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STUDENT NOTES

OPPRESS ME NO MORE: AMENDING THE ILLINOIS LLC ACT TO PROVIDE ADDITIONAL REMEDIES FOR OPPRESSED MINORITY MEMBERS

PAUL T. GESKE*

INTRODUCTION

In his 2014 State of the State Address, Illinois' Governor proposed lowering the filing fee for limited liability companies (LLCs) from \$500 to \$39, the lowest in the country, as a way of drawing new businesses to Illinois.¹ However, making Illinois an attractive place for businesses requires more than just financial incentives.² Illinois should provide a stable legal environment in which the rights and obligations of business-owners are predictable and unambiguous.³ Given the popularity of LLCs among entrepreneurs and small businesses,⁴ lawmakers should start by revisiting the Illinois Limited Liability Company Act (ILLCA).⁵

Courts and commentators recognize that LLC members who own a minority interest in their company, like minority shareholders of close cor-

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1. Monique Garcia et al., *Quinn Pushes for Minimum Wage Increase, Early Childhood Education Spending*, CHI. TRIB. (Jan. 29, 2014, 7:16 PM), <http://www.chicagotribune.com/news/politics/clout/chi-quinn-pushes-for-minimum-wage-increase-early-childhood-education-spending-20140129,0,1416085.story?page=1>. In 2014, Patrick Quinn was governor of Illinois and delivered the State of the State address. Bruce Rauner defeated Quinn in the November 2014 election and took office in January 2015.

2. See, e.g., Amanda Vinicky, *Businesses: LLC Fee Drop a Drop in the Bucket*, WUIS.ORG (Feb. 3, 2014, 6:05 AM), <http://wuis.org/post/businesses-llc-fee-drop-drop-bucket>.

3. For example, Delaware is known for being an attractive state to corporations because of its responsiveness to corporate needs, well-developed case law, and prestigious reputation. WILLIAM L. CARY & MELVIN ARON EISENBERG, *CASES AND MATERIALS ON CORPORATIONS* 83 (7th ed. 1995). For that reason, Delaware is "the preeminent state in terms of the number of publicly held corporations incorporated there." *Id.*

4. Steven C. Bahls, *Application of Corporate Common Law Doctrines to Limited Liability Companies*, 55 MONT. L. REV. 43, 90 (1994) ("Limited liability companies uniquely combine attributes of partnerships and corporations in a way that makes them very attractive to closely held businesses."); Douglas K. Moll, *Minority Oppression & The Limited Liability Company: Learning (or not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 885-86 (2005) ("In recent years, [the application of the oppression doctrine to the LLC] has taken on critical importance, as the LLC has emerged as the favored business structure for many closely held enterprises.").

5. 805 ILL. COMP. STAT. ANN. 180/1-1 (West 2013).

porations, are particularly vulnerable to oppressive⁶ conduct like freeze-outs and deadlock.⁷ In some situations, members are even more vulnerable than their shareholder counterparts.⁸ For these minority interest-holders, the ILLCA offers little clarity, as it neither defines oppressive conduct nor an oppressed member's rights, and only states that an LLC must dissolve and wind-up its business upon a finding of oppression.⁹ However, because courts are reluctant to impose a harsh remedy like dissolution,¹⁰ oppressed LLC members may require additional or alternative relief appropriate to their grievance. But the ILLCA provides no other options. As a point of comparison, the section of the Illinois Business Corporation Act (IBCA) dealing with oppression of shareholders of "non-public corporations" creates at least *twelve different remedies* for oppression.¹¹ In contrast to this section of the IBCA, the oppression provision of the ILLCA is simultaneously ambiguous and terse.¹²

6. "Oppressive" is a legal term of art that now appears in many business corporation acts and LLC acts. Its meaning has been defined over time by the courts. The definition is broad yet highly fact-specific, and will be discussed below in Part I.C.

7. Where the parties' relationship breaks down, corporate norms of majority rule enable the controlling group to exclude the minority from the business and from receiving any profits. Market forces do not constrain this behavior, because there is no market for ownership interests in small businesses. See generally *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 328 N.E.2d 505, 513 (Mass. 1975); *Walensky v. Jonathan Royce Int'l, Inc.*, 624 A.2d 613, 615 (N.J. Super. Ct. App. Div. 1993) ("The interest owned by a minority shareholder in a closely held corporation is often a precarious one. In fact, it has been characterized by this court as being one of 'acute vulnerability.'"); F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLCs: LAW AND PRACTICE § 1:13 (3d ed. 2013).

8. The added flexibility and freedom to contract enjoyed by participants in LLCs offers little protection and may only exacerbate problems if the parties' operating agreement is slanted to favor the party with greater bargaining strength. F. HODGE O'NEAL & ROBERT B. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 6:2 (2d ed. 2013) ("LLCs are now set up to follow the experience of close corporations where participants similarly chose the corporation for liability and tax reasons and encountered unexpected problems down the line after a falling out among the parties."); Mark J. Loewenstein, *Wilkes v. Springside Nursing Home, Inc.: A Historical Perspective*, 33 W. NEW ENG. L. REV. 339, 365 (2011) ("The typical limited liability company act contains few protections for members and most of these protections are waivable in the operating agreement."); see Sandra K. Miller, *What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company?*, 38 HARV. J. ON LEGIS. 413, 426-27 (2001) ("[R]estrictions on withdrawal and/or distribution rights effectively 'lock in' the LLC owner whose agreement lacks a provision expressly bestowing buyout rights or a provision addressing deadlocks or disputes. In these circumstances, the minority LLC member is potentially more vulnerable to a squeeze-out than a minority shareholder in a closely held corporation.")

9. See 805 ILL. COMP. STAT. ANN. 180/35-1 (West 2013); see also Bahls, *supra* note 4, at 84 (examining the LLC statutes of other jurisdictions and finding that "state statutes do not typically authorize courts to order equitable remedies less drastic than dissolution").

10. See *infra* notes 164-165 and accompanying text.

11. 805 ILL. COMP. STAT. ANN. 5/12.56 (West 2013).

12. See *infra* Part III.B.1.

Leaving the ILLCA as is would be improvident; there are already over 200,000 LLCs in Illinois,¹³ and the LLC is emerging as the premier entity for small-business owners and entrepreneurs.¹⁴ This Comment advances the argument that the Illinois legislature should amend the ILLCA to provide greater protection and additional, flexible remedies for oppressed minority members of LLCs. Even in the absence of an amendment, courts should be willing to render equitable remedies similar to those in the IBCA because there is little justification for differentiating between LLCs and close corporations in this respect.¹⁵ Additional protection and flexibility is necessary to safeguard minority members, ensure the confidence of investors, and make Illinois an attractive place for new businesses.

Part I of this comment briefly recalls the origin of the LLC as an entity before discussing why minority shareholders and members are especially vulnerable to oppression. It then outlines what courts have done to provide a remedy in cases involving oppressive conduct. Part II covers a recent case that illustrates the problems created by a poorly drafted LLC act. Part III lays out proposed changes to the ILLCA that would provide additional protection to minority members. Part IV addresses counterarguments to the proposed changes.

I. UNDERSTANDING THE LLC AND OPPRESSION IN CONTEXT

Understanding the problem of oppression in LLCs requires some background knowledge, including a familiarity with the entities that preceded the LLC. The LLC inherited its structural features from its older cousins, partnerships and corporations.¹⁶ And along with those features, the LLC also inherited the problem of oppression.¹⁷ This Part outlines the legal history of the LLC, and then explains why minority members are so vulnerable to oppression and what courts have done in the past to remedy the problem.

13. See Vinicky, *supra* note 2. The number of LLCs nationwide has grown rapidly as well. In 1993, there were only 17,000 LLCs nationwide, but by 1996 there were 221,000. MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 502–03 (8th ed. 2000).

14. See Bahls, *supra* note 4, at 48 (“Because of the unique combination of tax benefits with limited liability, limited liability companies are likely to become the organizational form of choice for many closely held businesses.”); Laurel Wheeling Farrar & Susan Pace Hamill, *Dissociation from Alabama Limited Liability Companies in the Post Check-the-Box Era*, 49 ALA. L. REV. 909, 909 (1998) (calling the LLC “the newest and fastest growing business form”).

15. Moll, *supra* note 4, at 976 (“[T]he ‘seeds’ of oppression in the close corporation are also present in the LLC setting. As a result, the LLC seems destined to repeat the oppression experience of the close corporation.”).

16. EISENBERG, *supra* note 13, at 498.

17. See generally Moll, *supra* note 4.

A. History Leading Up to the LLC

It is helpful to think of the various business entities as existing along a spectrum. On one end are small, mom-and-pop partnerships or sole proprietorships. On the other end are large corporations with many shareholders and publicly traded stock. Toward the middle of the spectrum, it is more difficult to draw distinctions between different types of entities. Even so, courts have attempted to classify business entities for the purpose of giving each type a fairer treatment under the law.¹⁸ Defining the differences between entities has important consequences for entrepreneurs, business owners, and the attorneys who advise them as they decide which entity to form.¹⁹

During the twentieth century, as the corporation became a more popular and flexible vehicle for businesses, courts grappled with how to apply older, stodgy legal doctrines in new situations.²⁰ Traditionally, corporation statutes were rigid, and legislatures and courts were slow to accommodate changes in the business community.²¹ Over time, legislatures relaxed their corporation statutes as a way of drawing new businesses to their state and generating tax and fee revenue.²² This process is sometimes called the “race of laxity.”²³ Nonetheless, as more and more businesses decided to incorporate to receive the benefit of liability protection, courts had to deal with the

18. See generally Thomas M. Madden, *Do Fiduciary Duties of Managers and Members of Limited Liability Companies Exist as with Majority Shareholders of Closely Held Corporations?*, 12 DUQ. BUS. L.J. 211 (2010).

19. See CARY & EISENBERG, *supra* note 3, at 76–77 (discussing the increasing complexity involved in choosing which entity to form coupled with the blurring between different forms); O’NEAL & THOMPSON, *supra* note 7, § 2:3.

20. *Lee v. Jenkins Bros.*, 268 F.2d 357, 365–66 (2d Cir. 1959) (“As the corporation became a more common vehicle for the conduct of business it became increasingly evident that many corporations, particularly small closely held ones, did not normally function in the formal ritualistic manner hitherto envisaged.”); Robert B. Thompson, *The Shareholder’s Cause of Action for Oppression*, 48 BUS. LAW. 699, 702 (1993) (“Traditional corporate norms, oriented as they are toward publicly held corporations, proved unsuitable for close corporations.”).

21. *Jenkins Bros.*, 268 F.2d at 365–66 (For example, laws that limited the activities of corporations to a stated purpose and legal doctrines, such as *ultra vires*, proved to be formalistic to the point of burdensome); ROBERT W. HAMILTON ET AL., CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 161 (11th ed. 2010) (“Historically, a great deal of importance was attached to the statement of purposes in the articles of incorporation . . . This problem has just about disappeared under modern statutes.”); *id.* at 172–73 (“when all is said and done, the [ultra vires] doctrine was an undesirable one, involving harsh and erratic consequences.”).

22. HAMILTON, *supra* note 21, at 138–39.

23. *Id.* (“The removal by the leading industrial states of the limitations upon the size and powers of business corporations appears to have been due, not to their conviction that maintenance of the restrictions was undesirable in itself, but to the conviction that it was futile to insist upon them . . . Lesser states, eager for the revenue derived from the traffic in charters, had removed safeguards from their own incorporation laws . . . The race was one not of diligence but of laxity.”).

problems created by applying the same corporation statute in radically different situations.²⁴

1. The Close Corporation: A Precursor to the LLC

One subject of great interest to early corporate law commentators is the difference between close corporations and regular corporations.²⁵ Large corporations that have publicly traded stock are distinct from close corporations, but otherwise, it is difficult to make broad generalizations.²⁶ Not all large corporations have publicly traded stock and not all non-public corporations are close corporations. And due to the circumstances, underlying policies, and problems unique to close corporations, formal rules of corporate law sometimes seem incongruous in cases involving smaller, closely held businesses.²⁷ In some cases, courts have even analogized the close corporation to a partnership, and imported legal doctrines from partnership law.²⁸

In the second half of the 20th century, courts and legislatures began to recognize close corporations as a *sui generis*.²⁹ Probably the most famous case defining the close corporation is *Donahue v. Rodd Electrotype Co. of*

24. 6 AM. JUR. 2D *Proof of Facts* § 387 (2013) (“With this growth [in the number of close corporations] came an increase in the problems peculiar to close corporations, which increase forced recognition of basic differences between the close and the publicly held corporation, and of the inadequacy of laws developed for the latter when applied to regulation of the day-to-day affairs of the former.”); HAMILTON, *supra* note 21, at 166 (“[M]ost states have adopted some provisions designed to ameliorate to some extent the traditional rules of corporate management when applied to small corporations.”).

