellent discussion of the similarity between the GmbH and the U.S. close corporation, see Scogin, supra note 5, at 133 n.20.

The GmbH Law of 1892 provides for many of the attributes that later characterized the U.S. close corporation statutes. This aspect of German company law was widely noted in U.S. legal literature at the time those statutes were formulated. The U.S. Limited Liability Company, however, is much closer in its structure and operation to a limited partnership than is a GmbH. The German courts have stressed the distinction between the limited partnership and the GmbH in discussing dispute resolution issues.

Id. at 133 n.20, n.21.


21. See Krishnan S. Chittur, Resolving Close Corporation Conflicts: A Fresh Approach, 10 HARV. J.L. & PUB. POL’Y 129, 134-35 (1987) (indicating that the minority investors of public companies may sell their shares, but that the minority of a close corporation is left without such systemic protection).

22. Id.

23. Id. at 161-62 (emphasizing that the quasi-adversarial relationship between shareholders and management of the public corporation operates as a strong constraining factor which deters management form enriching itself at the expense of investors).

24. Id.
ity of management.  

In contrast to the stock of the public corporation, the stock of a private company has no ready market. Each owner is dependent on the other to buy out the ownership interest in the event of a dispute. Further, the controlling shareholders are likely to be the dominant members of the Board of Directors. The dual role played by dominant shareholders of the private company as both owners and Board members creates a climate which fosters self-interested conduct. The relaxed corporate structure of the private European limited liability company provides an environment in which opportunistic conduct by majority owners may flourish. The doctrine of majority rule creates the possibility for majority shareholders to make decisions which further their own interests at the expense of the minority owners. Self-interested dealing has taken many forms such as the personal appropriation of corporate assets, removal of minority shareholders from company management, refusal to pay dividends, and termination of salary and/or employment.

The problems faced by the minority shareholder of the U.S. close corporation have been addressed through both case law and remedial legislation. First, through judicial construction, partnership-like fiduciary duties have been imposed on the majority shareholder. In Meinhard v. Salmon, then Judge Cardozo stated that "[j]oint adventurers, like copart-

25. See infra Part II.
26. See In re Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984) (observing that "[t]he stock of closely held corporations generally is not readily salable, a minority shareholder at odds with management policies may be without either a voice in protecting his or her interests or any reasonable means of withdrawing his or her investment"). See also John E. Davidian, Corporate Dissolution in New York: Liberalizing the Rights of Minority Shareholders, 56 St. John's L. Rev. 24, 27 (1981). Noting that:

To the [minority]'s dismay, however, disagreement ultimately may develop and the minority shareholder may find himself removed from his directorship, office, and employment by action of the controlling faction . . . . The shares of the close corporation typically do not return a dividend. Moreover, since a minority position in a close corporation, unlike its publicly held counterpart, usually lacks marketability, the shareholder is frustrated by the realization that he cannot sell his shares.

Id.

27. Id. (noting that the minority shareholder lacks liquidity and in many cases may receive an offer from the controlling shareholder to purchase his or her shares at a price the minority believes is inequitable).

28. See infra Part II. For an interesting survey of involuntary dissolution cases, see Harry J. Haynsworth, The Effectiveness of Involuntary Dissolution Suits As A Remedy For Close Corporation Dissension, 35 Clev. St. L. Rev. 25, 50-56 (1987) (reporting a nationwide survey of involuntary dissolution cases in 1984 and 1985). Remedies for deadlock and squeeze-outs and misapplication of corporate assets were considered. Id. A buy-out was ordered in fifty-four percent of the cases reviewed. Roughly forty percent involved dissension in family-owned businesses. Id.


30. 164 N.E.2d 545 (N.Y. 1928).
ners, owe to one another . . . the duty of finest loyalty . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. In the seminal case Donahoe v. Rodd Electrotype Co., this "heightened" fiduciary duty was extended to close corporation shareholders. Second, remedial statutory and judicial remedies have evolved to protect minority shareholders from oppressive conduct by the majority.

31. Id. at 546.
32. 328 N.E.2d 505 (Mass. 1975) (noting the similarity between partners and the owners of close corporations).
33. For an early case in which majority owners are regarded as having a fiduciary duty to the minority, see Southern Pacific Co. v. Bogert, 250 U.S. 483 (1919). See also Helms v. Duckworth, 249 F.2d 482 (D.C. Cir. 1957) (comparing close corporation shareholders to joint venturers); Tillis v. United Parts, Inc., 395 So.2d 618 (Fla. App. 1981) (recognizing a majority shareholder fiduciary duty); Comolli v. Comolli, 246 S.E.2d 278 (Ga. 1978) (imposing a good faith requirement with regard to minority shareholders); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976) (involving a minority shareholder whose salary was terminated and who was voted out as an officer and director of the company); Fought v. Morris, 543 So.2d 167 (Miss. 1989) (imposing a standard of intrinsic fairness upon majority shareholders); Crosby v. Beam, 548 N.E.2d 217 (Ohio 1989) (extending a heightened fiduciary duty to close corporation shareholders). Perhaps the most noteworthy and eloquent description of the fiduciary duty that the majority shareholders owe to minority shareholders is found in Jones v. H.F. Ahamanson & Co., 1 Cal. 3rd 93, 108, 81 Cal. Reptr. 592, 599, 460 P.2d 464, 471 (1969), in which Chief Justice Traynor held:

[M]ajority shareholders, either singly or acting in concert to accomplish a joint purpose, have a fiduciary responsibility to the minority and to the corporation to use their ability to control the corporation in a fair, just and equitable manner. Majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business.

34. For an excellent discussion of the special problems encountered by the minority shareholder, see O'Neal, supra note 7, at 873 (providing an overview of the status of legislation applicable to closely-held corporations and emphasizing the need to protect shareholders who fail to expressly contract for protection). See also Frank H. Easterbrook & Daniel R. Fischel, Close Corporations and Agency Costs, 38 Stan. L. Rev. 271 (1986) (providing an overview of cost management of close corporations); Robert H. Hillman, The Dissatisfied Participant In The Solvent Business Venture: A Consideration of the Relative Permanence of Partnerships and Close Corporations, 67 Mass. L. Rev. 1, 75 (1982) (Discussing the problems encountered by the close corporation and partnership and the importance of the reasonable expectation test as a measure of oppressive conduct); John D. Davidian, Corporate Dissolution in New York: Liberalizing the Rights of Minority Shareholders, 56 St. John's L. Rev. 25 (1981) (providing an overview of the development of New York Legislation enhancing the rights of minority shareholders); Victor B. Brudene & Marvin A. Chirlstein, A Restatement of Corporate Freeze-outs, 87 Yale L.J. 1354 (1978) (providing an overview of corporate freezesouts largely from the perspective of the public corporation, including a discussion of transactions involving going private). For a discussion of the definition of "oppressive conduct" by majority shareholders, see O'Neal & Thompson, supra note 9, §§ 9.02, 9.29, 9.30. O'Neal and Thompson explain that some courts provide relief to the minority shareholder if his or her reasonable expectations have been dissapointed. Thus, if the minority shareholder reasonably expected to take an active role in corporate management, if the majority fires the minority or fails to permit the minority to maintain a position as an officer, such conduct may be characterized as oppressive. The reasonable expectation standard arguably fosters sensitivity on the part of courts to the perils faced by participants who have concentrated their financial and human resources in a close corporation which...
Such remedies include judicial corporate dissolution or other less drastic remedies. The Model Business Corporation Act provides for both voluntary and judicial dissolution. Judicial dissolution may be permitted if the directors are deadlocked in the management of corporate affairs, and irreparable injury is threatened. Judicial dissolution may also be granted if the conduct of the directors or those in control of the corporation is illegal, oppressive or fraudulent. In addition, a number of states provide liberal dissenter's rights awarding minority shareholders the fair market value of their shares.

provides no easy answer when dissension occurs. It is maintained that by focusing on the reasonable expectations of the participants, courts have a clearer, more specific standard to apply in resolving disputes.

35. See Joshua M. Henderson, Note, Buyout Remedy For Oppressed Minority Shareholders, 47 S.C. L. Rev. 195 (1995) (reviewing the remedy of judicial dissolution with particular emphasis on South Carolina law).

36. See Model Bus. Corp. Act Ann. §§ 14.01, 14.30 (1996). Section 14.30 sets forth the grounds for involuntary dissolution as follows:

The [name or describe court or courts] may dissolve a corporation:
(1) in a proceeding by the attorney general if it is established that:
   (i) the corporation obtained its articles of incorporation through fraud; or
   (ii) the corporation has continued to exceed or abuse the authority conferred upon it by law;
(2) in a proceeding by a shareholder if it is established that:
   (i) 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;
   (ii) 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;
   (iii) 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
   (iv) the corporate assets are being misapplied or wasted;
(3) in a proceeding by a creditor if it is established that:
   (i) the creditor's claim has been reduced to judgment, the execution on the judgment returned unsatisfied, and the corporation is insolvent; or
   (ii) the corporation has admitted in writing that the creditor's claim is due and owing and the corporation is insolvent; or
(4) in a proceeding by the corporation to have its voluntary dissolution continued under court supervision.

Model Bus. Corp. Act Ann. § 14.30, at 14-112 (indicating in a statutory comparison as of December 1, 1995, that all jurisdictions make provision for involuntary dissolution of corporations in defined circumstances, most commonly including the circumstances enumerated in the Model Act for deadlock, instances of abuse of corporate powers, or waste of corporate assets). All but six jurisdictions follow the Model Act pattern that any shareholder may bring an action for judicial dissolution. Id. A few jurisdictions such as Massachusetts and Nevada condition the suits upon ownership percentages. Id. Delaware, Kansas, Oklahoma, and Puerto Rico provide for a dissolution proceeding by the attorney general upon his own motion or that of a proper party. New Hampshire’s new Corporations Act excludes “oppression” as a ground for dissolution. See N.H. Rev. Stat. Ann. § 293-A:14.30(b) (1993).

38. Id. § 14.30(2)(ii).
39. Id. § 13.02 (providing that “[a] shareholder is entitled to dissent from, and obtain payment for the fair value of his shares in the event of” a variety of circumstances
Although not widely used, the Model Business Corporation Close Corporation Supplement has been developed for elective use by close corporations. The Model Statutory Close Corporation Supplement provides for dissolution at will or upon the occurrence of a specified contingency. Further, court action is authorized if the conduct of the directors or those in control is illegal, oppressive, fraudulent or unfairly prejudicial to the

including: 1) certain mergers; 2) share exchanges; 3) sale or exchange of property of the corporation other than in the usual course of business; and 4) amendments of the articles of incorporation that materially and adversely affect the shareholder's rights in specified circumstances. The statutory comparison as of December 1, 1995, following § 13.02 indicates that all jurisdictions grant dissenters' rights in many merger situations. Id. at 13-19. Forty-five states follow the Model Act pattern of making dissenters' rights available following a plan of merger requiring shareholder approval including Alabama, Alaska, Arizona, Arkansas, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, Wisconsin, and Wyoming. See id. For examples, see Del. Code Ann. tit. 8, § 262 (1992) (awarding appraisal rights in certain cases involving mergers and consolidations); see also Cal. Corp. Code § 1300 (West 1996); 15 Pa. Cons. Stat. Ann. § 1571 (a), (b) (1996) (generally providing for the payment of fair market value of shares of stock to dissenting shareholders and outlining exceptions including shareholders holding certain stock listed on the national securities exchange or held by more than 2,000 shareholders).


41. See 4 Model Bus. Corp. Act Ann., Model Close Corporation Supp. § 40 (1996). A number of states have adopted some form of statutory relief specifically tailored for the close corporation. Some states offer protection to minority shareholders not only in their capacity as shareholders, directors, or officers, but also in their capacity as employees. See, e.g., N.J. Stat. Ann. § 14A:12-7 (West 1996) (permitting appointment of a custodian, a provisional director or an order to sell the corporation stock). Dissolution is available where a corporation has 25 or fewer shareholders, where "the directors or those in control have acted fraudulently or illegally, [have] mismanaged the corporation or [have] abused their authority as officers or directors, or have acted oppressively or unfairly toward one or more minority shareholders in their capacities as shareholders, directors, officers, or employees." Id. See also 15 Pa. Cons. Stat. Ann. § 1767 (1996) (providing for the appointment of a custodian of a corporation on deadlock, or other causes including where "the directors or those in control of the corporation have acted illegally, oppressively, or fraudulently toward one or more holders or owners of 5% or more of the outstanding shares of any class of the corporation in their capacities as shareholders, directors, officers, or employees.") Under the Amended Committee Comment-1990 to the Pennsylvania provision, it is indicated that the Pennsylvania statute was modeled in part after New Jersey Law. Id. cmt. The comment notes that the extension of protection of minority shareholders in their capacity as employees departs from the Model Business Corporation Act which eliminates relief in the capacity as employee but continues relief for officers. Id. See also Del. Code Ann. tit. 8, § 352(a)(1) (1991) (providing for the appointment of a custodian for a close corporation in part if the business and affairs of the corporation are managed by the stockholders and they are so divided the business of the corporation is suffering or is threatened with irreparable injury).

