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If You Can't Trust a Fiduciary, Who Can You Trust? Using State Fiduciary Duties to Compel Shareholders in Closely Held Corporations to Disclose Preliminary Merger Negotiations

IF YOU CAN'T TRUST A FIDUCIARY, WHO CAN YOU TRUST? USING STATE FIDUCIARY DUTIES TO COMPEL SHAREHOLDERS IN CLOSELY HELD CORPORATIONS TO DISCLOSE PRELIMINARY MERGER NEGOTIATIONS

To prevent the oppression of minority shareholders[1] of closely held corporations,[2] courts traditionally have imposed state law fiduciary duties[3] on corporate directors, officers, and majority shareholders (controlling shareholders) of closely held corporations.[4] These state law fiduciary duties require

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1. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515-16 (1975) (minority shareholder is shareholder that owns less than fifty percent of total outstanding corporate stock); BLACK'S LAW DICTIONARY 900 (5th ed. 1979) (defining minority shareholders).

2. *See* H. HENN. & J. ALEXANDER, LAWS OF CORPORATIONS §257, at 695-96 (3d ed. 1983) (defining closely held corporations as having few shareholders); BLACK'S LAW DICTIONARY 308 (5th ed. 1979) (same); *supra* notes 16-22 and accompanying text (closely held corporations have few shareholders, and have no ready market for corporations' stock). Courts define closely held corporations as corporations with stock held by a small number of shareholders that are active in business of the corporation. *See* Brooks v. Wilicuts, 78 F.2d 270, 273 (8th Cir. 1935) (defining closely held corporations). Additionally, courts recognize that shareholders of closely held corporations infrequently buy or sell their stock and that no ready market exists for the sale or exchange of the stock. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, 586, 328 N.E.2d 505, 511 (1975) (giving judicially recognized characteristics of closely held corporations); *infra* notes 85-94 and accompanying text (discussing *Donahue* court's decision).

3. *See* Southern Pacific Co. v. Bogert, 250 U.S. 483, 487-88 (1919) (fiduciary duty is duty of good faith and inherent fairness); Jones v. H.F. Ahmanson & Co., 1 Cal.3d 93, ____, 460 P.2d 464, 471, 81 Cal. Rptr. 592, ____ (1969) (assigning fiduciary duty to controlling shareholders of closely held corporation); H. HENN & J. ALEXANDER, *supra* note 2, §232, at 613 (defining fiduciary duty). A fiduciary duty exists in any situation in which a person places trust and confidence in another person's skill and integrity. *See* Rees v. Briscoe, 315 P.2d 758, 762 (Okla. 1957) (describing circumstances under which fiduciary duties arise). Courts have determined that directors and officers of corporations have a fiduciary duty to the corporation and its shareholders. *See, e.g.*, Columbus Outdoor Advertising Co. v. Harris, 127 F.2d 38, 42 (6th Cir. 1942) (corporate directors and officers owe fiduciary duty to corporation); Arrigoni v. Adorno, 129 Conn. 673, ____; 31 A.2d 32, 35 (1943) (director of corporation is in fiduciary relationship with shareholders and corporation); Northern Trust Co. v. Essaness Theatres Corp., 348 Ill. App. 134, ____, 108 N.E.2d 493, 497 (1952) (same); H. HENN & J. ALEXANDER, *supra* note 2, §276, at 747 (directors of closely held corporations have high fiduciary duty). Additionally, courts have determined that majority shareholders of a corporation have a duty to deal fairly with minority shareholders. *See Southern Pacific*, 250 U.S. at 487-88 (imposing fiduciary duty on majority shareholders exercising control of corporation); Overfield v. Pennroad Corp., 42 F. Supp. 586, 606 (E.D. Penn. 1941), *aff'd in part and rev'd in part*, 146 F.2d 889 (1944) (same); *see also infra* note 5 and accompanying text (discussing imposition of fiduciary duties on controlling shareholders of closely held corporations).

4. *See, e.g.*, Guy v. Duff & Phelps, Inc., 672 F. Supp. 1086, 1090-91 (N.D. Ill. 1987) (imposing trustee fiduciary duty on corporate directors, officers, and majority shareholders in closely held corporations in matters relating to stock); Levin v. Garfinkle, 540 F. Supp. 1228, 1234 (E.D. Pa. 1982) (officers of closely held corporations have fiduciary duty to shareholders); *Donahue*, 367 Mass. at ____, 328 N.E.2d at 515 (imposing fiduciary partnership duty on

controlling shareholders of closely held corporations to act with good faith and fair dealing toward minority shareholders.[5] Consequently, these fiduciary duties have deterred controlling shareholders from "freezing out"[6] minority shareholders of closely held corporations.[7] Historically, one method by which controlling shareholders have attempted to freeze out minority shareholders has been to purchase minority shareholders' stock in a closely held corporation without telling the minority shareholders that the closely held corporation was negotiating for a merger with another corporation.[8] Because the value of the stock of a "target corporation"[9] can increase greatly during a merger, concealing the existence of merger negotiations from a minority shareholder selling his stock can reduce the minority shareholder's profits from the stock sale.[10] To protect minority shareholders in closely held corporations from receiving inadequate prices for their stocks, the state fiduciary duties that courts have imposed on controlling shareholders of closely held corporations

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shareholders in closely held corporation); H. HENN & J. ALEXANDER, *supra* note 2, §240, at 651 (controlling shareholders of closely held corporations must meet high fiduciary duty); Haskell, *The Relationship of Directors of a Close Corporation to its Creditors*, 1 CUM. SAMFORD L. REV. 209, 209 (1970) (directors of closely held corporation have fiduciary duty to corporation and to shareholders); *infra* notes 51-66 and accompanying text (discussing *Guy* court's imposition of trustee fiduciary duty on directors, officers, and majority shareholders of closely held corporations in matters that relate to closely held corporation's stock); *infra* notes 86-94 and accompanying text (discussing *Donahue* court's imposition of partnership fiduciary duty on shareholders of closely held corporations).

5. *See, e.g.*, Gord v. Iowana Farms Milk Co., 245 Iowa 1, ____, 60 N.W.2d 820, 830 (1953) (controlling shareholders of closely held corporations have duty of good faith and fair dealing in dealings with minority shareholders); Guth v. Loft, Inc., 23 Del. Ch. 255, ____, 5 A.2d 503, 510 (1939) (same); 1 F. O'NEAL, CLOSE CORPORATIONS §1.15, at 31-32 (1958) (same); *see also supra* note 3 (defining fiduciary duty).

6. *See* 1 F. O'NEAL & R. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, § 1:02, at 2-3 (2d ed. 1987) (defining "freezeouts" as exercises of controlling shareholders' power to deny minority shareholders profits from their investments or privileges of stock ownership); BLACK'S LAW DICTIONARY 599 (5th ed. 1979) (same); *infra* notes 25-30 and accompanying text (describing freezeout methods and strategies).

7. *See* 2 F. O'NEAL & R. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 7:17, at 122-23 (2d ed. 1987) (describing fiduciary obligations of controlling shareholders that provide minority shareholders with basis of relief from freezeouts).

8. *See, e.g.*, Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 433 (7th Cir. 1987) (controlling shareholder can freeze out minority shareholder by purchasing minority shareholder's stock without disclosing existence of merger negotiations), *cert. dismissed*, 108 S. Ct. 1067 (1988); Jaynes v. Jaynes, 98 Cal. App. 2d 447, ____, 220 P.2d 598, 599-600 (1950) (same); Aggatuci v. Corradi, 327 Ill. App. 153, ____, 63 N.E.2d 630, 632 (1945) (same).

9. *See* 1 M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS § 1.01 [1], at 4 (1987) (defining "target" corporation as corporation that is object of friendly or unfriendly takeover bid for merger).

10. *See* Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 433 (7th Cir. 1987) (merger of closely held corporation increased value of plaintiff's stock from $23,500 to $646,000), *cert. dismissed*, 108 S. Ct. 1067 (1988); *infra* notes 72-75 and accompanying text (explaining how shareholders of closely held corporations can make large profit by not disclosing corporation's agreement to merge with another corporation).

require the controlling shareholders to disclose the existence of merger negotiations before purchasing minority shareholders' stocks.[11]

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11. *See, e.g.*, Strong v. Repide, 213 U.S. 419, 431 (1909) (defendant, as director and majority shareholder, owed stockholders good faith duty to disclose impending sale of corporation's lands before purchasing stockholders stock); Jaynes v. Jaynes, 98 Cal. App. 2d 447, ___, 220 P.2d 598, 600-601 (1950) (director violated fiduciary duty to shareholders by buying stock from shareholder without disclosing possibility that closely held corporation would merge with another corporation); Aggatuci v. Corradi, 327 Ill. App. 153, ___, 63 N.E.2d 630, 632 (1945) (in special circumstances, such as assured sale of corporation, corporate officers have duty to disclose assured sale of corporation); *infra* notes 41-45 and accompanying text (discussing application and rationale of "special circumstances doctrine"). Some courts have adopted the special circumstances doctrine, which attempts to deter a corporate insider from taking advantage of a minority shareholder by requiring the corporate insider, before purchasing a minority shareholder's stock, to inform the minority shareholder that the closely held corporation is engaging in an assured merger with another corporation. *See infra* notes 41-45 and accompanying text (discussing special circumstances doctrine). Other courts have adopted the "minority rule," which requires a controlling shareholder of a closely held corporation to disclose not only the existence of assured merger negotiations, but also the existence of any preliminary merger negotiations to a minority shareholder before purchasing the minority shareholder's stock. *See* Weatherby v. Weatherby Lumber Co., 94 Idaho 504, ___, 492 P.2d 43, 45-46 (1972) (because directors of closely held corporations owe fiduciary duty to both corporation and shareholders, director had duty to disclose preliminary merger negotiations to minority shareholder before purchasing stock); *infra* notes 46-49 and accompanying text (discussing minority rule).

