In the closely held business, there is often a stark line of demarcation between “those in control of the corporation” and those who are not. “Those in control” dominate corporate affairs, typically through a majority shareholding interest, officer or director positions, or both. They have the power to direct and implement corporate decisions, such as officer and employee compensation levels; engage in self-interested transactions or pursue corporate opportunities; pay distributions to shareholders; and oversee financial reporting of the company. These decisions financially impact not only the corporation, but also the non-controlling shareholders. Given the risk that those in control may abuse their power, the common law imposes on them a “special duty of care,” which “requires a higher standard of fiduciary responsibility, a standard more akin to partnership law.”

The Michigan Business Corporation Act builds on this common-law principle by providing statutory protection for non-controlling shareholders and close corporations. MCL 450.1489 permits shareholders to file lawsuits for relief from conduct that is “illegal, fraudulent, or willfully unfair and oppressive to the corporation or to the shareholder.” This article focuses on the judicial application of Section 1489 since the Michigan Court of Appeals recognized a direct statutory cause of action for shareholders and, in particular, three noteworthy decisions that have been issued since 2009.

Specific Findings of Actionable Conduct Since Franchino v Franchino

In 2004, the Michigan Court of Appeals issued a published opinion in Franchino v Franchino, holding that the termination of Section 1489 since the Michigan Court of Appeals recognized a direct statutory cause of action for shareholders and, in particular, three noteworthy decisions that have been issued since 2009.

Fast Facts

Those in control of close corporations bear a high standard of fiduciary responsibility.

Courts have affirmed liability under Section 1489 based on disparities in shareholder benefits, intent to “squeeze out” minority shareholders, self-dealing, corporate usurpations, and mismanagement.

A court-ordered stock redemption of a minority’s shares at “fair value” under Section 1489(1)(e) does not necessitate a minority discount.
of a shareholder’s employment and directorship did not constitute oppression.8 The allegations underlying the Franchino holding were narrow; as the Court noted, “[t]he plaintiff alleged only that the defendant engaged in shareholder oppression under MCL 450.1489 by (1) terminating plaintiff’s employment, (2) removing plaintiff from the board of directors, and (3) amending the bylaws of the corporation.”9 The Court held that such facts did not constitute “willfully unfair and oppressive conduct” under Section 1489(3) because they did not implicate the plaintiff’s interests “as a shareholder.”10

The Franchino decision quickly generated criticism, since shareholders in closely held businesses often receive their returns through salaries and bonuses rather than dividends or other forms of distributions.11 Soon after Franchino’s release, the Michigan legislature enacted an amendment to Section 1489(3) to clarify that “willfully unfair and oppressive conduct” can include “the termination of employment or limitations on employment benefits to the extent that the actions interfere with the distributions or other shareholder interests disproportionately as to the affected shareholder.”12

Some courts have cited to Franchino in support of a narrow statutory interpretation that would limit actions under Section 1489 to those that impact a shareholder’s right to vote at meetings, elect directors, adopt bylaws, amend charters, examine corporate books, or receive corporate dividends.13 However, general judicial interpretation of what can qualify as “oppressive” conduct has broadened considerably since the 2004 Franchino opinion. In recent years, the Michigan Court of Appeals and federal district courts have found the following conduct to be actionable under Section 1489:

- “Funneling” corporate funds and property to other corporations owned by the controlling shareholders.14
- Making loans from the corporation to other corporations owned by the controlling parties where the loans are “interest free, are not secured by collateral, and have no repayment date or terms of default.”15
- Imposing charges on the corporation by a corporation owned by the controlling parties where there are no written agreements or “other detailed documentation to support” the charges.16
- Depriving the minority from receiving benefits while the controlling shareholder receives substantial benefits.17
- Refusing to pay dividends to the minority shareholder despite the existence of cash reserves.18
- Attempting to implement a stock redemption plan that favors the controlling shareholders.19
- Eliminating financial distributions to a minority shareholder while increasing distributions to controlling shareholders.20
- Engaging in conduct with intent to “squeeze plaintiff out of the company rather than to give him his fair share of his investment.”21
- Engaging in conduct designed to hide corporate profits.22
- “Mismanagement of the corporation resulting in harm both to the corporation and to the interests of the shareholders.”23
- The appropriation of corporate opportunities by controlling parties.24

This list is not exhaustive. As Judge Zatkoff succinctly wrote in Bromley v Bromley:25

[It] is reasonable to conclude that the type of conduct amounting to a breach of fiduciary duties in close corporations is the type of conduct prohibited by § 450.1489. Examples of such conduct include investments deemed not to be in the corporation’s best interest, denying access to corporate books and records, diverting corporate opportunities and assets to other entities, removing minority shareholders from positions in management, refusing to declare dividends, and diluting minority equity interests.26

This growing body of caselaw illustrates that the trend is toward a broad interpretation of what constitutes actionable conduct.