25. Although commentators have devised different ways of measuring whether something is a close corporation or closely held business, most agree that they have a small number of shareholders. CARY & EISENBERG, *supra* note 3, at 269. For early discussion on the subject of close corporations, see generally Carlos D. Israels, *The Close Corporation and the Law*, 33 CORNELL L.Q. 488 (1948), and Norman Winer, *Proposing a New York “Close Corporation Law”*, 28 CORNELL L. Q. 313 (1943).

26. CARY & EISENBERG, *supra* note 3, at 269 (“Exactly what constitutes a close corporation is often a matter of theoretical dispute.”).

27. *Id.* at 279–80 (“[M]any of the problems raised by the early close-corporation case law reflects the fact that traditional statutory norms were drafted with publicly held corporations in mind.”); Farrar & Hamill, *supra* note 14, at 932 (“[C]lose corporations developed as a reaction to vast problems experienced by small business owners using a business form, the corporation, with default provisions and legal doctrines totally unsuited for small business.”).

28. CARY & EISENBERG, *supra* note 3, at 269 (“[C]ertain aspects of partnership law form an important backdrop to the study of close corporations [I]n recent years legislators and courts have increasingly looked to partnership-law norms in solving close-corporation-law problems.”).

29. *Galler v. Galler*, 203 N.E.2d 577, 585 (Ill. 1964) (“This court has recognized, albeit *sui silentio*, the significant conceptual differences between the close corporation and its public-issue counterpart.”); O’NEAL & THOMPSON, *supra* note 7, § 1:21 (“Courts, like legislatures, increasingly have recognized the distinctive characteristics and needs of close corporations and have shown a growing willingness to treat these enterprises differently than public-issue corporations.”); Farrar & Hamill, *supra* note 14, at 924 (“Over time, both courts and legislatures recognized a need to alter the traditional corporate law to provide relief for minority shareholders in closely held corporations.”).

New England.³⁰ In *Donahue*, the Massachusetts Supreme Court devised a three-part definition of close corporations as those with: “(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction, and operations of the corporation.”³¹ These three attributes show that close corporations have a lot in common with partnerships.³² For example, shareholders of close corporations, like partners, act in multiple roles.³³ It is typical in close corporations for the shareholders, directors, and officers to be the same people.³⁴ Thus, in both partnerships and close corporations there is usually no separation between ownership and management.³⁵ In fact, if not for the attractiveness of limited liability protection, some businesses might have foregone incorporation and formed partnerships instead.³⁶

The *Donahue* court went further than just classifying close corporations as a distinct breed. The actual issue before the *Donahue* court concerned shareholders’ fiduciary duties to fellow shareholders.³⁷ The court considered whether a controlling group of directors, possessing a majority of stock of the corporation, owed a fiduciary duty to the minority shareholders, and whether they breached that duty when they voted to purchase the shares of a retiring director at a special price without giving the same deal to the minority shareholders.³⁸ The court held that the majority shareholders’ refusal to extend the same deal to the minority was a breach of fiduciary duty, and the corporation had to give the minority the same opportunity to sell back its shares at an identical price.³⁹

Recognizing the need for greater protection of minority shareholders, the *Donahue* court imposed heightened fiduciary duties on shareholders of

30. *Donahue v. Rodd Electrotype Co. of New England*, 328 N.E.2d 505 (Mass. 1975).

31. *Id.* at 511.

32. CARY & EISENBERG, *supra* note 3, at 269 (“[T]he close corporation resembles the partnership, which is also typically characterized by a small number of owners, as well as owner-management and nontransferability of ownership interests.”).

33. *Id.*; see *Helms v. Duckworth*, 249 F.2d 482, 486 (D.C. Cir. 1957).

34. *Duckworth*, 249 F.2d at 486 (discussing “the practical realities” of close corporations, “in which the stockholders, directors and managers are the same persons.”).

35. *Id.*

36. Partnerships have a more flexible structure and are easier and cheaper to set up compared to corporations, because there are no required filings with the state and no need to draft bylaws or comply with other corporate formalities. See CARY & EISENBERG, *supra* note 3, at 75 (“corporations tend to be more costly to organize and maintain than other forms”).

37. *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 328 N.E.2d 505, 511 (Mass. 1975).

38. *Id.* at 520.

39. *Id.* at 521.

close corporations.⁴⁰ The court borrowed from partnership law, holding that “stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.”⁴¹ This statement was momentous because under traditional corporate law, ownership of stock alone, without more, imposed no fiduciary duties on a shareholder.⁴² This traditional rule may be appropriate for public corporations, where there are many shareholders, most of whom are passive investors who probably do not know or even have any contact with other shareholders.⁴³ However, in the close corporation context, shareholders’ heightened duties are more appropriate from a policy standpoint.⁴⁴ Majority shareholders in close corporations wield a substantial amount of power, as they often double as directors or officers.⁴⁵ This power, when coupled with the particular vulnerability of the minority, justifies greater legal safeguards.⁴⁶ While parts of the *Donahue* holding have since been limited in certain contexts by subsequent cases,⁴⁷ the case has had a major influence on corporate law and shareholder duties.⁴⁸

40. *Id.* at 513.

41. *Id.*

42. *See, e.g.,* *Hagshenas v. Gaylord*, 557 N.E.2d 316, 321 (Ill. App. Ct. 1990) (“In general, a mere owner of stock in a company does not owe a fiduciary duty to that company. The [Illinois] Business Corporation Act provides that “[a] holder of or subscriber to shares of a corporation shall be under no obligation to the corporation or its creditors with respect to such shares”); LARRY E. RIBSTEIN & ROBERT R. KEATINGE, *RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES* § 9:11 (2013) (“Corporate shareholders . . . generally owe no duty to each other or the firm when they act solely as shareholders.”); CARY & EISENBERG, *supra* note 3, at 271 (“The traditional view [now changing in certain important respects] was that, shareholders do not stand in a direct fiduciary relationship to each other.”).

43. O’NEAL & THOMPSON, *supra* note 7, § 1:9 (“Unlike the typical shareholder in a publicly held corporation, who may be simply an investor or a speculator and does not desire to assume the responsibilities of management, the shareholder in a close corporation considers himself or herself as a co-owner of the business and wants the privileges and powers that go with ownership.”).

44. *Galler v. Galler*, 203 N.E.2d 577, 583–84 (Ill. 1964) (“While the shareholder of a public-issue corporation may readily sell his shares on the open market should management fail to use . . . sound business judgment, his counterpart of the close corporation often has a large total of his entire capital invested in the business and has no ready market for his shares should he desire to sell. He feels, understandably, that he is more than a mere investor . . . [A] large minority shareholder might find himself at the mercy of an oppressive or unknowledgeable majority.”); *Hagshenas v. Gaylord*, 557 N.E.2d 316, 323–24 (Ill. App. Ct. 1990) (internal citations omitted) (recognizing “a significant difference between a shareholder of a closely held corporation and a shareholder of public stock” for similar reasons).

45. *See Galler*, 203 N.E.2d at 584 (“[T]he shareholders of a close corporation are often also the directors and officers thereof.”). *See also supra* notes 32–35 and accompanying text.

46. *See* O’NEAL & THOMPSON, *supra* note 7, § 1:22.

47. *See, e.g.,* *Zimmerman v. Bogoff*, 524 N.E.2d 849, 853 (Mass. 1988) (“the *Donahue* remedy is not intended to place a strait jacket on legitimate corporate activity.”); *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976).

48. *See, e.g.,* *Hagshenas*, 557 N.E.2d at 323 (adopting the *Donahue* court’s holding regarding fiduciary duties); O’NEAL & THOMPSON, *supra* note 7, § 1:21 (calling *Donahue* “[t]he most recognized separate judicial treatment of close corporations”); Loewenstein, *supra* note 8.

Today, years after the *Donahue* decision, many states give close corporations different treatment and use a definition that is similar to, if not the same as, the three-part test set forth in *Donahue*.⁴⁹ Indeed, courts and academics frequently cite *Donahue* and its progeny as support for separate treatment of close corporations.⁵⁰ Illinois has not expressly adopted the *Donahue* definition, but uses one that is essentially the same.⁵¹ Along with Illinois, states that treat close corporations as distinct entities do so through a combination of statutory and common law,⁵² and it is typical for states to allow businesses to elect to be treated as a close corporation when filing or amending their articles of incorporation.⁵³ In these states, close corporations are governed under specific provisions rather than the general business corporation act.⁵⁴

The creation, or rather, recognition of the close corporation as a distinct entity is important in two respects: it is an example of courts responding to the practical realities of the business community, and it shows that courts are willing to be flexible when applying a rigid body of corporate law to closely held businesses. Laws that were based on the classic corporate form seemed harsh when applied to close corporations, and the *Donahue* court's solution ameliorated that harshness.

49. Loewenstein, *supra* note 8. However, other states have rejected the *Donahue* approach outright. *Nixon v. Blackwell*, 626 A.2d 1366, 1379–80 (Del. 1993) (rejecting a cause of action for oppression in a Delaware close corporation and positing that minority shareholders should instead bargain for contractual protections); HAMILTON, *supra* note 21, at 366 (“Delaware appears to have flatly rejected the approach of *Donahue*.”).

50. HAMILTON, *supra* note 21, at 362–63 (“The [*Donahue* holding] has been widely cited and accepted. Courts in more than 25 states have either cited *Donahue* approvingly or have cited cases that relied upon *Donahue*”); Charles W. Murdock, *Limited Liability Companies in the Decade of the 1990s: Legislative and Case Law Developments and Their Implications for the Future*, 56 BUS. LAW. 499, 570 (2001) (“[*Donahue* has] been cited as precedent in many jurisdictions.”); *see, e.g.*, *Nelson v. Martin*, 958 S.W.2d 643 (Tenn. 1997) (citing to *Wilkes* and *Donahue* for their holding regarding fiduciary duties owed by majority shareholders to the minority).

51. *Galler v. Galler*, 203 N.E. 2d 577, 583 (Ill. 1964) (“[A] close corporation is one in which the stock is held in a few hands, or in a few families, and wherein it is not at all, or only rarely, dealt in by buying or selling.”); *Rexford Rand Corp. v. Ancl*, 58 F.3d 1215, 1219 (7th Cir. 1995) (applying Illinois law and citing to *Donahue*).

52. *See* CARY & EISENBERG, *supra* note 3, at 280 (comparing the corporation statutes in California, Delaware, and New York); RIBSTEIN & KEATINGE, *supra* note 42, § 1:2 (discussing the “statutory close corporation”).

53. RIBSTEIN & KEATINGE, *supra* note 42, § 1:2.

54. *Id.*; 6 AM. JUR. 2D *Proof of Facts* § 387 (2013).

