

CHAPTER EIGHT

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Section 8.01 Shareholder Actions Against Corporation, Generally

There are five basic types of lawsuits in which a shareholder can become involved between a shareholder and the corporation or between the shareholders themselves:

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

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

C. The third type of shareholder lawsuit is brought because the corporation has oppressed a minority shareholder or because there is voting deadlock. These lawsuits have historically been brought pursuant to the judicial dissolution statutes, although the courts have generally refused to order dissolution and instead fashion some other remedy. Recently, Oregon has enacted a statute covering close corporations (ORS 60.952) which provides for some of these alternative remedies. These suits and remedies are discussed in Section 8.04 of this Chapter.

D. The fourth type of shareholder lawsuit occurs when a shareholder sues a third party seeking to enforce a right held by the corporation or all shareholders, as a group. In such a case, after demand, the shareholder sues the third party – including the corporation as a nominal defendant. Such lawsuits are known as "derivative" lawsuits. Derivative lawsuits are discussed in Section 8.05 of this Chapter.

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

Section 8.02 Individual Claims

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

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

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

A shareholder may only sue a third party to enforce an individual right – not a corporate right.

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

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

A shareholder who seeks to recover for corporate waste or for the misappropriation of corporate funds may *not* do so individually – a shareholder may do so only derivatively. ORS 60.261; *Smith v. Bramwell*, 146 Or 611, 31 P2d 647 (1934).

There are at least four reasons underlying this basic rule:

In the instant case, the reasons requiring derivative suits do not exist. The reasons underlying the general rule are that 1) it prevents a multiplicity of lawsuits by shareholders; 2) it protects corporate creditors by putting the proceeds of the recovery back in the corporation; 3) it protects the interests of all shareholders by increasing the value of their shares, instead of allowing a recovery by one shareholder to prejudice the rights of others not a party to the suit; and 4) it adequately

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compensates the injured shareholder by increasing the value of his shares. (citations omitted) *Thomas v. Dickson*, 250 Ga 772, 774, 301 SE2d 49, 51 (1983).

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

This is true even where the injury to the corporation has brought about a decrease in the value of the shareholder's shares. *Lee v. Mitchell*, 152 Or App 159, 953 P2d 414 (1998); *Weiss v. Northwest Acceptance Corp.*, 274 Or 343, 546 P2d 1065 (1975); *Smith v. Bramwell*, 146 Or 611, 31 P2d 647 (1934). *But see: Wills v. Nehalem Coal Co.*, 52 Or 70, 96 P 528 (1908).

B. Individual contract claims against corporation.

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

C. Claims when third party owes direct duty to both corporation and shareholder.

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

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

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

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

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

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

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

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

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

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

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

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

A shareholder may have an individual claim when both the corporation and the shareholder are parties to a contract with a third party

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

As an exception to the general rule, a stockholder may maintain an action in his own right against a third party (although the corporation may likewise have a cause of action for the same wrong) when the injury to the individual resulted from the violation of some special duty owed to the stockholder but only when that special duty had its origin in circumstances *independent* of the stockholder's status as a stockholder. *Hunter v. Knight, Vale & Gregory*, 18 Wash App 640, 571 P2d 212, 216 (1977).

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

D. Individual claims for declared dividends.

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

Once a dividend is declared by the board, the right to payment is a personal right in the person who owned the stock on the date that the dividend was declared. ORS 60.181(6); *McJannet v. Strehlow Supply Co.*, 25 Wash 2d 468, 171 P2d 684 (1946); *Gellerman v. Atlas Foundry & Machine Co.*, 45 Wash 114, 87 P 1059 (1906).

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

See, also: In re Wilson's Estate, 85 Or 604, 167 P 580 (1917); *Cowin v. Bresler*, 741 F2d 410 (DC Cir 1984); *Mann-Paller Foundation*,

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Inc. v. Econometric Research, Inc., 644 F Supp 92 (1986); *Cole Real Estate Corp. v. Peoples Bank and Trust Co.*, 160 Ind App 88, 310 NE2d 275 (1974).

E. Inspection of corporate records.

Actions brought under ORS 60.781(2) to compel a corporation to allow a shareholder to inspect records may be brought as an individual action in the shareholders's own name. *Babbitt v. Pacco Investors Corp.*, 246 Or 261, 425 P2d 489 (1967).

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

F. Action seeking judicial dissolution.

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

G. Action to compel stock transfer.

If a shareholder seeks to compel a corporate officer to register a stock transfer, the shareholder may bring a mandamus action against the officer. *Hern v. Looney*, 90 Wash App 519, 959 P2d 1116 (1998).

Section 8.03 Special Case – Closely Held Corporations

A. Oregon.

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

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

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472, 841 P2d 682, 687 (1992).

See, also: *Wulf v. Mackey*, 135 Or App 655, 899 P2d 755, review denied, 322 Or 168, 903 P2d 886 (1995); *Chiles v. Robertson*, 94 Or App 604, 767 P2d 903, reconsideration allowed in part, opinion modified, 96 Or App 658, 774 P2d 500, review denied, 308 Or 592, 784 P2d 1099 (1989). But, see: *Wilcox v. Stiles*, 127 Or App 671, 873 P2d 1102 (1994); *Stringer v. Car Data Systems, Inc.*, 314 Or 576, 841 P2d 1183 (1992), reconsideration denied, 315 Or 308, 844 P2d 905 (1993).

