Business Breakups: Terminating Ownership Interests in Closely Held Businesses

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In the current market, liquidity is everywhere. Large banks pooled mortgages that converted illiquid mortgage notes into liquid securities. Buying and selling stocks is easier and less expensive than ever. However, one investment class that has not seen increased liquidity is investments in closely held businesses. Although these investments may provide owners with pride, a job, or above-market returns, investments in closely held businesses are among the least liquid investments available. Forensic analysts, legal counsel, business owners, and the Internal Revenue Service are often concerned with how quick, how easy, at what price, and at what cost, the owner of a noncontrolling ownership interest in closely held company can sell his or her shares? This discussion presents some of the more common methods available to both controlling owners and noncontrolling owners to sell or otherwise dispose of their investment in the closely held company. As summarized throughout this discussion, there are limited methods for noncontrolling owners to cash out of their investment in a closely held company. Most methods available to noncontrolling owners involve litigation, which can be costly and can involve an uncertain outcome.

INTRODUCTION

When owners of minority interests become dissatisfied with those in corporate control of a publicly traded corporation, those owners can simply sell their shares and immediately terminate their relationship with the corporation. Such is not the case for owners of minority interests in closely held businesses. The market for minority interests in closely held businesses is negligible. Very often, the only persons interested in acquiring a minority ownership interest are the majority owners of that business. Likewise, when majority owners become unhappy with minority owners, there are only a few recognized methods for forcing the minority owners to relinquish their ownership interests in the business entity.

This discussion explores a few of the methods available for terminating the relationship between majority owners and minority owners in closely held businesses.

Throughout this discussion, Oregon is used to provide illustrative examples of methods to terminate ownership interests in closely held businesses. Every state has unique statutes and case law with regard to terminating ownership interests in closely held businesses. However, statutes and case law are often similar between states. Therefore, although this discussion focuses on Oregon, the methods discussed herein may be applicable to other states.

The five business breakup methods presented in this discussion include the following:

1. Negotiated resolution
2. Buy-sell agreements and other contracts
3. Squeeze-out mergers
4. Actions arising out of oppression and deadlock
5. Break-ups among members in an LLC
NEGOTIATED RESOLUTION
The simplest and least costly method for severing the business relationship is through negotiations. Many of the methods discussed later in this discussion are very costly in terms of legal fees—as well as in terms of the time and emotional involvement of the owners themselves.

Negotiating an acceptable deal between the parties—even though the end result may not be fully satisfactory to either party—is often quicker and less costly than resorting to litigation. There are a number of mediators and professional organizations (1) that deal with closely held businesses and (2) that can facilitate these negotiations.

Even in a negotiated resolution, there are technical legal and accounting issues that should be addressed fairly early in the negotiation process. Therefore, it is advisable to involve both legal and accounting assistance early, even if the parties are negotiating directly with each other.

BUY-SELL AGREEMENTS AND OTHER CONTRACTS
It is common for shareholders in closely held corporations to negotiate and sign a buy-sell agreement at formation.¹

In a limited liability company, the operating agreement often includes a mechanism for terminating the relationship between the members.

Sometimes a buy-sell agreement provides that the corporation’s board of directors will periodically set a buyout price. It has been this author’s experience that the board often forgets to set a new price each year.

Therefore, when the falling out occurs, the last board pronouncement on “value” has often occurred many years prior to the proposed buyout. The last value set by the board may bear little relationship to the current value of the company.

It is very important for the board of directors to revisit the issue of value each and every year, or to revise the buy-sell agreement to have the value set in a manner that does not require periodic reviews of this value by the board (such as having the value of the shares determined by independent appraisal).

Right of First Refusal
A buy-sell agreement usually contains a provision that gives the corporation (and sometimes other shareholders) a “right of first refusal.” A right of first refusal is a provision that gives the corporation the right to match any third-party offers to purchase the shareholder’s shares. This provision exists primarily to make it virtually impossible for a shareholder to sell shares to a third party.² A right of first refusal provision does not usually help in the event of a falling out between the owners.

Death Clauses
Buy-sell agreements frequently contain a provision that gives the corporation the right—but usually not the obligation—to buy out a shareholder’s shares in the event in death.

Occasionally, a buy-sell agreement requires the corporation to buy out the shares of the deceased shareholder. However, this provision is usually coupled with a requirement that the corporation buy life insurance on the shareholders. This provision is usually not helpful in the event of shareholder disagreement.

Retirement or Disability
Sometimes a buy-sell agreement contains a provision giving the corporation the right—but not the obligation—to purchase the shares of a shareholder/employee who retires or becomes disabled. Since this provision does not give the minority shareholder the right to require that his/her shares be purchased, it is not usually helpful in a business dissolution.

Likewise, the definitions of “retirement” and “disability” in the buy-sell agreement usually restrict this provision to a true retirement or disability.

Termination of Employment
Sometimes a buy-sell agreement contains a provision that provides for the purchase of a minority shareholder’s shares in the event that employment is terminated. Often, distinctions are made for termination by the corporation “for cause” and “without cause,” and for terminations initiated by the employee. Obviously, the specific wording in the buy-sell agreement will control.