2. The Limited Liability Company: The Birth of a Hybrid Entity

The LLC⁵⁵ started out as an experiment, and now it is the premier entity for small businesses.⁵⁶ The first state to enact a law creating the LLC as a business entity was Wyoming in 1977.⁵⁷ The goal was to create an entity that would enjoy both limited liability and favorable federal income tax treatment.⁵⁸ In the past, businesses had to choose between the liability protection of a corporation and the favorable tax treatment of a partnership. Corporations offer limited liability to shareholders, but corporate profits are taxed twice—once at the entity level and once again at the shareholder level because individual shareholders report dividends on their personal tax returns.⁵⁹ Alternatively, partnerships receive pass-through taxation, meaning that profits are only taxed once at the time when the partners report distributions of profits from the partnership on their personal tax returns.⁶⁰ However, partners are not protected from outside liability and are personally liable for the obligations of the partnership.⁶¹ The LLC solved this long-standing dilemma, combining partnership taxation with corporate limited liability.⁶²

Initially, there was uncertainty as to whether Wyoming's experiment would succeed. At first, treasury regulations essentially provided that an LLC could receive pass-through tax treatment as long as it was not too much like a corporation.⁶³ The regulations identified four corporate-like features, and if an entity had three or more of those features, then it would

55. "An LLC has been described as 'a non-corporate business that provides its owners ('members') with limited liability and allows them to participate actively in the entity's management.'" CARY & EISENBERG, *supra* note 3, at 78.

56. HAMILTON, *supra* note 21, at 1185–86 ("The [LLC] is now undeniably the most popular form of new business entity in the United States Rising from near obscurity in the 1990s, the LLC has now taken its place as the new 'king-of-the-hill' among business entities, utterly dominating its closest rivals [T]he number of new LLCs formed in America in 2007 now outpaces the number of new corporations formed by a margin of nearly two to one."); RIBSTEIN & KEATINGE, *supra* note 42, § 1:2; *see supra* notes 13–14.

57. RIBSTEIN & KEATINGE, *supra* note 42, § 1:2; Loewenstein, *supra* note 8, at 364.

58. RIBSTEIN & KEATINGE, *supra* note 42, § 1:2; *see generally* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459 (1998).

59. EISENBERG, *supra* note 13, at 496 ("[I]f the [corporation] has income or expenses, or gains or losses, those items go into the [corporation]'s taxable income, not into the owners' taxable income. If the [corporation] then makes distributions to its owners out of after-tax income, the owners ordinarily pay taxes on those distributions. This is sometimes referred to as 'double taxation.'").

60. *Id.* ("[A general partnership] is not subject to taxation. Instead, all of the [partnership]'s income and expenses, and gains and losses, are taxable directly to the [partnership]'s owners. Distributions are not taxed. There is no 'double taxation' effect.").

61. REVISED UNIF. P'SHIP ACT § 306 (West 2013) ("[A]ll partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.").

62. Bahls, *supra* note 4, at 52–53; Farrar & Hamill, *supra* note 14, at 909.

63. *See* Miller, *supra* note 8.

be taxed as a corporation instead.⁶⁴ The four features were continuity of life, limited liability, free transferability of ownership interests, and centralized management.⁶⁵ States' efforts to comply with these regulations are reflected in many early LLC acts, which contained provisions designed to defeat the LLC's continuity of life by providing for dissolution upon specified events such as a member's death or bankruptcy.⁶⁶ The need for these workarounds and legal fictions was short-lived, however, because the Internal Revenue Service issued a new set of regulations in 1996, often called the "check-the-box" regulations, which allowed LLCs to simply elect to be taxed as a partnership without regard to their corporate-like features.⁶⁷ The advent of the check-the-box "era" is significant for two reasons: first, the LLC increased in popularity because its favorable tax status was assured,⁶⁸ second, it became harder for members to dissolve or dissociate from an LLC as states curtailed the easy-exit provisions that they had originally included to defeat the entity's continuity of life.⁶⁹

In response to increased demand from the business community, other states followed Wyoming's lead. Now, every state has an LLC act.⁷⁰ In Illinois, the LLC Act was enacted in 1992 and later amended in 1998 and 2001 to its current form.⁷¹ As a general rule, the ILLCA, like other states' LLC acts, only governs by default, and "an operating agreement may modify any provision or provisions of [the] Act governing relations among the

64. *Id.*

65. HAMILTON, *supra* note 21, at 1184–85.

66. These statutes also provided that the LLC would continue to exist beyond dissolution as if it never dissolved as long as all the remaining members so consented. *See, e.g.*, 805 ILL. COMP. STAT. ANN. 180/35-3(b) (West 2014) ("At any time after the dissolution of a limited liability company and before the winding up of its business is completed, the members . . . may unanimously waive the right to have the company's business wound up and the company terminated.").

67. Farrar & Hamill, *supra* note 14, at 912; HAMILTON, *supra* note 21, at 1267.

68. RIBSTEIN & KEATINGE, *supra* note 42, § 1:2 ("After . . . the [IRS] stated clearly that properly organized limited liability companies would be treated as partnerships, all of the remaining states adopted limited liability company statutes.").

69. RIBSTEIN & KEATINGE, *supra* note 42, § 1:4 ("The check-the-box tax classification rule . . . has caused statutory drafters to reconsider the 'noncorporate' characteristics in existing LLC statutes. In particular, many LLC statutes have been amended to eliminate the rule that an LLC must dissolve on the dissociation of a member."); Farrar & Hamill, *supra* note 14, at 929 (discussing Alabama's LLC act and noting the "elimination of dissolution rights, that were once but no longer needed to ensure that the LLC would meet the partnership classification regulations"); Murdock, *supra* note 50, at 501.

70. CHARLES R. T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 536 (6th ed. 2006); Murdock, *supra* note 50, at 499.

71. *See generally* 7 CHARLES W. MURDOCK, ILLINOIS PRACTICE SERIES: BUSINESS ORGANIZATIONS § 5:2 (2d ed. 2014).

members, managers, and company.”⁷² Aside from a few exceptions, the members can draft an operating agreement that modifies, supersedes, or eliminates any of the various statutory provisions of the ILLCA.⁷³ This makes the LLC a creature of both contract and statutory law.⁷⁴

The LLC is a hybrid entity in another sense as well. It combines characteristics of both corporations and partnerships.⁷⁵ For example, as with a corporation’s articles of incorporation, founders of an LLC in Illinois must file “articles of organization” with the secretary of state.⁷⁶ However, like a partnership, the relationships among the members of an LLC are primarily governed by agreement, namely an operating agreement.⁷⁷ The operating agreement also sets out how the business will be managed and conducted.⁷⁸ Indeed, contracting is at the heart of the LLC’s identity.⁷⁹ Compared to a corporation, members of an LLC have more freedom and flexibility to define their relationships via contract.⁸⁰

Regarding its management structure, an LLC can be member-managed or manager-managed, which will make it more like either a partnership or a corporation, respectively.⁸¹ In member-managed LLCs, as with partner-

72. 805 ILL. COMP. STAT. ANN. 180/15-5(a) (West 2013) (but note that some exceptions to the default rule are available: the quoted section references these exceptions, which are listed in subsection (b)).

73. *Id.*; Farrar & Hamill, *supra* note 14, at 933 (“LLC business participants that wish to eliminate all dissociation rights can easily do so in the operating agreement”).

74. *Katris v. Carroll*, 842 N.E.2d 221, 224 (Ill. App. Ct. 2005) (quoting *Harbison v. Strickland*, 900 So.2d 385, 389 (Ala. 2004)).

75. CARY & EISENBERG, *supra* note 3, at 78 (“Some characteristics of the LLC resemble those of partnerships; other characteristics resemble those of corporations.”).

76. HAMILTON, *supra* note 21, at 1187 (“Like limited partnerships, corporations, and LLPs, LLCs are formed by filing a document, usually known as the ‘articles of organization’ or ‘certificate of organization,’ with the secretary of state or equivalent official of the appropriate jurisdiction.”).

77. *Id.* (“The real detail on the governance of an LLC is usually provided in a separate document known as an ‘operating agreement’ or a ‘limited liability company agreement.’”).

78. HAMILTON, *supra* note 21, at 1187.

79. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-1101(b) (2013) (“It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.”); *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 291 (Del. 1999) (“The basic approach of the Delaware Act is to provide members with broad discretion in drafting the Agreement and to furnish default provisions when the members’ agreement is silent. The Act is replete with fundamental provisions made subject to modification in the Agreement . . .”).

80. *Murdock*, *supra* note 50, at 518 (“[W]ith the [LLC] statute generally only providing default provisions, the organizers of an LLC should be able to create whatever structure, and use whatever nomenclature, they desire.”).

81. *See* Robert B. Keatinge, *New Gang in Town*, BUS. L. TODAY, Apr. 4, 1995, at 5; *see also* 805 ILL. COMP. STAT. ANN. 180/15-1 (West 2013) (pertaining to management of a limited liability company).

ships, there is no separation between ownership and control.⁸² And like partners, by default each member has equal rights in the management and conduct of the business.⁸³ Alternatively, manager-managed LLCs offer a corporate-like structure, and are typically governed by a “board of managers” analogous to a board of directors.⁸⁴ The operating agreements of such LLCs can prescribe whether each individual member’s voting power will be proportionate to the quantity of the member’s ownership interest, as with shareholders of corporations.⁸⁵

On the spectrum of business entities discussed above, the LLC falls closer to the mom-and-pop side, somewhere between the partnership and the close corporation. Because it has a flexible structure, the limited liability protection of a corporation, and the favorable tax treatment of a partnership, the LLC is especially popular for small business owners and entrepreneurs.⁸⁶

B. Vulnerability Endemic to Closely Held Businesses

Courts generally, including those in Illinois, have long recognized that minority shareholders of close corporations are in a particularly vulnerable and precarious financial position.⁸⁷ Shareholders of close corporations often invest substantial personal savings in the corporation.⁸⁸ They may also rely on employment by the corporation as the source of their livelihood.⁸⁹ And unlike partnerships where each partner by default has an equal right to manage the partnership,⁹⁰ corporations are managed by majority rule.⁹¹ As

82. HAMILTON, *supra* note 21, at 1190 (“Most LLC statutes assign, as a default rule, all management functions to members This member-managed structure resembles a general partnership, as each of the owners has management rights.”).

83. *See id.*; 805 ILL. COMP. STAT. ANN. 180/15-1(a)(1) (West 2014) (“each member has equal rights in the management and conduct of the company’s business”); REVISED UNIF. P’SHIP ACT § 401(f) (2013) (“Each partner has equal rights in the management and conduct of the partnership business.”).

84. RIBSTEIN & KEATINGE, *supra* note 42, § 2:3.

85. *Id.* § 8:3.

86. *See generally id.* §§ 9:10 to 9:11.

87. *Galler v. Galler*, 203 N.E.2d 577, 583–84 (Ill. 1964) (discussing the unique properties of close corporations that place minority shareholders at the “mercy” of an oppressive majority); *Walensky v. Jonathan Royce Int’l, Inc.*, 624 A.2d 613, 615 (N.J. Super. Ct. App. Div. 1993); *see also Kantzler v. Benzinger*, 73 N.E. 874 (Ill. 1905).

88. 6 AM. JUR. 2D *Proof of Facts* § 387 (2013) (“Frequently such corporations were made up of shareholders who contributed a large part of their general assets to the business, looked to the company for employment to furnish their principal livelihood, and expected to be intimately involved in company management.”).

89. *Id.*

90. *See supra* note 83.

a result, there are many ways in which the minority in interest is at the mercy of the majority or controlling group.⁹² Where one party has a controlling interest, the minority is virtually dependent on the majority to safeguard his or her personal investment.⁹³ And since the owners of close corporations are often family members or friends, shareholders lean heavily on the trust and loyalty of their fellow shareholders.⁹⁴ If the parties' relationship starts to break down, or the minority wants to pull its investment out of the business, the minority cannot easily sell its shares because there is no market and no willing buyers for ownership interests in closely held businesses.⁹⁵ All this makes minority shareholders particularly vulnerable to oppressive conduct. And these reasons apply just as strongly, if not more strongly, to minority members of LLCs.⁹⁶

1. Freeze-Outs

If the parties' relationship breaks down, the minority's interest and entire investment may be at stake.⁹⁷ For example, one common type of internal discord is the "freeze-out."⁹⁸ A freeze-out involves a pattern of behavior designed to force the minority out of the corporation.⁹⁹ Some typical freeze-out tactics include withholding dividends, voting strategically to prevent the minority from having representation on the board, issuing new shares to dilute the minority's interest,¹⁰⁰ and other forms of hostility di-

91. O'NEAL & THOMPSON, *supra* note 7, § 1:16 ("The usual corporate statute centralizes all corporate powers in the hands of the directors. Holders of a majority of voting shares can elect most or all the members of the board and the board normally acts by majority rule.")