The close corporation problem remains a concern in the United States despite the growing popularity of the U.S. limited liability company (LLC). Because of the high potential tax costs of corporate liquidations, many U.S. close corporations cannot afford to convert to the LLC structure. Further, although the LLC member is typically entitled to receive the fair market value for his or her interest upon withdrawal, disputes may arise regarding the nature and scope of the member's exit rights. In

43. Id. § 40. Two levels of judicial relief may be obtained if the conditions of Section 40 have been satisfied. Section 41 provides for Ordinary Relief and Section 42 provides for Extraordinary Relief. Ordinary Relief consists of a variety of remedies including:
1) The performance, prohibition, alteration, or setting aside of any action of the corporation or of its share-holders, directors, or officers or any other party to the proceeding;
2) the cancellation or alteration of any provision in the corporation's articles of incorporation or by-laws;
3) the removal from office of any director or officer;
4) the appointment of any individual as a director or officer;
5) an accounting with respect to any matter in dispute;
6) the appointment of a custodian to manage the business and affairs of the corporation;
7) the appointment of a provisional director (who has the rights, powers and duties of a duly elected director to serve for the term and under the conditions prescribed by the court);
8) the payment of dividends;
9) the award of damages to any aggrieved party.

Id. Extraordinary relief in Section 43 consists of dissolution, unless the stock of the aggrieved shareholder is purchased by the remaining shareholder or shareholders pursuant to Section 42. A statutory comparison as of December 1, 1995, reveals that a number of states have integrated close corporation statutes including Alabama, Arizona, California, Delaware, Washington, D.C., Georgia, Illinois, Kansas, Maryland, Nevada, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Wisconsin, and Wyoming.

44. See Dennis S. Karjala, Planning Problems in the Limited Liability Company, 73 WASH. U. L.Q. 455, 467 (1995) (indicating that the close corporation problem is likely to resurface in the LLC. Although under default statutes, members of the LLC may have a right to withdraw from the LLC, the withdrawal rights may be subject to limitations. Members may well disagree on the meaning and scope of withdrawal rights. As a practical matter, the dissatisfied LLC member may end up holding an illiquid investment. Id. at 468.

45. See I.R.C. §§ 336, 331 (1995) (providing a network of taxation which results in a double taxation of corporate liquidations). The corporation itself is taxed on liquidation of its assets, whether sold to the shareholder(s) or to a third party. Id. In addition, the shareholders are taxed on an individual basis when they receive a liquidating distribution. Consequently, the liquidation of a corporation can be extremely costly, exacting a tax on both individual and corporate levels. Id.

46. CALIF. CORP. CODE § 17058 (West 1996) (upon a withdrawal that does not cause a dissolution, the withdrawing member is entitled to receive amounts in accordance with the operating agreement, and if not otherwise provided, payment of the fair market value of the member's interest); DEL. CODE ANN. tit. 18, § 604 (West Supp. 1995) (providing that except as otherwise provided in the subchapter, a resigning member is entitled to receive any distribution in accordance with the operating agreement, and if not otherwise provided is entitled to receive the fair value of his interest based upon his right to share in distributions from the limited liability company); LA. REV. STAT. ANN. §§ 12:1325, 12:1327 (West 1996) (providing for payment of fair value of interest upon withdrawal, but subject to restrictions on distributions outlined in section 1327 disal-
addition, some LLCs may be established for a term of years or until the accomplishment of a specific undertaking.\footnote{See Unif. Limited Liability Company Act (1995) § 101(2), 6A U.L.A. 425, 4334 (1995).} In such event, the member may have no buy-out rights prior to the occurrence of the stated event or the passage of time.\footnote{Id. The Uniform Act creates a distinction between limited liability companies established "at will" and a "term company" in which the members have agreed to remain members until the expiration of a term specified in the articles of organization. Sec. 101(2) describes the at will entity and Sec. 101(19) establishes a term company. Section 701(a)(1) broadly provides for the limited liability company to purchase the member's interest in an at will company, but under Section 701(a) (2) the company is not obligated to purchase the member's interest in a term company until the expiration of the term specified. This can create an illiquid investment for the member of a term limited liability company member.} Clearly, like the minority shareholder in the close corporation, the minority or passive owner of the U.S. LLC bears a risk of majority misconduct.\footnote{Karjala, supra note 44, at 466 (indicating that both active and inactive participants have goals and needs which may change over the life of the business). Circumstances change, and control may shift from one generation to another. Divorce, and other personal disputes present jurisprudential problems in the private business enterprise. Id.} The informal structure of the LLC, coupled with the doctrine of majority rule provide the opportunity for the majority owner to take advantage of minority and/or passive owners.\footnote{See Chittur, supra note 21, at 171 (recommending that the majoritarian model and the business judgment rule be discarded in close corporation context).} Unfortunately, unlike the corporate statutes, most state LLC statutes do not provide for judicial dissolution in the event of oppressive or unfairly prejudicial majority conduct.\footnote{In Delaware, and in a number of other states, judicial dissolution may be granted whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement. See Del. Code Ann. tit. 6, § 18-801(1) (1993). The determination of whether it is reasonably practicable to carry on the business depends on the facts and circumstances. See, e.g., PC Tower Center, Inc. v. Tower Center Dev. Assoc. Ltd. Partnership, CIV.A No. 10788, 1989 WL 63901 (Del. Ch. June 8, 1989) (holding that it was not reasonably practicable to carry on business where the value of the partnership's property was less than the debt and liens encumbering the property and where the principal tenant was insolvent). Many states other than Delaware provide for involuntary dissolution of the limited liability company if it is no longer practicable to carry on business in conformity with the limited liability company agreement. See, e.g., Ariz. Stat. Ann. § 29-785 (West 1996); Cal. Corps. Code § 17351 (West 1996). In contrast, only a small handful of state limited liability company statutes in the United States provide for judicial dissolution when those in control act in an illegal, oppressive, fraudulent, or unfairly prejudicial manner. See Unif. Limited Liability Company Act (1995) § 801(5)(v), 6A U.L.A. 425, 482 (1995). See also Minn. Stat. Ann. § 322B.03(11) (West 1995); Idaho Code § 53-643(2) (1996); Calif. Corp. Code § 17351(2), (5) (West 1996). For an in depth discussion of the vulnerability of the minority member of the limited liability company in the U.S., see Sandra K. Miller, What Remedies Should Be Made Available To The Dissatisfied Participant In A Limited Liability Company? 44 Am. L. Rev. 465 (1994); Sandra K. Miller, What Standards of Conduct Should Apply To Members and Managers of Limited Liability Companies?, 68 St. John's L. Rev. 21 (1994). See also Karjala, supra note 44, at 455. It should be noted that most limited liability companies in the United States permit the assignment of a membership interest in the company.}
As with most state corporate laws in the United States, the company laws of Germany, the UK, and France reveal both statutory and judicial efforts to address shareholder dissension in the private limited liability company. Even though Germany is a civil law country, a substantial body of law has evolved over the past seventy years to address private company shareholder disputes. The UK company law gives the judiciary substantial discretion to develop equitable remedies to redress private shareholder grievances. The French statute offers the option of judicially-ordered dissolution. In spite of the significance of the close corporation problem in these European countries, the European Community has made no attempt to provide a unified remedy. At present, there appears to be considerable diversity in the way individual countries address the problems of shareholder dissension and overreaching by the majority shareholders. The remedial measures that have been taken rest largely on judicial discretion which creates an undesirable degree of uncertainty in the law.

interest but the assignee is unable to participate in management rights without the consent of the other members. See COLO. REV. STAT. ANN. § 7-80-702 (West 1995) (providing the membership interest is personal property and is assignable or transferrable, however the assignee has no right to participate in the business affairs of the limited liability company or to become a member unless unanimous consent is obtained from the other members); DEL. CODE ANN. tit. 18, § 18-702 (Supp. 1995) (providing in part that an assignee has no right to participate in management of the business and affairs of a limited liability company except as provided in the limited liability company agreement and the approval of all members is obtained or there is compliance with any procedure in the limited liability company agreement); FLA. STAT. ANN. § 608.432 (West Supp. 1995) (providing that an interest in a limited liability company may be transferred or assigned as provided in the operating agreement). However, if the other members do not approve of the transfer by unanimous written consent, the transferee of the interest has no right to participate in management of the business and affairs of the company or to become a member. The transferee is entitled only to receive the share of profits or other compensation. Id. For similar provisions, see KAN. STAT. ANN. § 17-17618 (1995) (limiting assignee's right to participate in management); LA. REV. SAT. ANN. § 1332 (West 1996) (except if otherwise required in the operating agreement an assignee does not become a member or participate in management absent unanimous written consent of other members); Md. CODE ANN., CORPS & ASS'NS §§ 4A-603, 604 (Supp. 1995) (preventing the assignee from participating in management absent agreement to the contrary); Minn. Stat. Ann. § 322B.313 Subd. 2 (West 1995) (requiring unanimous consent of members before assignee may obtain management rights); Nev. Rev. Stat. Ann. § 86.351 (Michie 1995) (preventing the transferee from becoming a member absent unanimous consent of other members); Okla. Stat. Ann. § 2035 (West 1995) (providing that an assignee may become a member as provided in the operating agreement, and absent such provision may become a member only by written instrument dated and signed by the member, or evidenced by a vote taken at a meeting); Wyo. Stat. § 17-15-122 (Michie 1989 & Supp. 1996) (requiring unanimous consent for assignee of management rights).

52. See infra Part II.
54. Id.
55. See infra note 148.
II. The Corporate Structure and the Close Corporation Problem: A Comparative Analysis of German, UK, and French Law

A close look at the corporate structures under German, French, and UK law reveals significant differences in corporate organization. Germany and France tend to have the most formalistic corporate structures while the UK has the least restrictive organizational form. In all countries considered, the public corporation is subject to considerable formalities. The private limited liability companies enjoy a considerable degree of informality in the way in which business may be conducted.

With regard to standards of conduct for shareholders, German law is the most exacting of all three countries. All three countries have developed equitable remedies to resolve shareholder disputes (i.e., shareholder buyouts, corporate dissolutions). Under German law, a shareholder may withdraw himself, or may seek an expulsion of a fellow shareholder upon a showing of "substantial causes."57 The substantial causes pertain largely to the personal characteristics of the shareholder and focus on the personal relationship between the parties.58 In contrast, equitable remedies under UK law do not focus on the personal characteristics of the shareholder, but rather on the conduct of the shareholder in the course of managing the business.59 UK law broadly provides for equitable remedies where the shareholder’s conduct of the company’s affairs has been “unfairly prejudicial” to the other members.60 France has also enacted remedies for the shareholder of the private company. French law provides for anticipatory dissolution of a company for “valid reasons” including nonperformance of one’s obligations or discord among members.61

A. The German Corporation: A Two-Tiered Structure for Public Companies

The German legal system may be described as a civil law system governed primarily by statute.62 The laws governing business entities are found in specific statutes.63 The German equivalent of the publicly-held US corporation is known as the public limited company (Aktiengesellschaft or AG).

56. See infra notes 89, 108-10.
57. See infra note 78.
58. See infra notes 80-81.
59. See infra notes 125-29.
60. See infra notes 130-31.
61. See infra note 148.
62. The Civil Law system is derived from Roman law after the Roman pattern ius civile and like all European continental law rests on codified statutory law. As in other Civil law systems, technically case law in Germany is not legally binding. For an excellent description of the German legal system, see 1 BUSINESS TRANSACTIONS IN GERMANY, supra note 19, §§ 4.03(2), 4.06(1) (Dennis Campbell et al. eds., 1994). The major legal codes of the Federal Republic of Germany consist of the Civil Code (Bürgerliches Gesetzbuch/BGB), the Commercial Code (Handelsgesetzbuch/HGB) and the Criminal Code (Strafgesetzbuch/StGB). A variety of additional specialized statutes also exist. It has been observed that German case law has assumed an important and independent role. See id. § 4.06(1).
63. Id. § 4.03(2).
The AG has a two-tiered management system consisting of a Supervisory Board (Aufsichtsrat) and a Board of Directors (Vorstand).  

The affairs of the AG are subject to considerable formality and regulation. The minimum capital requirements of the AG are relatively high. The accounts of the AG must be audited by a certified public accountant. In light of the highly regulated nature of the AG there are only approximately 3,000 in existence in Germany.