In addition to actions for breach of fiduciary duties under state law, a shareholder also may bring an action under the Securities & Exchange Commission's rule 10b-5 (rule 10b-5) to recover damages from an individual or corporation that fails to announce to the minority shareholder before purchasing the minority shareholder's stock that the corporation will merge with another corporation. *See* 17 C.F.R. § 240.10b-5 (1987) (prohibiting corporations' false or misleading statements or omissions concerning assured merger negotiations); H. HENN & J. ALEXANDER, *supra* note 2, §298, at 824-29 (discussing rule 10b-5). *But see* Ewell, *Rule 10b-5 and the Duty to Disclose Merger Negotiations in Corporate Statements*, 96 YALE L.J. 547, 548-54 (1987) (rule 10b-5 does not require corporation to disclose existence of preliminary merger negotiations). For a shareholder to bring an action under rule 10b-5, the shareholder must establish that the merging corporation had settled on the price and structure of the merger but had failed to disclose the merger to the shareholder before purchasing the shareholder's stock. 17 C.F.R. § 240.10b-5 (1987). *See, e.g.*, Flamm v. Eberstadt, 814 F.2d 1169, 1174-75 (7th Cir.) (once corporation reaches fundamental agreement on price and structure of merger, corporation has duty to disclose merger to shareholders), *cert. denied*, 108 S. Ct. 157 (1987); Reiss v. Pan American Airways, Inc., 711 F.2d 11, 14 (2d Cir. 1983) (same); Staffin v. Greenberg, 672 F.2d 1196, 1204-07 (3rd Cir. 1982) (same); 17 C.F.R. § 240.10b-5 (1987). Courts call the duty that the corporation has to disclose the existence of merger negotiations to shareholders once the corporation reaches an agreement on the price and structure of the merger the "price structure rule." *See Flamm*, 814 F.2d at 1174-75 (defining price structure rule). Recently, however, the United States Court of Appeals for the Seventh Circuit leniently applied the price structure rule in dealings in closely held corporations. *See* Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 434-35 (7th Cir. 1987) (although closely held corporation had not reached agreement on price and structure of merger, corporation could have duty to disclose to shareholders existence of preliminary merger negotiations), *cert. dismissed*, 108 S. Ct. 1067 (1988); Michaels v. Michaels, 767 F.2d 1185, 1195-96 (7th Cir. 1985) (same). The Seventh Circuit in *Jordan v. Duff & Phelps* determined that rule 10b-5 could require a closely held corporation to disclose preliminary merger negotiations. *See Jordan*, 815 F.2d at 434-35 (price structure rule may be inappropriate for closely held corporations); *Michaels*, 767 F.2d at 1195-96 (same); *see also* Karjala, *Federalism, Full Disclosure, and the National Markets in the Interpretation of Federal Securities Law*, 80 NW. U.L. REV. 1473,

Although the fiduciary duties that some courts impose on controlling shareholders purchasing stock from minority shareholders during merger negotiations help deter freezeouts, these fiduciary duties have provided incomplete protection to minority shareholders of closely held corporations.[12] Traditionally, to comply with state fiduciary duties, courts have not necessarily required controlling shareholders purchasing minority shareholders' stock to disclose merger negotiations that merely are preliminary and not yet final or assured (preliminary merger negotiations).[13] Furthermore, courts imposing state fiduciary duties may not require controlling shareholders of closely held

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1545-46 (1986) (explaining application of rule 10b-5 to closely held corporations); Note, *A New Approach to Rule 10b-5: Distinguishing the Close Corporation*, 1978 WASH. U.L.Q. 733, 750 (same).

Although rule 10b-5 creates fiduciary duties, minority shareholders of closely held corporations often may more easily bring an action under state fiduciary duties than under rule 10b-5. *See Flamm*, 814 F.2d at 1174-75 (if corporation reaches fundamental agreement on price and structure of merger, corporation has duty to disclose merger to shareholders); *supra* notes 41-59 and accompanying text (some state fiduciary duties could require corporations or controlling shareholders to disclose existence of preliminary merger negotiations before purchasing minority shareholder's stock). Unlike rule 10b-5, state fiduciary duties may require a corporation to disclose to a minority shareholder the existence of merger negotiations before purchasing the minority shareholder's stock, even though the merger negotiations are preliminary and not yet assured under the 10b-5 price structure rule. *See supra* notes 41-59 and accompanying text (discussing state fiduciary duties that could require controlling shareholders or corporation to disclose existence of preliminary merger negotiations to minority shareholder before purchasing minority shareholder's stock). Shareholders of a closely held corporation, therefore, more easily might prevail in a suit claiming that a corporation's failure to disclose preliminary merger negotiations violated state fiduciary duties than in a suit claiming that the corporation's failure to disclose preliminary merger negotiations violated rule 10b-5. *Id.*

12. *See infra* notes 60-66 and accompanying text (discussing incomplete protection from freezeouts that many states' fiduciary duties afford minority shareholders of closely held corporations).

13. *See* Agatucci v. Corradi, 327 Ill. App. 153, ____, 63 N.E.2d 630, 632 (1945) (under special circumstances doctrine, controlling shareholders of closely held corporations only have duty to disclose existence of assured sale of corporation to minority shareholder if purchasing minority shareholder's stock); Easterbrook & Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 291-93 (1986) (discussing fiduciary duty that closely held corporations have to disclose preliminary merger negotiations); *infra* notes 41-45 and accompanying text (discussing basis of special circumstances doctrine). The terms "final merger negotiations" and "assured merger negotiations" pertain to violations of federal disclosure laws under rule 10b-5 as well as to violations of state fiduciary duties. *See* 17 C.F.R. § 240.10b-5 (1987) (prohibiting corporations' false or misleading statements or omissions concerning assured merger negotiations); *see also* Flamm v. Eberstadt, 814 F.2d 1169, 1174-75 (7th Cir.) (explaining price structure method of determining whether negotiations are assured), *cert. denied*, 108 S. Ct. 157 (1987); Reiss v. Pan American Airways, Inc., 711 F.2d 11, 14 (2d Cir. 1983) (same); Staffin v. Greenberg, 672 F.2d 1196, 1204-07 (3d Cir. 1982) (same); *supra* note 11 (discussing rule 10b-5). State courts' definitions of preliminary merger negotiations and assured merger negotiations are not as specific or structured as the definitions of preliminary and assured merger negotiations that federal courts use in interpreting rule 10b-5. *See* Northern Trust Co. v. Essaness Theatres Corp., 348 Ill. App. 134, ____, 108 N.E.2d 493, 495-97 (1952) (before applying special circumstances doctrine, court used no formal test to make factual determination that sale of corporation was assured); *Agatucci*, 327 Ill. App. at ____, 63 N.E.2d at 632 (same); Buckley v. Buckley, 230 Mich. 504, ____, 202 N.W. 955, 956 (1925) (same).

corporations to disclose the existence of preliminary merger negotiations if the controlling shareholder is purchasing a minority shareholder's stock in an individual capacity and not for the corporation.[14] By applying a fiduciary duty that requires controlling shareholders to disclose both preliminary and assured merger negotiations to minority shareholders before purchasing the minority shareholders' stocks, regardless of the capacity in which the shareholder is acting, courts more completely would protect minority shareholders in closely held corporations from freezeouts.[15]

I. DEFINING CLOSELY HELD CORPORATIONS

In imposing fiduciary duties on shareholders of closely held corporations, courts necessarily have distinguished closely held corporations from publicly held corporations.[16] Courts distinguish closely held corporations from publicly held corporations by recognizing that, although publicly held corporations may have an unlimited number of shareholders,[17] closely held corporations only have a few shareholders.[18] Furthermore, courts recognize that, unlike public corporations, most closely held corporations integrate corporate management and corporate ownership.[19] The shareholders of closely held corpo-

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14. *See infra* notes 41-49 and accompanying text (discussing rules that only address shareholder purchasing stock on his own behalf from minority shareholder). *But see* Guy v. Duff & Phelps, Inc., 672 F. Supp. 1086, 1090-91 (N.D. Ill. 1987) (imposing trustee fiduciary duty on controlling shareholder of closely held corporation purchasing stock from minority shareholder on behalf of corporation that requires controlling shareholders to disclose existence of preliminary merger negotiations); *infra* notes 51-59 and accompanying text (discussing *Guy* court's decision).

15. *See supra* notes 13-14 and accompanying text (discussing incomplete protection from freezeouts that courts that distinguish between shareholders acting in individual capacity and in corporate capacity afford shareholders of closely held corporations); *infra* notes 67-83 and accompanying text (explaining protection that courts could afford minority shareholders of closely held corporations by imposing same fiduciary duties on controlling shareholders acting in corporate capacity and controlling shareholders acting in individual capacity).

16. *See infra* notes 17-29 and accompanying text (defining closely held corporations).

17. H. HENN & J. ALEXANDER, *supra* note 2, §257, at 695-96 (contrasting between closely held corporations and publicly held corporations).

18. *See, e.g.*, Brooks v. Willcuts, 78 F.2d 270, 273 (8th Cir. 1935) (closely held corporation is corporation with few number of shareholders); Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 511 (1975) (same); Israels, *The Close Corporation and the Law*, 33 CORNELL L. Q. 488, 491 (1948) (same); *supra* note 2 (defining closely held corporations). Under courts' liberal definitions of closely held corporations, the vast majority of corporations are closely held corporations. *See* H. HENN & J. ALEXANDER, *supra* note 2, §257, at 695 (large majority of corporations are closely held corporations); 1 F. O'NEAL & R. THOMPSON, *supra* note 6, § 1:01, at 2 n.1. (same). Even though closely held corporations consist of only a small number of shareholders, closely held corporations may have vast assets and international operations. *See* 1 F. O'NEAL, *supra* note 5, § 1.03, at 5 (noting that Ford Motor Company was closely held corporation until going public in 1955).

19. *See, e.g.*, Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 511 (1975) (closely held corporations integrate ownership and management); 1 F. O'NEAL, *supra* note 5, § 1.02, at 2-5 (in closely held corporations, most shareholders also manage corporation); Israels, *The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution*, 19 U.

rations typically are also the employees, directors, and officers of the corporation.[20] Additionally, the shareholders in closely held corporations usually are friends or family relations.[21] Consequently, the formal corporate titles in closely held corporations largely are nominal, and the distinctions between corporate functions may be nonexistent.[22] Finally, courts acknowledge that, because closely held corporations have a small number of shareholders and the shareholders have personal interests in the corporations, shareholders in closely held corporations have no ready market for the sale or transfer of their stock.[23] As a result, controlling shareholders of closely held corporations have substantial opportunities to freeze out minority shareholders in closely held corporations.[24]

Freezeout tactics deny minority shareholders the privileges that are inherent in owning stock in closely held corporations.[25] Controlling shareholders may freeze out minority shareholders by refusing to declare dividends, by refusing to employ the minority shareholders, or by awarding themselves excessive bonuses and salaries.[26] The characteristics of closely held corpora-

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CHI. L. REV. 778, 778 (1952) (management and ownership in closely held corporations essentially are identical); H. HENN & J. ALEXANDER, *supra* note 2, §257, at 695-96 (contrasting between closely held corporations and publicly held corporations).

20. *See* C. ISRAELS, CORPORATE PRACTICE 48-49 (1963) (duties of directors, officers, and managers in closely held corporations may be difficult to distinguish); 1 F. O'NEAL, *supra* note 5, § 1.07, at 13 (most shareholders of closely held corporations usually serve as officers or directors).

21. *See, e.g.*, Easterbrook & Fischel, *supra* note 13, at 274-77 (shareholders, directors, and officers of closely held corporations frequently are friends and family); Kramer, *Foreword to Symposium on Close Corporations*, 18 L. & CONTEMP. PROBS. 433, 433 (1953) (shareholders of closely held corporations typically are friends and family); Annotation, *Duty and Liability of Closely Held Corporation, Its Directors, or Majority Shareholders, In Acquiring Stock of Minority Shareholder*, 7 A.L.R.3D 500, 502 (1966) (same).

22. *See supra* notes 17-20 and accompanying text (explaining informal nature of management that typically exists in closely held corporations).

23. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515-16 (1975) (typically, shareholders of closely held corporations do not have ready market for sale of stock); 1 F. O' NEAL, *supra* note 5, § 1.02, at 3 (shareholders of closely held corporations rarely buy or sell closely held corporation's stock); *infra* notes 85-94 and accompanying text (discussing *Donahue* court's decision).

24. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 513-14 (1975) (susceptibility of minority shareholders of closely held corporations to freeze out devices is manifest in nature of closely held corporations); Comment, *Close Corporations - Stockholders' Duty of "Utmost Good Faith and Loyalty" Requires Controlling Shareholder Selling a Close Corporation Its Own Shares to Cause the Corporation to Offer to Purchase a Ratable Number of Shares from Minority* - Donahue v. Rodd Electrotype Co., 89 HARV. L. REV. 423, 428 (1975) (same); *infra* notes 86-94 and accompanying text (discussing *Donahue* decision).

25. *See* 1 F. O'NEAL, *supra* note 5, § 8.07, at 105 (explaining objectives of freezeouts); *infra* note 26 and accompanying text (describing various freezeout tactics). The causes of freezeout tactics are numerous. *See* 1 F. O'NEAL & R. THOMPSON, *supra* note 6, § 2:01, at 2 (listing causes of freezeout tactics). Although the primary motivations for freezeout tactics are greed and power, other factors, like personality conflicts, family disputes, or changes in corporate philosophies also may motivate controlling shareholders to exercise freezeout techniques. *Id.* § 2:02, at 2-5 (same).

26. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 513-

tions facilitate freezeout techniques because a few shareholders can collude to control a closely held corporation's policies and daily operations concerning corporate mergers, dividend distributions, and stock purchases.[27] If majority shareholders collude against minority shareholders, minority shareholders may have no control over the corporation or their personal investments in the closely held corporation.[28] Moreover, because of the absence of a ready market for the sale of stock in closely held corporations, minority shareholders may not be able to profitably surrender their interests in the closely held corporation.[29] A disgruntled minority shareholder in a closely held corporation, therefore, normally has no satisfactory escape from an oppressive freezeout situation.[30]

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15 (1975) (discussing ways in which majority shareholders, directors, and officers of closely held corporations can freeze out minority shareholders); 2 F. O'NEAL & R. THOMPSON, *supra* note 7, § 6:09, at 41-54 (listing various freezeout techniques). Controlling shareholders of a closely held corporation may freeze out minority shareholders by selling stock to majority shareholders at lower prices than to minority shareholders, by screening minority shareholders' corporate mail, and by disregarding and humiliating minority shareholders at corporate functions. *See* 2 F. O'NEAL & R. THOMPSON, *supra* note 7, § 6:09, at 41-54 (listing various freezeout techniques); *see* Note, *Freezing Out Minority Shareholders*, 74 HARV. L. REV. 1630, 1630-34 (1961) (describing merger and consolidation, sale of corporate assets, dissolution, withholding of dividends, and alterations of voting rights as methods of freezing out minority shareholders).

27. *See supra* notes 26-27 and accompanying text (because closely held corporations have limited number of shareholders and integrated management, shareholders easily may collude against each other). To freeze out a minority shareholder in a closely held corporation, a board of directors may withhold dividends or other corporate rights from minority shareholders. *See* Hayden v. Beane, 293 Mass. 347, ____, 199 N.E. 755, 755-56 (1936) (board of directors withheld voting stock and staged secret meetings to elect board members); Patton v. Nicholas, 154 Tex. 385, 393, 279 S.W.2d 848, 850-51 (1955) (board of directors maliciously withheld dividends from minority shareholders in closely held corporation). Courts, however, under the "business judgment rule," prefer not to question the business decisions of directors because business decisions are the discretionary duty of the director. *See, e.g.*, Perry v. Perry, 339 Mass. 470, 479, 160 N.E.2d 97, 102-03 (1959) (under business judgment rule, director has complete discretion in matters relating to dividends, limited only by requirement that director not act in bad faith); Crocker v. Waltham Watch Co., 315 Mass. 397, 402, 53 N.E.2d 230, 233-34 (1944) (same); 1 F. O'NEAL & R. THOMPSON, *supra* note 5, § 3.03, at 4-7 (business judgment rule promotes corporate directors' and officers' use of freezeout techniques in closely held corporations).

28. *See* Galler v. Galler, 32 Ill. 2d 16, 27, 203 N.E.2d 577, 583-84 (1964) (unlike shareholders of publicly held corporations, shareholders of closely held corporations often have large percentage of total personal capital invested in closely held corporation); 1 F. O'NEAL, *supra* note 5, § 1.07, at 15 (shareholders of closely held corporations often depend on closely held corporation as principle source of income).

29. *See, e.g*, Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515 (1975) (shareholders of closely held corporations often are unable either profitably to sell stock of closely held corporation or to find buyer for closely held corporation's stock); Galler v. Galler, 32 Ill. 2d 16, 27, 203 N.E.2d 577, 584 (1965) (same); Page, *Setting the Price in a Close Corporation Buy-Sell Agreement*, 57 MICH. L. REV. 655, 656 (1959) (stockholders in personal or family businesses often cannot find buyers for stock); *see supra* note 23 (stocks of closely held corporations lack marketability).

30. *See supra* notes 23-30 and accompanying text (describing prohibitive market characteristics for sale of closely held corporations' stocks).

II. Deterring Freezeouts of Minority Shareholders in Closely Held Corporations - Stock Purchases by Controlling Shareholders Acting on Their Own Behalf

To deter controlling shareholders from freezing out minority shareholders, courts have imposed varying types of state fiduciary duties on controlling shareholders of closely held corporations.[31] A controlling shareholder of a closely held corporation may freeze out a minority shareholder by purchasing the minority shareholder's stock without disclosing to the minority shareholder that the corporation has negotiated to merge with another corporation.[32] For example, a controlling shareholder of a closely held corporation who has knowledge of a merger because of his corporate position, could purchase stock from a minority shareholder who is unaware of the merger.[33] If the controlling shareholder purchases the stock for 100,000 dollars, and the value of the stock increases to 500,000 dollars during or after the merger, the controlling shareholder effectively has earned a 400,000 dollar profit from his purchase of the minority shareholder's stock.[34] Although controlling shareholders effectively can freeze out minority shareholders by purchasing the minority shareholders' stocks without disclosing the existence of merger negotiations, courts differ substantially on the degree to which courts should protect minority shareholders.[35]

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31. *See infra* notes 36-49 and accompanying text (discussing majority rule, special circumstances doctrine, and minority rule approaches of assigning fiduciary duty to shareholders in closely held corporation).

32. *See* Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. Fin. Econ. 5, 7-15 (1983) (during merger, target corporations' stock value increases average of 20%); Langley, *SEC To Require Disclosure Talks*, Wall St. J., July 9, 1985, at 3, col. 1 (if corporation discloses merger negotiations, stock prices of target corporations may increase to the price that acquiring corporation is offering for stock). Because the value of stock increases during or after a merger, concealing the existence of merger negotiations from minority shareholders can be very profitable to controlling shareholders of closely held corporations. *See, e.g.*, Guy v. Duff & Phelps, Inc., 672 F. Supp. 1086, 1088-89 (N.D. Ill. 1987) (closely held corporation's stock value drastically increased shortly after corporation purchased stock from minority shareholder without disclosing existence of preliminary merger negotiations); Jaynes v. Jaynes, 98 Cal. App. 2d 447, ____, 220 P.2d 598, 599 (1950) (same); Aggatuci v. Corradi, 327 Ill. App. 153, ____, 63 N.E.2d 630, 631 (1945) (value of stock, which controlling shareholder acting in personal capacity purchased from minority shareholder for $7,000 without disclosing existence of preliminary merger negotiations, increased in value to $13,333 during merger); *supra* notes 50-59 and accompanying text (discussing *Guy* court's decision).

33. *See* Aggatuci v. Corradi, 327 Ill. App. 153, ____, 63 N.E.2d 630, 631 (1945) (controlling shareholder earned approximately $6300 by not disclosing existence of preliminary merger negotiations before purchasing minority shareholder's stock); *supra* note 32 (explaining that stock value dramatically may increase during and after merger).

34. *See Aggatuci*, 327 Ill. App. at ____, 63 N.E.2d at 631 (controlling shareholder acting in personal capacity earned approximately $6300 by not disclosing existence of preliminary merger negotiations); *supra* notes 32-33 and accompanying text (discussing profits that corporations and controlling shareholders can earn by failing to disclose preliminary merger negotiations).

35. *See infra* notes 36-49 and accompanying text (discussing different fiduciary duties that majority rule, special circumstances doctrine, and minority rule impose).

If the controlling shareholder is purchasing the minority shareholder's stock for his own benefit and not for the closely held corporation, some courts give virtually no protection to the minority shareholder.[36] Under the "majority rule," controlling shareholders of closely held corporations do not have to disclose to minority shareholders the existence of either preliminary or assured merger negotiations before the controlling shareholder can purchase, on his own behalf, the minority shareholder's stock.[37] Courts adopting the majority rule reason that a minority shareholder of a closely held corporation has the ability to examine the closely held corporation's affairs before deciding to sell his stock to a controlling shareholder.[38] Under the majority rule, therefore, a controlling shareholder who wants to purchase a minority shareholder's stock has no duty to reveal the closely held corporation's financial status to the minority shareholder.[39]

Although several courts have adopted the majority rule, the majority rule is harsh because the rule allows controlling shareholders to conceal the existence of merger negotiations and to freeze out a minority shareholder by purchasing the minority shareholder's stock at a price below the stock's true market value.[40]

Because of the harshness of the majority rule, many courts have qualified the majority rule by adopting the "special circumstances doctrine."[41] The

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36. *See infra* notes 37-49 and accompanying text (discussing rationale for fiduciary duties that majority rule and special circumstances doctrine impose).

37. *See, e.g.*, Chatz v. Midco Oil Corp., 152 F.2d 153, 154-55 (7th Cir. 1945) (under Oklahoma's majority rule, officers or directors of corporation are not trustees of shareholders with respect to stock purchases and, therefore, are under no duty to disclose preliminary merger negotiations to minority shareholders before purchasing stock); Buckley v. Buckley, 230 Mich. 504, ____, 202 N.W. 955, 956 (1925) (following majority rule that corporate directors, if purchasing shareholders' stock, are not in fiduciary relationship with shareholders); Crowell v. Jackson, 53 N.J.L. 656, ____, 23 A. 426, 427 (1891) (same). Under the majority rule, a director or officer of a closely held corporation owes no fiduciary duty to a shareholder in transactions involving the corporation's stock. *See* H. HENN & J. ALEXANDER, *supra* note 2, §239, at 646 & n.4 (discussing majority rule).

38. *See, e.g.*, Buckley v. Buckley, 230 Mich. 504, ____, 202 N.W. 955, 956 (1925) (reasoning that all shareholders can examine corporate books before selling their stock); Bollstrom v. Duplex Power Car Co., 208 Mich. 15, ____, 175 N.W. 492, 496 (1919) (same); 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1168.1, at 382 (rev. perm. ed. 1986) (same).

