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## The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute

Susanna M. Kim

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# The Provisional Director Remedy for Corporate Deadlock: A Proposed Model Statute

Susanna M. Kim\*

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### I. Introduction

It is widely known that no feuds are as bitter as those between family members or close friends. The conflict can be particularly destructive when the dispute involves money and power. In the business context, friends or family members who enter into business together may begin on good terms, but their confidence in each other and in the bright prospects for the business may blind them to the risks of future dissension.<sup>1</sup> Although their relationship as fellow investors may be cooperative initially, it can often turn acrimonious and result in serious corporate deadlock.<sup>2</sup> In the most severe cases, irreconcil-

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1. See Robert B. Thompson, *Corporate Dissolution and Shareholders' Reasonable Expectations*, 66 WASH. U. L.Q. 193, 199 (1988) (noting that shareholders "often fail to anticipate the failure of their enterprise, or they demonstrate an overly optimistic trust in those with whom they are undertaking the venture"). Business partners who have been friends for years may never consider the possibility that serious hostility could arise between them at some point in the future. See, e.g., *Balsamides v. Protameen Chems., Inc.*, 734 A.2d 721, 722 (N.J. 1999) (describing acrimonious relationship that developed between two former friends and close business associates who operated successful business together for twenty-five years).

2. Deadlock has been defined as "a decision or indecision of stockholders, which results in the corporation's inability to perform its corporate powers . . . [or] a state of inaction or neutralization caused by the opposition of persons or of factions." *Hendley v. Lee*, 676 F. Supp. 1317, 1323 (D.S.C. 1987) (quoting *Callier v. Callier*, 378 N.E.2d 405, 408 (Ill. App. Ct. 1978)); see also C. Clifford Allen, Annotation, *Dissolution of Corporation on Ground of Intracorporate Deadlock or Dissension*, 83 A.L.R. 3d 458, 462 n.3 (1978) (noting that deadlock "exists when two or more factions, engaged in irreconcilable differences, have enough power in corporate affairs which they may exercise, in enforcement of their respective views, in a way that hampers corporate operations"). Statutory provisions that authorize involuntary dissolution of corporations typically define shareholder deadlock as the "fail[ure] at two consecutive annual meetings at which all voting power was exercised, to elect successors to directors whose terms have expired." E.g., CAL. CORP. CODE § 1800 (West 1990).

able differences may require that the business be dissolved even though the parties have operated it successfully for many years.<sup>3</sup>

Shareholder conflicts that result in deadlock pose some of the most difficult challenges for corporations and for corporate law.<sup>4</sup> Although courts have the authority to dissolve corporations that parties can no longer operate effectively due to deadlock,<sup>5</sup> other less extreme measures are available. Many states have statutes that specifically authorize courts to order any one of several alternative remedies in cases of shareholder or director deadlock,<sup>6</sup>

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3. In *In re Hedberg-Freidheim & Co.*, 47 N.W. 2d 424 (Minn. 1951), two couples who were friends each owned one-half of the business. *Id.* at 425. The corporation prospered financially for several years before severe dissension arose between the two sides. *Id.* at 426. The bitterness between the two factions was so deep that whenever one side offered a suggestion for the benefit of the company, the other would "vote against it wholly in disregard of the interests of the corporation" and without regard to the merits of the suggestion itself. *Id.* at 427. Because it was safe to say "a stalemate [had] been reached," the court ruled that the corporation could be dissolved due to the irreconcilable differences between the two equally divided factions. *Id.* at 427-28.

4. Part of the difficulty stems from the fact that relationships among corporate principals can break down for any number of reasons, including personality differences, divergent opinions regarding the future direction of the company, or possible self-dealing by one of the participants. Courts and commentators often observe that the deterioration of relationships among corporate participants may simply be the inevitable result of human nature. *See, e.g., In re Application of Evening Journal Ass'n*, 71 A.2d 158, 167 (N.J. Super. Ct. Ch. Div. 1950) ("Where the stock of a corporation is divided into two equal parts, human nature being what it is, it is necessary and advisable for the parties to anticipate the possibility of a deadlock."), *aff'd*, 74 A.2d 303 (N.J. 1950); J. Leon Lebowitz, *Corporations, 1972 Survey of Texas Law*, 26 SW. L.J. 86, 154 (1972) ("[G]iven the frailties of human nature, such [shareholder] relationships can be easily soured for a variety of reasons ranging from petty annoyances to incompatibility to outright knavery.").

5. *See, e.g.,* *Gidwitz v. Lanzit Corrugated Box Co.*, 170 N.E.2d 131, 138 (Ill. 1960) (allowing dissolution when two shareholder factions had been deadlocked for ten years and evidence of oppressive conduct by one faction existed); *In re Collins-Doan Co.*, 70 A.2d 159, 166 (N.J. 1949) (affirming order of dissolution in situation in which irreconcilable differences between equally divided shareholders and directors existed). Many states have statutes for involuntarily dissolving deadlocked corporations. *E.g.,* ARIZ. REV. STAT. ANN. § 10-1430 (West 1996); CAL. CORP. CODE § 1800 (West 1990); N.Y. BUS. CORP. LAW § 1104(a)(1) (McKinney Supp. 2001); WASH. REV. CODE ANN. § 23B.14.300 (West Supp. 2002). However, even in the absence of a statute, courts have retained the equity power to order the dissolution of corporations. *See* Carlos L. Israels, *The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution*, 19 U. CHI. L. REV. 778, 787-88 (1952) (stating that several courts have used general equity powers to dissolve corporations).

6. *See* 16A WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 8043 (perm. ed. rev. vol. 1995) (finding that states provide alternative remedies because dissolution is viewed as extreme remedy); *see also* FLA. STAT. ANN. § 607.1434 (West 2002) (providing alternative remedies); 805 ILL. COMP. STAT. ANN. 5/12.55, 5/12.56 (West Supp. 2002) (same); N.J. STAT. ANN. § 14A:12-7 (West Supp. 2002) (same).

including the following: the purchase of the shares of one shareholder by another, the removal of officers or directors, or an accounting with respect to any matter in dispute.<sup>7</sup> The purpose of many of these alternate forms of relief is to preserve the ongoing operations of the business.

One particular remedy that courts may grant in lieu of dissolution is the appointment of a provisional director. The provisional director is a neutral third party appointed by the court to the board of directors to act as a tie-breaking director.<sup>8</sup> Provisional directors possess the same rights and powers of ordinary directors to vote at meetings. The role of the provisional director is to vote to break deadlocks in the corporation.<sup>9</sup> Part of the value of provisional directors lies in their ability to mediate between hostile factions and to encourage both sides to consider new ideas and alternatives for resolving disputes amicably.<sup>10</sup> As a result, the provisional director remedy is a "unique dispute-settling arrangement with characteristics akin to those of compulsory arbitration, mediation, and conciliation."<sup>11</sup> To date over twenty states have adopted statutes that specifically empower courts to appoint provisional directors in cases of corporate deadlock,<sup>12</sup> and courts in all states have the

7. See, e.g., 805 ILL. COMP. STAT. ANN. 5/12.56 (West Supp. 2002) (listing eleven remedies in addition to dissolution that courts may order in action involving shareholder or director deadlock); MONT. CODE ANN. § 35-9-502(1) (2001) (listing nine additional remedies); WYO. STAT. ANN. § 17-17-141(a) (Michie 2001) (same).

8. See *In re Annrhon, Inc.*, 21 Cal. Rptr. 2d 599, 604 (Cal. Ct. App. 1993) (describing provisional director as tie-breaker); ROBERT C. CLARK, CORPORATE LAW § 18.4.3, at 797 (1986) (discussing role of provisional director).

9. 16A FLETCHER, *supra* note 6, § 8043.

10. See Stuart L. Pachman, *Provisional Directors, Custodians and Similar Referees*, N.J. LAW. MAG., Nov./Dec. 1994, at 13, 14 (explaining provisional director's role).

11. 2 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 9.33 (3d ed. 2000); see also Ernest L. Folk, III, *Corporation Statutes: 1959-1966*, 1966 DUKE L.J. 875, 953 (describing provisional director as type of arbitrator or mediator).

12. ALA. CODE § 10-2A-310 (1999); ALASKA STAT. § 10.06.640 (Michie 2000); CAL. CORP. CODE § 308 (West Supp. 2002); DEL. CODE ANN. tit. 8, § 353 (1991); D.C. CODE ANN. § 29-101.167 (2002); FLA. STAT. ANN. § 607.1435 (West 2001); GA. CODE ANN. § 14-2-941 (1994); HAW. REV. STAT. ANN. § 415B-67 (Michie 1997) (providing for provisional director remedy in nonprofit corporations); 805 ILL. COMP. STAT. ANN. 5/12.56(b)(7) (West Supp. 2002); KAN. STAT. ANN. § 17-7213 (1995); ME. REV. STAT. ANN. tit 13-C, § 1434 (2)(E) (West 2002) (providing for appointment of "additional director"); MO. ANN. STAT. §§ 351.323, 351.855 (West Supp. 2001); MONT. CODE ANN. § 35-9-502(1)(g) (1999); NEV. REV. STAT. 78A.150 (2001); N.J. STAT. ANN. § 14A:12-7(3) (West Supp. 2002); OHIO REV. CODE ANN. § 1701.911 (West 1994); 15 PA. CONS. STAT. ANN. § 2334 (West 1995); S.C. CODE ANN. § 33-18-410(a)(7) (Law. Co-op. 1990); TEX. BUS. CORP. ACT ANN. art. 12.53 (Vernon Supp. 2001); WIS. STAT. ANN. § 180.1833(2)(a)(7) (West 2002); WYO. STAT. ANN. § 17-17-141(a)(vii) (Michie 2001). Michigan allows the corporation's shareholders or directors to designate one or more directors as an "independent director." MICH. COMP. LAWS ANN. § 450.1505(3) (West

equitable power to order the designation of an additional director in lieu of dissolution.<sup>13</sup>

The provisional director approach to resolving corporate deadlock raises difficult questions about both the autonomy rights of shareholders and the ability of a court appointee to interfere with private business. One may argue that "as a matter of principle no state or public interest justifies taking away the right to veto corporate decisions from either of the deadlocked factions."<sup>14</sup> However, at the same time, judicial intervention to alleviate the paralytic effects of deadlock may arguably be necessary to uphold the foundations of private ordering.<sup>15</sup>

Perhaps the underlying complexity of the provisional director remedy explains the widely divergent treatment of the remedy in different jurisdictions. The discord among various states, courts, and authorities concerning the appointment of provisional directors is striking. For example, the Model Statutory Close Corporation Supplement to the Model Business Corporation Act (MBCA-CC) provides for the appointment of provisional directors as one remedy of many for corporate deadlock.<sup>16</sup> California allows courts to appoint provisional directors in both public and private corporations.<sup>17</sup> Delaware affords the provisional director remedy only to the limited number of corporations that affirmatively elect close corporation status.<sup>18</sup> In Ohio, a court may

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Supp. 2002).

13. See, e.g., *In re* Application of Hickory House, Inc., 177 N.Y.S.2d 356, 357–58 (N.Y. Sup. Ct. 1958) (finding that order to dissolve corporation would be improper but that "an order may be submitted forthwith on consent providing for designation of a third director"). The provisional director remedy appeared in an earlier proposed version of the New York Corporations Code. However, much to the chagrin of corporate law scholars who recognized the value of the provisional director remedy, the provision was "unaccountably . . . omitted from the bill as finally approved." Robert A. Kessler, *The New York Business Corporation Law*, 36 ST. JOHN'S L. REV. 1, 62 (1961). Professor Kessler considered the omission to be "unfortunate." *Id.*

14. CLARK, *supra* note 8, § 18.4.3, at 797.

15. See *infra* Part III.C (discussing tension between principles of public law and private ordering).

16. 4 MODEL BUS. CORP. ACT ANN., MODEL STATUTORY CLOSE CORP. SUPPLEMENT § 41(a)(7) (3d ed. Supp. 1998/99) [hereinafter MBCA-CC].

17. CAL. CORP. CODE § 308 (West Supp. 2002). Commentators consider California's provisional director statute to be the "prototype of this form of relief." Charles E. Murphy Jr., Note, *Revision of the North Carolina Statute's Corporate Deadlock Provisions*, 51 N.C.L. REV. 815, 830 (1973); see also John W. Wall, Note, *Corporations—The Court-Appointed Provisional Director for Deadlocked Corporations*, 10 WAKE FOREST L. REV. 635, 636 (1974) (referring to California statute as "pioneer legislation on this subject").

18. DEL. CODE ANN. tit. 8, § 353 (2001). Delaware's code contains a separate subchapter of special provisions devoted entirely to statutory close corporations. *Id.* §§ 341–56.

appoint a provisional director only if the corporation's articles of incorporation expressly provide for it.<sup>19</sup> Several jurisdictions state that the provisional director possesses all the "rights, powers, and duties of a duly elected director."<sup>20</sup> However, other states conspicuously omit the reference to "duties" and provide only that the provisional director has the same "rights and powers" of a director.<sup>21</sup>

The considerable variance with which states and courts have construed the provisional director remedy reflects deep confusion over the remedy's functions, goals, and limits. Although much attention has been given to other forms of judicial relief for corporate deadlock, such as dissolution and buy-out, no comprehensive review or analysis of the provisional director remedy has been conducted, nor has a theory emerged that incorporates the competing policy principles underlying the remedy. This Article provides a detailed examination of the nature and scope of the provisional director remedy, the status of state legislation and current judicial application concerning the remedy, and the fundamental public and private interests that its use as a cure for deadlock implicates. This Article formulates a new statutory model for adoption in states' general corporations codes. The proposed model statute sets forth an integrated and constructive method for implementing the provisional director remedy as a first step toward resolving the internecine board-room battles that often arise in corporations.

Part II of this Article begins with an overview of corporate deadlock and pays particular attention to the problems faced by close corporations.<sup>22</sup> The provisional director remedy can be of particular interest to close corporations

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19. OHIO REV. CODE ANN. § 1701.911(A) (West 1994).

20. GA. CODE ANN. § 14-2-941(a)(7) (1994); MO. ANN. STAT. § 351.855(7) (West 1991); MONT. CODE ANN. § 35-9-502(1)(g) (2001); S.C. CODE ANN. § 33-18-410(a)(7) (Law. Co-op. 1990); WIS. STAT. ANN. § 180.1833(2)(a)(7) (West 2002); WYO. STAT. ANN. § 17-17-141(a)(vii) (Michie 2001).

21. ALA. CODE § 10-2A-310(c) (1999); ALASKA STAT. § 10.06.640(b) (Michie 2000); CAL. CORP. CODE § 308(c) (West Supp. 2002); DEL. CODE ANN. tit. 8, § 353(c) (2001); D.C. CODE ANN. § 29.101-167(c) (2002); FLA. STAT. ANN. § 607.1435(1) (West 2001); KAN. STAT. CODE ANN. § 17-7213(c) (West 1995); MO. ANN. STAT. § 351.323(2) (West Supp. 2002); NEV. REV. STAT. 78A.150(3)(c) (2001); N.J. STAT. ANN. § 14A:12-7(3) (West Supp. 2002); 15 PA. CONS. STAT. ANN. § 2334(d) (West 1995); TEX. BUS. CORP. ACT ANN. art. 12.53(B)(2) (Vernon Supp. 2001).

22. A close corporation is "a corporation whose shares are not generally traded in the securities markets." 1 O'NEAL & THOMPSON, *supra* note 11, § 1.02. Generally, close corporations possess certain distinct features that make them very similar to partnerships. See Henry F. Johnson, *Strict Fiduciary Duty in Close Corporations: A Concept in Search of Adoption*, 18 CAL. W. L. REV. 1, 1 (1982) (comparing close corporations to partnerships and sole proprietorships); see also Lawrence E. Mitchell, *Close Corporations Reconsidered*, 63 TUL. L. REV. 1143, 1153-54 (1989) (discussing comparison between close corporations and partnerships).

because their unique characteristics make the likelihood of deadlock much greater than in public corporations.<sup>23</sup> Part II also attempts to provide some context within which to view the position of the provisional director remedy along the spectrum of available remedies.

Although a number of approaches to deal with director and shareholder deadlock exist, one distinct set of alternatives involves the use of a neutral, outside person to help resolve the dispute or manage the business. I refer to these measures as "third-party alternatives." These alternatives include the appointment by the court of custodians and temporary receivers to manage the operations of the company and preserve its business as a going concern. Third-party alternatives for corporate deadlock can also incorporate different forms of dispute resolution, including arbitration, mediation, and a hybrid form called mediation-arbitration. In many ways, the provisional director functions much like an arbitrator, listening to the arguments of conflicting factions and then deciding in favor of one side to break the tie. However, the provisional director also serves in a mediating capacity as a fellow director in board meetings where ideas are discussed and analyzed. Of course, if the provisional director's efforts at mediation fail and the parties are unable to reach agreement, the provisional director's role as a mediator must come to an end, and a tie-breaking vote must be cast. This process mirrors what occurs in the mediation-arbitration process. Part II discusses these various third-party alternatives as they relate to the provisional director remedy.

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23. See 2 O'NEAL & THOMPSON, *supra* note 11, § 9.02 (discussing problems of deadlock in close corporations); see also 16A FLETCHER, *supra* note 6, § 8066.10 ("Shareholder or management deadlock[s] usually occur in closely-held or family-owned corporations."). Although public companies may occasionally experience deadlock, it theoretically can be broken easily through the purchase of additional shares. J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 7 n.10 (1977); see also JAMES D. COX ET AL., CORPORATIONS 381 (Aspen 1997) ("Deadlock is truly a phenomenon of the closely held corporation; it would not long exist within the public corporation.").

Several states make the provisional director remedy available to close corporations through the use of statutory provisions designed particularly for close corporations. ALA. CODE § 10-2A-310 (1999); DEL. CODE ANN. tit. 8, § 353 (2001); GA. CODE ANN. § 14-2-941 (1994); KAN. STAT. ANN. § 17-7213 (1995); MONT. CODE ANN. § 35-9-502 (1999); NEV. REV. STAT. 78A.150 (2001); 15 PA. CONS. STAT. ANN. § 2334 (West 1995); S.C. CODE ANN. § 33-18-410(a)(7) (Law. Co-op. 1990); TEX. BUS. CORP. ACT ANN. art. 12.53 (Vernon Supp. 2001); WIS. STAT. ANN. § 180.1833(2)(a)(7) (West 2002); WYO. STAT. ANN. § 17-17-141(a)(vii) (Michie 2001). The problem with statutory close corporation provisions is that only those few corporations that affirmatively elect close corporation status can take advantage of such provisions. The vast majority of eligible corporations do not make that election. See 1 O'NEAL & THOMPSON, *supra* note 11, § 1.19 (stating that, of those eligible for close corporation status, 5% or less elect such status).



The appointment of a provisional director raises fundamental policy concerns that Part III examines. The wide variance in the statutory and judicial treatment of the provisional director remedy suggests a deeper conflict between competing policy principles. The remedy arguably infringes on shareholder autonomy rights. Statutes uniformly guarantee shareholders basic voting rights to elect the company's board of directors.<sup>24</sup> When courts appoint provisional directors to the board, courts arguably usurp the rights of shareholders to make their own choices. This alteration of shareholder rights becomes particularly clear in those states with statutes authorizing the appointment of provisional directors "notwithstanding any contrary provision of the articles of incorporation or the bylaws or agreement of the shareholders."<sup>25</sup> In other words, even if shareholders have agreed among themselves that they prefer never to have a provisional director in cases of deadlock, courts may nonetheless appoint one. Such judicial interference with private contracting may be problematic if one considers shareholder autonomy a primary value.

In addition, judicial interference raises concerns about the scope of the court's authority and involvement in implementing the provisional director remedy. When the court appoints a provisional director, a question arises as to whether the court has delegated its judicial authority to the provisional director in some measurable sense. If the provisional director is an officer of the court—an extension of the court's own hand, making binding judgments on disputed matters for the parties—then a number of intended and unintended consequences may follow. For example, provisional directors, as proxies or substitutes for the judges themselves, should be completely impartial and held to the same standards as judges in avoiding even the appearance of bias. Under this theory, current provisional director statutes that do not require complete impartiality would be severely deficient; only those statutes that mandate impartiality would be proper. Moreover, if the provisional director is considered a judicial officer, an issue arises as to whether absolute judicial immunity would extend to provisional directors. If so, provisional directors would not be liable for the consequences of their decisions, even if those decisions were made in bad faith.<sup>26</sup> With this approach, state statutes that

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24. *E.g.*, DEL. CODE ANN. tit. 8, § 211(b) (2001); *see also* 2 FLETCHER, *supra* note 6, § 283 (discussing inherent power of shareholders to elect corporation's directors and officers); Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 IOWA L. REV. 485, 497 (1994) ("Shareholder voting holds a position of central importance in modern enabling statutes. A large portion of every modern corporate statute devotes itself to voting in the corporation.").

25. ALA. CODE § 10-2A-310(a) (1999); DEL. CODE ANN. tit. 8, § 353(a) (2001); D.C. CODE ANN. § 29-101.167(a) (2002); KAN. STAT. ANN. § 17-7213(a) (1995); NEV. REV. STAT. 78A.150(1) (2001); 15 PA. CONS. STAT. ANN. § 2334(a) (1995).

26. Absolute judicial immunity protects judges from liability for judicial acts and

currently impose on provisional directors all the same "rights, powers, and duties of duly elected directors" would be improper because provisional directors would not be subject to the same fiduciary duties as ordinary directors.<sup>27</sup> In contrast, if provisional directors are viewed simply as additional directors with the same rights and powers of their fellow directors, the same duties and obligations arguably should apply as well.

All of these questions reflect an uneasy tension between various public and private interests. Part IV explores these competing considerations and undertakes a broad critical analysis of the current scope of provisional director legislation. Part IV argues that one of the reasons why statutes, as well as courts, differ so much in constructing the provisional director remedy is because they lack a balanced, integrated theory for viewing the function of provisional directors.

In light of this deficiency, Part V proposes a model provisional director statute that incorporates the interests of the corporation and the prerogatives of the shareholders. The statute will give courts a clearer image of the role that the provisional director should play in helping to resolve corporate deadlock. The proposed model statute contained in this Article also addresses the immunity of provisional directors, an issue that has heretofore remained completely unaddressed in state provisional director legislation. This Article argues that courts should extend qualified immunity to provisional directors who act in good faith within the scope of their powers and duties.

## II. Corporate Deadlock

### A. Deadlock in Close Corporations

Deadlock generally refers to "an impasse in corporate decisional processes."<sup>28</sup> It can occur on two levels. First, the shareholders of the company may be so divided that they are unable to elect directors as a result of a stale-

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decisions made within their jurisdiction, "even if the judges are alleged to have been corrupt, malicious, or negligent." ABIMBOLA A. OLOWOFOYERU, *SUING JUDGES: A STUDY OF JUDICIAL IMMUNITY* 33 (1993).

27. Corporate directors are subject to the fiduciary duties of care and loyalty. See DOUGLAS M. BRANSON, *CORPORATE GOVERNANCE* §§ 6.01–6.23, 8.01–8.38 (1993) (explaining director's duties of care and loyalty); FRANKLIN A. GEVURTZ, *CORPORATION LAW* §§ 4.1–4.2 (2000) (same); HARRY G. HENN & JOHN R. ALEXANDER, *LAWS OF CORPORATIONS* §§ 234–41 (3d ed. 1983) (same). Directors can be held liable for bad faith actions or omissions. See DEL. CODE ANN. tit. 8, § 102(b)(7) (2001) (prohibiting corporations from limiting liability of directors for "acts or omissions not in good faith").

28. Note, *Deadlock in a Close Corporation: A Suggestion for Protecting a Dissident, Co-Equal Shareholder*, 1972 DUKE L.J. 653, 654 [hereinafter *Deadlock in a Close Corporation*].

mate in voting. Second, a division among the directors themselves may render the board unable to take effective management action.<sup>29</sup> In both cases, if the deadlock is not resolved, the corporation's business may suffer serious impairment that causes substantial commercial loss.<sup>30</sup> Shareholders and directors may be deadlocked on any number of issues. For example, they may disagree on whether to use corporate surplus funds to issue dividends or reinvest the funds in the business. They might deadlock over the election of officers or the appropriate level of compensation they are to be paid. Deadlock is harmful because it frustrates the exercise of important shareholder rights. Corporate law upholds the "importance of participation in corporate decisionmaking as an inherent element of the property right shareholders hold in their companies."<sup>31</sup> Deadlock results in a breakdown in the decisionmaking process and thereby thwarts shareholders' ability to obtain all the benefits of their ownership rights.

Deadlock can occur in a number of ways. The most obvious is when two shareholders, or two groups of shareholders, each own fifty percent of the corporation's shares or when an even-numbered board of directors is equally divided in two halves. A stalemate can also be reached if three or more shareholders each own an equal number of shares, but refuse to join together to form a majority.<sup>32</sup> Supermajority requirements or veto rights given to minority shareholders to protect them from oppression by the majority also have the potential to create deadlock.<sup>33</sup> These powers to veto majority decisions essen-

29. Statutes authorizing dissolution because of corporate deadlock typically encompass both shareholder and director forms of deadlock. *E.g.*, CAL. CORP. CODE § 1800(b)(2), (3) (West 1990); N.Y. BUS. CORP. LAW § 1104(a)(1), (2) (McKinney Supp. 2002).

