EQUAL TREATMENT FOR SHAREHOLDERS:
AN ESSAY

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Although our form is corporate, our attitude is partnership. Charlie Munger and I think of our shareholders as owner-partners, and of ourselves as managing partners. . . . We do not view the company itself as the ultimate owner of our business assets, but instead view the company as a conduit through which our shareholders own the assets.¹

Many a corporate law professor would be looking for work if more corporations adhered to the guidance practiced by Warren Buffett and Charles Munger in their stewardship of Berkshire Hathaway. There simply would not be enough material to excite the students and fill the classrooms. But the unemployment rolls are not so swelled, and a good many lawyers have work because many dominant owners and managers have a different, indeed opportunistic, view of their relationship toward stockholders than do Messrs. Buffett and Munger. Evidence of opportunism unleashed on corporations' owners can be found in merger freeze-outs, recapitalizations, and other transactions that treat minority owners as less than equals. The spirit of such buccaneers of capitalism can also be found in the writings of those who counsel that the forces that shape relationships among owners are not normative but dynamic, within which competitive advantages are secured by the most aggressive of the group. No one more eloquently argues for this position than do Judge Frank Easterbrook and Professor Daniel Fischel:

Many scholars, though few courts, conclude that one aspect of fiduciary duty is the equal treatment of investors. Their argument takes the following form: fiduciary principles require fair conduct; equal treatment is fair conduct; hence, fiduciary principles require equal treatment. The conclusion does not follow. The argument depends on an equivalence between equal and

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fair treatment. To say that fiduciary principles require equal treatment is to beg the question whether investors would contract for equal or even equivalent treatment.  

This Article examines the notion of whether fairness—that litmus for so much in corporate law—should have as one of its components an unwavering commitment to equal treatment. Part I reviews recent decisions of the Delaware Supreme Court, where we find the court consistently provides a resounding negative response to the view of a linkage between fairness and equal treatment. Part II examines the most famous decision calling for equal treatment, Jones v. H.F. Ahmanson & Co.  Jones serves as a foundation for the discussion in Part III of the relationship between a commitment to equal treatment and justification for unequal treatment premised on service to the corporate interest. The final portion of this Article concludes that a commitment to equal treatment requires both safeguarding the statutory rights of stockholders when their contractual rights and preferences are being systematically altered, and a strong business justification for all other types of unequal treatment.

I. The Death of Equality in Delaware

What is “fair” is always an intriguing question. In the corporate context, fairness is not a point, but a spectrum of values. Inquiries in this context therefore seek to determine whether the transaction falls within that spectrum. When the question is the rights among stockholders, particularly those of the same class, there is some authority that there are spectrums within spectrums. For example, in Nixon v. Blackwell,  the Delaware Supreme Court reversed the Chancery Court’s holding that the non-employee holders of Class B stock were entitled to liquidity equal to that which the employee holders of Class B stock enjoyed. More than half of the Class B shares were held by an employee stock ownership plan (“ESOP”). Employees being terminated and those retiring were granted the option to receive their interest in the ESOP in Class B shares or cash.  Senior officers and directors owned Class A shares and, by agreement, could exchange those shares for Class B shares upon the officer’s or director’s retirement or death.  

4 626 A.2d 1366 (Del. 1993).
5 See id. at 1371.
6 See id. at 1371-72.
facilitate repurchase of Class B shares held by former officers or directors, the corporation purchased “key man” insurance to fund purchases that were triggered by the holder’s death.7 Because a comparable repurchase option was not extended to non-employee Class B stockholders, they sued, alleging they were improperly excluded from the company’s share repurchase program.8

The Nixon case involved self-dealing because directors, as prospective holders of Class B shares, unlike the plaintiffs, enjoyed their shares being redeemed by the corporation with funds provided by insurance policies purchased by the corporation. Nevertheless, Chief Justice Veezy rejected the plaintiff’s call for equal treatment, reasoning that “[t]o hold that fairness necessarily requires precise equality is to beg the question.”9 “[S]tockholders,” he explained, “need not always be treated equally for all purposes.”10 On this point, the court was greatly influenced by the above-quoted reasoning of Judge Easterbrook and Professor Fischel. The thesis advanced by Easterbrook and Fischel is that, because individuals bring to the corporation very different backgrounds, talents, and motives, transactions that maximize wealth for the stockholders may require disproportionate sharing of gains so as to provide those in control with sufficient rewards for their risky entrepreneurial activities.

Nixon answered the question of fair treatment for the non-employee Class B holders by identifying a corporate benefit with the corporation’s repurchase of retiring employees’ shares—to prevent the shares from passing into the hands of members of the founder’s family or descendants of employees.11 The court believed the arrangement was consistent with the intent underlying the original creation of the Class B stock; the Class B shares were to be held by passive investors with no active voice in the corporation.12 One can easily get lost in a vast semantical battle under Nixon’s approach to fairness, where qualities unrelated to the share terms are considered in evaluating how value is to be distributed among the owners. For example, no one disputes the fact that parties receiving the same, i.e., equal, amount for their shares have each been treated fairly. If one looks beyond a person’s status as a shareholder, however, to some other endowment she carries to the

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7 See id. at 1372.
8 See id. at 1370.
9 Id. at 1377.
10 Id. at 1376.
11 See id. at 1377, 1379.
12 See id. at 1379.
transaction, such as longevity, loyalty, or some element of sacrifice for the corporate good, one may argue that the failure to compensate such shareholder for those intangible qualities results in that person's unfair treatment. Thus, equal payment for all shares is unfair because it fails to respect the additional value some holders add to their shares. Correlatively, if the person who brings additional endowments to the corporation receives a higher price than those who do not, those receiving the lesser amount are not being treated unfairly. Under this type of analysis, the semantical question turns on the context in which "fairness" is being assessed. Should it be evaluated only with respect to the rights of a share, or should it include the characteristics of the shareholder herself? If the latter theory prevails, the fairness approach advocated by Nixon appears to be correct.

