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The Big Crowd and the Small Enterprise: Intracorporate Disputes in the Close-But-Crowdfunded Firm

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The Big Crowd and the Small Enterprise: Intracorporate Disputes in the Close-But-Crowdfunded Firm

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ABSTRACT

Equity crowdfunding is a financial innovation that allows small businesses and startups to access capital through soliciting investment over the Internet. The current literature on crowdfunding has focused on its theoretical background and on the development of crowdfunding exemptions from the securities laws permitting the practice. There is less discussion of the impact of crowdfunding on corporate governance. This article fills that gap by outlining the potential for a panoply of intracorporate disputes between and among majority shareholders and "crowd" minority shareholders, placing the discussion within the longstanding—if uneasy—divide in judicial treatment of disputes in public corporations and close corporations. From there, the article argues that courts adjudicating disputes in "close-but-crowdfunded" firms should adopt the contractual approach exemplified by Delaware law, and refrain from importing minority shareholder oppression doctrine into the crowdfunding context. The two primary justifications for providing special protections for close corporation minority shareholders are much weaker in the crowdfunding context. First, the mechanics of the crowdfunding process create both the incentive and opportunity to select appropriate terms upon which the founders will continue their

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relationship and which will be offered to the crowd. Second, and similarly, that same process undermines the inference that there are unwritten, yet reasonable, expectations about any shareholder's role in the venture. Furthermore, the application of oppression doctrine in the crowdfunded firm would ultimately harm crowd and non-crowd shareholders alike, while undermining the potential gains from equity crowdfunding as a new source of capital accumulation.

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I. INTRODUCTION

Crowdfunding is a disruptive financial and technological innovation that has drawn both excitement and skepticism.[1] Together with its intuitive appeal to businesses in search of new sources of capital, its emergence as an investment mechanism has attracted the attention of lawmakers and regulators across the United States. Acting upon authority granted to it by the 2012 Jumpstart Our Business Startups Act (JOBS Act),[2] the Securities and Exchange Commission (SEC) recently finalized the first set of crowdfunding regulations, Regulation Crowdfunding.[3] Likewise, many state legislatures have acted to permit intrastate sales of securities to Internet-based crowds.[4] As entrepreneurs avail themselves of these securities law exemptions and begin experimenting with crowdfunding as a source of equity financing,[5] disputes between and among founders and the crowd may lead to new varieties of intracorporate litigation.

The emergence of equity crowdfunding arrives against the backdrop of an ongoing debate about whether, or to what extent, close corporations should be treated differently than public corporations.[6] The defining traits of a public corporation are the clear separation between the identities and roles of the shareholders, officers, and directors, and the

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1. "Crowdfunding" refers to a broad range of activities that generally involve soliciting money for business or social ventures through Internet platforms or networks. *See* Joan MacLeod Heminway, *Crowdfunding and the Public/Private Divide in U.S. Securities Regulation*, 83 U. CIN. L. REV. 477, 477 n.1 (2014). This article will focus on "securities" or "investment" crowdfunding, as opposed to "rewards-based" or "donation" crowdfunding. *See infra* Part II.

2. *See generally* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012). The JOBS Act refers to Titles II, III, and IV of the Act, each of which opened a different avenue to crowdfunding. *Id.* §§ 201, 301–305, 401–402, 126 Stat. at 313–15. In brief, Title II permits "general solicitation" over the Internet to accredited investors under Regulation D, while Title III permits solicitation to unaccredited investors. *Id.* §§ 201(a)(1), 302(a), 126 Stat. at 314–15. Title IV granted the SEC authority to create a tiered version of the prior Regulation A, named Regulation A+, that allowed for relatively larger offerings through crowdfunding portals to both accredited and unaccredited investors. *Id.* § 401(a), 126 Stat. at 323–24.

3. Regulation Crowdfunding, 17 C.F.R. §§ 227.100–.503 (2017); *see also infra* notes 82–85 and accompanying text.

4. At least 34 states and the District of Columbia have state-level crowdfunding exemptions as of 2016. *See* N. AM. SEC. ADMIN. ASS'N, INTRASTATE CROWDFUNDING UPDATE: NOVEMBER 16, 2016 2 (2016), http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2014/12/NASAA-Intrastate-Crowdfunding-Update-111616.pdf.

5. *See* Heminway, *supra* note 1, at 477 n.1. This article assumes a sufficiently large number of entities will utilize some form of equity crowdfunding. As discussed later in this Part, there are several reasons crowdfunding may not be adopted widely.

6. *See generally* Robert B. Thompson, *Allocating the Roles for Contracts and Judges in the Closely Held Firm*, 33 W. NEW ENG. L. REV. 369 (2011).

availability of a liquid market for the shares of the corporation's stock.[7] Minority shareholders in public corporations generally expect only dividends or appreciation in stock value and have little more than a passive role in corporate affairs.[8] If an individual or group of minority[9] shareholders are dissatisfied with corporate policies or performance, they can—and are expected to—exit the corporation by selling their shares.[10]

Close corporations are defined by a blending of the roles of shareholder, officer, and director; the close personal relationships between the players; and the lack of market for reselling shares.[11] Minority shareholders in close corporations typically are not passive; often expect to be officers and directors; and expect to derive their financial participation from a salary or other payments for service as officers and directors.[12] Appreciation in value is a remote consideration given the illiquid resale market, though in most cases, close corporation minority shareholders expect to participate in profits on similar terms as the majority.[13]

Both types of corporations utilize similar formal characteristics: the seat of power in both is the board of directors, which, in the absence of charter, bylaws, or agreements holding otherwise, makes all important decisions by majority vote.[14] The close corporation minority shareholder faces a uniquely precarious position: a falling out between the majority and minority can result in the majority utilizing these formal powers of the corporation to diminish the role of the minority shareholder from full

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7. *See* Douglas K. Moll, *Minority Oppression & the Limited Liability Company: Learning (or Not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 888–92 (2005).

8. *See generally* Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L.Q. 1099, 1102–04 (contrasting the close corporation shareholder to the public shareholder by noting that investors often receive salaries instead of dividends and that the minority "has great difficulty selling its stock to realize capital appreciation").

9. Professor Moll defines "majority" and "minority" shareholders simply as those shareholders who do and do not have control over the corporation. *See* Moll, *supra* note 7, at 883 n.1. This article will use "majority" and "minority" in the same way.

10. *See* Ragazzo, *supra* note 8, at 1103 (suggesting that one option for disaffected public shareholders is to sell their stock).

11. *See* Moll, *supra* note 7, at 888–92. As discussed in Part III, the dividing line between "public" and "close" corporations is far from clear. *See infra* Section III.E. For purposes of this article, "public" corporations will refer to corporations with clear distinctions between the roles and expectations of shareholders, officers, and directors, while "close" corporations will refer to corporations with substantial overlap and interaction between those roles.

12. *See* Moll, *supra* note 7, at 890–91.

13. *See* Moll, *supra* note 7, at 888, 890 (describing close corporation shareholder expectations of participation in the business in addition to mere return on investment and payment of a salary in lieu of dividends as distributions of earnings).

14. *Id.* at 889–90.

management and financial participation to mere ownership of a completely illiquid equity interest.[15]

Courts and legislatures have grappled for some time with how to protect close corporation minority shareholders from the hard edge of such disputes.[16] Their uneasy answer to the question includes two primary solutions: (1) awarding damages or equitable relief for the breach of a special, close corporation heightened fiduciary duty owed by the majority to the minority,[17] or (2) ordering an involuntary dissolution of the corporation, a buyout of the oppressed minority shareholder, or some similar equity-style remedy premised on statutory authority.[18] The standard for imposing a remedy under either theory typically is whether the court finds a material impairment of the minority shareholder's reasonable expectations regarding his or her investment.[19] The justification for these solutions is twofold. First, courts note that personal relationships among founding players usually result in minority shareholders relying on trust instead of explicit contractual protections and forgoing the expense of hiring lawyers to negotiate such protections during the business's planning phase.[20] Second, in the absence of such contracting and the sophistication it suggests, courts have been willing to make inferences about parties' reasonable expectations based upon the course of the parties' dealings with one another.[21] These circumstances are foreign to public corporations because of the clear functional distinctions between shareholders and those in control—by the time the corporation is large or public, courts no longer view minority shareholders as in need of special protections.

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15. *Id.*

16. *Id.* at 883 ("For decades, the law has struggled with the plight of the close corporation minority shareholder."); *see also* Thompson, supra note 6, at 371 (articulating the view that the debate involves allocating the role of contracting and judicial resolution of disputes).

17. *See* Donahue v. Rodd Electrotype Co. of New Eng., 328 N.E.2d 505, 515 (Mass. 1975) (articulating and applying a heightened fiduciary duty for close corporation shareholders).

18. *See* Meiselman v. Meiselman, 307 S.E.2d 551, 553 (N.C. 1983) (interpreting a North Carolina statutory provision providing for dissolution or other "appropriate" remedies).

19. *See* Moll, *supra* note 7, at 884 nn.5–6, 892 n.33; Thompson, *supra* note 6, at 386–88.

20. *See Meiselman*, 307 S.E.2d at 557–60 (evaluating the argument that close corporation non-controlling shareholders could bargain for protections prior to entering the arrangement); *see also* Helms v. Duckworth, 249 F.2d 482, 486–87 (D.C. Cir. 1957); *Donahue*, 328 N.E.2d at 515 ("No outsider would knowingly assume the position of the disadvantaged minority.").

21. *See, e.g.*, *Meiselman*, 307 S.E.2d at 563 (discussing "reasonable expectations" as discernible from the "course of dealing" of the parties).

Equity crowdfunding applies a new tension to the already uneasy division between public and close corporations.[22] Equity crowdfunding likely will be utilized in startups[23] and small- to medium-sized business entities.[24] For the most part, startups utilizing crowdfunding will do so for a specific purpose—perhaps to close a gap in funding early in their life cycle or to avoid selling substantial equity to other types of investors.[25] Given the nature of the startup life cycle, these corporations generally expand beyond the typical bounds of the close corporation as they use early capital to build scale, with a clear expectation that early investors will reap gains when the corporation is later sold or taken public.[26] The same will not be true of many permanently small businesses that may also utilize crowdfunding.[27] Such entities typically are not prime candidates for traditional equity investments, even if they stand to achieve and maintain long-term and stable profitability.[28]

For that reason, this article focuses on intracorporate lawsuits in equity-crowdfunded entities that mirror those arising in closer and non-public enterprises. Close, non-public enterprises usually have a relatively smaller number of founding players, many of which serve as officers and directors in addition to maintaining their ownership interests. By contrast, most crowd shareholders who invest in such ventures are likely to be mere shareholders. The result is the "close-but-crowdfunded" entity: an enterprise expected to remain close between and among the founding shareholder-officer-directors and illiquid as to every shareholder, while looking much larger and more public because it has invited a crowd of additional shareholders from the Internet into the

22. As discussed later, there are now many large and private corporations that also do not fit neatly into the definition of a public or close corporation. *See infra* Section III.E.

23. *See generally* Seth Oranburg, *Bridgefunding: Crowdfunding and the Market for Entrepreneurial Finance*, 25 CORNELL J.L. & PUB. POL'Y 397 (2015) [hereinafter Oranburg, *Bridgefunding*].

24. *See* Richard Swart, *Why Equity Crowdfunding Matters to Small Business*, ENTREPRENEUR (July 21, 2016), https://www.entrepreneur.com/article/278744. Larger corporations desiring access to capital from a large number of investors should be expected to continue conducting traditional public securities offerings.

25. *See* Oranburg, *Bridgefunding*, *supra* note 23, at 419; *see also* Darian Ibrahim, *Equity Crowdfunding: A Market for Lemons?*, 100 MINN. L. REV. 561, 580–81 (2015) (describing misfit between professional investment and the lower cash needs of certain types of startups).

26. *See* Oranburg, *Bridgefunding*, *supra* note 23, at 405.

27. *See id.* (describing smaller businesses as distinguished from fast-growing startups).

28. *Id.*

corporate fold.[29] The tensions created by close-but-crowdfunded entities raise important questions in light of the ongoing debate about intracorporate disputes in close corporations. How should this close-but-crowdfunded entity, as a whole, be defined once the crowd invests? Does it remain a close corporation, or is it now a public corporation? If it is a public corporation, should the close corporation doctrine merely vanish? In light of this new tension, courts and legislatures may again find themselves grappling with how to resolve disputes between founding shareholder-officer-directors in crowdfunded corporations or lawsuits brought by crowd shareholders against non-crowd shareholder-officer-directors on both old and new theories of oppression.[30]

This article argues that courts should resolve intracorporate disputes in crowdfunded ventures in a manner closer to those occurring in public corporations.[31] Delaware courts have long rejected oppression doctrine in favor of a contractual approach.[32] Specifically, Delaware courts refuse to provide special protections to non-controlling close corporation shareholders, instead taking the position that corporate founders should bargain over protections and formalize the specific terms of their relationship to each other and the corporation at the outset, no matter how small or large their business ultimately becomes.[33] While some majority-minority inequities that arise in traditional close corporations will undoubtedly manifest themselves in close-but-crowdfunded entities, these tensions are insufficient to support judicial intervention of the kind applied in close corporation cases. Courts therefore should be reluctant to impose heightened fiduciary duties, buyouts, or dissolutions on majority shareholders in close-but-crowdfunded entities, primarily because the reasonable expectations analysis is not justified in light of the disparate expectations that can exist in close-but-crowdfunded corporations. Equity crowdfunding's arrival on the scene compels the more heavily contractual analysis applied in Delaware over the judicial supervision contemplated in close corporation cases.

This article's analysis depends upon a few assumptions and caveats about the widespread adoption and trajectory of equity crowdfunding and the status of oppression doctrines in numerous states. First, the article

29. *Cf.* Heminway, *supra* note 1, at 479–80 (describing the manner in which crowdfunding blurs the longstanding distinction in securities regulation between public and private securities).

30. *See infra* Section IV.C (illustrating potential oppression-like claims that could arise in close-but-crowdfunded ventures).

31. *See infra* Sections IV.C–.D.

32. *See* Nixon v. Blackwell, 626 A.2d 1366, 1379 (Del. 1993) (holding that Delaware law does not provide special remedies for non-statutory closely-held corporations).

33. *Id.* at 1379–80.

assumes equity crowdfunding will be adopted broadly enough to produce lawsuits. Given the thoroughly discussed shortcomings of Regulation Crowdfunding, widespread equity crowdfunding activity simply may never arrive.[34] Even so, early reports suggest equity crowdfunding is taking root in some businesses in some places.[35] Other reports suggest that many small ventures are utilizing state law crowdfunding exemptions and forgoing nationwide offerings of securities.[36] In addition, much of this article focuses on businesses that will likely remain relatively small and close, and otherwise would not become large or public.[37] Finally, this article does not provide significant substantive analysis of Delaware law, which, as noted above, has never recognized a heightened fiduciary duty, does not have statutory provisions or judicial recognition for buyouts or dissolutions,[38] and has expressed a clear preference for contracting in non-statutory close corporations.[39] Despite

34. *See generally* C. Steven Bradford, *The New Federal Crowdfunding Exemption: Promise Unfulfilled*, 40 SEC. REG. L.J. 195 (2012); Joan MacLeod Heminway, *How Congress Killed Investment Crowdfunding: A Tale of Political Pressure, Hasty Decisions, and Inexpert Judgments that Begs for a Happy Ending*, 102 KY. L.J. 865 (2014).

35. *See generally* Marc A. Leaf, Robert T. Esposito & Abigail Luhn, *Leading the Crowd: An Analysis of the First 50 Crowdfunding Offerings*, DRINKERBIDDLE (July 14, 2016), http://www.drinkerbiddle.com/insights/publications/2016/07/leading-the-crowd-first-50-crowdfunding-offerings.