30. The corporate paralysis that results from deadlock prevents the corporation from functioning economically and can lead to economic disaster. NORMAN D. LATTIN, *THE LAW OF CORPORATIONS* § 180, at 635 (2d ed. 1971); Hugh H. Makens & Bruce C. Young, *War and Pieces: The Impact of Deadlock in the Michigan Closely Held Corporation*, 42 WAYNE L. REV. 1863, 1865-66 (1996) (describing negative effects of deadlock, including "[l]osses from operations or dramatic diminution of profit").

31. Hugh T. Scogin Jr., *Withdrawal and Expulsion in Germany: A Comparative Perspective on the "Close Corporation Problem"*, 15 MICH. J. INT'L L. 127, 173 (1993).

32. See Richard C. Tinney, *Dissension or Deadlock of Corporate Directors or Shareholders*, 6 AM. JUR. PROOF OF FACTS 2d 387, § 4 (1975) (explaining how odd numbers of shareholders may become deadlocked).

33. See MBCA-CC, *supra* note 16, § 40, Official Cmt. ¶ 1 ("[D]eadlocks [can be] created by veto rights given minority shareholders."); *Deadlock in a Close Corporation*, *supra* note 28, at 654 (noting that vesting of veto powers in minority shareholders and setting of high voting requirements for shareholder or director action greatly enhance possibility of corporate deadlock). Involuntary dissolution statutes recognize that supermajority voting requirements can cause deadlock just as easily as an even division in voting power. See, e.g., 805 ILL. COMP. STAT. ANN. 5/12.56(a)(1) (West Supp. 2002) (stating that deadlock can occur "because of [an] even division in the number of directors or because of greater than majority voting requirements

tially establish a unanimity requirement for the approval of proposed corporate actions.<sup>34</sup> Even without supermajority provisions, a minority shareholder may be able to exercise effective control and produce deadlock when the shareholder has specialized skills or knowledge upon which the business depends. In essence, deadlock is possible whenever one corporate participant has the ability to negate the power of the remaining participants to effectuate corporate actions.

The distinguishing features of close corporations make them particularly vulnerable to deadlock. Generally speaking, close corporations are composed of a small number of shareholders who are actively engaged in management, who hold shares that are not freely transferable or traded on an established market, and who are likely to have a large portion of their wealth invested in the business.<sup>35</sup> They often contribute much of their time, energy, and money to make the corporation a successful enterprise.<sup>36</sup> The sole return on their investment may be in the form of the salary they receive as active managers of the company, and the salary, in turn, may constitute the only source of their

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in the articles . . . or the by-laws").

34. See *Olincy v. Merle Norman Cosmetics, Inc.*, 19 Cal. Rptr. 387, 392 (Cal. Ct. App. 1962) (confirming validity of minimum voting requirements that have practical effect of requiring unanimity); Stuart L. Pachman, *Corporations Evenly Divided: Judicial Remedies for Equal Shareholders*, 24 SETON HALL L. REV. 234, 237 n.9 (1993) ("Stalemate or deadlock is also possible in corporations that have adopted high or unanimous vote requirements."). In *Smith v. Atlantic Properties, Inc.*, 422 N.E.2d 798 (Mass. App. Ct. 1981), for example, four shareholders each held equal interests in a corporation whose articles of incorporation required all major corporate actions to be approved by an 80% vote of the outstanding stock, effectively requiring unanimity. *Id.* at 799. Although three of the shareholders voted to use excess corporate funds to issue dividends, the fourth continuously vetoed the action, creating an irresolvable deadlock. *Id.* at 800-01.

35. See William S. Hochstetler & Mark D. Svejda, Empirical Research Project, *Statutory Needs of Close Corporations—An Empirical Study: Special Close Corporation Legislation or Flexible General Corporation Law?*, 10 J. CORP. L. 849, 852 (1985) (discussing unique characteristics of close corporations); Mitchell, *supra* note 22, at 1151 (same); see also Israels, *supra* note 5, at 778 (describing close corporation as one in which management and ownership are substantially identical). Statutory definitions of close corporations often include a limit on the maximum number of shareholders in the corporation. See, e.g., DEL. CODE ANN. tit. 8, § 342(a)(1) (2001) (limiting close corporation to maximum of 30 shareholders). See generally 1 O'NEAL & THOMPSON, *supra* note 11, § 1.02 (discussing various definitions of close corporations).

36. William R. Quinlan & John F. Kennedy, *The Rights and Remedies of Shareholders in Closely Held Corporations Under Illinois Law*, 29 LOY. U. CHI. L.J. 585, 586 (1998). Close corporations resemble partnerships, and the shareholders often view themselves as partners. 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 2:10 (2d ed. 1997); Johnson, *supra* note 22, at 1 (noting that close corporations preserve intimacy and control features of partnerships).

income.<sup>37</sup> Because no public market for their shares exists and because so much of their wealth is tied up in one firm, close corporation shareholders face a greater risk of loss than public corporation shareholders. If dissension develops among the participants of the close corporation, shareholders who wish to exit the firm may be unable to do so because they "cannot dissolve the company at will like members of a partnership, nor can they sell their shares on the open market like shareholders in a publicly held corporation."<sup>38</sup> Recognizing that close corporations have these unique characteristics and special needs, many states now provide greater statutory flexibility and protection for close corporation shareholders.<sup>39</sup> For example, current statutes often explicitly permit the establishment of supermajority voting requirements for shareholder or director actions.<sup>40</sup> This arrangement shields each shareholder from being outvoted by the others and thereby provides greater protection for each shareholder's investment. As mentioned previously, these voting protections can increase the risk of deadlock.<sup>41</sup>

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37. See Quinlan & Kennedy, *supra* note 36, at 586 ("Often, the shareholder's only return on his investment is the salary the shareholder receives as compensation for a position within the corporation."); *Deadlock in a Close Corporation*, *supra* note 28, at 654 (noting that close corporation shareholders "expect[] to derive much, if not all, of their income in the form of salaries for managerial services rendered the corporation"). Shareholders may also receive non-monetary returns on their investment, including the psychological satisfaction that accompanies running one's own business. Terry A. O'Neill, *Self-Interest and Concern for Others in the Owner-Managed Firm: A Suggested Approach to Dissolution and Fiduciary Obligation in Close Corporations*, 22 SETON HALL L. REV. 646, 671 (1992).

38. *Muellerberg v. Bikon Corp.*, 669 A.2d 1382, 1386 (N.J. 1996); see also Raymond G. Leffler, *Dispute Settlement Within Close Corporations*, 31 ARB. J. 254, 255 (1976) (contrasting withdrawal capabilities in partnerships, public corporations, and close corporations); Scogin, *supra* note 31, at 129 (explaining close corporation shareholder's inability to sever ties with fellow shareholders).

39. Many states have made amendments or additions to their general corporations codes that are intended to benefit close corporations, but are not expressly limited to them. See 1 O'NEAL & THOMPSON, *supra* note 11, § 1.18 (discussing statutory close corporations supplements). Some states, like Delaware, have enacted separate close corporation acts or subchapters for corporations that elect to be treated as statutory close corporations. DEL. CODE ANN. tit. 8, §§ 341-56 (1991); see also Thompson, *supra* note 1, at 197-98 (discussing changes in statutory norms toward greater flexibility for close corporations).

40. See 1 O'NEAL & THOMPSON, *supra* note 11, § 4.07 (discussing supermajority voting requirements).

41. See *supra* notes 33-34 and accompanying text (discussing potential for deadlock); see also Hochstetler & Svejda, *supra* note 35, at 854 (noting that unanimous vote requirements increase potential for deadlock and therefore make deadlock more likely in close corporations than in public corporations); Leffler, *supra* note 38, at 256 ("In the close corporation the granting of veto power to all of the shareholders may enhance a risk of paralysis.").

An important factor in the analysis of close corporation deadlock is that the participants are often family members or close friends. Ninety-five percent of all businesses in the United States are family-owned enterprises.<sup>42</sup> The family members who own and manage these companies have direct, personal relationships, interacting with each other on a regular and frequent basis. The intensity and intimacy of these bonds, along with the continuous interaction both in and outside the business, can lead to strife or heightened conflicts and misunderstandings between the participants.<sup>43</sup> Sibling rivalry, competition among generations, and corporate succession problems may paralyze the business and contribute to its demise.<sup>44</sup> Family and intergenerational dynamics can exacerbate delicate balances of power existing within the corporation and make the enterprise particularly vulnerable to deadlock.

Because of the increased potential for deadlock problems in close corporations, courts and legislatures have developed broad relief for shareholders. Courts have the equitable power to order the dissolution of the corporation if deadlock renders the corporation incapable of functioning effectively any longer.<sup>45</sup> Alternatively, courts may order the buy-out of one shareholder's

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42. JOHN L. WARD, *KEEPING THE FAMILY BUSINESS HEALTHY*, at xv (1987); *see, e.g.*, *Balsamides v. Protameen Chems., Inc.*, 734 A.2d 721, 722 (N.J. 1999) (involving dispute between two former friends who jointly owned business); *Belfer v. Merling*, 730 A.2d 434, 437-38 (N.J. Super. Ct. App. Div. 1999) (involving dispute among family members of close corporation). When family members and friends enter business together, they embark on a "cooperative adventure," purchasing "not stock, but a future." Joseph E. Olson, *A Statutory Elixir for the Oppression Malady*, 36 *MERCER L. REV.* 627, 629 (1985).

43. *See* 1 O'NEAL & THOMPSON, *supra* note 36, § 2:02 (discussing personality clashes and family discord as factors in close corporation squeeze-outs); Lewis D. Solomon & Janet Stern Solomon, *Using Alternative Dispute Resolution Techniques to Settle Conflicts Among Shareholders of Closely Held Corporations*, 22 *WAKE FOREST L. REV.* 105, 105 (1987) ("It is notorious that no feuds are so venomous as those within families . . ." (quoting Joseph W. Bishop Jr., Book Review, 1976 *DUKE L.J.* 155, 158 (reviewing F. HODGE O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS: EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES (1975)))).

44. *See* WARD, *supra* note 42, at xv, 3 (discussing difficulties experienced by close corporations held by families); *see, e.g.*, *Balsamides*, 734 A.2d at 722-23 (describing acrimonious relationship that developed between two shareholders after both men brought their sons into business); *Pedro v. Pedro*, 489 N.W.2d 798, 800 (Minn. Ct. App. 1992) (involving dispute among three brothers who each owned interests in family close corporation).

45. Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 *J. CORP. L.* 285, 295 (1990). Most states have deadlock statutes authorizing the dissolution of the corporation upon director or shareholder deadlock. *E.g.*, *ARIZ. REV. STAT. ANN.* § 10-1430 (West 1996); *CAL. CORP. CODE* § 1800(b)(2), (3) (West 1990); *N.Y. BUS. CORP. LAW* § 1104(a)(1) (McKinney Supp. 2002); *MBCA-CC, supra* note 16, § 40. These statutes also authorize dissolution upon a showing of fraudulent, oppressive, or illegal conduct by the directors. This Article focuses primarily on the provisional director remedy as it relates

shares by the corporation or by another shareholder,<sup>46</sup> or the court can order a partitioning of assets.<sup>47</sup>

Despite the availability of these remedies, shareholders who believe their corporation has a promising future may not feel that dissolution or a forced buy-out is an acceptable solution.<sup>48</sup> They may have strong personal reasons for keeping the company intact, "including loyalty to employees, strong views about continuation of the company name and work, or the ability to keep younger family members involved in the business."<sup>49</sup> Even though buy-out remedies give deadlocked shareholders the ability to exit a difficult situation, the shareholders may not necessarily wish to leave, particularly if they feel they have poured considerable time and energy, not to mention their heart and soul, into the success of the enterprise up to that point.

In lieu of dissolution or buy-out of one side by the other, different alternatives designed to preserve the ongoing nature of the business and to break the corporate deadlock by bringing in an outside neutral third party are available. These third-party alternatives may be effective either because they give the bitterly disputing parties an opportunity to calm down for a period of time or because they facilitate a resolution of the contested issues. The following subparts briefly describe these alternatives, including the provisional director remedy.

to deadlock, rather than to oppression.

46. See, e.g., *Hendley v. Lee*, 676 F. Supp. 1317, 1324–25 (D.S.C. 1987) (ordering forced buy-out in lieu of dissolution); see also *Folk*, *supra* note 11, at 954–56 (discussing compulsory buy-out remedy for deadlock in close corporations). One difficult issue in buy-out situations is determining the fair value of the shares to be purchased or sold. See, e.g., *Balsamides*, 734 A.2d at 733–38 (analyzing valuation methods for fair value of shares in ordered buy-out); see also Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 471–88 (1990) (discussing minority and liquidity discounts in valuing shares for purposes of judicially ordered buy-out); *Thompson*, *supra* note 1, at 231–36 (discussing valuation procedures in buy-outs). Another difficult question concerns which of the parties should be given the purchase option. See, e.g., *Muellerberg v. Bikon Corp.*, 669 A.2d 1382, 1389–90 (N.J. 1996) (choosing to order sale of majority shareholder's shares to minority shareholder after consideration of equities).

47. See *Bahls*, *supra* note 45, at 305–06 (discussing courts' ability to partition corporate property among shareholders if possible to divide business "in accordance with prorated ownership interest"). Partitioning the assets would involve the division of the corporation into two or more firms. If the assets cannot be severed into economically viable units, the remedy loses its utility. See *Hendley v. Lee*, 676 F. Supp. 1317, 1324 (D.S.C. 1987) (declining to order division of corporation because partitioning of certain assets such as customer accounts might "generate continued animosity and additional litigation").

48. See F. Hodge O'Neal, *Resolving Disputes in Closely Held Corporations: Intra-Institutional Arbitration*, 67 HARV. L. REV. 786, 787 (1954) (asserting that dissolution may not be acceptable to shareholders if corporation is prosperous).

49. *Makens & Young*, *supra* note 30, at 1892 n.113.

## B. Third-Party Alternatives and Forms of Relief

### 1. Custodians and Temporary Receivers

When corporate participants are unable to agree on critical business decisions necessary to advance the operations of the company, a court may appoint a custodian or temporary receiver to manage the affairs of the corporation until the conflicts are resolved.<sup>50</sup> The terms "custodian" and "temporary receiver" are often used interchangeably and are to be distinguished from receivers who are appointed to wind up the corporation and liquidate its assets.<sup>51</sup> The custodian has the power to take over and maintain all operations of the deadlocked corporation until the parties can reach agreement and resume management of the corporation's affairs. Because the custodian is vested with the ability to exercise all of the powers of the board of directors, the custodian effectively replaces the board as the decisionmaking body of the corporation.<sup>52</sup>

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50. Cheryl Jean Lew, Comment, *The Custodian Remedy for Deadlocks in Close Corporations*, 13 U.C. DAVIS L. REV. 498, 508-09 (1980); Murphy, *supra* note 17, at 822. Statutes authorizing the custodian remedy may apply to both general and close corporations. The statutes typically specify shareholder or director deadlock as one of the grounds for ordering the remedy. See, e.g., DEL. CODE ANN. tit. 8, § 352 (1991) (stating that custodial appointment is available if shareholders of close corporation "are so divided that the business of the corporation is suffering or is threatened with irreparable injury"). See generally 2 O'NEAL & THOMPSON, *supra* note 11, § 9.34 (discussing custodian remedy).

51. *Whitman v. Fuqua*, 549 F. Supp. 315, 322 (W.D. Pa. 1982); 16 FLETCHER, *supra* note 6, § 7713; see also *Valley View State Bank v. Owen*, 737 P.2d 35, 38 (Kan. 1987) ("A custodian is appointed to continue the business of the corporation, and, unless the court otherwise directs, not to liquidate its assets."); Harry J. Haynsworth, *The Effectiveness of Involuntary Dissolution Suits as a Remedy for Close Corporation Dissension*, 35 CLEV. ST. L. REV. 25, 28 n.11 (1987) (stating that custodians preserve business whereas receivers liquidate assets). Statutes providing for the appointment of custodians clarify the scope of the custodian's powers. See, e.g., KAN. STAT. ANN. § 17-6516 (West 1975) ("[T]he authority of the custodian is to continue the business of the corporation and not to liquidate its affairs and distribute its assets . . ."); 15 PA. CONS. STAT. ANN. § 1767(c) (West 1995) ("[T]he authority of the custodian shall be to continue the business of the corporation and not to liquidate its affairs and distribute its assets . . ."). For a thorough discussion of permanent receivers who take full title to the corporate property and are charged with the task of winding up the corporation and distributing its assets for the benefit of the creditors and shareholders, see 16A FLETCHER, *supra* note 6, §§ 8196-8216.

52. See *Hetherington & Dooley*, *supra* note 23, at 24 (stating that custodian is given full authority of board of directors until court restores control to board); Murphy, *supra* note 17, at 830 (noting that custodian is responsible for making decisions that directors were formerly collectively responsible for making). Some statutes permit the custodian's powers to be exercised through or in conjunction with the current board. See, e.g., N.J. STAT. ANN. § 14A:12-7(4) (West Supp. 2002) (providing that powers of custodian "may be exercised directly or through, or in conjunction with, the corporation's board or officers, in the discretion of the custodian or as the court may order"); MODEL BUS. CORP. ACT § 14.32(c)(2) (1998)



Appointing a custodian is less severe than ordering dissolution. It provides the parties with the opportunity to attempt to break the deadlock themselves by giving them "a sufficient cooling off period" to restore their relationship.<sup>53</sup> The presence of the custodian also encourages the parties to resolve their differences quickly so that the outsider may be removed from managing the business for them.

One of the drawbacks of appointing a custodian or temporary receiver is the potential negative impact it will have on the company's relationship with its creditors, suppliers, and customers. These groups may view the appointment of the custodian as an indication that the corporation is financially troubled, and they may consequently demand greater protections or refuse to approve further extensions of credit.<sup>54</sup> In a broader sense, the custodian's effectiveness is limited because businesses typically "will not prosper as well in the hands of an outside custodian."<sup>55</sup> Custodians in effect maintain the status quo; they are appointed to preserve the operations of the business, not to maximize its profitability.

Critics of the custodian remedy argue that it unduly intrudes on the management of private business and wrests control of the corporation from those who are entitled to run the business.<sup>56</sup> Because the appointment of a custodian "involves the complete relocation of corporate control,"<sup>57</sup> some commentators have suggested that the remedy may be better utilized in

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[hereinafter MBCA] (allowing custodian to exercise powers "through or in place of [the corporation's] board of directors or officers").

53. Note, *Deadlock and Dissolution in Close Corporations*, 45 IOWA L. REV. 767, 773 (1960).

54. See Eileen A. Lindsay, *What Can I Do for You? Remedies for Oppressed Shareholders in New Jersey*, N.J. LAW. MAG., August 2000, at 37, 39 (noting that creditors may insist on greater protection once custodian is appointed); cf. *In re Jamison Steel Corp.*, 322 P.2d 246, 250 (Cal. Dist. Ct. App. 1958) (discussing negative effects on corporation's credit once receiver is appointed).

55. Thompson, *supra* note 1, at 230. The custodian remedy is only a temporary solution. "Sooner, rather than later, the participants will need to arrive at a better accommodation of their respective interests, or a different remedy will be required." *Id.*

56. See Murphy, *supra* note 17, at 830 (noting that disadvantage of custodian remedy is that it takes all control from directors); see also Hetherington & Dooley, *supra* note 23, at 24 (noting that custodianships "substitute judicially controlled management for management by the owners"); Lew, *supra* note 50, at 512 ("[T]he custodian's power over the corporation can result in excessive judicial interference into private business . . ."). If the custodian is appointed to run the affairs of the entire business, the custodian's powers could potentially be quite broad, including the power to declare dividends, hire and fire employees, and set salaries. *Id.* at 513 (citing Wilderman v. Wilderman, 315 A.2d 610 (Del. Ch. 1974)).

57. Murphy, *supra* note 17, at 823.

situations involving evidence of fraudulent or oppressive conduct by one faction.<sup>58</sup> Presumably, by taking management powers from the offending shareholders, the custodian can stop the improper conduct and prevent economic loss to the corporation.

## 2. Arbitration

Arbitration is another third-party alternative for deadlocked corporations. Arbitration involves the use of a neutral outsider who considers the claims of the disputing parties and renders a binding decision.<sup>59</sup> It has become a very common method for resolving disputes in close corporations.<sup>60</sup>

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58. See Pachman, *supra* note 10, at 14 ("[A] custodian may be more appropriate where there is intentional wrongdoing, self-dealing, mismanagement or serious fraudulent or illegal acts."); see also Haynsworth, *supra* note 51, at 28 (noting that custodial receiver remedy works best when majority shareholders have committed fraudulent activity); Lew, *supra* note 50, at 510 (observing that custodian remedy is preferable when shareholders have committed fraudulent and illegal acts).

59. G. Richard Shell, *Arbitration and Corporate Governance*, 67 N.C. L. REV. 517, 521 (1989); Solomon & Solomon, *supra* note 43, at 116. Once the arbitrator renders a decision, the award may be converted into a judgment in court pursuant to federal and state arbitration statutes. See 9 U.S.C. § 9 (2000) (giving arbitration parties right to submit arbitration award to court for judge to issue order confirming award); Unif. Arbitration Act § 22, 7 U.L.A. 41 (Supp. 2002) (allowing party to make motion to court for order confirming arbitration award); Shell, *supra*, at 523 (stating that federal and state statutes allow courts to convert arbitrator's decision into judgment through judicial confirmation). After the arbitration award is made, it is extremely difficult to challenge the decision because statutes provide for only limited rights to appeal. See, e.g., 9 U.S.C. § 10(a) (2000) (limiting grounds for vacation of arbitration awards to situations in which party procured award by corruption, fraud, undue means, misconduct, or evident partiality on part of arbitrator). One commentator has estimated that the number of arbitration awards that are challenged each year is "less than two hundred out of more than twenty-five thousand (perhaps as many as forty thousand)" awards. Edgar A. Jones Jr., *Selected Problems of Procedure and Evidence*, in ARBITRATION IN PRACTICE 48, 49 (Arnold M. Zack ed., 1984).

60. See Shell, *supra* note 59, at 534 (referring to arbitration of close corporation disputes as "a matter of everyday practice"). Traditionally, arbitration was a disfavored approach because there was concern that decisionmaking by outside arbitrators divested the board of directors of its power and obligation to manage the corporation's affairs. *Id.* at 530. Today, most state statutes uphold private arbitration agreements. See 2 O'NEAL & THOMPSON, *supra* note 11, § 9.11 (stating that arbitration clauses are generally accepted in close corporations); see, e.g., MICH. COMP. LAWS ANN. § 600.5001(2) (West 2000) ("A provision in a written contract to settle by arbitration . . . shall be valid, enforceable, and irrevocable . . ."); MBCA-CC, *supra* note 16, § 20 & Official Cmt. (authorizing close corporation shareholder agreements that require arbitration of issues over which shareholders or directors are deadlocked). See generally IAN R. MACNEIL, AMERICAN ARBITRATION LAW 83-155 (1992) (discussing nationalization of American arbitration law).

As a means of resolving disputes, arbitration is generally considered to be less expensive and less time-consuming than litigation.<sup>61</sup> It affords the participants greater privacy, a feature that may be highly valued by close corporation shareholders who do not wish to air their family disputes in the public setting associated with litigation.<sup>62</sup> Arbitrators who have business expertise and familiarity with the company or the industry can render a decision that reflects a deeper understanding of the issues, increasing the likelihood that the parties will be satisfied with the judgment.<sup>63</sup> The average civil litigation judge may not have comparable specialized knowledge or the time to develop the same level of expertise. Arbitrators are not necessarily bound by precedent or formal rules of evidence and procedure, and arbitrators therefore have the flexibility to tailor their decisions specifically for the parties.<sup>64</sup> Unlike custodianships, arbitration does not entail the insertion of the outside third party into the corporation, nor does it involve the complete surrender of corporate control. The parties remain in control of the business as they take their dispute to the outside arbitrator for judgment.

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61. 2 O'NEAL & THOMPSON, *supra* note 11, § 9.09; Leffler, *supra* note 38, at 258; Solomon & Solomon, *supra* note 43, at 117. Courts have also recognized the value of arbitration in close corporation disputes. *See, e.g.*, Siegel v. Ribak, 249 N.Y.S.2d 903, 909 (N.Y. Sup. Ct. 1964) (encouraging arbitration in close corporation disputes). In fact, courts will enforce arbitration agreements between shareholders and stay any petition for dissolution pending the arbitration. *E.g.*, Siegel v. 141 Bowery Corp., 362 N.Y.S.2d 897, 901-02 (N.Y. Sup. Ct. 1974), *aff'd*, 380 N.Y.S.2d 232 (N.Y. App. Div. 1976).