Nixon's application of this reasoning (namely, that differing treatment for non-employee shares was intended by the parties), however, is gravely flawed. If, for example, fostering employee ownership of nearly seventy percent of the outstanding Class B stock was in the company's interest, is there any reason to believe that the ESOP's purchase of the Class B shares, held by the non-employees would not also be in the company's interest? The company's interest in reducing the number of shares held by non-employee members would be advanced by pursuing any option to purchase Class B shares, whether those shares were held by an employee or non-employee. For example, we would expect that non-employee Class B shares not purchased by the company would wind up in the hands of a non-employee, thus perpetuating the very problem the court recognized the Class B shares were intended to address.

Furthermore, the Class B stock was authorized and issued nearly fifty years before the ESOP was created. Thus, it is unreasonable to conclude, as did Chief Justice Veasey, that an implied term of the Class B shares was that any future employee holder would be treated differently than a non-employee holder. Moreover, the fourteen complaining non-employee holders of Class B

13 See id. at 1371, 1379. Chief Justice Veasey reasoned that the practice of favoring repurchase of employee shares could be traced back to the practice of a corporation buying insurance to purchase the firm's founder's shares upon his death. On this point, the court appears to commit a fatal mistake of failing to distinguish, on the one hand, the role of "key man" insurance and legitimate estate planning interest on the part of its founder and, on the other hand, a systematic practice of favoring insiders whose importance to the firm and estate planning needs are quite different from that of the firm's founder.

14 See id. at 1379.
shares became such no later than two years before the ESOP was created.\textsuperscript{15} Thus, even accepting the notion that such holders’ share contract embodied practices that prevailed when they acquired their Class B stock, there would be no basis for saying that those holders acquired their shares with knowledge, or even notice, of the preferential treatment to be accorded other holders. One may therefore wonder whether, in its rush to reject the plaintiff’s argument that fairness demands equality, the Nixon court blinded itself to the facts on which it purported to justify such unequal treatment as serving the corporation’s interest.

In the Delaware Supreme Court’s recent decision upholding the adoption of a “tenure voting”\textsuperscript{16} arrangement, the court further distanced itself from equating fairness and equal treatment. In Williams v. Geier,\textsuperscript{17} the Delaware Supreme Court upheld an amendment to the corporation’s articles of incorporation which established a tenure voting arrangement that the minority unsuccessfully argued disproportionately advantaged the majority. Though finding that the proposed tenure voting arrangement would slightly enhance the controlling family’s voting power, the majority opinion did not view that change to be so extreme as to cause grossly disproportionate effects on the minority holders.\textsuperscript{18} The court’s majority relied heavily on the amendment having been approved by both the company’s independent directors and the stockholders after full disclosure of all material facts.\textsuperscript{19} Though the amendment was approved by a majority of the minority shares represented at the meeting, approximately fifty-two percent of the minority shares voted against the change, abstained from voting, or were not represented at the meeting.\textsuperscript{20} Nevertheless, a majority of the justices was satisfied that the change had followed approval by a vote of the shareholders, and, significantly, the majority did not believe the amendment’s disproportionate effects required a minority stock-

\textsuperscript{15} See id. at 1370-71.

\textsuperscript{16} Tenure voting, whereby the extent of a particular holder’s voting power is, in part, a function of the time she has held her shares, has been justified in Delaware on the grounds that the distinctions provided are not among shares of the same class, but rather among the holders of shares. See, e.g., Providence & Worcester Co. v. Baker, 378 A.2d 121, 123 (Del. 1977).

\textsuperscript{17} 671 A.2d 1368 (Del. 1996).

\textsuperscript{18} Prior to the amendment, the Family Group controlled the voting of over 50% of the shares. After the amendment, if all stockholders (majority and minority) sold 30% of their shares, the Family Group would still hold 51.9% of the total voting power. See id. at 1373 n.10.

\textsuperscript{19} See id. at 1385.

\textsuperscript{20} See id. at 1374 n.12.
holder plebiscite. The court held the amendment was not a self-dealing transaction that should be adjudged by the entire fairness standard. They reasoned that self-dealing was not implicated by a transaction which was not disproportionate on its face, even though its effects over time would give rise to disparate results between the minority and majority stockholders.21 Thus, one can see in Williams the suggestion that, even if a majority of the minority votes against the proposal, the transaction is still protected by the presumptions of the business judgment rule.

As will be seen in the next section, Williams is in stark contrast to the approach taken in Jones v. H.F. Ahmanson & Co.22 It is far wiser that the test of whether the business judgment rule attaches be not the degree of disproportional impact on the minority, but whether there is any disproportional effect at all. Minimally, such a result should, the dissenting justices in Williams concluded, remove the presumption of propriety so that the majority must bear the burden of proof.

