Rights and Remedies of Shareholders in Closely Held Corporations under Illinois Law, The

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The Rights and Remedies of Shareholders in Closely Held Corporations Under Illinois Law

William R. Quinlan & John F. Kennedy*

I. INTRODUCTION

For several years, Illinois has protected shareholders of closely held corporations by recognizing them as the virtual legal equivalent of partners. Operating on the cutting edge of such issues, Illinois law imposes upon shareholders of closely held corporations the identical fiduciary duties that partners owe to one another in a partnership venture. Each shareholder must treat other shareholders with the utmost honesty and fairness in all corporate affairs and is prohibited from engaging in any form of secret dealing. Moreover, because every shareholder has the right to participate in the management and control of the corporation, Illinois law prohibits majority shareholders from depriving minority shareholders of their right to participate meaningfully in corporate governance, providing them with broad protections and wide-ranging remedies where those in control of a corporation act in an oppressive or unlawful manner.

Both the fiduciary obligations owed by shareholders of close corporations and the legal and equitable remedies available to those shareholders arise from the significant distinctions between close corporations and large public corporations. Close corporations usually

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1. See infra Part II.
2. See infra Part III.
3. See infra Part IV.
have only a few shareholders and are often family-owned. Generally, these shareholders invest not only money, but also a substantial amount of time and energy to make the corporation a success. Each shareholder of the close corporation has a legitimate expectation to participate in the day-to-day management of the business, to be named as a corporate officer and director, and to be employed by the corporation. Often, the shareholder's only return on his investment is the salary the shareholder receives as compensation for a position within the corporation. By protecting the expectations of shareholders, both the Illinois common law and recent amendments to the Illinois Business Corporation Act are designed to recognize the commercial realities of the closely held corporation.

Family business disputes often arise among shareholders that ultimately result in the business' failure. For example, of the family-owned corporations with at least twenty employees that existed in the Chicago area in 1924, eighty percent were no longer operating in 1984. This failure of closely held corporations can be attributed mostly to "typical family problems [such] as sibling rivalry [and] competition between the generations" that result in disputes among shareholders and problems of corporate succession. Recognizing the unique problems associated with closely held corporations, Illinois law provides shareholders of close corporations with both the means to resolve disputes that arise, and mechanisms to avoid those disputes through advance planning.

This Article illustrates these mechanisms by examining the rights and duties of shareholders of closely held corporations organized under Illinois law. The Article will explore the nature of the legal and equitable relationships of the owners of closely held or family-owned corporations, common disputes, and ways to avoid or resolve such disputes. First, the Article discusses the nature of close corporations and the fiduciary obligations that exist among the shareholders. The Article then addresses the problems that typically plague closely held corporations and methods through which owners of small businesses

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4. See infra Parts II-III.
7. See id.
8. See infra Part IV.
9. See infra Part II.
may avoid such problems. Next, the Article will analyze Illinois law regarding disputes among shareholders, which gives courts great latitude to fashion remedies to protect the minority shareholders’ investment and rights of control, preserve the assets of the business, and, if possible, avoid dissolution of the business. Finally, this Article will suggest the role that legal counsel can play to help the corporation avoid conflicts and disputes.

II. CLOSELY HELD CORPORATIONS UNDER ILLINOIS LAW

In the landmark case *Galler v. Galler*, the Illinois Supreme Court defined the closely held corporation as “one in which the stock is held in a few hands, or in a few families, and wherein it is not at all, or only rarely, dealt in by buying or selling.” The Illinois legislature likewise defined a non-public corporation as “a corporation that has no shares listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national or affiliated securities association.”

Several unique characteristics distinguish closely held corporations from public corporations. In addition to involving close family or other personal relationships, close corporations, unlike publicly traded corporations, have no market for the corporation’s shares. Therefore, it is difficult for shareholders to cash out their investments. In addition, the closely held corporation frequently employs its shareholders, who also play a meaningful role in the corporation’s management. As a result, shareholders invest

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10. See infra Parts III-IV.
11. See infra Parts V-VII.
12. See infra Part VII.
13. 203 N.E.2d 577 (Ill. 1965).
14. Id. at 583.
15. 805 ILL. COMP. STAT. ANN. 5/12.56 (West 1997).
17. See *Galler*, 203 N.E.2d at 583-84. The *Galler* court stated that “[w]hile the shareholder of a public-issue corporation may readily sell his shares on the open market, . . . his counterpart of the close corporation often has a large total of his entire capital invested in the business and has no ready market for his shares should he desire to sell.” Id.; see also Bamonte, supra note 16, at 259 (noting the special characteristics of close corporations).
19. See *Galler*, 203 N.E.2d at 584.
substantial amounts of time and money and expect a return on that investment in the form of salaries rather than dividends or capital appreciation.20

There is a prevailing misconception that the rights of the shareholders of a closely held corporation are no different than the rights of shareholders of a public corporation. Majority shareholders often incorrectly believe that they have the exclusive right to manage and control the corporation without regard for the interests of the minority shareholders. Such a misconception can lead to expensive litigation and result in costly judgments for compensatory and punitive damages.21

A. Origins of Fiduciary Duties Among Shareholders in Closely Held Corporations

The characteristics unique to closely held corporations give rise to certain fiduciary duties that do not exist in publicly held corporations. Because of the separation of ownership and control, a shareholder of a corporation generally owes no fiduciary duties to the corporation.22 However, the separation of ownership and control is lacking in a closely held corporation, where the entity is owned by a small group of shareholders who also exercise control over its management. Because of these distinctions, courts have found it necessary to apply principles concerning fiduciary duties to the officers, directors, and shareholders of closely held corporations.23

23. See id. at 323; see also Rexford Rand Corp. v. Ancel, 58 F.3d 1215, 1218 (7th Cir. 1995) (maintaining that "[u]nder Illinois law, a shareholder in a close corporation owes a duty of loyalty to the corporation and to other shareholders"); Illinois Rockford Corp. v. Kulp, 242 N.E.2d 228, 233 (Ill. 1968) (explaining that "[t]heir decision to form and operate as a corporation does not change the fact that they were embarking on a joint enterprise, and their mutual obligations were similar to those of partners" (quoting Tilley v. Shippee, 147 N.E.2d 347, 352 (Ill. 1958)); Giammanco v. Giammanco, 625 N.E.2d 990, 1002 (Ill. App. Ct. 1993) (discussing whether sole and co-equal shareholders owe each other a fiduciary duty similar to that of partners); Graham v. Mimms, 444 N.E.2d 549, 556 (Ill. App. Ct. 1982) (finding that those who control the corporation owe a fiduciary duty to the corporation and its shareholders). See generally Bamonte, supra note 16, at 259-261 (discussing the expansion of fiduciary duty principles intended to protect shareholders against oppression); Thompson, supra note 16, at 705-06 (finding high vote requirements and minority-shareholder initiated dissolutions appropriate means to protect minority investors).
For example, in *Hagshenas v. Gaylord*, the Illinois Appellate Court found that a fifty percent shareholder in a closely held corporation owed a fiduciary duty to the other two shareholders and the corporation. Although the court recognized that a shareholder of a public corporation, unlike a partner in a partnership, generally owes no fiduciary duties, it concluded that in "an intimate business venture such as this, the stockholders of a close corporation occupy a position similar to joint adventurers and partners." The court reasoned that unlike shareholders of public corporations, who can readily sell their stock when disagreements arise, shareholders of closely held corporations do not have available markets within which to sell their shares. The court explained that engagement in small business enterprises required the shareholders to place that trust and confidence in one another, thus establishing a fiduciary duty among the shareholders.

Although *Hagshenas* became a subject of widespread criticism and scrutiny, the decision did not fundamentally depart from the line of reasoning already adopted by Illinois courts. More than twenty years prior to *Hagshenas*, the Illinois Supreme Court found that a fiduciary relationship could exist among the shareholders of a close corporation. In *Illinois Rockford Corp. v. Kulp*, a fifty percent shareholder, while negotiating the sale of a business, secretly secured a better deal for himself than for the company's other fifty percent shareholder. Proclaiming the existence of a fiduciary relationship "in all cases in which a confidential relationship has been acquired" regardless of how the confidence originated, the Court held that the defendant stood in a fiduciary relationship with the plaintiff and

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24. 557 N.E.2d 316.
25.  See id. at 323.
26.  See id. at 321.
27.  *Id.* at 322 (citing Helms v. Duckworth, 249 F.2d 482 (D.C. Cir. 1957)).
28.  See id. at 324.
29.  See id. The *Hagshenas* court referred to *Illinois Rockford Corp. v. Kulp*, in which the Illinois Supreme Court held that a fiduciary relation exists in all cases where a confidential relationship has been created. See id. at 324 (citing *Illinois Rockford Corp. v. Kulp*, 242 N.E.2d 228 (Ill. 1968)).
30.  See Bamonte, *supra* note 16, at 262. The controversy over *Hagshenas* arose from its holding that the fifty percent shareholder continued to owe a fiduciary duty despite his resignation as an officer and director. See *Hagshenas*, 557 N.E.2d at 323. The court concluded that the shareholder, by the mere act of maintaining a fifty percent interest, still exercised considerable control in the corporation. See id.
31.  See *Illinois Rockford Corp.*, 242 N.E.2d at 233-34.
32.  242 N.E.2d 228 (Ill. 1968).
33.  See id. at 231.
breached his duty to deal openly and honestly with respect to the sale of the corporation’s stock.34

_Hagshenas_ and _Illinois Rockford_ exemplify the tendency of Illinois courts to impose fiduciary duties upon the principals of closely held corporations, both to the corporation and to the other shareholders.35 Courts have held that it is necessary to impose fiduciary duties upon shareholders of closely held corporations because, although the close corporation “embodies the corporate form, it in many ways resembles a partnership. Thus, ‘the mere fact that a business is run as a corporation rather than as a partnership does not shield the business venturers from a fiduciary duty similar to that of true partners’.”36 By employing this partnership analogy to impose fiduciary duties upon shareholders of close corporations, Illinois courts are able to protect minority shareholders from oppressive conduct by the majority.37

_B. Extent of Fiduciary Duties_

Fiduciary duties under Illinois law are sweeping, indeed. They do not cease when the shareholder resigns from his position with the corporation, is terminated, or is even frozen-out of the business.38

34. _Id._ at 233.

35. See also Rexford Rand Corp. v. Ancel, 58 F.3d 1215, 1218 (7th Cir. 1995) (imposing on the shareholder of a closely held corporation a duty of loyalty to the corporation and other shareholders).