92. J.A.C. Hetherington & Michael P. Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 5 (1977) ("The greatest opportunities for exploitation exist in close corporations where the power to control resides with one faction. In that instance, the controlling or majority faction has significant opportunities to exploit the minority.")

93. *Id.*

94. *See* Brenner v. Berkowitz, 634 A.2d 1019, 1026–27 (N.J. 1993) (shareholders in close corporations frequently consist of family members or friends and once the personal relationship is destroyed, the company deteriorates.); Moll, *supra* note 4, at 912–13 ("[C]lose corporation owners are frequently linked by family or other personal relationships [and] there is often an initial atmosphere of mutual trust.")

95. *See infra* notes 104–107 and accompanying text.

96. *See* Miller, *supra* note 8.

97. *See* Meiselman v. Meiselman, 307 S.E.2d 551, 558 (N.C. 1983) ("when the personal relationships among the participants [in a close corporation] break down, the majority shareholder, because of his greater voting power, is in a position to terminate the minority shareholder's employment and to exclude him from participation in management decisions.")

98. *See generally* Note, *Freezing out Minority Shareholders*, 74 HARV. L. REV. 1630 (1961).

99. *Id.*

100. *See* Katzowitz v. Sidler, 249 N.E.2d 359, 364 (N.Y. 1969) ("When new shares are issued, however, at prices far below fair value in a close corporation or a corporation with only a limited mar-

rected toward the minority personally.¹⁰¹ Where the minority shareholder is employed by the corporation, a freeze-out may also include firing the minority shareholder or reducing his or her salary.¹⁰²

Unlike shareholders of regular corporations, minority shareholders of close corporations and minority members of LLCs are particularly vulnerable to freeze-out tactics and other oppressive conduct.¹⁰³ First, the shares of close corporations and memberships in LLCs are unmarketable.¹⁰⁴ It is difficult to value these shares or find a willing buyer.¹⁰⁵ Even if the minority could find a buyer, that person likely would not want to trade places with the minority.¹⁰⁶ This means that the minority cannot simply unload its shares whenever it wants out of the business.¹⁰⁷ Second, shareholders of close corporations and members of LLCs typically have a substantial personal investment in the business.¹⁰⁸ Whereas shareholders of public corporations usually have diverse portfolios, minority shareholders of close corporations and LLCs may have all their eggs in one basket and may therefore rely heavily on their investment for receipt of salary or dividends.¹⁰⁹ Third, the founders of close corporations and LLCs often fail to plan ahead and provide adequate contractual protection for their interest.¹¹⁰ This is especially perilous in the LLC context since the members' internal relationships are governed principally by an operating agreement, rather

ket for its shares, existing stockholders, who do not want to invest or do not have the capacity to invest additional funds, can have their equity interest in the corporation diluted to the vanishing point.”).

101. Brenner v. Berkowitz, 634 A.2d 1019, 1028 (N.J. 1993) (“oppression is usually directed at a minority shareholder personally”); Mary-Hunter Morris, *Only “The Punctilio” If I Say So: How Contractual Limitations on Fiduciary Duties Deny Protection to Victims of Oppressive Freeze-outs Within Private Business Entities*, 10 DUQ. BUS. L.J. 73, 87–88 (2008).

102. See Graham v. Mimms, 444 N.E.2d 549, 558 (Ill. App. Ct. 1982).

103. See *supra* notes 87-96 and accompanying text.

104. Moll, *supra* note 4, at 891–92.

105. *Id.* at 898–99 (“Even if a minority shareholder could locate prospective outside investors, a minority ownership position in a close corporation is unlikely to garner much interest. A minority ownership position lacks sufficient voting power to control the operations of the firm. As a result, a minority interest is far less appealing (as well as less valuable) to outside investors.”).

106. *Id.* (“Where the company has a track record of oppressive majority conduct, a minority interest is even less attractive.”).

107. *Id.* (“The lack of an active securities market for the stock and the relative undesirability of a minority position effectively doom any effort to sell.”).

108. See *supra* notes 88–89 and accompanying text.

109. Moll, *supra* note 4, at 890–91 (“[T]he close corporation investor generally looks to salary rather than dividends for a share of the business returns because the ‘[e]arnings of a close corporation often are distributed in major part in salaries, bonuses and retirement benefits.’ When actual dividends are not paid, therefore, a minority shareholder who is discharged from employment and removed from the board of directors is effectively denied any return on its investment as well as any input into the management of the business.”).

110. *Id.* at 911.

than by statute.¹¹¹ The operating agreement allows the members to modify nearly every provision of the LLC statute, including members' fiduciary duties, as long as doing so is not manifestly unreasonable.¹¹² So a member with greater bargaining power can draft the operating agreement in a way that curtails members' obligations to one another.¹¹³ A failure to provide contractual protection for minority members *ex ante* leaves them exposed in the event of oppression, deadlock, or freeze-out.¹¹⁴ Further, at least one study showed that a significant portion of LLC operating agreements are based on prewritten forms.¹¹⁵ This only exacerbates the problem, as forms are not individualized or tailored to the members' business.

Freeze-outs are only possible because corporations are operated according to majority rule.¹¹⁶ The shareholder(s) with the majority or controlling interest can dominate decisions, including elections of directors, hiring and firing of officers, and deciding whether to declare dividends.¹¹⁷ In a typical freeze-out, the minority is voted off the board of directors, fired from employment by the corporation, refused access to books and records, or otherwise marginalized.¹¹⁸ If the majority also declines to declare dividends, the minority will see virtually no return on its investment.¹¹⁹ And because the minority's shares are unmarketable, its interest is effectively held hostage by the corporation.¹²⁰ With its entire investment on the line, an oppressed minority faces a dilemma: either remain in the corporation and

111. See *supra* note 77 and accompanying text.

112. See 805 ILL. COMP. STAT. ANN. 180/15-5(a) (West 2013).

113. Farrar & Hamill, *supra* note 14, at 930 ("Practitioners advising sophisticated business owners and joint venture participants undoubtedly can give many examples of clients insisting that the LLC operating agreement eliminate, as much as the tax law would permit, all dissociation and dissolution rights.")

114. *Id.*

115. See Sandra K. Miller, *A New Direction for LLC Research in a Contractarian Legal Environment*, 76 S. CAL. L. REV. 351, 422 (2003).

116. O'NEAL & THOMPSON, *supra* note 8, § 1:2 ("[A] corporation operates under the principle of majority rule: the holders of a majority of the shares with voting power control the corporation. Persons holding a majority of the voting shares have the power to elect all the directors In turn, the board of directors usually acts by majority vote Under this pattern of corporate control, majority interests can deprive minority interests of any effective voice in the operation of the business.")

117. See Brenner v. Berkowitz, 634 A.2d 1019, 1033 (N.J. 1993) ("[B]ecause the majority has the controlling interest, it has the power to 'dictate to the minority the manner in which the corporation is run.'" (citing *Bostock v. High Tech Elevator Indus., Inc.*, 616 A.2d 1314, 1320 (N.J. Super. Ct. App. Div. 1992))).

118. See *supra* notes 98–102 and accompanying text.

119. See *supra* note 109.

120. Brenner, 634 A.2d at 1027 ("The inability to reflect dissatisfaction by withdrawing one's investment places the majority shareholder in an enhanced power position to use the minority's investment 'without paying for it' As a consequence, a shareholder challenging the majority in a close corporation finds himself on the horns of a dilemma, he can neither profitably leave nor safely stay with the corporation.").

be marginalized, or give in and sell the interest back to the corporation at an artificially low price and potentially part with a substantial portion of personal savings.¹²¹

Practically speaking, freeze-outs only occur in close corporations and LLCs.¹²² In other entities, an owner of a minority interest is simply not susceptible to the same tactics.¹²³ For example, if a controlling group of a public corporation tried to freeze-out a minority shareholder, the shareholder would simply sell its shares and move on to another investment.¹²⁴ Or if a controlling partner of a general partnership tried to freeze-out another equity partner, the partner could easily dissolve the partnership.¹²⁵ Minority shareholders of close corporations cannot take advantage of these options, and minority members of LLCs have very limited options, if any.¹²⁶

2. The Business Judgment Rule: An Additional Hurdle

In practice, minority shareholders have trouble challenging the propriety of the majority's actions in court because it is very difficult to overcome the business judgment rule.¹²⁷ Under the business judgment rule, courts will defer to the judgment of a corporation's directors and are reluctant to second-guess their decisions in managing the corporation.¹²⁸ As long

121. *Id.*

122. Moll, *supra* note 4, at 891 ("In the public corporation, the minority shareholder can escape . . . abuses of power by simply selling its shares on the market. By definition, however, there is no ready market for the stock of a close corporation. Thus, when a close corporation shareholder is treated unfairly, the investor 'cannot escape the unfairness simply by selling out at a fair price.'").

123. *Id.* at 897 ("In a publicly held company, a shareholder dissatisfied with the conduct of management can sell its holdings on a securities market and recover the value of its investment. This ability to liquidate protects public corporation investors from the conduct of those in control.").

124. Shareholders of publicly-traded firms are also protected by their right to sell out if they are dissatisfied with current management. REVISED MODEL BUS. CORP. ACT § 14.34 (1994).

125. Dissolution is much easier under partnership statutes than under corporation statutes. REVISED UNIF. P'SHIP ACT § 801(1) (West 2013), allows partners to exercise their right to dissolve the partnership at will.

126. Hetherington & Dooley, *supra* note 92, at 6 ("[N]o other form of business organization subjects an owner to the dual hazards of a complete loss of liquidity and an indefinite exclusion from sharing in the profitability of the firm.").

127. O'NEAL & THOMPSON, *supra* note 7, § 1:16 ("The effectiveness of fiduciary duty is limited by judicial use of the business judgment rule, a doctrine which embodies a broad judicial deference to the corporation's board of directors in matters of business policy.").

128. O'NEAL & THOMPSON, *supra* note 8, § 3:3 ("[C]ourts 'hesitate to substitute their judgment on complicated questions of business policy for that of the elected managers of the business and have limited the scope of judicial review they are willing to undertake.' The business judgment rule usually operates as a presumption that the directors acted appropriately."). Illinois courts take this position as well. *See, e.g., Wheeler v. Pullman Iron & Steel Co.*, 32 N.E. 420, 423 (Ill. 1892) ("[C]ourts of equity will not undertake to control the policy or business methods of a corporation, although it may be seen that a wiser policy might be adopted, and the business more successful if other methods were pursued.

as the majority exercises an informed business judgment, its actions will not be subject to searching judicial oversight or close scrutiny.¹²⁹ This deference makes it easier for the majority to act oppressively with impunity.¹³⁰ At the very least, the business judgment rule weakens the effectiveness of legal obligations like fiduciary duties and protections like anti-oppression provisions.¹³¹

C. Oppression

Oppression is a term of art used in many LLC and close corporation statutes,¹³² although it is usually not defined within the statute itself.¹³³ Instead, legislatures have left it up to the courts to flesh out the word's meaning.¹³⁴ As a cause of action, oppression is an independent ground for relief and the plaintiff need not show fraud, illegality, mismanagement, wasting of assets, or deadlock, although evidence of such factors is sometimes present.¹³⁵ Oppression can also be part of an ongoing course of conduct.¹³⁶ The term embraces a broad range of improper conduct, reflecting the fact that courts have defined the term expansively in the close corporation context.¹³⁷ At one time, the most oft quoted definition of oppression described it as:

burdensome, harsh and wrongful conduct, a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members, or a visible departure from the standards of fair dealing, and a[] violation

[The majority shareholders] must be permitted to control the business of the corporation in their discretion.”).

129. See *Wheeler*, 32 N.E. at 423; see also CARY & EISENBERG, *supra* note 3, at 410 (“If the conditions of [the business judgment rule] . . . are met, then under the rule the substance or quality of the director’s or officer’s decision will be reviewed, not under the basic standard of conduct to determine whether the decision was prudent or reasonable, but only under a much more limited standard.”).

130. O’NEAL & THOMPSON, *supra* note 8, § 3:3 (“[I]f the business judgment rule applies, the court’s review is cursory; almost any reason supporting the directors’ action will usually suffice.”).