II. The Enshrinement of Equal Opportunity: Jones v. H.F. Ahmanson & Co.

Few corporate law cases provide as much protection to the minority as provided by the California Supreme Court three decades ago in Jones v. H.F. Ahmanson & Co.23 Though the facts are complex, the dispute was fairly straightforward. The defendants, the so-called “Ahmanson Group,” transferred their Association common shares (which represented eighty-five percent of all Association shares) to United Financial, a holding company they had created. In exchange, the defendants received 250 United Financial shares and, ultimately, an additional $927.50 cash for each Association share so transferred.24 The minority shareholders were not provided the opportunity to participate in this exchange. The suit charged not only that the minority’s exclusion was wrongful, but that the transaction effectively destroyed the marketability of the minority’s shares. The minority’s victory in Jones is significant both for the breadth of the duty the California Supreme Court imposed whenever “control of the corporation is material,”25 and for the novel remedies it provided to redress the defendant’s breach of

21 See id. at 1378.
23 Id.
24 See id. at 467 n.6.
25 Id. at 474.
this duty. Not only did the court call for a comprehensive rule of
good faith obligation on the part of the majority to the minority,26
but also the minority shareholders were offered the choice between
exiting the company by selling their shares at fair value or receiving
value equivalent to what the majority shareholders had garnered
for themselves.27

The purpose here is not to reexamine Jones, but to use its facts
to question the content of fiduciary duties among shareholders in
the corporate setting. Jones is an excellent vessel to launch this
discussion because the case is paradoxical in many respects.
Though Jones is rich with facts supporting many potential bases for
awarding the minority relief, Justice Traynor’s opinion focuses on
broad pronouncements for relationships between the majority and
the minority, with few specifics regarding the harm that was actu-
ally suffered by the minority in Jones. There is, thus, much room
within the case to examine the purpose and content of protections
to be afforded minority shareholders.

The challenged transaction occurred in May 1959, when the
Ahmanson Group, comprised of fifteen individuals and four corpo-
rations, transferred 5564 Association shares to the newly created
United Financial. Their shares represented 85% of Association’s
outstanding shares; the remaining 15% (982 shares) were then held
by 400 stockholders. As explained above, in return for their Asso-
ciation shares, the defendants received 250 United Financial com-
mon shares and $927.50 cash. The total amount of cash paid to the
defendants was $6.2 million, which was 85% of the proceeds of
United Financial’s public offering of convertible subordinated de-
bentures and 120,000 shares of its stock.28 Subsequently, there was
an additional public offer by United Financial of 50,000 shares, plus
600,000 United Financial shares owned by the defendants.29 The
overall effect of having sold these 770,000 United Financial shares
to the public was the creation of a viable market for United Finan-
cial shares. It was, however, a market that was not available to the
plaintiffs who continued to hold Association shares.

Justice Traynor emphasized the “fundamental corporate change”30
that the creation of United Financial visited on the Asso-

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26 “Majority shareholders may not use their power to control corporate activities to
benefit themselves or in a manner detrimental to the minority.” Id. at 471 (emphasis
added).
27 See id. at 476-78.
28 See id. at 467.
29 See id. at 468.
30 Id. at 477.
ciation minority. His concern transcended the loss of marketability of the minority's Association shares; his focus was on the likelihood that Association's policies—particularly with respect to dividends—would be guided by the needs of a set of stockholders quite different from those who owned shares directly in Association. The argument is interesting given that the parties stipulated that no harm to Association had resulted from the defendant's creation of the holding company. Thus, by virtue of the stipulation, Justice Traynor's concern must have been the fundamental change in the nature of the minority's relationship to Association, rather than any change in Association itself. One such source of concern for the Association minority was the undertaking by United Financial that it would, if necessary, exercise its control of Association to either liquidate Association or encumber its income-producing assets so as to distribute cash to United Financial in order to service or retire the debentures issued in June 1960.

Even more ominous for the minority was United Financial's offer in September 1960 to purchase up to 350 Association shares at $1100 per share. Though at first glance helpful relief for the minority shareholders who were otherwise finding few takers for their shares, the offer was under-subscribed, as the book value of Association shares was then $1412. Soon after that offer, but well before the offer lapsed, United Financial caused Association's president to announce that shareholders could not expect Association to continue the customary large special dividend in addition to its regular dividend. Though one may admire the candor of such an announcement, the motive behind it is suspect. Transparently, this feature of Jones' facts strongly suggests a "minority freeze-out" was afoot. The exclusion of the minority from the exchange, thereby destroying the hope of a broader market for Association shares, was arguably the first step by the majority to acquire the minority's shares at fire sale prices.

Another source of abuse by the defendants is evidenced by their sale to the public of 600,000 of the United Financial shares they had acquired in their exchange of Association shares. Had the minority shareholders of Association been treated equally so

31 See id.
33 See id. at 300.
35 See id. To be sure, no special dividend was paid in 1961, but a special dividend of $75 per share was paid in 1960, and an $84 per share special dividend was paid in 1962. See Jones, 76 Cal. Rptr. at 301.
that they too received 250 United Financial shares for each Association share, the majority could not have sold 600,000 United Financial shares without losing their control of the company (United Financial). Thus, had the minority shareholders been included, the defendants would have received at least $1,780,000 less than they did through their February 1961 resale.\textsuperscript{36} The potential for a minority freeze-out, as well as the majority's exclusion of the minority so as to maximize the number of shares they could resell in their secondary distribution, gave rise to the defendants garnering an unshared gain.

Another source of an unshared gain by the defendants is the manner of providing themselves with $927.50 cash for each of their Association shares. As seen above, the bulk of this cash was raised through the sale of debentures for which the defendants had pledged to exercise their control over Association to liquidate Association or, if necessary, encumber its assets in order to service or retire the debentures. A significant question, of course, is how the defendants could fulfill this contractual commitment so long as there continued to be minority holders of Association shares. Though Justice Traynor believed the arrangement posed a fundamental change in the minority's status, one may also wonder why this arrangement should be viewed so narrowly. The bond indenture could more easily be seen as inviting the controlling stockholders' highly personalized use of company assets for private purposes.\textsuperscript{37} After all, the proceeds of the debentures were used as part of United Financial's purchase price for the defendants' Association shares. The debentures and their covenants were the means by which the defendants reaped an unshared gain of $927.50 per Association share.\textsuperscript{38}

\textit{Jones} may well be the high-water mark for protection of minority shareholders. The case arose not out of a dispute regarding

\begin{footnotesize}
\textsuperscript{36} The inclusion of the minority need not have affected the defendants' receipt of $927.50 for each of their Association shares, because the source of that cash was 85\% of the proceeds of the June 1960 public sale of securities by United Financial. Thus, the remaining proceeds could have been made available to the minority without reducing the amount distributed to the defendants.