36. _Id._ at 1219 (quoting _Hagshenas_, 557 N.E.2d at 322); see also _Illinois Rockford_, 242 N.E.2d at 233 (quoting Tilley v. Shippee, 147 N.E.2d 347 (Ill. 1958)).

37. See _Rexford Rand_, 58 F.3d at 1219; Bamonte, _supra_ note 16, at 259-261; Thompson, _supra_ note 16, at 705-706; see also _Illinois Rockford_, 242 N.E.2d at 233 (noting that “[t]heir decision to form and operate as a corporation rather than a partnership does not change the fact that [the shareholders] were embarking on a joint enterprise, and their mutual obligations were similar to those of partners”); Doherty v. Kahn, 682 N.E.2d 163 (Ill. App. Ct. 1997) (treating as a partnership a close corporation in which shareholders acted as directors and officers and participated in the day-to-day operations); Giammanco v. Giammanco, 625 N.E.2d 990 (Ill. App. Ct. 1993) (adopting the principle that sole and coequal shareholders of the corporation owed each other a fiduciary duty similar to that of partners); Graham v. Mimms, 444 N.E.2d 549 (Ill. App. Ct. 1982) (determining that a majority shareholder in a close corporation had a fiduciary duty to the minority shareholders because he used his majority status to elect his sister and brother-in-law to corporate positions, thereby retaining control of the corporation). But see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 249-252 (1991) (presenting the shortcomings of comparing a closely held corporation to a partnership).

38. See _Rexford Rand_, 58 F.3d 1215 (7th Cir. 1995) (interpreting Illinois substantive law as imposing a duty of loyalty on shareholders to their corporation even after the shareholders have been frozen out). In _Rexford Rand_, a company that failed to file an annual report with the State of Illinois was administratively dissolved, causing it to lose its rights in the name “Rexford Rand” and another trade name used by the corporation. See _id._ at 1217. The defendant, a twenty-five percent shareholder who had
Moreover, a shareholder can breach his fiduciary duty simply by placing his own interests above those of the corporation.\textsuperscript{39}

As fiduciaries, business venturers must “exercise the highest degree of honesty and good faith in their dealings” with business associates and the corporation.\textsuperscript{40} Thus, shareholders must “deal fairly, honestly and openly with fellow stockholders and [they must] make disclosure of all essential information.”\textsuperscript{41} In such a fiduciary relationship, all forms of trickery, secret dealings, and preference are prohibited in matters related to the principal’s business.\textsuperscript{42} Accordingly, a shareholder’s use of corporate assets to further his own goals is a violation of his fiduciary duties.\textsuperscript{43}

been terminated from his positions as Vice President and Treasurer prior to the company’s dissolution subsequently reserved these trade names without informing the other two shareholders. See id. He then secured a new corporate charter in the name of “Rexford Rand,” thereby preventing the original Rexford Rand from re-incorporating under its original name. See id.

The corporation sued alleging that the defendant had breached his fiduciary duty to the corporation by depriving the company of the use of its name. See id. In defense, the defendant maintained that he had been frozen-out of the business, and as such, any fiduciary duty he owed to the business ended when the other shareholders froze him out. See id. The court rejected this argument and held that the defendant continued to owe the corporation a duty of loyalty even while frozen-out of the business. See id. The court stated that “[m]inority shareholders have an obligation as de facto partners in the joint venture not to do damage to the corporate interests. If a minority shareholder harms the corporation through ‘unscrupulous and improper “sharp dealings”’ with the majority, he has breached his duty of loyalty.” Id. at 1219 (quoting Donahue v. Rodd Electrotype Co. of New England, Inc., 328 N.E.2d 505, 515 n.17 (Mass. 1975)).

The court reasoned that by taking the corporate name, defendant unscrupulously threatened serious damage to the well-being of the company and to the other two shareholders’ investment. See id. at 1220. The court further reasoned that the freeze-out did not relieve defendant of his duty of loyalty because he was not deprived of his status as a shareholder. See id. According to the court, even if defendant was frozen-out of the business, he should not have resorted to self-help measures because Illinois law provides judicial remedies for disgruntled shareholders. See id. at 1221. The court concluded that “[i]f shareholders take it upon themselves to retaliate any time they believe they have been frozen out; disputes in close corporations will only increase.” Id.

39. See id. at 1220 (stating that a shareholder in a close corporation has an obligation to place “the interests of the corporation above his personal interests”).


41. Hagshenas v. Gaylord, 557 N.E.2d 316, 323 (Ill. App. Ct. 1990) (citing Helms v. Duckworth, 249 F.2d 482, 486 (D.C. Cir. 1957)); see Rexford Rand, 58 F.3d at 1219. In Rexford Rand, the court stated that shareholders must “deal with the utmost good faith, fairly, honestly, and openly with their fellow stockholders.” Rexford Rand, 58 F.3d at 1219 (quoting In re Dearborn Process Service, Inc., 149 B.R. 872, 880 (Bankr. N.D. Ill. 1993)).

42. See Bakalis v. Bressler, 115 N.E.2d 323, 327 (Ill. 1953).

C. Consequences of Breach of Fiduciary Duty

Aside from compensatory damages, breach of fiduciary duties also may give rise to punitive damages, particularly when the breach is intentional.\(^44\) For instance, in *Levy v. Markal Sales Corp.*\(^{45}\) a forty percent shareholder of a closely held corporation brought numerous claims for breach of fiduciary duty against the company's other two shareholders, alleging that they had conspired against him by secretly agreeing to terminate plaintiff's employment and by usurping a valuable business opportunity by establishing their own separate corporation.\(^{46}\) After first determining that defendants owed a fiduciary duty to the corporation and to the plaintiff, the court held that defendants breached that duty by failing to give the original corporation the opportunity to represent the large client and by using the original company's assets to develop and support the new corporation.\(^{47}\) The court also held that defendants breached their fiduciary duties by intentionally concealing their agreement from plaintiff until they fired him.\(^{48}\) As a result, the court upheld an award of punitive damages.\(^{49}\) In reaching its decision, the court stated that "'[p]unitive damages are appropriate to punish and deter conduct where the defendant is guilty of . . . an intentional breach of fiduciary

\(^{44}\) See *Levy v. Markal Sales Corp.*, 643 N.E.2d 1206, 1223 (Ill. App. Ct. 1994); see also *Home Sav. & Loan Ass'n v. Schneider*, 483 N.E.2d 1225, 1228 (Ill. 1985) (permitting award of punitive damage where false representations are wantonly made); *Obermaier v. Obermaier*, 470 N.E.2d 1047, 1053 (Ill. App. Ct. 1984) (stating that punitive damages are appropriate to punish and deter intentional breach of fiduciary duty); *Zokozych*, 344 N.E.2d at 819 (permitting award of punitive damages where there is a wanton breach of fiduciary duty).


\(^{46}\) See *Levy*, 643 N.E.2d at 1210-14. In *Levy*, 40% of a close corporation's stock was owned by plaintiff, another 40% was owned by one defendant, and the remaining 20% was owned by another defendant, with all three owners serving in various capacities as officers, directors, and employees. *See id.* at 1210. The plaintiff alleged that the defendants secretly entered into an agreement with the corporation providing that the defendants would remain employed with the company for a five year term and that the 40% shareholder would eventually purchase the interest of the 20% shareholder. *See id.* The plaintiff further alleged that, at a directors' meeting after the agreement was signed, defendants voted to terminate plaintiff's employment. *See id.* at 1211. Thereafter, defendants excluded plaintiff from the daily activities of the corporation, only advising him of their agreement after he had been terminated. *See id.* Additionally, plaintiff claimed that defendants rejected an offer to allow the company to represent a large client and usurped the opportunity by establishing their own separate corporation to represent the client. Defendants then served as the sole officers, directors, and shareholders of the new corporation and utilized the original company's assets for the benefit of the new company. *See id.*

\(^{47}\) *See id.* at 1216-17.

\(^{48}\) *See id.* at 1224.

\(^{49}\) *See id.*
III. PROBLEMS ARISING IN CLOSELY HELD CORPORATIONS

The unique characteristics that differentiate a closely held corporation from a public one precipitate a multitude of problems regarding management and control of the close corporation. The following discussion identifies several of the most common contentious issues in the operation of a closely held corporation.

A. Oppression of Minority Shareholders

Oppressive conduct by an officer, director, or shareholder of a close corporation is among the most common problems associated with the management and control of closely held corporations and often produces an assortment of dilemmas for the corporation. Because oppressive behavior among shareholders can come in various forms, the courts are reluctant to define what constitutes oppressive behavior too narrowly. Instead, the courts prefer to apply a descriptive definition characterizing oppression as "arbitrary, overbearing, and heavy-handed course of conduct." Although, under Illinois law, the mere failure of shareholders to get along does not constitute oppressive conduct if the corporation is still performing its corporate functions, however, a "continuing and escalating deterioration" of the business relationship between shareholders may amount to oppression.

50. Id. at 1223 (quoting Obermaier v. Obermaier, 470 N.E.2d 1047 (III. App. Ct. 1984)). In Obermaier, plaintiff and defendant were brothers that owned equal shares of a family corporation. See id. at 1050. The brothers decided to sell the corporation and the defendant dealt with all prospective buyers. See id. Plaintiff's attorney was not appraised of any developments in the sale of the business. See id. When a sale to a prospective buyer was canceled, the defendant offered to buy-out the plaintiff. See id. The defendant told the plaintiff that he would not look for another buyer for at least one year. See id. However, the day that defendant bought out plaintiff, the defendant participated in negotiations for the sale of the business at a higher price than originally contemplated by plaintiff and defendant. See id. at 1050-51. As a result, the defendant received a great profit. See id. When plaintiff learned of the sale and defendant's profit, he brought an action against his brother for fraud and breach of fiduciary duties for failing to disclose all relevant information about the stock sale. See id. at 1051. The court affirmed the trial's court award of punitive damages because there existed a "flagrant breach of fiduciary responsibility and clear evidence of fraud." Id. at 1053-54.

51. See supra Part II.A.


1. Domination of Corporate Affairs by the Majority

Illinois’ adoption of a broad definition of “oppressive conduct” gives courts wide latitude in correcting domineering or abusive conduct by shareholders. For example, in Compton v. Paul K. Harding Realty Co., the plaintiff brought suit alleging a domination of corporate affairs by the controlling shareholder. The plaintiff alleged that the corporation’s operation and management were at the exclusive direction and control of the defendant and without the knowledge or consent of the plaintiffs because no notices for shareholder or director meetings were sent, nor had any such meetings occurred. The plaintiff also alleged that the defendant earned a salary greater than what was originally agreed upon.