62. *See* S.S.J. Jr., Note, *Mandatory Arbitration as a Remedy for Intra-Close Corporate Disputes*, 56 VA. L. REV. 271, 285 (1970) (noting that advantage of arbitration in close corporation disputes is privacy); Note, *Arbitration as a Means of Settling Disputes Within Close Corporations*, 63 COLUM. L. REV. 267, 286 (1963) (suggesting that arbitration allows "corporation and its owners to avoid the adverse publicity incidental to judicial proceedings"). The private nature of arbitration proceedings may also be important to parties who wish to preserve certain corporate secrets. *See* Hochstetler & Svejda, *supra* note 35, at 971-92 (noting that arbitration "safeguard[s] corporate secrets"); Makens & Young, *supra* note 30, at 1887 (discussing advantage of privacy in arbitration proceedings).

63. O'Neal, *supra* note 48, at 790; Murphy, *supra* note 17, at 824; *see also* Stephen K. Huber, *The Role of Arbitrator: Conflicts of Interest*, 28 FORDHAM URB. L.J. 915, 917 (2001) (noting that arbitrators are commonly chosen "precisely because they have considerable knowledge about the subject matter of the arbitration"); Leo Kanowitz, *Alternative Dispute Resolution and the Public Interest: The Arbitration Experience*, 38 HASTINGS L.J. 239, 255 (1987) (stating that arbitrators may know more about subject matter of dispute than judges or juries).

64. *See* S.S.J., *supra* note 62, at 286-87 (discussing procedural advantages of arbitration); *see also* Jones, *supra* note 59, at 52 (noting that "legal rules, procedures, and evidence are not legally required" in arbitration); Leffler, *supra* note 38, at 258 (noting arbitrators' flexibility in making decisions).

Arbitration has its limitations. Although less formal than litigation, arbitration does have adjudicative elements. The process can be somewhat intimidating, and it often requires the involvement of the parties' lawyers.<sup>65</sup> Like judges, arbitrators may be asked to listen to witnesses, entertain the presentation of arguments from both sides, and impose decisions that result in binary, win-lose outcomes for the parties.<sup>66</sup> These outcomes may not address the real reasons why the deadlock occurred in the first place. Arbitrators are constrained in their ability to restore consensus between the parties and to resolve the personal grievances that underlie many of the disputes in close corporations. A single arbitration may not be an effective solution if the conflicts are deep and the parties subsequently deadlock over a continuing stream of issues.

### 3. Mediation

Mediation offers an alternative for close corporation shareholders who are deeply divided and likely to remain so unless they are able to identify and deal with the core reasons for their conflict. In mediation, a neutral third party facilitates communication and negotiation between the parties to move them toward a mutually acceptable resolution.<sup>67</sup> The goal is to "transform[] the relationship from conflict to cooperation"<sup>68</sup> as the mediator helps the parties move past their hostility to address their real interests.<sup>69</sup> The mediator has no authority to impose a final decision upon the parties; rather, the mediator listens to the parties, promotes understanding between them, and utilizes creative problem-solving methods for resolving the tensions at the root of the

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65. See Ronald W. Haughton, *Running the Hearing*, in *ARBITRATION IN PRACTICE* 37 (Arnold M. Zack ed., 1994) (discussing nature of arbitration hearings); Jones, *supra* note 59, at 50–55 (describing process of arbitration hearing); see also Unif. Arbitration Act § 16, 7 U.L.A. 32 (Supp. 2002) (providing for representation of arbitration parties by lawyers).

66. In this regard, the arbitration process retains the adversarial structure of the litigation model. Thus, commentators have referred to arbitration as "quasi-adjudicatory." Judith Resnik, *Many Doors? Closing Doors? Alternative Dispute Resolution and Adjudication*, 10 OHIO ST. J. ON DISP. RESOL. 211, 218 (1995).

67. KIMBERLEE K. KOVACH, *MEDIATION: PRINCIPLES AND PRACTICE* 17 (1994).

68. Carole Silver, *Models of Quality for Third Parties in Alternative Dispute Resolution*, 12 OHIO ST. J. ON DISP. RESOL. 37, 76 (1996); see Lon L. Fuller, *Mediation—Its Forms and Functions*, 44 S. CAL. L. REV. 305, 308, 325 (1971) (noting that objectives of mediation are to "bring[] about a more harmonious relationship between the parties" and "to reorient the parties toward each other").

69. See Robert H. Mnookin & Lee Ross, *Introduction*, in *BARRIERS TO CONFLICT RESOLUTION* 2, 22–23 (Kenneth J. Arrow et al. eds., 1995) (discussing role of mediators in overcoming barriers to resolution).

conflict. The process is less adversarial than arbitration and is conducted much more informally.<sup>70</sup>

The mediation process is particularly valuable in situations in which some emotional hostility is present<sup>71</sup> or in which parties generally must maintain a continued relationship,<sup>72</sup> two factors that often coalesce in family close corporation disputes. The conflicts between the parties may have grown to the point that each side refuses to capitulate on even the smallest issue because of a desire simply to harm the other side. In such cases, the mediator may be able to engage the parties in integrative bargaining so that the parties gain more by compromising and trading for what each side values most.<sup>73</sup> The

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70. The mediator is not limited by the same rules of evidence and procedure that bind judges or even arbitrators who may be constrained by certain rules of formality. See, e.g., Jones, *supra* note 59, at 49–50 (discussing formal practice of swearing in witnesses under oath in arbitration hearings). In mediation, the parties can vent their feelings and concerns, even if such statements would be technically "irrelevant" in a court of law. See Solomon & Solomon, *supra* note 43, at 121 (noting that in mediation "what a party deems relevant is relevant"); see also FORREST S. MOSTEN, *THE COMPLETE GUIDE TO MEDIATION* 57 (1997) (contrasting mediators who are able to provide full and undivided attention to parties with judges who have other cases and administrative pressures that preclude them from devoting extensive time and attention to any one case); L. Randolph Lowry, *Preparing Your Client . . . For Mediation*, DISP. RESOL. J., Aug. 1998, at 30, 36 ("[I]t is important for clients to express, sometimes quite emotionally, their view of the conflict and its implications. The adversarial system stifles [that].").

71. Mediation can be "an attractive alternative when the issues are complicated or involve strong feelings." ROBERT COULSON, *FAMILY MEDIATION: MANAGING CONFLICT, RESOLVING DISPUTES* 16 (2d ed. 1996). In the context of close corporation disputes, the function of the mediator would be to get the parties "to put their emotions behind them and work out rational, commercially reasonable outcomes." James C. Freund, *Anatomy of a Split-Up: Mediating the Business Divorce*, 52 BUS. LAW. 479, 484 (1997).

72. See MARK D. BENNETT & MICHELE S.G. HERMANN, *THE ART OF MEDIATION* 12 (1996) (emphasizing that "[m]ediation's forte is to work with disputes involving future relationships"); Note, *Mandatory Mediation and Summary Jury Trial: Guidelines for Ensuring Fair and Effective Processes*, 103 HARV. L. REV. 1086, 1091 (1990) [hereinafter *Mandatory Mediation*] (noting that mediation is beneficial for parties who must interact on regular basis in future dealings). Particularly in the close corporation context, the parties are locked into a relationship that is not easy to exit. In a sense, "each is dependent for its very existence on some collaboration with the other . . . [, and] they simply must find some way of getting along with one another." Fuller, *supra* note 68, at 310. The types of relationships that mediation presupposes are those that have "some strong internal pull toward cohesion." *Id.* at 314.

73. See *Mandatory Mediation*, *supra* note 72, at 1092 (noting that, in mediation, parties can make concessions on issues they discount in order to gain ground on issues they view as important). If parties do not place the same value on things, they can ultimately achieve more satisfying results by "trading for what they value more but what the other party values less." Carrie Menkel-Meadow, *Whose Dispute Is It Anyway?: A Philosophical and Democratic Defense of Settlement (in Some Cases)*, 83 GEO. L.J. 2663, 2673 (1995). Professor Menkel-Meadow graphically describes this type of resolution as a "divi[sion] of goods, not in half, but by interest, so that a piece of chocolate cake is divided into cake and icing." *Id.* at 2672.

process of mediation may be especially effective for close corporation disputes because the parties, as business people, understand the nature of creative problem-solving, brainstorming, devising options, and risk-taking.<sup>74</sup> If the mediator can help the parties overcome the emotional barriers that prevent them from rationally approaching their problems, the parties can use their own skills to forge a mutually acceptable solution.

Unlike the custodian remedy, which removes control from the shareholders, and the arbitration process, which imposes a final decision on them, mediation gives the parties a greater level of control over their own outcome. The parties may be more likely to adhere to and feel satisfied with an agreement they have taken part in forming.<sup>75</sup>

Mediation most likely cannot work if the parties' relationship has deteriorated to the point of being extremely adversarial. Even if the parties are willing to engage in mediation, the informal and voluntary nature of the process may limit its effectiveness. The parties' freedom to end the mediation without any agreement at all can reduce the likelihood that the parties will continue the process through to completion. The fact that the mediator has no real power to direct the parties' actions or render a final decision may induce the parties to take the mediation less seriously.<sup>76</sup> In this regard, mediation lacks the certainty of a formal binding resolution.

#### 4. Mediation-Arbitration (*Med-Arb*)

A hybrid form of dispute resolution combines mediation and arbitration to capture the benefits of both methods. Mediation-arbitration, or med-arb, involves the use of a neutral third party who acts first as a mediator between the parties in an attempt to reach a voluntary agreement. If the mediation phase fails to resolve all the disputed issues, the process switches to arbitration, and the third party renders a binding decision on the remaining points of

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74. Lowry, *supra* note 70, at 34. It may be "relatively easy to get business clients to think creatively—that is how businesspeople are trained . . . [and] their business success depends on it." *Id.*

75. Empirical studies indicate that the majority of participants in mediation tend to reach an agreement, tend to be satisfied with the outcome and the process, and tend to comply with the terms and conditions of the agreement over time. Michael Benjamin & Howard H. Irving, *Research in Family Mediation: Review and Implications*, *MEDIATION Q.*, Fall 1995, at 53, 57–58, 64; see also Lowry, *supra* note 70, at 36 ("Those who are satisfied with a decision are much more likely to comply with it.")

76. Sherry Landry, *Med-Arb: Mediation with a Bite and an Effective ADR Model*, 63 *DEF. COUNS. J.* 263, 264 (1996); see also Solomon & Solomon, *supra* note 43, at 124 (identifying mediator's lack of power to induce settlement or enforce compliance as shortcoming of mediation).

disagreement.<sup>77</sup> Med-arb affords the parties the opportunity to engage in the cooperative aspects of mediation, while providing the parties with the certainty of a final decision.

Med-arb may create incentives for the parties to participate in the mediation with sincerity and good faith because they know that if they do not resolve the dispute themselves, they will lose control over the outcome, and a third party will impose a final resolution upon them.<sup>78</sup> The parties are more likely to approach the bargaining table with their honest demands, rather than advancing extreme positions that have no possibility of being accepted.<sup>79</sup> The mediator-arbitrator can play an active role in mediating the dispute and addressing the parties' underlying interests, something that the typical arbitrator is constrained from doing in the more formal atmosphere of traditional arbitration.<sup>80</sup> Med-arb may be a more efficient process because, if the mediation does not succeed, the mediator-arbitrator, who is already familiar with the parties, their dispute, and their respective positions, is in a position to make a quicker decision than an outside third party who must begin anew.<sup>81</sup>

Some empirical research has confirmed the greater effectiveness of med-arb in comparison to straight mediation. In one study, disputants were more conciliatory and less hostile under med-arb than under mediation alone; the med-arb disputants made more new proposals for settlement and tended to

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77. Barry C. Bartel, Comment, *Med-Arb as a Distinct Method of Dispute Resolution: History, Analysis, and Potential*, 27 WILLAMETTE L. REV. 661, 664-65 (1991); see also STEPHEN B. GOLDBERG ET AL., DISPUTE RESOLUTION 246-71 (1985) (discussing med-arb process).

78. GOLDBERG ET AL., *supra* note 77, at 265; see also Landry, *supra* note 76, at 264-65 (suggesting that parties will make greater effort to reach voluntary agreement when they know that they are under threat of arbitration); Karen L. Henry, Note, *Med-Arb: An Alternative to Interest Arbitration in the Resolution of Contract Negotiation Disputes*, 3 OHIO ST. J. ON DISP. RESOL. 385, 390 (1988) (stating that presence of mediator-arbitrator and threat of arbitrated decision "creates tremendous incentive for the parties to successfully mediate their dispute").

79. This tendency to be more honest and straightforward is said to be in contrast to what occurs in arbitration. See GOLDBERG ET AL., *supra* note 77, at 265 (noting that parties tend to advance extreme positions in arbitration in hopes of getting larger recovery). But see James T. Peter, Note, *Med-Arb in International Arbitration*, 8 AM. REV. INT'L ARB. 83, 97 (1997) (discussing argument that parties are likely to be less frank in mediation because they know that mediator-arbitrator has "decisional power" and may ultimately use damaging disclosures against them).

80. See Bartel, *supra* note 77, at 665 (noting that mediator-arbitrator plays more active role than arbitrator); Henry, *supra* note 78, at 393-94 (contrasting formality of arbitration to informality of med-arb).

81. See WILLIAM L. URY ET AL., GETTING DISPUTES RESOLVED: DESIGNING SYSTEMS TO CUT THE COSTS OF CONFLICT 57 (1988) (noting efficiency of med-arb); see also Henry, *supra* note 78, at 393 (discussing med-arb's ability to save time and costs).

offer more concessions during the negotiations.<sup>82</sup> Although some critics challenge the use of the same person as the mediator and the arbitrator in med-arb,<sup>83</sup> the same study found that when a different person acted as the arbitrator after the mediation phase, the mediator was less active and less involved, and the disputants tended to be less creative.<sup>84</sup> Apparently vesting the mediator-arbitrator with the power to make a binding decision encourages the parties to engage in creative problem-solving and to reach agreement in the mediation stage.

For these reasons, the med-arb approach may be helpful in corporate deadlock situations. In fact, arbitration, mediation, med-arb, and the custodian remedy can each provide a unique means of assisting disputants caught in

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82. Neil B. McGillicuddy et al., *Third-Party Intervention: A Field Experiment Comparing Three Different Models*, 53 J. PERSONALITY & SOC. PSYCHOL. 104, 110 (1987); see also Dean G. Pruitt, *Solutions Not Winners*, PSYCHOL. TODAY, Dec. 1987, at 58, 60 (discussing results of same study). Under med-arb, the participants seemed more motivated to reach agreement and showed greater respect for the mediator. *Id.* The researchers hypothesized that the greater motivation to please the mediator may have been "due to the respect that is naturally given to a person who has the power to make decisions about one's welfare." McGillicuddy et al., *supra*, at 110.

83. One set of concerns is that the skills needed to be an effective mediator are not the same as those needed to be an effective arbitrator and, therefore, it should not be assumed that the same person should act in both roles. See Silver, *supra* note 68, at 78 n.103 (quoting British solicitor who explained that some arbitrators do not make good mediators because they "are too used to sitting back and hearing evidence rather than working with the people towards . . . a solution that will settle their differences"). Respondents to this argument dismiss this concern as merely a "practical problem" that can be solved by finding someone who has the necessary skills in both areas. *E.g.*, Peter, *supra* note 79, at 97. A separate concern involves the potential for coercion when the same person acts as the mediator-arbitrator. See Bartel, *supra* note 77, at 679-80 (noting that mediator-arbitrator may abuse power). If the mediator-arbitrator firmly pushes one or both parties toward settlement during the mediation stage, the parties may feel compelled to accept settlement out of fear of antagonizing the mediator-arbitrator, who will be the ultimate decisionmaker in the arbitration phase. The resolution then may not be the one the parties would have voluntarily accepted had they known a different person would be assigned to arbitrate the case if they could not reach a mediated settlement. See URY ET AL., *supra* note 81, at 57 ("What appears to be a negotiated resolution may be perceived by the parties as an imposed one, thus diminishing the degree of satisfaction and commitment."). McGillicuddy's med-arb research found that mediators who also acted as arbitrators did act forcefully in the mediation session, advocating certain positions and threatening to end the sessions if no progress were made. However, these tactics were used only at the end of sessions, suggesting a "last-ditch effort" to save the mediation, "rather than a policy of forceful advocacy." McGillicuddy et al., *supra* note 82, at 110; Pruitt, *supra* note 82, at 61. Critics also fear that using the same person to mediate and arbitrate the dispute compromises the integrity of the adjudicative role because it improperly allows the arbitrator to use information learned in confidence in the mediation phase against the parties in the arbitration phase. Freund, *supra* note 71, at 530; Solomon & Solomon, *supra* note 43, at 126; Henry, *supra* note 78, at 396-97.

84. McGillicuddy et al., *supra* note 82, at 111; Pruitt, *supra* note 82, at 61.



deadlock. As discussed below, the provisional director remedy draws on and combines many of the features of these various approaches.

### C. Provisional Director Remedy: A Snapshot

A provisional director is a neutral third party who is appointed by the court and vested with the rights and powers of a director to vote at board meetings.<sup>85</sup> The provisional director acts as a type of in-house arbitrator with the power to vote to break deadlocks.<sup>86</sup> At the same time, the provisional director serves a mediating function by facilitating communication between the parties at board meetings and offering new ideas or alternatives for resolving the contested issues. In this regard, the provisional director remedy appears to share many of the same characteristics as med-arb as a form of dispute resolution: the provisional director listens to the parties state their positions and vent their emotions, attempts to help them reach some type of agreement and, failing that, votes to break the tie. The remedy is less severe than the appointment of a custodian or receiver who takes over the management of the business entirely. The provisional director cannot initiate actions over the objections of the other directors, nor can the provisional director shift control of the business operations away from the owners.<sup>87</sup>

Various advantages are associated with the provisional director remedy. It avoids the dissolution of the corporation and enables the business to continue operating as a going concern in the hands of its current owners. Share-

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85. 16A FLETCHER, *supra* note 6, § 8043. Many statutes authorizing the appointment of provisional directors make their voting authority explicit. *See, e.g.*, DEL. CODE ANN. tit 8, § 353(c) (2001) (providing that "a provisional director shall have all the rights and powers of a duly elected director of the corporation, including the right . . . to vote at meetings of directors").

86. *See* Folk, *supra* note 11, at 953 (stating that "procedure is essentially a means of compelling the warring shareholders and directors to accept a type of arbitration"); Mason Willrich, Comment, *Unusual Statutory Remedies for the Deadlocked Corporation in California: Voluntary Dissolution and the Provisional Director*, 48 CAL. L. REV. 272, 281 (1960) (stating that provisional director remedy is "akin to compulsory arbitration"); *supra* Part II.B.2 (discussing arbitration).

87. *See In re Annrhon, Inc.*, 21 Cal. Rptr. 2d 599, 604 (Cal. Ct. App. 1993) (stating that provisional director cannot "override a decision of the board . . . [nor] take over ultimate management from the owners"); Bahls, *supra* note 45, at 310 (noting that, because provisional directors have "only one vote, [they] cannot initiate actions over the objections of the other directors"); Thompson, *supra* note 1, at 229 (observing that "the provisional director lacks the authority to act alone and can only combine with other directors to create the necessary majority required for corporate action"). *But see* Mitzner v. Lights 18 Inc., 660 A.2d 512, 514 (N.J. Super. Ct. App. Div. 1994) (referring to the provisional director as a person who was "appointed by the court to run Lights 18").

holders of successful companies presumably wish "to restore rather than to destroy the symbiotic relationship which was once the source of mutual wealth."<sup>88</sup> Like the custodian remedy, the appointment of a provisional director buys the parties some time to cool off and attempt to reestablish cooperation with each other. However, in contrast to custodianships, the provisional director remedy allows the parties to stay in charge of the company and involves less disruption to the business.<sup>89</sup> Moreover, the appointment of a provisional director does not draw the same alarm from the corporation's creditors and suppliers as the appointment of a custodian or receiver.<sup>90</sup>

The mere presence of the third-party director at meetings may reduce some of the hostility between the parties. The introduction of an outsider tends to put the parties on their best behavior.<sup>91</sup> They see the outsider as someone who is judging them, but who is also there to help the corporation; accordingly, each side wants the outsider to view it as being fair, reasonable, and mindful of the corporation's best interests.<sup>92</sup> The provisional director's votes could possibly help alter the direction of corporate activity so that the likelihood of future deadlock is minimized.<sup>93</sup> Even if the deadlock cannot be

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88. S.S.J., *supra* note 62, at 287. When the corporation has been successful, solutions that keep the business going in the hands of those who have made it profitable are often preferable to solutions calling for dissolution. Leffler, *supra* note 38, at 256. Even when dissolution will result in the buy-out of one shareholder, the shareholder may prefer to be temporarily "locked in" to realize greater future gains rather than be bought out at a discounted price that does not reflect the going concern value of the business. Murdock, *supra* note 46, at 447.

89. See Haynsworth, *supra* note 51, at 27 (referring to provisional director device as being "less intrusive on management prerogatives"). As a temporary addition to the board, the provisional director does not permanently alter the corporation's ownership structure or balance of power. 2 O'NEAL & THOMPSON, *supra* note 11, § 9.33.

90. See Bahls, *supra* note 45, at 310 (noting that "a provisional director does not create the stigma of a court-appointed agent operating the business" and that "[t]herefore, damage to relationships with creditors and customers is minimized"). The provisional director's presence does not necessarily strike creditors and debtors of the company as being a major change in management, whereas the appointment of a custodian may be a sign of possible insolvency. Lew, *supra* note 50, at 514.

91. See Jeffrey A. Barach, *Is There a Cure for the Paralyzed Family Board?*, SLOAN MGMT. REV., Fall 1984, at 3, 6, 10 (noting that bringing outsiders onto boards "forces the discussion process to be held on an adult level" and suppresses "childish and inappropriate behavior"); see also Fuller, *supra* note 68, at 309 (observing that "mere presence of a third person tends to put the parties on their good behavior").

92. Cf. John A. Fiske, *Mediation*, in 1 MASS. FAM. LAW MANUAL § 4.7.2 (1996) (discussing parties' subtle need for approval of mediator and parties' desire to be seen as good or fair).

93. See Folk, *supra* note 11, at 953 (stating that "the deadlock-breaking votes of a provisional director may so change the direction of corporate activity that deadlock will not recur"). In situations in which the deadlock persists, the provisional director's "impartial views

cured, however, the provisional director remedy may be the most useful "first step" in attempting to provide relief for corporate deadlock.<sup>94</sup>

The "first step" nature of the provisional director remedy is arguably one of its disadvantages. If the parties have become completely incompatible, the appointment of a provisional director may be futile and may only delay the inevitable break-up of the company.<sup>95</sup> The remedy involves higher transaction costs because the parties must return to the court for more serious relief if the remedy fails.<sup>96</sup> Proponents of the provisional director remedy counter that the remedy should not be discounted merely because it might not always be the final solution for deadlock.<sup>97</sup> The fact that the remedy may help save the corporation and its shareholders from the devastating effects of deadlock may make it worth a try.

However, the provisional director remedy may be problematic on more fundamental grounds. It deprives resisting shareholders of their right to veto managerial decisions by vesting in a court-appointed stranger the authority essentially to override the veto.<sup>98</sup> This raises deeper questions about the

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on the problems at hand may help reconcile the discordant directors." David E. Rosenbaum, Comment, *The Provisional Director Statute*, 31 MO. L. REV. 536, 540 n.29 (1966).

94. Wall, *supra* note 17, at 637; see also Lew, *supra* note 50, at 515 (discussing flexibility of courts to order "milder provisional director remedy first"). Shareholders themselves often recognize the value of this approach. See, e.g., *Ironite Products Co. v. Samuels*, 17 S.W.3d 566, 569 (Mo. Ct. App. 2000) (noting that one shareholder wrote to another shareholder suggesting that they would benefit from "objective tie-breaking director").

95. See *In re O'Brien Machinery, Inc.*, 36 Cal. Rptr. 782, 784 (Cal. Dist. Ct. App. 1964) (noting that provisional director who served on board of deadlocked corporation for one year sought to be removed, alleging that remedy was not adequate to deal with shareholders' severe dissension); *Bonavita v. Corbo*, 692 A.2d 119, 129-30 (N.J. Super. Ct. Ch. Div. 1996) (finding that continued presence of provisional director would not solve ongoing divergence between two equally divided shareholders and that only feasible remedy was to order buy-out of one shareholder's interests).

96. See Bahls, *supra* note 45, at 327 (discussing transaction costs of resolving shareholder dissension); Hetherington & Dooley, *supra* note 23, at 25 (noting that "judicially monitored management is costly to the judicial system and to the parties").

97. Murphy, *supra* note 17, at 832. Hodge O'Neal addressed similar arguments against arbitration fifty years ago. He argued that the "pessimistic view" that dissolution is the only remedy for severe deadlock "fails to give proper weight to the moral force of arbitration and the disposition of men to accept a determination fairly arrived at by disinterested persons." O'Neal, *supra* note 48, at 792. Commentators have suggested that virtually any remedy that does not alter the structure of the corporation or the identity of its participants may be only postponing the implementation of more drastic remedies. E.g., Murphy, *supra* note 17, at 832.