The role of the Supervisory Board is to oversee the management board, which is responsible for the corporation's daily affairs. The primary function of the Supervisory Board is to review management's performance. German Supervisory Boards receive periodic reports from management, annual reports and balance sheets. The Supervisory Board can compel reports and has the authority to require that the Board of Directors obtain the Supervisory Board's approval before entering into specific transactions.

B. The Flexible Privately-Owned German Limited Liability Company

The entity of choice for most privately-owned businesses in Germany is the limited liability company (Gesellschaft mit beschrankter Haftung or GmbH). Unlike the AG, the GmbH has a comparatively flexible management structure. The GmbH must have one or more managing directors but generally need not create a Supervisory Board unless it is a large employer or is engaged in specialized industries. If a Supervisory Board

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64. For a thorough discussion of the public German corporation, see Hwa-Jin Kim, Markets, Financial Institutions, and Corporate Governance: Perspectives From Germany, 26 Law & Pol'y Int'l Bus. 371 (1995) (providing a review of the German corporation with particular emphasis on the impact which banks have on corporate governance in Germany).

65. The incorporation of the AG requires a minimum capital of DM 100,000. Of a total of DM 100,000, DM 25,000 must be paid by five founding members who subscribe to the share capital. See Thomas Stohlmeier, German Limited Liability Company—Unlimited Liability of Parent Company?, 21 Int'l Bus. Lw 135 (1993) (describing the German corporate structure generally, and focusing specifically on the liability of a parent company for the debts of a subsidiary).

66. Id.

67. Id. at 136.


69. Id. (indicating that approximately 500,000 GmbHs are registered throughout Germany).


71. See Gesetz betreffend die Gesellschaften mit beschränkter Haftung (Act on Limited Liability Companies), § 6(1), v.10.5.1994 (BGBl. I 2911), translated in 4 Business Transactions in Germany App. 6 (providing that the company shall have one or more managing directors). See also id. § 52 (providing for specific contingencies in the event that a Supervisory Board is appointed pursuant to the articles of association). It should be noted that there are some circumstances in which the appointment of a Supervisory Board is mandatory. If certain Co-Determination Acts apply, then a Supervisory Board is required. The Co-Determination Acts require that there be employee participation at the
is created the Supervisory Board supervises the managing directors but does not itself engage in management activities.\textsuperscript{72} Ultimate authority resides in the shareholders.\textsuperscript{73}

The capitalization requirements for the \textit{GmbH} are significantly less onerous than those applicable to the \textit{AG}. The \textit{GmbH} must be capitalized with at least 50,000 DM and the share capital contribution of each shareholder must be at least 500 DM.\textsuperscript{74}

The \textit{GmbH} most nearly approximates the U.S. close corporation rather than the LLC which has recently been authorized by virtually all states in the United States.\textsuperscript{75} In the United States, for tax purposes, most LLCs have

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\textsuperscript{72} See Gesetz betreffend die Gesellschaften mit beschränkter Haftung (Act on Limited Liability Companies), § 5(1), v. 10.5.1994 (BGBl. I 12922) (F.R.G.), translated in \textbf{BUSINESS TRANSACTIONS IN GERMANY}, supra note 19, ¶ 23.05(1).

\textsuperscript{73} Id.

\textsuperscript{74} Id.

\textsuperscript{75} Id.
been designed to lack technically the corporate characteristic of a perpetual life, referred to in IRS Treasury regulations as continuity of life. In contrast, the GmbH usually has a perpetual life unless the articles provide to the contrary.

C. The German Close Corporation Problem

German law provides highly discretionary judicial remedies when the shareholder has a dispute with other GmbH shareholders. To some extent the judicial remedies function as a source of additional regulation of shareholder conduct. Section 61 of the GmbH law provides that: (1) The company may be dissolved by a court decision in which case it becomes impossible to accomplish the purpose of the company or when there are substantial causes (wichtige Grund) for the dissolution resulting from the conditions of the company.

Because the dissolution remedy is so severe, the German courts have developed two additional remedies, the withdrawal (Austritt) and the expulsion (Ausschließung). Under the withdrawal concept, the aggrieved shareholder seeks to withdraw from the company and is entitled to obtain the fair market value of his or her interest in the company. In an expulsion, the aggrieved shareholder seeks to expel the other shareholder or shareholders. The right to obtain either a withdrawal or an expulsion is premised on a showing that there is a "substantial basis" or "wichtige Grund" for the remedy.

76. In order to obtain desired taxation as a partnership, U.S. LLCs have had to avoid possessing more corporate than non corporate characteristics. See I.R.C. § 7701 (1997). The four corporate characteristics are outlined in Treas. Reg. §§ 301.7701-2(b) (1) to 301.7701-2(c): 1) continuity of life; 2) centralized management; 3) limited liability; and 4) free transferability of interests. In I.R.S. Notice 95-14, 1995-14 IRB 7, the IRS announced its intention to jettison the existing rules for distinguishing corporations from partnerships. In proposed Regulations 301.7701-1, to .7701-3, the IRS gives the taxpayer an unfettered choice of electing taxable status as a partnership or a corporation, irrespective of the business entity's tax attributes. (Published in the Federal Register on May 13, 1996.)

77. 1 BUSINESS TRANSACTIONS IN GERMANY, supra note 19, § 23.09(1).

78. See Gesetz betreffend die Gesellschaften mit beschränkter Haftung (Act on Limited Liability Companies) § 61(1), v.10.5.1995 (BGBl. 1 2911), translated in BUSINESS TRANSACTIONS IN GERMANY, supra note 19, app. 6.

79. It has been observed that the leading post-war German decision on the dissolution remedy emphasizes that dissolution leads to a loss of business and a loss of jobs. Hence, over a seventy year period Courts have developed the withdrawal and expulsion remedies as an alternative to the action for dissolution. See Scogin, supra note 5, at 132-33, 152 n.101 citing BGHZ 9, 157. For an excellent explanation of the withdrawal and exclusion, see 1 BUSINESS TRANSACTIONS IN GERMANY §§ 23.09(1), 23.09(3) n.7 (pointing out that the leading cases on these remedies are Supreme Court of the German Reich, decision of August 13, 1942, RGZ 169, 330; Federal Court of Justice, decisions of April 1, 1953, BGHZ 9, 157; February 5, 1955, BGHZ 16, 317; and February 23, 1981, NJW 1981, 2302 (F.R.G.).

80. Scogin, supra note 5, at 127, 154-60.
There are three possible grounds for establishing a "substantial basis" for a withdrawal: 1) objectionable personal characteristics of the shareholder; 2) the arbitrary exercise of management by the shareholder; and 3) the existence of special factors unique to the facts and circumstances. Personal circumstances of the withdrawing shareholder which may serve as a substantial basis include extreme financial need, a lengthy and expensive illness, relocation abroad, or the inability to perform the requisite duties. An analysis of the shareholder's misconduct is made if it is alleged that the shareholder exercises majority power in an arbitrary fashion. Special factors can operate as a substantial basis where the shareholder's financial return is undesirable, or where the company's purposes change and pose additional risks to the shareholder. The articles of incorporation may not restrict or eliminate the right to withdraw.

If an expulsion is sought, the party seeking to expel another shareholder may do so based on personal factors relating to the shareholder or based on the shareholder's conduct. Advanced age, extended illness, or mental derangement may be cited as personal factors which justify an expulsion. A variety of shareholder conduct can also justify an expulsion. The aggrieved party may argue that the shareholder has disorganized financial circumstances, lacks trustworthiness or creditworthiness, or has lost personal qualifications required by the articles. An expulsion can be sought if the shareholder has been derelict in his duties, breaches trust, causes incurable dissension, or makes improper sexual advances. The mechanism for expulsion is through a court order.

The remedies of withdrawal and expulsion illustrate the importance of case law in Germany. It is frequently said that common law systems rely on case law precedents and civil law systems do not. Yet, the German close corporation remedies are based on case law rather than statute. The broad scope of the definition of a "substantial basis" justifying a withdrawal or expulsion gives rise to considerable uncertainty in shareholder relations and operates as an added dimension of the regulation of shareholder conduct. The GmbH shareholder must not only monitor his or her conduct, but must also make sure that personal circumstances do not develop which arguably could be regarded as grounds for withdrawal or expulsion. The GmbH shareholder who also functions as a member of the Board of Directors bears an even greater burden because the Director must comply with a separate set of stringent standards of conduct applicable to Board Members.

81. Id.
82. Id.
83. Id.
84. Id.
85. Id.
86. Id.
87. Id.
88. Scogin, supra note 5, at 133-34.
89. The standards of conduct of the Directors of the GmbH are quite strict and are virtually identical to those applicable to the AG. The managing directors of the GmbH
The character of the shareholder, his or her personal circumstances and personal relationships are scrutinized by a court which is entertaining a petition for an expulsion or withdrawal. The inquiry is not confined to the shareholder's conduct in managing the business. For example, in a 1953 German GmbH decision involving a dispute between two owners of a cabaret-dance bar, the defendant's extramarital affairs were relevant to a determination of whether he should be expelled from the corporation. The plaintiff sought to expel the defendant because the defendant failed to credit the company with certain funds, and purchased a car without consulting the plaintiff. In addition, the defendant had been found guilty of adultery. In determining whether the remedy should be given, the court evaluated the character of both parties and the defendant's adultery became relevant to the evaluation of his character. The defendant argued that he should be permitted to continue in the business. He maintained that his own behavior was neutralized by the behavior of the plaintiff, because the plaintiff had also committed adultery. The court ultimately concluded that the plaintiff was entitled to an expulsion.

The sweeping scope of judicial discretion, and its potential for bending to serve political and/or governmental policies is illustrated by the application of the withdrawal and expulsion remedies during the reign of the Third Reich. During this period, Jewishness constituted a "substantial basis" for expulsion. The leading case was decided in 1942. In 1937, the Jewish plaintiff was expelled by the defendants and sued to obtain a determination that his expulsion was null and void. The defendants had taken the position that the plaintiff's Jewishness was an economic disadvantage and was grounds for expulsion. Although the plaintiff won in the trial court, upon appeal the expulsion of the plaintiff was upheld. The court reasoned that the GmbH must have the opportunity to eliminate a partner if the character of the partner becomes intolerable. The court of
appeal concluded that the plaintiff's affiliation with the Jewish race was intolerable.93

After World War II when the political climate changed, the decision holding Jewishness as a "substantial basis" was condemned and the expulsion remedy became controversial.94 However, in 1953 the Court upheld the expulsion remedy.95 Although Jewishness is no longer grounds for expulsion, the courts continue to award expulsions based on the rationale that a shareholder should not be trapped in an unbearable commercial relationship.

The close corporation remedies under German law are clearly broader than those found in most states in the United States. In contrast to the German remedies of withdrawal and expulsion, equitable remedies under U.S. law are typically, although not exclusively geared to alleviating the problems of the minority shareholder.96 U.S. remedies focus rather narrowly on the shareholder's conduct in the business, rather than on the shareholder's overall character. Finally, while U.S. partnership law provides a mechanism for the expulsion of a partner,97 shareholder expulsion has not been adopted as a remedy in the U.S. corporate context.

D. The Public and Private Company Under UK Law

The corporate organizational forms in the United Kingdom differ significantly from their German counterpart.98 The most widely used corporate form for commercial enterprise in the UK is the Registered Company. The three types of Registered Company include: 1) the company "limited by shares"; 2) the company "limited by Guarantee"; and 3) the "unlimited company."99 The company which is "limited by shares" may be publicly or

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93. Id.
94. Scogin, supra note 5, at 142.
97. See UNIF. PARTNERSHIP ACT (1994) § 601, 6 U.L.A. 72 (1994) (providing in part that a partner is dissociated from a firm upon the partner's expulsion by unanimous vote of the other partners in a number of circumstances).
98. See DOING BUSINESS IN THE UNITED KINGDOM 18.01-.05 (1996).
99. The Companies Act, 1985, ch. 1, § 1(2), provides that:
A company so formed may be either-
  a) a company having the liability of its members limited by the memorandum to the amount, if any unpaid on the shares respectively held by them ("a company limited by shares");
privately owned. The liability of its shareholders is limited to the shareholders' capital contributions. In contrast, the company "limited by guarantee" is used typically for charitable or non-profit-making purposes. The liability of shareholders in a "limited by guarantee" company is specified in the company's memorandum. The memorandum obligates the shareholders to pay a specific amount upon the winding up of the company. Finally, the shareholders of the unlimited company have personal liability. In practice there are few such companies because of the significant potential exposure to legal liability.