39. *See, e.g.*, Clayton v. James B. Clow & Sons, 212 F. Supp. 482, 582-83 (N.D. Ill. 1962) (majority shareholder, under Illinois law, has no fiduciary duty to minority shareholders to disclose all pertinent facts because corporate books are open for minority shareholders' examination), *aff'd*, 327 F.2d 382 (7th Cir. 1964); Anderson v. Lloyd, 64 Idaho 768, ____, 139 P.2d 244, 250 (1943) (same); 3A W. FLETCHER, *supra* note 38, § 1171, at 394 (same).

40. *See* Anderson v. Lloyd, 64 Idaho 768, ____, 139 P.2d 244, 245 (1943) (majority rule did not prohibit majority shareholder of closely held corporation from purchasing minority shareholder's stock at less than half of stock's true value without disclosing existence of merger negotiations); H. HENN & J. ALEXANDER, *supra* note 2 §239, at 646 n.4 (discussing harshness of majority rule).

41. *See infra* notes 42-45 and accompanying text (discussing special circumstances doctrine); *supra* notes 36-40 and accompanying text (discussing harshness of majority rule). Because of the

special circumstances doctrine imposes a fiduciary duty on controlling shareholders in a closely held corporation who are acting on their own behalf to disclose to the minority shareholder the existence of merger negotiations before purchasing a minority shareholder's stock.[42] Unlike courts adopting the majority rule, courts adopting the special circumstances doctrine reason that much of the information that the controlling shareholder possesses is not available to a minority shareholder who wants to investigate the value of the closely held corporation's stock.[43] Courts that have adopted the special circumstances doctrine, however, have limited the doctrine to require a controlling shareholder of a closely held corporation to disclose only an assured merger to a minority shareholder in a closely held corporation before purchasing the minority shareholder's stock.[44] Under the special circumstances doctrine, therefore, a controlling shareholder, before purchasing a minority shareholder's stock, may not have to disclose to the minority shareholder the existence of merely preliminary merger negotiations.[45]

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harshness of the majority rule, few courts have applied the rule in its pure form in the last 75 years. H. HENN & J. ALEXANDER, *supra* note 2 §239, at 646 n.4 (discussing harshness of majority rule). Most jurisdictions that follow the majority rule have modified the rule under the "special circumstances doctrine." *Id.*; *see supra* notes 42-45 and accompanying text (discussing special circumstances doctrine).

42. H. HENN & J. ALEXANDER, *supra* note 2 §239, at 647 (defining special circumstances doctrine). *See, e.g.*, Strong v. Repide, 213 U.S. 419, ____ (1909) (before purchasing stockholder's stock, defendant, as director and majority shareholder, owed stockholder good faith duty to disclose impending sale of corporation's lands); Jaynes v. Jaynes, 98 Cal. App. 2d 447, ____, 220 P.2d 598, 601 (1950) (director violated fiduciary duty to shareholder by buying stock from shareholder without disclosing possibility that corporation would be sold); Aggatuci v. Corradi, 327 Ill. App. 153, ____, 63 N.E.2d 630, 632 (1945) (assured sale of corporation is special circumstance that requires controlling shareholders to disclose to minority shareholder existence of assured sale before purchasing minority shareholder's stock). Under the traditional majority rule, a controlling shareholder has no duty to disclose information to persons from whom the controlling shareholder buys and sells stock. *See Aggatuci*, 327 Ill. App. at ____, 63 N.E.2d at 632 (stating majority rule); Buckley v. Buckley, 230 Mich. 504, ____, 202 N.W. 955, 956 (1925) (same). If the controlling shareholder purchases stock from a minority shareholder during an assured merger, however, a special circumstance exists that requires the controlling shareholder to disclose the corporation's assured merger to the minority shareholder. *See Aggatuci*, 327 Ill. App. at ____, 63 N.E.2d at 632 (explaining special circumstances doctrine).

43. *See, e.g.*, *Aggatuci*, 327 Ill. App. at ____, 63 N.E.2d at 632 (explaining that unavailability of information from corporate books, including existence of merger negotiations, is basis for special circumstances exception to majority rule); Buckley v. Buckley, 230 Mich. 504, ____, 202 N.W. 955, 956 (1925) (same); 3A W. FLETCHER, *supra* note 38, § 1171, at 394 (same); *supra* notes 38-39 and accompanying text (same).

44. *See, e.g.*, James Blackstone Memorial Library Ass'n v. Gulf, M. & O.R. Co., 264 F.2d 445, 450-52 (7th Cir.) (if purchasing stock, controlling shareholders have no duty to disclose negotiations for sale of corporate land to minority shareholders because sale of land was not final), *cert. denied*, 361 U.S. 815 (1959); *Agatucci*, 327 Ill. App. at ____, 63 N.E.2d at 632 (officers have duty to disclose special circumstances, such as assured sale of corporation, to minority shareholder if purchasing minority shareholder's stock); Buckley v. Buckley, 230 Mich. 504, ____, 202 N.W. 955, 956 (1925) (recognizing that special circumstances doctrine does not require controlling shareholders of closely held corporations to disclose merger negotiations to minority shareholders before purchasing stock if merger is not assured).

45. *See supra* note 44 and accompanying text (explaining that special circumstances doctrine only might apply to assured mergers, not preliminary mergers).

As an alternative to the majority rule and special circumstances doctrine, some courts have adopted the "minority rule," which assumes that a controlling shareholder of a closely held corporation is in a trustee relationship with the other shareholders in matters concerning corporate stock.[46] The trustee fiduciary duty requires controlling shareholders of a closely held corporation to act under a duty of good faith and fair dealing with respect to the stock.[47] Under the minority rule, therefore, a controlling shareholder, before purchasing a minority shareholder's stock for himself, must disclose any information that would increase the value of the corporate stock.[48] The minority rule, in contrast to the majority rule and special circumstances doctrine, requires a controlling shareholder of a closely held corporation to disclose the existence of preliminary merger negotiations to a minority shareholder before purchasing the minority shareholder's stock for his own benefit.[49]

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46. *See, e.g.*, Logan v. Arnold, 82 Fla. 237, ____, 89 So. 551, ____ (1921) (officer of corporation owed shareholder trustee fiduciary duty to disclose financial condition of corporation before purchasing minority shareholder's stock, even if books of corporation revealed financial condition); Bettendorf v. Bettendorf, 190 Iowa 83, ____, 179 N.W. 444, 456 (same), *supp. op.*, 179 N.W. 945 (1920); *see also* H. HENN & J. ALEXANDER, *supra* note 2, §239, at 648 (defining minority rule); 3A W. FLETCHER, *supra* note 38, § 1168.2, at 388 (under minority rule, controlling shareholders are trustees of minority shareholders stock).

47. *See, e.g.*, Mansfield Hardwood Lumber Co. v. Johnson, 268 F.2d 317, 322-23 (5th Cir.) (under Louisiana law, corporate officers had duty to all shareholders to deal in atmosphere of trust and confidence and disclose any superior knowledge to shareholders before purchasing shareholder's stock), *cert. denied*, 361 U.S. 885 (1959); Weatherby v. Weatherby Lumber Co., 94 Idaho 504, ____, 492 P.2d 43, 45-46 (1972) (because directors of closely held corporations owe fiduciary duty to both corporation and shareholders, director had duty to disclose preliminary merger negotiations to minority shareholder before purchasing stock); Jacobson v. Yaschik, 249 S.C. 577, ____, 155 S.E.2d 601, 605 (1967) (officers and directors of closely held corporations always owe fiduciary duty to shareholders).

48. *See* Weatherby v. Weatherby Lumber Co., 94 Idaho 504, ____, 492 P.2d 43, 45-46 (1972) (because preliminary negotiations enhance value of stock, directors of closely held corporations owe fiduciary duty to disclose to minority shareholder existence of preliminary merger negotiations before purchasing minority shareholder's stock); Blakesley v. Johnson, 227 Kan. 495, ____, 608 P.2d 908, 914 (1980) (controlling shareholder of closely held corporation has strict fiduciary duty to disclose any information affecting value of stocks to minority shareholder before conducting any dealings concerning corporation's stock); *see also supra* note 32 and accompanying text (explaining that value of stock of target corporation greatly increases during merger).

49. *Compare* Weatherby v. Weatherby Lumber Co., 94 Idaho 504, ____, 492 P.2d 43, 45-46 (1972) (under minority rule, director of closely held corporation has duty to disclose preliminary merger negotiations to minority shareholder before purchasing stock) *and* Jacobson v. Yaschik, 249 S.C. 577, ____, 155 S.E.2d 601, 604-06 (1967) (same) *with supra* notes 36-40 and accompanying text (under majority rule, controlling shareholders of closely held corporations have no duty to disclose assured merger negotiations or preliminary merger negotiations to minority shareholders before purchasing stock) *and supra* notes 41-45 and accompanying text (under special circumstances doctrine, controlling shareholders of closely held corporations only have duty to disclose assured merger negotiations to minority shareholders before purchasing stock).

III. Deterring Freezeouts of Minority Shareholders in Closely Held Corporations- Stock Purchases by Controlling Shareholders Behalf of the Corporation

Although the majority rule, special circumstances doctrine, and minority rule place different fiduciary duties on controlling shareholders of closely held corporations who are purchasing the stock on their own behalf, at least one court has placed an even stricter duty on controlling shareholders purchasing stock for the corporation.[50] In *Guy v. Duff and Phelps, Inc.*[51] the United States District Court for the Northern District of Illinois considered whether corporate officers, acting in a corporate capacity for a closely held corporation, had a fiduciary duty to disclose the existence of preliminary merger negotiations to a minority shareholder before purchasing the minority shareholder's stock for the corporation.[52] In *Guy* a corporate officer, acting on behalf of a closely held corporation, purchased stock from the plaintiff, a minority shareholder, without informing the plaintiff that the corporation was conducting preliminary merger negotiations with Security Pacific, Inc. (Security).[53] After the corporation purchased the plaintiff's stock, the corporation announced that Security had acquired the corporation's stock for an amount that greatly exceeded the price per share at which the defendant corporation had purchased the plaintiff's stock.[54] Subsequently, the plaintiff filed suit in the United States District Court for the Northern District of Illinois, alleging that the defendant, a closely held corporation, owed the

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50. *See* Guy v. Duff & Phelps, Inc., 672 F. Supp. 1086, 1090-91 (N.D. Ill 1987) (imposing trustee fiduciary duty on controlling shareholders of closely held corporations purchasing stock from minority shareholders in corporate capacity); *supra* notes 37-49 and accompanying text (explaining majority rule, special circumstances doctrine, and minority rule, which refer to controlling shareholders purchasing stock on their own behalf); *infra* notes 57-66 and accompanying text (explaining courts' differentiation between controlling shareholders of closely held corporations acting in individual capacity and corporate capacity); *infra* notes 51-59 and accompanying text (discussing *Guy* court's decision).