36. *E.g.*, Jeannette Lee Falsey, *Sitka Brewery Is First to Sell Shares Under New Alaska Crowdfunding Law*, ALASKA DISPATCH NEWS (Apr. 14, 2017), https://www.adn.com/business-economy/2017/04/14/sitka-brewery-is-first-to-sell-shares-under-new-alaska-crowdfunding-law/.

37. Some examples include craft breweries, *see id.*, food trucks, and similar business ventures whose strategy includes an appeal to smallness or localness. *See* Oranburg, *Bridgefunding*, *supra* note 23, at 406 (discussing permanently small businesses expected to grow sustainably, but not quickly); *see also* J.W. Verret, *Uber-ized Corporate Law: Toward a 21st Century Corporate Governance for Crowdfunding and App-Based Investor Communications*, 41 J. CORP. L. 927, 930–31 (2016) (observing a space for crowdfunded small businesses to experiment with new ideas in their governance).

38. The Delaware General Corporation Law does provide for the appointment of a custodian with the authority to sell or dissolve a corporation upon the finding of a deadlock between directors and related circumstances. DEL. CODE ANN. tit. 8, § 226 (2017). Deadlock, however, is not the same as oppression in the vast majority of cases. *See generally* F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL & THOMPSON'S OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 7.16 (rev. 2d ed. 2004) [hereinafter O'NEAL & THOMPSON'S OPPRESSION] (describing how various state statutes define deadlocks that would give rise to judicial remedies).

39. *See, e.g.*, Nixon v. Blackwell, 626 A.2d 1366, 1379–80 (Del. 1993) (discussing the opportunity for shareholders in close corporations to contract for various protections *ex ante*). The Delaware approach to close corporations likely mirrors the one proposed for close-but-crowdfunded corporations advanced in this article. Nonetheless, Delaware has recognized the existence of an equitable dissolution remedy for LLC membership assignees in the context of the deadlocked LLC, which, importantly, derived not from the statute—which provided for dissolution only upon petition of a member—but from the

Delaware's significance in the development of corporation law, early evidence suggests crowdfunding is occurring in a substantial number of corporations formed outside of Delaware.[40] In these places, and in the business sectors where equity crowdfunding may be expected to take root, close-but-crowdfunded corporations are poised to become a substantial slice of the crowdfunding market. It is in these jurisdictions that this article's proposal to follow Delaware's contract-focused approach will be most important.

The current scholarly focus on crowdfunding involves the merits and demerits of Title III of the JOBS Act and its resultant Regulation Crowdfunding,[41] proposals for the continued development of crowdfunding,[42] and the critical work of constructing the phenomenon's theoretical architecture—especially in the investment crowdfunding context.[43] Less material exists covering corporate governance issues that may emerge in crowdfunded ventures.[44] This article supplies the first exploration of equity crowdfunding in the context of the close corporation.

Part II of this article provides a brief history of crowdfunding, distinguishes equity crowdfunding from other forms of crowdfunding, discusses the forms equity investment may take in investment crowdfunding, briefly evaluates potential limitations to equity crowdfunding under current law, and discusses the broader social and economic context from which crowdfunding emerged.[45] Part III contains a review of the divide between judicial treatment of public corporations and close corporations, and illustrates how crowdfunding applies tension to this divide.[46] Part IV defends the claim that crowdfunding will emerge in previously close corporations and argues that courts should not apply—and crowd shareholders should not expect courts to apply—close

constitutional power of the Delaware courts. *See In re* Carlisle Etcetera LLC, 114 A.3d 592, 601–02 (Del. Ch. 2015). Some crowdfunded equity may be sold as membership units in LLCs. *See* Leaf et al., *supra* note 35 (stating that 6 of the first 50 filings under this new regulation include a sale of LLC membership interests).

40. *See* Leaf et al., *supra* note 35 (showing that 24 of the first 50 offerings under this new regulation were in Delaware). *See generally* Anthony Zeoli, *Intrastate Crowdfunding: The Often Overlooked Option*, CROWDFUND INSIDER (May 25, 2016, 12:23 PM), https://www.crowdfundinsider.com/2016/05/86096-intrastate-crowdfunding-the-often-overlooked-option/.

41. *See generally* Bradford, *supra* note 34; Heminway, *supra* note 34.

42. *E.g.*, Oranburg, *Bridgefunding*, *supra* note 23, at 419–22 (introducing a proposal for crowdfunding to provide a "bridge" in the financing life cycle for startups).

43. *See* C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 1; Heminway, *supra* note 1, at 477.

44. *See generally* Verret, *supra* note 37.

45. *See infra* Part II.

46. *See infra* Part III.

corporation doctrines in close-but-crowdfunded corporations.[47] A brief conclusion follows.

II. A BRIEF HISTORY OF CROWDFUNDING

Crowdfunding lies at the convergence of technological innovations in networked communication and the age-old concept of raising money by soliciting small contributions from a large number of people.[48] The Internet revolutionized social networks and obliterated communication barriers, while payment systems evolved to permit quick and easy digital transfers of funds. This dramatic change culminated in inexpensive platforms where people could collect money easily and efficiently.[49] Cataloguing the permutations of crowdfunding is beyond the scope of this article, but this Part provides an illustrative sample.

A. Crowdfunding By Definition

Crowdfunding connects excitement for an idea, product, or service with previously untapped funds. In addition to the efficiencies in communication and payment systems discussed above, crowdfunding is identifiable by the outpouring of funds from communities of common interest.[50] For example, one of the first instances of modern, Internet-based crowdfunding was an informal 1997 fundraising drive by fans of the English progressive rock band Marillion.[51] When the band's record

47. *See infra* Part IV.

48. *See* Bradford, *supra* note 43, at 11 n.17 (comparing crowdfunding to the donative model used to fund political campaigns). Another historical example is famed newspaper publisher Joseph Pulitzer's fundraising drive to purchase and construct the pedestal for the Statue of Liberty. *See The Statue of Liberty and America's Crowdfunding Pioneer*, BBC NEWS (Apr. 25, 2013), http://www.bbc.com/news/magazine-21932675. The statue, a gift from the people of France, faced a funding crisis as funding bills in the State of New York and Congress failed. *Id.* Pulitzer stepped in, publishing his plea for funds in his *New York World* newspaper with the promise that every donor's name would be printed. *Id.* The campaign raised just over the $100,000 needed to complete the project. *Id.*

49. *See* Bradford, *supra* note 43, at 10 n.11 ("[A]n entrepreneur can 'in real time and with no incremental cost . . . [sell] . . . to literally millions of potential investors.'") (quoting Stuart R. Cohn & Gregory C. Yadley, *Capital Offense: The SEC's Continuing Failure to Address Small Business Financing Concerns*, 4 N.Y.U. J.L. & BUS. 1, 6 (2007)).

50. *See* Mathieu-Claude Chaboud, *How Do the Crowdfunders Judge the Crowdfunded? Crowdfunding, Social Capital, and the Gatekeepers of the Financial Legitimacy*, *in* STRATEGIC APPROACHES TO SUCCESSFUL CROWDFUNDING 78, 79 (Djamchid Assadi ed., 2016) (discussing generally the idea of support for a particular product from a community of interest).

51. *See* Dean Golemis, *British Band's U.S. Tour Is Computer-Generated*, CHI. TRIB. (Sept. 23, 1997), http://articles.chicagotribune.com/1997-09-23/features/9709230071_1_music-fans-newsgroup-marillion.

label faced financial trouble, Marillion announced to United States-based fans that it would be unable to make its scheduled summer tour in the United States.[52] Disappointed fans connected with one another through message boards and email and began raising money to bring Marillion to the United States.[53] The cavalcade of donations quickly reached $25,000, allowing Marillion to schedule the tour.[54] The campaign ultimately raised $47,000, with money left over to fund the production of 1,000 special edition live recordings of the tour, which were distributed to donors.[55]

Marillion's story illustrates the affinity-based ethos of crowdfunding. Since Marillion's 1997 United States tour, numerous other musicians, artists, writers, and other creative producers have turned to crowdfunding to collect money for their projects.[56] Such projects now are often described as "donation," "rewards-based," or "pre-order" crowdfunding, based on what the crowdfunders receive in return for their funds, such as a discounted copy of the eventual product, other promotional items, or various tokens of gratitude.[57] For many crowdfunders, providing money for these projects is an exercise in patronage—that is, the donation is made out of affinity for the artist, art, or product, rather than a desire for the reward itself.

Donation, rewards-based, and pre-order crowdfunding are not limited to creative ventures. Producers of many varieties launch crowdfunding campaigns as a part of pre-marketing or even pre-producing their products, or to market-test a new line.[58] Further, there are several non-equity crowdfunding platforms devoted to general-purpose entrepreneurship and business ideas across a multitude of industries.[59]

The other major form of donation or rewards-based crowdfunding is the charitable micro-lending form best exemplified by Kiva.[60] Founded

52. *See id.*
53. *See id.*
54. *See id.*
55. *See id.*
56. *See* Bradford, *supra* note 43, at 12 nn.22–23, 13 n.29.
57. *See* Seth C. Oranburg, *The Non-Pecuniary Value of Equity Crowdfunding* 3 (Chi.-Kent Coll. of Law, Research Paper No. 2015-10, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2620011.
58. *See* Ryan Underwood, *3 Smart Ways to Use Data When Developing Products*, INC., Dec. 2013–Jan. 2014, https://www.inc.com/magazine/201312/ryan-underwood/how-to-put-data-in-product-development.html (describing the use of crowdfunding as a "proof-of-concept tool").
59. For example, Peerbackers bills itself as "the first crowdfunding platform for entrepreneurs." *See About the Team*, PEERBACKERS, http://peerbackers.com/about.html (last visited Oct. 9, 2017); *see also* Bradford, *supra* note 43, at 12 nn.23–27 (listing crowdfunding sites for various industries).
60. *See The Journey of a Kiva Loan*, KIVA, https://www.kiva.org/about/how (last visited Oct. 9, 2017). Closely related—perhaps as a precursor to charitable micro-lending—are micro-finance organizations that loan money to the poor, but collect interest

in 2005, Kiva is a platform where crowdfunders provide small amounts of money to be loaned to micro-entrepreneurs in the developing world.[61] The loans carry no interest but are to be repaid.[62] According to the site, most Kiva donors simply roll their "returns" into other loans.[63] Kiva's version of crowdfunding is charitable in nature—again, no Kiva crowdfunder expects investment-style returns in exchange for providing capital.[64]

B. *Hurtling Toward Investment Crowdfunding: Debt and Equity*

Given the success stories of donation, rewards-based, and pre-order crowdfunding, there inevitably emerged a desire, by entrepreneurs and potential crowd investors alike, for a way to utilize crowdfunding platforms for financial investments. Not only were the non-investment crowdfunding platforms a new *way* to raise money, they also opened up a new *class* of potential investors.[65]

Small businesses or fast-growing startups[66] almost invariably find themselves in need of substantial seed, growth, and operating capital. Traditional sources of capital begin with friends and family,[67] or a dedicated group of other, more established business people—known as "angel" investors—who provide capital along with mentorship, management expertise, or other resources.[68] These resources are limited; venturers only have so many friends, may not have family members with substantial resources, may not be able to persuade bankers of the viability of their product or service, and may not have the personal and geographic connections that usually lead to a pitch meeting with angel investors or other venture capitalists.[69] Likewise, venture capitalists

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and retain earnings much like banks. *See* Michael S. Barr, *Microfinance and Financial Development*, 26 MICH. J. INT'L L. 271, 278–79 (2004).

61. *See The Journey of a Kiva Loan*, *supra* note 60.

62. *Id.*

63. *Id.*

64. *Id.* (stating that Kiva borrowers pay no interest to lenders or Kiva).

65. *See generally* Andrew Schwartz, *The Digital Shareholder*, 100 MINN. L. REV. 609, 615 (2015) (stating that moving from non-investment to investment crowdfunding takes the model "one step further").

66. Discussion of investment crowdfunding often appears in the context of fast-growing startups, which burn through capital quickly before eventually maturing into a larger enterprise or being acquired by one. *See* Oranburg, *Bridgefunding*, *supra* note 23, at 405. Nonetheless, crowdfunding may be viable in "permanently" small businesses. *See* Schwartz, *supra* note 65, at 624 (describing crowdfunding as a source of financing for businesses outside the traditional Silicon Valley startup model).

67. And "fools," as they are sometimes called.

68. *See* Seth C. Oranburg, *A Place of Their Own: Crowds in the New Market for Equity Crowdfunding*, 100 MINN. L. REV. HEADNOTES 147, 150 (2016).

69. *See id.* at 150 (discussing the personal networks of professional investors in Silicon Valley); *see also* Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed*

primarily invest in fast-growing startups only after some proof of viability, in hopes of landing huge returns on scalable ventures.[70] For a small, local, or community-based business, the relevant scale is less steep and the possibility of a grand future payday may be remote, even if long-term profitability is achievable.

On the investor side, many people participate in some form of investing, even if only through a retirement account or placing savings within various "retail" investment funds such as mutual funds. Many more people participate in social networking, with networks or sub-networks coalescing around common interests. Contributing to a Kickstarter[71] in return for a first-run version of the product, or even a t-shirt, represents a tangible connection to the relevant community of common interest.[72] Another notable example is that of the fans of the National Football League's Green Bay Packers, who have on multiple occasions rushed to purchase "shares" of the football team, despite the fact that such shares never pay dividends, cannot be resold, and otherwise have no tangible market value.[73] The football team has used funds raised from the sale of these largely valueless shares to fund the continued residence of the team in Green Bay, Wisconsin, and several capital-intensive improvements to their facilities.[74] How different, then, is a "real," even if small, investment in a business or idea? At least in theory, crowdfunding connects small businesses or startups in need of capital with a new class of investors, brought together by common interest, the networking power of the Internet, and perhaps a non-financial affinity for the people, products, or services at the heart of the business.

There is only one small hurdle: selling equity to a large group of investors quite clearly is an offering of securities subject to the Securities

at Your Peril: Crowdfunding and the Securities Act of 1933, 78 TENN. L. REV. 879, 931–32 (2011).

70. *See* Oranburg, *Bridgefunding*, *supra* note 23, at 410–11.

71. Kickstarter is among the more well known crowdfunding platforms. Essentially, any person can post a "project" and seek donations from the crowd. *See generally About Us*, KICKSTARTER, https://www.kickstarter.com/about?ref=nav (last visited Oct. 10, 2017). The site began as an alternative funding source for creative projects, but many entrepreneurs have used it to test more traditional business ideas. *Id.*; *see also Technology*, KICKSTARTER, https://www.kickstarter.com/discover/categories/technology?ref=footer (last visited Oct. 10, 2017).

72. *See* Chaboud, *supra* note 50, at 79 (discussing the manner in which donation crowdfunding endeavors to tap into particular communities of interest). *See generally* Heminway & Hoffman, *supra* note 69 (discussing crowdfunders as consumer-investors whose investments may derive from a passion for the product or service).

73. *See* GREEN BAY PACKERS, INC., COMMON STOCK OFFERING DOCUMENT 4 (2011), http://shareholder.broadridge.com/pdf/gbp/gbp_2011_offering_document.pdf.

74. *See id.* at ii (describing 2003 and 2011 offerings as being conducted for stadium improvements).

Act of 1933[75] (the "1933 Act"),[76] not to mention state securities laws.[77] Section 2(a)(1) of the 1933 Act defines "security" broadly to include essentially any sale of an investment opportunity.[78] In *SEC v. W.J. Howey Co.*,[79] the United States Supreme Court adopted a similarly broad definition of "investment contract" under Section 2(a)(1), finding within the reach of the 1933 Act any "contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."[80] The breadth of the 1933 Act established the essential framework for securities law: all public offerings of securities must be registered in accordance with the 1933 Act and relevant implementing regulations, unless some exemption applies.[81]

Because crowdfunded sales of debt or equity in a venture are subject to the 1933 Act, Congress enacted the JOBS Act, which included the CROWDFUND Act.[82] The latter instructed the SEC to implement an exemption for crowdfunding.[83] The SEC finalized "Regulation Crowdfund," or "Regulation CF," on October 30, 2015, and the rules became effective on May 16, 2016.[84] Reception of the CROWDFUND Act and its implementing regulations has been lukewarm, at best.[85] The specific provisions are beyond the scope of this article, but suffice to say, the Act and regulations—at a minimum—create a legal avenue for experimenting with crowdfunding.