131. *Id.*

132. Thompson, *supra* note 20, at 710 (“Thirty-seven American states now include oppression or a similar term in their corporations statutes.”).

133. *Id.* at 711; see, e.g., *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1178 (N.Y. 1984) (“[Oppressive conduct] does not enjoy [definitional] certainty gained through long usage. As no definition is provided by the statute, it falls upon the courts to provide guidance.”).

134. See, e.g., *In re Kemp & Beatley*, 473 N.E.2d at 1178; see also Farrar & Hamill, *supra* note 14, at 927 (“Courts and commentators dealing directly with statutory oppression remedies . . . have struggled over the statutory definition of oppression.”).

135. *Jaffe Commercial Fin. Co. v. Harris*, 456 N.E.2d 224, 231 (Ill. App. Ct. 1983).

136. *Id.*

137. *Davis v. Sheerin*, 754 S.W.2d 375, 381 (Tex. App. 1988).

of fair play on which every shareholder who entrusts his money to a company is entitled to rely.¹³⁸

The above definition, as general as it is, reflects the fact that courts have taken “an especially broad view of the application of oppressive conduct to closely held corporations, where oppression may more easily be found.”¹³⁹

It is also common for court definitions of oppression to include some reference to the minority’s reasonable expectations.¹⁴⁰ The reasonable expectations approach requires a highly factual inquiry into the facts and circumstances of each case, since “actions which might be oppressive under one set of circumstances will not be oppressive under others.”¹⁴¹ The reviewing court will ask “whether the acts complained of serve to frustrate the legitimate expectations of minority shareholders.”¹⁴² The expectations definition is an ideal one for courts and commentators who see oppression as primarily a protection against freeze-outs, because it puts the focus back on why the minority entered the business and what it hoped to get out of its investment and continuing participation in the enterprise.¹⁴³ For example,

A shareholder who reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, a place in corporate management, or some other form of security, would be oppressed in a very real sense when others in the corporation seek to defeat those expectations and there exists no effective means of salvaging the investment.¹⁴⁴

The expectations definition of oppression gives courts a way to provide the equitable relief from freeze-outs that minority shareholders need.¹⁴⁵ The disadvantage of the expectations definition is the ambiguity

138. *Id.* at 382 (quoting *Baker v. Commercial Body Builders, Inc.*, 507 P.2d 387 (Or. 1973)) (internal quotation marks omitted). This definition has its roots in English common law.

139. *Davis*, 754 S.W.2d at 381 (quoting *Skierka v. Skierka Bros. Inc.*, 629 P.2d 214 (Mont. 1981)); see also HAMILTON, *supra* note 21, at 462 (“[T]he kinds of conduct within a closely held corporation that are viewed as oppressive have been broadened both by statute and by judicial decisions analogizing the closely held corporation to a partnership.”).

140. Cynthia S. Grandfield, *The Reasonable Expectations of Minority Shareholders in Closely Held Corporations: The Morality of Small Businesses*, 14 DEPAUL BUS. L.J. 381, 386–87 (2002); see generally *In re Wiedy’s Furniture Clearance Ctr. Co.*, 487 N.Y.S.2d 901 (N.Y. App. Div. 1985); *Davis*, 754 S.W.2d at 381; Robert B. Thompson, *Corporate Dissolution and Shareholders’ Reasonable Expectations*, 66 WASH. U. L.Q. 193 (1988).

141. *Gray v. Hall*, 295 N.E.2d 506, 509 (Ill. App. Ct. 1973) (giving the example of large salaries for corporate officers which “might be justified where a corporation has large retained earnings”).

142. *Davis*, 754 S.W.2d at 381.

143. See also *Meiselman v. Meiselman*, 307 S.E.2d 551 (N.C. 1983); O’NEAL & THOMPSON, *supra* note 8, § 7:12; Thompson, *supra* note 140 at 219.

144. *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984).

145. F. Hodge O’Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 885 (1978).

surrounding the phrase “reasonable expectations.”¹⁴⁶ It is not completely clear which expectations, if defeated, would show oppression.¹⁴⁷ A minority shareholder may have entered the enterprise with the expectation that he would make a return on his investment, but a failure to receive dividends would not necessarily mean that the minority had been a target of oppressive conduct if the corporation was unprofitable.¹⁴⁸

The ILLCA uses the term oppression but does not define it.¹⁴⁹ Rather, Illinois courts use a definition similar to the first one quoted above. For instance, in *Jaffe Commercial Finance Co. v. Harris*, the Illinois Supreme Court considered whether a controlling group of shareholders in a close corporation acted oppressively when, following an exchange of harsh words, they effectively forced one of their investors out of the business by firing him from his positions as secretary and consultant and voting him off of the board of directors.¹⁵⁰ In its analysis, the court quoted an earlier case where a corporation’s president acted oppressively by engaging in an

‘arbitrary, overbearing and heavy-handed’ course of conduct . . . including his failure to call board meetings; his failure to consult with the plaintiff shareholder and officer regarding management of corporate affairs; his imperious attitude when questioned about his salary; and, his dilatory action in response to certain requests made by plaintiffs.¹⁵¹

The *Jaffe* court discussed oppression and freeze-outs in the same breath, indicating that Illinois falls in line with those states that view oppression as a cause of action for a minority interest-holder who is forced out of the business.¹⁵²

While oppression predated the LLC and made it into many LLC statutes, there is less case law on oppression in the LLC context than the close corporation context because the LLC is a relatively new form of business

146. Miller, *supra* note 8, at 461–62 (“It may be argued, however, that the reasonable expectations test is vague and provides insufficient guidance to the business and legal communities.”); see *Ritchie v. Rupe*, No. 11-0447, 2014 WL 2788335 (Tex. Sup. Ct. 2014) (refusing to recognize the reasonable expectations definition of oppression because the standard “is so vague and subject to so many different meanings in different circumstances”).

147. *Id.*

148. *In re Kemp & Beatley*, 473 N.E.2d at 1179 (“Majority conduct should not be deemed oppressive simply because the petitioner’s subjective hopes and desires in joining the venture are not fulfilled. Disappointment alone should not necessarily be equated with oppression.”).

149. See 805 ILL. COMP. STAT. ANN. 180/35-1 (West 2013).

150. *Jaffe Commercial Fin. Co. v. Harris*, 456 N.E.2d 224, 227–32 (Ill. App. Ct. 1983).

151. *Id.* at 231 (quoting *Compton v. Paul K. Harding Realty Co.*, 285 N.E.2d 574, 581 (Ill. App. Ct. 1972)).

152. See also *Gidwitz v. Lanzit Corrugated Box Co.*, 170 N.E.2d 131, 138 (Ill. 1960), *reh’g denied*, 170 N.E.2d 131 (Ill. 1960); *Notzke v. Art Gallery, Inc.*, 405 N.E.2d 839, 842–43 (Ill. App. Ct. 1980); *Compton*, 285 N.E.2d at 581.

entity.¹⁵³ Even though most of the case law defining oppression involves close corporations, the cases and their discussions of oppression are equally applicable in the LLC context. Had the legislature wanted to convey a different meaning, it could have chosen a term that was not already a term of art appearing in many cases and corporation statutes.

1. Dissolution: The Principal Remedy for Oppression

Courts and legislatures have approached the problem of oppressive conduct against minority shareholders through a combination of equitable doctrines and statutory remedies.¹⁵⁴ One such remedy is dissolution of the entity.¹⁵⁵ Many business corporation acts make dissolution available to shareholders of close corporations upon the occurrence of certain events.¹⁵⁶ For example, prior to oppression doctrines, dissolution was the traditional remedy in cases of deadlock.¹⁵⁷ In a typical deadlock scenario, disagreement among the shareholders or a breakdown in their relationship makes management of the corporation effectively impossible, and the shareholders are unable to resolve their disputes on their own—either because they cannot get 51 percent of the votes for any one course of action or because the bylaws have no provision for resolving deadlock.¹⁵⁸

Over time, states began extending the dissolution remedy to oppressed minority members as well.¹⁵⁹ However, dissolution as a remedy is far from

153. See EISENBERG, *supra* note 13, at 498 (“The LLC is a relatively new form. As a result, the LLC statutes are still evolving and the case law is still sparse.”); HAMILTON, *supra* note 21, at 1182 (“[T]he LLC is a relatively new form of business organization in [the United States]. Although its ‘birth’ dates back to 1977, its widespread use is more recent. Compared to other forms of business organization . . . the LLC is less established, and there are still a number of open questions for lawyers and courts to wrestle with.”).

154. HAMILTON, *supra* note 21, at 462.

155. See REVISED MODEL BUS. CORP. ACT § 14.30(2) (1994) for a statute typical of many state involuntary dissolution statutes.

156. Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285, 295–96 (1990) (“Today every state has a statute that permits courts to dissolve corporations. Most states specifically permit judicially decreed dissolution if directors or shareholders are deadlocked in voting power, or if the directors have acted fraudulently, oppressively, or illegally.”); see, e.g., 805 ILL. COMP. STAT. ANN. 5/12.35 (West 2013); REV. MODEL BUS. CORP. ACT § 14.30(2) (1994).

157. HAMILTON, *supra* note 21, at 462; see CARY & EISENBERG, *supra* note 3, at 363 (but note that “courts have been reluctant to order dissolution of [profitable corporations] on deadlock grounds”).

158. See generally Harry J. Haynsworth, *The Effectiveness of Involuntary Dissolution Suits as a Remedy for Close Corporation Dissension*, 35 CLEV. ST. L. REV. 25 (1987).

159. *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1177 (N.Y. 1984) (observing that historically dissolution was only allowed in certain narrow, statutorily prescribed situations, and that more recently courts may order dissolution as an equitable remedy or as a remedy for oppression); CARY & EISENBERG, *supra* note 3, at 377 (“[P]artly based on a wave of dissolution-for-oppression statutes, courts . . . became more willing to grant dissolution . . . not only on the ground of deadlock but also on the ground of oppression.”).

a panacea. Dissolution is not always the appropriate remedy, nor is it always a reliable one. Courts look at dissolution as a last resort when the parties' relationship has degenerated to the point where the corporation can no longer function.¹⁶⁰ Courts are reluctant to order dissolution because it is very harsh¹⁶¹—not only does it spell death for the corporation, it also means that the corporation must wind up and liquidate its assets.¹⁶² Typically, the company's assets are sold off quickly at a "fire sale," and as a result, the corporation will lose much of its going concern value in the process.¹⁶³

2. *In re Radom & Neidorff*: An Example of Courts' Traditional Reluctance toward Dissolution

A case illustrative of the courts' attitude toward dissolution is *In re Radom & Neidorff, Inc.*¹⁶⁴ In *Radom*, a brother and sister were the sole shareholders of a close corporation; each owned a fifty percent interest.¹⁶⁵ The brother also served as president and bore the responsibility for managing the business.¹⁶⁶ The two siblings disliked and distrusted each other, and their feud carried over into the management of the corporation.¹⁶⁷ The sister refused to sign her brother's salary checks or to participate at shareholder

160. EISENBERG, *supra* note 13, at 444 ("At one time, courts were extremely reluctant to order the involuntary dissolution of a profitable business, on the ground that it was bad social policy . . ."); see, e.g., *Bator v. United Sausage Co.*, 81 A.2d 442, 444 (Conn. 1951) ("Dissention among the members of a corporation is not a ground for dissolution unless it goes so far as to render it impossible to carry on the corporate affairs."); *In re Radom & Neidorff, Inc.*, 119 N.E.2d 563, 565 (N.Y. 1954); *Wollman v. Littman*, 316 N.Y.S.2d 526, 527 (N.Y. App. Div. 1970) ("Irreconcilable differences even among an evenly divided board of directors do not in all cases mandate dissolution . . .").