51. 672 F. Supp. 1086 (N.D. Ill. 1987).

52. Guy v. Duff & Phelps, Inc., 672 F. Supp. 1086, 1090-91 (N.D. Ill. 1987).

53. *Id.* at 1088. In *Guy v. Duff & Phelps, Inc.* the defendant corporation, Duff & Phelps, Inc. (Duff & Phelps), was a financial consulting firm. *Id.* at 1087. The plaintiff, Guy, who was an employee of the defendant, purchased and owned stock under a stock restriction and purchase agreement (the Agreement). *Id.* at 1088. Guy, under the Agreement, had purchased 400 shares of Duff & Phelp's stock. *Id.* The Agreement required Guy to sell his shares back to Duff & Phelps at the stock's book value if Guy resigned or the corporation terminated Guy's employment for any reason. *Id.*

In addition to his employment with Duff & Phelps, Guy operated a profitable commodities trading advising business that had earned approximately $138,000 in 1982 and 1983. *Id.* Duff & Phelps gave Guy an ultimatum that, unless Guy discontinued the consulting business, Duff & Phelps would terminate Guy's employment. *Id.* Duff & Phelps, however, did not disclose to Guy that the corporation was negotiating a merger. *Id.* Guy chose not to discontinue his consulting business, and Duff & Phelps terminated Guy's employment effective September 1, 1983. *Id.*

54. *Id.*

plaintiff a fiduciary duty to disclose the existence of preliminary merger negotiations before purchasing the plaintiff's shares.[55]

The district court in *Guy* recognized that, under the special circumstances doctrine that Illinois follows, a corporate officer acting on his own behalf has a fiduciary duty to disclose to a minority shareholder an assured sale of the corporation before purchasing the minority shareholder's stock in the corporation for his own benefit.[56] The *Guy* court, however, recognized that Illinois distinguishes controlling shareholders acting on their own behalf from controlling shareholders acting on behalf of the corporation.[57] The district court reasoned that a corporation, before repurchasing any of its outstanding stock from a minority shareholder, owes a trustee fiduciary duty of good faith and fair dealing to the minority shareholder to disclose any material facts to the shareholder that might affect the value of the corporation's stock.[58] Because the preliminary merger negotiations with Security were material to the price of the stock, the *Guy* court concluded that the corporate officer, acting in a corporate capacity for the closely held corporation, had a trustee fiduciary duty to disclose to the minority shareholder that the corporation was conducting preliminary merger negotiations.[59]

Although the *Guy* court's trustee fiduciary duty is stricter than the fiduciary duties under the majority rule and the special circumstances doctrine, the *Guy* court's fiduciary duty only applies to controlling shareholders who are purchasing stock for the closely held corporation.[60] The *Guy* court, in

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55. *Id.* at 1087-88. In *Guy* the plaintiff, Guy, filed suit in the United States District Court for the Northern District of Illinois, alleging that Duff & Phelps, in purchasing Guy's shares, had violated a fiduciary duty to Guy by not disclosing that Duff & Phelps might merge with another corporation. *Id.* Guy also alleged that Duff & Phelp's failure to disclose the existence of preliminary merger negotiations to Guy before purchasing Guy's shares of stock constituted fraud. *Id.* at 1087. In response, Duff & Phelps maintained that it did not have a fiduciary duty to disclose to Guy the existence of preliminary merger negotiations and, therefore, moved for summary judgment. *Id.* at 1089. Additionally, Duff & Phelps contended that summary judgment was appropriate because, under the Agreement, the corporation's purchase of the stock was automatic on Guy's termination, because Duff & Phelps had no intent to deceive Guy, and because Guy could not show that he had suffered from the corporation's failure to disclose the existence of preliminary merger negotiations. *Id.* The district court determined that Guy presented sufficient evidence that, because Guy had control over the decision to quit the defendant corporation's employment, Guy's decision to continue the consulting business essentially was the equivalent of deciding to sell the stock. *Id.* The district court concluded that, although the defendant's lack of intent to defraud Guy defeated Guy's fraud claim, intent is not an element a breach of fiduciary duty claim. *Id.* at 1092. The district court, therefore, denied Duff & Phelp's motion for summary judgment as to Guy's breach of fiduciary duty. *Id.* at 1093.

56. *Id.* at 1090.

57. *Id.*

58. *Id.*

59. *Id.* The district court in *Guy* reasoned that the materiality of the merger negotiations was a jury question and, consequently, denied the defendant's motion for summary judgment as to Guy's breach of fiduciary duty claim. *Id.*

60. *See id.* (corporate officer acting in corporate capacity with respect to minority shareholder's stock owed minority shareholder fiduciary duty of good faith and fair dealing); *see also supra* notes 50-59 and accompanying text (discussing *Guy* court's holding that controlling

imposing a trustee fiduciary duty on controlling shareholders acting on behalf of their corporations, reasoned that a closely held corporation is, in effect, a trustee of the shareholders' stock and, therefore, under the trustee relationship cannot take monetary advantage of a minority shareholder.[61] The trustee relationship creates a fiduciary duty in controlling shareholders to relay to the selling shareholder any information, including the existence of preliminary merger negotiations, that may increase the value of the selling shareholder's stock.[62]

In contrast to the *Guy* court's trustee fiduciary duty, courts adopting the special circumstances doctrine or the majority rule reason that a controlling shareholder of a closely held corporation acting on his own behalf is not a trustee of the other shareholders of the closely held corporation, and, therefore, the majority rule and special circumstances doctrine do not impose a trustee fiduciary duty to disclose preliminarymerger negotiations.[63] The minority rule differs from the *Guy* court's trustee fiduciary duty because courts do not apply the minority rule to controlling shareholders purchasing a minority shareholder's stock for the corporation.[64] Conversely, the *Guy* court's

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shareholder of closely held corporation acting in corporate capacity has trustee fiduciary duty to disclose to minority shareholder existence of preliminary merger negotiations before purchasing minority shareholder's stock).

61. *Guy*, 672 F. Supp. at 1090-91; *see* Oliver v. Oliver, 118 Ga. 362, 367-68, 45 S.E. 232, 233 (1903) (director or other managing officer of closely held corporation is trustee for individual shareholders and for corporation); Northern Trust Co. v. Essaness Theatres Corp., 348 Ill. App. 134, ____, 108 N.E.2d 493, 497-98 (1952) (same); *see also* 3A W. FLETCHER, *supra* note 38, §1168.2, at 387-88 (trustee relationship between directors and shareholders is basis for minority rule); *supra* notes 46-49 and accompanying text (same).

62. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, , 328 N.E.2d 505, 516 (1975) (corporation's failure to disclose preliminary merger negotiations to minority shareholder before purchasing minority shareholder's stock breached trustee fiduciary duty); *supra* notes 46-49 and accompanying text (under minority rule, trustee fiduciary duty requires controlling shareholders of closely held corporations, before purchasing stock from minority shareholder, to disclose to minority shareholder any information that could increase value of stock).

63. *See, e.g.*, Bawden v. Taylor, 254 Ill. 464, ____, 98 N.E. 941, 942 (1912) (under majority rule, corporate director may remain silent concerning impending sale of corporation if purchasing stock from minority shareholder); Hooker v. Midland Steel Co., 215 Ill. 444, 451, 74 N.E. 445, 447 (1905) (same); Agatucci v. Corradi, 327 Ill. App. 153, ____, 63 N.E.2d 630, 632 (1945) (under special circumstances doctrine, officers have no duty to disclose existence of preliminary merger negotiations before purchasing stock from minority shareholders); Voss v. Lakefront Realty Corp., 48 Ill. App. 3d 56, 66, 365 N.E.2d 347, 355 (1977) (under majority rule, corporate director may remain silent concerning impending sale of corporation if purchasing stock from minority shareholder); *supra* notes 36-45 and accompanying text (analyzing special circumstances doctrine and majority rule).

64. *See, e.g.*, Mansfield Hardware Lumber Co. v. Johnson, 268 F.2d 317, 322-23 (5th Cir. 1959) (applying minority rule to controlling shareholder acting in personal capacity); Weatherby v. Weatherby Lumber Co., 94 Idaho 504, ____, 492 P.2d 43, 45-46 (1972) (under minority rule, controlling shareholder could not conceal preliminary merger negotiations to make personal profit); Jacobson v. Yaschik, 249 S.C. 577, ____, 155 S.E.2d 601, 605 (1967) (applying minority rule to controlling shareholder acting in personal capacity); *supra* notes 60-61 and accompanying text (stating that *Guy* court's trustee fiduciary duty applies only to controlling shareholders purchasing for corporation).

trustee fiduciary duty does not apply to controlling shareholders of closely held corporations purchasing a minority shareholder's stock in an individual capacity.[65] Although the *Guy* court recognized that state case law differentiates between corporate directors acting on their own behalf and acting on behalf of the corporation, the court questioned whether any valid justification existed for the distinction.[66]

IV. Extending a Trustee Fiduciary Duty to Controlling Shareholders Purchasing Stock from Minority Shareholders on Their Own Behalf

Even though the *Guy* court's fiduciary duty sufficiently protects minority shareholders from receiving an inadequate price for their stock from controlling shareholders purchasing for the corporation, the *Guy* court fiduciary duty does not protect minority shareholders against receiving an inadequate price for their stock from controlling shareholders purchasing the stock for themselves.[67] Courts that impose a trustee fiduciary duty on controlling shareholders purchasing stock for the corporation, but that do not impose a trustee fiduciary duty on controlling shareholders purchasing stock on their own behalf, improperly analyze the distinction between shareholders of closely held corporations acting in an individual capacity and acting in a corporate capacity.[68] Because the roles of shareholders in closely held corporations are not very diversified, the considerations that require shareholders acting for the corporation to act as fiduciaries for all shareholders should impose the same trustee fiduciary duty on shareholders acting in a personal capacity.[69]

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65. *Compare supra* notes 46-49 and accompanying text (explaining minority rule's imposition of trustee duty on controlling shareholder of closely held corporation acting on own behalf) *and supra* note 64 and accompanying text (same) *with Guy*, 672 F. Supp. at 1090-91 (imposing trustee fiduciary duty on controlling shareholder of closely held corporation acting on behalf of corporation and dealing in matters concerning corporate stock) *and supra* notes 50-59 and accompanying text (discussing *Guy* court's decision).

66. *Guy*, 672 F. Supp. at 1091. Although the *Guy* court questioned the propriety of imposing a stricter fiduciary duty on shareholders acting in an individual capacity than on shareholders acting in a corporate capacity, the court deferred to state law and imposed the stricter trustee fiduciary duty on shareholders acting for the corporation. *Id.*; *see* Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938) (federal courts should base decisions on state law unless issue involves United States Constitution or Acts of Congress).

67. *Compare supra* notes 46-49 and accompanying text (explaining that minority rule only applies to controlling shareholders of closely held corporations acting in individual capacity in matters relating to minority shareholder's stock) *with Guy*, 672 F. Supp. at 1090-91 (trustee fiduciary duty only applies to controlling shareholders of closely held corporations acting in corporate capacity in matters concerning minority shareholder's stock) *and supra* notes 50-59 and accompanying text (discussing *Guy* court's decision).