The Compton court held that the defendant’s failure to call meetings of the board of directors and failure to consult with plaintiff regarding the management of corporate affairs, as well as defendant’s attitude and reaction toward plaintiff when questioned about his salary, constituted “an arbitrary, overbearing, and heavy-handed course of conduct,” and supported a finding of oppression. The court upheld the trial court’s order to dissolve the corporation.

2. The Freeze Out

Frequently, minority shareholders in closely held corporations encounter shareholder freeze-out. Illinois courts have used the term “freeze-out” to refer to:

the use of corporate control vested in the statutory majority of shareholders or the board of directors to eliminate minority shareholders from the enterprise or reduce their voting power or claims on corporate assets to relative insignificance. A freeze-out implies a purpose to force upon the minority shareholder a change which is not incident to any other corporate business goal.

56. See id. at 577.
57. See id.
58. See id.
59. Id. at 581.
60. See id.
61. Rexford Rand Corp. v. Ancel, 58 F.3d 1215, 1227 n.3 (7th Cir. 1995) (quoting Fleming v. International Pizza Supply Corp., 640 N.E.2d 1077, 1080 n.4 (Ind. Ct. App. 1994) (citation omitted), vacated, 676 N.E.2d 1051 (Ind. 1997)); see also Bamonte, supra note 16, at 257-60. In the prototypical situation, a controlling shareholder unilaterally: terminates a minority shareholder-employee; removes the minority shareholder from the board of directors; and then pays no dividends, causing the minority shareholder to receive no return on his or her investment. See Bamonte, supra
The following example illustrates the dynamics of a freeze-out in a close corporation. Two equal shareholders are sole directors of a family business. The corporate bylaws provide that the directors can only take corporate action by a majority vote. One shareholder denies the other access to the corporate books and records. Without a majority vote, the shareholder also amends the bylaws to add a third director position and appoints a long-time business associate to that position. Such action eliminates the need for the other shareholder’s approval to take future corporate action.

Another typical freeze-out technique is used when a minority shareholder is threatened with termination from his employment within the corporation in order to force a sale of his shares of stock at a deflated price.62 Terminating a minority shareholder’s employment is particularly devastating because it leaves the shareholder “‘frozen-out’ yet ‘locked in.’”63 When a shareholder is “frozen-out, yet locked in,” he still holds his stock, but he has no ability to participate in corporate governance or to protect his investment, and he receives no financial return on his investment. With depleted funds and no available market for corporate shares, the majority often pressures the minority shareholder into selling his shares for far less than their worth.64

The Hagshenas and Rexford Rand holdings further amplify the difficulties created when a shareholder is terminated from his employment with the close corporation.65 Both Hagshenas and Rexford Rand hold that a shareholder maintains his fiduciary duty to the corporation even after the shareholder’s employment with the corporation is terminated.66 Thus, under Hagshenas and Rexford Rand, a majority shareholder might rely on the minority shareholder’s fiduciary duty to create what is in essence a common law covenant not to compete against the majority shareholder.67 The minority

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62. See Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976); see also F. HODGE O’NEAL & ROBERT B. THOMPSON, O’NEAL’S OPPRESSION OF MINORITY SHAREHOLDERS § 3.06 (2d ed. 1985) (describing a minority shareholder’s removal from a management or employment position as “a devastatingly effective squeeze-out technique”).


64. See O’NEAL & THOMPSON, supra note 62, at § 3.06.

65. See supra notes 24-40 and accompanying text (discussing both cases).

66. See supra notes 30 and 38.

shareholder is then both frozen-out of the corporation and barred from seeking employment with a business in competition with or even in the same industry as the corporation from which he was ousted. In such a situation, the minority shareholder might be prevented from exercising the very skills that he relies on to earn a living. The minority shareholder would be frozen-out of both the business he owns and his chosen profession. Courts should freely exercise the powers granted to them under section 12.56 of the Business Corporation Act and the common law to fashion an appropriate remedy under these circumstances.

Additional methods that freeze shareholders out of the corporation include: controlling signatory rights on corporate accounts; hiding checkbooks; changing locks; withholding financial information; or making a resolution to relieve minority shareholders of their positions as director, officer, or employee of the corporation. Regardless of the method of freeze-out, when a shareholder is frozen-out, he is deprived of any opportunity to participate meaningfully in the management of the corporation.

3. The Conspiratorial Ploy

Minority shareholders of close corporations also may face another form of corporate oppression, the "conspiratorial ploy." When shareholders conspire against minority shareholders, such action can affect an individual shareholder's right to participate in the management and control of the corporation, as well as any right to benefit from its effective operation or profitability. For example, in Notzke v. Art Gallery, Inc., among the three individuals who owned equal shares of a close corporation, two shareholders conspired to deprive the plaintiff of control of the corporation. The two shareholders expressed an apparent interest in selling their shares and indicated that they found potential buyers, allowing them to determine

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68. See Hager-Freeman v. Spircoff, 593 N.E.2d 821, 829-31 (Ill. App. Ct. 1992) (holding that the trial court erred in dismissing, for failure to state a cause of action, one count of a shareholder's complaint which alleged that another shareholder controlled signatory rights on corporate accounts, hid checkbooks, changed the locks on the business, and withheld financial information).


71. See id. at 842.
the market value of their shares.\textsuperscript{72} Despite the plaintiff's desire to buy-out one of the other two shareholders, the other two shareholders rejected his offer, even though he had funds to almost pay the quoted price.\textsuperscript{73} Rather than selling to an outside party, one shareholder sold to the other on an installment plan with preferential terms; this deal was not offered to the plaintiff, leaving the plaintiff with a minority interest.\textsuperscript{74} Once in control, the majority shareholder fired the plaintiff, depriving the plaintiff of his position in the corporation, his share of corporate control, and his managerial employment.\textsuperscript{75}

Because of a "continuing and escalating deterioration" of the business relationship between the plaintiff and the majority shareholder, the court in \textit{Notzke} ultimately dissolved the corporation.\textsuperscript{76} The court held that "[c]onspiratorial action allegedly affecting [the plaintiff's] control over corporate matters and the effective operation and profitability of the venture coupled with alleged irregularity in the equity transfer" amounted to oppressive conduct.\textsuperscript{77}

\section*{B. Corporate Deadlock}

Corporate deadlock occurs when "because of decision or indecision of stockholders, [the corporation] cannot perform its corporate powers."\textsuperscript{78} \textit{Gidwitz v. Lanzit Corrugated Box Co.}\textsuperscript{79} provides a typical example of corporate deadlock. In \textit{Gidwitz}, two factions of one family equally divided the stock of a corporation.\textsuperscript{80} An equal number of family members representing each faction comprised the corporation's board of directors.\textsuperscript{81} With the corporation's president being head of one of the two factions, its shareholders and directors

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\item \textsuperscript{72} See \textit{id.} at 841; see also \textit{infra} Part III.F (discussing the problem of share valuation in close corporations).
\item \textsuperscript{73} See \textit{id.}
\item \textsuperscript{74} See \textit{id.}
\item \textsuperscript{75} See \textit{id.} at 841-42.
\item \textsuperscript{76} \textit{Id.} at 844.
\item \textsuperscript{77} \textit{Id.} at 843.
\item \textsuperscript{78} Callier v. Callier, 378 N.E.2d 405, 408 (Ill. App. Ct. 1978) (quoting RKO Theaters, Inc. v. Trenton-New Brunswick Theaters Co., 74 A.2d 914, 918 (N.J. Super. Ct. Ch. Div. 1950)). In \textit{Callier}, the Fifth District also relied upon the dictionary definition of deadlock which described it as a "counteraction of things producing entire stoppage; hence, a state of inaction or of neutralization caused by the opposition of persons or of factions, as in a government or in a voting body." \textit{Id.} at 408 (quoting \textit{WEBSTER'S NEW INTERNATIONAL DICTIONARY, UNABRIDGED} 674 (2d ed. 1956) (emphasis added by court)).
\item \textsuperscript{79} 170 N.E.2d 131 (Ill. 1960).
\item \textsuperscript{80} See \textit{id.} at 135.
\item \textsuperscript{81} See \textit{id.} at 133-34.
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\end{small}
became hopelessly deadlocked because those from one faction voted in one manner, while those from the other faction voted in another manner.\textsuperscript{82}

For ten years, the president refused to consult with the directors of the opposite faction regarding corporate policy decisions.\textsuperscript{83} Although the opposing faction continuously requested that the number of shareholders and directors be increased in order to break the deadlock, the president refused to call any meetings to effectuate such change.\textsuperscript{84} Thus, the president utilized his position in the corporation to deprive the opposing faction of participating and managing the corporation.\textsuperscript{85} This ten-year deadlock among shareholders prompted the Gidwitz court to ultimately dissolve the corporation.\textsuperscript{86}

\textbf{C. Fraudulent and Illegal Acts}

Many individuals who invest in a close corporation assume that their business partners will not act fraudulently or illegally. Unfortunately, this assumption is not always correct. Indeed, disputes and problems that arise among shareholders in closely held corporations are often the result of illegal conduct or fraud.\textsuperscript{87} For example, in \textit{Kalabogias v. Georgou},\textsuperscript{88} two brothers who owned a forty-nine percent stake in a restaurant brought suit for dissolution of the corporation based on the illegal activities of the majority shareholders.\textsuperscript{89} Although the

\begin{itemize}
\item \textsuperscript{82} See id. at 136.
\item \textsuperscript{83} See id.
\item \textsuperscript{84} See id. at 135.
\item \textsuperscript{85} See id.
\item \textsuperscript{86} See id. at 138. Because the corporation’s directors and shareholders were hopelessly deadlocked and unable to manage corporate affairs, the court decided to dissolve the corporation based on: (1) the failure to call annual meetings of the shareholders for ten consecutive years, (2) the failure to end deadlock by enacting amendments proposed at director and shareholder meetings, and (3) numerous instances of improper conduct by the defendant including: (a) his unilateral decision to hire someone as a corporate “employee” at a salary comparable to that of other board members and to allow that employee to use the company car; (b) his decision to give gave salary increases to two assistant secretaries without approval of the board of directors; (c) his use of corporate funds to organize another corporation without board approval; (d) his decision to borrow over $500,000 for the corporation from banks and partnerships in which he was part owner without approval of the board of directors; (e) his execution of a proxy to himself voting the stock of one of the corporation’s subsidiaries; and (f) his deductions from plaintiff’s salary also without board approval. See id. at 135-38.
\item \textsuperscript{87} See, e.g., Schirmer v. Bear, 672 N.E.2d 1171 (Ill. 1996); Gidwitz v. Lanzit Corrugated Box Co., 170 N.E.2d 131 (Ill. 1960).
\item \textsuperscript{88} 627 N.E.2d 51 (Ill. App. Ct. 1993).
\item \textsuperscript{89} See id. at 53-54. In \textit{Kalabogias}, one of the majority shareholders had maintained false and fraudulent accounts and failed to report the corporation’s actual income and
defendants claimed that the plaintiffs could not proceed individually with a suit seeking the corporation’s dissolution, the court held that it “is the rule that a minority shareholder may sue the corporation directly for its dissolution if he can establish that ‘those in control of the corporation have acted . . . in a manner that is illegal, oppressive, or fraudulent.’” Additionally, the court held that “[t]he rationale underlying this remedy is to protect the interests of minority shareholders against majority shareholders who ‘reap the benefits of ownership through compensation and other withdrawals not available to the minority.’”