This liberal policy of permitting a minority shareholder in a close corporation to bring a direct action against a controlling shareholder is not true where a corporation has a large number of shareholders or is a public corporation, *Loewen v. Galligan*, 130 Or App 222, 882 P2d 104, review denied, 320 Or 493, 927 P2d 793 (1994); *Kahn v. Sprouse*, 842 F Supp 423 (D Or 1993); *Guenther v. Pacific Telecom, Inc.*, 123 FRD 341 (D Or 1987). It is also not true where the minority shareholder seeks to enforce some corporate right against a non-shareholder. *Lee v. Mitchell*, 152 Or App 159, 953 P2d 414 (1998); *Hampton Tree Farms, Inc. v. Jewett*, 125 Or App 178, 865 P2d 420 (1993), affirmed, 320 Or 599, 892 P2d 683 (1995); *Johnson v. Con-Vey/Keystone, Inc.*, 814 F Supp 931 (D Or 1993). But, see: *Far West Federal Bank, SB v. Office of Thrift Supervision-Director*, 119 F3d 1358 (9th Cir 1997)(permitting a direct action by shareholders against third party).

NOTE: Often, controlling shareholders will also control the corporation in their capacity as officers and directors. When control persons transfer corporate assets to themselves for inadequate consideration, it may be difficult to discern whether they acted in their capacity of controlling shareholders (giving rise to a direct action) or in their capacity as officers and directors (giving rise to a derivative action only). In such cases, Oregon courts give weight to whether the corporation is a closely held or public. Compare: *Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682 (1992)(direct action permitted in close corporation) and *Loewen v. Galligan*, 130 Or App 222, 882 P2d 104, review denied, 320 Or 493, 887 P2d 793 (1994)(only derivative action permitted in public corporation). But, see: *Wilcox v. Stiles*, 127 Or App 671, 873 P2d 1102 (1994).

NOTE: Direct actions by minority shareholders against those in control of the corporation should be pled as actions against controlling shareholders in their "shareholder" capacity; actions pled

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against control persons in their capacity as officers or directors will almost always be construed as a derivative claim only. See, for example: *Lee v. Mitchell*, 152 Or App 159, 953 P2d 414 (1998).

Persons who assist shareholders in breaching their fiduciary duty to the other shareholders – including attorneys who aid the breaching shareholders – may also be liable for the breach. *Granewich, II v. Harding*, 329 Or 47, 945 P2d 1067 (1999); *Reynolds v. Schrock*, 197 Or App 564, 107 P3d 52, review allowed, 339 Or 475 (2005).

B. Other states.

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

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

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

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

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

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

Delaware, for one, has not. When the controlling stockholder of a family corporation transferred its assets for independent consideration, Delaware required the minority investors to pursue derivative litigation, observing that the value of the minority shares went down only to the

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extent the corporation as an entity was worth less. When the owner of 95% of a closely held firm's stock proposed to liquidate the corporation at what the minority thought was an inadequate price, Delaware again required the minority to bring the objection derivatively. In neither case did the Chancellor think it important that the wrong alleged involved the controlling stockholder enriching itself at corporate expense, or that the corporation was closely held. The author of the leading treatise treats [the second Delaware case cited] as establishing the proposition that the closely held nature of the corporation is irrelevant to the distinction between direct and derivative actions. (citations omitted) *Bragdon v. Bridgestone/Firestone, Inc.*, 916 F2d 379, 383-4 (7th Cir 1990), *cert denied*, 500 US 952 (1991).

See: Frank v. Hadesman & Frank, Inc., 83 F3d 158 (7th Cir 1996).

Section 8.04 Actions Arising Out of Oppression & Deadlock

ORS 60.661(2) has long permitted a shareholder to seek judicial dissolution of a corporation when the majority's conduct is "illegal, oppressive or fraudulent" or when there is a voting deadlock. Specifically, shareholder may seek court intervention if:

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

Although the only remedy mentioned in this statute is dissolution, courts have usually fashioned other remedies for oppressive conduct – relying on their traditional equitable power to protect minority owners. *Browning v. C & C Plywood Corp*, 248 Or 574, 434 P2d 339 (1968); *Baker v. Commercial Body Builders, Inc.*, 264 Or 614, 507 P2d 387 (1973); *Delaney v. Georgia-Pacific Corp.*, 278 Or 305, 564 P2d 277, *supplemented*, 279 Or 653, 569 P2d 604 (1977), *appeal after remand*, 42 Or App 439, 601 P2d 475 (1979).

Even though not mentioned as a remedy under ORS 60.661, a common remedy in oppression cases is an order for the controlling shareholders to purchase the shares of the oppressed minority.

Under ORS 60.661, the trial court had the authority to choose a remedy for defendants' actions; we agree with it that requiring defendants to purchase plaintiff's shares is the preferable option. A purchase will disentangle the parties' affairs while keeping the corporation a going

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concern; dissolution would not benefit anyone, and plaintiff did not seek it at trial. *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 114, 7 P3d 717 (2000).

See, also: Tiff v. Stevens, 162 Or App 62, 78, 987 P2d 1 (1999), *review denied*, 330 Or 331, 6 P3d 1101 (2000).

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

In 2001, ORS 60.952 took effect. The new statute applies only to close corporations. It mirrors ORS 60.661(2) in the triggering events (oppression, voting deadlock, corporate waste), but sets out a long, but non-exclusive, list of possible remedies that a court might apply – remedies previously applied by courts. The new statute also gives the corporation the right to buy-out the complaining shareholder but gives the court the ability to set the price.

It is likely that much of the case law interpreting the older ORS 60.661 will apply to the new statute as well.

A. *Illegal, oppressive or fraudulent conduct.*

"The legislature has not defined "oppression" for present purposes. . . Rather, courts must determine on a case-by-case basis whether the conduct complained of rises to the level of oppression" *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 265, 21 P3d 178 (2001).

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

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

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

"burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members; or a visual departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely."