As with most investments, crowdfunding can take the form of debt or equity. Peer-to-peer lending networks, such as Lending Club, are a

75. Securities Act of 1933, Pub. L. 73-22, 48 Stat. 74.

76. For a thorough and conclusive analysis on this matter, see Heminway & Hoffman, *supra* note 69, at 882–906.

77. *See, e.g.*, DEL. CODE ANN. tit. 6, §§ 73-101(b), -103(a)(20) (2017) (definition of "security").

78. *See* 15 U.S.C. § 77b(a)(1) (2012).

79. SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

80. *Id.* at 298–99.

81. *See* Heminway, *supra* note 1, at 481.

82. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 301, 126 Stat. 306, 314–15 (2012).

83. *See* Crowdfunding, 80 Fed. Reg. 71,387, 71,389 (Nov. 15, 2015) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239–40, 249, 269, 274) (describing Title III of the JOBS Act and the SEC's role in implementing the legislation and citing its statutory authority); *see also* 15 U.S.C. § 78*l*(g)(6) (authorizing the SEC to exempt transactions as set forth in the JOBS Act).

84. *See* Crowdfunding, 80 Fed. Reg. at 71,537, 71,611.

85. Most commentators have been critical of the exemption, suggesting it is too costly and too slow to achieve its stated purpose of connecting potential crowd investors with small businesses and startups who could benefit from crowdfunding. *See, e.g.*, Oranburg, *Bridgefunding*, *supra* note 23, at 418 (citing figures suggesting that a round of \$100,000 of investment could cost as much as \$39,000); *see also supra* note 34 and accompanying text.

form of debt crowdfunding.[86] The basic premise is that an individual or small business applies for a loan amount, Lending Club computes the credit risk factors, and then loan investors choose whether or not to fund them.[87] Similarly, many current crowdfunding portals include offerings of short- or long-term notes.[88] Debt crowdfunding, however, is not the focus of this article—offering notes and seeking loans from investors do not implicate the internal workings of a corporation.[89] This article focuses on equity crowdfunding, where the utilization of crowdfunding results in new shareholders being welcomed to the venture.

III. A SORT OF DIVIDE: INTRACORPORATE DISPUTES LARGE AND SMALL

Public corporations and close corporations, and the disputes that arise within each, are different because of the differences in formal separation of the roles of shareholder, officer, and director, the exercise of corporate decision-making power, and the market for resale of shares. Courts and legislatures have devised special protections for close corporation non-controlling shareholders to mitigate the effects of losing their roles and financial interests through otherwise permissible business decisions such as termination from employment and removal from companies' boards. These protections are special—they expand the rights of a non-controlling shareholder beyond the formal rights contained within most general corporation statutes. Courts usually rely on two justifications for providing these special protections. First, close corporation shareholders usually trust each other more than typical co-venturers because of preexisting family or social relationships. Because of their lack of resources and this implicit trust, they do not develop and negotiate minority protections or contingencies for disputes or engage counsel to do so for them. Because of this observed lack of contracting, courts have concluded that requiring such contracting can be impracticable and unfair. Second, and similarly, the lack of contracting and the more discernible course of dealing among close corporation shareholders permit courts to draw relatively strong inferences about the reasonable expectations of minority shareholders with respect to their roles and financial interests in the venture.

86. *See generally* LendingClub Corp., Annual Report (Form 10-K) 6–7 (Feb. 28, 2017) (describing how borrowers apply for loans and investors invest in loans).

87. *See id.* at 9–10.

88. *See, e.g.*, Brewtex, LLC, Offering Statement (Form C) (Apr. 28, 2017) (offering promissory notes in increments of one dollar to fund development of a craft beer-themed event complex).

89. *See* Ibrahim, *supra* note 25, at 563 ("From a legal perspective, equity crowdfunding is the far more interesting of the two types . . . .").

A. The Public Corporation as the Paradigm of the Corporate Form

Corporations, axiomatically, are creatures of numerous state statutes, each of which sets forth the package of formal features of the arrangement known as the "corporation."[90] Since the advent of general incorporation statutes—as opposed to the requirement of a legislative charter—state corporation law has applied rigidly to all corporations, regardless of size, value, or number of shareholders.[91] Most corporation statutes establish the following general attributes: "formal creation as prescribed by state law; legal personality; separation of ownership and control; freely alienable ownership interests; indefinite duration; and limited liability."[92] Resting atop these identifying features of the corporation is the equally important package of rights, responsibilities, and duties that exist among the corporate players themselves: the shareholders, officers, and directors.[93]

Generally, shareholders invest capital in return for the right to the residual value of the corporation, and exercise their voice in corporate affairs by voting on the election of directors.[94] Shareholders also may freely sell their shares.[95] Directors, as a board, possess all corporate decision-making power, which is exercised through majority vote of the board.[96] Officers manage the corporate assets and act on behalf of the corporation under the supervision of the board of directors.[97] As a default, the shareholder vote on the election of directors and the director vote on matters of corporate policy require only a simple majority—minority shareholders can lose a vote on the election of directors, and directors can lose a vote on matters of corporate policy.[98]

At the significant economic inflection point of the Great Depression, federal regulation of the sale of securities imparted a drastic change to corporation law.[99] The 1933 Act and the Securities Exchange Act of 1934[100] (the "1934 Act") imposed significant regulatory obligations on corporations with substantial numbers of outstanding

90. *E.g.*, DEL. CODE ANN. tit. 8, ch. 1 (2017).
91. *See* Dennis S. Karjala, *An Analysis of Close Corporation Legislation in the United States*, 21 ARIZ. ST. L.J. 663, 664 (1989).
92. STEPHEN M. BAINBRIDGE, CORPORATE LAW 2 (2d ed. 2009).
93. *See generally* DEL. CODE ANN. tit. 8, §§ 141–174; MODEL BUS. CORP. ACT chs. 7–8 (AM. BAR ASS'N 2016).
94. *See* MODEL BUS. CORP. ACT § 7.28.
95. *See* BAINBRIDGE, *supra* note 92, at 6.
96. *E.g.*, DEL. CODE ANN. tit. 8, § 141(b).
97. *E.g.*, *id.* § 142.
98. *E.g.*, *id.* § 216(2).
99. *See* Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 344 (2013).
100. Securities Exchange Act of 1934, Pub. L. 73-291, 48 Stat. 881.

shares of stock and those who wished to become such corporations.[101] That is, corporations that arguably were relatively *larger*—in number of shareholders, asset value, and other indicators—became subject to the newly-extended reach of federal regulatory jurisdiction.

As federal securities regulation pressured corporations seeking wider sources of capital to engage in cost-increasing reporting and disclosure activities, state law liberalized in ways that were often more beneficial or efficient in the context of the large, public corporation.[102] Larger and more sophisticated corporations with the resources to engage expensive counsel could assemble the appropriate set of statutory features while efficiently navigating formalities and regulatory requirements. In a sense, this reflected a fair trade for the economically valuable features of the corporate form. Those wishing to avail themselves of limited liability, legal personality, and the other desirable features of the corporate form could bear the costs of navigating formalities and regulatory requirements. Furthermore, small groups intent upon carrying on a profitable enterprise could utilize the tried-and-true partnership form, with its heightened partner-to-partner fiduciary obligations, less rigorous formal requirements, and dissolution-at-will.[103] Given the historical development of the law regarding public corporations, the principles espoused in most states' general corporation laws fit best in the public corporation context.[104]

B. Close Corporations and the Blurring of the Roles

Limited liability and perpetual existence are desirable features for anyone seeking to operate a business, not just those looking to accumulate and deploy relatively large amounts of capital.[105] Some "small" businesses may achieve relative largeness by asset value without the capital accumulating power of public equity markets.[106] The

101. *See id.*

102. *See* Karjala, *supra* note 91, at 666. Further, Delaware became the most prominent state for incorporation, ostensibly because its corporation law is "enabling" or "liberal" relative to other states. *See* Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913, 913 (1982).

103. *See* Bohatch v. Butler & Binion, 977 S.W.2d 543, 545–48 (Tex. 1998) (discussing fiduciary duties and the at-will nature of the partnership relationship).

104. Some commentators suggest these principles *only* fit large, public corporations. *See* ROBERT A. RAGAZZO & FRANCES S. FENDLER, CLOSELY HELD BUSINESS ORGANIZATIONS 341 (2d ed. 2012) ("The requirements for formal board action often make little sense . . . [w]hen all of the shareholders are directors and participate in the management of the business . . . .").

105. *See* Karjala, *supra* note 91, at 677.

106. For example, Cargill, Inc., one of the world's largest private corporations, was valued at approximately $55 billion based upon figures made public during a 2011

business's smaller number of private shareholders or early market success may deliver substantial capital, or the peculiarities of its product or service may counsel against seeking public investment.[107] This kind of relative largeness makes limited liability valuable and the unlimited liability of the partnership form undesirable.[108] Despite potential misfit, smaller businesses with no intention of becoming large or public adopted the corporate form to achieve limited liability.[109] As a result, these firms also accepted the permanence, majority-rules power structure, and rigid formal roles of shareholders, officers, and directors.[110] Despite using the same package of features, the expectations, motivations, and incentives of the primary players in close corporations are very different than those of the primary players in the typical public corporation.[111]

Investors in public corporations are almost exclusively "mere" shareholders.[112] Their investment decisions revolve around financial returns, and they lack significant personal interest in the operation or management of the corporation, unless particularly bad management conduct harms the investors' financial interests.[113] Furthermore, vesting corporate power and discretion with a smaller group of directors is considered a competitive advantage of the corporate form.[114] Public

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spinoff. *See* Lisa Lee, *Cargill Valuation Validates Wall St Rules of Thumb*, REUTERS (Jan. 20, 2011), http://blogs.reuters.com/breakingviews/2011/01/20/cargill-valuation-validates-wall-st-rules-of-thumb/.

107. *See* Oranburg, *Bridgefunding*, *supra* note 23, at 406 (describing the limited utility of equity investment in very small businesses).

108. Modern hybrid entities, such as limited liability companies, provide the protection of limited liability but with more flexible governance features than general corporation law. *See* Wayne M. Gazur, *The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role*, 58 LAW & CONTEMP. PROBS. 135, 139 (describing flexibility as part of the "original mission" of the limited liability company).

109. *See* Karjala, *supra* note 91, at 677.

110. *Id.*

111. *Id.* at 888–89.

112. *Id.*

113. Some commentators have argued that the view of the dispersed, passive shareholder is no longer an accurate representation of the reality of the public corporation. *See* Ronald J. Gilson & Jeffery N. Gordon, *The Agency Costs of Agency Capitalism*, 113 COLUM. L. REV. 863, 864 (2013) (describing the paradigm of the dispersed class of shareholders as "obsolete" in light of substantial institutional investor ownership of shares); *see also* Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1871–72 (2017) (proposing a paradigm shift in the view of the individual public shareholder from an activism perspective). *But see* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1752 (2006) (arguing that the costs of corporate governance activism in most cases generally will not exceed the benefits that might be expected to derive from that activism).

114. *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 555–56 (2003).

corporation shareholders' ability to sell their shares in a liquid market provides recourse for poor performance or disagreement with director or manager decision-making—a consideration known as "exit."[115] Exit, in turn, increases efficiency by providing a measure of market discipline.[116]

On the other hand, shareholders in close corporations often are not mere shareholders. These shareholders often serve as officers who have invested not only capital, but also substantial opportunity costs in their ventures.[117] Rounding out their roles, they also serve as directors, taking an active role in fundamental business decisions.[118] Thus, many actors in close corporations are best identified as "shareholder-officer-directors," assuming and performing all roles in the life of the business at various times. Because the relatively small number of shareholder-officer-directors makes communication and coordination of decision-making easy, the parties often—or at least occasionally—forgo required formalities such as board meetings and recorded votes.[119] Shareholder-officer-directors in close corporations also expect that their personal financial success will flow from direct participation in the business as an officer and director with a salary and benefits.[120] Consequently, most shareholder-officer-directors do not expect that their equity ownership in the company will be the primary source of the financial return on their investment.[121] This "intimate, illiquid"[122] arrangement is suitable, unless conflict emerges between the shareholder-officer-directors.

When a conflict between the majority and minority emerges, the rigid and formal majority-rules power structure becomes of renewed importance. Using the formal authority of the corporation—authority that perhaps has not been exercised since the inception of the business—a controlling shareholder-officer-director can not only outvote a minority shareholder-officer-director on the substantive issue leading to the

115. *See* Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 GEO. L.J. 1207, 1217 (2009).

116. *See* Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 291–93 (1986) (proposing that managers of public corporations who make errors should be subject to market discipline).

117. *See, e.g.*, *In re* Topper, 433 N.Y.S.2d 359, 365 (N.Y. Sup. Ct. 1980) (addressing a case where a minority shareholder invested substantial assets and worked for a close corporation, giving rise to expectation of participation in the business's financial success).

118. *See, e.g.*, Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 659–60 (Mass. 1976) (discussing a corporation where all shareholders also served as officers and directors).

119. *See* Karjala, *supra* note 91, at 698–99.

120. *See* Ragazzo, *supra* note 8, at 1107–11.

121. *See* Thompson, *supra* note 6, at 372–73 (discussing the loss in value of an investment when employment is terminated).

122. *Id.* at 3.

disagreement, but can also unceremoniously remove him or her from the board and terminate the minority shareholder from his or her officer position.[123] The result of these actions is to silence the minority shareholder's voice in corporate affairs. Yet again, illiquidity of close corporation stock, as well as other restrictions on transfers, makes exiting the close corporation untenable for the newly silent minority shareholder.[124] No longer earning the salary and benefits that once represented his or her financial return for participation in the venture, the minority shareholder typically is offered a fire-sale amount for his or her equity stake, thus completing what sometimes is described as a "freezeout," "squeezeout," or more generally, "oppression."[125]

Rigid formal organization works efficiently enough for large corporations that operate with no confusion about the roles and responsibilities of individuals within the corporation. There is no confusion about Mark Zuckerberg's roles as an officer, director, and public shareholder of Facebook. To illustrate the contrast to the close corporation, consider a small corporation consisting of three shareholder-officer-directors: *A*, *B*, and *C*. In this hypothetical firm, the formal divisions and allocation of power become somewhat of a second thought.

A, *B*, and *C* decide to start an artisanal hamburger restaurant, "The Burger Joint," and form a corporation under the general corporation law of their state. Each owns an equal equity stake in the corporation, maintains one of three seats on the board of directors, and participates fully in the day-to-day operations of the business as an officer. Perhaps for perfectly rational reasons, they decide not to clutter their by-laws or stockholder agreement with buyout procedures or alter the default, majority-rules decision process. Bound by pre-existing social relationships, the three defy the odds and steer the fledgling restaurant to initial success, while acting harmoniously as shareholder-officer-directors. They split the profits evenly by paying themselves monthly salaries,[126] which grow larger as the business thrives. In fact, it is likely *A*, *B*, and *C* rarely consider what roles they are playing in the day-to-day operation of the business, perfectly content with growing profits and wealth.