\textsuperscript{37} See Coggins v. New England Patriots Football Club, Inc., 492 N.E.2d 1112 (Mass. 1986) (business purpose test for merger freeze-out of minority is not satisfied when merger's purpose is to permit controlling shareholder to use corporate assets to reduce debt incurred in acquiring control).

\textsuperscript{38} It would be inappropriate to treat as an unshared gain that portion of the cash payment that arose from the sale of United Financial shares since there was no potential appropriation of Association assets, but rather an appropriation of the majority's interest in Association.
\end{footnotesize}
the latitude the corporation (or its board of directors) has in differentiating among members of the same class of stock, or whether the minority was disproportionately harmed because of the control the defendants exercised over the corporation. Instead, the triggering event in Jones was the defendants' disposition of their shares; they simply exercised control over their own shares. More importantly, their sale was carefully structured so as to retain their control over Association. In this way, defendants avoided having their case aligned with the traditional sale of control case where the former controlling shareholder's breach arose because of the new fox he placed in the hen house.39

The most interesting feature of Jones is that the opinion holds that it did not matter why the minority shareholders were excluded. The court considered it irrelevant whether they were excluded as a first step toward squeezing the minority out of the corporation or whether their exclusion was for the purpose of allowing the defendants to sell more of their United Financial shares while continuing to control United Financial. The important point for the court was that the minority shareholders were excluded and that there was a consequential disproportionate gain on the part of the defendant. Correlatively, the exclusion of the minority also produced, in the court's eyes, a disproportionate loss in the marketability of their shares.

III. SAFEGUARDING THE PRINCIPLE OF EQUAL TREATMENT

One can find in Jones a variety of bases for protecting the minority shareholders from the effects of their majority colleagues. At one level is the appeal of an easily administrable rule that all shareholders are to be treated equally on any corporate matter. Support for this interpretation of Jones lies in Chief Justice Traynor's broad call for a comprehensive rule of good faith and inherent fairness whenever control is material.40 However, the facts narrow the breadth of this call considerably. Jones may not stand so much for equal minority participation in the unshared gain otherwise garnered by the majority, as it calls for a meaningful prophylaxis when there is evidence the unshared gain is a step toward


a minority freeze-out. Jones may also be seen as a bar to the majority abusing its control over a corporation by contracting to appropriate its assets for the majority's benefit without the consent of, or benefit to, the minority. This interpretation finds support in the aforementioned covenant in the United Financial debentures to apply Association assets to satisfy United Financial's debentures, if necessary. The case is further constrained by its procedural setting; Jones's focus was the complaint's dismissal in response to the defendants' demurrer. The factual record was, thus, the one set forth in the complaint. This undoubtedly clouded the record which does not reveal a business justification for the minority's exclusion. We can only speculate what impact a business justification would have had on Chief Justice Traynor, had one been advanced.

A. Alchemy of a Business Purpose Test

Ease of administration is a worthy, though not necessary, feature of any fiduciary standard.\footnote{\textit{We should not, however, be blinded solely by the virtues of a rule that is administrable and predictable. Even such a rule can prove dysfunctional. For example, early rules subjecting transactions between the corporation and its directors to automatic avoidance proved unworkable because they discouraged the beneficial transactions that involved the firm's directors. See Harold Marsh, Jr., \textit{Are Directors Trustees?}, 22 BUS. LAW. 35 (1966). Similarly, Section 16, the short-swing provision of the Securities Exchange Act, 15 U.S.C. § 78p (1988), is popularly seen as providing more relief to lawyers than protection to securities markets from insider trading by proscribing certain insider trading profits made within six months of a security's purchase. See, e.g., Marleen A. O'Connor, Toward a More Efficient Deterrence of Insider Trading: The Repeal of Section 16(b), 58 FORDHAM L. REV. 309 (1989). But see Merritt B. Fox, Insider Trading Deterrence Versus Managerial Incentives: A Unified Theory of Section 16(b), 92 MICH. L. REV. 2088 (1994). Thus, many easily administrable corporate rules have, nevertheless, posed costs that arguably outweigh the rules' benefits.}} Certainly a fairness-requires-equality standard is more easily administered than the more fact specific inquiry in Nixon or the not grossly disproportionate conclusion in Williams. Nothing can be more easily determined than whether shareholder X, whose ownership percentage is twice that of shareholder Z, received more or less than twice that of Z, or was accorded rights not available to Z. Thus, for example, requiring sharing in strict proportion to the parent's ownership interest of the benefits arising from the parent and its subsidiary filing consolidated tax returns, whereby the parent's losses reduce the subsidiary's taxes, is a far simpler and less mischievous approach\textsuperscript{42} than

\footnote{\textit{See, e.g., Smith v. Tele-Communication, Inc., 184 Cal. Rptr. 571 (Ct. App. 1982). This is the approach taken by the American Law Institute. See 1 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.11 cmt. d(1)(a) (1994) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE].}}
the vaguer inquiry under a fairness standard defined only by a business justification for the division between the majority and the minority owners.\textsuperscript{43} But can there be a "greater good"—more specifically, the corporate interest—that can be considered in measuring whether the minority, though treated differently, was nevertheless treated fairly? Recall that \textit{Nixon} applied such a business purpose test in upholding the differential treatment of the non-employee holders.