98. See Hetherington & Dooley, *supra* note 23, at 21 (noting that "[n]o state or public interest appears to justify depriving the resisting party of the right to veto corporate decisions"). The veto power is an important device for protecting shareholder interests in close corporations. Professors Hetherington and Dooley argue that the appointment of a provisional director

extent to which courts may influence or interfere with private business and, equally important, about whether courts should be intricately involved at all in the enforcement of ongoing, personal, consensual business relationships that are fraught with friction.<sup>99</sup> These questions implicate important policy concerns, including shareholder autonomy rights, the authority of the courts, and the tensions between public and private interests. The following Part discusses these competing policy principles and their effect on one's normative view of the provisional director remedy.

### III. Fundamental Policy Principles and Interests

#### A. Shareholder Autonomy

As a primary matter, courts should not unduly interfere with the internal affairs of corporations and have properly hesitated to do so even in cases of deadlock.<sup>100</sup> In the interests of private business and shareholder autonomy, courts must respect the decisions that are made by close corporation shareholders pursuant to their inherent rights to vote and manage the business. The fundamental voting rights of shareholders occupy a "sacred space" in corporate governance.<sup>101</sup> In close corporations in particular, the shareholder's exercise of "voice" through voting takes on greater significance because "exit" is not easy.<sup>102</sup> Shareholders possess the right to elect and remove directors and to have a meaningful voice in the operation of the corporation.<sup>103</sup> Any action

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unjustifiably destroys the veto powers of the shareholders and has extended detrimental effects on the shareholder who resists the appointment. *Id.* at 21–22.

99. *Id.* at 16.

100. See *Muellerberg v. Bikon Corp.*, 669 A.2d 1382, 1386 (N.J. 1996) ("Traditionally, American courts were reluctant to interfere in the internal affairs of a corporation.").

101. Robert B. Thompson, *Shareholders as Grown-Ups: Voting, Selling, and Limits on the Board's Power to "Just Say No"*, 67 U. CIN. L. REV. 999, 1009 (1999).

102. *Id.* at 1015–16 (discussing political scientist Albert Hirshman's well-known theory of voice and exit as alternative values). "A shareholder who has easy exit and liquidity by being able to sell her shares may well pay little attention to voting." *Id.* at 1015. On the other hand, if "exit is denied to an investor," either "because of the lack of a market or for other reasons, . . . voice becomes much more important and the investor will pay attention to, and value more highly, the shareholder franchise." *Id.* at 1016; see also *supra* note 38 and accompanying text (noting absence of exit options for close corporation shareholders).

103. See 2 FLETCHER, *supra* note 6, § 283 (noting that shareholders have "inherent power to appoint directors"). "In the absence of a compelling reason, . . . a court should not preclude shareholders from the full exercise of this right." *Id.* (citing *SEC v. Vesco*, 571 F.2d 129 (2d Cir. 1978)); see also *Orchard v. Covelli*, 590 F. Supp. 1548, 1558–60 (W.D. Pa. 1984) (noting "systematic effort to exclude [minority shareholder] from any meaningful role in the corporation" and ordering buy-out of minority shareholder's interest at fair value); *Compton v. Paul K. Harding Realty Co.*, 285 N.E.2d 574, 581 (Ill. Ct. App. 1972) (finding that defendant's failure

taken by the court to remedy corporate ills, including the appointment of a provisional director, must accommodate these important shareholder interests. If the provisional director remedy is constructed too broadly, the danger is that it will unduly infringe on the autonomy rights of shareholders to elect whom they want as directors and to exercise their right to veto certain managerial decisions, even if it creates deadlock.

The presence of the provisional director arguably does not interfere with shareholder voting rights that would otherwise be effective in the provisional director's absence. These voting rights were fully exercised by the shareholders; their voices were simply rendered ineffective by the shareholders' own actions. The appointment of a provisional director is not alone responsible for the muting of shareholder voice. The shareholders themselves cancelled out their own voices when they deadlocked. From this perspective, the court does not take away the voting rights of shareholders when it appoints a provisional director. Rather, the court is merely providing relief for shareholders who exercised their voting powers but suffered a breakdown in corporate decisionmaking by virtue of their own disagreement. In such cases, the court has broad powers to order remedies to assist shareholders. However, the breadth of these powers raises additional concerns about the extent of the court's authority and ongoing involvement in corporate matters.

### *B. Court Authority and Involvement*

Pursuant to their equitable powers, courts have extensive authority and flexibility to fashion remedies for problems resulting from discord within corporations.<sup>104</sup> However, when the court orders a remedy that requires the

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to call board meetings or to consult with minority shareholder regarding management of corporate affairs was sufficient "to justify the finding of oppression and the order of dissolution").

104. For example, many courts, invoking their inherent equitable powers, have ordered buy-outs of a shareholder's interest in the absence of any specific statutory authority. *See, e.g., Maddox v. Norman*, 669 P.2d 230, 236 (Mont. 1983) (affirming trial court's determination that liquidation and dissolution were not justified by equities and stating that courts can adopt flexible approaches); *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387, 395-98 (Or. 1973) (concluding that courts have power to order any appropriate equitable relief and citing list of several potential alternatives to dissolution); *see also* 2 O'NEAL & THOMPSON, *supra* note 11, § 9.35 (listing fourteen examples of "court-fashioned remedies" available to resolve close corporation disputes). Equitable remedies are powerful because they are so flexible, variable, and adaptable to the circumstances. 1 JOHN N. POMEROY, EQUITY JURISPRUDENCE § 109 (Spencer W. Symons ed., 5th ed. 1994). "[T]he court of equity has the power of devising its remedy and shaping it so as to fit the changing circumstances of every case and the complex relations of all the parties." *Id.* For a historical review of courts' willingness to use their equitable powers to fashion remedies providing "complete relief" for shareholder disputes, *see Bahls, supra* note 45, at 294-95.

continuing involvement of the court itself, cause for concern may exist. As a practical matter, courts should not become entangled in ongoing disputes over business, rather than legal, issues.<sup>105</sup> Generally, it would be inappropriate for the court to undertake, either directly or indirectly, the supervision of business management. When this principle is applied to the provisional director remedy, the scope of the remedy may be problematic. For example, if the provisional director is required to provide regular reports to the court regarding the status of the deadlock and the corporation's business, the remedy begins to take on the characteristics of indirect court supervision of management.<sup>106</sup>

More fundamentally, the issue is whether the provisional director may be viewed as an "officer of the court," serving at the direction and discretion of the court. There is a sense in which the provisional director acts as an extension of the judge who made the appointment. The remedy itself contemplates the creation of a special directorial position with traits akin to a court-appointed arbitrator or mediator who substitutes for, or provides assistance to, the judge in resolving a dispute.<sup>107</sup>

However, the analogy has weaknesses because the judges themselves would decline to make the very business decisions that the provisional director is being appointed to make to break the corporate deadlock. The provisional director renders business decisions for the parties in a way that courts would not, due to their adherence to the principle of non-involvement in internal corporate affairs. Nonetheless, the nature of the provisional director's position seems to carry with it a connection to the court that suggests some type of

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105. If, for example, the basis for the intra-corporate deadlock concerns disagreements over business issues, such as whether to expand the business, or pursue a new product line, or undertake a new round of financing, courts are not the appropriate forum to make such judgments for the parties. Courts traditionally have been reluctant to wade into matters of business judgment, and this in part has led to the development of judicial deference to managerial business decisions under the business judgment rule. See BRANSON, *supra* note 27, § 7.05, at 339 (noting that "courts are ill-equipped to exhume and reexamine business decisions"); see also DENNIS J. BLOCK ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* 12–18 (5th ed. 1998) (discussing underlying rationales for judicial deference to directors' business decisions).

106. Provisional director statutes in some states do have such reporting requirements. See, e.g., FLA. STAT. ANN. § 607.1435(2) (West 2001) (requiring provisional director to "report from time to time to the court concerning the matter complained of, or the status of the deadlock, if any, and of the status of the corporation's business").

107. See MOSTEN, *supra* note 70, at 109–14 (discussing court-annexed mediation); Lisa Bernstein, *Understanding the Limits of Court-Connected ADR: A Critique of Federal Court-Annexed Arbitration Programs*, 141 U. PA. L. REV. 2169, 2177–86 (1993) (discussing features of court-annexed arbitration); see also *supra* Parts II.B.2, II.B.3 (discussing aspects of arbitration and mediation).

"officer of the court" relationship.<sup>108</sup> If the provisional director's presence signifies the court's continuing jurisdiction over the dispute, the involvement of the court may be more extensive than policy principles would normally allow. Viewed in this manner, the provisional director remedy unavoidably involves significant tension between competing policy interests. On the one hand, it is desirable to provide courts with broad authority to fashion any type of appropriate remedy to meet the specific needs of the parties. On the other hand, principles of judicial restraint dictate that courts avoid extensive involvement in the supervision of business affairs. Before any accommodation of these competing concerns can be attempted, consideration must also be given to the overarching public and private interests at stake.

### C. Public Interest vs. Private Ordering

Concerns about the autonomy interests of shareholders and the extent of court involvement in corporate affairs reflect a deeper tension between competing views of the corporation itself. Corporate conduct can be viewed as the product of private ordering or as the subject of broader public interests.<sup>109</sup> Determining the appropriate scope of judicial remedies for corporate deadlock depends on which perspective is taken. If corporate activity is defined in purely private terms, then any dissension within the corporation should be seen

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108. The concept suggests a "formal and continuing special relationship with access and responsibilities to authority not possessed by, or due by, others." James A. Cohen, *Lawyer Role, Agency Law, and the Characterization "Officer of the Court"*, 48 BUFF. L. REV. 349, 359 (2000). Under this view, an officer of the court acts in a "quasi-judicial" or "quasi-official" capacity. *Id.* (quoting Eugene R. Gaetke, *Lawyers as Officers of the Court*, 42 VAND. L. REV. 39, 48 (1989)). Indeed, some courts have specifically found that provisional directors do possess such status. *E.g.*, *Abreu v. Unica Indus. Sales, Inc.*, 586 N.E.2d 661, 667 (Ill. App. Ct. 1991).

109. See David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 201-02 (recognizing "public/private distinction" that "explicitly and implicitly structur[es] thought about the nature of corporate activity"). Under the public model, "corporate activity has broad social and political ramifications" that raise certain public interest concerns. *Id.* at 201. In contrast, the focus of the private model is on the "private relations between the shareholders of the corporation and management" and "deal[s] primarily with the governance problems that arise inside the corporation." *Id.* at 201-02. The public-private distinction is part of a much larger, ongoing debate over the fundamental nature and purpose of corporations. See Lawrence E. Mitchell, *Private Law, Public Interest?: The ALI Principles of Corporate Governance*, 61 GEO. WASH. L. REV. 871, 872, 877-80 (1993) (discussing contrasting public and private views of nature of corporation and of corporate law). The debate over the public-private distinction permeates a wide range of legal issues and is subject to varying degrees of analysis. See generally *Symposium on the Public/Private Distinction*, 130 U. PA. L. REV. 1289 (1982). A comprehensive discussion or resolution of the public-private debate in corporate law is beyond the scope of this Article. The distinction is raised here only to inform the discussion of important policies underlying the provisional director remedy.

as merely a private spat between the parties. Courts should avoid substantial or ongoing intervention and instead allow the market to order the parties' conduct.<sup>110</sup> If a broader public interest perspective is taken, severe deadlock harms not only the owner of the corporation, but also all constituents who have a stake in the corporation's success, including its employees, creditors, suppliers, customers, and the surrounding community.<sup>111</sup> Under this view, courts arguably have greater justification for quick intervention to minimize the detrimental effects of deadlock, even if that intervention involves the deployment of the court's own officer to take a seat on the board and break the deadlock.

At times, corporate law has espoused a public-oriented view of corporate activity, as corporations were often perceived to be created for the public benefit.<sup>112</sup> Today, the law allows for a more private-oriented conception of the corporation as a nexus of contractual arrangements between parties. Shareholders are given wide discretion to make their own agreements, bargain for appropriate provisions in articles of incorporation, and generally protect their investments through private ordering mechanisms.<sup>113</sup> In the context of intra-

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110. The "ideology of 'privatization'" has deep roots in political and economic "laissez faire" theory. See Joan Williams, *The Development of the Public/Private Distinction in American Law*, 64 TEX. L. REV. 225, 225 & n.5 (1985) (discussing "laissez faire" theorists' antagonism toward government interference with private sphere of economic activity).

111. This view of corporate activity values the harmonious relations of corporate participants because it contributes to higher productivity and ultimately to the public good. Leffler, *supra* note 38, at 262. The concern for the public interest has prevented some courts from exercising their discretion to dissolve corporations for fear of injuring the public. See, e.g., *Struckhoff v. Echo Ridge Farm, Inc.*, 833 S.W.2d 463, 466 (Mo. Ct. App. 1992) (holding that, before ordering dissolution, courts "should consider the effect the dissolution would have on the public as well as the shareholders"); see also Bahls, *supra* note 45, at 296-97 (noting that courts that have been unwilling to dissolve corporations due to potential public harm presumably worry about harm to "displaced employees, suppliers, and frequently, customers").

112. See Morton J. Horwitz, *The History of the Public/Private Distinction*, 130 U. PA. L. REV. 1423, 1425 (1982) (noting that regulatory public law premises had dominated law of corporations prior to 1819); see also JAMES W. HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES: 1780-1970*, at 17-21 (1970) (discussing special charters granted to early corporations serving public utility function); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 292-96 (1998) (discussing relationship between early business corporations and public interest).

113. Robert B. Thompson, *The Law's Limits on Contracts in a Corporation*, 15 J. CORP. L. 377, 378 (1990). The view that individuals should be given the freedom to strike their own bargains and to structure their lives according to their own preferences is, in part, rooted in a contractarian view of society. David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1382 (1993). It was recognized decades ago that close corporation shareholders, in particular, need to have the freedom to enter into shareholder agreements to protect their investments. Therefore, legislatures moved to enact more enabling laws for close corporation participants to allow them to "make appropriate



corporate discord, respect for private ordering and for the autonomy rights of shareholders suggests that courts should defer to remedies that shareholders themselves have chosen *ex ante*.<sup>114</sup> Moreover, courts should have no jurisdiction to intervene unless the shareholders have first exhausted any non-judicial remedies that exist in shareholder agreements.

Standing alone, this purely private, non-interventionist orientation is somewhat extreme. It must be tempered with the recognition that law and courts do play an important role in corporate governance. The law should supplement private ordering, especially in the context of close corporations, when it is difficult for shareholders to bargain *ex ante* for the appropriate protections in agreements and articles.<sup>115</sup> The role of the court is essential in providing remedies that keep people from resorting to extreme self-help measures to resolve their disputes. The public court provides a forum for individuals to be assured that their claims will be heard and that their expectations of justice will be fulfilled.<sup>116</sup> To some extent, judicial intervention in

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arrangements to resolve . . . problems for themselves." J.A.C. Hetherington, *Special Characteristics, Problems, and Needs of the Close Corporation*, 1969 U. ILL. L.F. 1, 5.

114. Private ordering may provide for any number of dispute resolution mechanisms. For example, the parties may enter into an agreement to arbitrate any future intra-corporate disputes, Thompson, *supra* note 113, at 384, 399, or to specify a particular person to cast the deciding vote in case of future deadlock, *e.g.*, *Belfer v. Merling*, 730 A.2d 434, 438 (N.J. Super. Ct. App. Div. 1999), or to fashion their own private provisional director remedy by creating a special class of stock with the power to elect a tie-breaking director, *e.g.*, *Lehrman v. Cohen*, 222 A.2d 800, 807-08 (Del. 1966).

115. See Thompson, *supra* note 113, at 402 (arguing that, due to characteristics of close corporations, private ordering should not necessarily always be starting point for resolving legal issues). Close corporation shareholders do not and cannot always take advantage of private ordering because "some aspects of the relationship do not lend themselves to advance planning." *Id.* at 394. Preparing adequately for contingencies that are distant in time is very difficult, especially if the contingency relates to the possible failure of the enterprise. *Id.* at 395. The start of the business venture is marked by optimism, and parties may consciously or subconsciously avoid contemplation of potential failure or irreconcilable disagreement. See Thompson, *supra* note 1, at 224 ("Parties entering into a business relationship are not always willing to fully explore the ramifications of possible disputes if things were to go wrong. A prolonged focus on the 'downside' may seem inconsistent with the mutual trust on which the business must depend."); see also Zenichi Shishido, *The Fair Value of Minority Stock in Closely Held Corporations*, 62 FORDHAM L. REV. 65, 92-94 (1993) (discussing reasons why close corporation shareholders either fail to make contracts or make incomplete contracts to protect their interests).

116. Richard C. Reuben, *Constitutional Gravity: A Unitary Theory of Alternative Dispute Resolution and Public Civil Justice*, 47 UCLA L. Rev. 949, 985-86 (2000). Individuals have a "broadly held expectation that legal disputes will be resolved in public courts of law." *Id.* at 985 (discussing Lawrence Friedman's conception of "general expectation of justice" (citing Lawrence M. Friedman, TOTAL JUSTICE 76 (1985))). The court's role is central because it assures individuals that their "claims of injustice will be heard, considered, and judged on their

shareholder disputes is inevitable to resolve controversies because such involvement is necessary for upholding greater flexibility in private ordering.<sup>117</sup> The judicial role is an important supplement to private ordering when advance private ordering is inadequate.<sup>118</sup> As a fundamental policy concern, costs are associated with judicial involvement in corporate governance, and courts surely should avoid unduly interfering with private business. Nonetheless, if the parties have come to court seeking relief, particularly in the form of the provisional director remedy, they have at least implicitly made the choice to forego other private dispute resolution mechanisms, such as private arbitrators or mediators, and have looked to the court to appoint its own officer to help.

These principles highlight the public and private features of the provisional director position itself. In some ways, the provisional director appears to be simply a private, neutral third party whose only obligations are to the parties who seek the provisional director's assistance. From a functional standpoint, the provisional director acts much like a private arbitrator or mediator who is contracted to help resolve the disputes of private parties. The parties themselves pay for the provisional director's fees through corporate funds.<sup>119</sup> Viewed in this light, the provisional director remedy may be classified with other private alternative dispute resolution methods.

However, the court's involvement in appointing the provisional director, administering the remedy, supervising the provisional director's activity, and

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merits." Albert W. Alschuler, *Mediation with a Mugger: The Shortage of Adjudicative Services and the Need for a Two-Tier Trial System in Civil Cases*, 99 HARV. L. REV. 1808, 1810 (1986). "In the end, some rights are sensed as rights, not merely as economically efficient arrangements." *Id.* at 1816.

117. See Christopher A. Riley, *Contracting Out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts*, 55 MOD. L. REV. 782, 782-90 (1992) (discussing process and form of inter-shareholder contracting and inevitability of some judicial interference in private contracting). Professor Coffee describes judicial oversight as an essential element of private ordering: "Judicial activism is the necessary complement to contractual freedom. In short, because such long-term relational contracting is necessarily incomplete, the court's role becomes that of preventing one party from exercising powers delegated to it for the mutual benefit of all shareholders for purely self-interested ends." John C. Coffee Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1621 (1989).

118. Thompson, *supra* note 1, at 237. Particularly in the close corporation context, the need for judicial monitoring is a corollary of the need for greater flexibility in contracting. John C. Coffee Jr., *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919, 941 (1988). For long-term contracts, "judicial involvement is not an aberration but an integral part of such contracting." Coffee, *supra* note 117, at 1620.

119. See, e.g., FLA. STAT. ANN. § 607.1435(3) (West 2001) (providing for "reasonable compensation to the provisional director for services rendered . . . which amounts shall be paid by the corporation").

finally ordering the dismissal of the provisional director, infuses this seemingly private dispute resolution process with significant public elements. The court lends its "power, prestige, and imprimatur to the results" of the process.<sup>120</sup> The provisional director therefore combines public and private functions. It is, in a sense, private resolution through public oversight. As will be discussed below, this blending of roles has important implications for the impartiality and expertise of the person who is chosen to be the provisional director. In addition, the amalgam of public and private interests is deeply significant when issues of duty, liability, and immunity are concerned.

An appropriate construction of the provisional director remedy must accommodate the fundamental policy principles involved. Statutes must balance the autonomy rights of shareholders with the important public role of courts in upholding and supplementing private ordering. When possible, shareholder autonomy interests should be primary; courts and their agents should keep their involvement to a minimum insofar as fairness and justice require.<sup>121</sup> How to strike the proper balance between the competing public and private policy principles is not easy. As the following Part indicates, state provisional director statutes for the most part have been unable to find that appropriate equilibrium and therefore have had a tendency to lean too far to one side or another.

#### *IV. Critical Analysis of State Provisional Director Statutes*

State provisional director statutes vary considerably in their approach. The differences in treatment are rooted in contrasting views of the nature of the remedy. The divergence is also a reflection of the underlying tension between competing fundamental policy principles. Because several states have statutes modeled after the Model Statutory Close Corporation Supplement to the Model Business Corporation Act (MBCA-CC) provision, the analysis of existing provisional director legislation will begin with an overview of the MBCA-CC approach.

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120. Reuben, *supra* note 116, at 1017 (referring to state's active participation in court-related and contractual alternative dispute resolution processes). Strictly private forms of dispute resolution do not carry the same "governmental imprimatur." Geoffrey C. Hazard Jr., & Paul D. Scott, *The Public Nature of Private Adjudication*, 6 YALE L. & POL'Y REV. 42, 57 (1988). Professor Reuben argues that the significant, central, and indispensable role of government in developing and administering certain modes of private alternative dispute resolution absorbs these modes into the broader public justice system. Reuben, *supra* note 116, at 989-1017; Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CAL. L. REV. 577, 590 (1997). In analyzing private dispute resolution mechanisms, a sense in which the fulfillment of private interests can ultimately serve the public interest exists. Kanowitz, *supra* note 63, at 241, 255-57.

121. *Giuricich v. Emtrol Corp.*, 449 A.2d 232, 240 (Del. 1982).

*A. Model Business Corporation Act*

The MBCA-CC and state statutes that are patterned after it apply only to corporations that affirmatively elect statutory close corporation status.<sup>122</sup> Because only a small percentage of corporations formally make this type of election,<sup>123</sup> the statute's reach is limited. The MBCA-CC authorizes courts to appoint provisional directors in situations involving corporate deadlock.<sup>124</sup> More specifically, under Section 41(a)(7), the court may order "the appointment of a provisional director (who has all the rights, powers, and duties of a duly elected director) to serve for the term and under the conditions prescribed by the court."<sup>125</sup> The statute does not provide specific guidelines for the implementation of the provisional director remedy other than to state that the court can set the term and conditions of the appointment. The absence of detailed standards is purposeful; the objective is to prevent undue restriction on courts' discretion in applying remedies.<sup>126</sup> The statute therefore gives courts extensive authority to define the scope of the provisional director remedy as broadly as they desire, arguably upholding a more public-oriented view of the remedy. The MBCA-CC provision has been adopted in various states without significant revision, including Georgia, Missouri, Montana, South Carolina, Wisconsin, and Wyoming.<sup>127</sup>

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122. See MBCA-CC, *supra* note 16, § 3(a) ("A statutory close corporation is a corporation whose articles of incorporation contain a statement that the corporation is a statutory close corporation.").

123. See 1 O'NEAL & THOMPSON, *supra* note 11, § 1.19 (noting that probably 5% or less of corporations eligible for statutory close corporation status elect such status in states with such statutes).

124. Deadlock is only one of three grounds that can trigger relief under the statute. More specifically, statutory relief is available in any of the following situations: (1) the directors or those controlling the corporation are acting illegally, oppressively, fraudulently, or with unfair prejudice to the petitioner; (2) the directors are deadlocked, resulting in irreparable injury to the corporation or the inability to conduct the business to the advantage of the shareholders generally; or (3) grounds for judicial dissolution exist under the general dissolution statute. MBCA-CC, *supra* note 16, § 40. MBCA section 14.30 provides for judicial dissolution upon the first two grounds as well as upon the misapplication of assets and shareholder deadlock that prevents the election of directors for two years. MBCA, *supra* note 52, § 14.30. Thus, the provisional director remedy in the MBCA-CC is tied to the dissolution provisions in a way that is intended to avoid dissolution if possible.

125. MBCA-CC, *supra* note 16, § 41(a)(7). The appointment of a provisional director is only one of several forms of ordinary relief under the MBCA-CC. Other forms of relief include the appointment or removal from office of any director or officer, the appointment of a custodian, the payment of dividends, or the award of damages to any party. *Id.* § 41(a).

126. *Id.* § 41, Official Cmt.

127. See GA. CODE ANN. § 14-2-941(a)(7) (1994) (adopting provision verbatim); MO. ANN. STAT. § 351.855(7) (West 2001) (same); MONT. CODE ANN. § 35-9-502(1)(g) (1999)

Other states have fashioned their own unique provisional director statutes that set forth the parameters of the remedy in greater detail. The following subpart analyzes the different approaches taken by these state statutes with respect to each aspect of the provisional director remedy. The analysis and conclusions drawn from the following discussion will serve as the basis for the proposed model provisional director statute set forth in Part V.