D. Corporate Waste and Mismanagement

Another problem commonly found in closely held corporations is corporate waste and mismanagement. Corporate assets are wasted or mismanaged when they are expended and “no consideration is received in exchange” and “there is no rational business purpose, or, if consideration is received in exchange, the consideration the corporation receives is so inadequate in value that no person of ordinary sound business judgment would deem it worth that which the corporation has paid.” Generally, courts in Illinois strictly adhere to the policy prohibiting a shareholder from using corporate assets to further the shareholder’s own interests. The classic example of corporate waste and mismanagement occurs when the president or majority shareholder of a corporation unilaterally takes out loans on behalf of the corporation and uses the loan funds to start a new

expenses. See id. at 55-56. This shareholder had also destroyed the corporation’s business records reflecting actual gross receipts and its diaries of daily cash expenditures. See id. at 56. Additionally, minutes of shareholder meetings were inaccurately kept and copies of waiver of notice of shareholders and directors meetings were altered and inaccurately circulated. See id. Furthermore, records were illegally altered to reflect the election of the majority shareholder’s wife as a director when, in fact, she had not ever been properly or legally elected. See id.

90. See id. at 56.
91. Id. at 57 (quoting 805 ILL. COMP. STAT. 5/12-50(b)(2) (West 1992)).
corporation of his own.95

E. Succession Planning: Problems Associated with the Transfer of Ownership and Control of the Closely Held Corporation

Within the closely held corporation, the death or departure of a shareholder can lead to various problems of ownership and control. Upon their death, shareholders of closely held corporations often leave their shares to family members or parties outside the corporation. For the remaining shareholders, this new ownership will threaten or change the established control and management of the corporation.

To illustrate, suppose two shareholders own a close corporation, each owning equal portions of the business and each serving as its only officers and directors. Suppose further that one shareholder dies, leaving his shares to his spouse. The remaining shareholder, however, refuses to recognize the widow’s right to participate in the management and control of the corporation. The surviving shareholder unilaterally issues a resolution amending the corporation’s bylaws, reducing the number of directors from two to one director. The surviving shareholder also elects himself and his spouse as the corporation’s officers. With the newly acquired control, the remaining shareholder executes a corporate resolution that limits corporate business and decision-making, including all aspects of the corporation’s finances, to only himself and his wife.

In such a situation, the widow becomes powerless to participate in any corporate activity despite new fifty percent ownership interest. The deceased shareholder could not have envisioned that his family would be effectively shut-out of the business he founded. This example illustrates the need for shareholders to enter into shareholder agreements to anticipate problems that can occur with the transfer of ownership. Without such an agreement, the widow will be left to seek relief in the courts.

F. “Cashing Out” Shares: Problems Associated with Exiting the Corporation

Many problems arise in the closely held or family corporation when a shareholder desires to relinquish his ownership in the company and attempts to sell his shares to an outside party. Generally, there is no

95. See Shlensky v. South Parkway Bldg. Corp., 166 N.E.2d 793 (III. 1960). Because an executive’s time is also a corporate asset, an executive may not use his time at work to advance his own interest contrary to that of the corporation. See, e.g., Graham, 444 N.E.2d at 558.
Therefore, the party seeking to "cash out" has few, if any, options for exiting a close corporation without losing his investment. For example, assume a close corporation has two shareholders, one holding a majority interest and the other holding a minority interest. Both shareholders are the sole officers and directors of the business. Further assume that the business is very successful and operates without any internal problems among shareholders or between a shareholder and the corporation. Next assume that the minority shareholder wants to sell her shares, which could occur for any number of reasons, including the immediate need for money or the simple desire to leave the business.

The minority shareholder is faced with a dilemma because section 12.56 does not explicitly authorize the courts to compel the majority shareholder or the corporation to buy-out her shares, in such a situation. Additionally, outside parties generally will have little interest in buying into a minority position in a close corporate setting. In this situation, the minority shareholder has few, if any, options and remains effectively trapped in the close corporation. Like the example above, this situation illustrates the need for shareholders to enter into shareholder agreements to anticipate the many problems that can occur in a close corporation.

IV. METHODS OF AVOIDING PROBLEMS IN CLOSE CORPORATIONS

A. **Shareholder Agreements**

One method of avoiding the problems encountered in close corporations and the costly litigation that results is the use of carefully drafted shareholder agreements. Shareholder agreements are contracts among shareholders that define arrangements among shareholders that are not covered by the corporation's governing documents. Shareholder agreements can be used to protect minority shareholders, avoid deadlock, protect ownership interests, create a valuation formula...
for shares, and provide an exit strategy for shareholders.99

Effective shareholder agreements should include a right of first refusal.100 A right of first refusal requires that a shareholder who wishes to sell his shares must first offer the shares to the corporation and its other shareholders before offering them to outside parties.101 Giving the corporation a right of first refusal enables its remaining shareholders to veto the addition of new shareholders.102 An effective shareholder agreement also should provide for the involuntary transfer of shares and should include an option to sell.103 An option to sell clause requires that a corporation or its shareholders purchase all shares that an exiting shareholder seeks to sell.104 An involuntary transfer clause requires that a shareholder allow the corporation or its shareholders to purchase shares if his shares become subject to any encumbrances or liens.105 Such agreements effectively enable existing shareholders to maintain control and prevent unwanted outside parties from obtaining an interest in their corporation.106

Shareholder agreements also can be an effective method of resolving deadlock among shareholders. Through such agreements, shareholders may agree to appoint an arbitrator to resolve any deadlock issues. Moreover, shareholder agreements may specify that a particular arbitrator, president, director, or corporate counsel cast the deciding vote whenever deadlock occurs.107

99. See Lavelle, supra note 98, at 112-129 (discussing in detail the contents of shareholders agreements). One example of a shareholder agreement is found in Butler v. Kent, 655 N.E.2d 1120 (Ill. App. Ct. 1995). In Butler, the court found that the plaintiff shareholder failed to establish by clear and convincing evidence the proper amount due him pursuant to a buy-out provision of a shareholder agreement. See id. at 1127. The shareholder agreement provided that, at the election of any one shareholder, the two remaining shareholders would be required to either buy the electing shareholder’s entire interest or sell the corporation with one-third of the proceeds going to the electing shareholder. See id. at 1122. The shareholder agreement also included a formula for determining the fair market value of the corporation to be sold, allowing for attorneys fees and expenses, for the prevailing party in an action to “enforce” the agreement. See id. at 1123.

100. See Lavelle, supra note 98, at 112.
101. See id.
102. See id.
103. See id. at 113-15. An option to sell is also known as a “put” option. See id. at 113.
104. See id.
105. See id. at 114-115.
106. See id. at 110.
107. See Lavelle, supra note 98, at 127.
Finally, shareholder agreements may set forth one of many available methods for valuating shares. There are several different methods of valuation that can be used to establish a purchase price for shares, depending on the characteristics of a particular close corporation. The simplest, but the least accurate method, is the fixed price method that allows shareholders to preset the price in the agreement. The obvious shortcoming of the fixed price method lies in the fluctuation of the value of the shares over time. Another method used to value corporate shares is the book value method that determines the book value of the corporation’s assets by dividing the corporation’s net worth (assets minus liabilities) by the amount of outstanding shares. Further, the capitalization of earnings method also can be utilized for share valuation. Under the capitalization of earnings method, the value of a shareholder’s shares is determined by studying the historical income information of the corporation and projecting earnings into the future for a set number of years. Finally, another method of share valuation involves allowing share values to be set by professional appraisers.

Despite the substantial protections shareholder agreements afford, there are limits to the use of shareholder agreements because shareholders cannot use such agreements to permit certain acts of wrongful or oppressive conduct or corporate waste. Recently, the Illinois Appellate Court examined this issue in *Winston & Strawn v. Nosal*. Although the *Nosal* decision involves a partnership agreement, it nevertheless is instructive for shareholders of close corporations. Specifically, the court applied a general rule that prohibits the use of such agreements to act in an illegal or oppressive manner. In *Nosal*, the plaintiff was expelled from the partnership

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108. For a more detailed discussion of the methods used in valuating shares, see Lavelle, *supra* note 98, at 120-124. See also Murdock, *supra* note 63, at 471-488 (analyzing the effectiveness of various valuation methods in judicially ordered buyouts).
110. See id.
111. See id. This method, however, rarely reflects the true value of the business. See id.
112. See id. at 122.
113. See id. at 123-24.
114. See supra notes 94-95.
116. See id. at 245-46. Due to the tendency of Illinois courts to employ the partnership analogy in cases involving close corporations, it is likely that this case would have had a similar outcome had it involved a closely held corporation. See supra Part II.A.
after a majority vote pursuant to the terms of their partnership agreement. The court held that "[r]egardless of the discretion conferred upon partners under a partnership agreement, [contractual freedom] does not abrogate [the partners'] high duty to exercise good faith and fair dealing in the execution of such discretion."

**B. Voting Agreements**

Voting agreements serve as another method that allows shareholders of close corporations to avoid internal problems. Voting agreements bind shareholders in how they may vote their stock on corporate issues. Such agreements prevent minority shareholders from being at "the mercy of an oppressive or unknowledgeable majority." Unlike in public corporations, the shares of close corporations are usually held by members of the board of directors. As a result, a board's decisions are rarely made free of the influence or personal motivations of its members as shareholders. Through effective voting agreements, shareholders can reduce the risk of such influences and secure "the rights and obligations of all concerned."

