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BOOK REVIEW

"SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS. By F. Hodge O'Neal.  

Participants in a private business, either a partnership or a close corporation, should be able to begin their business venture confident that if they act wisely and get lucky, they will achieve their objectives. These objectives usually include job security, control in managing the business, a decent income, and financial security for their families and their old age. Normally, if the business succeeds, so will its owners. Fulfilling these legitimate expectations is a worthy goal of corporation law.

Any new business, of course, must anticipate many obstacles on the road to success. One risk that the businessman does not foresee, however, at least when the venture begins, is a booby trap planted by his associates. Lawyers know from experience that warfare among business colleagues, whereby some fall victim to oppressive or fraudulent tactics of others, is a real danger. A business may succeed without all participants sharing proportionately in the rewards. Lawyers also know that careful business planning can circumvent many situations that lead to discord among "partners." The degree of avoidable risk, however, depends largely on the lawyer's familiarity with the available legal resources. Mere establishment of a legal business entity does not assure the fulfillment of legitimate business expectations.

Gradually, our legal system has begun to recognize the peculiar needs of close corporations. Close corporation statutes, and special provisions for close corporations in general corporate laws, permit flexibility in control and management, transferability of ownership, and dissolution of the business. Use of stockholder agreements to tailor a corporate structure to particular needs has increased significantly. Perhaps the most elusive goal of corporate law, however, is the prevention of so-called "freeze-outs" or "squeeze-outs." In part, this is because such tactics are rarely so characterized; indeed, many of the evils of squeeze-outs may lie in the eye of the beholder. Furthermore, prevention of squeeze-outs demands a degree of judicial activism that most courts shun.

1. Madill Professor of Law, Washington University. A.B., 1938, J.D., 1940, Louisiana State University; J.S.D., 1949, Yale University; S.J.D., 1954, Harvard University.
Progress in preventing squeeze-outs requires a clear recognition of the problem and a thorough analysis of its causes and cures. Professor F. Hodge O'Neal has performed this task in his new book, "Squeeze-Outs" of Minority Shareholders. Increased recognition by the bar and bench of the problems of close corporations, and legislative reform in the area, are largely attributable to the efforts of legal scholars such as Professor George Hornstein of New York University Law School and especially Professor O'Neal, who has written several important works in this field, including the leading treatise.² His latest book deserves to rank high in the literature.

Professor O'Neal suggests that he designed this book for both lawyers and their clients,³ but I suspect it will interest lawyers almost exclusively. Although lucidly written, the book necessarily contains a detailed description of many cases that will benefit lawyers much more than their clients. One of the book's greatest strengths is that it is undoubtedly the most complete collection of case citations on the subject, and is full of references to other legal authorities. The scope of its case material is greatly enhanced by the inclusion of lawyers' letters to the author describing situations not reported elsewhere. If only because of the book's comprehensiveness, every lawyer working in the area of close corporations will want to refer to it, or preferably to acquire his own copy.

The book begins with a discussion of the causes of squeeze-outs (or to use Professor O'Neal's accurate, if cacophonous term, why people become "squeezees"). Squeeze-outs sometimes result from simple personality clashes, or from a combination of greed and opportunity. A shareholder's death, refusal to retire, or inability to dispose of his stock may also precipitate a squeeze-out. Many squeeze-outs can be anticipated and avoided by careful planning; even squeeze-outs arising from relatively trivial disputes such as personality conflicts can be averted, since a conscientious attorney can safeguard against almost any contingency. As Professor O'Neal observes, however, many squeeze-outs occur because "lawyers do not fully understand the situations which give rise to squeeze-outs and are not thoroughly familiar with


³. F. HODGE O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS vi (1975) [hereinafter cited as O'NEAL].
rather complex and sometimes highly technical precautions which are necessary to protect minority interests.\textsuperscript{4}

In the following 350 pages, which comprise more than half the text, Professor O'Neal catalogues the richest assortment of squeeze-out techniques ever assembled. One category of practices might be called "operating techniques," as they all arise in connection with the operation of the business. Examples of operating techniques are withholding dividends, self-dealing transactions between the corporation and some of its principals, appropriation of corporate opportunities, and termination of employment. In other words, the business is operated to benefit only some of the shareholders, while others receive little or no gain. Since practical or legal constraints frequently prevent shareholders of close corporations from selling their stock, the victims of these tactics often must simply endure them.

The other major category of oppressive devices might be described as "structural techniques." This category consists of fundamental corporate transactions that do not occur in the routine operation of the business—squeeze-out mergers, recapitalizations, and various charter amendments. In this section, Professor O'Neal discusses the so-called "going private" transaction,\textsuperscript{5} a structural technique employed by publicly-held corporations that has received much recent attention. Professor O'Neal treats oppression resulting from sales of control separately, although such sales can also be viewed as fundamental corporate changes.

Professor O'Neal postpones to a later chapter his discussion of the legal defenses to squeeze-outs. As a result, the earlier chapters provide full description of the cases, but are sometimes disappointingly short on analysis. For example, Professor O'Neal sets forth the facts of the intriguing case of \textit{Farris v. Glen Alden Corp.},\textsuperscript{6} which involved application of the de facto merger doctrine, but does not analyze the holding of the case and its implications.

