SHAREHOLDERS ARE NOT FIDUCIARIES: A POSITIVE AND NORMATIVE ANALYSIS OF KENTUCKY LAW

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This Article considers a seemingly simple question—is the statement "shareholders in a Kentucky business corporation stand in a fiduciary relationship with one another" an accurate statement of the law? In fact, it is not. As is detailed herein, as a matter of positive law, (i) no Kentucky court has held there to be a fiduciary relationship among shareholders save in one narrow fact situation, and that decision may now be invalid consequent to intervening developments in the controlling statute, and (ii) the absence of a statutory inter-shareholder duty in the Business Corporation Act, when compared to the presence of inter-owner fiduciary duties in Kentucky's other business organization statutes, must evidence the absence of such obligations. Turning to a normative analysis, the absence of inter-shareholder fiduciary obligations is correct as: (i) the inter-shareholder relationship lacks the features of a fiduciary relationship; (ii) the imposition of fiduciary duties among shareholders would violate the statutory construct of majority control of the corporate enterprise; (iii) the existence of such duties would do violence to a consistent form in which, by statute, fiduciary obligations are imposed upon only those charged with the day-to-day management of the venture; and (iv) there are a variety of alternative structures in which, if desired, inter-owner fiduciary duties do exist. This Article concludes with a review of how perceived cases of oppression may be addressed through contractual (as contrasted with fiduciary) remedies.

By design this discussion is limited. Not considered herein are the fiduciary duties owed by the directors and officers of a corporation and to whom those duties are owed.[1] Additionally, this analysis is restricted to

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[1] Those issues are addressed in Rutheford B. Campbell, Jr., *Corporate Fiduciary Duties in Kentucky*, 93 KY. L.J. 551 (2004), and Thomas E. Rutledge, Is the Statutory Fiduciary Duty of Corporate Directors Exclusive? 1–2 (June 26, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2064923.

Kentucky law. That certain other states have come to different conclusions as to this question is acknowledged, but is ultimately of no import.[2]

I. SHAREHOLDERS ARE NOT FIDUCIARIES VIS-À-VIS ONE ANOTHER: A POSITIVE ANALYSIS

This Article will initially consider the admittedly limited but largely consistent case law of Kentucky addressing whether or not shareholders qua shareholders stand in a fiduciary relationship with one another.[3] In the course of that review the continuing viability of the *Kaye Elevator*[4] decision, holding that a duty exists in the context of a sale of the corporation's assets, will be examined against subsequent statutory developments in dissenters' rights and the exclusivity of that remedy. Having considered the decisional law as to this question, our attention will turn to a comparison of the Business Corporation Act and the statutes governing other organizational options. In that those other forms expressly address, and generally affirmatively impose, inter-owner fiduciary duties, this Article posits that the absence of such provisions in corporate law indicates an affirmative absence of such obligations.

Corporations are creatures of statute.[5] The creation of a jural entity endowed with perpetual existence,[6] the capacity to take title to property,[7]

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[2] Various states, an example being Massachusetts, impose fiduciary duties among the shareholders or from the majority shareholders to the minority. *See generally* 2 F. HODGE O'NEAL ET AL., O'NEAL AND THOMPSON'S CLOSE CORPORATIONS AND LLCS: LAW AND PRACTICE § 9.21 (3d ed. 2009). Kentucky, in contrast, has never adopted such a rule and has rejected the opportunity to do so. Some might argue that, in light of the actions taken by those other states, Kentucky should adopt a similar rule. Setting aside the adage that "[a] foolish consistency is the hobgoblin of little minds," based upon the normative analysis set forth in the second half of this Article, those other states would be well served to adopt the rule as it exists in Kentucky. 2 RALPH WALDO EMERSON, *Self-Reliance*, *in* THE COLLECTED WORKS OF RALPH WALDO EMERSON 33 (1979).

[3] By and large, this Article refers to the shareholders vis-à-vis one another without drawing distinctions between a minority shareholder (or a group of shareholders collectively constituting a minority position) and a majority shareholder (or a group of shareholders collectively constituting a majority position). In the absence of a fiduciary relationship, as is the case here demonstrated, there is no need to define who is burdened by and who is the beneficiary of the fiduciary obligation. Note, however, that the burden and benefit would not necessarily follow the majority-versus-minority format. For example, if shareholders stand in a fiduciary relationship with one another, might not a minority shareholder's exercise of a veto or blocking right be a breach of duty?