In Illinois, voting agreements are enforced in accordance with the principles of equity. Provided that no fraud is committed on the corporation or its minority stockholders and that public policy is not subverted, such agreements can provide that the majority stockholders will vote together and thus control the corporation. Moreover, a court may not inquire as to the shareholder's motive that actuates the distribution of his votes under voting agreements. Voting agreements can continue in effect for the lifetime of the particular stockholders and, in addition, can provide for the election of certain

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118. *Id.* at 246 (citing *Labovitz v. Dolan*, 545 N.E.2d 304, 313 (Ill. App. Ct. 1989)).
119. 805 I.L.L. Comp. Stat. Ann. 5/7.70 (West 1993). The statute provides: "Shareholders may provide for the voting of their shares by signing an agreement for that purpose . . . . A voting agreement created under this Section is specifically enforceable in accordance with the principles of equity." *Id.*
122. *Id.*
123. *See id.*
persons to specified offices for a fixed period of years.\textsuperscript{126}

C. Voting Trusts

Another method of avoiding problems among shareholders within the closely held corporation is the use of voting trusts. Through a voting trust, shareholders transfer legal title and voting rights to a trustee or trustees for a period not to exceed ten years, while personally retaining the other incidents of share ownership.\textsuperscript{127} Because voting trusts generally grant full voting rights to the trustee, they effectively protect minority interests by allowing for the impartial selection of corporate directors.\textsuperscript{128} The principal purpose of a voting trust is to acquire voting control of the corporation.\textsuperscript{129} Therefore, a voting trust can act as a useful instrument to prevent competing shareholders from attempting to gain control of the corporation.\textsuperscript{130} The creation of a voting trust limits the powers of shareholders because shareholders are left with only equitable ownership of stock, while the trustee becomes legal titleholder or owner of the stock.\textsuperscript{131} Full voting power passes from the shareholder to the trustee, and as such, the trustee possesses control over significant corporate decisions.\textsuperscript{132}

In order for a voting trust to be valid, Illinois courts have established the following requirements: the stock voting rights must be separate and distinct from other attributes of ownership; the transfer of these voting rights must be intended as irrevocable and for a definite period of time; and the principal purpose must be to acquire voting control of the corporation.\textsuperscript{133} A voting trust, however, may be established for any additional purpose as long as that purpose is not

\textsuperscript{126} See Galler, 203 N.E.2d at 586.
\textsuperscript{127} See 805 ILL. COMP. STAT. 5/7.65 (1996); see also Timothy W. Swain, What Every Lawyer Should Know About Voting Trusts in Illinois, 42 ILL. B. J. 878 (1954) (discussing the voting trust in Illinois and its purpose, validity, form, and obligations).
\textsuperscript{128} See Swain, supra note 127, at 878-79 (discussing the purpose of voting trusts and their ability to protect minority interests and insure stability of management).
\textsuperscript{129} See Lehrman v. Cohen, 222 A.2d 800, 805 (Del. 1966) ("[t]he principal purpose of [creating a voting trust] is to acquire voting control of the corporation").
\textsuperscript{130} See Swain, supra note 127, at 879; see also 5 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 2092 (perm. ed. rev. vol. 1996) (discussing the legal "[r]ights and status of shareholders voting trust certificate holder[s]").
\textsuperscript{131} See Swain, supra note 127, at 878; see also FLETCHER ET AL., supra note 130, § 2092, at 442-44.
\textsuperscript{132} See FLETCHER ET AL., supra note 130, §§ 2075, 2092, at 382-84, 442-44.
prohibited by any statute or rule of public policy.  
Furthermore, although the statute defining voting trusts states that they are to remain effective for a period not to exceed ten years, shareholders may agree to extend a voting trust or make a new voting trust for an additional ten-year period. Although no particular form for a voting trust exists, typical components include the trust purpose and a recitation of the duties of the trustee. 

V. JUDICIAL PROTECTION OF SHAREHOLDERS

Judicial relief is often the only remedy available to shareholders who do not anticipate the inherent problems in closely held corporations by entering into shareholder agreements, voting agreements, or voting trusts. Prior to the enactment of section 12.56 of the Business Corporation Act, however, disgruntled shareholders would only encounter courts reluctant to provide relief for close corporations when shareholder relationships broke down. The judiciary's aversion toward remedies for close corporations led shareholders to resort to self-help measures that were injurious both to themselves and the corporation. The use of such self-help measures eventually prompted the Illinois General Assembly and the Illinois courts to adopt a solution to corporate oppression that is both effective yet also extremely flexible. Today, Illinois courts are sympathetic to the plight of

134. See Gumbiner v. Alden Inn, Inc., 59 N.E.2d 648, 651 (Ill. 1945) (holding that "the purpose for which a voting trust is created determines its legality"); see also Fletcher et al., supra note 130, § 2080, at 399-400 ("[T]herefore, for a voting trust to be against public policy today, some statute must forbid what in some material part it tends to do, differentiating it from other personal property trusts, or else it must be obnoxious to some settled common-law principle, including in the latter such as are settled by judicial decisions.").
136. See Oppenheimer v. Cassidy, 102 N.E.2d 678, 682 (Ill. App. Ct. 1951) (providing that it is "immaterial whether the agreement be called an extension of the voting trust or a new voting trust").
137. For a more detailed discussion and suggested elements of voting trusts, see Swain, supra note 127, at 882-83.
139. See id. at 256-57 (citing Hagshenas v. Gaylord, 557 N.E.2d 316 (Ill. App. Ct. 1990)). In Hagshenas, the owner of fifty percent of the shares of a close corporation sought dissolution of the business based on the dissension and deadlock between himself and the other fifty percent shareholders. See Hagshenas, 557 N.E.2d at 317-18. When the court rejected plaintiff's petition and refused to intervene, plaintiff resorted to self-help measures which included establishing a competing business and hiring former employees of the close corporation. See id. at 318-320.
140. See Bamonte, supra note 138, at 256-57; see also Debate on S. 433 Before the
oppressed shareholders and have broad powers to redress shareholder grievances. The following comparison of the status quo ante with the current courts' attitude toward troubled close corporations will illustrate the significance of recent changes.

**A. Illinois Law Prior to the Enactment of Section 12.56**

The enactment of section 12.56 provides shareholders with broad equitable solutions for disputes arising within the closely held corporation. However, prior to the enactment of section 12.56, Illinois courts opted to abstain from intervening to resolve conflicts in close corporations. Specifically, two court decisions, followed by a statutory amendment, significantly affected the judiciary's refusal to resolve conflicts in close corporations.

1. **Coduti v. Hellwig**

The decision in *Coduti v. Hellwig* exemplified the earlier attitude of Illinois courts toward judicial intervention in closely held corporations. In *Coduti*, the First District of the Illinois Appellate Court concluded that, before a court should order a remedy other than dissolution, the defendant's conduct must be so egregious that it warranted dissolution. In *Coduti*, the plaintiff and defendant formed a corporation, in which plaintiff owned forty percent of the stock and defendant owned the remaining sixty percent. The board of directors of the corporation consisted of the plaintiff, the defendant, and the defendant's son.

A series of disputes led the plaintiff to file an action for dissolution of the corporation, alleging oppressive conduct. The plaintiff's oppression allegations against the defendant included: refusing to authorize dividends or bonuses despite large cash reserves of the

*Gen. Assembly, 89th Legis., 2d Sess. 171-74 (Ill. May 20, 1995) (amending the Illinois Business Corporation Act and specifying how a disgruntled shareholder of a close corporation can solve problems without resorting to dissolution).*

141. *See infra* Part V.B; *see also* 805 Ill. Comp. Stat. Ann. 5/12.56 (West Supp. 1997) (granting Illinois courts broad powers to intervene not only in situations where oppressive behavior exists, but also where shareholders are deadlocked in voting power, the directors are deadlocked, the directors act in a manner that is illegal or fraudulent, or in situations where corporate waste or mismanagement has occurred).


143. *See id.* at 224 (providing that the Illinois Supreme Court regards dissolution as a "drastic remedy that must not be lightly invoked").

144. *See id.* at 223.

145. *See id.*

146. *See id.* at 224.
corporation; refusing to allow the participation of the plaintiff’s attorney at directors’ meetings; holding directors’ meetings without notice to the plaintiff; opening the plaintiff’s mail without his authorization; and finally, belittling plaintiff in public and causing his arrest.\textsuperscript{147}

Despite the severity of the allegations, conflicting testimony prevented the court in \textit{Coduti} from finding sufficient oppression to warrant dissolution of the corporation.\textsuperscript{148} Explaining its reasoning, the \textit{Coduti} court noted that the alleged oppressive behavior must be analyzed in the context of a corporate organization, stating that it is:

fundamental in the law of corporations that the majority of its stockholders shall control the policy of the corporation, and regulate and govern the lawful exercise of its franchise and business. Every one purchasing or subscribing for stock in a corporation impliedly agrees that he will be bound by the acts and proceedings done or sanctioned by the majority.\textsuperscript{149}

Accordingly, the \textit{Coduti} court adhered to the line of decisions of Illinois courts that abstained from intervention in closely held corporations.\textsuperscript{150} Its ruling indicated a reluctance by courts to involve themselves in the regulation of a corporation’s internal affairs.

2. Section 12.55 and Its Judicial Interpretation

Following the \textit{Coduti} decision, section 12.55 of the Illinois Business Corporation Act became effective.\textsuperscript{151} The new section purposed to help resolve shareholder conflicts similar to the one in \textit{Coduti}. In lieu of ordering dissolution of the corporation, section 12.55 provided the court with the option of alternative remedies to dissolution, such as appointment of a provisional director or a custodian, or a direction to purchase the complaining shareholder’s shares.\textsuperscript{152}

\begin{itemize}
\item \textsuperscript{147} See id. at 225.
\item \textsuperscript{148} See id. at 227 (providing that determinations of fraud and oppression depend on the facts of each case).
\item \textsuperscript{149} \textit{Id.} at 229 (quoting Polikoff \textit{v. Dole & Clark Bldg. Corp.}, 184 N.E.2d 792 (Ill. App. Ct. 1962)). The \textit{Polikoff} court further noted that even though there might be a "wiser policy" for a business it is not the role of a court of equity to oversee the operation of a corporation. \textit{Polikoff, supra}, at 795.
\item \textsuperscript{150} See Bamonte, \textit{supra} note 138, at 258.
\item \textsuperscript{152} See \textit{id.} Section 12.55 provided in part:
\begin{quote}
In either an action for dissolution pursuant to Section 12.50 or an action which alleges the grounds for dissolution set forth in Section 12.50 but which
\end{quote}
In light of the legislature’s enactment of section 12.55, the plaintiff in Coduti petitioned the court for rehearing, requesting the alternative remedy of a forced purchase of his shares. However, the appellate court denied the plaintiff’s request, holding that in order to obtain any remedy for alleged shareholder wrongdoing, including “alternative remedies” such as buy-out, a plaintiff must show enough evidence of wrongdoing that would be sufficient to allow the court to order dissolution of the corporation. Thus, because the plaintiff failed to allege acts sufficient to order dissolution, the Coduti court held that he was not entitled to any remedy. Consequently, the Coduti decision established a very high threshold for the availability of alternative remedies, rendering section 12.55 unattainable for disgruntled shareholders in most circumstances.