Federal law has become an increasingly important source of corporate law due to the application of federal securities law to publicly-held and close corporations alike. Professor O'Neal notes this development throughout the book. He suggests, for example, that Rule 10b-5 of

\textsuperscript{4} O'NEAL, supra note 3, § 2.20, at 55.

\textsuperscript{5} Id. § 5.32.

\textsuperscript{6} 393 Pa. 427, 143 A.2d 25 (1958), discussed at O'NEAL, supra note 3, § 5.30, at 349-51.
the Securities and Exchange Act may empower courts to compel declaration of dividends. This theory is derived from *Mutual Shares Corp. v. Genesco, Inc.*, which held that an injunction could issue if corporate directors withheld dividends in order to reduce the market price of the corporation's stock. A recent Sixth Circuit decision, *Marsh v. Armada Corp.*, however, may greatly undercut the authority of *Genesco*. In *Marsh*, the Sixth Circuit dismissed an action against a controlling corporation that caused a subsidiary's dividend to be cut, allegedly to enable the controlling corporation to buy more shares of the subsidiary at a lower price. Plaintiffs alleged that the controlling corporate shareholder had breached its fiduciary duty, and thus violated Rule 10b-5. The court refused to equate breach of fiduciary duty with fraud, however; finding that the controlling shareholder had not deceived the plaintiffs, the court dismissed the complaint. The proposition that a breach of fiduciary duty is tantamount to fraud, which the *Marsh* court rejected, must be established if Rule 10b-5 is to play a vital role in the affairs of close corporations. Whether this will happen is hard to predict, especially in light of other cases discussed below.

The most dramatic development in the use of federal securities law to prevent squeeze-outs has occurred in connection with "going private" transactions. Professor O'Neal notes that mergers, especially short-form mergers that can be accomplished without a shareholder vote under the laws of a growing number of states, offer enormous opportunities for squeeze-outs of minority interests. He speaks of the increased use of this technique with raised eyebrow:

As [some] cases show, modern corporation statutes which facilitate mergers have made it easier to victimize minority shareholders. A minority shareholder who wants to prevent a merger must often prove what courts label "fraud," or occasionally "constructive fraud," terms which as might be expected are not defined with uniformity or precision. While some courts will inquire into the fairness of a merger agreement if the circumstances seem to warrant close scrutiny, others will set aside a merger only when unfairness is so patent as unmistakably to indicate bad faith or reckless indifference to the rights of the minority.11

7. 384 F.2d 540 (2d Cir. 1967).
8. O'NEAL, supra note 3, § 3.05, at 70.
9. 533 F.2d 978 (6th Cir. 1976).
10. See Ratner, Federal and State Roles in the Regulation of Insider Trading, 31 Bus. Law. 947 (1976), for a persuasive argument that Rule 10b-5 is an inappropriate vehicle for regulation of close corporations.
Taking his cue from former SEC Commissioner A.A. Sommer, Jr., Professor O'Neal expresses hope that courts will construe Rule 10b-5 to provide a remedy against the myriad forms of going private: "When courts are appealed to by public shareholders who have been squeezed out of a company or whose holdings have been diminished in value because a company has 'gone private,' the courts should find a way to give relief."  

Until recently, however, the leading case in this area, *Bryan v. Brock & Blevins Co.*, condemned a squeeze-out merger on the basis of Georgia law rather than Rule 10b-5. Professor O'Neal often refers to the *Bryan* case in connection with his suggestion that Rule 10b-5 might provide a remedy against squeeze-out mergers. He acknowledges, however, that the Fifth Circuit refused to pass on the federal question in *Bryan*, although the district court had found a violation of Rule 10b-5.  

The federal courts may have vindicated Professor O'Neal's prediction, however, in two celebrated cases decided last spring by the Second Circuit—*Green v. Santa Fe Industries, Inc.* and *Marshel v. AFW Fabric Corp.* In *Green*, the court held that a complaint states a 10b-5 cause of action "when it charges, in connection with a Delaware short-form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose." The importance of both cases is that the court found that deception of the shareholders is not prerequisite to a 10b-5 violation.  

These decisions met noisy objections from the bar, and both may be overruled by the Supreme Court. Even the Second Circuit conceded, in its ruling two months later in *Merrit v. Libby, McNeill & Libby*, that there may be less here than meets the eye. Nonetheless, Professor

12. *Id.* § 5.32, at 365 n.4.  
13. *Id.* at 364.  
14. 490 F.2d 563 (5th Cir. 1974).  
15. O'NEAL, supra note 3, § 7.09, at 469.  
17. 533 F.2d 1283 (2d Cir. 1976).  
18. 533 F.2d 1277 (2d Cir. 1976).  
19. 533 F.2d at 1291.  
21. 533 F.2d 1310 (2d Cir. 1976).
O’Neal is certainly correct in suggesting the strong possibility that federal law may provide stockholders significant protection from squeez-outs. The “going private” cases, of course, dealt with publicly-held companies. Federal remedies for breaches of fiduciary duties in close corporations may be less justifiable, since close corporations have no impact on the securities markets. Professor O’Neal does not discuss this distinction, nor have the courts given it serious consideration; in fact, the first private action under Rule 10b-5 involved a corporation with four stockholders. The Supreme Court may latch onto this distinction, however, if it continues its recent re-thinking of Rule 10b-5.