In these circumstances, a buy-sell agreement frequently includes a formula for valuing the shares of the departing shareholder. If such a provision exists, it is very important to periodically revisit that formula to make sure that the formula still makes sense for the business at its current level of development and in current economic conditions.

Forced Buy-Outs Clauses
Occasionally when a corporation has two equal owners, a buy-sell agreement may contain a provision that either shareholder can cause a buyout by
(1) naming a price and (2) giving the other shareholder a short period in which to decide whether to become the buyer or seller at that price.

Such a provision works best in corporations with two equal owners. It can sometimes be used when the ownership is close, but not exactly equal—for example, when there are 51 percent/49 percent owners.

But in such a situation, it is important to address the issue of whether or not a control price premium or discount for lack of ownership control is applicable.

This forced buy-out mechanism does not work well if the two owners own substantially different percentages of the stock or where there are multiple owners.

Summary
In the event of a falling out between business owners, contracts between those business owners—such as buy-sell agreements, operating agreements, and occasionally the bylaws—should be reviewed to see if there is a contractual mechanism for resolving the dispute, or for giving one owner the right to force the other owner to buy or sell his/her ownership interest.

SQUEEZE-OUT Mergers
If the majority owners wish to force the minority owners to sell their shares, there are forms of corporate reorganization that can accomplish this goal. The most common of these reorganizations is known as a “squeeze-out merger.”

In a classic squeeze-out merger, the majority owners contribute their shares in the company (OldCo) to a new corporation (NewCo). After this transfer, NewCo becomes the majority owner of OldCo’s shares.

Next, the two corporations adopt a plan of merger, merging OldCo into NewCo and requiring all individual shareholders (i.e., the minority owners) to be cashed out at the “fair value” of their shares.

Prior to the adoption of the plan of merger, the majority owners usually engage a business valuation firm to estimate the “fair value” of the shares. The statute requires those in control to offer a fair price for the minority owner’s shares only a short time into the process, so a stock valuation is often the first step undertaken.

This is also true because, soon after the process begins, those in control will be irrevocably committed to buying out the minority owners at a fair price, making it important to having an idea going in as to what that purchase price will likely be.

These types of reorganization plans give rise to “dissenter’s rights,” and a process covered by statute.

Steps Required by Oregon Statute
In Oregon, if a corporation proposes a squeeze-out merger or similar reorganization, the corporation must notify its shareholders of the right to dissent before the shareholder meeting when the vote to merge will occur. In order to dissent under such circumstances, a dissenting shareholder must deliver a written notice to the corporation before the vote is taken.

The written notice must include a demand for payment in exchange for the shareholder’s shares in the event the action is effectuated at the shareholder meeting.

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

But if the shareholders then vote and authorize an action giving rise to dissenters’ rights, the corporation must send a “dissenters’ notice” to all shareholders who previously dissented and must do so within 10 days of the shareholder vote authorizing the act.

This notice must:
1. state where the shareholder must send a payment demand,
2. state where and when the shareholders’ stock certificates must be deposited,
3. describe any transfer restrictions applicable to uncertificated shares,
4. supply a form for demanding payment, and
5. set a date by which the corporation must receive the payment demand (which can be no less than 30 and no more than 60 days after the date the dissenters' notice is delivered to the dissenters).

If the proposed action is taken without a shareholder vote, the corporation must inform its shareholders of the action taken and deliver this “dissenters’ notice” to all shareholders entitled to assert dissenters’ rights.

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

Upon receipt of a proper payment demand, the corporation is required to pay each such dissenter the amount the corporation estimates to be the “fair value” of the dissenters’ shares, plus accrued interest.

If a dissenter disagrees with the corporation’s estimate of “fair value,” the dissenter may notify the corporation in writing of his or her own estimate of fair value and may demand payment of this (presumably higher) amount. Unless the dissenter does so within 30 days, however, the dissenter waives the right to demand an amount higher than was originally offered by the corporation.

Once a dissenting shareholder sends a proper demand for the dissenter’s estimate of “fair value,” the corporation may either:

1. pay the amount demanded, or
2. commence a proceeding in circuit court for the appraisal of the shares.

If a corporation fails to initiate such a proceeding within 60 days of receiving the dissenters’ estimate of fair value, the corporation is required to pay each dissenter the amount previously demanded by the dissenter.

**Fair Value**

As discussed above, once a shareholder dissents and demands payment for his/her shares, the corporation is required to pay “fair value” in exchange for the shareholder’s shares. If, using the procedures discussed above, the corporation and the shareholder are unable to agree on an amount constituting “fair value,” the corporation must file a lawsuit in circuit court seeking to have the court determine the “fair value” of the corporation’s shares.

“Fair value” is not the same as “fair market value.” Fair market value—what a willing buyer and willing seller will pay—is only one factor in determining fair value. Rather, the circumstances of each case will determine the weight given to each of several methods. In a case involving dissenters rights, the Washington Supreme Court has noted:

No universal formula for determining the value of shares of a corporation can be stated. No two corporations are precisely alike, and a consideration that may be very influential in evaluating the shares of one may be meaningless with reference to another.

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

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

In order to estimate fair value, several methods or values are usually considered: market value, net asset value, and a third value, varyingly referred to as the earnings value, investment value, or enterprise value. “[T]he relative weight given each will depend on the circumstances of the case.”