Arevelo v Arevelo—A Departure from the Mainstream

In the 2010 opinion of Arevelo v Arevelo,27 the Court of Appeals affirmed the dismissal of oppression claims on MCR 2.116(c)(8) grounds, finding no “connection between [the defendant’s] alleged wrongful acts and the oppression of [the plaintiff’s] shareholder rights.”28 The plaintiff and defendant shareholders were divorced spouses involved in contentious post-judgment proceedings concerning the jointly owned business, including a personal protection order against the husband.29 The plaintiff’s allegations in support of an action under Section 1489 included not only conduct directly damaging to the business, such as misappropriation of and damage to business assets, but also physical and verbal assault and sexual harassment.30

Although the Arevelo plaintiff seems to have sought remedies under Section 1489 for “illegal” and “fraudulent” acts and not strictly for “willfully unfair and oppressive” conduct,31 the Court nonetheless focused only on whether the allegedly improper conduct affected her rights “as a shareholder”—the test for “willfully

THE RIGHTS OF SHAREHOLDERS INCLUDE

“VOTING AT SHAREHOLDER’S MEETINGS, ELECTING DIRECTORS, ADOPTING BYLAWS, AMENDING CHARTERS, EXAMINING THE CORPORATE BOOKS, AND RECEIVING CORPORATE DIVIDENDS.”
Remedies Under Section 1489: Recent Opinions Show Increased Judicial Confidence

Since the undoing and remediating of an oppressive corporate regime can be a complicated matter and the appropriate remedies are dependent on the facts and circumstances of each case, the statute vests courts with a tremendous degree of latitude. Section 1489 provides a list of “flexible discretionary remedies to shareholders of closely held corporations” in addition to vesting the court with the power to issue any orders or relief “as it considers appropriate.” Until recently, Section 1489 jurisprudence has been virtually silent on the application of these remedies. In 2009 and 2011, however, the Court of Appeals issued two instructive opinions as to how remedies can be tailored to the facts of a particular case.

**Schimke v Liquid Dustlayer, Inc**—Incomplete Plans, Inequitable Status Quo, and Redemption at “Fair Value”

In the 2009 case of *Schimke v Liquid Dustlayer, Inc.*, the Court of Appeals affirmed the trial court’s decision that oppression occurred where the controlling shareholder proposed an unconsummated plan to have the company redeem his stock on terms that were not made available to the plaintiff. The Court of Appeals held for the first time that an incomplete act or plan could constitute oppression because “§489 does not require that an act be completed before a court may intervene.” The Court based its holding on the remedies provided in subsections (c) and (d),
which allow the court to enjoin or direct the actions of the corporation, even where the defendants characterized their redemption plan as “mere speculation” and “an inchoate dream.”

The Court also held that its injunction against the redemption plan was not a sufficient remedy because there was an “inequitable status quo” arising out of a substantial financial disparity between the controlling and non-controlling shareholders. Accordingly, the Schimke Court ordered that the parties obtain a valuation and that the defendants redeem the plaintiff’s stock at the plaintiff’s stock at “fair value” pursuant to subsection 1489(d)(e). The defendants objected, arguing that fair value required application of a “minority discount”46 to the plaintiff’s shareholding interest. The Court of Appeals rejected the defendants’ argument and held that fair value under the statute does not necessitate a minority discount.47

**Berger v Katz—Innovative Buyout Remedies**

In the 2011 case of Berger v Katz, the Court of Appeals ordered a specially designed remedy that combined both the buyout and the liquidation mechanisms, thereby avoiding the complexities of reconciling competing opinions as to the fair value of the company. Determining that either a buyout or liquidation was needed, the trial court—which was affirmed in all respects by the Court of Appeals—ordered that the first step would be for the defendants to determine the fair value of the plaintiff’s stock. After the price was set, the plaintiff would have the option of either selling his one-third interest to the defendants based on the defendants' shares at twice that amount. The plaintiff’s option to purchase the defendants’ shares rather than accept a buyout served to implicitly police the plaintiff’s shareholding interest. The Court of Appeals rejected the defendants’ argument and held that fair value under the statute does not necessitate a minority discount.