After the initial meeting, the three do not call annual shareholder meetings or have board meetings—after all, the business is successful and everyone is on the same page with respect to all major corporate

123. *See* Moll, *supra* note 7, at 890–91.
124. *See* Means, *supra* note 115, at 1217.
125. *See* Moll, *supra* note 7, at 889–91 (describing the sequence of a typical freezeout).
126. The venturers likely chose this method over the payment of dividends on their shares to avoid income tax at the corporate level and at the individual level.

decisions. A few years later, however, a small disagreement emerges between *A*, *B*, and *C*. *A* and *B* wish to franchise the business due to the potential to further increase earnings and expand the restaurant's geographic footprint, despite the increased cost and managerial complexity that comes along with franchising. *C* disagrees, preferring the status quo and not wishing to assume the additional cost and complexity of running a franchised chain of burger joints. *A* and *B* realize that they outnumber *C*, and call the first board meeting in years to vote on whether to franchise the burger joint. As *fait accompli* would have it, *A* and *B* vote for the franchise plan and *C* casts her hopeless vote against it. As the franchising operations begin, *C* begrudgingly continues working with her fellow shareholder-officer-directors. Nonetheless, she cannot help but continue to voice her displeasure to *A* and *B*, who grow tired of the disagreement. The relationship between the once-unanimous group sours, leading *A* and *B* to conclude that it is beyond repair. At the next meeting of the shareholders, *A* and *B* decline to vote *C* to another term as a director. At the subsequent board meeting, *A* and *B* vote to terminate *C*'s employment. They also vote to continue their practice of not paying dividends, while voting to increase their own salaries; it is only fair, in their view, because they will now have increased workloads as a result of *C*'s termination.

Over the course of this intracorporate disagreement, *C*'s position diminishes from equal participation in the business through her employment and salary to only holding her equity stake. She is now merely a shareholder and no longer a shareholder-officer-director. Critically, unlike a large, public corporation shareholder, *C* is unable to sell her equity stake in any identifiable market. Furthermore, *A* and *B* do not wish—and have no incentive—to buy *C* out. *C* is now stuck with no salary, no dividends, and no role in the corporation of which she still owns one-third.

C. *The Judicial and Legislative Response*

C's story is a familiar one in close corporations. The blurring of the roles of the shareholder-officer-directors seems unimportant when the parties agree on all relevant matters, but the formalities of the exercise of corporate decision-making authority become painfully concrete when disagreement occurs. It was this kind of dispute that encouraged legislatures and courts in a number of jurisdictions to recognize remedies for "oppressed" minority shareholders of close corporations. These remedies include judicial recognition of a heightened fiduciary duty owed to the minority, enactment of statutory provisions for involuntary dissolution of the corporation or a buyout of the minority, and development of a judicial analysis of the minority's reasonable expectations regarding participation in the enterprise as the definition of oppression.[127]

1. Heightened Fiduciary Duties

While the first known "oppression" cases date to the late nineteenth century,[128] the Massachusetts Supreme Judicial Court decided the seminal oppression case in 1975. In *Donahue v. Rodd Electrotype Co. of New England, Inc.*,[129] the court concluded that controlling shareholders in close corporations owe an independent and heightened duty of fairness to minority shareholders.[130] Generally, there are no duties or obligations flowing between and among shareholders *qua* shareholders under general corporate principles as there are between partners in a partnership.[131]

The dispute in *Donahue* involved a stock repurchase, which is a common maneuver in corporations large and small, but for different reasons.[132] Harry Rodd, his sons, and a loyal corporate lawyer who was

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127. *See* Thompson, *supra* note 6, at 386–90. Another development was permitting traditionally derivative actions to be brought as direct actions where an individual shareholder was oppressed in a manner that also harmed the corporation in a derivative sense. *Id.* at 29; *cf.* Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 661 (Mass. 1976) (describing a situation where the only harm was the corporation's refusal to employ and compensate the minority shareholder); Donahue v. Rodd Electrotype Co. of New Eng., 328 N.E.2d 505, 510–11 (Mass. 1975) (describing a situation where corporate assets were depleted to repurchase the majority shareholder's shares).

128. *See, e.g.*, Miner v. Belle Isle Ice Co., 53 N.W. 218, 223 (Mich. 1892) (Campbell, J., dissenting).

129. Donahue v. Rodd Electrotype Co. of New Eng., 328 N.E.2d 505 (Mass. 1975).

130. *Id.* at 515–16.

131. *See id.* The analogy of the close corporation to the partnership animates some of the existing authority applying heightened fiduciary duties in the close corporation context, where partners do owe fiduciary duties to one another as partners. *See* Meiselman v. Meiselman, 307 S.E.2d 551, 560–61 (N.C. 1983) (describing the "partnership analogy" and applying North Carolina's dissolution provision under its general corporation law); Easterbrook & Fischel, *supra* note 116, at 297–300 (1986) (evaluating the "partnership analogy" as the basis for applying heightened duties in close corporations); *see also* O'NEAL & THOMPSON'S OPPRESSION, *supra* note 38, § 7.5. The partnership analogy is particularly relevant because traditionally partnerships did not exist perpetually and therefore partners could withdraw the value of their interest in the partnership as a matter of law. *See generally* REV. UNIF. P'SHIP ACT §§ 601 cmt. 1, 603 cmt. 1 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2013) (discussing the differences between the Uniform Partnership Act and the Revised Uniform Partnership Act on whether the partnership is dissolved when a partner withdraws). Though the Revised Uniform Partnership Act does not require dissolution and winding up of the partnership when a partner withdraws as its predecessor Uniform Partnership Act did, a partner has the power to withdraw from the partnership and the right to receive some form of a buyout upon disassociation. *See* REV. UNIF. P'SHIP ACT. § 701(a)–(b), 701 cmt. 1.

132. *Donahue*, 328 N.E.2d at 510; *see The Repurchase Revolution; Share Buy-Backs*, ECONOMIST, Sept. 13, 2014, at 71 (describing share repurchases in large corporations as

also a director utilized their voting power on the board of Rodd Electrotype Co. of New England, Inc. to cause the corporation to purchase outstanding stock held by Harry Rodd.[133] The Donahues requested that their shares be repurchased on the same terms, but the request was refused.[134] The practical result, then, was that the Rodds voted themselves a distribution of corporate assets and denied the Donahues such a distribution[135]—it was economically similar to the Rodds voting to declare dividends to be paid only on their own shares.[136] The court ultimately justified its departure from general corporate principles in part on the theory that close corporations involved a greater level of trust and confidence than is found in public corporations.[137]

The rule from *Donahue* figured prominently in a later Massachusetts Supreme Judicial Court case, *Wilkes v. Springside Nursing Home, Inc.*[138] *Wilkes*, compared to *Donahue*, may be more exemplary of the "freezeout" genre. Four shareholder-officer-directors shared roughly equal parts in the ownership, management, and control of a corporation whose primary business was operating a nursing home.[139] "Bad blood" brewed between the plaintiff, Wilkes, and another shareholder-officer-director, Quinn.[140] The non-belligerent parties sided

financial "sorcery" utilized to merely reshuffle the capital structure of the corporation without changing its underlying value); *see also* Ira Kay, *Executive Pay, Share Buybacks, and Managerial Short-Termism*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Jan. 26, 2016), https://corpgov.law.harvard.edu/2016/01/26/executive-pay-share-buybacks-and-managerial-short-termism/ (presenting research on, *inter alia*, whether managers of large, public corporations effect share buybacks to increase the value of stock options to high-level managers).

133. *Donahue*, 328 N.E.2d at 510.

134. *Id.* at 510–11. Notably, in the four or five years prior to the repurchase, the majority offered to repurchase the Donahues' shares, but at prices 5 to 25 percent ($40–$200 per share) of the ultimate price paid to Rodd ($800 per share). *See id.* at 511 n.10.

135. *Id.* at 519–20.

136. *Id.* at 518–19. The court also acknowledged the Donahues' inability to exit the corporation due to the non-marketability of their shares and that the opportunity to recover the full value of their ownership interests in the corporation was completely at the discretion of the Rodds. *Id.* at 519–20; *see also* Means, *supra* note 115, at 1217.

137. *Donahue*, 328 N.E.2d at 515–17. The court would later observe that "[n]o outsider would knowingly assume the position of the disadvantaged minority," *id.* at 515, implying that contractual arrangements might not be sufficient to protect non-controlling shareholders.

138. Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976).

139. *Id.* at 659–60.

140. *Id.* at 660. According to the court, the dispute emerged when Wilkes persuaded the two non-belligerents to demand a higher price for the sale to Quinn of a piece of property owned by the corporation. *Id.* Apparently, Quinn expected to purchase the property at a below-market price. *See* Eric J. Gouvin, *Fiduciary Duties in the Closely Held Firm 35 Years After* Wilkes v. Springside Nursing Home*:* Wilkes v. Springside Nursing Home, Inc.*: The Backstory*, 33 W. NEW ENG. L. REV. 269, 275–80 (2011) (suggesting Quinn regularly negotiated and maintained sweetheart deals for himself).

with Quinn, voting at board and shareholder meetings to terminate Wilkes's employment and dismiss him from the board of directors.[141] With his money locked in and his influence locked out, Wilkes sued the remaining shareholder-officer-directors, alleging, *inter alia*, that they breached their fiduciary duties owed to him as a minority shareholder.[142] Though the court cautioned against an "untempered application" of the *Donahue* rule—that is, the court clarified that *Donahue* was not meant to foreclose potentially oppressive decisions made for "legitimate business purpose[s]"—it ruled in Wilkes's favor, granting him his lost salary and remanding for a measure of his damages.[143] Similar to its analysis in *Donahue*, the *Wilkes* court relied upon the extent to which the closeness of the relationships among the parties justified heightened judicial scrutiny.[144] Further, the court made several important references to understandings of the parties that were not set forth explicitly in any written form.[145]

Some form of the rule established in *Donahue* and *Wilkes* exists in a number of states.[146] Nonetheless, Professors Robert B. Thompson and Mary Siegel have both noted that the heightened fiduciary duties version of oppression is not the most common or popular avenue for providing a remedy to an oppressed minority shareholder.[147] As Professor Thompson observes, the rule from *Donahue* and *Wilkes* has stood the test of time more as a reflection of the general principles of oppression than for the use of heightened fiduciary duties as the mode of establishing grounds for relief.[148] Today, the more common mode of relief is through statutes defining oppression and establishing specific forms of relief.[149]

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141. *Wilkes*, 353 N.E.2d at 660–61.

142. *Id.* at 659.

143. *Id.* at 663–65.

144. *Id.* at 663–64.

145. *See id.* at 660 (explaining that all the parties "understood" that their ownership and management of the firm would be conducted as equal partners).

146. *See* O'NEAL & THOMPSON'S OPPRESSION, *supra* note 38, §§ 7.4–.5 (collecting and analyzing cases applying a heightened or partnership-style fiduciary duty in close corporations); Mary Siegel, *Fiduciary Duty Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 381–82 (2004); *see also* Ritchie v. Rupe, 443 S.W.3d 856, 906 n.52 (Tex. 2014) (Guzman, J., dissenting) (citing cases where state courts adopted heightened fiduciary duties as a remedy for minority shareholder oppression); Thompson, *supra* note 7, at 388–89.

147. Siegel, *supra* note 146, at 382; Thompson, *supra* note 6, at 369–70.

148. Thompson, *supra* note 6, at 371. Notably, the heightened fiduciary duties rule for oppression was adopted as a matter of first impression as recently as 2009. *See* McLaughlin v. Schenk, 220 P.3d 146, 156 (Utah 2009). Alas, the Utah legislature acted quickly to overturn *McLaughlin*, passing the following unequivocal statutory language: "A shareholder of a corporation, when acting solely in the capacity of a shareholder, has no fiduciary duty or other similar duty to any other shareholder of the corporation, including not having a duty of care, loyalty, or utmost good faith." UTAH CODE ANN.

2. Statutory Dissolution and Buyout Remedies

Because Massachusetts's corporation law at the time *Donahue* and *Wilkes* were decided did not contain any particular statutory authorization to remedy oppression, the court developed the theory of heightened fiduciary duties.[150] In addition, no statute provided any specific remedy. Thus, the *Wilkes* court ordered money damages, while the *Donahue* court crafted two primarily equitable solutions.[151] Legislative solutions to the plight of the close corporation minority shareholder not only established a basis for relief from oppressive acts, but also propounded specific remedies. In general terms, these remedies involve empowering courts to equitably abrogate the corporation's traditionally perpetual existence in some way—such as ordering the dissolution of the entity. As a perpetually existing entity, a corporation does not cease to exist even if the shareholders find themselves in a protracted dispute, and no shareholder may simply "redeem" his or her stock for market, fair, or even book value. The most common legislative solutions include statutory "equitable" remedies such as dissolution or buyout provisions for oppression.[152]

An exemplary case is *Meiselman v. Meiselman*.[153] The case emerged from an internecine dispute between two scions of a burgeoning movie theater and commercial real estate empire.[154] A common tale in close corporations, the story begins with the litigants' father, H.B. Meiselman, who built the empire brick by brick.[155] Between 1951 and 1971, H.B. methodically transferred his interests in the constellation of

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§ 16-10a-622(3)(a) (LexisNexis 2017); *see also* McLaughlin v. Schenk, 299 P.3d 1139, 1145 (Utah 2013).

149. O'NEAL & THOMPSON'S OPPRESSION, *supra* note 38, § 7.11 (noting that 39 states have oppression statutes).

150. Massachusetts's statutes still do not provide for dissolution or any other statutory remedy for oppression. *See* Brodie v. Jordan, 857 N.E.2d 1076, 1082 n.7 (Mass. 2006).

151. Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 664–65 (Mass. 1976) (ordering that plaintiff minority shareholder be paid damages equal to his lost salary and benefits); Donahue v. Rodd Electrotype Co. of New Eng., 328 N.E.2d 505, 521 (Mass. 1975) (ordering defendant majority shareholder to either (1) return $36,000 plus interest to the corporation in exchange for the treasury shares he caused the corporation to purchase from him or (2) cause the corporation to buy out the minority shareholder for $36,000).

152. *Ritchie v. Rupe* provides an excellent 50-state survey of states that allow liquidation for oppressive or similar conduct. Ritchie v. Rupe, 443 S.W.3d 856, 894–95 & nn.12–14 (Tex. 2014). As a procedural matter, some states, such as Texas, conduct dissolution or buyout through appointment of a receiver to run the corporation while the court's resolution of the dispute is carried out. *See id.* at 863.

153. Meiselman v. Meiselman, 307 S.E.2d 551 (N.C. 1983).

154. *Id.* at 553–54.

155. *Id.* at 553.

family corporations to his sons, Michael and Ira, who began working in the family business in 1956 and 1965, respectively.[156] H.B.'s last large transfer of his corporate interests in 1971 fell overwhelmingly to Ira, leaving Ira in control of all but one of the corporations within the empire.[157]

The *Meiselman* opinion suggests that the brothers' personal and business relationship soured between 1971 and 1979, as Ira ascended to the operation and management of the primary corporation, Eastern Federal.[158] The controversy ultimately giving rise to the litigation began when Michael filed a lawsuit challenging Ira's sole ownership of a management corporation, Republic, which earned income from a services contract with Eastern.[159] Republic employed Michael and was the current iteration of several prior management entities utilized to account for management costs shared across the other corporations that Michael and Ira had owned jointly.[160] Further, Michael's primary participation in the family business, at least from a financial perspective, was through his employment with Republic.[161] Ira responded to the lawsuit by causing the two corporations to cease their management contract, and caused Republic to terminate Michael's employment, salary, and benefits.[162] The practical effect of the termination of both the contract and Michael's employment was to exclude him completely from any role in the day-to-day operation of the business and limit his financial participation.[163]

Michael sued his brother under North Carolina's general corporation law, which, at the time, contained provisions for equitable dissolution or other equitable judicial remedies to protect the interests of minority shareholders.[164] Michael pled two theories. First, he claimed

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156. *Id.* at 553–54.

157. *Id.* at 553.

158. *Id.* at 554–55. H.B. passed away in 1978, roughly one year prior to the beginning of the litigation. *Id.* at 556.