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

The most important factor in most cases, it pointed out, is investment or enterprise value, because that value reflects the business’ worth as a going concern. The purpose of the appraisal statute is to ascertain what the dissenter actually loses because of his or her unwillingness to go along with the controlling shareholders’ desires. The court refused to accept a minority discount because it would be a departure from that purpose. Such a discount affects market value more than investment value. The statute allows the majority to override the minority so long as it adequately protects the minority’s interests. There would be no protection if the minority could be squeezed out for less than the real value of its interest.

ORS 60.551(4) provides that fair value is to be determined “immediately before the effectuation of the corporate action to which the dissenter objects.” Factors that may be relevant to estimating fair value include, but are not limited to, the following:
the price at which the shares had been selling; the amount, if any, of present share value increase or decrease because of anticipated future earnings of the corporation; corporate assets; corporate earnings or losses; corporate reputation; anticipated competition. ORS 60.551(4) excludes consideration of appreciation or depreciation in anticipation of the corporate action, unless it would be inequitable to exclude such appreciation or depreciation.\textsuperscript{10}

**Valuation Discounts**

In determining fair value, a court must determine whether to apply a discount for lack of ownership control and/or a discount for lack of marketability.

A “minority discount” is a reduction in value “which recognizes that controlling shares are worth more in the market than are noncontrolling shares.”\textsuperscript{11}

A discount for lack of marketability, “measures the difference in the expected price between:

1. a liquid asset (that is, the benchmark price measure) and
2. an otherwise comparable illiquid asset (that is, the valuation subject).”\textsuperscript{12}

Although each case turns on its own facts, in an appraisal action based on dissenters’ rights, courts will often apply marketability discounts, but refuse to apply discounts for lack of ownership control.\textsuperscript{13}

*Columbia Management Co. v. Wyss* involved a corporate event that essentially squeezed out a shareholder in a close corporation and gave him the right to dissent.

The Court of Appeals upheld the trial court’s decision to apply a marketability discount, but overturned the trial court’s application of a minority discount.\textsuperscript{14}

Because a dissenting shareholder is exercising a right designed for his or her protection, and because the purchaser of the shares will be the corporation, not an outsider, this recognition of decreased market value may not be appropriate. “It is contrary to the purpose of the statute to discount the minority interest because it is a minority. This in effect would let the majority force the minority out without paying its fair share of the value of the corporation.” (citation omitted)

The discounts that apply may vary by the context of the appraisal. For instance, in actions by minority shareholders for oppressive conduct and breach of fiduciary duty, courts sometimes force the corporation to buy out the minority’s shares. In several such cases, courts have declined to apply either a minority or a marketability discount.\textsuperscript{15}

Hard and fast rules do not apply. Fair value is a question of fact. And, as such, it “will depend upon the circumstances of each case; there is no single formula for mechanical application.”\textsuperscript{16}

**Jury Trials and Burden of Proof**

In an appraisal action filed under ORS 60.591, either side may demand a jury.\textsuperscript{17} This is in contrast to actions for oppression pursuant to ORS 60.952 or actions alleging breach of fiduciary duty—actions that also sometimes result in the valuation of the minority shareholder’s shares—which are equitable proceedings that are tried to a judge, not a jury.

ORS 60.591 requires the corporation to initiate an appraisal action and the burden of proof is arguably on the corporation to prove fair value.\textsuperscript{18}

**Equitable Powers**

Many if not most courts will use their equitable powers to protect minority shareholders in a squeeze-out situation.

Numerous cases have held that courts retain their equitable power to protect minority shareholders from the majority’s fraud and self-dealing, despite enactment of an appraisal statute. These cases have recognized equitable remedies other than appraisal.\textsuperscript{19}

**Summary**

Squeeze-out mergers are one way for controlling owners to remove noncontrolling owners from a closely held company. However, if the controlling owner initiates a squeeze-out merger, he or she:

1. risks potential costly and time consuming litigation, and
2. faces risk over the fair value of the company shares if the noncontrolling shareholder initiates a dissenting shareholder lawsuit.

Moreover, this option is only available to controlling owners. The owner of a noncontrolling ownership interest in a closely held company cannot use a squeeze-out merger to terminate his or her interest in the company and receive fair value for his or her shares.
**Actions Arising out of Oppression and Deadlock**

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

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

A similar provision exists in the newer ORS 60.952, which applies only to closely held corporations. However unlike ORS 60.661(2) (which will now likely be invoked only against corporations that do not qualify as “closely held”), ORS 60.952 gives the corporation and/or the controlling shareholders the right to force the complaining shareholder to sell all of his/her shares at a price and terms set by the court. This nonrevocable election to buy out must be made within 90 days after the lawsuit is filed.

Although ORS 60.661 only provides for dissolution as a remedy, courts have usually fashioned other remedies for oppressive conduct—relying on their traditional equitable power to protect minority owners.

On the other hand, the newer ORS 60.952 (closely held corporations only) includes a long list of possible remedies and leaves the door open for the court to fashion other remedies as well.

Even though it is not mentioned as a remedy under ORS 60.661, a remedy commonly imposed by the courts in oppression cases is an order for the controlling shareholders to purchase the shares of the oppressed minority at the “fair value” of those shares.