161. *Schirmer v. Bear*, 672 N.E.2d 1171, 1176 (Ill. 1996) (citing *Coduti v. Hellwig*, 469 N.E.2d 220, 224 (Ill. App. Ct. 1984)) ("Judicial dissolution is an extreme remedy which courts are properly reluctant to order."); O'NEAL & THOMPSON, *supra* note 7, § 1:22 ("Courts traditionally have viewed dissolution as a drastic remedy, and they have been extremely reluctant to terminate a profitable operating business."); Bahls, *supra* note 156, at 296 ("Courts historically looked askance at dissolution as an extreme remedy. If alternative equitable remedies were available to resolve the dissension, they were ordered frequently.")

162. Bahls, *supra* note 156, at 297 ("When corporations are liquidated, they usually sell their assets for cash.")

163. *Id.* ("[T]he sale [of assets] does not yield the maximum value for any of the shareholders. Auction sales are fire sales. Rather than selling the entire business as a going concern, the business assets might be sold separately. If so, the sale does not yield the full value of a going concern."); see also EISENBERG, *supra* note 13, at 468 ("[A] mandatory sale of close corporation's business in the context of a dissolution proceeding may not in fact realize the fair value of the business. The problem with such a sale is that there may be no ready market for the corporation's business . . .").

164. *In re Radom*, 119 N.E.2d at 563.

165. *Id.*

166. *Id.* at 564.

167. *Id.*

meetings to elect a board of directors.¹⁶⁸ The corporation did not declare dividends, and some of the corporation's debts went unpaid.¹⁶⁹

The brother petitioned the court to order dissolution of the corporation, but the court denied his petition.¹⁷⁰ Despite facts showing that the corporation was embroiled in internal conflicts and the brother had not been paid a salary, the court held that there was "no absolute right to dissolution" under the circumstances.¹⁷¹ The court stated that it would only be willing to grant a petition for dissolution where "the competing interests 'are so discordant as to prevent efficient management' and the 'object of [the corporation's] existence cannot be attained.'"¹⁷² The court justified denying the petition by pointing to the fact that the corporation was still solvent and making a profit; however, as the dissent points out, the corporation's long-term financial health was much more precarious.¹⁷³

In denying the petition for dissolution, the court stated that the brother had other remedies available to him, but it failed to say what they were.¹⁷⁴ In reality, the irreconcilable discord left the brother with only two options: he could either continue to work without pay, or resign from his position as president and risk a financial loss to the corporation.¹⁷⁵ Such a position is untenable. *Radom* is emblematic of the classic dilemma that minority shareholders face in cases of deadlock and freeze-outs. Courts' reluctance to order dissolution may leave plaintiffs without a remedy.

II. *TUTUNIKOV V. MARKOV*: AN ILLUSTRATION OF THE PROBLEM

Tutunikov v. Markov,¹⁷⁶ decided in 2013, represents a position that, if followed in Illinois, could deter investment and discourage the growth of small businesses. The parties were both members of an LLC in the business of developing financial software.¹⁷⁷ Tutunikov, the plaintiff, was a minority member with a 10 percent equity interest, and the defendants were a controlling group, owning a combined interest of 74 percent.¹⁷⁸ The parties'

168. *Id.*

169. *Id.* at 566.

170. *Id.* at 565.

171. *Id.*

172. *Id.* (citing *In re Importers' and Grocers' Exch.*, 30 N.E. 401, 404 (N.Y. 1892)).

173. *Id.* at 566–68.

174. *See id.* at 565.

175. *Id.* at 567.

176. *Tutunikov v. Markov*, 2013 WL 3940889, at *1 (N.J. Super. Ct. App. Div. Aug. 1, 2013).

177. *Id.* at *2.

178. *Id.* at *2–3 (noting, however, that the exact percentage of each party's ownership interest was in dispute. In some years, the controlling group reported on their tax returns that they owned 41.25 percent each, or a combined interest of 82.50 percent).

relationship began to break down at the end of 2003.¹⁷⁹ In December of that year, the defendants announced they would be paying themselves a salary twice as large as they had in prior years.¹⁸⁰ They also failed to inform Tutunikov of negotiations with a potential investor who was proposing to invest at least \$500,000 in the company in exchange for substantial equity.¹⁸¹ Further, the trial court found that the defendants had paid themselves distributions attributable to treasury shares that should have been distributed to all shareholders proportionately.¹⁸²

After negotiations over a buyout of Tutunikov's interest broke down, Tutunikov filed suit.¹⁸³ In his complaint, Tutunikov alleged, *inter alia*, that the defendants had "breached fiduciary and contractual obligations to plaintiffs 'as managing members [of the company] and acted unfairly and oppressively'."¹⁸⁴ Even though the case involved an LLC, Tutunikov brought his oppression claim under New Jersey's Business Corporation Act because there was no equivalent oppression provision under the New Jersey LLC Act.¹⁸⁵ The trial court agreed with Tutunikov, reasoning that "it is appropriate in the absence of situations not covered by the LLCA to look to the [BCA] for guidance. Because the LLCA is silent regarding relief for claims of oppression, the court may logically look to the [BCA] for appropriate remedies."¹⁸⁶ The court found that the "defendants engaged in oppressive conduct toward the minority shareholders," thus entitling Tutunikov to a buyout of his interest in the company.¹⁸⁷ However, on appeal, the New Jersey Superior Court overturned the ruling, holding that Tutunikov had "no cognizable claim";¹⁸⁸ the court refused to import the remedy for oppression from the New Jersey Business Corporation Act into the LLC context.¹⁸⁹

The result from *Tutunikov* is troubling. Do minority members of an LLC require less protection than their close corporation counterparts? Is there a policy reason for allowing oppression claims in one context and not the other? This seems incongruent with the law of LLCs, which generally

179. *Id.* at *4.

180. *Id.*

181. *Id.* at *5–6.

182. *Id.* at *6.

183. *Id.*

184. *Id.* at *1.

185. *Id.* at *8; see N.J. STAT. ANN. § 14A:12-7(1)(c) (West 2013).

186. *Tutunikov*, 2013 WL 3940889, at *6.

187. *Id.*

188. *Id.* at *9.

189. *Id.*

recognizes that the LLC is a hybrid of a partnership and a corporation,¹⁹⁰ founded on legal doctrines from both entities.¹⁹¹

Illinois, like New Jersey, is among the states that recognize a statutory cause of action for oppression.¹⁹² Further, the ILLCA does provide a cause of action for oppression where the New Jersey LLC Act does not.¹⁹³ Even so, the ILLCA in its current form is inadequate because it fails to define oppression and only provides successful litigants with one remedy: dissolution followed by a windup of the LLC.

III. OPPRESSION IN ILLINOIS: PROBLEMS AND PROPOSED SOLUTIONS

Oppression in LLCs is not unique to Illinois, but the problem is worsened by the way the ILLCA is drafted. In this Part, I argue that the current remedies for oppression are insufficient or, at best, unreliable. I then propose ways to improve the remedies available to minority members in the form of statutory amendments and equitable remedies.

A. Existing Remedies under the ILLCA

1. Dissolution

Currently, dissolution is the only statutory remedy for oppression under the ILLCA.¹⁹⁴ Limiting an oppressed minority member's remedies to dissolution effectively vitiates any protection that an oppression provision can offer. Because courts are reluctant to order dissolution,¹⁹⁵ a minority member may be left without a remedy even where there is strong evidence of oppressive conduct.¹⁹⁶ Even if a minority member succeeds at having the company dissolved, the member may only recover a fraction of his original investment in the company.¹⁹⁷ Upon dissolution, the company must wind up and its assets are typically sold off quickly, on a piecemeal basis, for a

190. EISENBERG, *supra* note 13, at 498 (“Limited liability companies are noncorporate entities that are created under special statutes that combine elements of corporation and partnership law.”).

191. *Id.*; HAMILTON, *supra* note 21, at 1186 (“Because LLC statutes often reflect a mishmash of corporation, partnership, and limited partnership principles, courts frequently analogize to existing doctrines from other business forms when confronting LLC issues[.]”).

192. *See supra* note 132; 805 ILL. COMP. STAT. ANN. 180/35-1 (West 2014).

193. § 35-1.

194. In Illinois, the judicial dissolution statutes for non-public corporations and for LLCs are 805 ILL. COMP. STAT. ANN. 5/12.56(b) (West 2014) and 805 ILL. COMP. STAT. ANN. 180/35-1 (West 2014), respectively.

195. *See supra* notes 160–161 and accompanying text.

196. *See supra* notes 159–162 and accompanying text.

197. *See supra* note 163 and accompanying text.

price far below their going concern value.¹⁹⁸ Additionally, there are those who may not want to dissolve the company but would rather see it continue to operate with some changes to the management structure. For those who fall in this latter group, there are multiple options under the IBCA, but the ILLCA provides no relief. There may be some situations where dissolution is the proper or most appropriate remedy, but dissolution alone is not sufficient to protect the rights of minority members or to provide relief after a court's finding of oppression.

2. Buyouts

The ILLCA makes it fairly easy for a member to dissociate from the company, after which the company must purchase the former member's interest.¹⁹⁹ Among the enumerated circumstances causing dissociation is "[t]he company's having notice of the member's express will to withdraw" ²⁰⁰ In other words, a member can dissociate merely by expressing his will to do so. And under Section 35-50, a member of a member-managed LLC has this power to dissociate, rightfully or wrongfully, at any time.²⁰¹ The operating agreement cannot restrict this power.²⁰² The value of the dissociated member's interest is its fair value determined at the time of dissociation.²⁰³ After dissociation, the company must deliver an offer to purchase within 30 days, and if no agreement is reached within 120 days, the dissociated member may bring a proceeding asking the court to order the company to purchase the interest.²⁰⁴

Based on these sections, it would seem like dissociation provides an easy answer to the issue of oppression. Instead of bringing a claim and dissolving the company, the oppressed minority can simply dissociate at will and receive a mandatory buyout of its interest. If this were true, then a statutorily mandated buyout would be an alternate route for an oppressed minority to draw its investment out of the company. Unfortunately, for several reasons, this option is not a reliable one.

There are a number of important ways that an operating agreement can limit a minority member's ability to receive a buyout, and some are plain in the language of the ILLCA. Whereas a member of a member-managed

198. *Id.*

199. 805 ILL. COMP. STAT. ANN. 180/35-60(a) (West 2014).

200. *Id.* § 35-45(1).

201. *Id.* § 35-50.

202. *Id.* § 15-5(b)(5).

203. *Id.* § 35-60(a).

204. *Id.* §§ 35-60(b), (d).

LLC has an inalienable power to dissociate, a member of a manager-managed LLC does not. Section 35-50 specifically states, “If an operating agreement does not specify in writing the time or the events upon the happening of which a member of a manager-managed company may dissociate, a member does not have the power, rightfully or wrongfully, to dissociate from the company.”²⁰⁵ Yet even where the member *does* have the power to dissociate, the member may be unable to receive a buyout. Section 15-5(b)(5) states that the operating agreement can “determine whether a dissociation is wrongful” or not. A wrongful dissociation makes the member liable to the company for damages,²⁰⁶ which can offset any money the member would be entitled to receive as payment for his or her interest. Even more striking is Section 15-5(b)(5), which states that “[the operating agreement] may eliminate or vary the obligation of the limited liability company to purchase the dissociated member’s distributional interest.”²⁰⁷ This provision allows the parties to eliminate the right to a buyout altogether. Thus, a minority member in an LLC with a slanted or artfully drafted operating agreement cannot rely on a right to a buyout as protection against oppression.

Even if a member is able to dissociate, the problems inherent to valuation may prevent a dissociating member from actually receiving fair value for his or her interest.²⁰⁸ If the dissociating member’s interest is substantial, then the parties may go through prolonged litigation and spend considerable resources arguing over the value of the interest and whether it is fair. Further, Illinois courts have held that the phrase “fair value” in the statute gives them discretion to determine whether a minority interest should be discounted for lack of control or lack of marketability.²⁰⁹ These discounts further punish the minority member. The minority member lacks control of the company and its shares are already unmarketable; awarding a member less than fair value upon leaving the company only adds insult to injury.²¹⁰ Because of the problems involved in valuation, the limits on dissociation,

205. *Id.* § 35-50.

206. *Id.*

207. *Id.* § 15-5(b)(5).