159. *Id.* at 554–55. The crux of Michael's initial lawsuit was that Ira's sole ownership of Republic entitled him to an unfair share of the income of the overall enterprise through Republic's earnings. *Id.*

160. *Id.*

161. *Id.* at 555.

162. *Id.* at 554.

163. *Meiselman*, 307 S.E.2d at 555. Ira's litigation position was that Michael was not so excluded, noting that Michael was not banned from company property or denied notice of stockholder meetings. *Id.* The court noted, however, that it was "struck by the tone of Ira's comments" about his brother's participation in the management and direction of the business. *Id.*

164. *Id.* at 556. At the time, the North Carolina Business Corporation Act (N.C.B.C.A.) contained provisions permitting dissolution and a broad menu of other equitable oppression remedies such as buyouts and even canceling corporate acts. N.C. GEN. STAT. § 55-125.1 (1982), *replaced by* N.C. GEN. STAT. §§ 55-14-30 to -31 (2017).

that Ira was responsible to the corporation derivatively for incorporating a management company owned solely by him and causing Eastern Federal to pay the solely owned management company compensation.[165] Second, he requested the court use its equitable authority under Section 55-125.1(a)(4) of the North Carolina Business Corporation Act to compel a buyout of his interests in the corporation, claiming that a buyout was necessary to protect his rights and interests.[166]

The court began its analysis by recognizing a distinction between "close" corporations and "publicly-held" corporations.[167] Describing the former as "incorporated partnerships," the court discussed the potentially oppressive circumstances giving rise to a wave of commentary on close corporations.[168] Notably, the court considered and rejected the argument that pre-incorporation contracting presents an adequate opportunity to avoid oppression.[169] It reasoned that most minority shareholders purchase their shares with unequal bargaining power and without even considering the possibility of bargaining for minority protections.[170]

The court set forth the following analytical framework for oppression under the North Carolina statute: the court observed that the statutory "rights and interests" language represented those rights belonging particularly to the complaining shareholder.[171] Having defined the "rights and interests" as particular to the complaining shareholder, as opposed to shareholders generally, the court then confirmed that it would follow the analysis of courts that had established the shareholder's "reasonable expectations" as the criterion for oppression.[172] The court presented its reasonable expectations analysis as follows:

> For plaintiff to obtain relief under the expectations' analysis, he must prove that (1) he had one or more substantial reasonable expectations known or assumed by the other participants; (2) the expectation has

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In 1990, the broad equitable remedies provision was replaced. *See* Robert S. McLean, *Minority Shareholders' Rights in the Close Corporation Under the New North Carolina Business Corporation Act*, 68 N.C. L. REV. 1109, 1120–21 (1990). Judicial dissolution is the only remaining remedy under the N.C.B.C.A., but the corporation may elect to buy out the complaining shareholder if involuntary dissolution is ordered. *See id.*; *see also* N.C. GEN. STAT. § 55-14-31(d).

165. *Meiselman*, 307 S.E.2d at 556.

166. *Id.* The requested buyout was the only remedy before the North Carolina Supreme Court. *Id.*

167. *Id.* at 557–61.

168. *Id.* at 558–59.

169. *Id.* at 558; *cf.* Nixon v. Blackwell, 626 A.2d 1366, 1380 (Del. 1993).

170. *Meiselman*, 307 S.E.2d at 558 (citing J.A.C. Hetherington, *Special Characteristics, Problems, and Needs of the Close Corporation*, 1969 U. ILL. L.F. 1, 17–18).

171. *Id.* at 562.

172. *Id.* at 563.

> been frustrated; (3) the frustration was without fault of plaintiff and was in large part beyond his control; and (4) under all of the circumstances of the case, plaintiff is entitled to some form of equitable relief.[173]

As the Massachusetts court did in *Donahue* and *Wilkes*, the North Carolina court fashioned and applied its analysis on the basis that the close corporation shareholder possesses rights and interests beyond the usual interests of shareholders set forth in general corporation statutes.[174] Whether articulated as heightened, shareholder-to-shareholder fiduciary duty, or applied as a statutory oppression remedy, the crux of the oppression doctrine is that it carves out a special rule for close corporation majority shareholders from the general corporation law. Nonetheless, not every state recognizes a doctrine of minority oppression. Delaware, for its enormous influence over corporate law, stands in the minority with respect to the oppression doctrine.

D. Non-Starters: Delaware and Texas

Delaware has no legislative or judicial exceptions for relatively close corporations incorporated under its general corporation law. In *Nixon v. Blackwell*,[175] the Delaware Supreme Court had occasion to analyze an alleged instance of minority shareholder oppression reflected in several majority-beneficial corporate policies that created limited-purpose opportunities for certain shareholders to receive cash for their interests.[176] Because the majority enacted and benefitted directly from these policies, the Delaware Court of Chancery applied Delaware's well-known "entire fairness" analysis.[177] In its review, the Delaware Supreme Court agreed with the Delaware Court of Chancery that because the corporate policies at issue were preferential to the majority, therefore

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173. *Id.* at 564.

174. *Id.* at 565 (rejecting the argument that Michael had not been denied his "traditional shareholder rights" and concluding that "a shareholder's rights in a closely held corporation may not necessarily be so narrowly defined").

175. Nixon v. Blackwell, 626 A.2d 1366 (Del. 1993).

176. *Id.* at 1370–73. The specific policies included establishment of an Employee Stock Ownership Plan (ESOP) and the utilization of "key man" life insurance policies. *Id.* at 1371–72. The ESOP provided an opportunity for various employees to accrue retirement benefits, choosing upon retirement to take their interest in the ESOP in the form of the same Class B stock the minority shareholders owned or cash. *Id.* at 1371. The "key man" program included a provision allowing for the use of the life insurance proceeds to repurchase Class B shares from the employee's estate. *Id.* at 1371.

177. Blackwell v. Nixon, No. 9041, 1991 WL 194725, at *5 (Del. Chan. Sept. 26, 1991). The entire fairness test is the standard of review Delaware courts apply to actions of corporate boards of directors whose members benefit individually and directly from decisions of that board in the course of its direction of the corporation. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 711 (1983).

making the majority directors interested, entire fairness was the proper standard of review.[178]

Turning to the substance of the allegedly oppressive actions, the Delaware Supreme Court concluded that the entire fairness test had been met without accepting or rejecting the close corporation analysis of the Delaware Court of Chancery.[179] Once it concluded the challenged policies were fair in substance, the Delaware Supreme Court addressed the question of whether it should affirm the Delaware Court of Chancery's apparent adoption of *Donahue*-style minority protections, or—to put it in the terms of the *Meiselman* court—expand the view of the expectations of the minority shareholders beyond the "traditional" shareholder interests.[180] Specifically, the Delaware Supreme Court analyzed the rationale of the Delaware Court of Chancery's decision, which it articulated as requiring equality in liquidity, because liquidity is an ever-present concern in close corporations.[181]

"It is not difficult to be sympathetic, in the abstract, to a stockholder who finds himself or herself in that position," the court began, in a portion of the opinion titled "No Special Rules for a 'Closely-Held Corporation' Not Qualified as a 'Close Corporation' Under Subchapter XIV of the Delaware General Corporation Law."[182] The Delaware Supreme Court declined to adopt any form of the *Donahue* rule for three reasons. First, it concluded that "[i]t would do violence to normal corporate practice and our corporation law to fashion an ad hoc ruling which would result in a court-imposed stockholder buy[]out for which the parties had not contracted."[183] That is, parties generally are free to—and therefore should be expected to—contract for minority shareholder protections, liquidity or otherwise.[184] Second, Delaware has a separate statutory scheme for "close corporations" that counsels against the judicial creation of a category of non-statutory closely-held corporations.[185] Again, the court observed that parties desiring greater minority protections in the close corporation context could choose them in advance when selecting from the menu of statutory default rules.[186] Finally, the court expressed confidence that the entire fairness test, "correctly applied and articulated," provides the proper approach where

178. *See Nixon*, 626 A.2d at 1375.
179. *Id.* at 1377–78.
180. *Id.* at 1379–80.
181. *Id.* at 1376–77.
182. *Id.* at 1379.
183. *Id.* at 1380.
184. *Id.*
185. *See id.* (citing DEL. CODE ANN. tit. 8, § 342 (2017)).
186. *Id.* at 1380–81.

it otherwise applies under the general corporation law.[187] In sum, the Delaware Supreme Court's decision in *Nixon* reflected the state's very strong preference for contracting as the way to conduct intracorporate affairs.[188]

In 2014, the Texas Supreme Court joined Delaware's hands-off, contractual approach to close corporation shareholder disputes in *Ritchie v. Rupe*.[189] Prior to *Ritchie*, the Texas Supreme Court watched silently as intermediate appellate courts fleshed out an oppression doctrine relying upon heightened fiduciary duties, Texas's statutory receivership provision, and a definition consistent with the reasonable expectations analysis utilized in a number of states.[190] A decision of the Houston Court of Appeals, *Davis v. Sheerin*,[191] stood as Texas's primary oppression case from when it was decided in 1988 to the time of the *Ritchie* decision.[192] In *Davis*, the 45 percent shareholder of a corporation sued the 55 percent shareholders for a panoply of misdeeds, but the primary allegation involved the 55 percent shareholders' insistence that the 45 percent shareholder was not actually a shareholder at all.[193] The court began its analysis by resolving the remedial question of whether a buyout was the appropriate remedy for the allegedly oppressive acts found by the jury.[194] This question was important because Texas's oppression statute did not provide specifically for a buyout; it provided only for the appointment of a receiver for either rehabilitating the

187. *Id.* Though the court in *Nixon* did not rely upon it specifically, commentators have observed that corporate federalism provides 50 different sets of default rules from which incorporators can choose. *See, e.g.*, Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 843 (1992) ("Firms can . . . not only particularize their charters under a state code, but they can also seek to incorporate in the state whose code best matches their needs—i.e., the state whose code minimizes their cost of doing business."); *see also* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 6 (1996) ("[S]tates compete to offer—and managers to use—beneficial sets of legal rules."). If parties do not prefer Delaware's strong legislative and judicial commitment to freedom of contract, they can choose another state with more robust minority protections.

188. *See Nixon*, 626 A.2d at 1379–80.

189. Ritchie v. Rupe, 443 S.W.3d 856 (Tex. 2014).

190. *See* Douglas K. Moll, *Shareholder Oppression in Texas Close Corporations: Majority Rule (Still) Isn't What It Used To Be*, 9 HOUS. BUS. & TAX L.J. 33, 34 (2008) (noting that the Texas Supreme Court had not yet spoken on the matter); *see also id.* at 40–46 (discussing Texas precedent on both statutory and fiduciary duty developments).

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

192. *See* Moll, *supra* note 190, at 34 (describing *Davis* and the silence of the Texas Supreme Court).

193. *Davis*, 754 S.W.2d at 377–78. The majority shareholder's claim was that the minority shareholder had gifted his interest to the majority some years earlier. *Id.* There also was a supplemental issue regarding a partnership between the majority and minority. *Id.*

194. *Id.* at 378–80.

corporation or dissolving it.[195] Nevertheless, the court found it within the general equitable powers of Texas courts to fashion an appropriate remedy, including a buyout.[196] Returning to the substantive question of whether the majority had oppressed the minority, the court concluded that the majority's refusal to recognize the minority's ownership was uniquely oppressive in its efforts not only to impair, but also to extinguish entirely, the minority's expectations of ownership and participation.[197] The court supported its holding with reference to other states' precedent interpreting various statutory oppression remedies.[198] The Texas Supreme Court declined review of *Davis*, thus leaving Texas's trial and intermediate appellate courts to continue grappling with close corporation oppression cases. And grapple they did, developing a veritable stew of doctrine drawing upon statutory oppression remedies and direct majority-minority fiduciary duties of the *Donahue* variety.[199]

The Texas Supreme Court delivered a resounding answer in *Ritchie*, concluding that neither the Texas rehabilitative receivership statute nor common law established the broad oppression doctrine that had been developed in the intermediate appellate courts.[200] Instead, the court narrowed the definition of "oppression" from actions that harm a minority shareholder's reasonable expectations or that depart from a general standard of fair dealing to the following conjunctive standard:

> [D]irectors or managers engage in "oppressive" actions . . . when they abuse their authority over the corporation with the intent to harm the interests of one or more of the shareholders, in a manner that does not

195. *Id.* at 378 (discussing TEX. BUS. CORP. ACT ANN. arts. 7.05–.06 (West 1980) (codified at TEX. BUS. ORGS. CODE ANN. §§ 11.404(1)(C), 11.405 (West 2017))).

196. *Id.* at 380.

197. *See id.* at 382.

198. *Id.* at 381–84. Also notable was the court's decision to organize the misconduct in two separate parts. In addition to affirming the buyout as the remedy for the oppressive efforts to deny the minority's ownership, it also awarded damages for "informal dividends" the majority paid itself through a profit sharing plan that did not include the minority and for waste of corporate assets. *See id.* at 384–85. Of course, siphoning corporate assets can be a breach of fiduciary duty, but it is notable that the court affirmed a *direct* award of damages without further explanation of whether the "informal dividends" were wrongful as a breach of fiduciary duty to the *corporation* or as a breach of a direct duty to the minority. *See, e.g.*, *id.* As the *Ritchie* court would later observe, the relevant Texas statute relaxes the direct-derivative distinction in certain closely-held corporations. *See* TEX. BUS. ORGS. CODE ANN. § 21.563(c); *Ritchie*, 443 S.W.3d at 880–81.

199. Moll, *supra* note 190, at 40–50 (collecting cases representing Texas's minority oppression doctrine); *see also* Douglas K. Moll, *Majority Shareholder Oppression in Texas Close Corporations: Majority Rule Isn't What it Used to Be*, 1 HOUST. BUS. & TAX L.J. 12, 15–18 (2001).

200. *Ritchie*, 443 S.W.3d at 877, 891.

> comport with the honest exercise of their business judgment, and by doing so create a serious risk of harm to the corporation.[201]

Critically, the court placed the analysis of oppression under the statute within the framework of general corporation law, affirmatively interlinking any definition of oppression with the requirement of harm to the *corporation*, and not merely to the minority.[202] The court likewise declined to establish a common law duty not to act oppressively toward the minority, which it compared to a fiduciary duty to individual shareholders.[203] As the Delaware Supreme Court did in *Nixon*,[204] the *Ritchie* court referenced Texas's existing statutory protections for two types of non-public corporations, closely-held and close corporations.[205] Finally, the court's preference for contracting was stated as such: "[a]gain, we note that although [the majority and minority shareholders] did not enter into a shareholders' agreement, they certainly could have done so, and by doing so could have avoided the current dispute."[206]

Delaware and Texas remain in the minority in rejecting any independent doctrine of oppression of a close corporation minority shareholder.[207] While the courts in *Ritchie* and *Nixon* expressed a preference for contracting, both courts also rejected the claim that the general corporation law was too inflexible to provide adequate remedies for intracorporate disputes resulting in hardship to minority shareholders.[208] Furthermore, the *Ritchie* court made an observation not often discussed in the ongoing debate: the difficulty of developing a predictable procedural mechanism (direct or derivative action), doctrinal basis (statutory oppression, common law oppression, or heightened fiduciary duties), and remedy (dissolution, buyout, or money damages).[209] Though evaluation of close corporation doctrine in its current form is beyond the scope of this article, the *Ritchie* court's observation is instructive in the crowdfunding context, where more complication with respect to closeness and exit is layered upon the existing close entity.[210]

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201. *Id.* at 871.
202. *Id.*
203. *Id.* at 890.
204. Nixon v. Blackwell, 626 A.2d 1366, 1380 (Del. 1993).
205. *Ritchie*, 443 S.W.3d at 880–81.
206. *Id.* at 881.
207. *See* Ragazzo, *supra* note 8, at 1100.
208. *Nixon*, 626 A.2d at 1381 ("The entire fairness test, correctly applied and articulated, is the proper judicial approach."); *Ritchie*, 443 S.W.3d at 871 (framing the interpretation of the oppression statute in terms of business judgment and harm to the corporation).
209. *See Ritchie*, 443 S.W.3d at 889–90, 890 n.60.
210. *See infra* Section IV.B.