Under ORS 60.661, the trial court had the authority to choose a remedy for defendants’ actions; we agree with it that requiring defendants to purchase plaintiff’s shares is the preferable option. A purchase will disentangle the parties’ affairs while keeping the corporation a going concern; dissolution would not benefit anyone, and plaintiff did not seek it at trial.

ORS 60.661 applies to all corporations—close corporations, publicly traded corporations, and everything in between. That said, all of the cases in Oregon on judicial dissolution—and maybe all cases everywhere—involves close corporations.

In 2001, ORS 60.952 took effect. The new statute applies only to close corporations. It mirrors the language of ORS 60.661(2) for triggering events (oppression, voting deadlock, corporate waste), but sets out a long, nonexclusive list of possible remedies that a court may apply. The new statute gives the corporation the right to buy out the complaining shareholder at a price and terms set by the court.

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

**Illegal, Oppressive, or Fraudulent Conduct**

In Oregon, the determination of whether or not a corporation has committed illegal, oppressive, or fraudulent conduct is made on a case-by-case basis.

“The legislature has not defined ‘oppression’ for present purposes . . . Rather, courts must determine on a case-by-case basis whether the conduct complained of rises to the level of oppression.”

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

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

“burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members; or a visual departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.”
We agree, however, that the question of what is “oppressive” conduct by those in control of a “close” corporation as its majority stockholders is closely related to what we agree to be the fiduciary duty of a good faith and fair dealing owed by them to its minority stockholders.

Thus, an abuse of corporate position for private gain at the expense of the stockholders is “oppressive” conduct. Or the plundering of a “close” corporation by the siphoning off of profits by excessive salaries or bonus payments and the operation of the business for the sole benefit of the majority of the stockholders, to the detriment of the minority stockholders, would constitute such “oppressive” conduct as to authorize a dissolution of the corporation under the terms of ORS 57.595.25 (footnotes omitted)

A breach of the fiduciary duty owed by controlling shareholders to minority shareholders is likely to also constitute oppressive conduct.26

Although there is not, and probably cannot be, a definitive definition of oppressive conduct under the statute, at least in a closely held corporation conduct that violates the majority’s fiduciary duties to the minority is likely to be oppressive. Cooke v. Fresh Express Foods Corp., 169 Or. App. 101, 108, 7 P.3d 717 (2000).

But where there are both fiduciary duty breaches and oppressive conduct and where the remedy is a court-ordered buy-out of the minority shareholders, the breach of fiduciary duty claim “is essentially subsumed under the oppression claim” and there is not separate remedy for the fiduciary claim.27

But not all conduct that negatively affects the minority will give rise to a remedy under ORS 60.661 and 60.952.28

The existence of one or more of these characteristic signs of oppression does not necessarily mean that the majority has acted oppressively within the meaning of ORS 60.661(2)(b). Courts give significant deference to the majority’s judgment in the business decisions that it makes, at least if the decisions appear to be genuine business decisions. As we have noted, attempts to define what oppressive conduct is, instead of what it is not, have proved elusive, and cases of this sort depend heavily on their specific facts. See Weiner Investment Co. v. Weiner, 105 Or. App. 339, 342-43, 804 P.2d 1211 (1991). The court must evaluate the majority’s actions, keeping in mind that, even if some actions may be individually justifiable, the actions in total may show a pattern of oppression that requires the court to provide a remedy to the minority.29

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

Conduct that constitutes “oppressive conduct” is necessarily fact-dependent, and summary judgment on this issue is usually inappropriate.30

The other types of conduct that trigger ORS 60.661(2) and 60.952(1)—fraudulent and illegal conduct—have not been separately discussed in this context by the Oregon courts.

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

“Deadlock is the inaction which results when two equally powerful factions stake out opposing positions and refuse to budge.”31

If one shareholder owns a majority of the shares, the corporation is not necessarily deadlocked simply because its board is deadlocked. This is because ORS 60.661(2)(a) also requires that “the shareholders are unable to break the deadlock.”32

Likewise, even though shareholders are deadlocked, a corporation is not necessarily deadlocked if the board is not deadlocked or if shareholder deadlock has not lasted through at least two consecutive annual meeting dates.33

Power to Dissolve Is Discretionary
Under the Oregon statutes, a court’s power to dissolve is discretionary, and it is a power that the courts are reluctant to exercise.

In Baker v. Commercial Body Builders, Inc.,34 the court noted the power granted by the judicial dissolution statute was discretionary and pointed out that this statutory power did not limit the court’s more general equitable power to protect minority shareholders by fashioning remedies other than dissolution.

Historically, courts have been disinclined to intervene to dissolve a corporation—even in cases involving deadlock or oppressive conduct. This
author has been unable to find any Oregon appellate
decision in which judicial dissolution was ordered.