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

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

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

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

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

But where there is both fiduciary duty breaches and oppressive conduct and the remedy is a court ordered buy-out of the minority, the breach of fiduciary duty claim "is essentially subsumed under the oppression claim" and there is not separate remedy for the fiduciary claim. *Tiff v. Stevens*, 162 Or App 62, 78, 987 P2d 1 (1999), *review denied*, 330 Or 331, 6 P3d 1101 (2000).

One Washington case discusses two tests which have been applied to determine whether conduct is "oppressive."

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

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

burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members; or a visible departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.

Under either of these tests, the factual findings support the legal

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conclusion that [defendant] did not oppress [plaintiff] as a minority shareholder. (citations omitted) *Robblee v. Robblee*, 68 Wash App 69, 76, 841 P2d 1289, 1293 (1992).

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

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

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

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

The other two conducts which trigger ORS 60.661(2) and 60.952(1) – illegal and fraudulent conduct – have not been separately discussed in this context by the Oregon courts.

See: Moll, *Shareholder Oppression & Dividend Policy in Close Corporations*, 60 WASH & LEE L REV 841 (2003); Moll, *Shareholder Oppression in Close Corporations: The Unanswered Question of Perspective*, 53 VANDERBILT L REV 749 (2000).

B. Deadlock.

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

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

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since ORS 60.661(2)(a) also requires that "the shareholders are unable to break the deadlock." See also: *Gregory v. J. T. Gregory & Son, Inc.*, 176 Ga App 788, 338 SE2d 7 (1985).

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

C. Court's power to dissolve is discretionary.

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

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

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

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

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

At common law, many courts refused to intervene in shareholder disputes since the State licensed the corporation, and as such the State

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and not the courts had the authority to dissolve the corporation. In a few jurisdictions, courts of equity began to carve out areas in which they would use the powers of the chancellors to liquidate the assets and business of the corporation. A few courts asserted the power to liquidate on a showing of irreparable injury to the shareholders and the corporation due to gross or fraudulent mismanagement.

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

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

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

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

The Oregon Supreme Court has said:

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

Another court put it more bluntly:

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

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

Under ORS 60.661, a court may find inequitable conduct, but order

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

NOTE: Despite language in many earlier cases that indicates that courts are reluctant to intervene in internal corporate disputes, there has been an increasing tendency for the Oregon Court of Appeals to intervene and fashion some remedy to protect minority shareholders. *See: Tiff v. Stevens*, 162 Or App 62, 78, 987 P2d 1 (1999), *review denied*, 330 Or 331, 6 P3d 1101 (2000); *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 108, 7 P3d 717 (2000) *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 265, 21 P3d 178 (2001). The remedy chosen is often the forced buy-out of the minority's shares.

D. New statutory provisions for close corporations.

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

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

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

ORS 60.952 applies new procedure for close corporations, while leaving ORS 60.661 unchanged for public corporations. The highlights of this new statute are:

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

Under the new statute, in the event a court finds the threshold

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oppressive conduct, the statutory remedies available to the court are expanded beyond the drastic remedy of dissolution. The statute lists 12 other permissive statutory remedies – including appointment or removal of directors, appointment of a custodian to manage the business, submission of the dispute to mediation, award of damages and the forced purchase of shares. All of these statutory remedies have previously been applied by various courts – in Oregon and elsewhere – exercising their equitable power to regulate corporations. ORS 60.952(3) provides that the listed remedies are not exclusive of other legal and equitable remedies a court may impose.

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

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

NOTE: There has been a trend for some states to look to the “reasonable expectations” of the shareholders at formation in determining whether a triggering event of oppression has occurred. For example, whether at formation the shareholders had a “reasonable expectations” of employment throughout the existence of the corporation. In such states, employment termination might be a triggering event giving rise to a suit for oppression.

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

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717 (2000)(which took into account lost wages of the oppressed shareholder in awarding damages).

If a court orders either the corporation or its controlling shareholders to purchase the minority's shares, ORS 60.952(5) provides that the court shall determine the "fair value" of the shares – a value which shall take "into account any impact on the value of the shares resulting from the actions giving rise to the preceding." The court is also required to "consider any financial or legal constraints on the ability of the corporation or the purchasing shareholder to purchase the shares."

Up to this point, ORS 60.952 contains no significant departure from existing case law. Its only radically new provision – ORS 60.952(6) – provides that within 90 days after a minority shareholder initiates an oppression-type lawsuit, either the corporation or one or more of its controlling shareholders may force the plaintiff minority shareholder to sell his/her shares. Should the corporation or its controlling shareholders make such an election, the minority's lawsuit for oppressive conduct is suspended and the court need only determine the "fair value" of the minority's shares.

In theory, if the corporation elects to buy-out the minority under this provision, the minority need no longer prove oppression. But this issue may come in through the back door. Existing case law indicates that "fair value" is the value of the minority's share *with* a marketability discount, but *without* a minority discount. *Columbia Management Co. v. Wyss*, 94 Or App 195, 204, 765 P2d 207, 213 (1988), *review denied*, 307 Or 571, 771 P2d 1021 (1989).

But if the majority's acts are oppressive or a breach of fiduciary duty, *neither* the minority discount nor the marketability discounts apply. *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 276, 21 P3d 178 (2001); *Chiles v. Robertson*, 94 Or App 604, 767 P2d 903, *reconsideration allowed in part, opinion modified*, 96 Or App 658, 774 P2d 500, *review denied*, 308 Or 592, 784 P2d 1099 (1989).

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

See: Moll, *Shareholder Oppression and "Fair Value": Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L J 293 (2004).