68. *See infra* notes 69-83 and accompanying text (analyzing propriety of imposing different duties on controlling shareholder of closely held corporation acting on own behalf and on controlling shareholder of closely held corporation acting on behalf of corporation).

69. *See* Easterbrook & Fischel, *supra* note 13, at 273-74 (analyzing economic nature and diverse management structure of closely held corporations); *see also infra* note 70-83 and accompanying text (discussing rationale for applying same fiduciary duty to shareholders acting

In many closely held corporations, each shareholder normally serves as a director or a corporate officer.[70] Furthermore, because closely held corporations have a limited ownership and number of stockholders, any gain or loss of the corporation substantially benefits or damages the shareholders.[71] Consequently, a stock purchase by a closely held corporation shortly before a merger may produce a large windfall for the corporation, the profits of which only a few shareholders would share.[72] For example, in a corporation in which each of five shareholders owns 20 percent of the corporation's stock, the corporation, by failing to reveal the existence of preliminary merger negotiations to a minority shareholder, would earn a profit of 400,000 dollars in purchasing the minority shareholder's stock, of which each of the four remaining shareholders would receive 100,000 dollars of the profit.[73] Alternatively, if a shareholder acting on his own behalf, by failing to reveal the existence of preliminary merger negotiation to a minority shareholder of the corporation, made a profit of 400,000 dollars on the purchase of one of the shareholder's stock, the shareholder would keep the entire 400,000 dollar

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in corporate capacity as to shareholders acting in individual capacity); *supra* notes 19-22 and accompanying text (discussing lack of diversity between management and ownership in closely held corporations).

70. *See supra* notes 18-22 and accompanying text (discussing integration of management and ownership in closely held corporations).

71. *See supra* notes 16-18 and accompanying text (defining closely held corporation as having limited number of shareholders); *infra* notes 72-74 and accompanying text (discussing how profits from stock purchase by closely held corporation affect shareholders).

72. *See* Jensen & Ruback, *supra* note 32, at 7-15 (during merger, target corporations' stock value increases average of 20 percent); *supra* notes 17-18 and accompanying text (closely held corporations have few shareholders). If a closely held corporation merges with another corporation, the value of the closely held corporation's stock significantly increases. *See* Jensen v. Ruback, *supra* note 32, at 7-15 (target corporations' stock value normally increase during merger). If an acquiring corporation purchases a closely held corporation's stock for an amount that greatly exceeds the previous value of the closely held corporation's stock, a controlling shareholder that purchases a minority shareholder's stock in the corporation can liquidate his stock at a large profit. *See* Langley, *SEC To Require Disclosure Talks*, Wall St. J., July 9, 1985, at 3, col. 1 (if corporation discloses merger negotiations, stock prices of target corporations may increase to the price that acquiring corporation is offering for stock). A controlling shareholder, by remaining silent about a merger between the closely held corporation and another corporation, may make a bargain purchase from an uninformed shareholder of the closely held corporation. Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 433 (7th Cir. 1987) (value of stock, which corporation purchased from minority shareholder for $23,225 without disclosing existence of preliminary merger negotiations, increased in value to $646,000 during merger), *cert. dismissed*, 108 S. Ct. 1067 (1988); Aggatuci v. Corradi, 327 Ill. App. 153, ____, 63 N.E.2d 630, 631 (1945) (value of stock, which controlling shareholder acting in personal capacity purchased from minority shareholder for $7,000 without disclosing existence of preliminary merger negotiations, increased in value to $13,333 during merger).

73. *Cf.* Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 433 (7th Cir. 1987) (corporation made approximately $622,000 from purchasing minority shareholder's stock without disclosing existence of preliminary merger negotiations), *cert. dismissed*, 108 S. Ct. 1067 (1988); *supra* note 72 and accompanying text (discussing profits that corporations and controlling shareholders can earn by failing to disclose preliminary merger negotiations).

profit for himself.[74] Consequently, a controlling shareholder, regardless of whether he purchases stock for the corporation or for himself, could make a large profit by failing to disclose the existence of preliminary merger negotiations.[75] Given the dynamics of closely held corporations, therefore, few difference sexist between a controlling shareholder of a closely held corporation purchasing stock on his own behalf and a controlling shareholder purchasing stock on a corporation's behalf.[76] Furthermore, because shareholders purchasing stock in an individual capacity can make a larger profit than if purchasing in a corporate capacity, minority shareholders need at least as much protection against dishonest purchases by shareholders acting for themselves as against dishonest shareholders purchasing for the corporation.[77]

Because minority shareholders who are the subject of a freezeout suffer the same harm from controlling shareholders purchasing for themselves as from those purchasing for the corporation, extending the *Guy* trustee fiduciary duty to include controlling shareholders purchasing for themselves would better protect minority shareholders from freezeouts.[78] Because courts that impose a trustee fiduciary duty on controlling shareholders acting for closely held corporations seek to protect the interests of minority shareholders, the trustee fiduciary duty also should extend to controlling shareholders of closely held corporations acting in an individual capacity.[79] By imposing a fiduciary duty of good faith and fair dealing on a controlling shareholder of a closely

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74. *See* Aggatuci v. Corradi, 327 Ill. App. 153, ____, 63 N.E.2d 630, 631 (1945) (controlling shareholder acting in personal capacity earned approximately $6,300 by not disclosing existence of preliminary merger negotiations); *supra* notes 73-74 and accompanying text (discussing profits that corporations and controlling shareholders can earn by failing to disclose preliminary merger negotiations).

75. *See supra* notes 70-73 and accompanying text (explaining financial similarity in closely held corporations between controlling shareholder making bargain purchase of stock on own behalf and making bargain purchase on corporation's behalf).

76. *See supra* notes 71-74 and accompanying text (in closely held corporations, shareholder may make large profit whether making bargain purchase of stock on own behalf or on corporation's behalf).

77. *See supra* notes 71-74 and accompanying text (comparing profits that controlling shareholders purchasing for themselves and controlling shareholders purchasing for corporation can earn from not disclosing preliminary merger negotiations).

78. *See infra* notes 79-83 and accompanying text (discussing how trustee fiduciary duty safeguards against oppression of minority shareholders in closely held corporations); *supra* notes 25-30 and accompanying text (discussing effects that freezeout tactics can have on minority shareholders of closely held corporations).

79. *See* Guy v. Duff & Phelps, Inc., 672 F. Supp. 1086, 1090-91 (N.D. Ill. 1987) (corporate officer purchasing minority shareholder's stock for corporation owed minority shareholder trustee fiduciary duty of good faith and fair dealing); *supra* notes 56-66 and accompanying text (discussing *Guy* court's rationale for imposing trustee fiduciary duty, with respect to stock, on controlling shareholder of closely held corporation acting in corporate capacity); *supra* notes 25-30 and accompanying text (discussing need to protect minority shareholders of closely held corporations from freezeouts); *supra* notes 70-75 and accompanying text (comparing profits that controlling shareholders purchasing for themselves and controlling shareholders purchasing for corporation can earn from not disclosing preliminary merger negotiations).

held corporation dealing with a minority shareholder, courts would dissuade the controlling shareholder from effecting the damaging freezeout tactic of undervaluing the shareholder's stock value in buying out the shareholder.[80] The minority shareholder would have notice of the preliminary merger negotiations and, consequently, could make an informed decision on the proper selling price of his stock.[81] If the freezeout was successful, the damage to a shareholder who receives inadequate value for his stock is the same irrespective of whether the corporation or another stockholder purchases the minority shareholder's stock.[82] If courts do not extend the trustee fiduciary duty to a controlling shareholder of a closely held corporation acting in a personal capacity, a controlling shareholder who wants to freeze out other shareholders of their stocks' true values could avoid the stricter trustee duty that courts impose on controlling shareholders acting in a corporate capacity merely by making the purchase in an individual capacity rather than in a corporate capacity.[83]

V. Extending a Partnership Fiduciary Duty to All Shareholders of Closely Held Corporations

Although the *Guy* court questioned the justification for distinguishing between controlling shareholders purchasing for the corporation and purchasing for themselves in disclosing preliminary merger negotiations, several courts considering other types of freezeout tactics already have eliminated any distinction between the two situations.[84] These courts sometimes have

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80. *See* Guy v. Duff & Phelps, Inc., 672 F. Supp. 1086, 1090-91 (N.D. Ill. 1987) (corporate officer, if dealing with corporate stock in corporate capacity, owes minority shareholder trustee fiduciary duty of good faith and fair dealing); *supra* notes 50-59 and accompanying text (discussing *Guy* court's rationale for imposing trustee fiduciary duty on controlling shareholder of closely held corporation purchasing stock in corporate capacity from minority shareholder); *see also supra* notes 24-30 and accompanying text (discussing corporate freezeout maneuvers).

81. *See* Jensen & Ruback, *supra* note 32 at 7-15 (during merger, target corporations' stock value increases average of 20 percent); Langley, *SEC To Require Disclosure Talks*, Wall St. J., July 9, 1985, at 3, col. 1 (stock prices of target corporations may increase to the price that acquiring corporation is offering for stock). A minority shareholder who is aware of merger negotiations could make an informed decision on the true value at which his stock should sell. *See supra* notes 71-77 and accompanying text (discussing how controlling shareholders can freeze out minority shareholders by failing to disclose preliminary merger negotiations before purchasing minority shareholder's stock).

82. *See supra* notes 71-77 and accompanying text (purchasing minority shareholder's stock at less than fair market value is potent freezeout tactic).

83. *See supra* notes 60-66 and accompanying text (analyzing difference in duties that courts place on shareholders acting in corporate capacity and shareholders acting on own behalf).