Under ORS 60.661, a court may find inequitable
conduct, but order relief short of dissolution.\textsuperscript{35}

\textbf{Mismanagement Alone Usually Does Not Constitute Oppression}

Courts will usually not intervene in the case of
alleged director incompetence and mismanagement.\textsuperscript{36} One decision recognized the right of the
board to shift the balance of voting power, stating
that “directors . . . may in the exercise of their honest business judgment adopt a valid method of eliminating what appears to them a clear threat to the future of their business by any lawful means.”\textsuperscript{37} The Oregon Supreme Court has said:

\begin{quote}
In the absence of a fraudulent or coercive design or purpose on the part of the management neither the judgment of the court nor that of a minority stockholder can properly be substituted for the judgment of the majority of the directors and stockholders of a corporation.\textsuperscript{38}
\end{quote}

Another court put it more bluntly:

\begin{quote}
No principle of law is more firmly fixed in our jurisprudence than the one which declares that the courts will not interfere in matters involving merely the judgment of the majority in exercising control over corporate affairs.\textsuperscript{39}
\end{quote}

Usually, either bad faith or fraud must be present
in order for a court to intervene in internal corpo-
rate affairs.

\textbf{New Statutory Provisions for Close Corporations}

The remedy for oppressive conduct set out in ORS
60.661 is the dissolution of the corporation. This
author knows of no Oregon cases where this statu-
itory remedy was actually imposed. However, in one recent Multnomah County case, the court ordered the corporation split between the two warring fac-
tions.

In recent years, shareholder lawsuits alleging ille-
gal, oppressive, or fraudulent conduct have become increasingly common. Although courts have fre-
quently found that those in control of the corporation have acted in a manner that is “illegal, oppres-
sive or fraudulent,” courts rarely, if ever, order the drastic remedy of dissolution of the corporation.

Rather, most courts have disregarded the statu-
atory remedy of dissolution and instead exercised their equitable power to fashion some other remedy.

In response to this increase in litigation, the OSB Business Law Section created a task force to make proposals for new legislation addressing oppression cases in close corporations. The task force’s recom-
mendations were enacted into law as ORS 60.952 and took effect on January 1, 2002.

ORS 60.952 applies new procedures for close corporations, while leaving ORS 60.661 unchanged and applicable to public corporations.

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

Under the new statute, in the event a court finds that the threshold oppressive conduct exists, the statutory remedies available to the court are expanded beyond the drastic remedy of dissolution.

The statute lists 12 other permissive statutory remedies—including (1) the forced purchase of the oppressed minority's shares, (2) the appointment or removal of directors, (3) the appointment of a custodian to manage the business, (4) the submission of the dispute to mediation, and (5) the award of damages.

All of these statutory remedies have previously been applied by various courts—some in Oregon, some elsewhere—exercising their equitable power to regulate corporations. ORS 60.952(3) provides that the remedies listed in the statute are not exclusive and that the court may fashion other legal and equitable remedies.

Except for the remedies of an accounting, dam-
ges, or dissolution, the shareholders may agree to limit or eliminate any of the listed remedies through an agreement meeting the requirements of ORS 60.265.

ORS 60.952(4) provides that, in fashioning a remedy, a court may take into consideration the “reasonable expectations of the corporation’s share-
holders as existed at the time the corporation was formed and developed during the course of the shareholders’ relationship with the corporation and with each other.” The statute continues: “the court shall endeavor to minimize the harm to the business of the corporation.”\textsuperscript{40}

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

**Forced Buy-out Provisions**

Up to this point, ORS 60.952 contains no significant departure from existing case law. Its only radically new provision—ORS 60.952(6)—provides that within 90 days after a minority shareholder initiates an oppression-type lawsuit, either the corporation or one or more of its controlling shareholders may force the plaintiff minority shareholder to sell his/her shares. Should the corporation or its controlling shareholders make such an election, the minority’s lawsuit for oppressive conduct is suspended, and the court need only determine the “fair value” of the minority’s shares.41

In theory, if the corporation elects to buy-out the minority shareholder under this provision, the minority shareholder need no longer prove oppression. But this issue may come in through the back door. Existing case law indicates that “fair value” is the value of the minority’s share with a discount for lack of marketability, but without a discount for lack of ownership control.42 In cases involving oppression and breaches of fiduciary duty, the Oregon courts often refuse to apply either discount.43

It is unclear whether the Oregon courts will apply both discounts in a forced buy-out under ORS 60.952(6) or whether the issue of wrongdoing will come in on the discount issue. In a law review article published soon after the adoption of this statute, the chair of the task force that wrote this new provision assumed—without analysis—that the discount for lack of marketability would not apply.44

Another commentator argues forcefully against applying discounts for lack of marketability.45 Other states go both ways on the discount for lack of marketability issue.46

This new provision takes away the court’s ability to fashion a remedy. If the corporation or controlling shareholders elect to repurchase the plaintiff’s shares, the only issues left for the court’s determination are fair value and terms.

**Jury Trials**

An action under ORS 60.661—and presumably under ORS 60.952—is an equitable action.47 As such, there is likely no right to a trial by jury.

**Summary**

Owners of minority interests may be able to terminate their relationship with a corporation over a deadlock or if they have been subject to illegal, oppressive, or fraudulent conduct by the majority owners. However, these remedies all involve litigation.

As shown above, the courts have discretion to determine (1) if illegal, oppressive, or fraudulent conduct occurred and (2) if the answer to the first question is an affirmative, what the appropriate remedy will be. These remedies do not help a minority shareholder terminate his or her interest in a closely held company in situations where no illegal, oppressive, or fraudulent conduct has occurred.