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Thus, even though ORS 60.952(6) attempts to give controlling shareholders the ability to avoid the issue of whether their conduct was oppressive or a breach of fiduciary duty, evidence of oppressive conduct will likely still be admissible at trial to set the fair value of the minority's shares in order to determine whether or not to apply a minority discount.

This new provision takes out of the court's hands the ability to fashion a remedy. If the corporation or other shareholder elect to repurchase the plaintiff's shares, the only issue left to the court is a determination of fair value.

E. Court's equitable power to regulate corporate affairs.

An action under ORS 60.661 – and presumably under ORS 60.952 – is an equitable action. *Gl Joe's, Inc. v. Nitzam*, 183 Or App 116, 123, 50 P3d 1282 (2002); *Naito v. Naito*, 178 Or App 1, 4, 35 P3d 1068 (2001).

In addition to the rights granted by ORS 60.661 and 60.952, courts retain the equitable power to dissolve or regulate the affairs of a corporation. Oregon courts are more willing to utilize their equitable powers in order to fashion remedies other than dissolution. See, for example: *Browning v. C & C Plywood Corp*, 248 Or 574, 434 P2d 339 (1968); *Baker v. Commercial Body Builders, Inc.*, 264 Or 614, 507 P2d 387 (1973); *Delaney v. Georgia-Pacific Corp.*, 278 Or 305, 564 P2d 277, supplemented, 279 Or 653, 569 P2d 604 (1977), appeal after remand, 42 Or App 439, 601 P2d 475 (1979).

Section 8.05 Derivative Lawsuits

A. Generally.

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

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

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

Whenever a cause of action exists primarily in behalf of the corporation against directors, officers, and others, for wrongful dealing with corporate property, or wrongful exercise of corporate franchises, so that the remedy should regularly be obtained through a suit by and in the name of the corporation, and the corporation either actually or virtually refuses

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

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

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

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

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

In a derivative lawsuit, a shareholder sues both the corporation and a third party. The third party is the "real" defendant – the corporation is included in the lawsuit only as a nominal defendant. In a derivative lawsuit, the plaintiff-shareholder seeks a remedy against the third party defendant only – the plaintiff does **not** seek damages from the corporation, even though the corporation is a defendant. In fact, the plaintiff shareholder usually is not personally entitled to any damages awarded – any funds recovered from the "true" defendant are usually payable only to the corporation. The only exception is that the plaintiff may be awarded attorney fees out of the funds received by the corporation. *Hoekstre v. Golden B. Products, Inc.*, 77 Or App 104, 712 P2d 149 (1985), *review denied*, 300 Or 563, 715 P2d 94 (1986).

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

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

Another court said:

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

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

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

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

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

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

The development of derivative lawsuits is discussed in *Ross v. Bernard*, 396 US 531 (1970); *Davis v. Harrison*, 25 Wash 2d 1, 167 P2d 1015 (1946); Kaplan & Elwood, *The Derivative Action: A Shareholder's "Bleak House"?* 36 U BRITISH COL L REV 443 (2003); Ferrell, *A Hybrid Approach: Integrating the Delaware and the ALI Approaches to Shareholder Derivative Litigation*, 60 OHIO ST L J 241 (1999); Prunty, *The Shareholders' Derivative Suit: Notes on Its Development*, 32 NYU L REV 980 (1957).

B. Equitable action; extraordinary remedy.

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

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

Courts tend to disfavor derivative lawsuits. *Haberman v. Washington Public Power Supply System*, 109 Wash 2d 107, 744 P2d 1032, 1060 (1987), *amended*, 750 P2d 254 (1988). This is true, in part, due to the strong judicial tendency to defer to the business judgment of

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corporate management and, in part, due to perceived abuses which may occur in a derivative suit – particularly derivative lawsuits against public corporations. Consequently, courts impose a number of procedural requirements regarding derivative lawsuits, some of which have been codified in ORS 60.261. See, *also*: Federal Rules of Civil Procedure Rule 23.1.

NOTE: There is not a comparable provision to FRCP 23.1 in the Oregon Rules of Civil Procedure.

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

In order to bring a derivative lawsuit, the plaintiff must have been a shareholder of the corporation at the time of the allegedly improper transaction. ORS 60.261(1); *Bank of Santa Fe v. Petty*, 116 NM 761, 867 P2d 431 (NM App 1993), *cert denied*, 117 NM 10, 868 P2d 655 (1994); *Davis v. Harrison*, 25 Wash 2d 1, 167 P2d 1015 (1946); *The Contemporaneous Ownership Rule in Shareholders' Derivative Suits*, 25 UCLA L Rev 1041 (1978).

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

Whether the case is considered in the light of the Federal Rule or the Georgia Statute is immaterial because in each the allegation that the petitioner was a stockholder at the time of the transaction of which he complains, or that his shares have devolved upon him by operation of law, is required. *Hurt v. Cotton States Fertilizer Co.*, 145 F2d 293, 295 (5th Cir 1944), *cert denied*, 324 US 844 (1945).

A person need not be a shareholder of record in order to bring a derivative suit. An equitable interest may be sufficient. *Rosenfeld v. Schwitzer Corp.*, 251 F Supp 758 (SD NY 1966)(construing Indiana law). A widow's community property interest in stock has been held sufficient to enable her to bring a derivative lawsuit. *LaHue v. Keystone Investment Co.*, 6 Wash App 765, 496 P2d 343 (1972). A person with a security interest in stock may bring suit derivatively. *Gustofson v. Gustofson*, 47 Wash App 272, 734 P2d 949 (1987).