E. How Close is Close?

Naturally, if courts are inclined to treat close or small, private corporations differently than large, public corporations, there must be some analysis for dividing them. The court in *Donahue* observed that "[t]here is no single, generally accepted definition" of a close corporation.[211] Should the line be drawn at a certain number of shareholders?[212] Does the nature of family or social relationships in the founding of the business play a role?[213] Is "exit" the primary or overarching consideration?[214] Most courts and commentators have utilized a definition of close corporation similar to the one announced in *Donahue*: "(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."[215] Nonetheless, it is doubtful one could find a corporation with, suppose, 29 shareholders, where all of these shareholders are also shareholder-officer-directors. Likewise, as Professor Moll has observed, disputes often arise after the shareholder who actively participates in management dies or gifts the relevant shares, making his or her heirs or donees mere shareholders.[216] Exit remains the most acute issue, given that the complaining shareholder probably would not complain if he or she could sell the shares on an open market. But, there are enormous private,

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211. Donahue v. Rodd Electrotype Co. of New Eng., 328 N.E.2d 505, 511 (Mass. 1975).

212. *See, e.g.*, DEL. CODE ANN. tit. 8, § 342(a)(1) (2017) (limiting the number of shareholders in a statutory close corporation under Delaware law to no more than 30). While the statutory close corporation and the judge-made doctrine of close corporations are distinguishable, the statutory limitation is informative. *See, e.g.*, TEX. BUS. ORGS. CODE ANN. § 21.563 (West 2017) (limiting the number of shareholders in a statutory closely held corporation to fewer than 35).

213. *E.g.*, Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976) (social connections between co-venturers); Meiselman v. Meiselman, 307 S.E.2d 551 (N.C. 1983) (involving a family relationship between a father and his two sons).

214. *See generally* Means, *supra* note 115 (proposing that judicial scrutiny of allegedly oppressive actions be calibrated based on the extent to which the minority shareholder maintains a voice in corporate affairs).

215. *Donahue*, 328 N.E.2d at 511; *Meiselman*, 307 S.E.2d at 557–58; *see, e.g.*, Douglas Moll, *Majority Rule Isn't What It Used to Be: Shareholder Oppression in Texas Close Corporations*, 63 TEX. B.J. 434, 436 (2000) (discussing this common definition); *see also* Thompson, *supra* note 6, at 372 (contrasting the attributes of close corporations with public corporations).

216. *See* Moll, *supra* note 7, at 961–62, 961 n.249 (discussing unique issues involved when a shareholder becomes a shareholder by gift or inheritance). Inheritance was also at issue in *Donahue*, 328 N.E.2d at 583. Donahue's widow, Euphemia, was the complaining shareholder and named plaintiff. *Id.* How could her "reasonable expectations" include employment, participation in management, and other such matters, when she had never been employed or participated in management prior to her ownership? *See* Moll, *supra* note 7, at 961–62, 961 n.249.

illiquid corporations, such as Cargill, Inc., whose web of stock ownership is believed to comprise over 100 family-member shareholders.[217] Most of these mere shareholders face not only the liquidity problems affecting the smallest of corporations, but also face voice problems because there are many more mere shareholders than can possibly be directors.

The ongoing development of oppression doctrine—whether developed by judges, implemented by legislatures through enactment of statutory oppression remedies, or both—is premised upon the contrast between close corporations and public corporations in the context of intracorporate disputes. In all such cases, courts tend to focus on the "intimate, illiquid"[218] nature of the venture. This dividing line between the impersonal and liquid view of the public corporation and the intimate and illiquid version of the close corporation is blurred, if not outright smashed, by the arrival of crowdfunding. Crowdfunded corporations, undoubtedly, will be illiquid, but with a much larger number of shareholders who will invest through the Internet.

F. Blurring Again: The Close-But-Crowdfunded Firm

A corporation utilizing equity crowdfunding transitions overnight from a close corporation to a corporation with many quasi-public shareholders. This transition raises the question: does a crowdfunded close corporation remain a close corporation? Or does equity crowdfunding result in the corporation becoming "large" or "publicly-held"? Does "publicly-held" automatically mean that the corporation can no longer be "close"?

Generally, crowd investors will not expect employment or regular income from the business, and will not be placing their entire financial futures in a crowdfunded investment opportunity.[219] It also is almost assured that they will not accumulate a large enough share of the voting stock to exercise any real power over corporate decision-making. On the other hand, the vision, role, and direction of the corporation will remain in the hands of the non-crowd shareholder-officer-directors and they will still maintain the closeness, blending, and blurring that existed prior to the arrival of the crowd.

Additionally, neither founding shareholder-officer-directors nor crowd investors are likely to have real exit opportunities—even if the

217. Gregory Meyer & Neil Hume, *Cargill Guards Private Life in 150th Year*, FIN. TIMES (Apr. 19, 2015), https://www.ft.com/content/ec6f88c2-e4ec-11e4-bb4b-00144feab7de.

218. *See* Thompson, *supra* note 6, at 370.

219. In part, this will be because the crowdfunding regulations place limits on total investments. *See* 17 C.F.R. § 227.100(a)(2) (2017) (setting aggregate investment limits based upon income or net worth).

arrangement is less intimate, it remains practically as illiquid as it was before. The shareholder-officer-directors' original shares remain as difficult to sell as they were prior to the raise, and perhaps are not of the same class or character as the crowd shares.[220] Furthermore, there is no legal or regulatory provision for secondary trading of crowdfunded shares.[221] Along with the uncertain regulatory status of secondary private sales of crowdfunded shares, the transaction costs of individual-to-individual sales of crowdfunded equity should be expected to be relatively high—at least as high as the costs to the corporation and the individual shareholder of replacing a shareholder-officer-director. Even if some shareholder-officer-directors may have sufficient bargaining power to negotiate their exit at formation by negotiating the terms of bylaws, stockholder agreements, and other contractual provisions, crowd shareholders almost certainly will not.[222] This mix of expectations and limitations on founding shareholder-officer-directors and crowd shareholders no longer fits neatly into either the mix of expectations and limitations for public corporations or for close corporations at present.

IV. DISPUTES IN CLOSE-BUT-CROWDFUNDED FIRMS SHOULD BE TREATED LIKE BIG INVESTOR DISPUTES

A round of crowdfunded investment transforms a small, private corporation with only shareholder-officer-directors into a corporation with a small group of shareholder-officer-directors plus a large class of mere shareholders. Though it is not necessarily as large—by shareholders or assets—as a traditional publicly traded corporation, its equity ownership no longer consists of only the founders or people bonded by family ties or personal relationships—the kinds of people who

220. For example, the shares could be of the non-voting variety. *See, e.g.*, Cleveland Whiskey, LLC, Amended and Restated Operating Agreement (Exhibit 5 to Form C) 6 (May 19, 2016) (describing Class D units—the crowdfund unit—as non-voting).

221. It is not clear that such a secondary trading platform would even be viable—how liquid can a market remain if the original "crowd" begins selling their shares? *Cf.* Oranburg, *supra* note 57, at 1. *But see* Steve O'Hear, *Equity Crowdfunding Platform Seedrs to Launch Secondary Market*, TECHCRUNCH (May 7, 2017), https://techcrunch.com/2017/05/07/equity-crowdfunding-platform-seedrs-to-launch-secondary-market/. Further, it is unclear whether a secondary market would ease exit concerns the way that public markets do. For example, if a crowd funds a lemon, then a secondary market simply would result in a crowd-wide death-spiral sell-off that may not solve the exit problem at all.

222. Nonetheless, public shareholders have almost no bargaining power with respect to the terms of their stock ownership, and sometimes no voting power. *See, e.g.*, Cleveland Whiskey, LLC, Amended and Restated Operating Agreement (Exhibit 5 to Form C) 6 (May 19, 2016) (describing Class D units—the crowdfund unit—as non-voting); *cf.* Snap Inc., Registration Statement (Form S-1) (Feb. 2, 2017) (describing public offering of "non-voting" shares).

generally expect to be shareholders, officers, and directors of the corporation. Crowd shareholders will certainly appear more like public shareholders. Nonetheless, their relationships to their crowdfunded investments could result in a set of expectations that do not fit neatly into the large, public and small, private corporation paradigm described above.

This Part begins with a clarification of the choice to make the close-but-crowdfunded model the focus of this article.[223] It proceeds to evaluate the expectations of crowd shareholders within the framework for public and close corporation shareholders set forth above.[224] Much of the analysis of these issues is woven into a few hypothetical intracorporate disputes that could arise in crowdfunded ventures, which illustrate the similarities and differences in expectations.[225] Throughout this Part, it defends this article's primary claim: that courts deciding intracorporate disputes in close-but-crowdfunded firms should apply Delaware's contract-focused approach instead of the special protections for non-controlling shareholders contained within many states' oppression doctrines.[226]

A. *Close-But-Crowdfunded as a Significant Slice of Equity Crowdfunding Activity*

Professor Seth C. Oranburg aptly observed that crowdfunding could fill a funding gap in the startup life cycle between the initial investment stage and the stage at which startups attract more substantial investment from angel investors and venture capital funds.[227] The life cycle he describes involves heavy early-stage spending designed to build out a foundation for substantial later growth and long-term profitability; in contrast, he notes that small businesses, such as bike shops or food trucks, are expected to grow slowly.[228] Undoubtedly, the high-tech feel of purchasing shares of stock through Internet portals associates crowdfunding with fast-growing, capital-burning tech startups.

Nonetheless, an outsized number of the first 50 crowdfund offerings represent permanently small enterprises, such as craft alcohol companies, many of them offering some form of current or future equity interest.[229] One explanation is that there is some degree of irrational exuberance or

223. *See infra* Section IV.A.
224. *See infra* Section IV.B.
225. *See infra* Section IV.C.
226. *See infra* Section IV.A.–C.
227. Oranburg, *Bridgefunding*, *supra* note 23, at 419–22.
228. *Id.* at 406. Professor Oranburg also notes that small businesses typically are bad equity investments. *Id.*
229. *See* Leaf et al., *supra* note 35.

naiveté involved with crowdfunding—unsophisticated consumer-investors are merely investing in a lot of lemons whose founders turned to crowdfunding as a last resort.[230] Indeed, as Professor Darian M. Ibrahim notes, the unaccredited crowd associated with Title III crowdfunding is a bit of an enigma.[231] On the one hand, the crowd could have specialized knowledge drawn from participation in a community of common interest—Professor Ibrahim provides the useful example of a crowd of video gamers possessing better information about the viability of a video game than angel investors who are not video gamers themselves.[232] On the other hand, as best described by Professor Joan M. Heminway, crowds can be irrational and therefore may be expected to make unwise investment decisions.[233] For the purposes of this article, it is irrelevant whether the crowd irrationally chases lemons or reveals actual wisdom through investing money. However crowd shareholders arrive at their investing decisions, when they choose to invest in a close-but-crowdfunded venture, they become a mere shareholder in a previously very close enterprise.

The clearest example of the close-but-crowdfunded venture may be a local craft beer brewery or other local artisanal food or beverage company. Crowd investment in a local craft brewery ties together affinity for the beer itself, the community of local beer enthusiasts,[234] and perhaps a general affinity for local business. Craft beer brewing, much like running a restaurant, bike shop, food truck, or some other local business, is a small business activity. Founders of a craft beer brewery likely are shareholder-officer-directors and are probably bonded by friendship or family relationships. Prior to raising capital through crowdfunding, this type of venture would implicate existing close corporation doctrine. A company using crowdfunding in the manner proposed by Professor Oranburg may begin as a small corporation, but likely has no intention of staying that way.[235] The expectations and motivations of crowd shareholders in permanently small, close-but-crowdfunded corporations add an additional layer of complexity to the

230. *See generally* Ibrahim, *supra* note 25.
231. *Id.* at 597.
232. *Id.*
233. *Id.* (citing Joan MacLeod Heminway, *Investor and Market Protection in the Crowdfunding Era: Disclosing to and for the "Crowd"*, 38 VT. L. REV. 827, 829–30 (2014)).
234. Such an affinity apparently has existed for some time. According to a 2017 report, London's "Golden Lane Genuine Beer Brewery" raised the equivalent of £19 million in 1805 from 600 "co-partners." *See* MARTIN CORNELL, OFF3R, CROWDFUNDING TAPS BEER DRINKERS' ENTHUSIASM: A REPORT ON CROWDFUNDING AND BREWERIES 2, https://learn.off3r.com/wp-content/uploads/2017/07/Crowdfunding-taps-beer-beer-drinkers-enthusiasm-1.pdf.
235. *See* Oranburg, *Bridgefunding*, *supra* note 23, at 405–06.

existing close corporation doctrine. As described below, this complexity counsels against its application.

B. Fitting in with the Crowd

At first blush, crowd shareholders appear much closer to large, public shareholders than to close corporation shareholders. Their shares come with no expectation of management positions or a directorship. There is no expectation of employment, and, in light of individual investment limits and offering size limits, it is doubtful any crowd shareholder will find himself or herself as having invested substantial life savings in a venture. The crowdfunded shares likely will have many default features of other public common stock.[236] Even so, crowd shareholders do not have the same exit opportunities as public shareholders in widely traded corporations. These features of the relationship of the crowd shareholder with the crowdfunded corporation diverge from the features of the big investor, big firm relationship and the small shareholder-officer-director, small firm relationship, even before the unique features of crowdfunding come into focus.

Adding to the combination of lower traditional expectations and minimal exit opportunities is the potentially unique set of expectations that arise in the crowdfunding context. These expectations flow from three identifiable themes in the burgeoning field of financial technology and technological innovation in the delivery of various services. First, many forms of crowdfunding, as described earlier in this Part, involve a substantial affinity for the product or service or the people promoting the campaign.[237] This is especially true in donative crowdfunding, where the crowdfunder provides money in exchange for mere trinkets or because of a desire to purchase some yet-unfunded product.[238] This affinity for the product or company is less likely to motivate investors in large, public corporations. For example, it seems doubtful that some significant subset of investors in the common stock of the Coca-Cola Company owns the stock merely because they enjoy drinking the beverage.[239] Needless to

236. This is not guaranteed, however, given the heterogeneous expectations across crowd investors and crowdfunded firms. *See* Verret, *supra* note 37, at 930–31.

237. *See, e.g.*, GREEN BAY PACKERS, INC., *supra* note 73.

238. *See, e.g.*, *Oculus Rift: Step Into the Game*, KICKSTARTER, https://www.kickstarter.com/projects/1523379957/oculus-rift-step-into-the-game (last visited Oct. 9, 2017) (describing an offering of posters, t-shirts, and prototypes depending on the amount of money donated).

239. On the other hand, technology offerings such as SNAP, Inc. (the corporation that owns and operates the popular Snapchat mobile application) attracted significant investment despite having unique governance features—its IPO offered only non-voting shares, yet still traded at prices substantially above the IPO price of $17 for months following the offering. *See* Snap Inc., Registration Statement (Form S-1) (Feb. 2, 2017)

say, they do not need to invest in Coca-Cola to consume Coca-Cola products, in the way that Marillion's United States fan base needed to donate to a fund to see their favorite rock band live without traveling overseas.[240] The local fans of a craft beer brewery may need to invest in their local brewer to ensure they continue enjoying their favorite local beverage. The local (and non-local) fans of the Green Bay Packers at one time needed to invest in the club either to ensure it remained in Green Bay or simply to own a piece of their favorite club.[241]

Second, many emerging technology-based companies, such as Uber, rely on a social network effect to generate a community around the product or service.[242] The communities that emerge around these technologies ultimately come to shape the product or service itself. Community members may not join the community specifically to participate in the development of the product or service, but the nature of technology-based companies is to leverage the size and scope of the user community to fine-tune the deployment of the product or service.[243] Similarly, early investors from the community of common interest often can become ambassadors or evangelists for the brand or product.[244] Crowd investors, making their investments through web-based portals, likely could behave similarly to the community of users. Furthermore, technology companies are among those more likely to choose crowdfunding as a source of capital.[245] Similarly, but on a much smaller scale, in the close-but-crowdfunded brewery, crowdfunders may play an active, if informal, role in in the development and execution of new varieties of beer.