\textit{Nixon}’s invocation of a business purpose for the differential treatment of stockholders is analogous to the approach taken earlier by the Delaware Supreme Court in a leading business judgment rule decision in \textit{Bodell v. General Gas \& Electric Corp.},\textsuperscript{44} where the question involved the propriety of the board of directors issuing Class A shares at a price below market value. The company had outstanding Class A and Class B common shares whose features were nearly identical, except that Class A shares were a species of participating preferred stock, for they were entitled to a priority over Class B shares with respect to annual dividends of $1.50 per share and to a $25 per share liquidation preference.\textsuperscript{45} After the class B common received an equivalent dividend, both classes were to share equally in dividends and distributions of assets, subject to the Class A’s $25 liquidation preference. The dispute arose out of the directors’ program to enhance the attractiveness of Class A shares by allowing their holders to apply their yearly dividends toward the purchase of additional Class A shares with a stated purchase price of $25 per share. As a result of this arrangement, the company was able to issue additional Class A shares at an average price of $42 per share.\textsuperscript{46}

A holder of Class B shares complained, arguing that the directors’ policy diluted the value of the Class A shares by selling the shares below fair market value. The suit was dismissed on the court’s reasoning that the directors had a reasonable basis for their decision to permit holders of Class A shares to apply their dividends toward the purchase of additional Class A shares at below their market price. The court was persuaded that the practice served the corporation’s interest by making the Class A shares more attractive and boosting their market price to as much as $64

\textsuperscript{44} 140 A. 264 (Del. 1927).
\textsuperscript{45} See \textit{id.} at 265.
\textsuperscript{46} See \textit{id.}.
per share, so that funds could be raised by selling additional shares for an average price of $42 per share.

On closer examination, the court appears to have applied the wrong analysis to the dispute. The directors' decision essentially allowed existing holders of Class A shares to substantially augment their dividends by applying their cash dividends toward the bargain purchase of additional Class A shares. For every 16\% Class A shares owned, a shareholder received a dividend of $25 (16\% x $1.50), plus the gain in the amount that the stated purchase price of additional shares fell below the then fair market value of Class A shares. Thus, if the Class A shares had an average fair market value of $42, a Class A shareholder received a yearly return of $42 for each 16\% Class A shares held. This amounted to approximately $2.50 per Class A share. Though the arrangement advanced the corporation's interest and was wonderful for Class A shareholders, it turned the contract with the Class B stockholders on its head. Consider that the directors could also have enhanced the attractiveness and higher value of the Class A shares by simply raising their yearly dividend to $2.50 per share. However, this would also have required raising the dividend for the Class B shares because, as seen earlier, the Class A and Class B shares were fully participating with respect to dividends after each class received a dividend of $1.50 per share. Therefore, the question before the court in Bodell was not solely the scope of the directors' discretion under the business judgment rule, but their discretion in light of the contractual understandings among the classes of the company's stockholders.

The preceding analysis of Nixon and Bodell suggests that determining ex post the probable intent of the stockholders regarding their relative rights in the context of a specific transaction is highly problematic. In both cases, the Delaware Supreme Court could as easily have ruled in favor of the complaining stockholders by invoking the probable intent of the parties. Indeed, it is the rare dispute regarding the relative rights, privileges, and preferences among holders of the same class of stock that two equally plausible interpretations cannot be sought. In such a context, the first question is to settle upon an approach to resolving such disputes. This is not to suggest that intent is irrelevant or secondary. Intent is of great importance in resolving disputes among shareholders. Courts, however, must decide the starting point with regard to the parties' likely intent.
Fiduciary duties in the corporate context exist to fill gaps where the parties have not otherwise set forth their rights and relationships. Fiduciary duties are therefore similar to corporate statutes in that they provide convenient off-the-rack rules to simplify the process of contracting, and permit deviations from corporate provisions when the interests of third parties (most notably, creditors) will not be harmed. Though there is much concern and uncertainty regarding the duty owed minority stockholders, burdens of the directors' and controlling stockholders' fiduciary duties are not great. The commands of corporate fiduciary duties provide a fairly low threshold for what constitutes appropriate behavior in the corporation. Indeed, the most notable feature of corporate fiduciary duty law is the lack of rigor found in its prescriptions.

Far more important than the broad standards by which the courts purport to judge defendants' behavior is whether the court will deprive the challenged transaction of the deferential presumptions dictated by the business judgement rule. The all-important burden of persuasion follows from whether the defendants' conduct falls within the business judgement rule. So viewed, the single most important issue in considering the content of fiduciary duty obligations among stockholders is the threshold consideration whether the challenged transaction enjoys the presumption of propriety. In this context, the question of the content of the fiduciary duty among stockholders is answered by inquiring into what assumptions we should make regarding the rights, privileges, and preferences among stockholders who have not otherwise chosen to deviate from the recognized norm. Armed with this standard, courts can then take the next step of determining what showing is necessary to consider whether the parties before it have chosen to depart from that norm. This is precisely the course followed by Justice Traynor in Jones.