208. See generally Lin Hanson, *For LLC Minority Owners, “Fair Value” Often Isn’t*, 93 ILL. B.J. 148 (2005).

209. *Weigel Broad. Co. v. Smith*, 682 N.E.2d 745, 749 (Ill. App. Ct. 1996) (“The fact that the statute requires dissenting shareholders to be given ‘fair value,’ without specifically defining the term, we think, evidences a legislative intent to allow courts the freedom to fashion a remedy without limiting them to any single form of valuation. It is a legislative grant of broad discretion.”); *Independence Tube Corp. v. Levine*, 535 N.E.2d 927, 931 (Ill. App. Ct. 1988) (“There may be situations in which the minority or illiquid nature of the stock diminishes its value. In such instances, these factors should be considered in determining fair value.”).

210. See Hanson, *supra* note 208, at 148–49.

and the power to eliminate the right to a buyout, the buyout is only an illusory remedy.

B. The Illinois Limited Liability Company Act

Section 35-1 of the ILLCA, which enumerates the events causing dissolution and wind up of the company's business, is the only section that mentions oppression. In relevant part, the section states:

A limited liability company is dissolved, and . . . its business must be wound up, upon the occurrence of . . . [an] application by a member or a dissociated member, upon entry of judicial decree that . . . the managers or members in control of the company have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent with respect to the petitioner.²¹¹

Starting with the text of the statute, it would seem that dissolution must follow upon a finding of oppression. The statute states this as an imperative.²¹² Once a court finds oppression, the business must undergo dissolution.²¹³ Oppression is not defined elsewhere in the act, and dissolution is the only remedy available.

In contrast to the limited relief under the ILLCA, Section 12.56 of the IBCA provides a nonexhaustive list of twelve remedies available to an oppressed minority shareholder of a close corporation.²¹⁴ Courts may choose from any of the remedies on the list in fashioning a remedy for the aggrieved party. Under 12.56(a), if the plaintiff establishes that “[t]he directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent[,]”²¹⁵ the relief that the trial court may order

includes *but is not limited to* the following: (1) The performance, prohibition, alteration, or setting aside of any action of the corporation or of its shareholders, directors, or officers of or any other party to the proceedings; (2) The cancellation or alteration of any provision in the corporation's articles of incorporation or by-laws; (3) The removal from office of any director or officer; (4) The appointment of any individual as a director or officer; (5) An accounting with respect to any matter in dispute; (6) The appointment of a custodian to manage the business and affairs of the corporation to serve for the term and under the conditions prescribed by the court; (7) The appointment of a provisional director to serve for the term and under the conditions prescribed by the court; (8) The submission of the dispute to mediation or other forms of non-binding alter-

211. § 35-1(4)(E).

212. *Id.* (“A limited liability company *is dissolved*, and . . . its business *must* be wound up”)

213. *Id.*

214. 805 ILL. COMP. STAT. ANN. 5/12.56(b) (West 2007).

215. *Id.* § 12.56(a)(3).

native dispute resolution; (9) The payment of dividends; (10) The award of damages to any aggrieved party; (11) The purchase by the corporation or one or more other shareholders of all, but not less than all, of the shares of the petitioning shareholder for their fair value and on the terms determined under subsection (e); or (12) The dissolution of the corporation if the court determines that no remedy specified in subdivisions (1) through (11) or other alternative remedy is sufficient to resolve the matters in dispute.²¹⁶

The disparity between the two statutes is inexplicable given the similarities between the plights of the minority shareholder and minority member. Both statutes have similar policy goals, but one has a much more limited means of achieving those goals.

C. Proposed Solutions to Oppression in Illinois LLCs: Providing Additional Remedies

The Illinois legislature should amend the ILLCA to create more remedies for minority shareholders. Failing that, courts sitting in equity should import the remedies from the IBCA and make them available to oppressed minority members. Both of these solutions are aimed at increasing the protections for minority members of LLCs against oppressive conduct. The additional security will make investors feel more comfortable investing in businesses formed as LLCs, because they will not be as concerned about an oppressive majority freezing them out of the business or holding their investment hostage.

1. Proposed Amendments to the ILLCA

First, the legislature should amend the ILLCA to define oppressive conduct and add greater clarity to the circumstances that give rise to a cause of action for oppression. The legislature should use the “expectations” definition discussed above, because it draws the focus away from the oppressor’s conduct and puts it back onto the minority’s decision to invest in the company.²¹⁷ It also gives courts the discretion to render ad hoc decisions for an issue that is highly situational and fact-specific. For example, if a person who invested in an LLC, expecting to be personally employed in the company, was inexplicably fired and then frozen out of the business, he could point to the firing in arguing that the majority acted oppressively. The same would be true for a member who originally invested with the expectation of receiving dividends. The expectations definition has broad

216. *Id.* § 12.56(b) (emphasis added). I included the lengthy statute here to illustrate how many more options there are in the close corporation context than the LLC context.

217. *See supra* notes 140–148 and accompanying text.

support from respected corporate law commentators, and it has already been adopted by many other jurisdictions.²¹⁸

Section 1-5 of the ILLCA, the definitions section, is the most appropriate place for this amendment.²¹⁹ The added provision would read as follows: “‘Oppressive’ means a manner of conduct which frustrates the reasonable expectations that another member or former member had at the time it purchased its membership interest.” In any case, defining oppression in this way will help clarify members’ rights and the set of facts entitling an oppressed member to a remedy.

Further, an amendment should also add a new section containing a list of remedies for oppression modeled after Section 12.56 of the IBCA. The added section would include a nonexhaustive list of discretionary remedies, giving courts the flexibility to choose the most appropriate form of relief based on the circumstances. The new section would replace the old oppression provision, and state:

Upon entry of a judicial decree that the managers or members in control of the company have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent with respect to another member or former member, the relief that a court may order includes but is not limited to: (1) an injunction against further oppressive conduct; (2) a purchase, by the company or one of its members, of the oppressed member’s interest for its fair value; (3) the amendment of any provision in the company’s operating agreement; (4) the appointment or removal of any individual as manager of the company; (5) a distribution of profits in proportion to the oppressed member’s interest; (6) an award of damages to the oppressed member; (7) the appointment of a custodian to manage the business and affairs of the company; (8) the dissolution followed by wind-up of the company.

This suggested amendment includes some of the most commonly requested forms of relief, including a buyout, reinstatement on the board of managers, declaration of dividends, and injunctive relief. The Illinois legislature may also decide to have separate lists for manager-managed and member-managed LLCs in order to provide specific relief depending on the LLC’s management structure.

As explained above, neither the ILLCA’s current remedy of dissolution nor a member’s illusory right to a buyout are adequate remedies for oppression. And from a policy perspective, there is no strong reason for distinguishing between LLCs and close corporations regarding minority oppression—in both contexts the minority is in a particularly vulnerable position for the same reasons: lack of control, marketability, and judicial

218. See *supra* note 140 and accompanying text.

219. 805 ILL. COMP. STAT. ANN. 180/1-5 (West 2014)

oversight over the majority's management. In fact, a minority member's investment is even more vulnerable and precarious than that of a minority shareholder's because of the LLC's structural and managerial flexibility.²²⁰ Through artful drafting and superior bargaining power, a majority member can force the minority into an even weaker position.²²¹ At the very least, the legislature should amend Section 15-5 so that the operating agreement cannot eliminate a member's right to receive a buyout. That way, a member can pull out his or her investment in the event of a freeze-out, preventing the company from holding a member's interest hostage. Granting an inalienable right to a buyout does not completely solve the problem of oppression, but it goes quite a long way.²²²

2. Equitable Remedies to Oppression

Second, even if the legislature fails to amend the ILLCA, judges should craft an equitable remedy or import one from the IBCA. Other courts have recognized that courts of equity have various tools at their disposal for dealing with oppression.²²³ Illinois courts could adopt a stance similar to the one taken in *Brenner v. Berkowitz*, where the court stated, "Most acts of misconduct or oppression will warrant some type of remedy Importantly, courts are not limited to the statutory remedies, but have a wide array of equitable remedies available to them."²²⁴ The *Brenner* court reasoned that the remedial provisions of the statute were superimposed on top of a body of common law and did not replace the court's inherent equitable powers.²²⁵ If the ILLCA contained a nonexhaustive list of remedies similar to that of the IBCA, then courts would have the discretion to create equitable remedies other than the ones explicitly listed.

220. See *supra* notes 8, 96.

221. See Farrar & Hamill, *supra* note 14, at 930.

222. See Heatherington & Dooley, *supra* note 92, at 6 (concluding that a statutory right to receive a buyout is an effective solution to the problem of the minority shareholder's vulnerability at the hands of the majority).

223. See, e.g., Schirmer v. Bear, 672 N.E.2d 1171, 1176 (Ill. 1996); Meiselman v. Meiselman, 307 S.E.2d 551 (N.C. 1983); Brenner v. Berkowitz, 634 A.2d 1019, 1033 (N.J. 1993); Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 395-96 (Or. 1973) (listing ten possible remedies for oppression short of dissolution).

224. *Brenner*, 634 A.2d at 1033.

225. *Id.* at 1031. For a case where the court took a similar approach and instead declined to recognize a common law cause of action for oppression, see Ritchie v. Rupe, No. 11-0447, 2014 WL 2788335, at *13 (Tex. June 20, 2014) ("This Court has never recognized a common-law cause of action for 'minority shareholder oppression.'").

IV. RESPONDING TO CRITICISMS

This final Part responds to potential arguments against creating additional remedies for oppressed LLC members. Critics may take the position that additional remedies are unnecessary and, therefore, there is no need to amend the ILLCA. Critics may also argue that additional, flexible remedies would be incongruent with the body of corporate law legal doctrines. This Part addresses and rejects both kinds of counterarguments.

A. The Appeal of Formalism

Some courts and commentators may balk at expanding the rights of oppressed LLC members based on the remedies available to shareholders of close corporations. This may be due in part to the attractiveness of a formalistic approach. A court taking this approach would be reluctant to import remedies from the IBCA, reasoning that legislatures created certain rights and remedies in one context and intentionally chose not to make them available outside that context. Out of respect for the intent of the legislature and public policy, it would be improper to judicially extend the law beyond what the people's representatives thought was appropriate. This was the reasoning behind the *Tutunikov* court's holding.²²⁶ The *Tutunikov* court thought that the conspicuous absence of a cause of action for oppression from the New Jersey LLC Act was tantamount to an expression of the legislature's intent that there should be none.²²⁷

This approach has some appeal, especially in the formalistic field of corporate law. Indeed, corporations themselves are formalistic by nature.²²⁸ Business entities are a legal fiction, created by legislatures to achieve economic and policy objectives. It makes sense that a person who specifically chooses to organize as an LLC and not some other entity should have his decision honored in court. That person may have deliberately chosen the LLC over other entities at least in part due to the lack of certain obligations toward minority members. A formalistic approach is also attractive to entrepreneurs, investors, and businesspeople because it boasts increased stability and predictability. It is easier for an entrepreneur to plan and organize a business when he does not have to worry about the legislature significantly altering his rights and obligations later on.

However, borrowing legal doctrines from another context is not unheard of in corporate law. Cases dealing with agreements between share-

226. See *Tutunikov v. Markov*, 2013 WL 3940889, at *1 (N.J. Super. Ct. App. Div. Aug. 1, 2013).

227. *Id.* at *9.

228. See generally O'NEAL & THOMPSON, *supra* note 7, § 1:18 (discussing corporate formalities).

holders of corporations are one example. Originally, courts were adverse to shareholder agreements where they contravened the corporate form by impinging on the authority of the board of directors.²²⁹ While most agreements between shareholders are valid, in the past, some courts held that such contracts were illegal if shareholders attempted to use them as an instrument to bind or control matters that should be left up to the board of directors, such as hiring officers, determining corporate policies, or managing the business.²³⁰ For example, in *McQuade v. Stoneham*, a New York court held that a shareholder agreement that fixed officers' salaries was illegal because it was contrary to the corporate form and, therefore, void as against public policy.²³¹

Two years following *McQuade*, a court created an exception to the *McQuade* holding for close corporations. In *Clark v. Dodge*, the court held a shareholder agreement legal and enforceable even though it restricted the authority of the board of directors.²³² In *Clark*, the parties to the contract were the sole directors and shareholders of the corporation.²³³ Therefore, any invasion of the board's authority was minimal.²³⁴ Furthermore, the agreement was not against public policy because enforcing the agreement would not be detrimental to any interested parties; no creditors were harmed, and there was no fraud.²³⁵ Illinois falls in line with *Clark* and takes the position that when dealing with close corporations, a court should not invalidate a shareholder agreement as against public policy where there is no apparent public injury, no complaining minority interest, and no harm to creditors.²³⁶ Upholding shareholder agreements is just one example of

229. See generally CARY & EISENBERG, *supra* note 3, at 279 (“[C]orporation law has not in the past been as attuned to contractualization, and in the corporate context there has often been serious question whether such arrangements will be deemed valid.”).