ORS 60.261(4) specifically includes within the definition of shareholder: "a beneficial owner whose shares are held in a voting trust or held by a nominee on behalf of the beneficial owner." Oregon law is silent on whether a beneficiary of a trust – other than a voting trust – may initiate a derivative lawsuit. Some courts hold a beneficiary of a trust which owns shares may initiate a derivative lawsuit. *Edgeworth v. First National*

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Bank of Chicago, 677 F Supp 982 (SD Ind 1988). Other courts hold beneficiaries lack standing to bring a derivative lawsuit. *Matties v. Seymour Manufacturing Co.*, 270 F2d 365 (2nd Cir 1959), *cert denied*, 361 US 962 (1960).

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

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

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

Not only must a person be a shareholder at the time that the allegedly improper transaction occurred, that person must usually be a shareholder at the time the derivative lawsuit is filed and continue on as a shareholder throughout the course of the lawsuit. *Metal Tech Corp. v. Metal Techniques Co., Inc.*, 74 Or App 297, 703 P2d 237 (1985); *Zauber v. Murray Savings Ass'n*, 591 SW2d 932 (1980).

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

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But there are exceptions. The Ninth Circuit permits a former shareholder to maintain a derivative lawsuit – at least where the rights of creditors and other shareholders are not prejudiced – when the former shareholder parts "with his shares without knowledge of prior wrongful misappropriation of corporate assets by the directors" and where "the misappropriation had reduced the value of his prior shareholdings." *Watson v. Button*, 235 F2d 235, 237 (9th Cir 1956).

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

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

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

See, also: Blasband v. Rales, 971 F2d 1034 (3rd Cir 1992); *Schreiber v. Carney*, 447 A2d 17, 22 (1982).

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

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

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

Other courts have refused to permit persons frozen-out as shareholders to maintain a derivative action. *See, for example: Guenther v. Pacific Telecom, Inc.*, 123 FRD 341 (D Or 1987); *Bronzaft v. Caporali*, 162 Misc2d 281, 616 NYS2d 863 (1994); *Blasband v. Rales*, 971 F2d 1034 (3rd Cir 1992)(interpreting Delaware law); *Yanow v. Teal Industries, Inc.*, 178 Conn 263, 422 A2d 311 (1979).

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D. Who may bring suit: representative plaintiff.

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

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

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

FRCP 23.1 applies to derivative lawsuits filed in federal court – even lawsuits involving Oregon corporations. *See, for example: Rothenberg v. Security Management, Inc.*, 667 F2d 958 (5th Cir 1982).

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

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

A corporate director may qualify as a representative shareholder. *Dotlich v. Dotlich*, 475 NE2d 331 (Ind App 1985). The most important consideration is whether the shareholder bringing the derivative lawsuit

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has an economic interest antagonistic to innocent shareholders. *Newell Co. v. Vermont American Corp.*, 725 F Supp 351 (ND Ill 1989). "Courts have found inadequacy of representation based on conflict of interest when the shareholder plaintiff had personal entanglements adverse to the interest of the other shareholders." *Sonkin v. Barker*, 670 F Supp 249, 251 (SD Ind 1987). Whether a plaintiff is an adequate representative "is firmly committed to the discretion of the trial court, reviewable only for abuse." *Smith v. Ayres*, 977 F2d 946, 948 (5th Cir 1992).

E. Demand requirement.

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

Before initiating a derivative lawsuit, a shareholder must first make demand on the corporation that the corporation itself institute proceedings against the wrongdoers on its own behalf. *North v. Union Savings & Loan Ass'n*, 59 Or 483, 117 P 822 (1911). The "demand requirement is intended to allow the corporation the opportunity to take over a suit brought on its behalf." *Haberman v. Public Power Supply System*, 109 Wash 2d 107, 153, 744 P2d 1032, 1063 (1987), *amended*, 750 P2d 1032 (1988).

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

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

ORS 60.261(2) provides:

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

Even though it may have a valid claim against a third party, a corporation may decide not to sue. "Thus, the demand requirement implements the basic principle of corporate governance that the decision of a corporation - including the decision to initiate litigation - should be made by the board of directors or the majority of shareholders." (citations

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omitted) *Kamen v. Kemper Financial Services, Inc.*, 500 US 102 (1991).

If the corporation's decision not to sue is a decision supportable by the business judgment rule, many courts will not permit a shareholder to override this decision and proceed with a derivative lawsuit. *See, for example: When Should Courts Allow the Settlement of Duty-of-Loyalty Derivative Suits?*, 109 HARV L REV 1084 (1996); Kinney, *Stockholder Derivative Suits: Demand and Futility Where the Board Fails to Stop Wrongdoers*, 78 MARQ L REV 172 (1994).

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

Another court has said:

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

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

In a leading case, New York's highest court upheld the business judgment of a committee of disinterested directors not to pursue a lawsuit against management involved in foreign bribes and kickbacks, finding the committee believed that in relation to the likelihood of success that such a lawsuit would be too costly and disruptive to management and that the adverse publicity would damage the corporation's business. The court

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said that “[w]hile the court may properly inquire as to the adequacy and appropriateness of the committee’s investigative procedures and methodologies, it may not under the guise of consideration of such factors trespass in the domain of business judgment.” *Auerbach v. Bennett*, 47 NY2d 619, 634, 419 NYS 2d 920, 393 NE2d 994 (1979).

Many courts follow the *Auerbach* rule and give great deference to the business judgment of the board. See: *Millsap v. American Family Corporation*, 208 Ga App 230, 430 SE2d 385 (1993); *Will v. Englebretson & Co.*, 213 Cal App3d 1033, 261 Cal Rptr 868, 872-3 (1989); *Black v. NuAire, Inc.*, 426 NW2d 203, 209-10 (Minn App 1988); *Genzer v. Cunningham*, 498 F Supp 682, 686-9 (ED Mich 1980).