After a good many incantations of the majority's fiduciary obligations to act in good faith toward the minority, Jones applies the standard of equal treatment for the minority, unless the majority

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48 See, e.g., Levien v. Sinclair Oil Corp., 261 A.2d 911 (Del. Ch. 1969) (holding that dominant stockholder breached fiduciary duty with respect to its control over subsidiary's dividend policies because it was unable to sustain the burden of proving corporate interest served by compelling dividends in excess of earnings), rev'd, Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) (holding that where self-dealing is not established, controlling shareholder has no burden to justify its actions; thus a suit challenging subsidiary's practice of distributing dividends in excess of its earnings must be dismissed unless the complaining stockholder can prove the dividend policy harmed the controlled subsidiary by depriving it of funds to embrace reasonable business opportunities).
invokes a compelling justification for deviating from the norm.\textsuperscript{49} As seen above, the majority would be hard pressed to justify the minority's exclusion on any basis other than that their participation would have substantially reduced the gains the majority earned for themselves.

Thus, the separation between \textit{Jones} and \textit{Nixon-Williams-Bodell} is not whether, as a general proposition, the minority seeks equal treatment, but how great the presumption of such treatment is to be. \textit{Nixon}, \textit{Williams}, and \textit{Bodell} employ the standard business judgment rule approach of upholding unequal treatment on a showing of rational business judgment that courts presume was accepted by the minority. In contrast, \textit{Jones}, by requiring any deviation from unequal treatment to be justified by a "compelling business reason," requires a balancing of the competing means for accomplishing a transaction. The contrast between these two approaches is illustrated in a Ninth Circuit decision that applied \textit{Jones} to facts posing the same liquidity issues raised in \textit{Nixon}.\textsuperscript{50} There, the Ninth Circuit held that, under the compelling business reason standard, it was error to dismiss the minority's suit arguing that the majority breached its fiduciary duty by engineering a reverse stock split and terminating a long-standing practice of the corporation's purchase of holders' shares at book value.\textsuperscript{51} The issue in that case was much like that in \textit{Nixon} and \textit{Williams} because the minority shareholders were challenging a transaction that produced disadvantages falling disproportionately upon the minority shareholders. The Ninth Circuit held that only if the corporate advantages gained by these changes in company policies outweighed their disproportionate effects on the minority would the majority escape the conclusion that they had breached their fiduciary duty to the minority.\textsuperscript{52}

But just what is accomplished by the court announcing that the appropriate standard for unequal treatment of similarly situated owners is a compelling business justification for the transaction? Though this heightened level of scrutiny can hardly be seen as old wine in a new bottle, the approach nevertheless harmfully dulls the focus of concern. How is it that, among similarly situated

\textsuperscript{49} See \textit{Jones}, 460 P.2d at 476.
\textsuperscript{50} See \textit{Shivers} v. \textit{Amerco}, 670 F.2d 826 (9th Cir. 1982).
\textsuperscript{51} See \textit{id}.
\textsuperscript{52} See \textit{id}. at 834. In this respect, the court applies the approach taken earlier in \textit{Klaus} v. \textit{Hi-Shear Corp.}, 528 F.2d 225 (9th Cir. 1975), that, under \textit{Jones}' compelling business reason test, the reviewing court "balances...the good to the corporation against the disproportionate advantage to the majority shareholders and incumbent management." \textit{Id} at 234.
stockholders, the managers or dominant owners can engineer a transaction that gravely disadvantages one group, yet somehow produces a collective benefit to all owners simply because the dominant entity benefits? The logic of this approach, whether housed in the business purpose or compelling business purpose standard, should be considered in light of the probable intent of the parties.

B. The Probable Intent of the Parties

An interesting revelation about Jones' compelling business reason test is its striking similarity to the test in a leading close corporation case protecting a minority stockholder from expulsion. In Wilkes v. Springside Nursing Home, Inc., the Massachusetts Supreme Judicial Court stated that the "strict good faith duty" the majority owes the minority in a close corporation requires the majority only to advance a legitimate business purpose to support the action questioned by the minority. If the minority responds by arguing that the legitimate business purpose could have been accomplished "through an alternative course of action less harmful to the minority's interest," the court then exercises its independent judgment "to weigh the legitimate business purpose . . . against the practicality of a less harmful alternative." Though much of the opinion in Wilkes is devoted to the unique needs of the minority in a close corporation, the protection afforded Mr. Wilkes is quite similar to that afforded Mrs. Jones.

Earlier, in Donahue v. Rodd Electrotype Co. of New England, Inc., the Massachusetts Supreme Judicial Court announced that special fiduciary duty obligations apply in close corporations. The dispute arose out of the minority's complaint, much like that in Nixon, that the close corporation's co-founder's shares were purchased at a value that reflected their book and liquidation value. The court purported to invoke a prophylactic "equal opportunity" rule for close corporations so that, "if the stockholder whose shares were purchased was a member of the controlling

54 See id. at 663.
55 Id.
56 Id.
57 Similarly, Nixon, though clearly involving a complaint centered on illiquidity, suggests that the content of the majority's fiduciary obligations is not influenced by whether the firm is a close or public corporation. In this respect, Nixon mirrors the approach in Jones which also makes no distinction between the majority's obligations based upon whether the company is a public or close corporation.
58 328 N.E.2d 505 (Mass. 1975).
group, the controlling stockholder must cause the corporation to offer each stockholder an equal opportunity to sell a ratable number of his shares to the corporation at an identical price.\textsuperscript{59}

Though prophylactic rules, such as those announced in \textit{Donahue}, have among their virtues ease and predictability of application and content, their bluntness provides the potential for mischief. Easterbrook and Fischel question whether the minority may not, instead of an equal opportunity rule, prefer one that permits the corporation to repurchase the aging founder's shares as a means of revitalizing the corporation by infusing new and younger management.\textsuperscript{60} They thus wisely advise that there is a need to qualify an otherwise unbending requirement of equal opportunity.\textsuperscript{61} The flexibility of which Easterbrook and Fischel wrote is embodied in \textit{Jones'} “compelling justification” standard and, of course, even greater latitude is accorded under the \textit{Nixon-Williams-Bodell} business purpose inquiry.