84. *See*, Michaels v. Michaels, 767 F.2d 1185, 1191-1206 (7th Cir. 1985) (controlling shareholders of closely held corporations have fiduciary duty to disclose existence of preliminary merger negotiations to minority shareholders before purchasing minority shareholders' stocks), *cert. denied*, 474 U.S. 1057 (1986); Guy v. Duff & Phelps, Inc., 672 F. Supp. 1086, 1090-91 (N.D. Ill. 1987) (in dicta, questioning distinction between controlling shareholders purchasing on own behalf and controlling shareholders purchasing for corporation); *infra* note 85 and accompanying text (listing decisions that impose partnership fiduciary duty on shareholders of closely held corporations).

imposed a broad fiduciary duty on shareholders of closely held corporations that is the equivalent of the fiduciary duty that partners owe to other partners.[85] For example, recognizing the disadvantaged position of minority shareholders in closely held corporations, the Supreme Judicial Court for the State of Massachusetts, in *Donahue v. Rodd Electrotype Company*,[86] considered whether a closely held corporation must offer minority shareholders the same stock repurchase offer that the corporation tendered to a majority shareholder.[87] In *Donahue*, a closely held corporation refused to repurchase a minority shareholder's stock in the corporation at the same price at which the corporation had repurchased the shares of the corporation's president.[88] The minority shareholder brought suit against the controlling shareholder and the closely held corporation to rescind the corporation's purchase of the president's stock.[89] The *Donahue* court recognized that, substantively, closely held corporations resemble partnerships.[90] The *Donahue* court reasoned that because shareholders in closely held corporations typically rely on other shareholders' skills and judgment, and because the stock in closely held corporations generally is nontransferable, closely held corporations closely resemble incorporated partnerships.[91] Accordingly, the *Donahue* court determined that because closely held corporations substantively possess the characteristics of partnerships, shareholders of a closely held corporation owe other shareholders the same fiduciary duty that partners owe other partners.[92] The *Donahue* court recognized that the partnership fiduciary duty requires all partners to act toward each other with the utmost good faith and loyalty, and not to act out of greed or self-interest.[93] Consequently, the *Donahue* court determined that because the defendant corporation had not extended

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85. *See* Helms v. Duckworth, 249 F.2d 482, 486-88 (D.C. Cir. 1957) (imposing partnership fiduciary duty on minority and majority shareholder engaging in stock purchase agreement); Wilkes v. Springside Nursing Home, Inc., 370 Mass 842, ____, 353 N.E.2d 657, 664 (1976) (shareholders in closely held corporations have fiduciary duty to other shareholders that resembles duty that partners owe other partners); Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515-16 (1975); H. HENN & J. ALEXANDER, *supra* note 2, §240, at 655 & n. 23 (listing decisions in which courts have extended partnership fiduciary duty to shareholders in closely held corporations); *infra* notes 86-94 and accompanying text (discussing courts' extension of partnership fiduciary duty to shareholders of closely held corporations).

86. 367 Mass. 578, 328 N.E.2d 505 (1975).

87. Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 511 (1975).

88. *Id.* at ____, 328 N.E.2d at 508.

89. *Id.* at ____, 328 N.E.2d at 509. In *Donahue v. Rodd Electrotype Company* the president of Rodd Electrotype Company (Rodd Company) had named one of the president's sons as a vice president of Rodd Company, and another son as a corporate director. *Id.* After the president retired, Rodd, without the approval of the plaintiff, Donahue, who was a minority shareholder of Rodd Company, purchased forty-five shares of the president's stock for 800 dollars per share as part of a retirement plan. *Id.* at ____, 328 N.E.2d at 510. Comparatively, Rodd Company, between 1965 and 1969, had offered only 40 dollars to 200 dollars per share for the plaintiff's stock. *Id.* at ____, 328 N.E.2d at 511 n.10.

90. *Id.* at ____, 328 N.E.2d at 512.

91. *Id.* at ____, 328 N.E.2d at 511.

92. *Id.* at ____, 328 N.E.2d at 515.

93. *Id.*

to all shareholders the same purchase price offer that the corporation extended to the corporation's president, the closely held corporation had violated its partnership fiduciary duty to its shareholders.[94]

Although courts and commentators have questioned to what situations courts might apply the *Donahue* partnership fiduciary duty, no courts ever have applied the *Donahue* partnership fiduciary duty to require an individual or corporation to disclose the existence of preliminary or assured merger negotiations.[95] The reasoning in *Guy*, however, demonstrates the degree to

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94. *Id.* at ____, 328 N.E.2d at 521.

95. *See, e.g.*, Note, *Contractual Disclaimer of the* Donahue *Fiduciary Duty: The Efficacy of the Anti-*Donahue *Clause*, 26 B.C.L. REV. 1215, 1226-33 (1985) (failing to find any court decision that extend *Donahue* partnership fiduciary duty to require disclosure of merger negotiations); Comment, *supra* note 24, at 431 (questioning how strictly and to what situations courts would impose broad *Donahue* partnership fiduciary duty); Comment, *Shareholders in a Close Corporation Owe to One Another Substantially the Same Fiduciary Duty Owed by Partners to One Another*: Donahue v. Rodd Electrotype Co., 21 VIL. L. REV. 307, 317 (1975-1976) (same). Although courts have not determined that the *Donahue* fiduciary duty applies to situations in which a controlling shareholder of a closely held corporation conceals the existence of preliminary merger negotiations from a minority shareholder before purchasing the minority shareholder's stock, courts have extended the *Donahue* fiduciary duty to numerous other situations. For example, in *Wilkes v. Springside Nursing Home, Inc.*, the Supreme Judicial Court for the State of Massachusetts considered whether majority shareholders, by terminating the employment of a minority shareholder of a closely held corporation, had violated a fiduciary duty to the minority shareholder. Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, ____, 353 N.E.2d 657, 659 (1976). In *Wilkes* the board of directors for the defendant corporation, after disagreeing with the minority shareholder over business matters, terminated the minority shareholder's employment with the corporation. *Id.* at ____, 353 N.E.2d at 659-61. Even though the minority shareholder owned 25 percent of the closely held corporation's stock, the other shareholders did not reelect the minority shareholder as either a director or an officer of the corporation. *Id.* The *Wilkes* court characterized the board's actions as a freezeout of the minority shareholder and reasoned that, under *Donahue*, the shareholders owe the minority shareholder a duty similar to the fiduciary duty that partners owed other partners. *Id.* at ____, 370 Mass. at 662-63. The Massachusetts court, therefore, determined that the *Donahue* fiduciary duty applied to situations involving the termination of a minority shareholder's employment with a closely held corporation. *Id.* The *Wilkes* court, however, reasoned that if the board of directors of the closely held corporation had a legitimate business purpose for terminating the minority shareholder's employment, the corporation would have a valid defense to the minority shareholder's claim that the defendant had breached its *Donahue* partnership fiduciary duty to the minority shareholder. *Id.* at ____, 353 N.E.2d at 663-64. The *Wilkes* court, however, concluded that the closely held corporation did not possess a legitimate business purpose for terminating the minority shareholder's employment and, consequently, determined that the corporation had violated its *Donahue* partnership fiduciary duty to the minority shareholder. *Id.* at ____, 353 N.E.2d at 664.

After *Wilkes*, the Massachusetts Supreme Judicial Court, in *Pupecki v. James Madison Corp.*, considered whether amajority shareholder, who owned 90 percent of the stock in a closely held corporation, had a fiduciary duty not to authorize the sale of substantially all of the corporation's assets for less than the fair market value of those assets. Pupecki v. James Madison Corp., 376 Mass. 212, ____, 382 N.E.2d 1030, 1031-32 (1978). The *Pupecki* court recognized that, statutorily, the majority shareholder had the right to effect the sale of the closely held corporation's assets. *Id*; *see* MASS. GEN. LAWS ANN. ch. 156B, § 75 (West 1970 & Supp. 1988) (two-thirds vote of corporate stock is necessary to sell all or substantially all of corporation's assets). The *Pupecki* court, however, determined that a majority shareholder, even with a statutory right to sell the corporate assets, had a partnership fiduciary duty under *Donahue* to other

which some courts have gravitated toward the *Donahue* partnership fiduciary duty principles in considering whether controlling shareholders of closely held corporations, acting in either an individual capacity or a corporate capacity, have a duty to disclose preliminary merger negotiations to minority shareholders before purchasing minority shareholders' stocks.[96] The trustee fiduciary duty that the *Guy* court adopted substantively is similar to the *Donahue* court's partnership fiduciary duty because both duties require controlling shareholders to act in good faith toward minority shareholders.[97] As a result, the *Donahue* partnership fiduciary duty, like the *Guy* court's trustee fiduciary duty, should require a controlling shareholder of a closely held corporation acting in either an individual or a corporate capacity to disclose the existence of preliminary merger negotiations before purchasing a minority shareholder's stock.[98]

By extending the *Donahue* court's partnership fiduciary duty to require the disclosure of preliminary merger negotiations in closely held corporations, courts would offer greater protection to shareholders than the *Guy* trustee fiduciary duty provides.[99] The *Donahue* partnership fiduciary duty applies to

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shareholders to receive an adequate price for the corporation's assets. *Pupecki*, 376 Mass. at ____, 382 N.E.2d at 1033.

After *Pupecki*, the Massachusetts Appeals Court, in *Smith v. Atlantic Properties, Inc.*, considered whether a minority shareholder who owned 25 percent of a closely held corporation's stock violated a fiduciary duty to the majority shareholders of the corporation by consistently voting against allowing the corporation to declare dividends and preventing the corporation from declaring dividends. Smith v. Atlantic Properties, Inc., 12 Mass. App. Ct. 201, ____, 422 N.E.2d 798, 800 (1981). In *Smith* a corporate charter required that 80 percent of the closely held corporation's shareholders to approve the corporation'sdeclaration of dividends. *Id.* at ____, 422 N.E.2d at 791. The *Smith* court reasoned that, under *Donahue*, a shareholder's partnership fiduciary duty applied to acts of minority shareholders as well as to acts of majority shareholders. *Id.* at ____, 422 N.E.2d at 801-02. The *Smith* court determined that the minority shareholder did not have a legitimate business purpose for voting against the corporation's declaration of dividends and, therefore, concluded that the minority shareholder had violated the *Donahue* partnership fiduciary duty. *Id.* at ____, 422 N.E.2d at 803-04.

96. *Compare Guy v. Duff & Phelps, Inc.*, 672 F. Supp. 1086, 1090-91 (N.D. Ill. 1987) (imposing trustee fiduciary duty on shareholders dealing with stock in corporate capacity) *and supra* notes 49-58 and accompanying text (discussing *Guy* court's decision) *with Donahue v. Rodd Electrotype Co.*, 367 Mass. 578, ____, 328 N.E.2d 505, 515-16 (imposing fiduciary partnership duty on shareholders in closely held corporation) *and supra* notes 84-94 and accompanying text (discussing *Donahue* court's decision).

97. *Compare Guy*, 672 F. Supp. at 1090-91 (imposing trustee fiduciary duty of good faith and fair dealing on shareholders dealing with stock in corporate capacity) *and supra* notes 50-59 and accompanying text (discussing *Guy* court's decision) *with Donahue*, 367 Mass. at ____, 328 N.E.2d at 515-16 (imposing fiduciary partnership duty of utmost good faith on shareholders in closely held corporation) *and supra* notes 84-94 and accompanying text (discussing *Donahue* court's decision).

98. *See supra* notes 95-97 and accompanying text (comparing practical effects of imposing trustee duty and partnership duty on shareholders of closely held corporations); *see also* Comment, *supra* note 24, at 428 (describing distinction between partnership fiduciary duty and trustee fiduciary duty as "elusive").