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

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

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

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

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

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

If the business judgment rule does not support a board’s decision forego corporate claims against a third party, a shareholder may sue

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derivatively. Derivative lawsuits often involve allegations of wrongdoing by the corporation's directors, management and controlling shareholders.

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

The Delaware courts have held:

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

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

Aronson v. Lewis, 473 A2d 805 (1984). To successfully maintain a stockholder derivative claim where pre-suit demand was not made, a plaintiff must plead particularized facts sufficient to create a reasonable doubt that the business judgment rule protects the challenged corporate transaction. A plaintiff may adequately plead demand futility by satisfying either prong of the two-prong test of *Aronson*. (some citations omitted) *Kahn v. Roberts*, [1993-4 Transfer Binder] FED SEC L RPTR (CCH) ¶ 98,201 (Del Ch Ct February 28, 1994).

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

Other cases require that the demand contain sufficient information so that the board can properly evaluate the claim. *Renfro v. Federal Deposit Insurance Corp.*, 773 F2d 657 (5th Cir 1985). See also: Official Comment to RMBCA § 7.42. "At a minimum, a demand must identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused to the corporation, and request remedial relief." *Allison on behalf of General Motors Corp. v. General Motors Corp.*, 604 F Supp 1106, 1117 (D Del 1985).

F. Recovery belongs to corporation – not plaintiff-shareholder.

A derivative lawsuit is filed on behalf of the corporation. If the lawsuit is successful and damages recovered, these funds belong to the

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corporation – not the shareholder/plaintiff. *American Timber & Trading Co. v. Niedermeyer*, 276 Or 1135, 558 P2d 1211 (1977); *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wash App 502, 728 P2d 597 (1986), review denied, 107 Wash 2d 1022 (1987); *Lynch v. Patterson*, 701 P2d 1126 (Wyo 1985); *Ross v. Bernhard*, 396 US 531 (1969).

Under rare circumstances, a court may permit direct recovery by shareholders. For example, if the majority shareholder participated in the wrongful act, a court may conclude recovery by the corporation would be unjust since the majority shareholder would be rewarded by a pro rata distribution of the derivative lawsuit proceeds. *American Timber & Trading Co. v. Niedermeyer*, 276 Or 1135, 558 P2d 1211 (1977).

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

If awarding a recovery to a corporation would result in a stockholder's receiving a portion thereof to which he was not entitled, then a court of equity will look beyond the corporation and award the recovery to the individual stockholders entitled thereto. However, when third-party rights of higher priority, such as those of corporate creditors or claimants, are involved, then a judgment in favor of the stockholders, which would prejudice such rights, would be improper. (citations omitted). *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wash App 502, 519-520, 728 P2d 597, 608-9 (1986), review denied, 107 Wash 2d 1022 (1987).

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

G. Settlement.

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

In *Goodwin v. Castleton*, *supra*, the court held that since the claim actually belonged to the corporation, the corporation retained the right to compromise or abandon the lawsuit at any time, subject to court approval.

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

A proceeding commenced under this section may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the

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interest of the corporation's shareholders or a class of shareholders, the court shall direct that notice be given to the shareholders affected. ORS 60.261(3).

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

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

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

H. Attorney fees.

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

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

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

Even prior to adoption of the current Act, Oregon courts held that a plaintiff-shareholder was entitled to attorney fees chargeable against the corporation if the derivative lawsuit benefited the corporation. *Hoekstre v. Golden B. Products, Inc.*, 77 Or App 104, 712 P2d 149 (1985), review

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denied, 300 Or 563, 715 P2d 94 (1986). This was true even if the outcome meant the corporation was likely to dissolve and liquidate. *Krause v. Mason*, 272 Or 351, 537 P2d 105 (1975).

But attorney fees may not be recoverable when a lawsuit's most substantial benefit inures to the benefit of the shareholder/plaintiff – rather than to the corporation itself. *Serbick v. Timpco-Pacific, Inc.*, 88 Or App 633, 746 P2d 1167 (1987); *Delaney v. Georgia-Pacific Corp.*, 279 Or 653, 569 P2d 604 (1977); *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wash App 502, 728 P2d 597 (1986), *review denied*, 107 Wash 2d 1022 (1987).

Attorney fees are usually not recoverable in a direct action by the shareholder against other shareholders. *Chiles v. Robertson*, 96 Or App 658, 774 P2d 500, *review denied*, 308 Or 592, 784 P2d 1099 (1989).

I. Oregon does not require plaintiff to post security.

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

J. Equitable defenses.

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

A defense of unclean hands may be available. *Roles v. Roles Shingle Co.*, 147 Or 365, 31 P2d 180 (1934); *Foy v. Klapmeier*, 992 F2d 774, 779 (8th Cir 1993)(applying Minnesota law); *Dobry v. Dobry*, 324 P2d 534 (Okla 1958); *Liken v. Shaffer*, 64 F Supp 432, 442 (ND Iowa 1946).

[S]hareholder derivative actions are inventions of courts of equity, and even though [plaintiff] is merely a nominal plaintiff bringing suit on behalf of [the corporation], equity requires that a shareholder derivative action cannot be maintained if the nominal plaintiff has unclean hands in connection with the transactions which are the bases for the litigation or has participated or acquiesced in, or benefitted from the conduct of which he now complains. (citations omitted) *Forkin v. Cole*, 192 Ill App3d 409, 548 NE2d 795, 805 (1989).

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

A defense of laches may also be available if the shareholder bringing suit delays too long after learning of the claim. *Parker v. Richards*,

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

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

Courts have taken two positions on the issue of who needs to know of the wrongdoing before the statute of limitations begins to run: some courts have only required that a single disinterested director have knowledge of the wrongdoing; others that a majority of decision-makers have such knowledge. Oregon follows the more liberal of these two views – the disinterested majority version of the rule.