Private companies in the UK may be operated with less formality and expense than public companies. A public company may not conduct business unless the registrar of companies has issued an appropriate certificate. Public companies must be capitalized with a minimum of 50,000 pounds while private companies are subject to no minimum capital

b) a company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up ("a company limited by guarantee"); or

c) a company not having any limit on the liability of its members ("an unlimited company").

Section 3(1) further provides in part:

(1) Subject to the provisions of sections 1 and 2, the form of the memorandum of association of-

a) a public company, being a company limited by shares,
b) a public company, being a company limited by guarantee and having a share capital,
c) a private company limited by shares,
d) a private company limited by guarantee and not having a share capital,
e) a private company limited by guarantee and having a share capital, and
f) an unlimited company having a share capital, shall be specified respectively for such companies by regulations made by the Secretary of State, or as near to that form as circumstances admit.

Id.

b) a company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up ("a company limited by guarantee"); or

c) a company not having any limit on the liability of its members ("an unlimited company").

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a) a public company, being a company limited by shares,
b) a public company, being a company limited by guarantee and having a share capital,
c) a private company limited by shares,
d) a private company limited by guarantee and not having a share capital,
e) a private company limited by guarantee and having a share capital, and
f) an unlimited company having a share capital, shall be specified respectively for such companies by regulations made by the Secretary of State, or as near to that form as circumstances admit.

Id.

100. Id. ch. 1, § 1(3). Section 1(3) defines a public company as:

[A] company limited by shares or limited by guarantee and having a share capital, being a company-

a) the memorandum of which states that it is to be a public company, and
b) in relation to which the provision of this Act or the former Companies Acts as to the registration or registration of a company as a public company have been complied with on or after December 22, 1980;

and a "private company" is a company that is not a public company.

Id.

101. Id. § 1(2)(b).

102. DOING BUSINESS IN THE UNITED KINGDOM, supra note 98, § 18.02 (providing an excellent commentary on the different types of companies in the UK).

103. Id.


105. Companies Act, 1985, ch. I, § 117(1) (requiring public companies to obtain certificate prior to conducting business). See also Durham, supra note 93, at 553 n.19.
Public companies must have at least two directors whereas private companies may have only one director. Further, although all companies must have an auditor, private companies are subject to fewer accounting requirements and are not required to file interim financial reports.

Unlike the German AG, or the French société anonyme (SA), public and private UK companies have a single-tier management structure. The UK company is managed by a Board of Directors and does not possess a Supervisory Board. Generally, public companies must have at least two directors and private companies must have one director. All companies must also have a Secretary and Auditors.

E. The UK Close Corporation Problem

Because the shareholder of a private UK company may not freely transfer his or her corporate interest, the shareholder of a private company is vulnerable in the event of a dispute with other shareholders. The minority shareholder is particularly at risk where there is misconduct by the majority owner. Disagreements among shareholders can bring corporate operations to a grinding halt.

Historically, the shareholder of a company has been prevented from obtaining court involvement in company affairs by the doctrine of Foss v. Harbottle. This 1843 decision states that in the case of a wrong done to the company, the company is the proper plaintiff, and where a wrong could be ratified by a majority of shareholders, no individual member could bring an action. However, a major statutory exception to the rule of Foss v. Harbottle was enacted in The Companies Act of 1948.

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107. Id. ch. II, § 282 (providing that "[e]very company registered on or after 1st November 1929 (other than a private company) shall have at least two directors [and] [e]very private company shall have at least one director"). Companies registered before November 1, 1929 (other than private companies) are required to have only one director. Id.
108. Id. ch. II, § 272, sets forth the statutory requirements with regard to interim accounts for public companies. Section 384 imposes the duty to have an auditor on all companies. Id. ch. V, §§ 3, 4.
109. Id. ch. II, § 282.
110. Id. ch. II, § 283(1). See also id. ch. V, § 384 (providing in part that every company shall appoint an auditor or auditors). See also DOING BUSINESS IN THE UNITED KINGDOM, supra note 98, § 18.03 (indicating that every registered company must have directors, a secretary, and an auditor, all of whom have statutory duties).
112. A.J. Boyle, Directors Fiduciary Duties: The Continuing Problem of Effective Enforcement, FORUM INTERNATIONALE (Oct. 1986) (providing that the rule in Foss v. Harbottle does not extend to a case where the act complained of is either illegal or ultra vires, or is a fraud upon the minority, and where there is unfair and oppressive conduct against the minority).
113. ROBERT R. PENNINGTON, DIRECTORS' PERSONAL LIABILITY 228 (1987) (observing that the Companies Act of 1948 provided a remedy for oppressive conduct on the part of majority shareholders. Previously the court had power to order a winding up of the company as a remedy to minority owners based on earlier Companies Acts dating back
the 1948 Act, the minority shareholder could petition the court for an equitable remedy if it could be established that the affairs of the company were being conducted in an "oppressive" manner. The court was empowered to fashion its own remedy with a view to bringing the objectionable conduct to an end.

Under the 1948 law, the ordinary dictionary definition of oppressive conduct was employed and required proof of the occurrence of "burdensome, harsh and wrongful conduct." In the seminal case *Scottish Co-operative Society Ltd. v. Meyer* oppression was regarded as taking various forms and consisted of conduct indicating a lack of probity and fair dealing in the affairs of the company. Thus, the English approach to providing remedies to shareholders of the close corporation differs fundamentally from its German counterpart. Under German law, expulsion or withdrawal from a private company could be obtained where the *individual characteristics* of a fellow shareholder provided substantial causes, whereas under UK law, an equitable remedy may be provided if it can be shown that *conduct of the company's affairs* has been improper. The German law focuses on the shareholders' personal relationship, whereas the UK law focuses on conduct of the business.

Although the 1948 remedy was intended as a remedial measure for minority shareholders, it was applied in a highly restrictive manner. In the history of the statute only two petitioners were ever granted the remedy. In 1962 the Jenkins Committee reviewed the law and recommended that the provision be revised to become more accessible.

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114. *Id.*

115. *Id.* See also *Re Saul D. Harrison & Sons* [1995] 1 BCLC 14, 18 (C.A. Eng.) (observing that "[e]nabling the court in an appropriate case to outflank the rule in *Foss v. Harbottle* was one of the purposes of the section").


117. [1958] 3 All E.R. 66 (involving a suit by the minority against the majority who had adopted a policy of starving the company of supplies of rayon cloth for its manufacturing process).

118. *Id.*

119. *See Re Harmer* 1 W.L.R. 62 (C.A. 1959) (Eng.) (involving a father who ran the affairs of the company in a dictatorial manner in disregard of his sons' wishes); *Scottish Co-op. Wholesale Soc. Ltd.*, 3 All E.R. at 66 (involving a company whose business was diverted to another company). See also Instone, *supra* note 104, at 973 (pointing out that unfair removal from the board of directors did not constitute a ground for relief under the 1948 Companies Act, citing Elder v. Elder & Watson Ltd., (1952) SC 49, because only a member of the company (not a director) could obtain the remedy).

A new provision was inserted into the 1980 Companies Act to provide assistance to the minority shareholder. The new formulation, now found in Section 459 of the Companies Act 1985 provides:

A member of a company may apply to the court by petition for an order under this Part on the ground that the company’s affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.\(^{121}\)

Section 461(1) provides the court with wide discretion to award a remedy.\(^{122}\) If the court is satisfied that a petition is justified the court may fashion a remedy in any number of ways including, but not limited to: 1) issuing an order regulating the conduct of the company’s affairs in the future; 2) requiring the company to refrain from certain conduct; 3) ordering civil proceedings; and 4) ordering one or more members to purchase the shares of other members.\(^{123}\)

The intent of the change was to provide a more comprehensive remedy to minority shareholders and to broaden the circumstances under which relief would be granted.\(^{124}\) The revised provisions have now opened up a floodgate of litigation and the new rules have been widely criticized for producing lengthy and costly litigation.

Unfairly prejudicial conduct has been asserted in a wide variety of circumstances. Unfairly prejudicial conduct has been alleged where: 1) one member prevents another from participating in the management of the company;\(^{125}\) 2) one member has seriously mismanaged a business;\(^{126}\) 3) a member improperly uses corporate assets;\(^{127}\) 4) one member misappropri-
ates sums of the company’s money; and 5) a member diverts substantial profits from the company to himself.

The judicial construction of the definition of unfairly prejudicial conduct has been purposely vague. As noted in *Burr v. Harrison*:

'Unfairly prejudicial' is deliberately imprecise language which was chosen by Parliament because its earlier attempt in s 210 of the Companies Act 1948 to provide a similar remedy had been too restrictively construed... In deciding what is fair or unfair for the purposes of s 459, it is important to have in mind that fairness is being used in the context of a commercial relationship.

Recently in the UK, as in the United States, the British courts have looked to the legitimate expectations of the shareholder to define unfairly prejudicial conduct. Under the legitimate expectations analysis, the court may look beyond the intentions of the parties as reflected in the articles of incorporation. The court will attempt to discern the fundamental understanding of the parties as to the nature of their relationship and the conduct of the business. Thus, the court may conclude that part of

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128. Adam Wilson Young and Others v. Falkirk Football and Athletic Club Ltd. Outer House Cases (involving allegations of improper personal expenditures, incompetent management causing loss of goodwill, and misappropriation of funds).

129. Lowe v. Fahey and others [1996] 1 BCLC 262 ((Ch. Eng.) (alleging that substantial profits from two development projects were diverted from the company). See also *In Re London School of Electronics Ltd. [1986] 1 Ch 211, [1985] 3 WLR 474, [1985] BCLC 273, [1983-85] BCC, 394 (Ch. Eng.) (involving a diversion of the company’s students from the company’s program to a different program).


131. *Id.*

132. *Re Postgate & Derby (Agencies) Ltd. [1987] BCLC 8, [1986] BCC 99, 353 (Ch. Eng.)* in which the court reviewed a management buy-out which was in which the directors had an interest. In articulating the legal standard required under Section 459 of the Companies Act 1985 the court explained: "The concept of unfair prejudice which forms the basis of the jurisdiction under s 459 enables the court to take into account not only the rights of members under the company’s constitution, but also their legitimate expectations arising from the agreements or understandings of the members inter se." *Id.*

133. See O’NEAL & THOMPSON, supra note 9, § 9.30 (discussing the analysis of the minority’s reasonable expectations to determine whether the majority has acted in an oppressive or unfairly prejudicial manner).