## *B. Parameters of the Provisional Director Remedy in State Legislation*

### *1. Role of the Provisional Director*

#### *a. Rights and Powers*

Statutes vary in defining the precise scope of the provisional director's powers. Several states endow the provisional director with all the same "rights, powers, and duties of a duly elected director."<sup>128</sup> On its face, the grant of power seems quite broad because the provisional director possesses rights identical to those of all other directors. The statute treats provisional directors as if parties had elected them directly. However, this broad language is immediately limited by the caveat that the provisional director "serve[s] for the term and under the conditions prescribed by the court."<sup>129</sup> Thus, the court retains the authority to circumscribe specifically the role that the provisional director is to play in each case.

Other states are much more explicit about the court's authority to define the scope of the provisional director remedy. Illinois, for example, conspicuously omits the reference to the same rights and powers of duly elected directors and instead allows provisional directors to serve only "for the term and under the conditions prescribed by the court."<sup>130</sup> However, many states do not

(same); S.C. CODE ANN. § 33-18-410(a)(7) (Law. Co-op. 1990) (adopting substantially similar provision); WIS. STAT. ANN. § 180.1833(2)(a)(7) (West 2002) (adopting provision verbatim); WYO. STAT. ANN. § 17-17-141(a)(vii) (Michie 2001) (same).

128. GA. CODE ANN. § 14-2-941(a)(7) (1994); MO. ANN. STAT. § 351.855(7) (West 2001); MONT. CODE ANN. § 35-9-502(1)(g) (2001); WIS. STAT. ANN. § 180.1833(2)(a)(7) (West 2002); WYO. STAT. ANN. § 17-17-141(a)(vii) (Michie 2001); *see also* S.C. CODE ANN. § 33-18-410(a)(7) (Law. Co-op. 1990) (granting provisional director "rights, powers, and duties of an elected director").

129. GA. CODE ANN. § 14-2-941(a)(7) (1994); MO. ANN. STAT. § 351.855(7) (West 2001); MONT. CODE ANN. § 35-9-502(1)(g) (2001); S.C. CODE ANN. § 33-18-410(a)(7) (Law. Co-op. 1990); WIS. STAT. ANN. § 180.1833(2)(a)(7) (West 1992); WYO. STAT. ANN. § 17-17-141(a)(vii) (Michie 2001).

130. 805 ILL. COMP. STAT. ANN. 5/12.56(b)(7) (West Supp. 2002). The Maine statute is even more specific. It provides for an "additional director" to be appointed to act "in those matters the court directs, and to hold office as a director for any period the court orders, but not longer than 2 years." ME. REV. STAT. ANN. tit. 13-C, § 1434(2)(E) (West 2002).

include a reference to the court's powers to define the provisional director's role. Rather, the statutes provide that the provisional director has "all the rights and powers of a duly elected director," including the right to notice of and to vote at meetings of directors until the provisional director is removed.<sup>131</sup>

Statutes that equate the rights and powers of provisional directors with those of duly elected directors seem to misconceive the purpose of the provisional director remedy. The ultimate role of the provisional director is a limited one: to cast tie-breaking votes to end deadlocks between conflicting factions.<sup>132</sup> The court appoints the provisional director as an extension of the court to act in some capacity as a mediator for the warring parties, but ultimately as a final arbitrator or decisionmaker on issues that cannot be resolved by the parties themselves. To assert that provisional directors have all the same rights and powers as full-fledged board members is improper because provisional directors cannot themselves initiate actions or bind the company in the same way that elected directors can.

For example, suppose that the reason for a deadlock is that two equally divided shareholders who are acting as directors wish to expand the company's operations into new product lines. One shareholder prefers product line *A* while the other prefers product line *B*. If, in the provisional director's judgment, product line *C* would actually be the most advantageous option for the company, the provisional director might make that suggestion in the board meeting to facilitate a compromise among the factions. However, the provisional director should not have the same right as a true director to reject the proposals of the two shareholders and thus halt altogether any expansion by refusing to create a majority decision. Like arbitrators, provisional directors "are not original formulators of policy."<sup>133</sup> The role of the provisional director

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131. ALA. CODE § 10-2A-310(c) (1999); DEL. CODE ANN. tit. 8, § 353(c) (Supp. 1998); D.C. CODE ANN. § 29-101.167(c) (2002); FLA. STAT. ANN. § 607.1435(1) (West 2001); KAN. STAT. ANN. § 17-7213(c) (West 1995); MO. ANN. STAT. § 351.323(2) (West Supp. 2002); NEV. REV. STAT. ANN. 78A.150(3)(c) (Michie 1999); N.J. STAT. ANN. § 14A:12-7(3) (West Supp. 2002); 15 PA. CONS. STAT. ANN. § 2334(d) (West 1995); TEX. BUS. CORP. ACT ANN. art. 12.53(B)(2) (Vernon Supp. 2001). Alaska, California, and Ohio provide simply that the provisional director possesses the same rights and powers as a director. ALASKA STAT. § 10.06.640(b) (Michie 2000); CAL. CORP. CODE § 308(c) (West Supp. 2002); OHIO REV. CODE ANN. § 1701.911(B) (West 1994).

132. *In re Annrhon, Inc.*, 21 Cal. Rptr. 2d 599, 604 (Cal. Ct. App. 1993); *Latt v. Superior Court*, 212 Cal. Rptr. 380, 384 (Cal. Ct. App. 1985); *cf. Bosworth v. Ehrenreich*, 823 F. Supp. 1175, 1182 (D.N.J. 1993) (ordering that provisional director be allowed to cast *two* votes to break ties when provisional director was added to three-member board).

133. O'Neal, *supra* note 48, at 792. Provisional directors are similar to arbitrators in that they "do not make decisions *ab initio* or on their own motion." *Id.*; *see also* Thompson, *supra* note 1, at 229 (noting that provisional directors cannot act on their own and can only combine with other directors to create majority vote that is needed for corporate action). Interestingly,

should be to vote with one side to break the deadlock even if, had the provisional director been an ordinary director of the company, the provisional director would have voted to veto the ideas of the other two shareholders based on an honest belief as to what would be most advantageous for the company.

Therefore, the rights and powers of a provisional director are limited to making tie-breaking decisions in the provisional director's discretion. Unlike custodians, provisional directors are not empowered to make unilateral decisions to maintain the operations of the business. This is not to say that provisional directors vote only on minor matters. The fact that their role involves voting with one side to break ties does not mean that the tie-breaking vote cannot concern matters of enormous significance. The provisional director's decisions may quite properly effect major structural changes within the company.<sup>134</sup>

Statutes granting provisional directors the same rights and powers as duly elected directors are problematic because they imply that provisional directors, like ordinary directors, are entitled to vote on any and all board matters. However, the parties may wish to specify which issues in particular require the provisional director's vote. All other matters may remain within the domain of the parties and need not be considered by the provisional director at all.

A pair of contrasting cases illustrates this issue. The cases involved the scope of the provisional director's authority to vote on certain matters. In *In re Annrhon*,<sup>135</sup> a court appointed a provisional director for a corporation whose shareholders were divided into two equal factions. The shareholders, as

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two states, California and New Jersey, allow for the appointment of more than one provisional director. See CAL. CORP. CODE § 308(b) (West Supp. 2002) (providing for appointment of "a provisional director or directors"); N.J. STAT. ANN. § 14A:12-7(3) (West Supp. 2002) (providing for "one or more provisional directors"). The statutes do not clarify whether two or more different provisional directors may serve simultaneously or whether the authorization is for consecutive appointments.

134. For example, in *In re Jamison Steel Corp.*, 322 P.2d 246 (Cal. Dist. Ct. App. 1958), the provisional director had the authority to vote for an amendment to the company's articles of incorporation. *Id.* at 253; see also *In re Calvert*, 135 B.R. 398 (Bankr. S.D. Cal. 1991) (appointing provisional director for corporation whose two 50% shareholders had disagreements as directors of company). The effects of the provisional director's actions in *Calvert* were dramatic: at a special board meeting, the provisional director voted with one shareholder to issue additional shares of stock to that shareholder in satisfaction of a debt owed to the shareholder by the corporation. *Id.* at 399. The net effect of the equity-for-debt exchange was to increase that shareholder's percentage of ownership of the company, thereby making him a majority shareholder. *Id.* The shareholder then petitioned "for removal of the provisional director on the ground that a provisional director was no longer necessary since [he] was now the majority shareholder and the basis of the stalemate no longer existed." *Id.* The provisional director's vote therefore effected a complete change in the ownership structure of the company.

135. *Annrhon*, 21 Cal. Rptr. 2d at 599.

directors, were deadlocked on several issues, including whether to expand the business or, in the alternative, to sell it.<sup>136</sup> Although one faction wanted the court to specify the deadlocked issues on which the provisional director could vote, the court held that the provisional director had the powers of a director to vote on all matters, making it unnecessary for the court to "list[] the issues upon which the provisional director could vote."<sup>137</sup> In contrast, the court in *Abreu v. Unica Industrial Sales*<sup>138</sup> found that the provisional director, as an officer of the court, served "at the discretion and direction of the court" and could be instructed by the court to vote only upon certain matters.<sup>139</sup> The differing results in *Annrhon* and *Abreu* reflect the tension between different visions of the provisional director remedy and the underlying policy interests. Is the provisional director an officer of the court or a part of the corporation's leadership team like other directors? Are the provisional director's primary obligations to the court or to the shareholders and the corporation's best interests?

The answer seems to lie somewhere in between: provisional directors combine both public and private functions, and therefore a balancing of interests is required. If the parties had submitted their dispute to a private mediator-arbitrator, that person would have been authorized to decide only those issues that the parties chose to submit to the mediation-arbitration process. The provisional director acts in a similar capacity, but is also a public court appointee. The court must reserve some power to define the scope of the provisional director's role in each case. However, the provisional director needs sufficient freedom to exercise discretion similar to that of an ordinary director in making decisions that are in the best interests of the company. To accommodate all of these dynamics, the best approach is to start with the assumption that provisional directors have the authority to vote on all deadlocked matters, unless parties specifically ask the court to restrict the issues on which the provisional director may vote. At the time of the appointment, the court can instruct the provisional director to vote on a specific set of matters and authorize the provisional director to vote on other issues as they arise if the parties desire. This approach would avoid undue interference with private business

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136. *Id.* at 605.

137. *Id.* at 606. A separate issue in *Annrhon* was whether a shareholder's agreement shifted the powers of the board to the shareholders such that "a provisional director cannot vote on any of the disputed issues because they are matters completely within the power and control of the shareholders." *Id.* The court found that "the shareholder's agreement did not entirely divest the board of all powers" over the company, and therefore the provisional director had the power to vote on disputed issues involving the ultimate direction of the company. *Id.* at 607.

138. *Abreu v. Unica Indus. Sales*, 586 N.E.2d 661 (Ill. App. Ct. 1991).

139. *Id.* at 667.



and uphold the autonomy rights of the parties while preserving the public functions of the provisional director remedy.

Because statutes that define provisional directors' rights and powers as identical to those of "duly elected directors" are misleading, a better approach would be to clarify that provisional directors have the rights and powers to vote as directors on all issues, unless otherwise requested by the parties and prescribed by the court.<sup>140</sup> These clarifications would reflect the fact that, as court appointees, provisional directors are not quite the same as ordinary directors and should not be treated the same way.

### *b. Duties*

Similar concerns arise when examining the duties and responsibilities of the provisional director. Statutes that follow the MBCA-CC approach provide that a provisional director carries the same "duties of a duly elected director."<sup>141</sup> Many other states, while granting provisional directors the same "rights and powers" as ordinary directors, lack any reference to similar duties.<sup>142</sup> Two states, Florida and New Jersey, add that provisional directors have the duty to report periodically to the court on the status of the deadlock and the corporation's business.<sup>143</sup> Provisional directors in these states also submit recommendations to the court, when so directed, as to the appropriate disposition of the action.<sup>144</sup>

Statutes that say provisional directors have the same "duties of a duly elected director" leave unanswered the question whether provisional directors in fact have the same *fiduciary* duties to the corporation and its shareholders that ordinary directors have. A fundamental tenet of corporate law is that

140. See *infra* Part V.A (proposing model statute).

141. GA. CODE ANN. § 14-2-941(a)(7) (1994); MO. ANN. STAT. § 351.855(7) (West 2001); MONT. CODE ANN. § 35-9-502(1)(g) (2001); WIS. STAT. ANN. § 180.1833(2)(a)(7) (West 1992); WYO. STAT. ANN. § 17-17-141(a)(vii) (Michie 2001); MBCA-CC, *supra* note 16, § 41(a)(7).

142. ALA. CODE § 10-2A-310(c) (1999); DEL. CODE ANN. tit. 8, § 353(c) (Supp. 1998); D.C. CODE ANN. § 29-101.167(c) (2002); FLA. STAT. ANN. § 607.1435(1) (West 2001); KAN. STAT. ANN. § 17-7213(c) (West 1975); MO. ANN. STAT. § 351.323(2) (West Supp. 2001); NEV. REV. STAT. ANN. 78A.150(3)(c) (Michie 1999); N.J. STAT. ANN. § 14A:12-7(3) (West Supp. 2002); 15 PA. CONS. STAT. ANN. § 2334(d) (West 1995); TEX. BUS. CORP. ACT ANN. art. 12.53(B)(2) (Vernon Supp. 2001). Alaska, California, and Ohio provide simply that the provisional director possesses the same rights and powers as a director. ALASKA STAT. § 10.06.640(b) (Michie 2000); CAL. CORP. CODE § 308(c) (West Supp. 2001); OHIO REV. CODE ANN. § 1701.911(B) (West 1994).

143. FLA. STAT. ANN. § 607.1435(2) (West 2001); N.J. STAT. ANN. § 14A:12-7(6) (West Supp. 2002).

144. FLA. STAT. ANN. § 607.1435(2) (West 2001); N.J. STAT. ANN. § 14A:12-7(6) (West Supp. 2002).

directors are subject to fiduciary duties of care and loyalty in exercising their powers on behalf of the corporation.<sup>145</sup> These duties require that a director act in good faith and in a manner the director reasonably believes to be in the best interests of the corporation.<sup>146</sup> In close corporations, where shareholders usually act as directors and managers of the corporation, courts are particularly prone to impose heightened fiduciary duties of the utmost good faith and fair dealing.<sup>147</sup> Any breach of these fiduciary duties can result in the offending director's personal liability for the harms caused by the breach.<sup>148</sup> Whether provisional directors can or should be subject to the same directorial fiduciary duties as ordinary directors presents a difficult question.

On the one hand, if provisional directors are to be treated for all intents and purposes as duly elected directors, they should not only be granted the same rights and powers, but also be subject to the same duties and responsibilities. The possibility always exists that provisional directors, like ordinary directors, may abuse their decisionmaking powers and their position of authority in a manner that harms the corporation. For example, provisional directors might engage in various forms of self-dealing, including the appropriation of certain corporate opportunities or the failure to disclose conflicts of interest when the board votes to approve a proposed transaction. In order to discourage such conduct, provisional directors arguably should be held to the same fiduciary standards of good faith and fair dealing as ordinary directors.<sup>149</sup>

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145. See COX ET AL., *supra* note 23, at 179–217 (discussing directors' fiduciary duties); 1 WILLIAM E. KNEPPER & DANA BAILEY, *LIABILITY OF CORPORATE OFFICERS AND DIRECTORS*, §§ 1-7, 3-1–4-24 (6th ed. 1998 & Supp. 2001) (noting directors' role as fiduciaries and explaining their duties of loyalty and diligence).

146. See, e.g., MBCA, *supra* note 52, § 8.30 (stating standards of conduct for corporate directors).

147. See, e.g., *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 661 (Mass. 1976) (noting that close corporation stockholders, like partners in partnership, owe one another duty of good faith and loyalty); *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 515 (Mass. 1975) (holding that stockholders in close corporation owe each other substantially same fiduciary duties of good faith and loyalty that partners owe one another).

148. See 1 KNEPPER & BAILEY, *supra* note 145, §§ 3-16, 3-17, at 111–13 (discussing liability of directors and officers for damages resulting from their own misconduct); see also PAT K. CHEW, *DIRECTORS' AND OFFICERS' LIABILITY* 213–18 (1995) (discussing unique duties and liabilities of close corporation directors).

149. See Rosenbaum, *supra* note 93, at 543 (discussing reasons for holding provisional director to fiduciary duties of ordinary director). A recent case in the receivership context held that corporate receivers are subject to fiduciary duties of loyalty to the corporation and, like directors and officers, are liable for acquiring corporate opportunities in violation of that duty. *Cnty. Nat'l Bank v. Med. Benefit Adm'rs., LLC*, 626 N.W.2d 340, 344 (Wis. Ct. App. 2001). The court found that receivers are fiduciaries to all parties with an interest in the receivership estate. *Id.* at 343–44; see also *Shannon v. Superior Court*, 217 Cal. App. 3d 986, 993 (Cal. Ct. App. 1990) (noting that receivers, as fiduciaries, are not immune from liability for failing to

Provisional directors can always avail themselves of the same mechanisms that ordinary directors use to protect themselves from liability for fiduciary breaches. In particular, if the corporation's articles include indemnification provisions for the directors, or provisions eliminating or limiting personal liability of directors for breaches of their duties, then these protections might be construed to apply to provisional directors as well.<sup>150</sup> Indeed, at least one court has found that, in the custodial context, a custodian appointed to continue the business of a corporation is not personally liable for negligent loss of corporate assets because the custodian enjoys the same protection from liability as any other director or officer.<sup>151</sup> Although custodians assume greater corporate control than provisional directors, sufficient analogies might be drawn to argue that provisional directors, like custodians, "step into the shoes of the . . . directors of the corporation" for purposes of personal liability.<sup>152</sup>

On the other hand, if provisional directors are charged with the same fiduciary duties as duly elected directors, these duties may create disincentives for individuals to serve as provisional directors. In the context of making tie-

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carry out their duties properly); 16 FLETCHER, *supra* note 6, § 7811 (discussing fiduciary capacity of receivers). Of course, the appointment of a receiver who takes control over the corporation is a much more drastic step than appointing a provisional director and, therefore, courts may more easily justify imposing fiduciary duties on receivers.

150. Statutes in all states now have provisions permitting or requiring indemnification of corporate directors and officers for their expenses in defending against claims that allege breaches of their duties. 2 KNEPPER & BAILEY, *supra* note 145, § 22-2 (noting that statutory indemnification legislation has been enacted in all fifty states). The objective of such statutes is to encourage qualified individuals to serve as directors and officers by providing them with sufficient financial protection in case they are sued for their conduct. See *VonFeldt v. Stifel Fin. Corp.*, 714 A.2d 79, 84 (Del. 1998) (describing indemnification statute as serving dual purpose of "allowing corporate officials to resist unjustified lawsuits" and "encouraging capable [professionals] to serve as corporate directors and officers" by requiring corporation to bear "costs of defending their honesty and integrity"). Many states also have legislation authorizing corporations to include charter provisions that eliminate or limit the personal liability of directors for monetary damages for breaches of their duties. See 2 KNEPPER & BAILEY, *supra* note 145, app. B (listing state statutes that limit director liability).

151. *Valley View State Bank v. Owen*, 737 P.2d 35, 39-40 (Kan. 1987). In *Owen*, a prior court had appointed a custodian due to irreconcilable conflicts between two equal shareholders of a corporation. *Id.* at 37. The narrow holding of the *Owen* court addressed the issue of the standing of creditors, rather than shareholders, to sue custodians for negligence. *Id.* at 39. The court held that the custodian assumes the management function ordinarily performed by the officers and directors, but the court did not specifically state that custodians would owe the same fiduciary duties that directors and officers owe to the corporation and its shareholders. *Id.* at 40. See generally Thomas G. Fischer, Annotation, *Liability of Corporate Custodian for Negligence in Dealing with Affairs or Assets of Corporation*, 74 A.L.R. 4th 770 (1989) (discussing cases in which courts have analyzed whether personal liability can be imposed upon corporate custodians for failure to manage corporation properly).

152. *Owen*, 737 P.2d at 40.

breaking decisions, one winner and one loser will always be found, and the losing party may want to blame the provisional director. More specifically, the risk always exists that losing parties will bring suits against provisional directors alleging breaches of fiduciary duties in making decisions that favor the other side. Individuals who are contemplating service as provisional directors may be unwilling to accept the appointment even with strong indemnification protections because the benefits are simply not worth the risk of becoming entangled in litigation.<sup>153</sup> After all, individuals who agree to serve as provisional directors are simply temporary additions to the board and are not expecting that their limited role as mediating, tie-breaking decisionmakers will suddenly transform them into fiduciaries of a company. In the close corporation context, unlike the other shareholder-directors of the company who likely have invested considerable time, energy, and money into the business and who regard each other as partners, the provisional director has no similar relationship with the company or with its participants. To hold the provisional director to the same fiduciary duty of utmost good faith and loyalty seems incongruous with the purposes of the remedy and the nature of fiduciary law.

One way of viewing fiduciary relationships is to conceive of them as a form of "entrusting" wherein one party entrusts itself to another to act on its behalf and in its best interests.<sup>154</sup> As the beneficiary of the relationship, the entrustor is dependent on the fiduciary who acts as a type of substitute for the entrustor and has the power to affect the entrustor's property or welfare.<sup>155</sup> Fiduciaries are entrusted with power to perform their functions. This power

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153. Harold D. Field Jr., *Resolving Shareholder Disputes and Breaking Deadlocks in the Close Corporation*, 58 MINN. L. REV. 985, 1006 (1974); Haynsworth, *supra* note 51, at 27.

154. Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 800 & n.17 (1983). The doctrine of fiduciary duty is extraordinarily complex, and an extended discussion of its parameters is beyond the scope of this Article. The brief description of the "entrusting" element in fiduciary relationships is intended to provide only some context for analyzing the question of whether fiduciary duties should be imposed on provisional directors. For a more extensive overview of fiduciary law, see 2A AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, *THE LAW OF TRUSTS* §§ 170-85 (4th ed. 1987); J.C. SHEPHERD, *THE LAW OF FIDUCIARIES* (1981); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879.

155. DeMott, *supra* note 154, at 912; Frankel, *supra* note 154, at 808; see also Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 U. PA. L. REV. 1675, 1682-88 (1990) (discussing fiduciary relationship as one of power and dependency). The relationship is "founded upon trust or confidence reposed by one person in the integrity and fidelity of another." *Alpert v. Shafer*, No. 89 Civ. 0839, 1991 WL 222130, at \*6 (S.D.N.Y. Oct. 24, 1991); see also *Williams v. Griffin*, 192 N.W.2d 283, 285 (Mich. Ct. App. 1971) ("Such a relationship exists when there is a reposing of faith, confidence, and trust, and the placing of reliance by one upon the judgment and advice of another."). Professor Chaykin refers to this aspect of fiduciary duty as the "principle of justifiable trust." Arthur A. Chaykin, *Mediator Liability: A New Role for Fiduciary Duties?*, 53 U. CIN. L. REV. 731, 744 (1984).

carries with it the risk that the fiduciaries will misuse their power and injure the entrustor.<sup>156</sup> Strict standards of care and loyalty are thus placed on fiduciaries to ensure that they will act to benefit, rather than harm, the beneficiaries of the relationship.<sup>157</sup>

Applying these concepts to the provisional director context proves to be an uneasy fit. Although provisional directors are vested with the power to make tie-breaking decisions for disputing corporate parties, they do not act as substitutes for the parties or for the benefit of the parties in the typical fiduciary way. In assuming a mediating or arbitrating function on behalf of the parties, the provisional director does not acquire the same type of trust or power that would normally give rise to a fiduciary relationship. If, for example, the parties had simply submitted their dispute to private arbitration, they would entrust the final outcome to the arbitrator's judgment, but that entrustment would not then transform the arbitrator into a fiduciary. The arbitrator would surely have a duty to be fair, impartial, and free of conflicts or bias, and any decision made in violation of that duty would be subject to attack.<sup>158</sup> However, the arbitration process by itself would not impose on the arbitrator fiduciary duties to the parties. The same would be true if the parties chose to litigate their case in court. To say that they entrust themselves and their resources to the judge to make a decision on their behalf is not the same as saying that the judge then owes them or the corporation fiduciary duties.<sup>159</sup> If provisional directors' functions are comparable to mediators or arbitrators, or if provisional directors serve as substitutes for the judge as officers of the court, then the imposition of fiduciary obligations would be inappropriate. The fact that the provisional director acts similarly to a director in voting at board meetings does not necessarily mean that the provisional director should be subject to the same fiduciary duties as duly elected directors.

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156. Frankel, *supra* note 154, at 809.

157. The fiduciary obligation therefore places significant burdens on the fiduciary. "The fiduciary's duties go beyond mere fairness and honesty; they oblige him to act to further the beneficiary's best interests . . . [and] avoid acts that put his interests in conflict with the beneficiary's." DeMott, *supra* note 154, at 882; *see also* Johnson, *supra* note 22, at 3-4 (noting that relationship between director and corporation is directly analogous to that between trustee and beneficiary and that, accordingly, director may not acquire interests in conflict with beneficiary).

158. *See* 9 U.S.C. § 10(a) (2000) (providing for vacatur of arbitration awards resulting from corruption, fraud, undue means, misconduct, or evident partiality on part of arbitrator).