**Break-Ups Among Members in an LLC**

Limited liability companies share some characteristics with corporations and some characteristics with partnerships.

**Expulsion of a Member**

While there may be roundabout methods of doing so, generally a corporation cannot expel a shareholder and a partnership cannot expel a partner. An LLC, however, can expel a member, unless the operating agreement provides otherwise (which is often the case). ORS 63.209 provides:

63.209 Expulsion of member.

(1) A member may be expelled from a limited liability company:

(a) In accordance with a written provision in the articles of organization or any operating agreement; or

(b) Except as otherwise provided in writing in the articles of organization or any operating agreement, by a court, upon application of any member, if the court determines that:

(A) The member has been guilty of wrongful conduct that adversely and materially affects the business or affairs of the limited liability company; or

(B) The member has willfully or persistently committed a material breach of the articles of organization or any operating agreement or otherwise breached a duty owed to the limited liability company or the other members to the extent that it is not reasonably practicable to carry on the business or affairs of the limited liability company with that member.

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(2) The power of a limited liability company to expel a member pursuant to this section does not limit or adversely affect any right or power of the limited liability company to recover any damages or to pursue any other remedies provided for in the articles of organization or any operating agreement or permitted under applicable law or at equity. The limited liability company, in addition to any of its other remedies, may offset any such damages against any amounts otherwise distributable or payable to the expelled member.

Although an LLC may expel a member, the fiduciary duty considerations may apply. For example, in a Tennessee case where the controlling LLC members expelled minority members—paying $150 per ownership interest and then selling all the units for $250 per unit—the Tennessee Court of Appeals held that the LLC’s majority members owed the same fiduciary duties to minority members as do controlling shareholders in a corporation. On the other hand, a Texas court held that an 80 percent owner of an LLC did not owe a fiduciary duty to the other members under Texas law.

Under Virginia law, managers and members owe a fiduciary duty to the LLC, but not to the members themselves. In *Goezin v. Granite Depo, LLC*, the court upheld a trial court’s finding that a majority LLC member did not breach his fiduciary duty by amending the articles of organization to permit eliminating a member’s interest for nonpayment of a capital contribution and then seeking to eliminate the member.

The court found that the amendment did not adversely affect the company and had a proper purpose—ensuring that the LLC received the member’s capital contribution.

In *Bell v. Walton*, the court held that in order for a member to withdraw from an LLC, the member must strictly comply with the notice requirements in the statute. The court was unwilling to judicially impose a doctrine of constructive notice of withdrawal upon the statutory scheme.

In *Love v. Fleetway Air Freight & Delivery Service, LLC*, the court held that the members’ vote to remove the LLC’s manager did not also constitute his removal as a member under the wording of that LLC’s operating agreement.

Although the Louisiana LLC statutes do not set out the procedure for terminating a member, the expulsion of a member made in accordance with the operating agreement have been upheld.

### Right to Withdraw

ORS 63.205 permits a member to withdraw from the LLC. There is no similar provision in the Oregon Business Corporation Act. The withdrawal may subject the withdrawing member to liability. ORS 63.205 provides:

1. A member may voluntarily withdraw from a limited liability company:
   a. At the time or upon the occurrence of events specified in the articles of organization or any operating agreement; or
   b. Upon not less than six months’ prior written notice to the limited liability company, unless the articles of organization or any operating agreement expressly provide that a member has no power to withdraw voluntarily from the limited liability company or otherwise expressly limit or condition such power.

2. If a member with the power to withdraw voluntarily from a limited liability company exercises that power, but the withdrawal is in breach of any provision of the articles of organization or any operating agreement, then, unless otherwise provided in the articles of organization or any operating agreement, the limited liability company, in addition to any other remedy available at law or in equity, may recover from the withdrawing member damages incurred by the limited liability company as a result of the breach and may offset the damages against any amounts otherwise distributable or payable to the withdrawing member.

3. Unless otherwise provided in the articles of organization or any operating agreement, in the case of a limited liability company for a definite term or particular undertaking, a voluntary withdrawal by a member before the expiration of that term or completion of that undertaking is a breach of the applicable articles of organization or any operating agreement.

Even though a member may “withdraw” as a member, this does not mean that the LLC is obligated to cash out the withdrawing member’s interest. ORS 63.365 provides that “following the cessation of the member’s interest, the holder of the former member’s interest shall be considered an assignee of such interest and shall have all the rights, duties and obligations of an assignee under this chapter.”

This statement is also true in other states. In Wyoming, for example, absent provisions in the
operating agreement addressing this issue, the withdrawing member loses the right to participate in management, but retains his/her economic interest (much like an assignee). This is also true under Delaware law when it is the bankruptcy of a member which causes an implied withdrawal.

In Lamprecht v. Jordan, an LLC’s operating agreement provided that the termination of a member’s employment constituted the withdrawal of that member, entitling the member only to payment of an amount equal to the balance in his capital account, not the fair market value of his interest in the LLC. The court upheld this provision.

New York’s LLC statute does not allow a member to withdraw. In New York, “a member may withdraw from a limited liability company only as provided in its operating agreement. If the operating agreement is silent, a member may not withdraw prior to the dissolution of the company.”