134. See Exadaktilos v. Cinnaminson Realty Co. 400 A.2d 554, 561-62 (N.J. Super. 1979), aff’d, 414 A.2d 994 (N.J. 1980) (employing an analysis of the plaintiff’s reasonable expectations and concluding that the plaintiff’s reasonable expectations were not defeated in light of the fact that the plaintiff had not gotten along with others, had not learned the restaurant business, and had quit on more than one occasion). See also *In re Kemp & Beatley, Inc., 473 N.E.2d 1173 (N.Y. 1984)* (involving two minority shareholders of a table linen manufacturer who sought judicial dissolution on the grounds that the conduct of the majority was fraudulent and oppressive). The petitioners argued that they had been frozen out of the company. *Id.* at 1176. The court emphasizes that the defeat of the complaining member’s reasonable expectations constitutes shareholder oppression. *Id.* at 1178, 1180. The court adopts a case-buy-case approach. Several cases decided after *Kemp* have employed the reasonable expectation standard. See *In re Wiedy’s Furniture Clearance Ctr. Co., 487 N.Y.S.2d 901, 903 (N.Y. App. Div. 1985)* (indicating that mere disappointment in the results of a venture is not sufficient to justify dissolution); *In re Matter of Blake, 486 N.Y.2d 341 (N.Y. App. Div. 1985)* (involving a dispute regarding the valuation of stock); *In re Dubonnet Scarfs, Inc., 484 N.Y.S.2d*
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541, 544 (N.Y. App. Div. 1985) (invoking a shareholder whose financial difficulties could not justify his demand to be bought out); Gunzberg v. Art Lloyd Metal Prod. Corp., 492 N.Y.S.2d 83, 85-86 (N.Y. App. Div. 1985) (indicating that a shareholder who has a long history of being active in the business has reasonable expectations of continued employment and input into management, and even if there were sound business reasons for some of the corporation's actions the ultimate beneficiary was the majority); In re Mintz (Astoria Holding Corp.), 493 N.Y.S.2d 488, 492 (N.Y. App. Div. 1985) (noting that a determination of oppressive conduct can only be based on a determination of the full development of the facts and opportunity for discovery); In re Levitt, 492 N.Y.S.2d 736, 741 (N.Y. App. Div. 1985) (noting that an inactive shareholder's interest in receiving the fair market value of shares and any other result could enable the shareholder to use dissolution as a coercive tool); Landorf v. Glottstein, 500 N.Y.S.2d 494, 497 (N.Y. Sup. Ct. 1986) (observing that a minority shareholder's basic interest in the business is in active control of the business rather than passive investment in an enterprise conducted by others). See also Balvik v. Sylvester, 411 N.W.2d 383 (N.D. 1987) (invoking a suit for dissolution by minority shareholder who was fired from his position); Petraglia v. Whirlwind Music Distrib., Inc., 511 N.Y.S.2d 718 (N.Y. App. Div. 1987) (alleging that the majority diverted business from the corporation and refused to pay dividends and consequently pleading facts constituting oppressive conduct); In re Imperatore, 512 N.Y.S.2d 904, 905 (N.Y. App. Div. 1987) (indicating that the shareholder who purchased a minority interest with the understanding he would be a salaried employee could reasonably expect employment to continue as long as the corporation continues); In re Farega Realty Corp., 517 N.Y.S.2d 610, 611 (N.Y. App. Div. 1987) (indicating inactivity in maintaining records, failure to regularly consult petitioner and denial of access to records was not oppressive against a minority shareholder who was a passive investor); In re Brach, 522 N.Y.S.2d 612, 613 (N.Y. App. Div. 1987) (invoking situation where petitioner merely made allegations of dissatisfaction with management which would not support a finding of oppressive conduct); In re Musilli, 523 N.Y.S.2d 120, 123 (N.Y. App. Div. 1987) (invoking inactive minority shareholder whose legitimate goal should be in securing the fair market value of the interest); Burack v. I. Burack, Inc., 524 N.Y.S.2d 457, 460 (N.Y. App. Div. 1988) (indicating the doctrine of unclean hands is not an automatic bar to recovery but shareholder's acts made in bad faith and undertaken with a view toward involuntary dissolution will bar dissolution); In re Mitchell, 529 N.Y.S.2d 589 (N.Y. App. Div. 1988) (indicating a suit for dissolution should proceed to trial and not to a private referee); In re Pace Photographers, Ltd., 530 N.Y.S.2d 67 (N.Y. 1988) (holding that a shareholder's agreement providing for the sale of stock was not relevant in an action for dissolution of the corporation by a minority shareholder); In re Smith, 546 N.Y.S.2d 382, 384 (N.Y. App. Div. 1989) (indicating that after acquiescence in majority's exercise of control of day-to-day operation disappointment in not being voted onto board of directors should not be equated with oppression, nor should failure to pay dividends in the absence of a policy to pay dividends); In re Schlacter, 546 N.Y.S.2d 891, 892 (N.Y. App. Div. 1989) (indicating that spouse of terminated employee at will could not reasonably expect ancillary benefits of spouse's continued employment); Pedro v. Pedro, 463 N.W.2d 285 (Minn. App. 1990) (plaintiff was awarded compensation for lost wages which he reasonably expected to earn as an employee and stockholder of the company); In re Alleman, 574 N.Y.S.2d 216 (N.Y. App. Div. 1991) (involving a minority shareholder claim for oppression arising out of a proposed merger); In re Century 21 Metalios Rental Real Estate, Inc., 587 N.Y.S.2d 215 (N.Y. App. Div. 1992) (holding that because of a shareholder's agreement the minority shareholder may be entitled to a remedy other than dissolution); Gee v. Blue Stone Heights Hunting Club, Inc., 604 A.2d 1141 (Pa. Cmwlth. Ct. 1992) (indicating that oppressive actions refer to conduct that substantially defeats the reasonable expectations of the shareholder); Michaud v. Morris, 603 So.2d 886 (Ala. 1992) (defeated legitimate expectations alone do not always show there has been oppressive conduct); In re Application by Bon Neuve Realty Corp., 601 N.Y.S.2d 491 (N.Y. App. Div. 1993) (alleging that the minority was denied participation in the company); Smith v. Leonard, 876 S.W.2d 266 (Ark. 1994) (alleging breach of fiduciary duty and violation of minority shareholders' expectations where one of the shareholders obtained majority control of
the unwritten, but fundamental understanding between the parties is that they will both participate in management, receive dividends, or conduct business in a certain manner. Violations of this fundamental understanding may be regarded as unfairly prejudicial conduct.

While the law was revised with the best of intentions to provide aggrieved shareholders with fair access to a remedy, the new provision has lead to an overwhelming amount of lengthy and costly litigation. The definition of "unfairly prejudicial" must be decided on a case by case basis and has created a considerable degree of uncertainty involving the resolution of shareholder disputes. The UK Law Commission is currently studying the provision and is expected to develop recommendations for improvement in the law.

F. The Public and Private Company Under French Law

The two primary business entities in France are the public corporation or société anonyme (SA) and the private corporation or the société à responsabilité limitée (SARL). The SA is subject to a wide variety of formal rules regarding governance, while the SARL is operated with fewer formalities and is the entity of choice for the small or medium-sized business.

Overall, the French public corporate scheme more closely resembles the law governing public corporations in Germany than in the UK. Indeed, the French and German structures have similar approaches to employee participation in management and in standards of conduct of directors. However, under the French scheme, the founders of the company may choose between a one-tier or two-tier management structure.

Under the one-tiered approach, the management consists of the Board of Directors or conseil d'administration and the principal officer or president.

the corporation by acquiring another shareholder's stock in the company. The additional stock was acquired from a shareholder who had embezzled funds belonging to the corporation. The minority maintained that they were not informed of the plan to recover embezzled funds; in re O'Neill, 626 N.Y.S.2d 813 (N.Y. App. Div. 1995) (involving a minority shareholder who had been frozen out of the corporation after having been convicted of conspiring to import controlled substances); Bauer v. Bauer, No. A/67179, 1996 Cal. App. LEXIS 58 (1996) (holding that the term "persistent unfairness" as used in the California statute to justify judicial dissolution is not defined by the "reasonable expectations" of the minority shareholder).


137. See Code Civil [C. civ.] art. 1832(12) (95th ed., Petits Codes Dalloz 1995) (Fr.); Law No. 66-537 of July 24, 1966, arts. 36, 1(2). See 1 SIMEON & ASSOC. ET AL., DOING BUSINESS IN FRANCE § 5.01, at 5-12 (1996) [hereinafter DOING BUSINESS IN FRANCE]. Business entities in France other than the public and private companies include the société en nom collectif, a general partnership, and two types of limited partnerships referred to as the société en commandite simple and the société en commandite par actions. See id. §§ 5.05[1], at 5-117, and 5.05[2], at 5-128.1 (providing an excellent overview of commercial law in France).
Under the two-tiered approach, the company is operated by a Directorate which manages the business, and by a Supervisory Board or conseil de surveillance which supervises the Directorate. While both structures are subject to numerous formalities, most companies select the unitary form since it is somewhat less restrictive.

In the case of the two-tier public enterprise, the primary purpose of the Supervisory Board is to control the management of the corporation. The Supervisory Board is a management watch-dog of sorts, somewhat resembling the audit committee found increasingly in large U.S. public companies.

The management structure of the SARL is simpler than that of the SA. The SARL may consist of two to fifty managing directors or gérants. The managing directors need not be shareholders as is the case with the SA's Board of Directors. All SAs and all large SARLs must have statutory auditors. The French SA must have at least one statutory auditor. The purpose of the statutory auditor is to ensure that the corporation complies with applicable

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138. Law No. 66-537 of July 24, 1966, arts. 89, 117. See also 1 Doing Business in France, supra note 137, § 5.05[2], at 5-24 (reviewing the SA management structure).

139. Law No. 66-537 of July 24, 1966, arts. 118, 150. See also 1 Doing Business in France, supra note 137, § 5.05[2], at 5-24 (discussing the two-tiered management structure).

140. Breskovski, supra note 89, at 91 (indicating that while both the one- and two-tiered structures are available in France, most of the sociétés anonymes are organized under a unitary structure). Even if the one-tier structure is selected, the corporation must conform to significant formalities. Each member of the Board of Directors must be a shareholder. Law No. 66-537 of July 24, 1966, art. 95(3). See also 1 Doing Business in France, supra note 137, § 5.05[2], at 5-24. Absent a provision specifying the Directors' age limits, no more than one-third of the Directors may be older than age seventy. Law No. 66-537 of July 24, 1966, art. 90-1. See also 1 Doing Business in France, supra note 137, § 5.05[2], at 5-25.

141. See Principles of Corporate Governance § 3A.02 (1994). The A.L.I Corporate Governance Project recommends that every large publicly-held corporation have an audit committee. The purpose of the committee is to implement and to support the oversight function of the board by reviewing the corporation's processes for producing financial information, its internal controls, and the independence of its auditors. See DOUGLAS M. BRANSON, CORPORATE GOVERNANCE § 5.04, at 234 (1995) (indicating that the widespread use of the audit committee in the U.S. followed when the New York Stock Exchange in the late 1970's required that every corporation listed on the Exchange have an audit committee). Subsequently, the Securities Exchange Commission (SEC) required disclosure of the number of audit committee meetings. Id. In 1978, the Corporate Director's Guidebook strongly recommended installation of an audit committee. Id.

142. Law No. 66-537 of July 24, 1966, art. 49(1). See also 1 Doing Business in France, supra note 137, § 5.03[2], at 5-105. If there is only one member, the business is conducted in the form of a EURL.

143. Law No. 66-537 of July 24, 1966, art. 49(2). See also 1 Doing Business in France, supra note 137, § 5.03[2], at 5-105.

144. The SARL requires a statutory auditor if it meets two of the following three criteria: 1) the sum of the net values of the SARL's assets is greater than 10 million Francs; 2) the SARL has a turnover greater than 20 million Francs, or 3) the SARL employed an average of greater than fifty employees during the fiscal year. See Law No. 66-537 of July 24, 1966, art. 64(2); Decree No. 67-236 of March 23, 1967, arts. 43, 12(1), 51(2). See also 1 Doing Business in France, supra note 137, § 5.03[2], at 5-109.

145. See 1 Doing Business in France, supra note 137, § 5.02[2], at 5-34.
corporate law and to certify the fairness and accuracy of the financial statements. The scope of the statutory auditor's responsibility is broad. The statutory auditor must verify the accuracy of the financial statements, and ensure that the business is complying with the law.

G. The French Close Corporation Problem

The owners of a SARL face the same potential problems faced by investors who own shares in an illiquid private corporation. If the owners have a dispute, the company may be deadlocked, or one or more members may be squeezed out of the business enterprise. Dissolution is a remedy available to shareholders of the SARL who have irreconcilable grievances with one another. The company law provides for anticipatory dissolution of the company by tribunal upon demand of one of the members, where there are: "valid reasons, especially in the event of nonperformance of obligations by one of the members, or of discord among the members paralyzing the operation of the company."

Unfortunately, the statute provides no guidance as to the definition of "valid reasons" and there is virtually no case law to elaborate on the concept. Further, the remedy provided under French law is more severe than that provided under German or UK law. The French remedy is dissolution—a dramatic measure that extinguishes the corporation. In contrast, the German remedies of expulsion or withdrawal change the composition of shareholders, but leave the business entity intact. Similarly, the UK remedies for unfairly prejudicial conduct may include but are not limited to

146. See 1 DOING BUSINESS IN FRANCE, supra note 137, § 5.03(2), at 5-35.
147. Id.
148. See Law No. 78-9 of January 4, 1978, art. 1844-7, providing:
The company terminates:
1. Upon expiration of the time for which it was established, except where it has been extended in accordance with article 1844-6;
2. Upon accomplishment or extinguishment of its object;
3. Upon annulment of the company contract;
4. Upon anticipatory dissolution (dissolution anticipate) agreed to by the members;
5. Upon anticipatory dissolution pronounced by the tribunal upon demand of one of the members for valid reasons (justes motifs), especially in the event of nonperformance of his obligations by one of the members, or of discord among the members paralyzing the operation of the company;
6. Upon anticipatory dissolution pronounced by the tribunal in the case specified in article 1844-5;
7. (Law No. 88-15 of Jan. 5, 1988.) By the effect of a judgment ordering the judicial liquidation or the complete transfer of the assets of the company;
8. For any other cause specified in the statutes. It should be noted that these provisions apply to the SA and the SARL.
dissolution of the corporation. Under UK law, equitable solutions far short of dissolution may be fashioned, such as shareholder buy-outs.

The only other remedy available under French law short of anticipatory dissolution, is an order for the majority to prepare reports on specific matters of concern to the minority shareholders. The French law provides that ten percent of the shareholders may obtain an order from the Commercial Court to appoint an expert to prepare a report on one or more issues which concern the corporation. Upon completion of the report it must be sent to the petitioning shareholder, the corporation's statutory auditor, and if appropriate, the public prosecutor. The report must be published along with the annual report or notice to shareholders of the next annual meeting.