3. Schirmer v. Bear

Recently, the Illinois Supreme Court revisited the issue of alternative remedies and rejected the idea that a disgruntled shareholder must establish that the defendant’s conduct warrants judicial dissolution before obtaining an alternative remedy. Rejecting the Coduti holding, the Illinois Supreme Court held that a disgruntled shareholder need not prove that the defendant’s wrongdoing was so severe that it would justify dissolving the corporation in order to obtain alternative relief. In Schirmer, a corporation’s shares were divided approximately 39% to 61% between the plaintiff and defendant respectively. The company’s board of directors initially consisted of plaintiff, defendant,
and defendant’s friend. At a meeting of the board of directors, defendant moved to amend the bylaws of the corporation to reduce the number of directors from three to one. The motion passed after defendant voted his 61.1% of his shares in support of the motion and plaintiff voted his 38.9% interest against the motion. Defendant proceeded to nominate himself as sole director and was elected on the strength of his 61.1% ownership interest.

As sole director, defendant appointed himself president and treasurer of the corporation and appointed his wife secretary. Defendant extracted plaintiff’s name from the corporation’s accounts and set a date for plaintiff’s termination from employment with the business. As a result, plaintiff filed an action alleging that defendant wasted corporate assets and acted in an illegal, oppressive, or fraudulent manner. Plaintiff requested that the court dissolve the corporation or, in the alternative, order the corporation to buy his shares from him. The Illinois Supreme Court held that the disgruntled shareholder was in fact entitled to an alternative remedy without establishing that the defendant’s conduct was so severe that it justified dissolution of the corporation.

B. Section 12.56 of the Illinois Business Corporation Act

As the Schirmer appeal was pending, the Illinois legislature revised old section 12.55 and enacted an entirely new section, 12.56, to specifically address remedies in closely held corporations. Section 12.56 of the Illinois Business Corporation Act, which became effective in July 1995, contains a nonexclusive list of remedies intended to address the unique problems arising in the close, non-public corporation. Although the remedies available for public corporations are codified under section 12.55, section 12.56

159. See id.
160. See id. at 1173.
161. See id.
162. See id.
163. See id.
164. See id.
165. See id.
166. See id.
167. See id. at 1176.
169. See id. at 5/12.56.
170. See id.
171. See id. at 5/12.55. The statute applies to a corporation that "has shares listed
provides for alternative remedies for close corporations. Section 12.56 defines a non-public corporation as "a corporation that has no shares listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national or affiliated securities association." To be eligible for a remedy under the statute, the shareholder must establish at least one of the following: (1) the shareholders are deadlocked in voting power; (2) the directors have acted in a manner that is illegal, oppressive, or fraudulent; or (3) corporate waste or mismanagement has occurred.

As indicated previously, one method of invoking the statutory remedies from the court is to establish that shareholders have acted in an oppressive manner. To establish oppressive conduct, it is not necessary to prove fraud, illegality, or loss as long as "the record exhibits a continuing course of oppressive conduct for which the future holds little or no hope of abatement." A "continuing and escalating deterioration" of the business relationship between shareholders exhibits oppressive conduct and may warrant an order of dissolution.

An examination of case law discloses that no single, particular action by itself can be deemed "oppressive" without also examining the surrounding circumstances. Under Illinois law, the mere failure of shareholders to get along does not constitute oppressive conduct if the corporation is still performing its corporate functions. However, oppressive conduct is liberally construed and includes any "arbitrary, on a national securities exchange or regularly traded in a market maintained by one or more members of a national or affiliated securities association." Id. The remedies available to shareholders of public corporations include:

(1) The appointment of a custodian to manage the business and affairs of the corporation to serve for the term and under the conditions prescribed by the court;
(2) The appointment of a provisional director to serve for the term and under the conditions prescribed by the court;
(3) The dissolution of the corporation.

Id. at 5/12.55(b).

172. See id. at 5/12.56.
173. Id. at 5/12.56(a).
174. See id.
175. For examples of oppressive behavior, see supra Part III.A.
overbearing and heavy-handed course of conduct.” Moreover, courts will make a determination as to whether conduct is oppressive on a case-by-case basis.

Once a shareholder establishes the threshold requirement, the court may order any one of twelve remedies provided by the statute or may impose any other legal or equitable remedy. The broad remedies provided by section 12.56 include the following: (1) the performance or prohibition of any action; (2) the cancellation or alteration of any provisions of the articles of incorporation or bylaws; (3) the removal of any officer or director; (4) the appointment of an officer or director; (5) an accounting; (6) the appointment of a custodian to manage the business; (7) the appointment of a provisional director; (8) the submission of dispute to mediation or other form of alternative dispute resolution; (9) the payment of dividends; (10) the award of damages; (11) the purchase of shares by corporation; or (12) dissolution.

This list of remedies is provided “to discourage ill-advised self-help measures by disgruntled shareholders and the protracted litigation that can often result” from disputes among shareholders of closely held corporations.

181. See id.
182. See 805 ILL. COMP. STAT. ANN. 5/12.56(c) (West 1993 & West Supp. 1997).
183. See Jacobs v. Regas, 229 N.E.2d 487, 489-90 (Ill. 1967) (holding that a majority shareholder’s threat to terminate a minority shareholder from his position as an officer and director of a close corporation, thereby depriving the minority shareholder of his right to participate in corporate management, presents a “sufficient showing of imminent danger of irreparable damage” to justify temporary injunctive relief); see also People ex rel. Stony Island Church v. Mannings, 509 N.E.2d 572, 576 (Ill. App. Ct. 1987) (finding that a temporary restraining order and preliminary injunction were necessary to stop an allegedly unauthorized seizure of control of a church’s business and religious affairs).
184. See 805 ILL. COMP. STAT. ANN. 5/12.56 (West 1997). Dissolution of the corporation is the most drastic remedy and any shareholder may bring a direct action for the dissolution of the corporation. See Kalabogias v. Georgou, 627 N.E.2d 51, 57 (Ill. App. Ct. 1993). The Kalabogias court stated that “[i]t is the rule that a minority shareholder may sue the corporation directly for its dissolution if he can establish that ‘those in control of the corporation have acted in a manner that is illegal, oppressive, or fraudulent’ . . . [and that] [t]he rational underlying this remedy is to protect the interests of minority shareholders against majority shareholders who ‘reap the benefits of ownership through compensation and other withdrawals not available to the minority.’” Id.; see also Murdock, supra note 63, at 440-470 (discussing dissolution and other alternative remedies).
VI. APPLICATION OF ALTERNATIVE REMEDIES

Pursuant to the enactment of section 12.56, Illinois law provides broad equitable solutions for disputes arising within the closely held corporation.\textsuperscript{186} In selecting a solution from the statute’s available remedies, the Illinois appellate courts have indicated a deference to the trial court’s discretion in fashioning relief to redress shareholder grievances.\textsuperscript{187} Accordingly, as of now, there are no judicial interpretations of section 12.56. However, in \textit{Schirmer v. Bear}, the Illinois Supreme Court established how the statute should be interpreted.

A. Application of Alternative Remedies in Illinois

To reach its decision in \textit{Schirmer}, the Illinois Supreme Court analyzed not only the legislative intent behind section 12.55, but also the statute’s provisions for alternative remedies to dissolution.\textsuperscript{188} The court found that prior to the enactment of sections 12.55 and 12.56, shareholders could not seek redress for wrongful conduct unless the conduct justified the dissolution of the corporation.\textsuperscript{189} The court further stated that the “alternative remedies” statutes were “specifically enacted to correct this problem by increasing the remedies available to minority shareholders and by enlarging the discretionary authority of the circuit courts to award relief in situations which do not warrant dissolution but which do warrant some other, less severe remedy.”\textsuperscript{190}

\textsuperscript{186} Several states have enacted similar legislation to section 12.56. See Bahls, \textit{supra} note 6, at 312.

\textsuperscript{187} See Coduti v. Hellwig, 469 N.E.2d 220, 224 (Ill. App. Ct. 1984) (stating that the appellate court will not disturb a trial court’s finding unless it is manifestly against the weight of the evidence), \textit{overruled by} Schirmer v. Bear, 672 N.E.2d 1171 (Ill. 1996); \textit{see also} Swanson v. Shockley, 364 N.W.2d 252, 255-56 (Iowa 1985) (recognizing that the remedy must not work an unreasonable hardship upon stockholders); Fox v. 7L Bar Ranch Co., 645 P.2d 929, 936 (Mont. 1982) (considering the public interest and possible injury in deciding to dissolve a corporation); Meiselman v. Meiselman, 307 S.E.2d 551, 562 (N.C. 1983) (finding that courts must consider the rights and interests of all shareholders and the effect of relief upon the existing corporation); Henry George & Sons, Inc. v. Cooper-George, Inc., 632 P.2d 512, 517 (Wash. 1981) (concluding that trial courts must consider the benefit and the injury to the shareholders and must exercise its equitable discretion before granting dissolution); Bahls, \textit{supra} note 6, at 317 (arguing that some courts have sidestepped the difficult issue of setting standards by arguing that courts should have broad discretion).

\textsuperscript{188} See \textit{Schirmer}, 672 N.E.2d 1171, 1175-76 (Ill. 1996).

\textsuperscript{189} See \textit{id.} at 1176.