230. *Manson v. Curtis*, 119 N.E. 559, 562 (N.Y. 1918) (“the law does not permit the stockholders to create a sterilized board of directors.”); *Creed v. Copps*, 152 A. 369, 370 (Vt. 1930) (“[T]he business management of a corporation is confided to its directors They represent all the stockholders and creditors and cannot enter into agreements, either among themselves or the stockholders, by which they abrogate their independent judgments.”); but see *Luthy v. Ream*, 110 N.E. 373, 375 (1915) (“[I]t is legitimate for the owners of a majority of the stock of a corporation to combine for the purpose of controlling the corporation.”).

231. *McQuade v. Stoneham*, 189 N.E. 234, 236–38 (N.Y. 1934).

232. See *Clark v. Dodge*, 199 N.E. 641 (N.Y. 1936).

233. *Id.* at 643.

234. *Id.*

235. *Id.*

236. See DEL. CODE ANN. tit. 8, § 350 (2014) (permitting shareholder agreements, reflecting the general trend in most states now that such agreements are permissible); *Galler v. Galler*, 203 N.E.2d 577, 584–85 (Ill. 1964) (“this court [has] generally up[held], in the absence of fraud or prejudice to minority interests or public policy, the right of stockholders to agree among themselves as to the manner in which their stock will be voted”); HAMILTON, *supra* note 21, at 389 (“[*Galler*] has had a

courts' willingness to modify legal doctrines in the close corporation and small business context.

Despite the appeals of formalism, my recommendations are not inconsistent with a formalistic approach. I am arguing that the Illinois state legislature should formally amend the ILLCA to clarify and define a cause of action that already exists under the Act. Amending the ILLCA would actually add legal precision and clarify the present ambiguity regarding the rights of minority members. But even a judicially created remedy would not be a departure from past decisions. Without an amendment, judges would simply look to the IBCA and import a remedy already available to close corporations. Courts have recognized the need for flexibility when dealing with close corporations and LLCs, and borrowing remedies or importing legal doctrines is not wholly inconsistent with corporate law. As discussed earlier, the law of close corporations has borrowed substantially from partnership doctrines, especially in the area of fiduciary duties.²³⁷

Shareholder agreements, also discussed above, are another example.²³⁸ A decision importing a remedy would not be inconsistent with policy either, because the LLC already has a dual identity as a quasi-corporation even though it is not a close corporation. Any argument to formalism, although appealing, is ultimately unavailing because it does not give enough significance to the history and development of these entities and the policies underlying the LLC.

B. Bargaining for Protection in Founders' Agreements

An opponent to amending the ILLCA might argue that there is no need for additional protection for minority shareholders because the founders can simply write safeguards into the operating agreement.²³⁹ After all, that is what partners may do when drafting a partnership agreement. Someone taking this position would assert that the real solution is better lawyering, and not changes to the statutory scheme. But this argument fails for several reasons. The party with the minority share of the company is usually in a weaker negotiating position and might not be able to bargain for the

significant impact on the development of close corporation law. Its call for special legislative treatment of closely held corporations has led to statutory developments in most states.”).

237. See *supra* notes 40–41 and accompanying text.

238. See *supra* notes 229–236 and accompanying text.

239. For an example of this argument, see the court's opinion in *Nixon v. Blackwell*, 626 A.2d 1366, 1379–80 (Del. 1993) (“The tools of good corporate practice are designed to give a purchasing minority stockholder the opportunity to bargain for protection before parting with consideration.”).

protection it needs.²⁴⁰ Also, no one can predict every eventuality, and it is unrealistic to think that the parties can obviate every problem. Finally, and most significantly, many small businesses may have inadequate operating agreements or no agreement at all.²⁴¹

In practice, founders often fail to draft agreements among themselves *ex ante*.²⁴² First, the founders of a small business are often friends or family, and they assume that they will be able to resolve every disagreement amicably.²⁴³ This “atmosphere of mutual trust” leaves the shareholders without a plan for valuation or for how to break a deadlock.²⁴⁴ Second, the founders may be inexperienced in business and may fail to recognize the need to protect themselves contractually.²⁴⁵ Founders of small businesses and entrepreneurs do not necessarily think about these agreements the same way a lawyer would.²⁴⁶ Third, founders who are friends may not want to talk about worst case scenarios for fear that it will arouse harsh feelings and taint the close relationship that they have with their co-founders.²⁴⁷ In other words, they may feel that hard bargaining will harm their business or personal relationship with the other shareholders.²⁴⁸ Fourth, oppressive conduct can occur in multifarious ways, and it is difficult to foresee the situations that necessitate contractual protection.²⁴⁹ Fifth, founders may be reluctant to bind themselves to a long-term agreement that they might not like later on when the circumstances have changed and they have developed different expectations for the business.²⁵⁰ Lastly, a fully customized operating agreement is time consuming to draft, and many small businesses do not have the money to pay for extensive legal services.²⁵¹ It is difficult enough for a small business to turn a profit during the early stages, and

240. O’Neal, *supra* note 145, at 883 (shareholders of close corporations “may be unaware of the risks involved, or [their] bargaining position may be so weak that [they are] unable to negotiate for protection”).

241. See Farrar & Hamill, *supra* note 14, at 930 (“Unfortunately statutory default provisions denying LLC members dissociation rights . . . comes at a heavy price for less sophisticated persons that either cannot or will not seek competent legal advice before proceeding.”).

242. Moll, *supra* note 4, at 911.

243. *Id.* at 912–15.

244. *Id.*

245. *Id.* at 912; Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1805 (2001).

246. See Moll, *supra* note 4, at 912.

247. *Id.* at 915.

248. *Id.* at 915–16.

249. *Id.* at 913.

250. *Id.* at 914.

251. *Id.* at 916 n.112.

there may not be money in the budget for an operating agreement with all the “bells and whistles.”

No LLC should be without an operating agreement. But even where there is an agreement, the minority may end up in an even worse position if the terms are inadequate or slanted in favor of the parties holding a majority interest.²⁵² The party with the controlling interest may write the operating agreement to make dissociation wrongful or otherwise restrict the ability of the minority interest-holder to draw its capital out of the business.²⁵³ For these reasons, members of an LLC cannot expect to fully rely on operating agreements or good lawyering to protect them from shareholder oppression.

C. Fiduciary Duties

Others may argue that there is no need to amend the ILLCA because members already have sufficient protection by virtue of the fiduciary duties owed to them by the other members (or managers in a manager-managed LLC).²⁵⁴ Section 15-3 of the ILLCA contains a non-exhaustive list of these duties and what they include: “The fiduciary duties a member owes to a member-managed company and its other members *include* the duty of loyalty and the duty of care”²⁵⁵ The section goes on to add greater specificity to the duties and also acknowledges the obligation of good faith and fair dealing.²⁵⁶ Since the list of the members’ fiduciary duties is nonexhaustive, it implicitly acknowledges the existence of broader duties not listed.²⁵⁷ Thus, opponents of expanding remedies for oppression would claim that judicial scrutiny and enforcement of the fiduciary duties owed by members and managers are sufficient to protect members even without amending the Act to clarify a member’s rights against oppressive conduct.

This argument has little merit because it ignores the flexibility built into the ILLCA. The open-ended fiduciary duties enumerated in the ILLCA exist only by default or as a fallback. In practice, managers and members do not owe fiduciary duties in every situation. The flexibility of the ILLCA allows founders to alter and partially waive their fiduciary duties through

252. See *supra* note 8.

253. See *supra* note 73.

254. 805 ILL. COMP. STAT. ANN. 180/15-3(a) (West 2010) (providing that members owe fiduciary duties not just to the company but also to other members).

255. *Id.* (emphasis added).

256. *Id.* §§ 15-3(b), (d).

257. Compare the ILLCA’s flexible and open-ended, nonexclusive list with the RULLCA fiduciary duty provision, which uses an exclusive list.

artful drafting of the operating agreement.²⁵⁸ In the agreement, the founders can identify specific types of categories of conduct and provide that the conduct does not violate the members' fiduciary duties as long as doing so is "not manifestly unreasonable."²⁵⁹ The same goes for the obligation of good faith and fair dealing.²⁶⁰

Another problem with this argument is that it elides the distinction between shareholder oppression and breach of fiduciary duty. As stated above, these two doctrines are not synonymous.²⁶¹ Since the bar for proving a breach of fiduciary duty is higher than the bar for oppression, the courts' ability to provide equitable relief for breach of fiduciary duty may be inadequate to deal with all kinds of shareholder oppression. The lower threshold of oppression gives members additional protection against things like freeze-outs because it embraces conduct that might not rise to the level of breach of fiduciary duty.²⁶² Furthermore, oppression statutes offer additional protection to members of manager-managed LLCs. Members in manager-managed LLCs do not owe fiduciary duties to other members.²⁶³ As such, a member in a manager-managed LLC has little chance of bringing a cause of action for breach of fiduciary duty against another member, but at least he or she retains protection against oppressive conduct, as the oppression provision cannot be eliminated by the operating agreement.

While giving the founders this added flexibility makes sense conceptually and fits with the LLC's identity as an entity primarily governed by contract,²⁶⁴ it puts an additional burden on prospective investors and inexperienced business owners. Any investor looking to become a member in an LLC will have to pay extra attention to provisions that place certain types of conduct outside the protection of fiduciary duties. Although a skilled investor is expected to carefully scrutinize a business before investing, this burden falls heavily on amateur entrepreneurs and small business owners. And since it is difficult to foresee every problem that will arise

258. See Farrar & Hamill, *supra* note 14, at 914 ("Faced with default provisions allowing partners and LLC members to withdraw their capital, attorneys are often asked by their business clients . . . to restrict or eliminate these rights in a tailored operating agreement.").

259. § 15-5(b)(6).

260. *Id.* § 15-5(b)(7).

261. See, e.g., *Walta v. Gallegos Law Firm, P.C.*, 40 P.3d 449, 457 (N.M. Ct. App. 2001) ("[W]e hold that breach of this fiduciary duty can be asserted as an individual claim separate from the remedies available under our statutory corporate law for oppressive conduct.").

262. Thompson, *supra* note 140, at 228 ("[T]he lower threshold and the broader remedies complement one another in enabling courts to respond to the special needs of participants in close corporations.").

263. § 15-3(g)(1).

264. See *supra* notes 77–80 and accompanying text.

during the enterprise, a provision that is ostensibly innocuous during the drafting process may leave a member without protection when something goes wrong.

CONCLUSION

The popularity of the LLC continues to grow, and more small businesses are opting to organize as LLCs. Problems of oppression, which originated in the close corporation, have carried over to the LLC and will inevitably become more salient as more member disputes arise. Investors, considering whether to invest in a minority stake of an LLC, will look to states' LLC acts for a baseline of protection. Similarly, founders will flock to states that have a clear and well-defined legal framework for handling disputes among members.

For Illinois to be an attractive place for business and investment, the legislature should amend the ILLCA to define oppression, clarify members' rights, and provide vulnerable minority members the protection they need. Even absent an amendment, Illinois courts sitting in equity should resolve members' disputes through flexible, equitable remedies. As it stands now, shareholders of close corporations have many more remedies under the IBCA than their LLC member counterparts. This discrepancy is resolvable with the statutory amendments and equitable doctrines proposed in this Comment. Enacting these changes will positively respond to the popularity of LLCs among entrepreneurs and meet the needs of investors.