159. Judges do exert significant power over the rights and interests of parties. "Adjudication . . . differs from ordinary decisionmaking in entrusting a choice to a person who is not affected by it, a person who has special obligations to those whose interests are at stake." Alschuler, *supra* note 116, at 1844. These "special obligations" may include duties of "fairness, respect, and courtesy," but they most likely would not be defined as fiduciary duties to the parties. *Id.*

Conclusions drawn from any analysis of the duties and liabilities of provisional directors will depend on whether the remedy is viewed in private or public terms. The former perspective suggests that provisional directors and parties may simply contract for how much liability or responsibility the provisional director will undertake. The provisional director can bargain for indemnification or insurance that will provide protection for breaches of any duties that are assumed at the outset of the appointment.<sup>160</sup> If the provisional director instead is seen in more public terms as an officer of the court, intimately tied to the public court as an extension of, or substitute for, the judge responsible for the appointment, then arguably the provisional director should enjoy the same immunities from liability that are afforded judges in their decisionmaking capacity. When provisional directors provide periodic reports and recommendations to the court as to the status and disposition of the matter, they perform functions that seem acutely judicial in nature. If the rights and powers of provisional directors are not as extensive as those of duly elected directors, then provisional directors' duties and liabilities correspondingly should not be as far-reaching. As will be discussed later, the model provisional director statute proposed in this Article adopts this approach.<sup>161</sup>

Very few states include any reference in their provisional director legislation to the scope of provisional directors' liabilities for their decisions.<sup>162</sup> Those statutes that do refer to provisional directors' duties equate them with those of duly elected directors, a problematic approach, as the foregoing discussion suggests. A better solution would be to include specific reference to the duties of provisional directors to vote to break ties in the best interests of the corporation. Moreover, the ideal statute would include a clear indication as to the extent of liability that provisional directors can expect to have for their actions. The current variance in the statutory treatment of provisional direc-

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160. In one case involving a custodian for a deadlocked corporation, one of the parties in fact suggested providing the custodian with contractual protections from liability for the business decisions he would make in breaking the deadlocks. See *Marciano v. Nakash*, 1986 WL 4002, at \*1 (Del. Ch. Apr. 2, 1986). The court approved a procedure that would serve as an alternative to liability insurance. After each deadlock-breaking vote by the custodian, a ten-day period would follow during which the losing party could appeal the custodian's decision in court. *Id.* at \*2. If no appeal were made within that time frame, the parties would be barred from bringing any suit against the custodian arising from the vote. *Id.* The court noted that, without such protective procedures, few if any custodians would be willing to serve. *Id.* at \*3.

161. See *infra* Part V.A (proposing model statute).

162. Florida appears to be the only state that specifically defines the extent of provisional directors' liability for their actions. It provides: "No provisional director shall be liable for any action taken or decision made, except as directors may be liable under § 607.0831." FLA. STAT. ANN. § 607.1435(2) (West 2001). Section 607.0831 exempts ordinary directors from liability for monetary damages for their actions as directors. *Id.* § 607.0831. Thus, the Florida statute equates provisional directors' liabilities with those of ordinary directors.

tors' duties and the lack of clear guidelines in any of the statutes impair the ability of courts and their appointees to know exactly what duties and liabilities attach in any one case.

## 2. Impartiality and Qualifications of the Provisional Director

The effectiveness of the provisional director remedy depends in large part on the impartiality and neutrality of the provisional director. One would expect that statutes in all states would set forth a clear impartiality requirement for any person who is appointed to serve as a provisional director. However, states vary considerably in their standards for impartiality. Some states require the provisional director to be an impartial person, who is neither a shareholder nor a creditor of the corporation, nor related even "within the third-degree" to any of the other directors of the corporation or to the judge making the appointment.<sup>163</sup> In contrast, states that follow the MBCA-CC approach do not mention impartiality requirements at all.<sup>164</sup>

Statutes that fail to provide explicitly for the impartiality of provisional directors are fundamentally deficient. Without clear statutory standards of impartiality, courts might appoint provisional directors who have affiliations with shareholders of the company, thereby defeating the goal of having a tie-breaking decisionmaker who is completely neutral. *Abreu v. Unica Industrial Sales* provides a good example.<sup>165</sup> Plaintiff and defendant shareholders were divided into two hostile factions.<sup>166</sup> The trial court appointed a provisional director for the corporation, but because the Illinois statute did not explicitly require that the provisional director be an impartial person, the court appointed the plaintiff shareholder's son-in-law as the provisional director.<sup>167</sup> He had worked for the company for several years and held the title of General

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163. ALASKA STAT. § 10.06.640(b) (Michie 2000); CAL. CORP. CODE § 308(c) (West Supp. 2002); MO. ANN. STAT. § 351.323(2) (West Supp. 2001). The prohibition on appointments of provisional directors who are related in the third-degree by blood or marriage to any other director of the corporation or to the appointing judge is a high standard of impartiality that mirrors the standard found in the Model Code of Judicial Conduct. See MODEL CODE OF JUDICIAL CONDUCT Canon 3E(1)(d) (2000). Third-degree relations include "great-grandparent, grandparent, parent, uncle, aunt, brother, sister, child, grandchild, great-grandchild, nephew or niece." MODEL CODE OF JUDICIAL CONDUCT TERMINOLOGY (2000).

164. GA. CODE ANN. § 14-2-941(a)(7) (1994); MO. ANN. STAT. § 351.855(7) (West 2001); MONT. CODE ANN. § 35-9-502 (1999); S.C. CODE ANN. § 33-18-410(a)(7) (Law. Co-op. 1990); WIS. STAT. ANN. § 180.1833(2)(a)(7) (West 1992); WYO. STAT. ANN. § 17-17-141(a)(vii) (Michie 2001); MBCA-CC, *supra* note 16, § 41(a)(7).

165. *Abreu v. Unica Indus. Sales*, 586 N.E.2d 661, 661 (Ill. App. Ct. 1991).

166. *Id.* at 664.

167. *Id.* at 665.

Manager of Operations.<sup>168</sup> After his appointment, he made a number of decisions that seemed to favor the plaintiff, his mother-in-law.<sup>169</sup> The appellate court subsequently reversed some of his decisions, finding them to be inconsistent with the duties of a provisional director.<sup>170</sup> The court nonetheless upheld his appointment as the provisional director in spite of the defendant's assertion of bias.<sup>171</sup> Observing that the provisional director statute lacked any reference to impartiality, the court concluded that the statute gave the court the discretion to appoint persons who lacked traditional impartiality if the circumstances necessitated such an action. In particular, if the court determined that no independent third party had the skills and knowledge necessary to fill the position on an immediate basis, then the court could appoint a provisional director without regard to whether "that person ha[d] been aligned or appear[ed] to have been aligned with a particular group of shareholders."<sup>172</sup> Because the plaintiff's son-in-law was already familiar with the business and the dissension between the parties, the court felt it could properly appoint him to the provisional director position.<sup>173</sup>

The problem with this reasoning is that it will likely result in the appointment of a partial person in most cases. Third-party strangers to the corporation will almost always lack the intimate knowledge of the corporation and its participants possessed by insiders. If a current employee or family member

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168. *Id.* at 664-66.

169. For example, the provisional director voted in favor of reimbursing the plaintiff for attorneys' fees and costs at trial and on appeal, even though the defendant's director asked that the vote be postponed until he could consider the issue further. *Id.* at 666. The provisional director allegedly acted in ways that were unfair to the defendant faction; the defendant contended that the provisional director failed to provide the defendant's director with an agenda for a meeting until the start of the meeting. *Id.* at 667.

170. The court invalidated the board's vote to reimburse the plaintiff for attorneys' fees and costs, finding that the provisional director and the plaintiff improperly voted without giving the defendant director the opportunity to review the issue thoroughly before making a decision. *Id.* at 667-68.

171. The defendant argued that the provisional director was "merely a parrot or hand-maiden of plaintiff, voting with plaintiff on matters simply because he is her son-in-law." *Id.* at 665-66. The defendant claimed that "there was no such thing as an impartial son-in-law." *Id.* at 665.

172. *Id.* Resisting the imposition of a strict requirement of impartiality, the court observed that it would be difficult in this "crisis situation" to "find and appoint a traditionally impartial independent third party, and allow that person time to familiarize himself with the history and goals of the company." *Id.* In such situations, it might be preferable and in the best interests of the corporation simply to appoint "competent people who may not be traditionally impartial," but who are available to serve. *Id.*

173. *Id.* The court found that impartiality was only one of many factors it could consider in evaluating candidates for the provisional director position. *Id.*



who has such familiarity with the business is available, the tendency will always be to select that person to serve as the provisional director, rather than a completely independent outside third party. The court's disregard for whether the person may have been aligned with one of the warring factions in the corporation ignores the mission of the provisional director remedy to provide a neutral mediator-arbitrator in cases of corporate deadlock. Although the insider may have special and detailed knowledge of the company, the insider need not be given provisional director status to make use of such knowledge. A provisional director who is an outside third party can always invite insiders to attend board meetings and voice their opinions before the provisional director casts a vote on any issue.<sup>174</sup> The result in *Abreu* seems to neglect this point and therefore underscores the need to include clear impartiality requirements in provisional director statutes.

The impartiality of the decisionmaker is an essential feature of the provisional director remedy because it supports the parties' confidence in the outcome and their perception of having been treated fairly.<sup>175</sup> The closeness of certain family or business relationships tends to suggest partiality.<sup>176</sup> If the provisional director is seen as an officer of the court or a delegate of judicial power, the provisional director should have the same level of impartiality as the judge.<sup>177</sup> If the provisional director is compared to a private mediator or

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174. Professor Langevoort makes a similar point in the context of composing a corporate board balanced with both inside and outside directors. See Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 90 GEO. L.J. 797, 800, 806 (2001) (noting that insider participation in board deliberations may be allowed on regular and invited basis).

175. See Silver, *supra* note 68, at 49 ("Impartiality ensures that a [third party's] actions will be based upon the merits of the dispute rather than the personal influence or identity of the disputants."). In the alternative dispute resolution context, surveys have indicated that people are concerned about the personal biases of arbitrators and mediators. See Richard C. Reuben, *The Lawyer Turns Peacemaker*, A.B.A. J., Aug. 1996, at 54, 58 (noting that 70% of respondents expressed that concern).

176. In these relationships, the closeness of the tie may be demonstrative of partiality even if the court does not consider allegations or proof of actual bias. See, e.g., *Morelite Constr. Corp. v. New York City Dist. Council Carpenters Benefit Funds*, 748 F.2d 79, 84 (2d Cir. 1984) (finding that father-son relationship between arbitrator and officer of union, to which party to arbitration belonged, rose to level of "evident partiality" to justify vacating arbitration award); see also Martha Minow, *Stripped Down Like a Runner or Enriched by Experience: Bias and Impartiality of Judges and Jurors*, 33 WM. & MARY L. REV. 1201, 1203 (1992) (noting appearance of bias toward family members, friends, or business associates).

177. Statutes and ethics codes mandate strict judicial impartiality and it is an essential constitutional value. Jeffrey M. Shaman, *The Impartial Judge: Detachment or Passion?*, 45 DEPAUL L. REV. 605, 605 (1996). Judges must be disqualified from proceedings in which the judge's impartiality might reasonably be questioned. See 28 U.S.C. § 455(a) (2000) (discussing disqualification of judges); Leslie W. Abramson, *Appearance of Impropriety: Deciding When*

arbitrator, impartiality and neutrality are integral features of the dispute resolution process, especially in situations in which the issues are likely to be highly emotionally charged.<sup>178</sup> A neutral third party who is unaffiliated with either of the contending factions is best able to make objective judgments.

Provisional director statutes should therefore incorporate explicit impartiality standards. To avoid the adverse effects of partiality, the provisional director should be someone who, at the very least, is not a shareholder or creditor of the company, or any subsidiary of the company, and who has no close personal, business, or financial relationship with any contending faction within the corporation.<sup>179</sup> This standard of impartiality is broader than that contained in statutes prohibiting relations "within the third-degree" to a director or to the judge making the appointment. The broader standard reaches relations that may not fall within the third-degree but are nonetheless sufficiently close to suggest bias.

The qualifications of the person selected to serve as the provisional director are also important. A provisional director who has business experience or familiarity with the industry may be better able to understand the issues involved in the dispute. The parties are more likely to respect the decisions of provisional directors who have a certain level of expertise and authority. In light of their business knowledge and background, provisional directors therefore may be better suited than the judges who appoint them to

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*a Judge's Impartiality "Might Reasonably Be Questioned"*, 14 GEO. J. LEG. ETHICS 55, 92-95 (2000) (same); see also JEFFREY M. SHAMAN ET AL., JUDICIAL CONDUCT AND ETHICS §§ 4.01-4.26 (2d ed. 1995) (discussing judicial disqualification and conflicts of interests). For a historical overview of the judicial impartiality principle, see John T. Noonan Jr., *Judicial Impartiality and the Judiciary Act of 1789*, 14 NOVA L. REV. 123 (1989). One could argue that the level of impartiality required of judges should extend to all court appointees who serve as officers, or extensions, of the court. Thus, in the receivership context, the Supreme Court has held that "there should be no 'friendly' receiverships, because the receiver is an officer of the court and should be as free from 'friendliness' to a party as should the court itself." *Harkin v. Brundage*, 276 U.S. 36, 55 (1928); see also *Dinsmore v. Barker*, 212 P. 1109, 1110 (Utah 1923) (invalidating appointment of receiver who had very small stock interest in corporation because he could be considered "person interested in the action").

178. See *Poly Software Int'l, Inc. v. Su*, 880 F. Supp. 1487, 1494 (D. Utah 1995) (noting that success of mediation depends largely upon mediator neutrality); Reuben, *supra* note 116, at 1091 (noting that impartiality is indispensable quality in mediators and arbitrators). Impartiality is particularly important in dispute resolution efforts involving family members and business dissolutions in which emotions can run high. See COULSON, *supra* note 71, at 25-26 (discussing emotional stresses that block communication in family mediations); Freund, *supra* note 71, at 484 (referring to mediation of business dissolutions as "often highly emotional [situations], sometimes containing a degree of bitterness akin to that in a failed marriage").

179. Maine incorporates the final component of this proposed standard in its statute providing for the appointment of an "additional director" in lieu of dissolution. ME. REV. STAT. ANN. tit. 13-C, § 1434(2)(E) (2002).

produce informed and reasoned resolutions of corporate disputes.<sup>180</sup> In some cases, a person may need certain specialized credentials to serve as a provisional director of a particular type of corporation.<sup>181</sup> Ideally, the appointed person would also possess strong mediation or negotiation skills to guide the parties toward an acceptable resolution. Although there arguably may be some trade-offs between impartiality and expertise, it is entirely feasible for courts to appoint provisional directors who are both impartial and sufficiently knowledgeable of business affairs.<sup>182</sup>

Most state statutes fail to include any reference to the qualifications of provisional directors. Some statutes provide that the court itself may simply determine the qualifications, if any, that are needed for the appointment.<sup>183</sup> Ohio appears to be the only state that affirmatively requires provisional directors to be persons who are "generally conversant with corporate

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180. Judges themselves may not have the "technical or business expertise" or the time to develop such knowledge to "understand, factually, the particular subject matter underlying the dispute before them." George W. Coombe, Jr., *Anatomy of a Business Dispute: Successful ADR Analysis by the Office of General Counsel*, ARB. J., Sept. 1990, at 3, 11.

181. *E.g.*, *Marik v. Superior Court*, 236 Cal. Rptr. 751 (Cal. Ct. App. 1987). In *Marik*, a provisional director who was a retired judge was appointed to a medical corporation that was owned and managed equally by two shareholders who were both licensed doctors and who were deadlocked on several business issues. *Id.* at 752. The state professions code required all shareholders, directors, and officers of medical corporations to be licensed doctors. *Id.* at 753. The court found that because provisional directors must have the same rights and powers as other directors to perform their functions effectively, they must also be subject to the same requirements and restrictions as other directors. *Id.* at 754. Therefore, the court held that it was improper to appoint a provisional director who was not a doctor. *Id.*

182. Judge Richard Posner has discussed the exchange between impartiality and expertise in the context of voluntary arbitration. *Merit Insur. Co. v. Leatherby Insur. Co.*, 714 F.2d 673, 679 (7th Cir. 1983). One could argue that "impartiality is prized above expertise" in the judicial system because "[c]ourts are coercive, not voluntary, agencies." *Id.* The arbitration process, however, is voluntary, and parties choose and prefer expert decisionmaking that may mean a loss of strict impartiality. *Id.* In the provisional director situation, the ultimate choice may depend on contrasting visions of the role of the provisional director. If the provisional director is viewed more as a contributing director, then the preference may be to find someone with the business expertise to make sound management decisions. If the provisional director is perceived as a judicial substitute, however, then someone who is experienced in judicial decisionmaking, such as a retired judge, would be preferred. *Cf.* Field, *supra* note 153, at 999 (presenting alternatives for selection of arbitrators who have either judicial skills or industry expertise). Although these comparisons represent two extremes, parties probably will value both impartiality and expertise, and these two values are not necessarily mutually exclusive.

183. ALA. CODE § 10-2A-310(c) (1999); DEL. CODE ANN. tit. 8, § 353(c) (2000); D.C. CODE ANN. § 29-101.167(c) (2002); FLA. STAT. ANN. § 607.1435(1) (West 2001); KAN. STAT. ANN. § 17-7213(c) (1995); NEV. REV. STAT. 78A.150(3)(a) (2001); 15 PA. CONS. STAT. ANN. § 2334(c) (West 1995); TEX. BUS. CORP. ACT ANN. art. 12.53(B)(1) (Vernon Supp. 2001).

affairs.<sup>184</sup> Although moving in the right direction, this approach may go too far in restricting the pool of individuals who can serve as provisional directors. A better solution is for provisional director statutes to indicate a preference for the appointment of individuals with business experience, but not require these qualifications if the parties agree to accept the appointment of someone who may, for example, have specialized negotiating or mediating skills, rather than expertise in business.<sup>185</sup> Ultimately, the statute should affirmatively indicate that the provisional director be someone who is both qualified and impartial.

### 3. *Grounds and Standing*

Even though statutes differ in defining the type of deadlock that provides grounds for appointing a provisional director, most statutes typically require a showing of either shareholder or director deadlock that impairs or threatens the business of the corporation. For example, some states allow for the appointment of a provisional director if "the directors or those in control of the corporation are deadlocked" and as a result "the corporation is suffering or will suffer irreparable injury" or, alternatively, the corporation's business "can no longer be conducted to the advantage of the shareholders generally because of the deadlock."<sup>186</sup> Other states, such as California and Alaska, provide more specifically that deadlock exists when the corporation has "an even number of directors who are equally divided" and shareholders are so divided that "they cannot elect a board consisting of an uneven number."<sup>187</sup> While some provisional director statutes stand alone,<sup>188</sup> many states indirectly tie their provi-

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184. OHIO REV. CODE ANN. § 1701.911(C) (West 1993).

185. By the same token, parties may be better able than the court to determine what level and type of business expertise they would prefer in the provisional director.

186. GA. CODE ANN. § 14-2-940(a)(2) (1994); MO. ANN. STAT. § 351.850(1)(2) (West 2001); MONT. CODE ANN. § 35-9-501(1)(b) (2001); S.C. CODE ANN. § 33-18-400(a)(2) (Law. Co-op. 1990); WIS. STAT. ANN. § 180.1833(1)(b) (West 2002); WYO. STAT. ANN. § 17-17-140(a)(ii) (Michie 2001); *see also* MBCA-CC, *supra* note 16, § 40(a)(2) (mirroring state statutory language). Other state statutes use similar language to describe the grounds for relief. ALA. CODE § 10-2A-310(a) (1999); DEL. CODE ANN. tit. 8, § 353(a) (2001); D.C. CODE ANN. § 29-101.167(a) (2002); KAN. STAT. ANN. § 17-7213(a) (West 1995); NEV. REV. STAT. 78A.150(1) (2001); 15 PA. CONS. STAT. ANN. § 2334(a) (West 1995); TEX. BUS. CORP. ACT ANN. art. 12.53(A) (Vernon Supp. 2001).

187. ALASKA STAT. § 10.06.628(b)(2) (Michie 2000); CAL. CORP. CODE § 1800(b)(2) (West 1990); *see also* MO. ANN. STAT. § 351.323(1) (West 2001) (using similar language). The definition of deadlock in the Alaska and California codes is found in the involuntary dissolution provision. The codes of these states permit the appointment of provisional directors if the deadlock grounds are met under the involuntary dissolution provisions. ALASKA STAT. § 10.06.640(a) (Michie 2000); CAL. CORP. CODE § 1802 (West 1990).

188. *E.g.*, MO. ANN. STAT. § 351.323 (West 2001); OHIO REV. CODE ANN. § 1701.911 (West 1993); TEX. BUS. CORP. ACT ANN. art. 12.53 (Vernon Supp. 2001).

sional director statutes to custodian provisions<sup>189</sup> or to the state's broader statutory involuntary dissolution scheme.<sup>190</sup> As a result, the grounds for the custodian remedy and for involuntary dissolution also serve as grounds for the provisional director remedy.<sup>191</sup>

Statutory language that limits relief to circumstances involving "irreparable injury" to the corporation focuses too narrowly on the effect of the deadlock on the business, rather than the effect it has on the shareholders and their investment positions.<sup>192</sup> Injury to a shareholder or group of shareholders does not always and necessarily translate into immediate injury to the corporation. Therefore, the addition of the alternative phrase, "the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally because of the deadlock," expands the reach of the deadlock provisions and the remedies available under the statutes.<sup>193</sup> Statutes that define deadlock in terms of a divided board consisting of an "even number of directors" seem too narrowly focused as well. Deadlock can occur in a number of ways, including circumstances in which the number of directors is odd. Supermajority voting rights or veto powers provide opportunities for deadlock just as easily as the existence of even numbers of directors or shareholders. States that restrict the grounds for the provisional director remedy to deadlock on even-numbered boards fail to take these considerations into account.<sup>194</sup> The

189. *E.g.*, ALA. CODE § 10-2A-309(b) (1999); DEL. CODE ANN. tit. 8, § 352(b) (2001); D.C. CODE ANN. § 29-101.166(c) (2002); KAN. STAT. ANN. § 17-7212(b) (West 1995); NEV. REV. STAT. 78A.140(2) (Michie 1999); 15 PA. CONS. STAT. ANN. § 2333(b) (West 1995).

190. *E.g.*, FLA. STAT. ANN. §§ 607.1430, 607.1434-35 (West 2001); 805 ILL. COMP. STAT. ANN. 5/12.55-56 (West Supp. 2001); ME. REV. STAT. ANN. tit. 13-C, §§ 1430, 1434 (West 2002); N.J. STAT. ANN. § 14A:12-7 (West Supp. 2001).

191. Statutes authorizing involuntary dissolution and custodianships provide additional grounds for relief, including the waste or misapplication of corporate assets and the illegal, fraudulent, or oppressive conduct of directors. *E.g.*, GA. CODE ANN. § 14-2-1430(2)(B), (D) (1994); 805 ILL. COMP. STAT. ANN. 5/12.55(a)(2), (3) (West Supp. 2001); ME. REV. STAT. ANN. tit. 13-C, § 1430(2)(B), (E) (West 2002); MO. ANN. STAT. § 351.494(2)(b), (d) (West 2001); WIS. STAT. ANN. § 180.1430(2)(b), (d) (West 2002); MBCA, *supra* note 52, § 14.30(2)(ii), (iv) (1999). This Article does not attempt to review the various grounds for involuntary dissolution or custodianships, but rather focuses more directly on the deadlock ground as it relates to the provisional director remedy alone. For detailed discussions of the grounds for dissolution, see 2 O'NEAL & THOMPSON, *supra* note 11, §§ 9.25-9.28; Haynsworth, *supra* note 51, at 31-40.

192. *See* Haynsworth, *supra* note 51, at 34 (arguing that, for economic and policy reasons, there is little sense in "[d]enying any relief unless the corporation is on the brink of insolvency").

193. *See In re Jamison Steel Corp.*, 322 P.2d 246, 251 (Cal. Dist. Ct. App. 1958) (finding that this language is broad enough to establish grounds for provisional director remedy when corporation is unable to change existing policies due to perpetuation of incumbents in office).

194. In contrast, states such as Illinois recognize that deadlock can occur in varied circumstances and specifically provide for relief when "directors are deadlocked, whether

better approach is to accommodate the realities of the dynamics that produce deadlock and to give parties broader access to the provisional director remedy.