III. The Burdens and Benefits of Judicial Discretion in Resolving Close Corporation Shareholder Disputes

A review of private corporate structures and remedies for shareholder disputes in Germany, the UK, and France reveals considerable diversity in company laws. A comparative review reveals the highly discretionary nature of the law governing private shareholder remedies in each country, and the potential that vaguely-worded legal standards might increase rather than reduce uncertainty and confusion as the appropriate standard of shareholder conduct.

Without statutory guidance regarding shareholder conduct, both the minority and the majority shareholder face the potential of the arbitrary exercise of judicial discretion. Arbitrary judicial decision-making may assume many forms—religious prejudice is just one example. The enactment of statutory guidance to govern judicial decision-making would tend to increase the predictability of the law and would foster accountability on the part of the judiciary.

A. Amorphous Legal Concepts Surrounding Shareholder Conduct May Create a Potential for Abuse

In Germany, judicial discretion is perhaps the broadest where an expulsion or withdrawal may be obtained if there is a "substantial basis." The German experience with expulsions during the reign of the Third Reich illustrates the potential destructive force of vague legal concepts coupled with broad judicial discretion. Under German law today, the breadth of judicial discretion remains significant insofar as the shareholders' contrac-

149. See 1 Doing Business in France, supra note 137, § 5.02[3], at 5-50.
151. Supra note 78.
152. See Scogin, supra note 5, at 181 ("In evaluating alternative approaches, such as that of Germany, one must ask whether the amelioration of this problem (private company shareholder dissension) is worth the danger of abuse inherent in relying upon vague concepts coupled with considerable judicial discretion.").
tual agreement and business relationship do not provide a limited framework in which shareholder conduct may be evaluated. The judicial inquiry goes far beyond the commercial relationship of the parties and extends to the shareholder's personal relationships and personal characteristics. The French approach to the problem also creates the potential for unbridled judicial discretion. "Valid reasons" may trigger a dissolution in France, but no definition whatsoever is provided for the term "valid reasons."

In the UK, the shareholder's contractual agreement and conduct in the course of managing the business provides the framework for analyzing whether the defendant's conduct was "unfairly prejudicial." Since purely personal factors are not taken into account in assessing whether conduct is "unfairly prejudicial" the UK law provides less opportunity for judicial discretion than the German law and the French law. Nevertheless, the determination of unfairly prejudicial conduct is frequently made based on a determination of whether the shareholder's reasonable expectations were defeated. A case-by-case analysis of reasonable expectations creates considerable uncertainty in the application of the law.

B. Vague Standards for Shareholder Conduct May Compound Confusion Among International Investors

The socializing effect of the law has long been widely recognized. To a very real extent, shareholder remedies for misconduct either explicitly or implicitly provide standards of appropriate conduct for shareholders. The law's socializing and standard-setting objectives are undermined when the law is excessively vague. Vague legal standards may compound the confusion already experienced by shareholders from different cultures. A German and UK shareholder may operate on entirely different assumptions regarding acceptable shareholder conduct. The vague laws providing remedies for shareholder misconduct do nothing to dispel cultural

153. See supra Part II.
154. See supra note 148.
155. See O'Neal & Thompson, supra note 9, § 9.02.
157. See John C. Coffee, Litigation and Corporate Governance: An Essay On Steering Between Scylla and Charybdis, 52 Geo. Wash. L. Rev. 789, 792-93 (1984). Professor Coffee emphasizes the educational and socializing effects of the law. He indicates that "[t]his reductionist approach ignores the important educational and aspirational role that the law . . . [has] long played in our society in setting standards." See also Thomas C. Lee, Limiting Corporate Directors' Liability: Delaware's Section 102(b) (7) and The Erosion of The Directors' Duty of Care, 136 U. Pa. L. Rev. 239, 266 (1987) (emphasizing that the socializing effect of the law should not be overlooked).
158. See Robert J. Walters, "Now That I Ate the Sushi, Do We Have A Deal?"—The Lawyer as Negotiator in Japanese—U.S. Business Transactions, 12 Nw. J. Int'l. L. & Bus. 335 (1991) (emphasizing the dramatic impact which cultural differences have on the law).
As already indicated, a withdrawal or expulsion under German law does not require an element of fault, nor is it limited to conduct which takes place in the conduct of the business. Personal characteristics or personal circumstances of one's partner generally may be grounds for the expulsion or withdrawal. In contrast, the UK law looks strictly to the actual conduct of the business enterprise. A showing of a breach of fiduciary duty, disloyalty, self-dealing, or bad faith in the operation of the business is typically required. A UK shareholder who jointly owns and operates a business in Germany with a German shareholder may be surprised to find that his or her personal conduct, outside of his business conduct may be significant to his German co-investor. Yet, as noted by the German Court in 1953:

Even though the statute does not contain any equivalent regulation, it is possible that one partner can be expelled, if there has been significant reasons regarding his character. The exclusion takes place by a judicial verdict. In any case in a company which consists of two partners in a personified company GmbH, the behavior and the character of the partner who continues the company by himself has to be examined.

It is unlikely that a UK or American shareholder would anticipate that one's personal relationship with his or her spouse would be relevant to litigation with a co-investor as it was in one 1953 German case decision involving owners of a cabaret club. The UK business person is likely to make a distinction between business life and personal life. One is unlikely to assume that decisions affecting one's personal life will affect or be relevant to one's business life. Yet, this dichotomy between personal and business affairs may not be present in the mind of a business partner from a different culture.

The cultural distinction between the personal and business sphere is reflected in the UK law in a recent Chancery Division opinion regarding a suit for unfairly prejudicial shareholder conduct. The UK court emphasized that the conduct under scrutiny was conduct occurring in the conduct of the company's affairs noting:

... it befits the court, in my view, to be extremely careful to ensure that oppression is not caused to parties, respondents to such petitioners or, indeed, petitioners upon such petitioners, by allowing the parties to trawl...
through facts which have given rise to grievances but which are not relevant conduct within even the wide words of the section. The section requires these to have been conduct of 'the company's affairs' . . . 164

In a prior case, the Chancery Division Court denied a petition for unfairly prejudicial conduct because the plaintiff complained of the defendant's personal conduct rather than the defendant's conduct in the affairs of the company. 165 In describing one of the plaintiff's claims, the court indicated that the claim was:

an averment of a distasteful sort about thoroughly unattractive behavior by the respondent. It is, I need not say, hotly denied. The truth or falsity of it is not a matter before me. If it were all proved, it does not seem to me to have anything whatever to do with the business of the company or the conduct of the company's affairs. It is not alleged in it that there was any harm done to the company or that the persons alleged to have suffered it knew of the respondent's capacity in the company. It appears to be an attempt to blacken the name and to make the court look on her with disfavor as an immoral and unattractive woman; but it does not seem to me to amount to anything that is properly a petition ground for the Companies Court.

UK law assumes a dichotomy between business and personal life, whereas the German law recognizes no distinction. This important difference in perspective may be a source of confusion for international shareholders. If the UK and German laws more clearly articulated standards for misconduct, the law might better achieve its socializing and educational goals in setting standards of conduct.

C. The Costs and Burdens of Shareholder Litigation: A Call for Alternative Dispute Resolution Forums

A law with few limitations on the exercise of judicial discretion not only produces the potential for abuse but also sets the stage for protracted, lengthy and costly litigation. In light of the substantial costs of litigation, consideration should be given to using alternative forums, such as arbitration, for the resolution of shareholder disputes.

The UK case of Re Elgindata, Ltd. 166 serves to illustrate the extent to which the costs of shareholder litigation may exceed the financial recovery at stake in a private company. Further, the case demonstrates the highly discretionary nature not only of the underlying cause of action in the UK, but also of the allocation of litigation costs made by the judge hearing the case.

Elgindata involved a petitioner who was a one-third minority shareholder in a private U.K. company. The minority contended that the majority failed to consult him in decisions, seriously mismanaged the business,

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164. Id. at 767.
165. Re a company (No. 001761 of 1986) [1987] BCLC 141 (Ch. Eng.) (involving a petition for unfairly prejudicial conduct which was denied because the complaint focused on the defendant's personal behavior, rather than the behavior in the conduct of the company's affairs).
and improperly made personal use of the company's assets. Ultimately, the petitioner prevailed on one of four claims and the court ordered the majority to buy the minority's shares for 24,000 pounds. However the petitioner incurred legal costs of approximately 120,000 pounds and the defendant sustained legal fees of approximately 200 pounds. The trial lasted forty-three days. Further, although the general rule is that the defendant pays the litigation fees of the successful plaintiff, the court in the exercise of discretion required that the defendant pay only one-half of the plaintiff's costs of litigation.

The problems created by shareholder litigation in the UK close corporation is perhaps best summarized by Justice Harmon as follows:

Petitions (under S. 459 involving prejudicial conduct) have become notorious to the judges of this court—and I think also to the Bar—for their length, their unpredictability of management, and the enormous and appalling costs which are incurred upon them particularly by reason of the volume of documents liable to be produced. By way of example on this petition there are before me upwards of 30 lever-arch files of documents.

The criticisms leveled at the UK law are echoed in the commentary to comparable U.S. provisions designed to protect the minority against "oppressive conduct" by the majority shareholders. For example, in Orchard v. Covelli, the plaintiff obtained a court order for the majority to buy the plaintiff's stock. In addition to a buy-out price for the minority's stock of $354,447, a total of $163,690 of pre-judgment interest was required to be paid. In Stephano v. Coppock, the defendant paid a buy-out price of $32,000. In addition, eleven years of pre-judgment interest was charged totaling $23,431. The attorney's fees in the case amounted to $20,000.

In light of the costs of litigation, alternative strategies for settling shareholder disputes should be considered. Perhaps arbitration or other informal forums may be used for controversies involving disputes where the amounts in controversy are below pre-established levels.

D. The Rationale For Judicial Discretion in Resolving Close Corporation Shareholder Disputes
Is it inevitable that the law governing shareholder remedies be vague, highly discretionary, and culturally biased? A certain amount of discretion

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168. Id.
169. Re Unisoft Group Ltd (No. 3) [1994] 1 BCLC 609, 611 [1994] BCC 766, 768 (Ch. Eng.) (involving a claim that the majority's conduct was unfairly prejudicial).
172. See Haynesworth, supra note 28, at 31 (discussing the practicality of shareholder suits and related costs).
175. Brownlee, supra note 96, at 274 (providing an overview of Florida's contractual approach to oppressive conduct).
is inevitable and probably desirable in litigation to resolve shareholder disputes. Further, law is in essence an expression of culture and will always reflect the assumptions and biases of the society from which it springs. However, to increase the accountability of the judiciary, it may be possible to temper judicial discretion with an articulation of standards which must be applied in the decision-making process.

The importance of judicial discretion in resolving close corporation shareholder disputes should not be underestimated. Judicial discretion has been deliberately built into the law governing private company shareholder disputes to provide an opportunity for fair and equitable resolutions which might otherwise be precluded as the result of the application of the general principles of corporate law. In the UK and the United States for instance, the Majority Rule Doctrine and the Business Judgment Rule may operate to preclude minority shareholders from obtaining remedies for opportunistic majority conduct.  

Justice Hoffman, in the English case Re Saul D Harrison & Sons plc, explained that the term 'unfairly prejudicial' "is deliberately imprecise language which was chosen by Parliament because its earlier attempt in s 210 of the Companies Act 1948 to provide a similar remedy had been too restrictively construed." Similarly, in the United States, the Statutory Close Corporation Supplement to the Model Business Corporation Act provides that "[a] court should have broad discretion to fashion the most appropriate remedy to resolve the dispute. What works in one case may not work in another. Detailed standards are not provided on the grounds that such standards might . . . unduly restrict the court's discretion."  

unfortunately, two legal doctrines historically have served as barriers to removing inefficient or incompetent management. The first legal doctrine is the Majority Rule Doctrine. The majority shareholders select the board thereby effectively selecting management, and the minority shareholders have little input into the process . . . . A second and related legal doctrine is the Business Judgment Rule. It provides that courts will not second guess the decision of management if it is reasonable to believe that management is acting in good faith with a reasonable basis and within the scope of the power conferred upon them. As a result, the Business Judgment Rule creates thorny problems of proof for the minority shareholder bringing a suit for breach of a director's duty of care.

Id. (footnotes omitted).

177. [1995] 1 BCLC 14, 17 (alleging that the majority directors kept the company in business in order to earn remuneration even though the company was operating at a loss and should have been liquidated).