Third, the nature of close-but-crowdfunded entities suggests they will tap into a localized version of affinity and community. Doing so could result in disparate crowd shareholder expectations about the

(describing sale of "non-voting" shares); *see also SNAP Inc. Class A Common Stock Historical Stock Prices*, NASDAQ (http://www.nasdaq.com/symbol/snap/historical) (last visited Dec. 22, 2017).

240. *See supra* notes 50–55 and accompanying text.

241. *See* GREEN BAY PACKERS, INC., *supra* note 73, at ii.

242. *See* Byrne Hobart, *The Uber of X Will Be Uber*, MEDIUM (Mar. 5, 2017), http://bit.ly/2yDPIwm. This feature of crowdfunding may *not* be as prevalent in the close-but-crowdfunded context. Building a network from which insight and scalability can be monetized is a feature of the fast-growing startup Professor Oranburg describes. *See* Oranburg, *Bridgefunding*, *supra* note 23, at 406 (discussing the capital-intensive nature of building a "two-sided" market and using Facebook as an example); *see also* Kellen Zale, *When Everything is Small: The Regulatory Challenge of Scale in the Sharing Economy*, 53 SAN DIEGO L. REV. 949, 979–83 (2016) (describing the importance of network effects in the sharing economy).

243. *See generally* Hobart, *supra* note 242.

244. *See* Mitchell Hartman, *Crowdfund My Startup, Please!*, MARKETPLACE (May 16, 2016, 4:04 PM), http://bit.ly/2hUnVzZ.

245. *See generally* Leaf et al., *supra* note 35.

operation of the venture, and is most likely to involve the importation of crowd shareholders to the smallest group of shareholder-officer-directors. Shareholder expectations could include the belief that the business will provide some tangible benefit to the community or conduct business in a certain manner. It may even include the expectation that the company will remain small and local. If some change in circumstances results in a change in the way these businesses operate, crowd shareholder expectations could be blunted, and, as the corporation remains close, there would be no meaningful exit. Drawing upon these three themes, the following sections illustrate some of the potential intracorporate disputes in crowdfunded ventures and the diversity of governance issues that may percolate within the ventures.[246]

C. *Intracorporate Dispute Vignettes*

1. The Founders' Quarrel

The first potential source of intracorporate dispute in crowdfunded ventures is the traditional one. Let us return to the discussion of the local artisanal burger joint. Suppose, instead of The Burger Joint proceeding indefinitely as a close corporation with *A*, *B*, and *C* as shareholder-officer-directors, the three founders decide to crowdfund The Burger Joint in the local community pursuant to their state crowdfunding exemption. The Burger Joint issues shares worth 10 percent of the equity and voting power in the corporation, while *A*, *B*, and *C* each retain 30 percent of the equity and voting power. After inviting their new shareholder-only crowd investors to a "shareholders' meeting"—no doubt featuring a lot of hamburgers—*A*, *B*, and *C* retire to the back office of the restaurant to bask in the glow of their successful capital raise. *A* and *B*, much to *C*'s chagrin, begin discussing riding the wave of momentum of the crowdfunding campaign to expand the business, perhaps through franchising. *C* demurs, citing her lack of interest in the idea, as well as her belief that the energy of the crowd derives from The Burger Joint's localness, as well as its quality hamburgers. As it did before, the rift between *A*, *B*, and *C* festers and grows, until *A* and *B* decide that the only option is to terminate *C*'s employment and position as an officer with the corporation. Shortly thereafter, at the next annual meeting, *A* and *B* vote their shares to elect only themselves to the board of directors, thus ending *C*'s tenure as a director of The Burger Joint. The Burger Joint, of course, has never paid a dividend to its shareholders,

246. As Professor Verret observed, crowdfunding illustrates the substantial need for governance flexibility, as firms have varying governance needs. *See* Verret, *supra* note 37, at 938–41.

and, like many small corporations, distributes returns to its shareholders through salaries and benefits to shareholder-officer-directors.[247]

Co-founder *C*, now unceremoniously removed from her employment and directorship, watches her substantial financial interest in the corporation evaporate. Certainly, her investment in the venture has value, but she is locked out of realizing any of the return without her salary. Suppose *C* seeks redress through a lawsuit against *A*, *B*, and The Burger Joint. The animating theory of her suit would be that *A* and *B* caused The Burger Joint to terminate her and remove her from the board in contravention of her reasonable expectation of continued employment.[248] In the absence of a clear statement in The Burger Joint's bylaws or a stockholder agreement, a court would have two options: follow existing oppression precedent and analyze *C*'s reasonable expectations in light of the course of her dealings with *A* and *B* to this point, or follow Delaware and decide the case on whether the action was fair in its entirety or made with sound business judgment. The fundamental disagreement between the views expressed by the court in *Meiselman* and the court in *Nixon* is over the practicability of pre-dispute contracting. The court in *Meiselman* observed that the nature of close corporations was such that most minority shareholders would not have the bargaining power or inclination to pursue robust contractual minority protections.[249] The court in *Nixon* relied upon the extensive menu of permissible contractual tools available under the law when it declined to "fashion an ad hoc ruling which would result in a court-imposed stockholder buy[]out for which the parties had not contracted."[250] The decision to crowdfund, at minimum, creates a new opportunity to consider potential contractual options for the relationship between and among the founders and the crowd. This new opportunity to contract substantially undermines the justification for fashioning a broad remedy that the parties did not make explicit through contracting or the offering process. If the court chooses the latter option, several harms can result.

For example, if the court orders that the corporation reemploy *C*, it will have to bear the cost of reemploying a dissident officer.[251] Even if damages or a forced buyout were ordered against *A* and *B* individually

247. *Cf.* Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 660–61 (Mass. 1976) (describing shareholder-officer-directors' salaries and the later cancellation of the salary paid to the plaintiff-shareholder).

248. Such a theory could proceed either as a claim for breach of heightened fiduciary duties or oppression, or both, depending on the state. *See supra* Section III.C.1.

249. Meiselman v. Meiselman, 307 S.E.2d 551, 558–59 (N.C. 1983).

250. Nixon v. Blackwell, 626 A.2d 1366, 1380 (Del. 1993).

251. Front pay or back pay may also be a form of relief. *Cf. Wilkes*, 353 N.E.2d at 664–65 (ordering back pay jointly and severally against the majority stockholders, but permitting corporate assets to be "diverted" if appropriate).

(that is, not against The Burger Joint), the substantial alteration of *A* and *B*'s individual finances could impair their ability to infuse further capital into the business. Dissolution would be an equal if not greater harm—the crowd shareholders' hopes of a return on their investment would evaporate into liquidation along with the interests of the founding investors. One potential argument supporting oppression doctrine is that granting a minority shareholder remedies against the majority will cause harm only to the majority whose direct oppressive acts caused harm to the minority. In a crowdfunded venture, the crowd, like any group of public shareholders, is innocent of any transgression committed by the majority or minority founders against one another. Therefore, given the absence of a substantial justification for the court to make inferences about *C*'s reasonable expectations or about the decision not to provide for minority protections in their corporate documents, the harm that could befall The Burger Joint if a court applied existing oppression doctrine counsels following Delaware's approach.

2. The Locked-in Crowd

Consider a startup company designing a new household product, for example, some typical better mousetrap that one might see on an episode of ABC's *Shark Tank*.[252] When the forlorn founders walk off of the set with no shark investment, they turn to the crowd. Following a reasonably, but not overwhelmingly, successful raise, the founders have sold 15 percent of the business and raised around $100,000—more than enough to fill existing orders, do a bit more marketing, and increase the sales footprint for the product. Ultimately, however, the business never fully takes off, and the founders begin to allow the business to wither slowly. The crowd takes notice, but their 15 percent entitles them to no meaningful voting power and no ability to confront the withering strategy. Perhaps the founders even draw down the remaining corporate assets through the maintenance of their managerial salaries, even as sales decline and the business meanders toward inactivity. In the process, the crowd simply requests that the founders buy them out—that seems fair, after all.[253] The founders, acting as directors, deny the request. Though not frozen out of employment or their life savings, the crowd likely has

252. *Shark Tank* is a television program that consists of a panel of famous business experts hearing business pitches from small entrepreneurs. *See generally About Shark Tank TV Show Series*, ABC, http://abc.tv/1pqEUEb (last visited Oct. 22, 2017). The experts, called "sharks," decide whether and how to invest their own money in the businesses, and often provide feedback on the entrepreneurs' pitches and business ideas. *Id.*

253. For example, Professor Moll proposes a default buyout as a check against opportunism by the majority. *See* Moll, *supra* note 7, at 900.

been frozen out of their initial investment, and may never see any return. At least in part, this freezeout derives from the founders' otherwise formally permissible decisions to continue with payment of managerial salaries and to not expend any additional corporate resources toward growing the business. Like any other minority shareholder, the crowd is powerless to stop the majority shareholder-officer-directors and is denied the opportunity to liquidate in any meaningful way. Because exit and liquidity comprise an important part of the basis of oppression doctrine, crowd shareholders have a non-frivolous argument that the founders breached heightened fiduciary duties or otherwise oppressed them.

If the crowd shareholders sue the founders alleging oppression, the argument likely would consist of the factual argument that the shareholder-officer-directors provided themselves liquidity from their investment in the corporation by paying themselves salaries, while excluding the crowd from any liquidity. The litigation likely would turn on whether the crowd had any reasonable expectation of liquidity. Of course, the crowd could lose merely because, as described throughout this article and in others, crowd shareholders should not expect many crowdfund investments to provide substantial, much less liquid, returns.[254] But if the court awarded a buyout or dissolution, the founding shareholder-officer-directors would be *personally* liable for a substantial financial award to the crowd shareholders.

The risk of potential personal liability for otherwise corporate actions may be defensible in the context of a close corporation, where the expectations of the small number of shareholder-officer-directors are discernable and the causal link between the breach and the harm is clear. As noted, the crowd is a group of individuals with potentially widely different expectations. Thus, the proof of the causal link between the shareholder-officer-directors continuing to pay themselves salaries while the corporation withered is more tenuous as applied to the crowd. Yet again, the crowdfunding process created a new opportunity for the parties to set the terms of their relationship. If a "crowd buyout" was contemplated, it could be created within the framework of the offering—in the same way that future equity interests are being developed for crowdfunded ventures at present.

254. *See supra* note 219 and accompanying text; *see also* Oranburg, *Bridgefunding*, *supra* note 23, at 406 (describing equity investments in small businesses as questionable). *See generally* Ibrahim, *supra* note 25 (discussing the potential for a market for "lemons" which would result in irrational or poor investments); Heminway, *supra* note 233, 829–30.

3. The Loyal Employee

The first two vignettes set the founders against one another and against the crowd as a whole. Another possibility is that the founders could find themselves at odds with an individual shareholder from the crowd. Employment or managerial responsibility for the business is an ever-present theme in close corporation intracorporate disputes.[255] Like in *Wilkes*, the typical case involves a dispute where most or all of the shareholders hold management responsibility or employment with the venture.[256] Though this article has proceeded on the recognition that crowd shareholders typically will not expect employment with the venture, it is conceivable that employees could become crowd shareholders. Consider a venture with a class of crowdfunded shares that are not fully subscribed. As a holiday bonus, the principal shareholder-officer-directors issue crowdfunded shares to a few loyal employees who are not officers. With employees mixed into the crowd, an employment dispute could become intertwined with the relationship between the founders and the crowd. Specifically, an employee-crowd shareholder who is terminated or otherwise leaves her employment may find herself with an asset she valued only as a part of her employment with the venture.

The development of oppression doctrine often drew upon the employment expectations of minority shareholder-officer-directors and the relationship between the ownership of the stock and the position within the business. A terminated employee-crowd shareholder may come to believe that ownership of the stock is worthless if it is not connected to employment in the venture.[257] For the purposes of this

255. *See Wilkes*, 353 N.E.2d at 657, 659–60 (describing the management and directorship responsibilities of the four co-venturers).

256. *See id.*

257. *See generally* Ingle v. Glamore Motor Sales, Inc., 535 N.E.2d 1311 (N.Y. 1989) (providing a classic example of how employment, stock ownership, and financial participation in a business intertwine). In *Ingle*, a minority shareholder-officer-director purchased his shares subject to a stockholder agreement wherein the controlling parties (the business's original sole founder and his sons) could repurchase his shares if the minority shareholder-officer-director "cease[d] to be an employee." *Id.* at 1312. The controlling parties later terminated his employment and exercised the right to purchase the shares. *Id.* Though the plaintiff in *Ingle* pled the case as a wrongful termination, the driving force of his argument was that his status as a non-controlling close corporation shareholder prohibited his termination because it resulted in his being deprived of his ownership and role in managing the business. *Id.* at 1312–13. Though the majority of the court ultimately denied relief, *id.* at 1314, the dissent made a persuasive case that some equitable remedy was appropriate to protect "expectancies" generated through his role as a "coprincipal" in the business. *Id.* at 1317. The plaintiff in *Ingle* did not challenge the buyout price, but the dissent suggested it was low under the circumstances, also implicating the possibility that the plaintiff expected the value in his investment to be

vignette, assume also that the corporation maintains key-employee life insurance policies for certain levels of management, such that if a key manager is discharged from employment, the corporation can utilize the policy to buy back the shares from the manager's estate.[258]

In a suit by the loyal employee against the founding majority, the argument likely would proceed as a claim that the ownership of the shares came with an expectation of employment, as well as an allegation that one class of employee-shareholders (the key employees) receives liquidity upon separation, while the crowd shareholder class of employee-shareholders does not. Such would not be the case, of course, with the average crowd shareholder in the venture, but it would be the case of the loyal employee who received the crowdfund-share holiday bonus. The employee likely would lose if the court perceived the employee's proffered expectation of continued employment as based solely on share ownership.[259] Nonetheless, the employee could make a more nuanced argument—that the share ownership was a benefit of or compensation for employment that is worthless without the continued employment relationship. Likewise, a court may be tempted, in balancing the equities, to order the majority shareholders to buy out this single shareholder, the cost of which is much smaller than compelling the buyout of the entire crowd or the holder of a founder's share of stock in the corporation. A court may be even less hesitant to do so where the corporation provides liquidity to one class of employees as a benefit to those in control and not to the other class.

Similar to the prior vignettes, the mechanics of the crowdfunding process significantly weaken the justifications for taking an equitable approach instead of a contractual one: the parties can agree on whether and how liquidity will be made available and expectations of employment, stock ownership, and participation can be calibrated in express terms.[260] Furthermore, even a small buyout would be harmful to

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through employment compensation rather than capital appreciation, dividends, or a later acquisition. *Id.* at 1316 n.1.

258. *Cf.* Nixon v. Blackwell, 626 A.2d 1366, 1370–72 (Del. 1993). Such a pre-dispute arrangement is common in smaller corporations, not only for discharge or voluntary separation from serving as an officer, but also for the death of the key managerial employee. *Id.*

259. *Cf. Ingle*, 535 N.E.2d at 1313 (concluding that a position as a close corporation non-controlling shareholder does not abrogate employee-shareholder's employment at-will).