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

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

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

Section 8.06 Dissenters' Rights

At common law, the merger of one solvent corporation with another solvent corporation required unanimous shareholder approval. *Pomierski v. W. R. Grace & Co.*, 282 F Supp 385, 394 (ND Ill 1967); *Reynolds Metals*

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Co. v. Colonial Realty Corp., 41 Del Ch 183, 190 A2d 752, 755 (1963); *Shaffer v. General Grain, Inc.*, 133 Ind 598, 182 NE2d 461 (1962). By statute all, or nearly all, states have abandoned this common law rule and now permit a merger by vote of less than all shareholders.

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

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

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

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

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

Dissenters' and appraisal rights are governed by the laws of the state creating the corporation, and if so required by that state's statutes, shareholders may need to file suit in that state's courts to seek appraisal of their shares. *Meade v. Pacific Gamble Robinson Co.*, 21 Wash 2d 866, 153 P2d 686 (1944); *Grant v. Pacific Gamble Robinson Co.*, 22 Wash 2d 65, 154 P2d 301 (1944).

Merger is not the only event which creates dissenters' rights. ORS 60.554 grants a shareholder the right to dissent when any of the following extraordinary events occur: the consummation of certain plans of merger and plans of share exchange; the consummation of a sale of substantially all corporate assets; and enactment of certain amendments of the articles of incorporation which materially affect the rights of the dissenters' shares.

But not all mergers trigger to a right to consent. For instance, the right to dissent does not apply to a merger occurring solely to change the

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corporation's state of incorporation. *China Products North America, Inc. v. Manewal*, 69 Wash App 767, 775-6, 850 P2d 565, 569 (1993).

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

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

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

Dissenters' rights do not apply to holders of shares of most public companies. Dissenters' rights do not apply to any class of shares traded on a national securities exchange or on the National Market System of NASDAQ. ORS 60.554(3).

A. Steps required by statute.

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

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

But if the shareholders then vote and authorize an action giving rise to dissenters' rights, the corporation must send a "dissenters' notice" to all shareholders who previously dissented. The corporation must send the "dissenters' notice" within 10 days of the shareholder vote authorizing the act. This notice must: (i) state where the shareholder must send a payment demand; (ii) state where and when the shareholder's stock certificates must be deposited; (iii) describe any transfer restrictions applicable to uncertificated shares; (iv), supply a form for demanding payment; and (v) set a date by which the corporation must receive the

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payment demand (no less than 30 and no more than 60 days after the date the dissenters' notice is delivered to the dissenters). ORS 60.567.

If the proposed action is taken without a shareholder vote, the corporation is required to inform its shareholders of the action taken and to deliver a "dissenters' notice," described above, to all shareholders entitled to assert dissenters' rights. ORS 60.561(2).

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

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

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

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

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

B. Fair value.

As discussed above, once a shareholder dissents and demands

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

"Fair value" is not the same as "fair market value." Fair market value – what a willing buyer and willing seller will pay – is only one factor in determining fair value. *Columbia Management Co. v. Wyss*, 94 Or App 195, 199, 765 P2d 207, 210 (1988), *review denied*, 307 Or 571, 771 P2d 1021 (1989).

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

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

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

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

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

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

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either in market value or capitalized earnings value.

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

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

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

In order to determine fair value, several methods are usually considered: market value, net assets value, and a third value, varyingly referred to as the earnings value, investment value, or enterprise value. "[T]he relative weight given each will depend on the circumstances of the case." *Columbia Management Co. v. Wyss*, 94 Or App 195, 199, 765 P2d 207, 210-1 (1988), *review denied*, 307 Or 571, 771 P2d 1021 (1989).

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

The most important factor in most cases, it pointed out, is investment or enterprise value, because that value reflects the business' worth as a going concern. The purpose of the appraisal statute is to ascertain what the dissenter actually loses because of his or her unwillingness to go along with the controlling shareholders' desires. The court refused to accept a minority discount because it would be a departure from that purpose. Such a discount affects market value more than investment value. The statute allows the majority to override the minority so long as it adequately protects the minority's interests. There would be no protection if the minority could be squeezed out for less than the real value of its interest. *Columbia Management Co. v. Wyss*, 94 Or App 195, 201-2, 765 P2d 207, 212 (1988), *review denied*, 307 Or 571, 771 P2d 1021 (1989) (discussing *Woodward v. Quigley*, 257 Iowa 1077, 133 NW2d 38 (1965)).

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

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

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

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

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

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

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

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

A "minority discount" is a reduction in value "which recognizes that controlling shares are worth more in the market than are noncontrolling shares." *Columbia Management Co. v. Wyss*, 94 Or App 195, 204, 765 P2d 207, 213 (1988), *review denied*, 307 Or 571, 771 P2d 1021 (1989); *Tyron v. Smith*, 191 Or 172, 229 P2d 251 (1951).

A "marketability discount" is a reduction in value which recognizes

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that "interests in closely held business enterprises cannot readily be sold, they are less marketable and, therefore, less valuable than equivalent interests in companies whose securities are regularly traded in a recognized market." Haynesworth, *Valuation of Business Interests*, 33 MERCER L REV 457, 489 (1982).

Although each case turns on its own facts, in an appraisal action based on dissenters' rights, courts will often apply marketability discounts, but refuse to apply minority discounts. *Robblee v. Robblee*, 68 Wash App 69, 841 P2d 1289 (1992).

Columbia Management Co. v. Wyss, 94 Or App 195, 765 P2d 207 (1988), *review denied*, 307 Or 571, 771 P2d 1021 (1989) involved a corporate event which essentially squeezed-out a shareholder in a close corporation and gave him the right to dissent. The Court of Appeals upheld the trial court's decision to apply a marketability discount, but overturned the trial court's application of a minority discount.