Some state LLC statutes not only allow a member to withdraw, but also require the LLC to buy out the withdrawing member’s interest at its fair value.

Actions for Dissolution and Oppression

A limited liability company can be dissolved upon the occurrence of those events specified in the articles of organization or by vote of the members. An LLC may also be dissolved by the circuit court. ORS 63.647 sets forth grounds for judicial dissolution, as follows:

The circuit courts may dissolve a limited liability company:

1. In a proceeding by the Attorney General if it is established that:
   a. The limited liability company obtained its articles of organization through fraud; or
   b. The limited liability company has continued to exceed or abuse the authority conferred upon it by law.

2. In a proceeding by or for a member if it is established that it is not reasonably practicable to carry on the business of the limited liability company in conformance with its articles of organization or any operating agreement.

3. In a proceeding by the limited liability company to have its voluntary dissolution continued under court supervision.

The corporate judicial dissolution statutes contain essentially the same provisions regarding dissolution initiated by the state (ORS 60.661 & 60.952). However, the provisions regarding dissolution proceedings initiated by owners are worded quite differently.

Unlike the corporate statutes, the LLC statute contains no provisions for dissolution in the event of deadlock or where the corporation acts in a manner that is “illegal, oppressive or fraudulent.” Instead, the LLC statute uses the phrase: “if it is established that it is not reasonably practicable to carry on the business.”

There are no Oregon cases interpreting this language and no consistent interpretation by other courts interpreting this “reasonably practicable to carry on the business” language. A good review of various interpretations by various cases is set forth in Kirksey v. Grohmann, which begins:

A consistent view in other jurisdictions is that a limited liability company is governed by its articles of organization and operating agreement. See Horning v. Horning Const., LLC, 12 Misc.3d 402, 816 N.Y.S.2d 877, 881 (NY Sup. Ct. 2006); Historic Charleston Holdings, LLC v. Mallon, 365 S.C. 524, 617 S.E.2d 388, 393 (SC Ct. App. 2005); Dunbar Group, LLC v. Tignor, 267 Va. 361, 593 S.E.2d 216, 219 (2004). Beyond this, however, there is no prevailing interpretation of the terms “not reasonably practicable” and “economic purpose . . . unreasonably frustrated” in relation to dissolution of limited liability companies. See SDCL 47-34A-801.

Nevertheless, the cases interpreting language similar to our statutory terminology, whether involving a partnership or a limited liability company, are instructive. In defining what it means for it to “not be reasonably practicable” for a company to continue, one court consulted a dictionary to apply a plain and ordinary meaning. Taki v. Hami, 2001 WL 672399 (Mich. Ct. App.) (unpublished) (dissolution of a partnership). The Taki court held that “reasonably practicable’ may properly be defined as capable of being done logically and in a reasonable, feasible manner.” Id at 3. Another court emphasized that “[t]he standard set forth by the Legislature is one of reasonable practicability, not impossibility.” PC Tower Ctr., Inc. v. Tower Ctr. Dev. Assoc., LP, 1989 WL 63901, 6 (Del. Ch.) (unpublished) (dissolution of a partnership). Under this view, the standard does not require that the purpose of the company, as set out in
the operating agreement, be completely frustrated to warrant judicial dissolution. Rather, the term “reasonably practicable” signifies a company’s ability to continue the purpose identified in the operating agreement. (footnotes omitted) Kirksey, supra, 754 N.W.2d at 828.

The Delaware LLC statute does not provide for judicial dissolution of an LLC in the event of deadlock; a court may dissolve an LLC only when “it is not reasonably practicable to carry on the business in conformity with a limited liability agreement.”

In the case of In re Silver Leaf, LLC, the court judicially dissolved the LLC, reasoning that this business was unable to go forward, because the LLC had no assets other than a claim against another company that had defrauded it.

One New York court has said that it is inappropriate to import dissolution standards from corporate or partnership law; the courts must look only to the New York LLC statute:

Phrased differently, since the Legislature, in determining the criteria for dissolution of various business entities in New York, did not cross-reference such grounds from one type of entity to another, it would be inappropriate for this Court to import dissolution grounds from the Business Corporation Law or Partnership Law to the LLCL.

After careful examination of the various factors considered in applying the “not reasonably practicable” standard, we hold that for dissolution of a limited liability company pursuant to LLCL 702, the petitioning member must establish, in the context of the terms of the operating agreement or articles of incorporation, that (1) the management of the entity is unable or unwilling to reasonably permit or promote the stated purpose of the entity to be realized or achieved, or (2) continuing the entity is financially unfeasible.

In Dunbar Group, LLC v. Tignor, one of two LLC owners sought expulsion of the other owner based on alleged acts of misconduct. The trial court ordered the expulsion and the LLC’s dissolution. The Virginia Supreme Court found that expulsion of the member was proper, but that dissolution was not proper. This was because the evidence failed to demonstrate that it was not reasonably practicable to carry on the LLC’s business.

In Investcorp, LP v. Simpson Investment Co., LLC, members of a Kansas LLC owning a single property were deadlocked over decisions about that property. The Kansas statute contained no provision regarding dissolution as the basis of deadlock. However, the operating agreement provided that the withdrawal of members would trigger dissolution.