Broad and fixed fiduciary standards, such as those announced in \textit{Donahue}, will surely prove dysfunctional.\textsuperscript{62} Fixed requirements of equality that cover all corporate activities will discourage adaptation to the vicissitudes of business and lead to increased incorporation expenses, as incorporating attorneys advise their clients on provisions to navigate around inflexible prophylactic rules. Though great flexibility should be accorded managers on matters related to the conduct of the corporation’s business, this is not necessarily the case regarding decisions that impact the relative rights of owners' interests in the firm.\textsuperscript{63} The former is more clearly the type of business activity which is best lodged with the firm’s managers; the latter is not. Matters that involve the relationships

\textsuperscript{59} Id. at 518.

\textsuperscript{60} See \textit{Easterbrook \& Fischel}, supra note 2, at 246.

\textsuperscript{61} The qualification, however, does not appear to have merited a reversal in \textit{Donahue} where no corporate interest was alleged to be served by the repurchase of Harry Donahue's shares. Donahue did not suddenly become ill or aged; he lingered toward that condition, during which time others had assumed the responsibilities for managing the firm. Nevertheless, though \textit{Donahue} was not the appropriate case for illustration of the fact, there should still be opportunity to escape the broad commands of an otherwise unqualified rule of equal opportunity.


\textsuperscript{63} See \textit{Muellenberg v. Bikon Corp.}, 669 A.2d 1382, 1387 (N.J. 1996) (ordering a buy out of the majority's interest by the minority where the majority had “oppressed” the minority owner by terminating him as an officer, but cautioning that the court interferes reluctantly and has a healthy respect for the board of director's control of business policies and internal affairs).
among stockholders and effectively amend the contractual rights, privileges, and preferences among them invite close judicial review. Thus, it is noteworthy that the Massachusetts Supreme Judicial Court in Wilkes, by essentially embracing a compelling business reason test, retreats from the broad equal opportunity mandate it embraced earlier in Donahue. It should be further noted that because there was no articulated business reason in Donahue for either the share repurchase or for excluding the minority from such a repurchase option, a sound application of orthodox corporate principles might have resulted in a victory for the minority. Much of the reasoning in Donahue, therefore, is unnecessary for the case’s resolution.

Presumptions regarding the propriety of a transaction or a shareholder’s behavior are guided by careful characterizations of the transaction, generally for the purpose of deciding whether it is tainted by some evidence of self-dealing or overreaching. One of the strongest presumptions should be that stockholders of the same class of shares are entitled to equal treatment. This would be founded on the provision common to all state corporate statutes that shares within the same class shall enjoy identical rights, privileges, and preferences, unless otherwise provided. Because the statutes call for equal rights (with any deviation required to be (1) clearly set forth in the articles of incorporation, or (2) pursuant to the board of directors’ authority under the articles of incorporation), any power of the board of directors to treat shareholders of the same class differentially should at least face a heavy presumption that the directors lack such power. It is within such provisions that courts can find the basis for further protecting minority stockholders’ rights from unequal treatment. The protection of the class members’ right to equal treatment must, however, be accomplished within the equally strong feature of modern corporate statutes which dictate that the fount of authority over corporate affairs lies with the corporation’s board of directors and not with the shareholders. It is the interconnection between these two principles that

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64 “We hold that, in any case in which the controlling stockholders have exercised their power over the corporation to deny the minority such equal opportunity, the minority shall be entitled to appropriate relief.” Donahue, 328 N.E.2d 505, 519 (Mass. 1975). However, other courts have followed Donahue and provided the minority with an equal opportunity to sell their shares without qualifying their holdings with an exception for a non-pro rata purchase that advances the corporation’s interest. See, e.g., Schroer v. Stamco Supply, Inc., 482 N.E.2d 975 (Ohio Ct. App. 1984).

should inform the court when a business purpose analysis is an appropriate safeguard for the minority's rights.

Consider that the nature of the effects produced in Nixon and Bodell is similar to the tenure voting amendment approved in Williams. Each has a fundamental effect on the relative rights of the minority's shares. In Nixon, non-employee members were excluded from the buy-back option enjoyed by employee holders, and in Bodell the Class B shareholders were deprived of their contractual right to receive equal distributions from the corporation after each class had received dividends of $1.50 per share. If these changes were effected through an amendment of the articles of incorporation, the adversely affected stockholders would have received a class vote and, in many states, dissenters would be accorded an appraisal remedy. Moreover, it cannot be said that the board of directors has the inherent power under today's broadly enabling corporate statutes to alter the rights of a class of shareholders. The role of the courts in such instances should be to mediate tension between the more general concession of power to the board of directors and the statute's conditioning of alterations in the owners' rights, privileges, and preferences upon the owners' consent. Simply stated, the courts must commit themselves more aggressively to the statutory principle that the board of directors' discretion is restricted by the contractual rights of stockholders.

CONCLUSION

The policies announced by the boards of directors in Nixon and Bodell brought about systematic change and should have been examined by first considering the minority's protection against an amendment of their relative rights and preferences as stockholders. This is to be distinguished from Donahue, where there was no announced policy or systematic practice but, instead, a single event. In such circumstances as in Donahue, it is difficult to argue that there was a unilateral alteration of the rights of owners; though one can question whether there nevertheless was an abuse of power. An unwavering commitment to equal rights, therefore, begins with an equally strong commitment to the contractual foundations of

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66 Similarly, the veto power held by the owner of 30% of the shares was held to be a right attaching to the shares so that its elimination gave rise to appraisal under a provision that adversely affected the rights or preferences of shares. See Whetstone v. Hossfeld Mfg. Co., 457 N.W.2d 380 (Minn. 1990).