\textsuperscript{190} \textit{Id.} (noting that “the Advisory Committee perceived a need for [alternative] remedies less Draconian than dissolution, whenever anyone sought dissolution of a corporation”) (citing Advisory Committee to the Secretary of State on the Illinois Business Corporation Act of 1983, Section 12.55, Official Comments, \textit{reprinted in} 2 \textit{CORPORATION LAW COMM., CHICAGO BAR ASSOCIATION, THE ILLINOIS BUSINESS
The court added that requiring a disgruntled shareholder to prove that defendant's misconduct was so severe as to warrant corporate dissolution "defeats the legislative intent by severely curtailing the discretion invested in the circuit courts to order the alternative remedies."\textsuperscript{9} It further stated that requiring plaintiff to only establish the predicate misconduct and not that such conduct is so severe as to justify dissolution effectuates the legislature's intent to "increase shareholder remedies while, at the same time, providing adequate guidance for the courts."\textsuperscript{92}

Although decided prior to the enactment of section 12.56, \textit{Abreu v. Unica Industrial Sales, Inc.},\textsuperscript{93} also indicates where the sympathy of the Illinois courts lies. In \textit{Abreu}, the Illinois Appellate Court emphasized that the remedies should take into account the best interests of the closely held corporation, and it enumerated several factors probative to redressing shareholder grievances.\textsuperscript{194} In that case, the court applied section 12.55 to a closely held corporation where a fifty-percent shareholder brought a derivative action alleging breach of fiduciary duties by the other fifty-percent shareholder.\textsuperscript{195} The trial court found that the defendant committed oppressive and fraudulent self-dealing by establishing a company to directly compete with the existing corporation.\textsuperscript{196} In result, the trial court removed the oppressive shareholder as director of the corporation and appointed a provisional director to break any deadlock between directors.\textsuperscript{197}

The appellate court upheld the appointment of a provisional director to the company as an alternative to dissolution.\textsuperscript{198} Explaining its decision, the court stated that "a provisional director is appointed as an alternative remedy to judicial dissolution in times of corporate strife to..."
help guide the company through crisis toward the goal of stabilization and prosperity.\(^{199}\) According to the court, when appointing a provisional director, the ruling court should consider "only the best interests of the corporation" and should "use its discretion" in choosing a particular provisional director.\(^{200}\) The court set forth the following factors that the trial court may balance when evaluating candidates for the appointment:

- degree and quality of past involvement in the corporation; an understanding of the corporation's history and current situation; experience and abilities in providing a cooperative and unifying element; need for immediate appointment; degree of impartiality; and above all, a true interest in the viability and advancement of the corporation as an entity.\(^{201}\)

Given the infinite number of ways that business partners can oppress each other, the Illinois statutory scheme is effective because it is flexible enough to preserve the assets of the corporation, and because, at the same time, it provides the disputing parties with a framework that allows them to work out their differences.\(^{202}\) In the event the differences are insurmountable, the courts are authorized to dissolve the corporation and allocate the assets amongst the owners.\(^{203}\)

**B. Application of Alternative Remedies in Other Jurisdictions**

Several states have enacted statutes similar to Illinois' that provide various alternative remedies to judicial dissolution for a closely held corporation.\(^{204}\) An analysis of these statutes and the decisions that have followed reflects the courts' efforts to balance the best interests of the closely held corporation with the interests of oppressed shareholders.

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199. Id.
200. Id.
201. Id.
202. See supra Part V.B.
203. See 805 ILL. COMP. STAT. ANN. 5/12.56(b)(12) (West 1993 & West Supp. 1997); see also id. at 5/12.30(a) (describing post-dissolution winding up of a corporation).
For example, a South Carolina statute provides a list of alternative remedies to dissolution similar to that of Illinois.\textsuperscript{205} The official comments of the South Carolina statute provide that the purpose of listing the alternative relief available "is to overcome the reluctance some courts have shown in the past to ordering anything other than dissolution, or possibly a buy-out."\textsuperscript{206} These official comments acknowledge that courts have broad discretion to fashion remedies that are most appropriate to resolve a dispute and "what works in one case may not work in another."\textsuperscript{207} Moreover, the comments recognize that detailed standards prescribing which remedy should be ordered for a particular type of dispute are intentionally omitted because "they might encourage litigation and also unduly restrict the court's discretion."\textsuperscript{208} The comments further note that:

although most close corporation statutes contain special provisions . . . authorizing the appointment of custodians and provisional directors, the number of actual cases in which appointments will be the most appropriate remedy are probably few. Usually the threat of an outsider running the company or acting as a tie-breaker in a deadlock situation leads to a settlement of the controversy.\textsuperscript{209}

\textsuperscript{205} See S.C. CODE ANN. § 33-18-410 (Law. Co-op. 1990). Such remedies include:

(1) the performance, prohibition, alteration, or setting aside of any action of the corporation or of its shareholders, directors, or officers of or any other party to the proceeding;

(2) the cancellation or alteration of any provision in the corporation's articles of incorporation or bylaws;

(3) the removal from office of any director or officer;

(4) the appointment of any individual as a director or officer;

(5) an accounting with respect to any matter in dispute;

(6) the appointment of a custodian to manage the business and affairs of the corporation;

(7) the appointment of a provisional director who has all the rights, powers, and duties of a elected director to serve for the term and under the conditions prescribed by the court;

(8) the payment of dividends;

(9) the award of damages to any aggrieved party.

\textsuperscript{Id.}

\textsuperscript{206} Id. See, e.g., Gruenberg v. Goldmine Plantation, Inc., 360 So. 2d 884, 886-87 (La. Ct. App. 1978) (refusing to order other relief besides dissolution for oppressed minority shareholder); Harkey v. Mobley, 552 S.W.2d 79, 81 (Mo. Ct. App. 1977) (holding that the court had no power to remove a corporation's directors); White v. Perkins, 189 S.E.2d 315, 320 (Va. 1972) (holding that dissolution and the appointment of a custodian were the exclusive remedies available for rectifying oppressive conduct).


\textsuperscript{208} Id.

\textsuperscript{209} Id. But see Bahls, supra note 6, at 316 (arguing that unpredictability of outcome discourages each party from negotiating a solution short of litigation).
Similarly, New Jersey courts have interpreted an analogous statute also as affording broad discretion to the trial court to fashion a remedy flexible enough to accommodate the interests of both the corporation and its shareholders. In Brenner v. Berkowitz, for example, the Supreme Court of New Jersey discussed the procedures to be followed in selecting a remedy and found the remedy dependent on the harm to the minority shareholder or the shareholder’s interest in the corporation.

In Brenner, a minority shareholder of a close corporation sued the majority shareholders, alleging that they had acted illegally, oppressively, and unfairly in violation of New Jersey corporate law. The Supreme Court of New Jersey examined the state statute providing for alternative relief to judicial dissolution and stated that “the need for such a statute was attributable ‘at least in part, to the fact that traditional principles of corporate law were often unsuccessful at curbing abuses of power by majority interests in closely-held corporations.’” The court stated that before a court may order dissolution, it must weigh the “appropriateness of dissolution as a remedy against the loss to society, if the corporation is forced to liquidate.” It added that in weighing the loss to society, courts should consider factors of loss due to the corporation’s failure to be sold as a going concern, such as the loss of jobs by employees, the loss of a steady source of income by suppliers, and the loss of the corporation’s goodwill by the shareholders. The court further noted that courts must be cautious when determining whether dissolution is appropriate because “the statutory remedy was meant only to protect

211. 634 A.2d 1019 (N.J. 1993)
212. See id. at 1028-30.
213. See id. at 1021 (referencing N.J. STAT. ANN. 14A:12-7(1)(c)). In Brenner, the minority shareholder claimed that he had been precluded by the majority from participating in the management of the corporation, and had received no notice of the corporation’s affairs. See id. He further alleged that the majority shareholder had failed to pay sales tax on cash sales, failed to file tax forms for certain employees, and misappropriated cash funds. In his suit, the plaintiff sought appointment of a custodian, a court order for the sale of stock from the majority to the minority shareholder, and dissolution of the corporation. See id.
215. Id. at 1030.
216. See id.
the minority, not to provide a weapon to enable it to obtain unfair advantage against the majority."

Ultimately, the Brenner court held that dissolution was not appropriate because the acts of misconduct committed by the defendants neither prevented the company's growth nor affected the minority shareholder's investment.

The Brenner case illustrates what constitutes extreme circumstances sufficient to warrant judicial dissolution. By noting that "[t]he existence of less harsh remedies [in the statute] has the effect of increasing the willingness of courts to intervene and provide relief to shareholders," the New Jersey Supreme Court emphasized that dissolution is to be ordered only as a last resort. Moreover, the court acknowledged that suits brought seeking remedies other than judicial dissolution are very fact-sensitive, and thus any hard and fast rules are difficult to formulate. The many possible types of relationships in close corporations compel a flexible approach to the problem. The statute intends to protect minority shareholders in the vulnerable setting of a close corporation. Because the Legislature's goal was fairness to all shareholders, however, courts must ensure that minority shareholders are not permitted to use the statute to tyrannize the majority.

Other New Jersey decisions also provide insight as to when a forced buy-out is an appropriate remedy. For example, in Musto v. Vidas, a frozen-out minority shareholder of a close corporation requested that the court order the majority to sell their shares to the minority. The court refused to employ this remedy, stating that if a minority shareholder's fair and reasonable expectations as owner of the corporation are irredeemably frustrated, "the remedy is not to order a resolution that frustrates the fair and reasonable expectations of the majority," but to order the majority to buy-out the minority.


218. See id. at 1033. Although the court refused to dissolve the corporation, it upheld the lower court's issuance of an injunction against any future acts of misconduct by the defendants. See id. The court further noted that any future misconduct could require the court to consider the appointment of a provisional director. See id. at 1034.