Half the members withdrew, but the LLC refused to dissolve. The withdrawing members sued to force dissolution and the appointment of a receiver. The court ruled that the LLC must dissolve, but refused to appoint a receiver, holding that the LLC controlled the dissolution process.

Interpreting language similar to that in the Oregon LLC statute (“it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement”), a New York court held that judicial dissolution of an LLC will be ordered “only where the complaining member can show that the business sought to be dissolved is unable to function as intended, or else that it is failing financially.”

The court stated that the only grounds for judicial dissolution were those set out in the LLC statute, implying that the court had no inherent equitable power to protect minority owners.

In Haley v. Talcott, the two 50 percent owners of an LLC were deadlocked over how to manage the LLC’s property. The court found that it was not practicable to carry on business, and the court ordered dissolution and the sale of the LLC’s property. The court considered other “equitable” remedies based on provisions of the operating agreement, but did not find those remedies “equitable” under the facts of this case.

One court held that the Kansas LLC statute allows members to assert an oppression claim.

Arbitration Agreements
It is very common for operating agreements to contain the requirement that any disputes between the members, or between the LLC and the members, are subject to arbitration, rather than a lawsuit in court.

Courts give broad application to arbitration clauses in operating agreements.

Even though it is customary for only the LLC’s members to sign the operating agreement (and not for the LLC itself to sign), most courts hold that the LLC is also bound by the arbitration provisions of the operating agreement.
Summary
The best way for owners of noncontrolling ownership interests in LLCs to dispose of their interest in a closely held LLC is through mechanisms established prior to the company’s formation. These mechanisms are written into the LLCs organization documents (e.g., the operating agreement).

Summary and Conclusion
This discussion presented ways in which an owner in a closely held company—whether he or she has a controlling ownership interest or a noncontrolling ownership interest—can terminate his or her relationship with the company.

Many of the options presented in this discussion involve litigation, which may be costly and have an uncertain outcome.

If a valuation is required to determine the fair value of the closely held company stock, valuation discounts may be appropriate. Discounts for lack of ownership control and lack of marketability can be substantial and, if applied by the court in a shareholder dissolution case or other similar case, they can significantly affect the value of the closely held stock.

Potential investors of interests in closely held businesses should be aware of the risks of investing in securities that don’t have an established market where they can relinquish their ownership interests in the business entity.

Ownership interests in closely held companies can be extremely difficult to dispose of, and the investment horizon could match the investor’s lifetime in some cases.

Notes:
1. These types of agreements have many different names. Therefore, it is important to examine all of the agreements between the owners, including the Bylaws.
2. There is a long-standing rule against simply saying that property may never be sold. A right of first refusal clause is a mechanism that makes such sales highly unlikely, without actually prohibiting any sale at all. It is very difficult, if not impossible, for a minority owner to find a buyer for his or her shares. Such a sale is even more difficult if, after finding a potential buyer, the sale is suspended for a 30-day or 60-day period while the corporation decides whether to elbow aside the third-party purchaser and purchase the minority’s shares itself at the same price and on the same terms.
3. A reverse stock split is an alternative method used. In this procedure, shares are revalued (e.g., 100 shares of stock become 1 share of stock). Anyone owning shares that are reduced to less than 1 share (a fractional share) under the plan of reorganization are cashed out at their fair value rather than receiving a fractional share.
4. Most states have similar provisions for dissenters’ rights, although timeliness and other specifics may vary by state. It is important to read the statute that applies.
8. Columbia Management Co. v. Wyss, 94 Or. App. at 199.
9. Id. at 201-12 (discussing Woodward v. Quigley, 257 Iowa 1077, 133 N.W.2d 38 (1965)).
14. But see Perlman v. Peromite Manufacturing Co., 568 F.Supp. 222, 232 (ND Ind. 1983), aff’d, 734 F.2d 1283 (7th Cir. 1984) (although discounts for minority interest, lack of marketability and lack of diversity are proper, a discount for capital gains tax liability is not).
19. Coggins v. New England Patriots Football Club, 397 Mass. 525, 492 N.E.2d 1112 (1986) (appraisal statute does not deprive courts of their equitable powers); Bayberry Associates v. Jones, 783 S.W.2d 553 (Tenn. 1990) (despite appraisal statute, courts retain equitable right to assure fairness, including fair price and fair dealing); Mullen v. Academy Life


40. There is a trend in other states to look to the “reasonable expectations” of the shareholders at formation in order to determine whether a triggering event of oppression has occurred. In such states, if the court finds the shareholders had a “reasonable expectations” of continued employment at formation, the termination of one shareholder’s employment may be a triggering to an oppression claim.

The task force that proposed the Oregon statute (a task force on which this author served) rejected efforts to include “reasonable expectations” language in the triggering event provisions of ORS 60.952—leaving this issue to further development by the Oregon courts. However, the task force did include “reasonable expectations” language in the remedy section. Thus, a corporate act that disregards the subjective expectations of the shareholders is not necessarily a triggering event for an oppression suit, but ORS 60.952(4) requires the court to take these expectations into account in fashioning a remedy. This may be consistent with prior case law. See: Cooke v. Fresh Express Foods Corp., 169 Or. App. 101, 7 P.3d 717 (2000) (which took into account lost wages of the oppressed shareholder in awarding damages).

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