[B]ecause a dissenting shareholder is exercising a right designed for his or her protection, and because the purchaser of the shares will be the corporation, not an outsider, this recognition of decreased market value may not be appropriate. "It is contrary to the purpose of the statute to discount the minority interest because it is a minority. This in effect would let the majority force the minority out without paying its fair share of the value of the corporation." (citation omitted) *Columbia Management Co. v. Wyss*, 94 Or App 195, 204, 765 P2d 207, 213 (1988), *review denied*, 307 Or 571, 771 P2d 1021 (1989).

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

The discounts which apply may vary by the context of the appraisal. For instance, in actions by a minority shareholders for oppressive conduct and breach of fiduciary duty, courts sometimes force the corporation to buyout of the minority's shares. In several such cases, courts have declined to apply either a minority or a marketability discount. *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 276, 21 P3d 178 (2001); *Cooke v. Fresh Express Foods Corp.*, 169 Or App 101, 115, 7 P3d 717 (2000) *Chiles v. Robertson*, 94 Or App 604, 767 P2d 903, *reconsideration allowed in part, opinion mod*, 96 Or App 658, 774 P2d 500, *rev den*, 308 Or 592, 784 P2d 1099 (1989); Moll, *Shareholder Oppression and "Fair Value": Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L J 293 (2004).

Hard and fast rules do not apply. Fair value is a question of fact,

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and as such, it "will depend upon the circumstances of each case; there is no single formula for mechanical application." *Matter of Seagroatt Floral, Co., Inc.*, 78 NY2d 439, 583 NE2d 287, 290 (1991).

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

C. Legal action; burden of proof.

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

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

D. Attorney fees.

ORS 60.594 permits a court to assess attorney fees against either the corporation or the dissenters if the court finds that such party acted arbitrarily, vexatiously or not in good faith. In the case of a corporation only, the court may assess attorney fees if the corporation did not comply with the dissenters' rights provisions of the Act. *Chrome Data Systems, Inc. v. Stringer*, 109 Or App 513, 820 P2d 831 (1991).

E. Appraisal actions – exclusive remedy?

Most courts will use their equitable powers to protect minority shareholders in a squeeze-out situation. Oregon is among the minority of states where the appraisal statute is usually the sole remedy. *Stringer v. Car Data Systems, Inc.*, 314 Or 576, 841 P2d 1183 (1992), *reconsidered*, 315 Or 308, 844 P2d 905 (1993); Spencer, *The Oregon Supreme Court Grants Majority Shareholders in Close Corporations a License to Steal: Stringer v. Car Data Systems, Inc.*, 30 WILL L REV 373 (1994). *But see: Noakes v. Schoenborn*, 116 Or App 464, 841 P2d 682 (1992).

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

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

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

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

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

The Revised Model Act adopted the *Weinberger* approach.

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

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

But the prospect that shareholders may be "paid off" does not justify the corporation in proceeding unlawfully or fraudulently. If the corporation attempts an action in violation of the corporation law on voting, in violation of clauses in articles of incorporation prohibiting it, by deception

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

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

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

As fiduciaries seeking to "cash out" the minority stockholders of a Delaware corporation in a non-arm's length merger, the defendants had a duty to be entirely and scrupulously fair to the plaintiffs in all respects. *Weinberger v. UOP, Inc.*, 457 A2d at 710. The majority stockholder was obliged not to time or structure the transaction, or to manipulate the corporation's values, so as to permit or facilitate the forced elimination of the minority stockholders at an unfair price. The corporation's directors were obliged to make an informed, deliberate judgment, in good faith, that the merger terms, including the price, were fair and that the merger would not become a vehicle for economic oppression. And finally, the directors (and the majority stockholder, to the extent that it involved itself in such matters) were obliged to disclose with entire candor all material

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facts concerning the merger, so that the minority stockholders would be able to make an informed decision as to whether to accept the merger price or to seek judicial remedies such as appraisals, an injunction, or a post-merger damage action.

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

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

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

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

See, also: Fleming v. International Pizza Supply Corp., 676 NE2d 1051 (Ind 1997)(appraisal action is exclusive remedy but minority can litigate fraud and breach of fiduciary duty claims in that action as effecting fair value); *Brandt v. Travelers Corp.*, 44 Conn Sup 12, 665 A2d 616 (1995)(minority could not enjoin merger because appraisal is exclusive remedy); *Stepak v. Schey*, 51 Ohio St3d 8, 553 NE2d 1072 (1990)(remedy for breach of fiduciary duty involving only price that a shareholder receives is limited to appraisal statute); *Schloss Associates v. C & O Ry.*, 73 Md App 727, 536 A2d 147 (1988)(appraisal remedy wholly adequate in dispute essentially over price); *Green v. Santa Fe Industries, Inc.*, 70 NY2d 244, 514 NE2d 105 (1987)(appraisal adequate in dispute over mere inadequacy of price); Spencer, *The Oregon Supreme Court Grants Majority Shareholders in Close Corporations a License to Steal: Stringer v. Car Data Systems, Inc.*, 30 WILL L REV 373 (1994).

But see: Noakes v. Schoenborn, 116 Or App 464, 841 P2d 682 (1992) (minority shareholder may have direct action against majority if

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squeeze-out occurred in breach of majority's fiduciary duty).

Under Oregon law, a shareholder's appraisal right is the minority's exclusive remedy in a squeeze-out transaction.

For a discussion of corporate freezeouts, see Guhan Subrmanian, *Corporate Freezeouts*, 115 Yale L J 2 (2005).