260. For example, a number of technology companies, most notably Skype, grant equity purchase options as compensation under strict exercise and repurchase provisions, even to the point of reserving themselves the right to repurchase any equity shares purchased by the employee pursuant to the options. *See* Steven Davidoff Solomon, *Skype Not Alone When It Comes to Options*, N.Y. TIMES: DEALBOOK (July 6, 2011, 1:03 PM), http://nyti.ms/2qvDKAB (describing a number of companies' specific option programs).

the close-but-crowdfunded corporation, despite the fact that it might not be as drastic as dissolution or as costly as the buyout of a founder's share. As discussed previously, the major benefit of crowdfunding is the extent to which it can be used to open capital flows to small businesses.[261] Judicial interference in the growth and development of the practice by imposing stricter standards of conduct on majority shareholders or applying statutory remedies expansively, as it would in the other vignettes, impairs crowdfunding's potential. Further, such a rule would limit unnecessarily the ability of corporations and employees to reap the benefits of employee stock ownership.[262]

4. The Early Adopter

The "Early Adopter" is a savvy consumer who perceived value in a product or service in its early stages, perhaps prior to its existence in physical form.[263] A useful real-life example is the tale of the company Oculus and its virtual reality headset, the Rift, which raised $2.4 million on Kickstarter for development and production costs.[264] After two quick rounds of venture capital ("V.C.") investment of $16 and $75 million, Facebook purchased the fledgling company for $2 billion.[265] Suppose that instead of the promise of a prototype, the Kickstarter "investors" had received equity amounting to ten percent of the company—a valuation of approximately $25 million. Accounting (quite roughly) for the dilution associated with the additional $90 million of the V.C. rounds, a $2 billion sale to Facebook would have resulted in a valuation of $50 million for the crowd investors.

Many Oculus Rift crowdfunders felt they missed out on the deal of a lifetime, for quite obvious reasons.[266] This disappointment suggests there could be some expectation of loyalty to early adopters or "fans" in crowdfunded ventures. But was the source of this anger so obvious? The loss of a piece of the financial return received by the founder was upsetting, but there was no reason to believe donating to a Kickstarter

261. *See generally supra* Section II.B.

262. For a general discussion of the potential benefits of non-managerial employee stock ownership, see Xin Chang et al., *Non-Executive Employee Stock Options and Corporate Innovation*, 115 J. FIN. ECON. 168 (2015).

263. *See* Christian Catalini & Catherine Tucker, *Seeding the S-Curve? The Role of Early Adopters in Diffusion* 3 (NET Institute Working Paper, No. 16-02, 2016) (defining "early adopter" and discussing how technology companies may use a waitlist to identify them).

264. For a thorough account of the tale of Oculus Rift, see Chaboud, *supra* note 50, 86–90.

265. *Id.* at 87–88.

266. *See, e.g.*, Joel Johnson, *Oculus Grift: Kickstarter as Charity for Venture Capitalists*, VALLEYWAG (Mar. 26, 2014, 8:46 AM), http://bit.ly/1ePlt6Y.

campaign would entitle the funders to any part of the massive transaction proceeds. Arguably, there was some combination of expectations that included more than money—some belief that Oculus Rift was supposed to stay small or true to some undefined values.[267] At the outset, when Oculus was merely a startup in its founder's garage, crowdfunders participated in the Kickstarter campaign hoping the company would succeed and mass-produce its innovative new technology, which the crowdfunders would then consume.[268] They expected only to receive the product itself and perhaps engage with a community of like-minded enthusiasts.[269] The expectation appeared to change dramatically once the small startup transformed into a multi-billion-dollar asset of one of the world's largest technology corporations. Clearly, the view of the public corporation with shareholders motivated only by financial returns is inapplicable, and the view of the close corporation as a partnership would not be particularly helpful in explaining, much less resolving, the difficulty of the Oculus Rift scenario.

A future company that follows a similar path to success in the way that Oculus did with the Rift could be an equity crowdfunded venture. As Professor Oranburg observed, crowdfunding could be a source of "gap" funding between the early rounds of friends-and-family equity investment and the first major round of V.C. investment.[270] For the purposes of this vignette, let us assume that a small technology corporation conducts a crowdfund offering to raise funds within the traditional V.C. gap.[271] The expectation of the founders, of course, is that the crowdfund raise will provide Professor Oranburg's bridge between the friends-and-family round and the first real attention from V.C. funding. For that reason, the crowdfunding raise is very small as a percentage of the outstanding equity—perhaps only five percent of the total equity is sold for $1 million. After all, the founders did not want a cluttered capitalization table when the V.C. funding attention finally arose.

As with Oculus Rift, however, this corporation flies past any multi-round, multi-year V.C. and private equity funding pattern. Rather, another Facebook offers to pluck it from relative obscurity for $1 billion. The crowd's portion of the sale proceeds is, of course, substantial. Five percent of $1 billion is $50 million, a 5,000 percent gain.

267. *See* Chaboud, *supra* note 50, at 88–89.
268. *See* Ethan Mollick, *The Dynamics of Crowdfunding: An Exploratory Study*, 29 J. BUS. VENTURING 1, 3 (2014) (discussing the goals of funders of non-equity crowdfunding projects).
269. *See id.*
270. Oranburg, *Bridgefunding*, *supra* note 23, at 401–02.
271. *See id.*

In contrast to the other vignettes, litigation over a 50-fold increase in the value of one's investment seems unthinkable. But is it less unusual, in light of the existing corporation law, that *mere donors* to Oculus Rift felt that they were subject to some unfairness? This vignette is less useful to illustrate how courts could decide a specific dispute within a close-but-crowdfunded entity. Nonetheless, the possibility of litigation or other impairment to goodwill in Oculus Rift's situation—where crowdfunders received no equity and could not have had any reasonable expectation of sharing in the proceeds from the Facebook acquisition—illustrates the heterogeneous expectations that may drive tensions in close-but-crowdfunded corporations. In fact, such tensions may be more prevalent in close-but-crowdfunded ventures than in soon-to-be large ones such as Oculus.

As Professor J.W. Verret observed, ownership features of crowdfunded corporations illustrate the potential demand for creative governance solutions and the emergence of them outside of the traditional securities law framework.[272] The Early Adopter vignette, while unlikely to result in a traditional close corporation imbroglio over shareholder-to-shareholder duties or equitable remedies, illustrates the ways that crowdfunding can result in a demand for creative solutions to crowdfunding-specific governance issues.[273] The demand for creative solutions is supplied by development and experimentation with contractual terms and structures that can be deployed based on the individual needs of each potentially-crowdfunded business. The close-but-crowdfunded firm, then, is at the heart of Professor Thompson's question of how to allocate the solutions structure between contracting and judges.[274]

The major tensions in the tale of Oculus Rift are not only that the early adopters lost out on major financial returns, but also felt a sense of loss when the company abandoned its smallness.[275] Equity crowdfunding by itself may be the initial solution, but how should a close-but-crowdfunded firm with a group of early adopters manage the uncomfortable tension between their enthusiasm for the product or people and the ever-present financial aspect? Perhaps a more apt question would be: what happens when the local craft brewery decides to

272. Verret, *supra* note 37, at 936–48.
273. *Cf. id.*
274. *See* Thompson, *supra* note 6, at 403.
275. *See* Chaboud, *supra* note 50, at 89 (noting that more than 80% of the comments left on the Kickstarter page were negative with respect to the Facebook deal).

sell to an international conglomerate such as Anheuser-Busch InBev?[276] The first option, utilized in many technology corporations, is to establish non-voting or diluted-voting shares.[277] In such a scenario, the founders maintain control over the venture, but still offer early adopters a greater financial stake. Another option is to issue crowdfunded shares in a convertible form—that is, the shares represent the above-discussed five percent of the corporation's equity as long as the corporation remains close-but-crowdfunded or in the V.C. gap portion of its life cycle. But, if Facebook offers an extraordinary amount for the corporation, the shares can be converted to a larger financial stake. In contrast, many close-but-crowdfunded ventures with no intention of becoming large might actually sell crowdfunded shares that provide more substantial voting rights. Thus, if InBev wants to buy the craft brewing company, the deal might involve having to address the non-financial desires of the crowd. Any of these contractual arrangements between founders and the crowd can mitigate and allocate the tension between founders and the crowd in an Oculus Rift-style scenario. Thus, this vignette illustrates the superiority of contracting for the purposes of expanding the universe of capital for entrepreneurs. In the age of capital markets innovation, freedom to organize firms in creative new ways is ultimately more desirable.

D. Resolving the Tension: Small Crowd Shareholders as Big Investors

The heterogeneous expectations and motivations of crowd shareholders illustrated above make crowd shareholders unique from an equity investment perspective. Crowd shareholders do not fit neatly into the mold of the close corporation owner, whose stake in a company may be derived from personal involvement in the business or a personal relationship with its founders. While some crowd investors undoubtedly will invest solely with investment returns in mind, there is reason to doubt this expectation will be the primary motivation in all crowdfunded investments.[278] As described above, crowdfunded ventures inherently face massive risk of failure and a relatively long horizon to any payoff from an equity investment.[279] Such equity is not a great candidate for

276. *See, e.g.,* Ronnie Crocker, *Karbach to be Acquired by Anheuser-Busch InBev*, THE HOUSTON CHRONICLE (Nov. 3, 2016, 1:57 PM) http://www.chron.com/business/retail/article/Karbach-to-be-acquired-by-Anheuser-BuschInBev-10590579.php

277. *Cf.* Snap Inc., Registration Statement (Form S-1) 3 (Feb. 2, 2017) (describing sale of "non-voting" shares).

278. *See supra* Section IV.C.4 (discussing the non-pecuniary influences in the Oculus Rift saga).

279. *See supra* Section III.F.

many returns-focused investors, as the shares likely will not resemble robust, tradable, growth, or dividend-paying public equities that would attract such investors. Given the lack of a secondary market, they are unlikely to attract speculators looking to open and close positions quickly.

As illustrated above, the close-but-crowdfunded Burger Joint, or some other craft food and beverage concept, may be the quintessential crowdfunded venture.[280] Such corporations, once crowdfunded, will retain numerous features prevalent in close corporations. Investors in these ventures are not venture capitalists searching for the next unicorn, but perhaps are investing for personal aesthetics, as do many Packers fans. With this volatile mix of expectations, closeness, and lack of exit, existing oppression doctrine may become a theory upon which intracorporate litigation can emerge. Nonetheless, it is even more difficult to apply than usual,[281] not to mention less justified.

Courts faced with oppression claims from minority shareholders in close-but-crowdfunded ventures without determinative provisions in the charter, bylaws, or stockholder agreement have two options to avoid "untempered application"[282] of oppression doctrine in the crowdfunded venture. First, a court could conclude that the entity is no longer close and require the complaining minority shareholder to assert a claim that could be brought by a public shareholder for director self-dealing or lack of care.[283] This option may be the best for the frozen-out founder or the employee. In such a claim, simply articulating a reasonable expectation of employment along with stock ownership should be insufficient—that is, the act of the directors must be shown to be harmful, unjustified self-dealing, or demonstrating a lack of care that causes more harm to the corporation than would providing a remedy.

Second, even if a court wishes to identify the close-but-crowdfunded corporation as one subject to oppression doctrine, it should greatly circumscribe the range of reasonableness within the reasonable expectations analysis. With a very small number of shareholder-officer-

280. *See* Leaf et al., *supra* note 35 (observing that 8 of the first 50 crowdfund offerings were in the alcoholic beverage industry).

281. As the *Ritchie* court observed, oppression doctrine is a bit difficult to apply in a consistent and certain manner. *See* Ritchie v. Rupe, 443 S.W.3d 856, 889, 890 n.60 (Tex. 2014).

282. *See* Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 663 (Mass. 1976).

283. *Cf. Ritchie*, 443 S.W.3d at 871 (requiring the minority to prove that the majority abused its business judgment in a manner that harmed the corporation); Nixon v. Blackwell, 626 A.2d 1366, 1375–76 (Del. 1993) (applying the entire fairness analysis where the corporation established an ESOP for certain controlling employee-shareholders and not the minority non-employee shareholders). This could also implicate the question of whether such a claim could be direct or derivative.

directors, a court's ability to recreate and evaluate an individual investor's expectations is defensible, if debatable. Furthermore, in these cases, the court can fashion a remedy in a less restrictive manner. Such an approach would not be possible with a group of crowd shareholders with diverging expectations about their investment and the company in which they invested. Articulating any version of a reasonable expectation of a crowd shareholder outside the view of the ordinary public shareholder would serve to frustrate the most valuable purpose of crowdfunding: opening channels for new capital for the formation and expansion of small businesses. Likewise, articulating a reasonable expectation of a founding shareholder-officer-director—perhaps one who voted against crowdfunding altogether—is fraught with the risk of damaging the crowdfunded firm. Finally, while a substantive evaluation of oppression doctrine in its current form is beyond the scope of this article, it is enough to say that the concerns that the court in *Ritchie* articulated are even more acute in the crowdfunding context, where identifying and evaluating the determinative facts about the relationship between and among the founders and the crowd is even more complicated than in a corporation with only three or four players.[284]

To be sure, as it has been throughout the life of oppression doctrine, some wrongs may be left without a remedy. But, overall, discovering the full potential of crowdfunding as an investment mechanism should result in gains that are worth this cost.

V. CONCLUSION

Equity crowdfunding is just one part of a larger trend of experimentation and disruption brought about by technological innovation in the financial space. New technologies are driving new modes of finance for businesses of all shapes and sizes at a feverish pace across the United States and the world. This article represents an early effort at addressing the myriad of corporate governance issues that likely will percolate through courts as crowdfunded ventures become more common.

One likely place to find tension from the emergence of equity crowdfunding is in the relatively small corporation with relatively few founding shareholders—some or all of which may also be directors, officers, and employees. Courts in many jurisdictions provide special protections to non-controlling shareholders in close corporations to shield them from the harsh outcomes of many intracorporate disputes. Two primary justifications underlie these doctrines. First, history and the

284. *See Ritchie*, 443 S.W.3d at 889, 890 n.60 (noting the difficulty in applying oppression doctrine even within its traditional context); *supra* Section IV.C & D.

experience of small business disputes suggest that personal or family relationships among the principal actors in a business often result in minority shareholders relying on trust instead of explicit contractual protections, not to mention forgoing the expense of hiring lawyers to negotiate such protections during the business's planning phase. Second, in the absence of such contracting and the sophistication it suggests, courts can fairly infer that a minority shareholder has reasonable, but not contracted for, expectations of financial or managerial participation in the business based upon the course of the parties' dealings with one another, and that it is appropriate for courts to give those expectations effect through its equitable powers.

Once such a small business uses equity crowdfunding, the justifications for these protections become questionable. First, the mechanics of the crowdfunding process create both the incentive and opportunity for the founders to contract for whatever terms they believe best protect themselves and their business, and to decide upon what terms they will offer equity to the crowd. Second, and similarly, the crowdfunding process undermines the inference that there are unwritten, yet reasonable, expectations about any shareholder's role in the venture. Moreover, the heterogeneous and sometimes contradictory expectations crowd shareholders may have regarding their participation in the venture can further cloud the question of whether any given set of shareholder expectations is reasonable. In combination with the lack of exit or voice already prevalent in close corporations, similar iniquities in close-but-crowdfunded firms might lead to judicial skepticism of the sort that gave rise to the existing division in treatment of public and close corporations.

To resolve the tension created by equity crowdfunding, courts should apply the contract-focused approach exemplified in Delaware's rejection of oppression doctrine. Requiring all parties to bargain and contract for minority protections and other governance matters is a superior solution to the unique issues presented by close-but-crowdfunded firms, as well as any issues that are common to ordinary close corporations and crowdfunded close corporations. Using this approach instead of the equitable reasoning underlying oppression doctrine provides the flexibility needed to accommodate the heterogeneous expectations emerging with crowdfunding and financial technology more broadly. Crowds that invest in small ventures are still big—thus, big crowds in small ventures should be analyzed more like the big crowds that invest in big ventures.

The Big Crowd and the Small Enterprise: Intracorporate Disputes in the Close-But-Crowdfunded Firm, by Martin Edwards, published in the Penn State Law Review, 122 Penn. St. L. Rev. 411 (2018).