99. *See infra* notes 100-116 and accompanying text (analyzing advantages of extending *Donahue* partnership fiduciary duty to require all shareholders of closely held corporation, before purchasing another shareholder's stock, to disclose existence of preliminary merger negotiations).

each shareholder of a closely held corporation, regardless of the shareholder's corporate office or ownership status.[100] Unlike the *Guy* court's duty, the *Donahue* court's partnership fiduciary duty requires every shareholder of a closely held corporation to treat every other shareholder as a partner.[101] The *Guy* court's trustee fiduciary duty, however, only requires corporate directors, officers, and majority shareholders of closely held corporations purchasing stock from a minority shareholder to disclose the existence of preliminary merger negotiations.[102] Therefore, although the *Guy* court's fiduciary duty, by requiring controlling shareholders to disclose the existence of preliminary merger negotiations, protects minority shareholders from freezeouts by controlling shareholders, the *Guy* court's fiduciary duty does not protect controlling shareholders from freezeouts by minority shareholders.[103]

Although controlling shareholders normally employ freezeout tactics to oppress minority shareholders, minority shareholders may employ freezeout tactics to the disadvantage of controlling shareholders.[104] A minority shareholder's knowledge of the operations or physical assets of a closely held corporation may be essential to the operation or profitability of the corporation.[105] A minority shareholder may coerce controlling shareholders to

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100. *Compare* Smith v. Atlantic Properties, Inc., 12 Mass. App. Ct. 201, ____, 422 N.E.2d 798, 800 (1981) (*Donahue* partnership fiduciary duty applies to minority shareholders as well as majority shareholders) *and supra* note 95 (discussing *Smith* court's decision) *with Guy*, 672 F. Supp. at 1090-91 (imposing trustee fiduciary duty only on controlling shareholders of closely held corporation) *and supra* notes 49-58 and accompanying text (discussing *Guy* court's decision). *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, ____, 328 N.E.2d 505, 515 (1975) (*Donahue* partnership fiduciary duty imposes same fiduciary duty on shareholders of closely held corporations that partners owe to each other); *supra* notes 85-94 and accompanying text (discussing *Donahue* court's decision).

101. *See Donahue v. Rodd Electrotype Co.*, 367 Mass. 578, ____, 328 N.E.2d 505, 515 (1975) (all shareholders of closely held corporations owe each other same fiduciary duty that partners owe each other); *supra* notes 86-94 and accompanying text (discussing *Donahue* court's decision).

102. *See Guy v. Duff & Phelps*, 672 F. Supp. 1086, 1090-91 (N.D. Ill. 1987) (trustee fiduciary duty only applies to controlling shareholders of closely held corporation purchasing stock from minority shareholders during preliminary merger negotiations); *supra* notes 50-59 and accompanying text (explaining *Guy* court's application of trustee duty to controlling shareholders of closely held corporations).

103. *See Guy*, 672 F. Supp. at 1090-91 (imposing trustee fiduciary duty on controlling shareholders of closely held corporations purchasing stock for corporation from minority shareholder); *supra* notes 50-59 and accompanying text (discussing *Guy* court's decision).

104. *See, e.g., Donahue*, 367 Mass. at , 328 N.E.2d at 515 n.17 (minority shareholders may harm controlling shareholders by dealing unscrupulously with controlling shareholders); Smith v. Atlantic Properties, Inc., 12 Mass. App. Ct. 201, ____, 422 N.E.2d 798, 799-801 (1981) (because closely held corporation's charter required 80% vote of voting shares to approve declaration of dividends, shareholder of closely held corporation who held 25% of corporation's stock was able to prevent closely held corporation from declaring dividends); Easter & Fischel, *supra* note 13, at 296 (minority shareholders of closely held corporations may paralyze closely held corporation by refusing to attend meetings and preventing quorums, or by voting negatively on corporate matters requiring unanimous vote).

105. *See Donahue*, 367 Mass. at ____, 328 N.E.2d at 513-15 (shareholders of closely held corporations depend on each other's skills and abilities); *see also* 2 F. O'NEAL & R. THOMPSON,

comply with the minority shareholder's demands by threatening to withdraw aid and experience from the closely held corporation.[106] Additionally, minority shareholders may be able to collude and form a majority voting block.[107] By forming a majority, the minority shareholders can exercise many of the same freezeout techniques that controlling shareholders use against minority shareholders.[108] Unlike the *Guy* court's trustee fiduciary duty, the *Donahue* partnership fiduciary duty would prohibit freezeouts by minority shareholders.[109] For example, because a shareholder's corporate office and ownership status are irrelevant under the *Donahue* court's partnership fiduciary duty, a minority shareholder could not conceal the existence of preliminary merger negotiations to make a bargain purchase of another minority shareholder's stock or a majority shareholder's stock.[110] Similarly, a controlling shareholder of a closely held corporation could not advantageously conceal the existence of preliminary merger negotiations to make a profitable purchase of another controlling shareholder's stock.[111]

Even though the *Donahue* court's partnership fiduciary duty would require controlling shareholders of a closely held corporation purchasing stock in either an individual or corporate capacity to disclose preliminary merger

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supra note 7, §6:10, at 54-61 (listing various freezeout techniques that minority shareholders may use against controlling shareholders).

106. *See* Dresden v. Willock, 518 F.2d 281, 283-88 (3d Cir. 1975) (because minority shareholder of closely held corporation was also corporate attorney, corporate director, and corporate officer, minority shareholder was able to execute agreement that required majority shareholder to purchase stock at inequitable price); 2 F. O'NEAL AND R. THOMPSON, *supra* note 7, §6:10, at 54-61 (irreplaceable minority shareholder of closely held corporation may pressure controlling shareholders into transferring control of closely held corporation to minority shareholder).

107. *See, e.g.*, Ketchum v. Green, 557 F.2d 1022, 1023-24 (3d Cir.) (after minority shareholders of closely held corporation induced majority shareholders to elect minority shareholders to board of directors, minority shareholders terminated majority shareholders' employment), *cert. denied*, 434 U.S. 940 (1977); 2 F. O'NEAL & R. THOMPSON, *supra* note 7, §6:10, at 54-61 (explaining tactics that minority shareholders may use to become controlling shareholders); Axley, *The Case Against Cumulative Voting*, 1950 WIS. L. REV. 278, 282 (1950) (cumulative voting in corporations sometimes may allow minority of shareholders to elect majority of board of directors).

108. *See supra* notes 23-30 and accompanying text (discussing controlling shareholders' techniques of freezing out minority shareholders in closely held corporations).

109. *Compare Donahue*, 367 Mass. at ____, 328 N.E.2d at 515 (all shareholders of closely held corporations owe partnership fiduciary duty to each other, regardless of corporate office or ownership status) *and supra* notes 86-94 and accompanying text (discussing *Donahue* court's decision) *with Guy*, 672 F. Supp. at 1090-91 (imposing trustee fiduciary duty on controlling shareholders of closely held corporations purchasing stock for corporation from minority shareholder) *and supra* notes 50-59 and accompanying text (discussing *Guy* decision).

110. *See Donahue*, 367 Mass. at ____, 328 N.E.2d at 515 (regardless of corporate office or ownership status, all shareholders of closely held corporations owe partnership fiduciary duty to other shareholders); *supra* notes 85-94 and accompanying text (discussing *Donahue* court's decision).

111. *See Donahue*, 367 Mass. at ____, 328 N.E.2d at 515 (shareholders of closely held corporation owe partnership fiduciary duty to each other); *supra* notes 85-94 and accompanying text (discussing *Donahue* court's decision).

negotiations, no courts yet have applied the *Donahue* court's partnership fiduciary duty to require shareholders of closely held corporations to disclose any type of merger negotiations.[112] Furthermore, no courts yet have applied the *Guy* court's trustee fiduciary duty to controlling shareholders of closely held corporations acting in an individual capacity.[113] By imposing the *Guy* trustee duty on controlling shareholders of closely held corporations acting in either a corporate capacity or an individual capacity, however, courts would deter majority shareholders from oppressing minority shareholders better than imposing a trustee fiduciary duty only on shareholders acting in a corporate capacity.[114] Moreover, in addition to the protection that the *Guy* court's trustee fiduciary duty would offer, the *Donahue* court's partnership fiduciary duty would protect all shareholders of closely held corporations irrespective of whether a shareholder is a director, officer, majority shareholder, or minority shareholder.[115] By imposing the *Donahue* court's partnership fiduciary duty on shareholders of closely held corporations, courts effectively would deter all shareholders in closely held corporations, rather than just controlling shareholders, from refusing to disclose the existence of preliminary merger negotiations and from freezing out other shareholders.[116]

VI. CONCLUSION

In *Guy* the Illinois court recognized that the purpose of fiduciary duties is to prohibit persons from violating relationships of trust and confidence.[117] To further this purpose, the *Guy* court, in dicta, implied that controlling shareholders, regardless of the capacity in which they are acting, should have to disclose to minority shareholders the existence of preliminary merger

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112. *See supra* note 95 and accompanying text (discussing failure of courts to extend *Donahue* court's partnership fiduciary duty to require shareholders in closely held corporations to disclose merger negotiations).

113. *See supra* notes 50-59 and accompanying text (discussing *Guy* court's application of trustee fiduciary duty to closely held corporation's controlling shareholders acting on behalf of closely held corporation in matters relating to closely held corporation's stock); *supra* note 95 and accompanying text (discussing line of cases extending *Donahue* court's partnership fiduciary duty to various situations).

114. *See supra* notes 24-30 and accompanying text (discussing effects of freezeout tactics on minority shareholders of closely held corporations); *supra* notes 67-83 and accompanying text (analyzing advantages of imposing *Guy* court's trustee fiduciary duty on shareholders purchasing stock in individual capacity).

115. *See supra* notes 95-111 and accompanying text (discussing advantages of imposing *Donahue* court's partnership fiduciary duty to require shareholders of closely held corporations to disclose existence of preliminary merger negotiations before purchasing another shareholder's stock).

116. *See supra* notes 95-111 and accompanying text (discussing complete protection against freezeouts that courts would afford shareholders if courts, under the *Donahue* partnership fiduciary duty, required shareholders of closely held corporations to disclose existence of preliminary merger negotiations before purchasing another shareholder's stock).

117. *See supra* note 3 and accompanying text (defining fiduciary duties).

negotiations.[118] Although the *Guy* court's suggestion would offer minority shareholders better protection from freezeouts than they currently enjoy, courts more effectively could protect shareholders from freezeout tactics by applying the *Donahue* court's partnership fiduciary duty to require any shareholder to disclose the existence of preliminary merger negotiations before purchasing any other shareholder's stock in a closely held corporation.[119] Because the *Donahue* court's partnership fiduciary duty protects all shareholders of closely held corporations regardless of corporate titles or ownership status, the *Donahue* court's partnership duty furthers the purpose of fiduciary duties by requiring all shareholders of closely held corporations to deal fairly with one another.[120]

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118. *See Guy v. Duff & Phelps*, 672 F. Supp. 1086, 1091 (N.D. Ill. 1987) (trustee fiduciary duty only applies to controlling shareholders of closely held corporation purchasing stock from minority shareholders during preliminary merger negotiations); *supra* notes 50-59 and accompanying text (explaining *Guy* court's application of trustee duty to controlling shareholders of closely held corporations).

119. *See supra* notes 99-103 and accompanying text (comparing *Donahue* court's partnership fiduciary duty to *Guy* court's trustee fiduciary duty).

120. *See supra* notes 84-116 and accompanying text (discussing protection that *Donahue* partnership fiduciary duty affords minority shareholders of closely held corporations).