**Conclusion**

The reach of Section 1489 is broad, and with the wide discretion vested in trial courts as to the appropriate remedy, the statute is a powerful tool for resolving disputes between factions of closely held corporations. The bases of liability on which Section 1489 claims have been sustained are in line with that which has given rise to breaches of fiduciary duty and other conduct actionable at common law, so the practitioner should not overlook claims and caselaw dealing with fiduciaries generally when defining the contours of his or her case.

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**FOOTNOTES**


2. MCL 450.1489(1).

3. Estes, supra at 281; see also Band v Livonia Assoc, 176 Mich App 95, 113; 439 NW2d 285 (1989), citing 59A Am Jur 2d, Partnership, §420 (holding that partners owe each other the obligations of the utmost good faith and integrity in their dealings and fiduciary duties “connoting not mere honesty but the punctilio of honor most sensitive”).

4. MCL 450.1101, et seq.

5. MCL 450.1489(1).

6. Although MCL 450.1489 has been effective since October 1, 1989, the Michigan Court of Appeals did not formally recognize that the statute creates a direct, rather than derivative, cause of action until 2002. Estes, supra at 272.

7. Berger v Katz, unpublished opinion per curiam (2–1, Wilder dissenting) of the Court of Appeals, issued July 28, 2011 (Docket Nos. 291663, 293880); Arevelo v Arevelo, unpublished opinion per curiam of the Court of Appeals, issued April 6, 2010 (Docket Nos. 285548, 286742); Schimke v Liquid Dustlayer, Inc, unpublished opinion per curiam of the Court of Appeals, issued September 24, 2009 (Docket No. 282421).


9. Id. at 189.

10. Id.
12. MCL 450.1489(3).
13. See, e.g., Arevelo, n 7 supra at 17–18.
15. Weiner, n 14 supra at 15.
16. Id. at 15–16.
17. Schimke, n 7 supra at 13.
18. Id.
19. Id. at 12–13.
20. Berger, n 7 supra at 3, 12.
21. Id. at 12.
22. Id. at 15.
23. Bromley v Bromley, unpublished opinion of the United States District Court for the Eastern District of Michigan, Southern Division, issued June 7, 2006 (Docket No. 05-71798), p 15; see also McDonnell v Colburn, unpublished opinion per curiam of the Court of Appeals, issued October 21, 2010 (Docket No. 292601), p 4 (the trial court held that oppression occurred where the controlling shareholders reduced the corporation’s value by cancelling advertising, misappropriating opportunities, withholding of billings, and removal of marketing materials).
26. McDonnell, n 23 supra, citing 19 Am Jur 2d, Corporations, §2372 (citing cases from numerous jurisdictions); 1 O’Neal & Thompson, Oppression of Minority Shareholders and LLC Members, §3.11.
27. Arevelo, n 7 supra.
28. Id. at 18.
29. Id. at 3–4.
30. Id. at 16–17.
31. Id. at 16–20.
32. Id. at 18.
33. Id. at 16, citing Franchino, n 8 supra at 184.
34. Id. at 18.
35. In Trapp v Vollmer, unpublished per curiam opinion of the Court of Appeals, issued June 16, 2011 (No. 297116), the court dismissed another shareholder oppression claim based on a Franchino analysis. In Trapp, however, the plaintiff argued specifically that Franchino’s rejection of a “reasonable expectations” approach to define oppressive conduct had been negated by the 2006 amendment to Section 1489(3). The Trapp Court disagreed, and no Michigan Court of Appeals opinion has ever disputed Franchino’s rejection of the “reasonable expectations” approach.
36. See id.
37. Estes, n 1 supra at 278.
38. MCL 450.1489(1).
39. Schimke, n 7 supra.
40. Id. at 12–13.
41. Id. at 7.
42. Id. at 7, 10, 11.
43. Id. at 15.
44. Id. at 16.
45. Meaning, a reduction from the market value of the asset because the minority interest owner cannot direct the business operations.
46. Schimke, n 7 supra at 16–17.
47. Berger, n 7 supra. An application for leave to appeal to the Michigan Supreme Court is pending in this case, which, as of the date on which this article was submitted for publication, had not been adjudicated.
48. Id. at 16.
49. Id. The defendants owned two-thirds of the shares, and the plaintiff owned one-third. Id. at 1.
50. Id. at 16–17.