68 See, e.g., Whetstone, 457 N.W.2d at 384 (suggesting that enhanced availability of appraisal will deter oppression).
corporate law, while, at the same time, sweeping many more matters within the scope of procedures for amending the articles of incorporation.\(^69\)

By breathing life into a corporate statute's proscription of amendments that require stockholder approval, courts may carry out the probable intent of the stockholders. Easterbrook and Fischer quite correctly observe that in \textit{Donahue}, for example, the minority ex ante may well have preferred the board of directors to

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\(^{69}\) In his excellent study of the appraisal remedy, Professor Robert Thompson reports that over the last 10 years, appraisal has become a remedy used principally to address minority freeze-outs that are carried out through acquisition contracts. See Robert B. Thompson, \textit{Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law}, 84 Geo. L.J. 1, 25-27 (1995) (explaining that 80% of the 103 appraisal cases between 1984-1994 involved minority freeze-outs; only six cases arose in combinations between independent companies). State corporate statutes technically confine appraisal to a limited set of transactions and impose serious impediments in the dissenting shareholder's path that weaken its effectiveness against minority oppression. See \textit{id.} at 25 (citing 2 PRINCIPLES OF CORPORATE GOVERNANCE, supra note 42, at 294-95).

Appraisal exists for merger transactions and, in some states, combinations that occur through one company's sale of all or substantially all of its assets. A handful of states extend appraisal to dissenting stockholders in amendments of the articles of incorporation that adversely affect the rights, privileges, or preferences of an entire class of shares. In the area of acquisitions, the majority shareholders essentially define when appraisal is available because (1) corporate statutes and supporting doctrine provide much flexibility in the manner in which acquisitions can be structured and (2) the statutes define rather narrowly the types of transactions that will trigger appraisal. \textit{See} Thompson, \textit{supra}, at 9. In view of the overwhelming evidence that appraisal has evolved as a mechanism to address minority oppression, we should consider whether to follow \textit{Jones}' lead and invoke the remedy to address other instances of majority opportunistic behavior.

It would certainly be a small step to award the minority shareholders a fair determination of the value of their shares when they are being expelled from the corporation. The appraisal statutes do this, although their exemptions for (1) the market exception, (2) types of consideration received, and (3) the form of the transaction provide less than a complete response to the concern of majority opportunism. A far greater concern are those instances in which the harm to the minority is the combined effect of majority opportunism and minority illiquidity. \textit{Jones, Nixon, and Donahue} are examples of such an abusive combination. In each case, the fount of the minority's harm is their illiquidity and the source of their complaint is conduct that enables the majority to lift themselves, but not the minority, out of the morass of illiquidity. Additionally, as discussed in connection with \textit{Jones}, these events often serve as a prelude to the majority's opportunistic purchase of the minority's shares.

To so extend the appraisal remedy is consistent with its original objective. Appraisal statutes were originally enacted as a compromise to weaken the power of the minority to frustrate the majority's desire to undergo a beneficial acquisition. The minority had this power because, until the early 20th century, corporate statutes conditioned acquisitions on unanimous stockholder approval. Appraisal thus permitted dissenters a means to exit the acquisition. It was a means believed necessary because of the lack of dynamic markets to adequately compensate the minority for their shares. Thus, the appraisal remedy's early mission, in part, was to address feared minority illiquidity in the face of a transaction approved by the majority. Perhaps appraisal should once again be considered a response—albeit a judicially recognized one—to minority illiquidity, especially when that illiquidity is either the product of or exacerbated by majority opportunism.
have discretion to repurchase shares of its ailing founder to a rule of equal opportunity. Divining intent ex post, however, is always problematic, especially when the minority’s complaint is over facts to which the defendants assert the minority would earlier have consented. The role of intent and, more particularly, of finding it, is greatly aided by the approach suggested here—namely, determining whether the challenge involves a systematic alteration within a class of the minority’s rights, privileges, or preferences. On this issue, the minority’s probable intent is embodied in their contract with the corporation as memorialized in the state’s corporate statute which requires the consent of the stockholders for such a change.

A true commitment to equal treatment, however, requires more than a firm commitment to the commands of the governing corporate statute. Though the corporate statute may empower the majority with the mechanism to visit disparate effects on the minority stockholders, such authorization is not a license to do so. It is here that the role of a business purpose has served its most visible role in measuring our commitment to a fairness-requires-equality standard. As we have seen, Jones applies a compelling justification standard, whereas Nixon, Williams, and Bodell invoke the less demanding business purpose inquiry. The choice between these two standards reflects the court’s commitment to the principle of equal treatment. If the court were to seek guidance from the probable intent of the parties, it would likely have invoked the compelling justification standard, for only the compelling justification standard could possibly focus the inquiry so as to determine the stockholders’ likely intent. Whereas a business purpose inquiry searches for any one of many possible justifications for a transaction, a compelling justification is that option among many competing choices that is the most, or among the most, persuasive. On a matter as sensitive as defining the rights upon which the economic welfare of minority holders depends, there is every reason to believe that such holders would not be content to assign those rights for any purpose served by a transaction. Likely, the minority would so act only with respect to a purpose they found, under the circumstances, to be highly persuasive. Nixon, Williams, and Bodell, because they take the more enabling standard of a business purpose justification for unequal treatment, give insufficient attention to the owners’ probable intent.