The perceived need for flexibility is based on the desire to address a broad array of close corporation problems. However the breadth of the remedies comes at a price—that is, the price of uncertainty and unpredictability in the law and the potential for the arbitrary exercise of judicial discretion. The challenge for the future is to provide a more effective balance between the need for certainty, predictability, and accountability, and the competing need for equitable remedies which can be tailored to the exigencies of the individual case.

E. To What Extent Can Contractual Arrangements Solve the Close Corporation Problem?

Over the last decade, there has been a growing trend in U.S. business law to discourage judicial activism and to encourage parties to contractually address as many facets of their business relationship as possible. The increased emphasis on contractual arrangements in U.S. business law has manifested itself in: 1) the emergence of contractual provisions in corporate by-laws to indemnify directors who have been sued;

179 2) the passage of the Revised Uniform Partnership Act which arguably limits mandatory fiduciary duties among partners and defers largely to the contract between the parties;

180 and 3) the enactment of limited liability company legislation.

179. In the seminal case, Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), directors of a publicly held company were held liable for violating their duty of care. The events that followed in the wake of Smith v. Van Gorkom have been characterized as a "race to the bottom." See Thomas L. Hazen, Corporate Directors' Accountability: The Race To The Bottom-- The Second Lap, 66 N.C. L. Rev. 171 (1987) (discussing the lowering of legal standards of conduct for corporate directors); Marc I. Steinberg, The Evisceration of the Duty of Care, 42 S.W. L. Rev. 919 (1988). Although the Van Gorkam case articulated a relaxed gross negligence standard, many critics believed that the rule as applied in the case was widely regarded as imposing Draconian liability where misconduct was only slight. The majority of states enacted opt-out provisions which permit corporations to indemnify directors who have been held liable to third parties. Some statutes, such as in Delaware, authorize shareholders to adopt a charter provision which reduces or eliminates financial responsibility except for certain cases involving unlawful conduct or breaches of loyalty. See, e.g., Del. Gen. Corp. Law. § 102(b)(7) (permitting indemnification except for acts or omissions not in good faith or which involve a knowing violation of law, unlawful dividends or stock purchases, and transactions in which the director derives a personal benefit.) Other states such as Florida, Maine, Ohio, Virginia and Wisconsin eliminate due care liability without requiring charter provisions. See, e.g., Fla. Stat. Ann. § 607.1645 (West 1996). New York has adopted a more conservative approach and provides for relatively narrow circumstances in which indemnification may be made. See N.Y. Bus. Corp. L. § 402(b) (1987) (excluding transactions from which an improper benefit is derived).

180. Unif. Partnership Act § 18, 6 U.L.A. 125 (1995) (1914) relies heavily on the judiciary to address fiduciary duties. However, the standards of conduct found in the Unif. Partnership Act (1994) § 404, 6 U.L.A. 1, 58 (1995) (RUPA), arguably reflect the supremacy of the partnership agreement and the minimization of judicially-imposed mandatory rules among partners. By limiting fiduciary duties to those expressly enumerated, RUPA turns away from broad statements of fiduciary duty which have long been embraced by courts. Section 404 of the 1994 Act provides in part:

(a) The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in this section.
(b) A partner's duty of loyalty to the partnership and the other partners is limited to the following:
providing operating rules only in default of contractual agreements.\textsuperscript{181}

(1) to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use or appropriation by the partner of partnership property or opportunity without the consent of the other partners;

(2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business, as or on behalf of a party having an interest adverse to the partnership without the consent of the other partners; and

(3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership without the consent of the other partners.

(c) A partner's duty of loyalty may not be eliminated by agreement, but the partners by agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable.

(d) A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

(e) A partner shall discharge the duties to the partnership and the other partners under this Act or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing. The obligation of good faith and fair dealing may not be eliminated in the agreement, but the partners by agreement may determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable. . . . A partner may lend money to and transact other business with the partnership. The rights and obligations of a partner who lends money to or transacts business with the partnership are the same as those of a person who is not a partner, subject to other applicable law.

(g) This section applies to a person winding up the partnership business as the personal or legal representative of the last surviving partner as if the person were a partner.

For an excellent discussion of RUPA, see Donald J. Weidner, Three Policy Decisions Animate Revision of Uniform Partnership Act, 46 Bus. Law. 427, 428 (1991). Weidner explains the attempt to curb judicial activism as follows: "RUPA reflects the supremacy of the partnership agreement and minimizes mandatory rules among partners." Id. Weidner further notes that:

vague, broad statements of a powerful duty of loyalty cause too much uncertainty. It was suggested that, even if there are no bad holdings, overly broad judicial language left practitioners uncertain about whether their negotiated agreements will be voided. It was said that attorneys and their clients want to be able to negotiate transactions, reduce their agreements to writing, and have some comfort that those agreements will not be undone by "fuzzy" notions of fiduciary duties.

\textit{Id.} at 462.

Similarly, in the close corporation arena there has been a renewed emphasis on the important role of the contract between the parties. It has recently been suggested that statutory measures providing for involuntary dissolution of close corporations are not needed where the corporate law invites shareholders to contractually address the potential for shareholder disputes. As one commentator noted in explaining why the legislature should not enact minority shareholder legislation:

Thoughtfully designed shareholders' agreements deter oppressive conduct, reduce shareholder disputes, and decrease litigation. Shareholder agreements further force minority shareholders who bear the risk of losing an investment to fend for themselves in the commercial arena. ... (the) judiciary should not add to its already congested plate the role of "protector" of unsophisticated investors. Courts should not interfere with arms length transactions nor relieve shareholders from contractually bad bargains. 182

Particularly for the international investor, well-drafted contractual shareholder arrangements can be critical in governing the shareholder relationship. Contractually agreed upon choice of law provisions, buyout provisions, provisions permitting minority veto power in certain circumstances, employment contracts, and other special agreements which provide for dividend payments or other matters are extremely helpful in reducing potential shareholder disputes. Thus, contractual arrangements should be encouraged in the case of corporations owned by shareholders of different nations.

If it becomes necessary to litigate or arbitrate a shareholder dispute, the judiciary should give paramount importance to relevant contractual provisions agreed upon by the parties. In a recent UK case, the court emphasized the primacy of the contractual arrangement between the parties, which in that case was the articles of incorporation. As Justice Hoffman observes:


In deciding what is fair or unfair for the purposes of s 459 [determining unfairly prejudicial conduct], it is important to have in mind that fairness is being used in the context of a commercial relationship. The articles of association are just what their name implies: the contractual terms which govern the relationships of the shareholders with the company and each other. They determine the powers of the board and the company in general meeting and everyone who becomes a member of a company is taken to have agreed to them. Since keeping promises and honoring agreements is probably the most important element of commercial fairness, the starting point in any case under s 459 will be to ask whether the conduct of which the shareholder complains was in accordance with the articles of association.  

Nevertheless, contractual provisions between the parties will not always be equally relevant under all legal systems. Under UK or U.S. law, contractual provisions may well be drafted to define each shareholder's rights and responsibilities. In such event, it is difficult to disagree with the statement that the court should use the contract as a starting point and should defer to its provisions where relevant. Contractual provisions may very well be quite relevant in the determination of whether a shareholder acted improperly in the conduct of company affairs. However, an entirely different situation is presented if the law is similar to Germany's and a shareholder may obtain a remedy based not on the shareholder's pattern of conduct in company affairs, but rather, based upon the shareholder's personal characteristics. It may be much more difficult to contractually anticipate all of the various personal characteristics and/or personality traits which could legitimately become the basis of a shareholder lawsuit.

Even if the law is similar to UK and U.S. law and shareholder remedies rest on a pattern of conduct in the company's affairs, the organizing documents and related contracts may not always help to resolve a shareholder dispute. As a practical matter, the contractual documents may not specifically address the issues under dispute or may otherwise provide little guidance for its resolution.

In many cases written contracts governing shareholder rights and responsibilities may simply not exist. Small businesses may be conducted informally even if they are owned by shareholders from different countries and conduct business internationally. In fact, many small businesses are begun between friends or family members who have such a close personal relationship that they do not even consider that disputes could arise at a later time. Frequently, there are many aspects of the business relationship which will not be memorialized in a contract. The

184. See Orchard v. Covelli, 590 F. Supp. 1548 (W.D. Pa 1984) (minority shareholder alleged in part that the majority wrongfully discharged him, yet there was no evidence of the existence of a written or oral employment contract). The plaintiff was a stockholder and officer of the corporation but his position did not make him a tenured employee. Id.
185. Meiselman v. Meiselman, 307 S.E.2d 551, 558 (N.C. 1983) (explaining that close corporations are formed by friends or family members who simply may not believe that disagreements could ever arise).
186. McCauley v. McCauley, 724 P.2d 232 (N.M. App. 1986) (involving a lawsuit by a divorced wife against her former husband, parental in-laws, and two sons alleging that
agreement between the parties may be oral or may not even be articulated at all.\textsuperscript{187}

Further, business relationships do not remain static. The roles of the shareholders may change over time. Even if contracts were executed when the business was formed, they may not have been updated to reflect the changes in the roles of the parties. If documents are current, they may be imperfectly drafted. The contracts may not address the matters which are the subject of the shareholder dispute.\textsuperscript{188}

Particularly in the second or third generation of a family business, the shareholders who have acquired the stock by inheritance may not have entered any negotiations with respect to their roles in the business.\textsuperscript{189} The

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\textsuperscript{187} See O’Neal, supra note 7, at 884 (discussing the array of difficulties encountered by the majority shareholders). Professor O’Neal, a leading authority on close corporations explains that:

many participants in closely-held corporations are “little people,” unsophisticated in business and financial matters. Not uncommonly a participant in a closely-held enterprise invests all his assets in the business with an expectation, often reasonable under the circumstances even in the absence of an express contract, that he will be a key employee in the company and will have a voice in business decisions.

Many close corporations may be conducted without the observance of corporate formalities. See Balvik v. Sylvester, 411 N.W.2d 383 (N.D. 1987) (the court observed that the articles of incorporation had provided that a separate buy-sell agreement would be entered into, but the parties never executed the buy-sell agreement).

\textsuperscript{188} Easterbrook and Fischel observed that some shareholder documents may be intentionally written without provisions regarding minority shareholders because of the risk that a judge might misconstrue or misinterpret provisions which protect the minority protections to the disadvantage of the majority. See Easterbrook & Fischel, supra note 34, at 285.

Drafters of organizing documents of a closely held corporation cannot avoid a tradeoff. On the one hand they must provide some protection to minority investors to ensure that they receive an adequate return on the minority shareholder’s investment if the venture succeeds. On the other hand, they cannot give the minority too many rights, for the minority might exercise their rights in an opportunistic fashion to claim returns at the majority’s expense.

\textsuperscript{189} See Meiselman v. Meiselman, 307 S.E.2d 551, 558 (N.C. 1983), in which two brothers had inherited their respective stock holdings from their father. The plaintiff had inherited a minority interest and alleged that his brother violated his fiduciary duty. The court explained that “the minority shareholder who acquired his shares to secure
nature of the relationship between shareholders who have inherited their shares of stock is seldom the product of arms length bargaining. The understanding between such parties may be entirely oral or may be simply implied by the circumstances.

Thus, the relevance of the contract to the resolution of shareholder disputes depends largely on the nature of the law and the facts and circumstances of the individual case. Carefully drafted documents will not always resolve the controversy. It has long been the experience of the bar that the "easy cases" seldom reach the stage of litigation. It remains the task of the legislature to provide effective default rules for the parties where the written agreement does not resolve the conflict.

IV. The Feasibility of Harmonizing Close Corporation Dispute Resolution in the European Community

Given the diversity of approaches to close corporation shareholder dispute resolution, and the vague judicial concepts employed in different jurisdictions, is it feasible for the European Union to adopt standardized rules which provide increased guidance to the business community? While the European Union has the authority to establish minimum safeguards of company law, it never intended to displace broadly company law of member states. While minimum safeguards have been successfully passed in a number of areas, standards of shareholder and director conduct may well be regarded as matters traditionally within the scope of local discretion and local regulation by member states. A substantive proposal to standardize the law regarding the resolution of private company shareholder disputes is likely to be perceived as an unauthorized encroachment into the sovereignty of member states.

A variety of corporate regulations have been passed by the European Community. Indeed, the harmonization of corporate law is clearly within the mission of the European Community. Broadly stated, the task of the European Community, as stated in the Treaty of Rome is to "promote throughout the Community a harmonious and balanced development of economic activities," a continuous and balanced expansion, an increase in stability, an accelerated "raising of the standard of living" and closer relations between the States belonging to it.\(^\text{190}\)

Article 54(3)(g) of the Treaty of Rome expressly provides for the coordination of necessary "safeguards" applicable to companies and firms in order to make them equivalent throughout the Community.\(^\text{191}\) While the Treaty authorizes the passage of "safeguards" it does not broadly call for

\(^{190}\) See EEC Treaty, art. 2.