The standing requirements for requesting the provisional director remedy vary dramatically from state to state. In many states, a petition must be filed by at least (1) one-half the directors, (2) one-third of the shareholders who are entitled to elect directors, or (3) two-thirds of the shareholders of any class of stock if more than one class of stock is entitled to elect directors.<sup>195</sup> In one state, at least one-fourth of the directors or one-fifth of the shareholders may file for the appointment of a provisional director, but only if the articles of incorporation "expressly provide for such appointment."<sup>196</sup> In states that tie the provisional director remedy to the custodian statute or involuntary dissolution statute, any complaining shareholder may petition the court for a custodian or dissolution.<sup>197</sup> States that follow the MBCA-CC approach permit any shareholder to file for relief so long as the shareholder has exhausted all nonjudicial remedies contained in the shareholder agreement.<sup>198</sup> In contrast, several states provide for the appointment of a provisional director even if the articles of incorporation, the bylaws, or shareholders' agreements contain contrary provisions.<sup>199</sup>

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because of even division in the number of directors or because of greater than majority voting requirements." 805 ILL. COMP. STAT. ANN. 5/12.56(a)(1) (West Supp. 2002). The legislative comments in the New Jersey statute similarly recognize the potential for deadlock without an even-numbered board. See N.J. STAT. ANN. § 14A:12-7, Commissioner's Comment—1968 (1969) (rejecting "jurisdictional prerequisite that there be an even number of directors" because "[t]here may be as complete a deadlock with an odd number of directors as there is with an even number, and the consequences of a deadlock among an odd number may be as serious as those which result from a deadlock among an even number").

195. ALA. CODE § 10-2A-310(b) (1999); DEL. CODE ANN. tit. 8, § 353(b) (2001); D.C. CODE ANN. § 29-101.167(b) (2002); KAN. STAT. ANN. § 17-7213(b) (West 1995); NEV. REV. STAT. 78A.150(2) (2001); 15 PA. CONS. STAT. ANN. § 2334(b)(1) (West 1995).

196. OHIO REV. CODE ANN. § 1701.911(A) (West 1993).

197. DEL. CODE ANN. tit. 8, § 352 (2001); FLA. STAT. ANN. §§ 607.1430, 607.1434-35 (West 2001); 805 ILL. COMP. STAT. ANN. 5/12.56(a), (b)(6), (b)(7), (b)(12) (West Supp. 2002); N.J. STAT. ANN. § 14A:12-7(1), (2) (West Supp. 2002). Therefore, even if the standing requirements are not met under the state's provisional director statute, the court may nonetheless appoint a provisional director so long as the standing requirements for a custodian or involuntary dissolution are met.

198. GA. CODE ANN. § 14-2-940(c) (1994); MO. ANN. STAT. § 351.850(3) (West 2001); MONT. CODE ANN. § 35-9-501(3) (2001); S.C. CODE ANN. § 33-18-400(c) (Law. Co-op. 1990); WIS. STAT. ANN. § 180.1833(4)(b) (West 2002); WYO. STAT. ANN. § 17-17-140(c) (Michie 2001).

199. ALA. CODE § 10-2A-310(a) (1999); DEL. CODE ANN. tit. 8, § 353(a) (2001); D.C. CODE ANN. § 29-101.167(a) (2002); KAN. STAT. ANN. § 17-7213(a) (West 1995); NEV. REV. STAT. 78A.150(1) (2001); 15 PA. CONS. STAT. ANN. § 2334(a) (West 1995).

The various standing percentage requirements under the provisional director statutes seem to limit artificially the circumstances in which the remedy may be pursued. The fact that the percentage levels differ so widely from jurisdiction to jurisdiction reflects confusion over what levels are appropriate and, more fundamentally, whether such requirements are even necessary. Presumably the rationale for these thresholds is to deter meritless suits brought by shareholders and directors who do not have sufficient voting power to legitimize their claims.<sup>200</sup> However, no evidence exists that the provisional director remedy is more likely to produce frivolous suits than any other remedy for corporate deadlock. Many statutes allow for the appointment of a custodian or the involuntary dissolution of the corporation, which are much more extreme remedies, upon the application of a single shareholder on grounds that are similar to those required for the provisional director remedy.<sup>201</sup> The standing requirements for the provisional director remedy appear arbitrary when viewed in light of the absence of such requirements for other forms of relief.

Provisional director statutes should permit petitions to be brought by any shareholder or director when deadlock occurs. The fact that the petitioner must still meet the threshold of establishing deadlock that threatens to impair the business or renders the directors incapable of effecting action is sufficient to filter out weak claims. To the extent that fears of frivolous suits remain, legislatures may insert an attorneys' fees provision into the statute to discourage such suits. The provision would allow the court, if it finds that a party acted arbitrarily, vexatiously, or in bad faith by bringing the proceeding, to award other parties the reasonable fees and expenses they incurred in the proceeding.<sup>202</sup>

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200. Similar fears have been the basis for the adoption of "security for expense" statutes in shareholder derivative suits. *E.g.*, N.Y. BUS. CORP. LAW § 627 (McKinney 1986). Under these statutes, plaintiffs who hold less than a minimum percentage of shares must post security for the payment of the defendant's expenses if the defendant prevails in the suit. *See* HENN & ALEXANDER, *supra* note 27, § 372 (discussing security for expense statutes).

201. *E.g.*, ALA. CODE §§ 10-2A-309, 10-2B-14.30 (1999); CAL. CORP. CODE § 1800(a)(2), (b) (West 1990); IND. CODE ANN. § 23-1-47-1(2) (Michie 1991); IOWA CODE ANN. § 490.1430(2) (West 1999); N.H. REV. STAT. ANN. § 293-A:14.30(b) (1999); N.C. GEN. STAT. § 55-14-30(2) (1990); OR. REV. STAT. § 60.661(2) (2001); TENN. CODE ANN. § 48-24-301(2) (2002); VA. CODE ANN. § 13.1-747(A)(1) (Michie 1999).

202. As a procedural matter, statutes could require courts to hold hearings before appointing provisional directors and to give notice of the hearings to shareholders and directors. Such notice would be similar to that required in proceedings for the appointment of custodians and receivers. *See* MBCA, *supra* note 52, § 14.32(a) (discussing notice and hearing prior to appointment). Ohio appears to be the only state that currently requires notice of a hearing for the appointment of a provisional director. OHIO REV. CODE ANN. § 1701.911(A) (West 1993).

Tensions between contrasting policy interests exist in those statutes that authorize the appointment of provisional directors "notwithstanding any contrary provision" in the articles, bylaws, or shareholder agreements.<sup>203</sup> If shareholders have bargained for other forms of dispute resolution in these primary documents or if they have expressly agreed *not* to have a provisional director in cases of deadlock, then courts arguably intrude on shareholder autonomy rights when they appoint provisional directors in contravention of these agreements. At the same time, however, judicial oversight and intervention is helpful when private ordering is inadequate to protect shareholder interests. As discussed previously, shareholders cannot always bargain *ex ante* for the appropriate protections in articles and agreements.<sup>204</sup> States with provisional director statutes that permit courts to override contrary provisions in primary incorporation documents have apparently made the policy choice that public intervention is necessary to prevent the adverse effects of deadlock. In contrast, statutes that defer to the wishes of shareholders as expressed in their agreements have chosen to give predominance to shareholder autonomy concerns. Although the problem is not easy to resolve, the appropriate solution lies in upholding the rights of shareholders to strike their own bargains unless and until it is shown that these bargains do not reflect the parties' true intentions. Courts should intervene to alleviate the problems associated with deadlock when shareholders can show either that they have exhausted their own previously bargained-for remedies or that their *ex ante* bargains were clearly inadequate to provide for their current circumstances.<sup>205</sup> Although this approach is not without its costs, it attempts to strike a balance between competing public and private policy interests to provide parties with both freedom and sufficient protection.

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203. ALA. CODE § 10-2A-310(a) (1999); DEL. CODE ANN. tit. 8, § 353(a) (2001); D.C. CODE ANN. § 29-101.167(a) (2002); KAN. STAT. ANN. § 17-7213(a) (West 1995); NEV. REV. STAT. 78A.150(1) (2001); 15 PA. CONS. STAT. ANN. § 2334(a) (West 1995).

204. See *supra* notes 115-18 and accompanying text (discussing inadequacies of private ordering).

205. At the very least, the terms of any shareholder agreement should be upheld only if they were knowingly accepted. Cf. 2 O'NEAL & THOMPSON, *supra* note 36, § 7:24 (suggesting that courts should not allow a shareholders' agreement to override shareholders' statutory rights to seek remedies for majority shareholder misconduct, "unless the agreement contains a specific provision on this point which the shareholders have knowingly accepted"). Courts should consider the fact that the terms of the agreement may have been formed when relations were harmonious and intended to govern circumstances that differ from the current situation. *Id.* The MBCA suggests a similar approach in determining the fair price of shares in buy-out situations. The Official Comment to § 14.34 recommends that courts look to the terms of shareholder agreements to determine the fair value of shares, "unless the court decides it would be unjust or inequitable to do so in light of the facts and circumstances of the particular case." MBCA, *supra* note 52, § 14.34, Official Cmt. ¶ 4(b).



#### 4. Removal and Compensation

Statutes generally provide that provisional directors serve until removed by the court or by a majority of the shareholders entitled to elect directors.<sup>206</sup> A few states also allow the appointment to continue until the deadlock on the board or among shareholders is broken.<sup>207</sup> Some states place specific time limits on the tenure of provisional directors—for example, two or three years.<sup>208</sup> New Jersey is unique in that it prohibits the removal of the provisional director by the shareholders if the court otherwise orders the continuance of the appointment.<sup>209</sup> States that follow the MBCA-CC make no mention at all of the conditions necessary for removing the provisional director.

Whether the power to remove the provisional director should rest in the hands of the parties or in the discretion of the court is a question that again raises competing policy concerns. The easy case is when all parties agree that the deadlock has been broken and that the services of the provisional director are no longer needed. No one would object to the removal of the provisional director at that point. However, more complex problems occur when deadlock persists and the parties disagree on whether the provisional director should continue in office. On the one hand, the shareholders by majority vote should have the right to remove the provisional director if they decide that they do not want to have a third party making decisions for them, even if the deadlock continues to exist. The court should not force upon the parties a remedy that in many respects requires their cooperation in order to produce the most effective and acceptable solution for all concerned. On the other hand, the court must have a certain level of authority and discretion to control the terms and tenure of its own appointee and to prevent bad faith attempts to frustrate the court's authority. This policy concern underlies the New Jersey provision that allows the parties to remove the provisional director "unless otherwise

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206. ALA. CODE § 10-2A-310(c) (1999); CAL. CORP. CODE § 308(c) (West Supp. 2001); DEL. CODE ANN. tit. 8, § 353(c) (2001); D.C. CODE ANN. § 29-101.167(c) (2002); KAN. STAT. ANN. § 17-7213(c) (West 1995); 15 PA. CONS. STAT. ANN. § 2334(d) (West 1995); TEX. BUS. CORP. ACT ANN. art. 12.53(B)(3) (Vernon Supp. 2001).

207. ALASKA STAT. § 10.06.640(b) (Michie 2000); CAL. CORP. CODE § 308(c) (West Supp. 2001); MO. ANN. STAT. § 351.323(2) (West 2001). The Ohio statute requires the court to order the removal of the provisional director when the court finds that "irreconcilable differences no longer exist." OHIO REV. CODE ANN. § 1701.911(B) (West 1993).

208. See MO. ANN. STAT. § 351.323(2) (West Supp. 2001) (limiting term of provisional director to three years if deadlock is not broken). Maine authorizes the appointment of an "additional director" for a period not to exceed two years. ME. REV. STAT. ANN. tit. 13-C, § 1434(2)(E) (2002).

209. N.J. STAT. ANN. § 14A:12-7(3) (West Supp. 2002) (providing for removal "by order of the court or, *unless otherwise ordered by the court*, by a vote . . . of a majority of the votes entitled to be cast by the holders of shares") (emphasis added).

ordered by the court."<sup>210</sup> The statute's legislative history indicates that the legislature "felt it necessary to empower the court to prohibit removal by the shareholders since such power might be exercised by a majority in bad faith to frustrate the power of the court to determine all underlying facts."<sup>211</sup>

Although the court's effective oversight is an important concern, greater shareholder control should be the primary consideration. Shareholders may be deadlocked on certain management issues and yet be in agreement that they no longer wish to have a court-appointed stranger casting tie-breaking votes for them. The shareholders might decide to try to resolve the dispute in an alternative forum. If a majority of the shareholders votes to remove the provisional director, the court should not frustrate their right to choose their own path. More importantly, if the reason that the shareholders wish to dismiss the provisional director is because the relationship between the parties is extremely hostile and the shareholders' orientation toward the provisional director is equally hostile, then the provisional director remedy simply is no longer appropriate. The remedy will most likely be ineffective to solve the severe dissension in the long run anyway, and other more drastic remedies may be needed. The provisional director remedy is designed to be a first step in an attempt to resolve corporate deadlock, and the success of the remedy, much like mediation-arbitration, depends in large part on the voluntary cooperation of the parties. When the parties cannot even find sufficient common ground to continue with the provisional director approach, courts should not compel the parties to engage in a process that they do not accept. Therefore, provisional director statutes should clarify that provisional directors may be removed when the deadlock is broken, when the majority of the shareholders vote to remove, or when the court itself recognizes the futility of the remedy and orders the removal of its appointee.<sup>212</sup> The statutes should not authorize courts to prevent the removal of provisional directors if the shareholders have expressly indicated their preference for removal.

Finally, provisional director statutes should authorize the reasonable compensation of provisional directors for their services. Although some state statutes and the MBCA-CC fail to provide specifically for provisional directors' compensation, there is consensus among other states that an agreement between the provisional director and the corporation should determine compensation, with the approval of the court.<sup>213</sup> The court may fix the compensa-

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210. *Id.*

211. *Id.* Commissioner's Comment—1972 Amendments. Some commentators similarly fear that majority shareholders who can remove the director immediately after the appointment may frustrate the purposes of the provisional director remedy. *E.g.*, Wall, *supra* note 17, at 640.

212. *See infra* Part V.A (proposing model statute).

213. ALA. CODE § 10-2A-310(c) (1999); DEL. CODE ANN. tit. 8, § 353(c) (2001); D.C.

tion in the absence of such an agreement. Provisional directors also deserve reimbursement or the direct payment of any reasonable costs and expenses incurred in the course of the appointment.<sup>214</sup> These amounts should be paid by the corporation.<sup>215</sup>

## V. Proposed Model Provisional Director Statute

### A. Proposed Text and Recommendations

The foregoing critical analysis of the various state provisional director statutes suggests a need for a model statute that balances the important policy principles underlying the remedy. This subpart sets forth a proposed model statute that incorporates the conclusions drawn in the preceding discussion with respect to each aspect of the provisional director remedy. This Article recommends that the model statute be considered for adoption in all states' general corporations codes. The text of the proposed statute is as follows:

#### Model Provisional Director Statute

##### § 000 – Appointment of Provisional Director for Deadlock

(A) Grounds, Standing, and Exhaustion of Nonjudicial Remedies. If the directors or those in control of the corporation are deadlocked in the management of the corporation's affairs, the shareholders are unable to break the deadlock, and the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally or there is danger that the corporation's property and business will be impaired or lost because of the deadlock, the court may appoint a provisional director upon the petition of any complaining shareholder or director. If the petitioner has agreed in writing to pursue a nonjudicial remedy to resolve disputed matters, the petitioner may not commence a proceeding under this section with respect to the matter unless (i) the nonjudicial remedy has been exhausted or (ii) the petitioner estab-

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CODE ANN. § 29-101.167(c) (2002); KAN. STAT. ANN. § 17-7213(c) (West 1995); NEV. REV. STAT. 78A.150(4) (2001); OHIO REV. CODE ANN. § 1701.911(C) (West 1994); 15 PA. CONS. STAT. ANN. § 2334(e) (West 1995); TEX. BUS. CORP. ACT ANN. art. 12.53(B)(4) (Vernon Supp. 2001).

214. FLA. STAT. ANN. § 607.1435(3) (West 2001); 805 ILL. COMP. STAT. ANN. 5/12.56(g) (West Supp. 2002); N.J. STAT. ANN. § 14A:12-7(7) (West Supp. 2002).

215. See *Coles v. Taliaferro*, 840 P.2d 1102, 1106-07 (Kan. 1992) (holding that provisional director's fees must be paid out of corporation's assets).

lishes that the terms of the agreement are patently unfair or inadequate in light of current circumstances.

(B) **Impartiality and Qualifications.** The provisional director shall be an impartial person who is neither a shareholder, creditor, or debtor of the corporation or of any subsidiary or affiliate of the corporation and who has no close personal, business, or financial relationship with the members of any contending faction within the corporation. Persons who have a proven business background or who are conversant with corporate affairs shall be strongly preferred.

(C) **Rights, Powers, and Duties.** The provisional director shall have the right to notice of meetings of directors and the power to vote at such meetings on all matters upon which the parties are deadlocked, unless the parties request and the court prescribes a limited set of matters upon which the provisional director may vote. The duty of the provisional director is to cast votes in the best interest of the corporation with the purpose of breaking the deadlock upon such disputed matters. Upon the request of the court, the provisional director shall report to the court, periodically and in the presence of the parties, concerning the status of the deadlock and the corporation's business and shall submit recommendations to the court as to the appropriate disposition of the matter.

(D) **Removal and Compensation.** The provisional director shall serve until such time as the deadlock is broken or the provisional director is removed by order of the court or by a vote of the holders of a majority of the shares having voting power. The provisional director shall be entitled to reasonable compensation for services rendered, such compensation to be determined by agreement between the provisional director and the corporation with the approval of the court. The court may fix the compensation of the provisional director in the absence of agreement or in the event of disagreement between the corporation and the provisional director. All amounts shall be paid by the corporation. The corporation shall also reimburse or make direct payments to the provisional director for reasonable costs and expenses incurred during the term of the provisional director's appointment.

(E) Immunity. The provisional director shall be immune from civil liability for any acts or omissions within the scope of the performance of the provisional director's powers and duties, so long as the provisional director acted in good faith, without malice, and not for improper personal enrichment.

(F) Attorneys' Fees. If the court finds that the petitioner acted arbitrarily, vexatiously, or in bad faith in initiating a proceeding under this provision, the court may award one or more other parties their reasonable expenses, including attorneys' fees, incurred in the proceeding.

### B. Discussion

Section (A) of the proposed statute sets forth the grounds and the standing requirements for the appointment of a provisional director. The description of deadlock includes the broader grounds that the business of the corporation "can no longer be conducted to the advantage of the shareholders generally."<sup>216</sup> The statute omits any reference to deadlock on a board consisting of an "even number of directors" because, as discussed previously, deadlock can easily occur on boards consisting of odd numbers of directors as well.<sup>217</sup> The statute grants standing to any complaining shareholder or director and eliminates the artificial ownership percentage requirements for standing that are contained in most provisional director statutes.<sup>218</sup> To the extent that the broader standing provision induces fears of frivolous petitions, Section (F) discourages such petitions by allowing the court to award attorneys' fees and costs if it finds that the petitioner has brought the action in bad faith.<sup>219</sup> Finally, Section (A) attempts to strike the appropriate balance between the interests of private ordering and judicial oversight by requiring shareholders first to exhaust any remedies contained in shareholder agreements, unless such agreements are inadequate to provide the relief necessary to protect shareholder interests.<sup>220</sup> Section (A) does not include language permitting the provisional director remedy only if the articles of incorporation expressly provide for it. Nor does it authorize the provisional director remedy "notwithstanding any contrary provisions" contained in the articles or shareholder agreements.<sup>221</sup> The pro-

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216. MBCA-CC, *supra* note 16, § 40(a)(2); *supra* notes 192–93 and accompanying text.

217. *Supra* notes 32–34, 194 and accompanying text.

218. *Supra* notes 195–200 and accompanying text.

219. *Supra* notes 201–02 and accompanying text.

220. *Supra* notes 204–05 and accompanying text.

221. *Supra* note 203 and accompanying text.

posed statute rejects both extremes. Instead, the proposed statute accommodates both public and private interests by allowing the appointment of provisional directors so long as the appropriate grounds exist and the standing requirements are met.

Section (B) requires the complete impartiality of the provisional director and prohibits the appointment of anyone who has a close personal, business, or financial relationship with the members of any contending faction within the corporation. Because this standard is broader than the restriction on relations "within the third-degree" contained in some states' statutes, it ensures a greater level of impartiality.<sup>222</sup> The model statute expresses a preference for the appointment of individuals who have business experience and knowledge because these qualifications are particularly helpful in the resolution of business disputes. However, the statute does not mandate business expertise and credentials if, for example, the parties prefer individuals who possess other skills and qualifications, such as mediation and negotiation expertise.<sup>223</sup> Thus, the statute accommodates the interests and preferences of the parties in appointing a provisional director who is both completely neutral and sufficiently qualified.

Section (C) specifies the rights, powers, and duties of the provisional director. The proposed statute deliberately excludes language suggesting that provisional directors have the same "rights, powers, and duties as duly elected directors."<sup>224</sup> As previously discussed, provisional directors are not identical to ordinary directors, and statutes that equate their rights and obligations are misdirected.<sup>225</sup> The proposed statute also declines to swing to the other extreme of having the court prescribe every right, power, duty, term, and condition of the appointment. Instead, Section (C) specifies the default rule for provisional directors' rights and responsibilities. Provisional directors have directorial rights to notice of meetings and to vote on all deadlocked issues. Parties may opt out of this default rule by having the court, upon the parties' request, limit the issues upon which the provisional director can vote. In addition, the duties of the provisional director are specifically defined in Section (C) to include the duty to cast tie-breaking votes in the best interests of the corporation. Because the statute excludes any reference to the same "duties as duly elected directors," it eliminates the suggestion that provisional directors are subject to the same fiduciary duties as ordinary directors.<sup>226</sup> Finally, the statute requires provisional directors to report periodically to the

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222. *Supra* notes 163–79 and accompanying text.

223. *Supra* notes 180–85 and accompanying text.

224. *Supra* note 128.

225. *Supra* Part IV.B.1.a.

226. *Supra* Part IV.B.1.b.

court as to the status of the matter and make recommendations as needed. Such reporting can be particularly helpful to the court in determining the appropriate disposition of the matter.<sup>227</sup> All reports and recommendations must be submitted to the court in the presence of the parties so that they will have opportunities to respond.

Section (D) covers the removal and compensation of the provisional director. It states that reasonable compensation is to be paid to the provisional director for services rendered. It also provides for the removal of the provisional director once the deadlock is broken, or upon order of the court or majority vote of the shareholders.<sup>228</sup> The proposed statute excludes any arbitrary time limits for the tenure of the provisional director's appointment in order to preserve the flexibility of the court and the parties to utilize the remedy as they deem best.<sup>229</sup> As with the other components of the proposed statute, the removal provision attempts to balance competing public and private interests. The provision allocates control between the shareholders and the court in terminating the remedy when it has either served its purpose or otherwise would be in the best interests of the parties.

Finally, Section (E) grants qualified judicial immunity to provisional directors for the decisions they make within the scope of their appointment. No state statute currently addresses the issue of immunity for the decisions and actions of provisional directors. One court has held that provisional directors are protected by absolute quasi-judicial immunity from civil actions.<sup>230</sup> Whether provisional directors are entitled to immunity is a significant issue that merits consideration. The following subpart completes the discussion of the proposed model statute by analyzing the propriety of extending immunity to provisional directors.

### C. Immunity

Absolute judicial immunity shields judges from civil liability for acts that are judicial in nature and performed within the scope of judges' jurisdiction.<sup>231</sup> The judicial immunity doctrine protects the independence and freedom of

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227. *Supra* notes 143–44 and accompanying text.

228. *Supra* notes 206–12 and accompanying text.

229. *Supra* note 208 and accompanying text.

230. *Latt v. Superior Court*, 212 Cal. Rptr. 380, 382 (Cal. Ct. App. 1985).

231. See Jeffrey M. Shaman, *Judicial Immunity from Civil and Criminal Liability*, 27 SAN DIEGO L. REV. 1, 2 (1990) (describing doctrine of judicial immunity). The judicial immunity doctrine has a long history in our legal system. For discussions of the historical development of judicial immunity, see *Pulliam v. Allen*, 466 U.S. 522, 529–36 (1984); OLOWOFOYEKU, *supra* note 26, at 1–32; J. Randolph Block, *Stump v. Sparkman and the History of Judicial Immunity*, 1980 DUKE L.J. 879, 881–910.

judges to make decisions without fear of lawsuits brought by disgruntled litigants.<sup>232</sup> Judicial immunity exists not only to protect judges, but also to protect litigants and members of society at large, all of whom have an interest in a judiciary that acts independently and impartially, uninfluenced by fear of reprisal and harassment.<sup>233</sup>

Only judicial acts, rather than administrative acts, fall within the protection of judicial immunity. Acts are judicial in nature if they require the exercise of some amount of discretion and are functions normally performed by judges in their judicial capacity.<sup>234</sup> Judicial immunity does not generally cover ministerial and administrative acts, such as the hiring and firing of employees.<sup>235</sup> Because the purpose of the judicial immunity doctrine is to protect the independent decisionmaking function of the judiciary, the doctrine reaches only those acts that require the judgment and discretion typically exercised by judges in the adjudication of controversies.<sup>236</sup> Absolute immu-

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232. See SHAMAN ET AL., *supra* note 177, § 14.01, at 492 ("Today it is generally recognized that the most important purpose of judicial immunity is to protect judicial independence."); see also *Antoine v. Byers & Anderson, Inc.*, 508 U.S. 429, 435 (1993) ("The doctrine of judicial immunity is supported by a long-settled understanding that the independent and partial exercise of judgment vital to the judiciary might be impaired by exposure to potential damages liability."); *Butz v. Economou*, 438 U.S. 478, 508-09 (1978) (discussing need for judicial immunity to protect judges from complaints by losing parties). As the Supreme Court has stated, a judge must "be free to act upon his own convictions, without apprehension of personal consequences to himself. Liability to answer to every one who might feel himself aggrieved by the action of the judge . . . would destroy that independence without which no judiciary can be either respectable or useful." *Bradley v. Fisher*, 80 U.S. (13 Wall) 335, 347 (1871).