Another important effect of federal securities law is that it may have raised the standard of conduct that state courts demand from controlling shareholders. State court protection against squeeze-outs or freeze-outs (“freezees?”) has increased in recent years, particularly in “going private” transactions. Since the Supreme Court has narrowed the scope of Rule 10b-5 by limiting standing to purchasers and sellers of securities, requiring strong proof of scienter, and suggesting that regulation of internal corporate affairs is a state concern, this trend toward stricter state standards is perhaps the most important recent development in corporation law.

After discussing squeeze-out ploys, Professor O’Neal considers the defenses available to minority shareholders. At this point he reveals his bias, admitting that “This Chapter has been fun to write.” He recommends invigoration of the concept of fiduciary duties to check squeeze-outs; greater use of federal law; easier access to corporate information; and utilization of blue sky laws. The latter may seem misplaced in a list of defensive tactics for shareholders of close corporations, but Professor O’Neal points out that under the California Secur-

27. O’NEAL, supra note 3, § 7.01, at 409.
ities Act, the Commissioner "can do a great deal to protect minority shareholders in a recapitalization or reorganization."\textsuperscript{28} Provisions like California's are not universal, however, and afford limited protection. More relevant is his suggestion that plaintiffs urge courts to recognize that close corporations, like most partnerships, are founded on personal relationships which create certain legitimate expectations of fairness.\textsuperscript{29} Effective advocacy and a sensitive bench can go a long way towards protecting shareholders, and Professor O'Neal furnishes ample arguments to fuel both bench and bar.\textsuperscript{30}

The book ends with Professor O'Neal's proposed reforms to protect minority stockholders. Some of these changes call for legislation, such as statutes compelling payment of dividends under certain circumstances. Other proposals entail expanding stockholder dissent and appraisal rights, authorizing broader discretionary relief as permitted by section 210 of the English Companies Act, and calling upon courts to be more sympathetic and enterprising in protecting minorities.\textsuperscript{31} Substantial progress has been made at both the legislative and judicial levels in the past twenty years, but Professor O'Neal's book demonstrates the need for further change. Statutory reforms have facilitated planning for protection, but the courts' role must be greatly enlarged in order to provide adequate protection of minority shareholders. Requiring judges to read Professor O'Neal's book before deciding a case involving a struggle between majority and minority shareholders would be a step in the right direction.

It is difficult to conceive of a successful squeeze-out that does not involve the active participation of a lawyer. Since squeeze-outs constitute (at least in the opinion of Professor O'Neal and this reviewer) a type of fraud, lawyers' participation in such schemes is troublesome. Professor O'Neal occasionally refers to ethical problems, including a

\textsuperscript{28} Id. § 7.08, at 461.
\textsuperscript{29} Id. § 7.15.
\textsuperscript{30} A particularly useful example is a decision of the English House of Lords, Ebrahimi v. Westbourne Galleries Ltd., [1973] A.C. 360, rev'd In re Westbourne Galleries Ltd., [1971] Ch. 799, which involved a degree of judicial flexibility seldom found in American courts. See O'Neal, supra note 3, § 7.15.
\textsuperscript{31} A New York Court of Appeals decision, Kruger v. Gerth, 16 N.Y.2d 802, 210 N.E.2d 355, 263 N.Y.S.2d 1 (1965), is a good illustration of judicial timidity. See Fales, Judicial Attitudes Towards the Rights of Minority Stockholders, 22 Bus. Law. 459 (1967). The Iowa Supreme Court's decision in Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517 (Iowa 1974), discussed at O'Neal, supra note 3, § 9.05, demonstrates a better approach to squeeze-out problems.
discussion of the attorney-client privilege,\textsuperscript{32} but he does not explore the professional responsibility problem in depth. One of the most difficult aspects of the close corporation lawyer's role is that he often "represents" all of the participants at the time the corporation is formed. Under those circumstances, who should the lawyer regard as his "client?"

To what extent should he be involved in planning and negotiations, and how should he conduct himself when a divisive dispute later arises? The Code of Professional Responsibility provides minimal safeguards against these obvious conflicts of interest.\textsuperscript{33} Professor O'Neal does not address these problems, but one hopes he eventually will.

"Squeeze-Outs" of Minority Shareholders is richer in material than this review has been able to suggest. It is certain to be a standard reference for many years, probably until Professor O'Neal or one of his students—and we are all students of Professor O'Neal in this field—decides to revise the book.

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\textsuperscript{32} O'Neal, \textit{supra} note 3, § 7.06.

\textsuperscript{33} \textit{ABA Code of Professional Responsibility, Ethical Considerations} 5-14 to -19 (1970).

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