\(^{191}\) Id. § 54(3)(g). The treaty authorizes the adoption of a series of Directives for the purpose of "coordinating to the necessary extent the safeguards which, but for the protection of members and others, are required by Member States of companies and firms . . . with a view to making such safeguards equivalent throughout the Community." Id.
the displacement of corporate law of member states. Perhaps with the exception of the Draft Fifth Directive, the Community founders generally rejected the approach to uniformity taken by the United States through its variety of "uniform acts" and through the Model Business Corporation Act. Although the U.S. move toward uniformity has been voluntary, it provides a comprehensive model of corporate law. In contrast, the instrument of harmonization in the European Community is the binding "directive." The Directive dictates the result to be achieved, but leaves the form and method of implementation to each member state.

The European Community has been successful in developing a variety of "safeguards" for companies which are scattered throughout a number of directives. The primary areas which have been addressed include: 1) the requirement that each member state create a public registry at which key private and public company information must be filed; 2) the disclosure by private and public companies of the creation and maintenance of capital; 3) minimum standards for all aspects of financial accounting.
for public and private companies; \(^{200}\) 4) rules regarding mergers\(^ {201}\) and divisions;\(^ {202}\) and takeovers;\(^ {203}\) and 5) guidelines for one-member companies.\(^ {204}\) In addition, a legal entity called the European Economic Interest Grouping (EEIG)\(^ {205}\) has been established through which companies from different Community states may conduct business transactions.\(^ {206}\)}
Nevertheless, in spite of the many areas in which the Community has had success, it has always been reluctant to broadly displace existing corporate laws in member states. The Community's difficulty in obtaining passage of the Fifth Directive relating to corporate governance and its companion European Statute is an indication of the members' general reluctance to relinquish authority over corporate matters which have traditionally fallen within their own discretion. The Fifth Directive offers a choice between a one-tier system of corporate law and a two-tier system. The one-tier approach provides for management by the Board of Directors while the two-tier approach provides both a Board of Directors and a Supervisory Board based on the German/French model of governance. The Directive requires the representation of employees in management and establishes a standard for Director conduct. A companion

independence and without undergoing mergers of any type. At present, the EEIG is not widely used, but has been employed largely by professional groups such as lawyers and public relations consultants who wish to pool their resources. See Carsell & De Sarrau, supra note 199, § 4.09[3] (providing an overview of the EEIG and indicating that it is patterned after the French Groupement d'Interet Economique). See also Johan de Bruycker, EC Company Law—The European Company v. The European Economic Interest Grouping and the Harmonization of the National Company Laws, 21 GA. J. INT'L & COMP. L. 191 (1991) (examining harmonization efforts and including a discussion of the European Economic Interest Grouping).

207. See Conrad, supra note 3, at 2171-72 (explaining that the Treaty authorized coordinating only "safeguards" and coordinating only "to the necessary extent").


209. This approach is similar to that under French law wherein the French public corporation is given a choice between the one and two-tier system of management.

210. For an excellent discussion of the role of the Supervisory Board, see Alfred F. Conrad, The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law, 82 Mich. L. Rev. 1459, 1465 (1984) (indicating that industrial countries outside of the United States have required publicly held companies to provide for supervision of managers). Conrad indicates that in Germany, the Supervisory Board hires and fires the managers, sets compensation, and supervises management. Id. The Supervisory Board under German and French law dates from 1870 and 1863 respectively.

211. The Draft Fifth Directive provides a system of corporate governance. A companion European Company Statute has been drafted to go along with the Fifth Directive. See The European Company Statute, 1989 O.J. (C 263) 41; 1991 O.J. (C 138) 8; 1991 O.J. (C 176) 1. Thus far, the Proposals have not been adopted primarily because of political opposition from the United Kingdom. The Fifth Directive's provisions relating to employee participation in management are a significant concern to the United Kingdom. See Breskovski, supra note 89, at 91 n.104. See also Carsell & De Sarrau, supra note 199, § 4.05 (discussing the original and revised Fifth Directive); Barbara E. Hocklin, European Company Statute: Company Structure and Employee Involvement Across EC Borders, 16 N.C. J. INT'L L. & COM. 587 (1991) (discussing the history of the European Company Statute, the provisions for employee involvement, and opposing traditions for employee involvement in Germany and the UK); John T. Addison, Recent Developments in Social Policy in the New European Union, 48 INDUS. & LAB. REV. 5 (1994) (discussing the social and labor policy in the European Community); Terence L. Blackburn, The Societas Europea: The Evolving European Corporation Statute, 61 FORDHAM L. Rev. 695 (1993) (reviewing the history of the Fifth Directive in light of the history of the different legal traditions within the European Community); Klaus J. Hopt, Labor Representation on Corporate Boards: Impacts and Problems For Corporate Governance and Economic Integration in Europe, 14 INT'L REV. L. & ECON. 203 (1994) (discussing the legal and eco-
European Statute has been drafted which follows exactly the Draft Directive. The Directive and related European Statute has met with considerable controversy. One commentator described reaction to the initial version of the Fifth Directive as "an assault on national folkways . . . [which] awakened expectable resistance in member states."

The creation of a uniform approach to shareholder dispute resolution may well be regarded as an intrusion into the domain of members' existing corporate law, rather than as an effort to establish a minimum corporate "safeguard." Even if a workable model for dispute resolution could be developed, it is likely to be met with resistance, particularly in light of the current diversity in approach to the shareholder disputes, and the discretionary nature of existing laws.

V. Strategies for Close Corporation Dispute Resolution in the European Community

While it does not appear to be feasible or indeed appropriate for the Community to harmonize substantive company laws governing close corporation shareholder dispute resolution, at a minimum, discussion of the issues could prove useful to member states. An agenda for discussion and analysis should include: 1) the role of contractual agreements in resolving shareholder disputes; 2) the potential use of arbitration and alternative cost-effective forums for shareholder dispute resolution; and 3) the future revision of company statutes to articulate the criteria for fashioning shareholder remedies in the close corporation context.
Strategies to promote the use of contractual shareholder remedies should be considered. Perhaps company laws could require or otherwise encourage the use of by-laws or other separate shareholder agreements to address the manner in which shareholder disputes would be resolved. Contractual provisions could specify the circumstances which would trigger a shareholder remedy and the mode for dispute resolution.

Thus far, at least one state in the United States has enacted a corporate statute which is designed to encourage close corporation shareholders to contractually address the issue of shareholder disputes. In 1993, Florida's legislature enacted a provision which specifically provides investors in corporations with one hundred or fewer shareholders the right to contractually protect themselves against oppressive behavior, squeeze-outs and other unexpected occurrences.\textsuperscript{216}

Alternative forums for dispute resolution should be considered.\textsuperscript{217} Arbitration or other non-judicial methods for dispute resolution could be used. If shareholder by-laws already contain buy-out provisions using a fixed formula, or otherwise contain guiding principles for resolving shareholder disputes, judicial intervention may not be needed.

\begin{itemize}
  \item \textbf{216.} \textit{FLA. STAT. ANN.} § 607.0732(1) (West 1996), providing:
  \begin{itemize}
    \item Shareholder Agreements
    \begin{itemize}
      \item (1) An agreement among the shareholders of a corporation with 100 or fewer shareholders at the time of the agreement, that complies with this section, is effective among the shareholders and the corporation even though it is inconsistent with one or more other provisions of this chapter, if it:
        \begin{itemize}
          \item (a) Eliminates the board of directors or restricts the discretion or powers of the board of directors;
          \item (b) Governs the authorization or making of distributions whether or not in proportion to ownership of shares subject to the limitations in s. 607.06401;
          \item (c) Establishes who shall be directors or officers of the corporation, or their terms of office or manner of selection or removal;
          \item (d) Governs, in general or in regard to specific matters, the exercise or division of voting power by the shareholders and directors, including use of weighted voting rights or director proxies;
          \item (e) Establishes the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation and any shareholder, director, officer, or employee of the corporation;
          \item (f) Transfers to any shareholder or other person any authority to exercise the corporate powers to manage the business and affairs of the corporation, including the resolution of any issue about which there exists a deadlock among directors or shareholders; or
          \item (g) Requires dissolution of the corporation at the request of one or more of the shareholders or upon the occurrence of a specified event or contingency.
        \end{itemize}
    \end{itemize}
  \end{itemize}
\end{itemize}

\begin{itemize}
  \item See also Brownlee, \textit{supra} note 96, at 295 (discussing the role of the contract in resolving shareholder disputes).
\end{itemize}

\begin{itemize}
  \item \textbf{217.} \textit{See id.} for a critique of Florida's treatment of minority shareholders.
  
  Shareholders caught in a squeeze-out or an oppression dilemma usually either want to withdraw their capital from the corporation or alter the balance of power within the corporation itself because of policy disputes. Both of these options can be achieved without judicial dissolution. The most economical alternative is the shareholders' agreement. Shareholders' agreements deter oppressive conduct, reduce shareholder disputes, and decrease litigation.
\end{itemize}

\textit{Id.}
Of course, not all problems can be anticipated, and not all contracts will properly address the particular controversy. More effective statutory default rules should be drafted to more clearly identify the factors that are relevant in the determination of whether a shareholder is entitled to a remedy in the event of a dispute. In his opinion in *Re Saul Harrison & Sons*, Justice Hoffman emphasized the importance of the identification of factors which the court uses to evaluate shareholder conduct. Justice Hoffman observes that:

In explaining how the court sets about deciding what is fair in the context of company management, I do not think that it helps a great deal to add the reasonable company watcher to the already substantial cast of imaginary characters which the law uses to personify its standards of justice in different situations. An appeal to the views of an imaginary third party makes the concept seem more vague than it really is. It is more useful to examine the factors which the law actually takes into account in setting the standard.218

Currently, the French company statute provides for dissolution for "valid reasons."219 A revised version might provide a list of factors which the court would consider in determining whether valid reasons exist. The list need not be exhaustive but would give investors some idea of the standards against which they will be judged. Similarly, the German GmbH statute could provide a list of factors which would be used in reaching the conclusion that "substantial causes" exist for a withdrawal or expulsion. The UK statute could also identify the factors to be considered in the determination of whether "unfairly prejudicial conduct" has taken place.

For example, in an effort to elaborate on factors in the determination of "unfairly prejudicial conduct," the UK statute might indicate that a determination of "unfairly prejudicial" conduct would be based on all of the facts and circumstances and would take a number of factors into account. These would include but not be limited to: 1) the nature of the conduct which took place; 2) the motive of the conduct; 3) the nature of the damages; and 4) the reasonable expectations of the parties based on applicable commercial standards. The statute might provide a non-exhaustive list of acts which would be presumed to be prejudicial conduct. Of course, the defendant would be entitled to rebut the presumption. Such a list of acts might include the personal use of corporate assets; withholding of dividends without business purpose; excessive compensation to the majority without business purpose; withholding information regarding the company; violating corporate procedures; depriving the other shareholder(s) of a meaningful role in corporate decision-making; usurping a corporate opportunity for personal use; and executing corporate business plans that wrongfully deprive the other shareholders of their respective shares in corporate profits.220

It is difficult to accept any legal approach to dispute resolution which rests solely on judicial discretion in applying vague legal concepts. To provide a framework within which judicial discretion must be exercised, the applicable statute should identify the factors which will be applied in evaluating whether the aggrieved shareholder is entitled to a remedy. Such an approach would enhance the predictability of the law and increase the accountability of the judiciary without compromising each country’s rights to determine their own substantive laws.

Conclusion
A review of the “close corporation problem” in Germany, the UK, and France finds that vague standards of shareholder conduct and highly discretionary remedies exist for resolving disputes among shareholders of the private company. The potential for abuse is illustrated by the German experience with the expulsion remedy. Vague legal concepts regarding shareholder misconduct may increase rather than reduce the international shareholder’s confusion regarding the scope of acceptable conduct. While some amount of judicial discretion in the law is necessary to provide flexibility in fashioning remedies, existing approaches fail to provide any meaningful limitations or guidelines for the exercise of discretion. The adoption of a comprehensive and unified approach to close corporation shareholder remedies for the European Community does not appear feasible. However, at a minimum, member states would benefit from discussion and analysis of the role of contractual agreements in resolving private company shareholder disputes, and the use of alternative dispute resolution mechanisms. Consideration should be given to revising existing statutes to include an elaboration of the factors which will be applied in determining the entitlement to a remedy. The importance of flexibility in fashioning remedies must be balanced against the competing needs for certainty, predictability, and accountability in the administration of the law.