219. Id. at 1032.

220. Id.


222. See id. at 1310.

223. Id. at 1311. But see Muellenberg v. Bikon Corp., 669 A.2d 1382 (N.J. 1996). In Muellenberg, the Supreme Court of New Jersey held that a forced sale of the majority's shares to the minority was valid where the oppressed minority shareholder was willing
Although New Jersey case law clearly explains that the remedy of forced buy-out is a drastic remedy to be applied only when alternative remedies fail, a South Carolina case demonstrates a situation where a forced buy-out may be an appropriate solution. In *Hendley v. Lee*, the corporation at issue was exceptionally well run, profitable, and had great prospects for the future. However, the shareholders of the corporation disliked one another and were hopelessly deadlocked as to the appropriate managerial style for the company. The court acknowledged that allowing the problems among the shareholders to continue could result in irreparable injury to the corporation in the form of lost customers. Thus, the *Hendley* court examined potential remedies and held that dissolution of the corporation was improper because of the continued profitability of the business, potential for growth, and the shareholders' investments of time and money in the company. The court held that determining whether a corporation should be dissolved rests heavily upon the best interests of the shareholders and that interest is "reflected to a large degree in the profitability of the corporation." Accordingly, the court ordered a buy-out of the corporation by the party with a greater financial strength. Thus, because the court ordered a buy-out rather than dissolution, the corporation was permitted to continue its growth and prosperity.

and able to purchase the majority interest, was the most active in operating the business, was the only shareholder employed full time by the corporation, received his only income from his employment with the corporation, was responsible for developing the corporation's contacts, and sought to preserve the business at a time when the majority sought dissolution. See *id.* at 1389. The court affirmed the trial court's order of the forced buy-out by the minority but acknowledged that this is an "uncommon remedy." *Id.* at 1384.

224. *See Brenner*, 634 A.2d at 1033.
227. *See id.* at 1322-23.
228. *See id.* at 1323.
229. *See id.*
230. *See id.* at 1324.
231. *Id.* at 1324 (quoting Gillingham v. Swan Falls Land & Cattle Co., 683 P.2d 895, 898 (Idaho Ct. App. 1984)); *see also* Fox v. 7L Bar Ranch Co., 645 P.2d 929, 935 (Mont. 1982) (noting that in fashioning an appropriate remedy, the court should consider benefit or detriment to shareholders).
233. *See Bahls*, supra note 6, at 327. One commentator formulated the following factors for determining the appropriate remedy to resolve shareholder grievances: "(1) The remedy should maximize the ability of minority shareholders to realize their reasonable expectations (2) The remedy should minimize the administrative costs associated with resolving the dissension" between shareholders and "(3) The remedy
VII. DISSOLUTION OF FOREIGN CORPORATIONS BY ILLINOIS COURTS

Frequently, closely held corporations that perform business operations within Illinois are incorporated in another state. In the event that disputes arise among the shareholders of "foreign" corporations, Illinois courts are, nevertheless, empowered to redress shareholder disputes within that corporation, assuming personal jurisdiction is proper. Generally, courts of one state lack jurisdiction to dissolve corporations domiciled in another state.\(^2\)\(^3\)\(^4\)\(^5\)\(^6\) Subscribing to the general rule that a foreign corporation "should retain its legal existence until dissolved by the state which has incorporated it,"\(^2\)\(^3\)\(^5\) the Illinois Supreme Court has indicated that an Illinois court would not have the power to dissolve a foreign corporation.\(^2\)\(^3\)\(^6\)\(^7\) However, despite the general rule, several Illinois courts have asserted jurisdiction over matters involving the internal affairs of a foreign corporation where the corporation's assets, officers, and directors were located and all business functions were performed in Illinois.\(^2\)\(^3\)\(^7\)

In *Continental-Midwest Corp. v. Hotel Sherman, Inc.*,\(^2\)\(^3\)\(^8\) a minority stockholder brought a representative suit against a Delaware corporation and its majority stockholders charging, in part, waste of corporate assets and seeking an order restraining the majority from voting their stock.\(^2\)\(^3\)\(^9\) Although the controversy involved the internal affairs of a Delaware corporation, the appellate court held that Illinois had jurisdiction over the matter because all of the actions complained of occurred in Illinois, the corporate assets, officers and directors were located in Illinois, and all corporate business was conducted in

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\(^3\) Guthrie, *supra* note 234, at 1280.

\(^4\) See Babcok v. Farwell, 91 N.E. 683, 690 (Ill. 1910); Edwards v. Schillinger, 91 N.E. 1048, 1051 (Ill. 1910).


\(^7\) See *id.* at 401-02.
Illinois. Thus, the appellate court affirmed the trial court's order restraining the majority from voting its stock.

Courts in other states also have indicated a willingness to dissolve foreign corporations. For example, the District Court of Appeals in California held that California courts may “assume jurisdiction of the winding up of [a corporation’s] affairs preparatory to a dissolution.” The District of Columbia likewise has stated that “[a] court of equity has inherent power to appoint a receiver to liquidate a corporation... where abuse of trust is present whether or not insolvency is likewise present.” Meanwhile, a Pennsylvania federal court has exercised jurisdiction to appoint a receiver and liquidate and distribute a foreign corporation’s assets, and a New York court has explicitly acknowledged its having subject matter jurisdiction to dissolve foreign corporations.

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240. See id. at 402.

241. See id. at 405. Similarly, in Voorhees v. Mason, the stockholder of a Delaware corporation sued the corporation and its directors for the wrongful issuance of stock certificates and the wrongful collection and retention of dividends. See 91 N.E. 1056, 1056 (Ill. 1910). Although the defendant corporation was incorporated in Delaware, the corporate office, the corporate books and the corporate funds, along with a majority of the directors, were located in Illinois. See id. at 1057. The defendants challenged the court’s jurisdiction. See id. at 1058. The Illinois Supreme Court held that Illinois courts had jurisdiction over the suit despite the fact that the controversy involved the corporation's internal affairs. See id. at 1059-1060. It should be noted, however, that the Voorhees court held that the trial court may be required to interpret and apply Delaware law. See id. at 1060.


243. Bellevue Gardens, Inc. v. Hill, 297 F.2d 185, 187 (D.C. Cir. 1961) (quoting Bailey v. Proctor, 160 F.2d 78, 81 (1st Cir. 1947)). The Illinois Appellate Court in dicta has stated, “[t]he general rule is that the courts of one state will not interfere in controversies relating merely to the internal management of the affairs of a foreign corporation at the suit of a stockholder, and will refuse to appoint a receiver or dissolve the corporation or divide its assets among its shareholders.” Heitkamp v. American Pigment & Chemical Co., 158 Ill. App. 587, 595 (4th Dist. 1910). However, the Illinois Supreme Court recognizes that an Illinois court may appoint a receiver of the property of a foreign corporation situated in this state. See Holbrook v. Ford, 39 N.E. 1091, 1094-95 (Ill. 1894); see also People ex rel. Potts v. Continental Beneficial Assoc., 124 N.E. 352 (Ill. 1919) (holding that Illinois courts may act to protect property within their jurisdiction from misuse, misapplication, or removal from the state).

244. See Dallasega v. Victoria Amusement Enterprises, Inc., 43 F. Supp. 697, 698 (M.D. Pa. 1942). “The question is one of expediency and of discretion rather than of jurisdiction. This is all the more true where as here the corporation is purely a local concern and rests its claim of being a foreign corporation only upon the fact of its incorporation in a state other than Pennsylvania.” Id.

245. See In re Application for a Dissolution of Hospital Diagnostic Equipment Corp., 613 N.Y.S.2d 884, 885 (N.Y. App. Div. 1994). In Hospital Diagnostic Equipment, a proceeding was brought to dissolve a Delaware corporation where the
VIII. THE ROLE OF COUNSEL WHEN INTERNAL DISPUTES ARISE

When disputes arise among shareholders of a closely held corporation, shareholders often look to corporate counsel for advice. However, counsel for a close corporation cannot take sides in a dispute among shareholders and cannot represent a shareholder or the corporation in a dispute with another shareholder. An attorney for a close corporation owes a fiduciary duty to both the corporation and its shareholders. When shareholders are in a dispute with one another, "the only ethical position for an attorney to adopt when substantially identical interests which he has represented become divergent is to represent neither the individual nor the corporation." Attorneys owe their clients a duty of loyalty, which is breached when an attorney uses information gained through his representation of a client to the disadvantage of that client, or when an attorney takes action that is adverse to his client.

corporation's only connection with New York was maintenance of a corporate office in the state. See id. The court affirmed dismissal on the grounds of forum non conveniens, but acknowledged that New York courts have subject matter jurisdiction to dissolve foreign corporations, stating, "we have considered the litigant's remaining arguments . . . that the courts of New York lack subject matter jurisdiction to dissolve a foreign corporation, and find them to be without merit." But see In re Application of Dohring, 537 N.Y.S.2d 767 (N.Y. Sup. Ct. 1989). New York courts do not technically have power to dissolve a foreign corporation, but may "fashion a remedy, short of dissolution, which will attain substantial justice between the parties." Id. at 769.

246. See e.g., Metro-Goldwyn-Mayer, Inc. v. Tracinda Corp., 43 Cal. Rptr. 2d 327, 331-32 (Cal. Ct. App. 1995); Woods v. Superior Court of Tulare County, 197 Cal. Rptr. 185, 189 (Cal. Ct. App. 1983) (finding that a corporate attorney for a close family corporation could not represent the husband in divorce proceedings where corporate asset is the key concern in order to avoid appearance of impropriety); In re Greenberg, 614 N.Y.S.2d 825, 828 (N.Y. App. Div. 1994) (holding that corporate counsel may not represent individual shareholders where those shareholders' interests are adverse to other shareholders); Rosman v. Shapiro, 653 F. Supp. 1441 (S.D.N.Y. 1987) (holding that corporate counsel for a close corporation may not represent one of two shareholders in a dispute between the two shareholders in order to avoid appearance of impropriety); In re Banks, 584 P.2d 284, 293-94 (Or. 1978) (recognizing that an attorney for a family close corporation is in an untenable position if he represents either a corporate officer or the corporation when the interests of the two diverge).


248. In re Banks, 584 P.2d at 292.

IX. CONCLUSION

As this Article illustrates, the intimate relationships that exist among shareholders in close corporations often break down and lead to deadlock, oppression, or freeze-out. This Article examines many instruments, including shareholder agreements, voting agreements, and voting trusts, that shareholders can use in the pre-incorporation stages to avoid such problems. In the event that these prophylactic measures are not successful, the shareholders of close corporations have recourse under law.

Illinois courts provide a sympathetic forum to address conflicts among officers, directors and/or shareholders of close corporations. In 1995, the Illinois General Assembly enacted section 12.56 of the Illinois Business Corporation Act to provide a myriad of remedies to shareholders subjected to oppressive or unlawful conduct. Illinois courts treat close corporations as partnerships and, as such, impose fiduciary duties on and among the officers, directors, and shareholders of closely held corporations. The trend is clear that Illinois courts have become increasingly proactive in applying the remedies available under section 12.56 to redress the harm suffered by minority shareholders. As a policy matter, this serves the public good and the private interests of shareholders because it preserves the corporate assets while, at the same time, it provides a forum for shareholders to resolve their disputes fairly.