233. *Pierson v. Ray*, 386 U.S. 547, 554 (1967); *Block*, *supra* note 231, at 922-23. But see K.G. Jan Pillai, *Rethinking Judicial Immunity for the Twenty-First Century*, 39 HOW. L.J. 95, 105 (1995) (arguing that judicial immunity doctrine "has no constitutional or statutory basis" and is "repugnant to the American ideal of equality under the law").

234. See *Stump v. Sparkman*, 435 U.S. 349, 362-63 (1978) (developing two-part test for analyzing judicial acts based on nature of act itself and expectations of parties in dealing with judges in their judicial capacity).

235. *Forrester v. White*, 484 U.S. 219, 228-30 (1988); see also *Clark v. Campbell*, 514 F. Supp. 1300, 1302 (W.D. Ark. 1981) (finding that decisions of county judge in hiring and firing county employees do not constitute judicial acts because "[i]t is clear that these duties are purely administrative and ministerial in scope"). Commentators agree that the difference between judicial and nonjudicial acts is not always clear. See, e.g., Pillai, *supra* note 233, at 112-13 (noting that "dividing line between non-judicial official act and judicial act" can be blurry, "ending in confusion for those who try to distinguish between them"); Joseph Romagnoli, Note, *What Constitutes a Judicial Act for Purposes of Judicial Immunity?*, 53 FORDHAM L. REV. 1503, 1507-09 (1985) (discussing substantive problems with trying to define judicial acts).

236. See Supreme Court of Va. v. Consumers Union, 446 U.S. 719, 731 (1980) (contrasting judicial acts of court that arise out of controversies that must be adjudicated with legislative acts of court when promulgating disciplinary rules); *Richardson v. Koshiba*, 693 F.2d 911, 914



nity is very broad and covers all judicial acts, even if they were done in bad faith, with malice, or for corrupt reasons.<sup>237</sup> However, judges are not exempt from criminal liability for their criminal acts or misconduct.<sup>238</sup>

Judicial immunity has been extended to other persons who perform "quasi-judicial" functions and who exercise authority and discretion similar to that of judges.<sup>239</sup> Individuals who are integrally related to the judicial process and who serve as extensions of the court are afforded quasi-judicial immunity to ensure the independent performance of their duties.<sup>240</sup> Immunity has been granted to a host of quasi-judicial officers including, among others, administrative law judges, prosecuting attorneys, jurors, law clerks, and probation officers when submitting pre-sentencing reports to judges.<sup>241</sup> In instances in which judges delegate part of their authority to others or appoint individuals to perform services on behalf of the court, "judicial immunity may

(9th Cir. 1982) (noting that "adjudication of controversies between adversaries" is judicial function giving rise to "recognition of absolute immunity for judicial officers"); Calvin T. Wilson, *Judicial Immunity—To Be or Not to Be*, 25 HOW. L.J. 809, 814–15 (1982) (noting that judicial acts are those that involve exercise of discretion or judgment).

237. OLOWOFOYEKU, *supra* note 26, at 33; Shaman, *supra* note 231, at 2.

238. See *Braatelen v. United States*, 147 F.2d 888, 895 (8th Cir. 1945) ("Judicial title does not render its holder immune to crime even when committed behind the shield of judicial office."); SHAMAN ET AL., *supra* note 177, § 14.11, at 508 (explaining that judicial immunity does not exempt judges from criminal liability). Moreover, judges do not possess immunity for actions that violate ethical codes of judicial conduct. See *id.* § 14.01, at 494 (stating that immunity does not ordinarily apply to disciplinary actions against judges for violations of professional and ethical standards).

239. Shaman, *supra* note 231, at 6. One working definition of "quasi-judicial function" describes it as a "function or act which involves the exercise of independent judgment and discretion in arriving at a decision which affects individual interests and is based upon a consideration of facts and/or law, where the deciding body or individual is not a court or judge in the ordinary sense." OLOWOFOYEKU, *supra* note 26, at 82.

240. See OLOWOFOYEKU, *supra* note 26, at 86–91 (discussing quasi-judicial immunity).

241. See *Butz v. Economou*, 438 U.S. 478, 507 (1978) (granting immunity to administrative law judges); *Imbler v. Pachtman*, 424 U.S. 409, 427 (1976) (granting immunity to prosecutors); *Spaulding v. Nielsen*, 599 F.2d 728, 729 (5th Cir. 1979) (granting immunity to probation officers); *White v. Hegehorst*, 418 F.2d 894, 896 (9th Cir. 1969) (granting immunity to jurors); *Oliva v. Heller*, 670 F. Supp. 523, 526 (S.D.N.Y. 1987) (granting immunity to law clerks), *aff'd*, 839 F.2d 37 (2d Cir. 1988); see also *Mullis v. United States Bankr. Court*, 828 F.2d 1385, 1390 (9th Cir. 1987) (granting immunity to bankruptcy trustees); *Wiggins v. N.M. Supreme Court Clerk*, 664 F.2d 812, 815 (10th Cir. 1981) (granting immunity to court clerks); *Simons v. Bellinger*, 643 F.2d 774, 778 (D.C. Cir. 1980) (granting immunity to state bar examining committees when investigating an attorney's practice); *Silver v. Dickson*, 403 F.2d 642, 643 (9th Cir. 1968) (granting immunity to parole board members); *Schinner v. Strathmann*, 711 F. Supp. 1143, 1144 (D.D.C. 1989) (granting immunity to psychiatrist assisting court in determining person's mental competence to stand trial).

follow the delegation or appointment.<sup>242</sup> Thus, court-appointed mediators have been granted quasi-judicial immunity when performing their dispute resolution functions.<sup>243</sup> In one case involving the extension of immunity to a psychologist performing mediation services in a family custody proceeding, the court found that the mediator's function in attempting to resolve the dispute was similar to that of a judge.<sup>244</sup> The court reasoned that quasi-judicial immunity should apply to neutral third parties who perform "dispute resolution services which are connected to the judicial process and involve either (1) the making of binding decisions, (2) the making of findings or recommendations to the court, or (3) the arbitration, mediation, conciliation, evaluation or other similar resolution of pending disputes."<sup>245</sup> Although mediators do not make binding decisions, their role has been viewed as functionally comparable to that of judges insofar as judges actively manage cases to assist the parties in reaching a settlement.<sup>246</sup> This functional compara-

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242. SHAMAN ET AL., *supra* note 177, § 14.02, at 496.

243. *E.g.*, *Wagshal v. Foster*, 28 F.3d 1249, 1254 (D.C. Cir. 1994); *Mills v. Killebrew*, 765 F.2d 69, 72 (6th Cir. 1985); *In re Sargeant Farms, Inc.*, 224 B.R. 842, 848 (Bankr. M.D. Fla. 1998).

244. *See* *Howard v. Drapkin*, 271 Cal. Rptr. 893, 902 (Cal. Ct. App. 1990) (stating that job of "mediators, conciliators, and evaluators involves impartiality and neutrality, as does that of a judge, commissioner or referee; hence there should be entitlement to the same immunity given others who function as neutrals in an attempt to resolve disputes").

245. *Id.* at 903.

246. *See* J. Sue Richardson, *Mediation: The Florida Legislature Grants Judicial Immunity to Court-Appointed Mediators*, 17 FLA. ST. U. L. REV. 623, 632 (1990) (stating that mediator's role is similar to judge's role in helping parties to reach settlement); *see also* Cassandra E. Joseph, *The Scope of Mediator Immunity: When Mediators Can Invoke Absolute Immunity*, 12 OHIO ST. J. ON DISP. RESOL. 629, 662 (1997) (remarking that, from functional standpoint, role of mediators is similar to judge presiding at settlement conference). Many judges view themselves as mediators to the extent that they actively attempt to move the parties toward settlement. *See* *Silver*, *supra* note 68, at 72 (noting former judge's comment emphasizing similarity between mediators and judges). Judges in some courts receive mediation training and are encouraged to "actively and firmly (but not coercively) seek to settle every case on [their] docket." *Alschuler*, *supra* note 116, at 1829-30. In one mediator immunity case, the court found that the identification of factual and legal issues and the coordination of settlement efforts are tasks involving substantial discretion and are assumed not only by judges but by case evaluators and mediators as well. *Wagshal*, 28 F.3d at 1252. According to the *Wagshal* court, "the general process of encouraging settlement is a natural, almost inevitable, concomitant of adjudication." *Id.* Not all commentators agree with the result in *Wagshal*. Some have argued that the court's reasoning was flawed because the rationale for judicial immunity is to preserve the independence of judges' decisionmaking functions, not their settlement-inducing functions. *See* Caroline Turner English, *Mediator Immunity: Stretching the Doctrine of Absolute Quasi-Judicial Immunity: Wagshal v. Foster*, 63 GEO. WASH. L. REV. 759, 777 (1995) ("Encouraging settlement has never been considered as a basis for judicial immunity.").

bility has formed the basis for extending quasi-judicial immunity to those who perform mediation services.<sup>247</sup>

Immunity also has been granted to arbitrators for actions and decisions made in the scope of their arbitral functions.<sup>248</sup> By making findings and rendering decisions in an adversarial format, arbitrators function much like judges.<sup>249</sup> Arbitrators evaluate arguments of parties, listen to witness testimony, and exercise discretion in the same way that judges do. In order to preserve the independence of arbitrators' judgment, arbitral immunity is viewed as "essential to protect the [arbitrator] from undue influence and protect the decisionmaking process from reprisals by dissatisfied litigants."<sup>250</sup> Therefore, courts have widely held that arbitrators as quasi-judicial officers are entitled to immunity shielding them from liability for their decisions.<sup>251</sup>

In recognition of the functional comparability of mediators and arbitrators with judges, many states have enacted legislation that grants quasi-judicial immunity to mediators and arbitrators. These statutes extend two different categories of immunity. One set of statutes explicitly provides that mediators and arbitrators are to be treated exactly like judges in terms of the

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247. The extension of immunity to mediators has met with resistance and criticism by those who fear that it improperly denies recourse to litigants injured by incompetent mediation services. See Linda R. Singer, *Immunity Imperils the Public and Mediator Professionalism*, NAT'L L.J., Apr. 11, 1994, at C12 (arguing that granting immunity to mediators could damage parties with legitimate claims and impede mediator professionalism). Critics argue that the extension of judicial immunity to mediators is inappropriate because mediators do not make binding decisions and do not need freedom from liability similar to that possessed by adjudicators. Arthur A. Chaykin, *The Liabilities and Immunities of Mediators: A Hostile Environment for Model Legislation*, 2 OHIO ST. J. ON DISP. RESOL. 47, 81-83 (1986); English, *supra* note 246, at 776-83. But see Joseph B. Stulberg, *Mediator Immunity*, 2 OHIO ST. J. ON DISP. RESOL. 85, 85-86 (1986) (discounting theories of mediator liability and arguing in favor of immunity for mediators).

248. See Dennis R. Nolan & Roger I. Abrams, *Arbitral Immunity*, 11 INDUS. REL. L.J. 228, 229 (1989) (discussing doctrine of arbitral immunity).

249. *Id.* at 234. In many respects, "an arbitrator simply is a substitute judge." Chaykin, *supra* note 155, at 734. The fact that the similarities between the functions of arbitrators and judges justify the extension of judicial immunity to arbitrators is widely accepted. See, e.g., *Babylon Milk & Cream Co. v. Horvitz*, 151 N.Y.S.2d 221, 224 (N.Y. Sup. Ct. 1956) (finding that because there was "no reason to distinguish between a judge and an arbitrator in deciding the issue" of immunity, "the same rule of immunity should apply to arbitrators as applies to the judiciary, inasmuch as the same reasons of public policy are applicable").

250. *Corey v. N.Y. Stock Exchange*, 691 F.2d 1205, 1211 (6th Cir. 1982).

251. E.g., *Austern v. Chi. Bd. Options Exch., Inc.*, 898 F.2d 882, 885-86 (2d Cir. 1990); *Wasyf, Inc. v. First Boston Corp.*, 813 F.2d 1579, 1582 (9th Cir. 1987); *Int'l Union v. Greyhound Lines, Inc.*, 701 F.2d 1181, 1185-86 (6th Cir. 1983); *Tamari v. Conrad*, 552 F.2d 778, 780-81 (7th Cir. 1977); *Cahn v. Int'l Ladies' Garment Union*, 311 F.2d 113, 114-15 (3d Cir. 1962); *Hill v. Aro Corp.*, 263 F. Supp. 324, 326 (N.D. Ohio 1967).

scope of their immunity from civil liability. For example, North Carolina's statute states that "[a]rbitrators . . . shall have the same immunity as judges from civil liability for their official conduct."<sup>252</sup>

A second category of statutes places certain caveats on the conferral of immunity to mediators and arbitrators. These "qualified immunity" statutes typically allow mediators and arbitrators to claim immunity from civil liability so long as they act in good faith and without malice in the performance of their duties.<sup>253</sup> Oregon's mediation statute, for instance, exempts mediators from civil liability for any acts or omissions made in the scope of their duties unless "the act or omission was made or done in bad faith, with malicious intent or in a manner exhibiting a willful, wanton disregard of the rights, safety or property of another."<sup>254</sup>

Qualified immunity statutes provide a compromise between absolute judicial immunity on the one hand and exposure to full civil liability on the other. Unlike absolute immunity, qualified immunity does not extend so far as to cover bad faith, malicious, or corrupt actions.<sup>255</sup> Mediators and arbitrators who deliberately and maliciously abuse their positions of power are liable for their misconduct. All other good faith decisions and actions are fully protected by immunity. Thus, the doctrine of qualified immunity serves to balance competing policy interests, including "the need to protect officials

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252. N.C. GEN. STAT. § 7A-37.1(e) (2001); *see also* CAL. BUS. & PROF. CODE § 6200(f) (West Supp. 2002) ("[A]n arbitrator or mediator . . . shall have the same immunity which attaches in judicial proceedings."); FLA. STAT. ANN. § 44.107 (West 1998) ("An arbitrator . . . or a mediator . . . shall have judicial immunity in the same manner and to the same extent as a judge."); MICH. COMP. LAWS ANN. § 600.5073(1) (Supp. 2002) ("An arbitrator appointed under this chapter is immune from liability in regard to the arbitration proceeding to the same extent as the circuit judge who has jurisdiction of the action that is submitted to arbitration.").

253. *See, e.g.*, OKLA. STAT. ANN. tit. 12, § 1805(E) (West 1993) (providing no mediator civil liability unless action was result of "gross negligence with malicious purpose" or "in a manner exhibiting willful disregard of the rights, safety, or property of any party to the mediation"); R.I. GEN. LAWS § 28-30-23 (2000) (providing no arbitrator civil liability if arbitrator acted "in good faith, without malice, and not for improper personal enrichment"); VA. CODE ANN. § 8.01-581.23 (Michie Supp. 2002) (providing no mediator civil liability unless mediator acted in "bad faith, with malicious intent or in a manner exhibiting a willful, wanton disregard of the rights, safety or property of another").

254. OR. REV. STAT. § 36.210(1) (2001).

255. Courts have developed the doctrine of qualified immunity and applied it to government officials to shield them from suits for damages. *See Harlow v. Fitzgerald*, 457 U.S. 800, 806-07 (1982) (recognizing common law doctrine of immunity for public officers to protect them from "undue interference with their duties and from potentially disabling threats of liability"). Under the qualified immunity standard, officials performing discretionary functions are generally protected from civil liability unless their conduct violates "clearly established statutory or constitutional rights of which a reasonable person would have known." *Id.* at 818.

from harassing and often frivolous lawsuits" and "the need to provide relief to those subjected to an abuse of office."<sup>256</sup>

In the context of the provisional director remedy, no state statutes currently provide for the immunity of provisional directors from civil liability. However, the foregoing discussion reveals that the extension of immunity to provisional directors may be appropriate. The provisional director in many respects serves as a quasi-judicial officer appointed by the court to resolve corporate deadlock. In casting tie-breaking votes in favor of one contending faction, a provisional director acts much like a judge who considers the arguments of the parties and exercises discretion in rendering a decision. The same policy rationales for protecting the independent decisionmaking functions of the judiciary apply to provisional directors who must be free to make difficult decisions without fear of retaliation by losing factions. As court-appointed, provisional directors arguably act as extensions of the court by performing services on behalf of the court. For example, provisional directors may provide assistance to the court by reporting periodically on the status of the matter and providing recommendations to the court if necessary as to the disposition of the action.<sup>257</sup> There is a sense in which provisional directors derive their decisionmaking authority from the judge who appoints them, and they function in coordination with the judge.<sup>258</sup>

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256. *Austin Mun. Sec., Inc. v. Nat'l Ass'n of Secs. Dealers, Inc.*, 757 F.2d 676, 686 (5th Cir. 1985).

257. The model provisional director statute proposed in this Article provides for such reporting and submission of recommendations. *Supra* text accompanying note 227.

258. Indeed, the one appellate court that appears to have dealt directly with the issue held that provisional directors are entitled to absolute quasi-judicial immunity because they serve as delegated judges and their "duties are as judicial in all respects . . . as if they had been performed by the judge." *Latt v. Superior Court*, 212 Cal. Rptr. 380, 384 (Cal. Ct. App. 1985). In *Latt*, a provisional director, who himself was a retired judge, was sued by a shareholder who was ousted from his office in the corporation by a vote of the provisional director and the other shareholder faction. *Id.* at 381-82. After discussing the principle and purpose of judicial immunity, the appellate court affirmed the trial court's extension of immunity to the provisional director on the grounds that the provisional director statute "literally and inherently create[d] a judicial position to be filled by a delegate of a superior court judge." *Id.* at 384. The court found that the term "provisional director" could just as easily be replaced with the terms "delegated judge," "commissioner," or "court's representative." *Id.* The court viewed the qualifications for the provisional director position as being substantially similar to those required for the exercise of judicial and quasi-judicial functions. *Id.* Although the appointed provisional director was a retired judge, the trial court explicitly stated that that fact was irrelevant. *Id.* at 382. The trial court expressed a concern that the denial of immunity would have a chilling effect on the ability of parties to find qualified, impartial individuals who would be willing to serve as provisional directors. *Id.* The court viewed the provisional director remedy as an efficient procedure that saves courts' time by permitting the delegation of judicial authority that courts would otherwise have to assume. *Id.* at 384. As a result, the court felt it

From a dispute resolution standpoint, provisional directors function much like mediators and arbitrators. As discussed previously, a provisional director may be viewed in certain respects as a mediator-arbitrator who first attempts to help parties reach agreement, but if that fails, then renders a tie-breaking vote in favor of one side.<sup>259</sup> Courts and state legislatures have extended both absolute and qualified quasi-judicial immunity to mediators and arbitrators because their services have been held to be functionally comparable to those of judges. Because provisional directors share many of these same functions, the extension of immunity to the actions and decisions of provisional directors seems appropriate as well.<sup>260</sup>

In fact, provisional directors' functional comparability to judges, mediators, and arbitrators suggests that the conferral of absolute immunity would not necessarily be improper. Yet, parties may fear that absolute immunity provides too broad a shield against liability. Provisional directors who are not held to the same high standards of fiduciaries may be tempted to make decisions in bad faith or for corrupt reasons. If absolute immunity applies, parties may have no recourse in situations in which provisional directors have engaged in misconduct or intentionally abused the authority of their position for their own personal gain. In such instances, absolute immunity may produce a

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would be "patently unfair to burden a court's delegate (a provisional director) with civil liability for judicial acts performed for which a judge exercising the same functions could not be civilly liable." *Id.*

259. See *supra* Part II.B.4 (discussing mediation-arbitration).

260. One might argue that the extension of immunity is unnecessary because provisional directors and parties may simply define for themselves the scope of the provisional director's liabilities, and they may contract for indemnification or insurance to protect provisional directors to the extent desired. In fact, in the mediation context, to the extent that immunity does not apply, attempts have been made to use such private arrangements to avoid mediator liability. Some mediators have requested that their clients enter into agreements that contain general exculpatory clauses. Chaykin, *supra* note 247, at 47 n.2. The effectiveness and propriety of such exculpatory agreements may be questionable. See *id.* (observing that law frowns upon exculpatory clauses, construes them narrowly, and often finds them unenforceable); see also Joseph, *supra* note 246, at 664 (noting possibility of using insurance and indemnification to protect mediators from liability). The difficulty with attempting to contract for the appropriate protections is that the parties and provisional directors may not be able to come to an agreement that is mutually satisfactory. In *Marciano v. Nakash*, 1986 WL 4002 (Del. Ch. Apr. 2, 1986), for example, a court-appointed custodian was unable to reach an agreement with the parties as to the appropriate level of indemnities that were to be afforded to the custodian. *Id.* at \*1-\*2. In particular, one of the contending factions within the corporation took issue with several of the custodian's decisions and thereafter refused to provide personal indemnities and guarantees. *Id.* at \*1. The custodian therefore was "unwilling to serve as custodian without reasonable assurances that he [would] not be drawn into extensive and costly litigation as the result of his decisions which, perforce, [would] be opposed by one side or the other." *Id.* at \*2. Without judicial immunity, qualified individuals may be reluctant to serve as custodians and provisional directors.

result that seems unnecessarily harsh. At the same time, however, provisional directors must be free to work with the parties and make tie-breaking decisions without being constantly fearful that those decisions will result in lawsuits by angry losing factions. Provisional directors who are honest, sincere, and do their best to make well-reasoned decisions should be protected from liability when parties do not like the outcome. Imposing full liability on provisional directors may create disincentives for qualified, impartial persons to serve in this capacity.<sup>261</sup>

As discussed above, qualified immunity balances these competing policy interests by shielding only those actions that are made in good faith and without malice. This approach upholds the interests of parties in preventing misconduct by provisional directors while simultaneously protecting provisional directors from meritless lawsuits. The model provisional director statute proposed in this Article sets forth such a qualified immunity standard. It provides that provisional directors are immune from civil liability for any acts performed within the scope of their functions, so long as provisional directors act in good faith, without malice, and not for improper personal enrichment.<sup>262</sup> Although absolute immunity would arguably be justified in light of the quasi-judicial functions of the provisional director, states may instead wish to adopt the proposed qualified immunity standard due to the countervailing policy principles involved.

Like the other provisions in the proposed provisional director statute, the immunity clause is intended to reflect a balancing of interests. The statute should be considered as a whole. It attempts to provide an integrated view of the provisional director remedy. By incorporating and accommodating the fundamental policy principles that underlie the remedy, the proposed statute may go further than current provisional director statutes in promoting the goals and effectiveness of the remedy.

## VI. Conclusion

The provisional director remedy is a unique method of resolving corporate deadlock. Provisional directors share many of the same characteristics as custodians, arbitrators, and mediators, yet provisional directors have a unique

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261. See *Tamari v. Conrad*, 552 F.2d 778, 781 (7th Cir. 1977) (noting that individuals "cannot be expected to volunteer to arbitrate disputes if they can be caught up in the struggle between the litigants and saddled with the burdens of defending a lawsuit"); *Latt v. Superior Court*, 212 Cal. Rptr. 380, 382 (Cal. Ct. App. 1985) (observing that "absent a rule of immunity, there would be a chilling effect upon the ability of litigants in a case such as this to obtain services of a qualified, impartial arbiter"); see also *Chaykin*, *supra* note 247, at 51 (noting that "the fear of civil liability can have a demoralizing impact").

262. See *supra* Part V.A (proposing model statutory provision that incorporates qualified immunity for provisional directors).

function as voting members of the board. The appointment by the court of these temporary tie-breakers raises concerns about the appropriate balance among shareholder autonomy interests, court authority and involvement, and public and private ordering regimes. Different courts and state provisional director statutes vary considerably in their approach to the remedy, reflecting the difficulty of determining the exact nature, role, and purpose of the provisional director position. Efforts to fit provisional directors into neatly categorized boxes of "officers of the court" or "ordinary directors" for all purposes often produce unintended and undesirable results. The analysis presented in this Article attempts to construct a more comprehensive, integrated picture of the provisional director remedy and formulates a model that balances competing interests.

The appointment of a provisional director is not the answer for all forms of deadlock within corporations. However, it can be an important and effective first step in resolving certain impasses in corporate enterprises. Perhaps courts should be more willing to grant the provisional director remedy as a first line of attack in corporate deadlock cases, even in situations in which the differences seem irreconcilable upon first glance. The provisional director's presence may ultimately go a long way toward breaking the deadlock among the parties and moving the corporation forward. States without provisional director legislation should consider adopting such legislation to give corporate shareholders and directors more options for remedying deadlock. The model statute proposed in this Article provides states and courts with a framework for applying the provisional director remedy in a way that upholds the interests of shareholders and preserves the ongoing nature of the business.





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**THE WASHINGTON AND LEE  
LAW ALUMNI ASSOCIATION  
STUDENT NOTES  
COLLOQUIUM**

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