[4] Kaye v. Kentucky Pub. Elevator Co., 175 S.W.2d 142, 144–45 (Ky. 1943).

[5] *See, e.g.*, KY. REV. STAT. ANN. § 271B.17-050(1) (West, Westlaw through 2012 legislation). It is only through filing articles of incorporation in accordance with the statute that a corporation may be organized; Kentucky does not recognize a "common law" or "de facto" corporation. *Id.* § 271B.2-030(1).

[6] *Id.* § 271B.3-020(1).

[7] *Id.* § 271B.3-020(1)(d).

enter into contracts,[8] and sue and be sued in its own name,[9] is an act of the sovereign, as is the determination that the owners (shareholders) of that jural organization are not by virtue of their owner status liable for its debts and obligations.[10] As such, corporations are governed first by the enabling statute and only thereafter by the common law; to the extent that the statute imposes a particular rule, it supplants any common law to the contrary.[11] This is particularly the case in Kentucky, where Section 190 of the Commonwealth's Constitution, adopted in 2002, provides:

> Except as otherwise provided by the Constitution of Kentucky, the General Assembly shall, by general laws only, provide for the formation, organization, and regulation of corporations. Except as otherwise provided by the Constitution of Kentucky, the General Assembly shall also, by general laws only, prescribe the powers, rights, duties, and liabilities of corporations and the powers, rights, duties, and liabilities of their officers and stockholders or members.[12]

While ultimately the statutes must control over any contrary common law, our consideration of the issue at hand begins with a review of the sparse case law addressing the existence (or not) of fiduciary duties *inter se* the shareholders, from there turning to the statutory law.

A. The Kentucky Cases

Haldeman v. Haldeman[13] is a classic decision setting forth an exhaustive discussion of the different roles played by the board of directors and the shareholders within the corporate construct. After discussing the obligation of the board to look out for the best interests of the venture, the court contrasted the very different role of the shareholders:

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[8] *Id.* § 271B.3-020(1)(g).

[9] *Id.* § 271B.3-020(1)(a).

[10] *Id.* § 271B.6-220(2).

[11] *See* Willis v. Louisville/Jefferson Cnty. Metro. Sewer Dist., No. 2009-CA-001874-MR, 2010 Ky. App. LEXIS 198, at *19 (Ky. Ct. App. Oct. 22, 2010) ("We are ever mindful that the 'judicially created common law must always yield to the superior policy of legislative enactment and the Constitution.'" (quoting Commonwealth *ex rel.* Cowan v. Wilkinson, 828 S.W.2d 610, 614 (Ky. 1992))); *see also* Haldeman v. Haldeman, 197 S.W. 376, 380 (Ky. 1917) ("These two corporations owe their existence to these statutory enactments, and are, of necessity, controlled by them. Clearly, if the law as declared by the Legislature is to control, a personal agreement between three of the stockholders providing for a control directly in conflict with the method pointed out by the statute can avail nothing.").

[12] KY. CONST. § 190.

[13] *Haldeman*, 197 S.W. at 376.

> A stockholder occupies a position and owes a duty radically different from a director. A stockholder may in a stockholders' meeting vote with the view of his own benefit; he represents himself only.[14]

A generation later, the directions of *Haldeman* were affirmed by the Kentucky Court of Appeals in *Kirwan v. Parkway Distillery*:

> In the case of *Haldeman v. Haldeman*, it is pointed out that there is a radical difference when a stockholder is voting strictly as a stockholder and when voting as a director. When voting as a stockholder he has the legal right to vote with a view of his own benefits and is representing himself only . . . . "At such a meeting each shareholder represents himself and his own interest, and he in no sense acts as the representative of others."[15]

This viewpoint, namely that there is a marked distinction between the fiduciary role of the directors and the non-fiduciary role of the shareholders, is entirely consistent with the commentary of the time.[16]

Only two years after *Kirwan* and its endorsement of *Haldeman*, the Court of Appeals, in *Kaye v. Kentucky Public Elevator Co*.,[17] found there to be, in the limited fact pattern of a sale by a corporation of all of its assets followed by a dissolution, a fiduciary duty from the majority shareholder to the minority shareholder.[18] There are, as to the *Kaye* decision, at least three interesting points addressing the question here under consideration. First, it is a narrow holding, expressly limited to asset sales followed by liquidation.[19] Second, the language as to the existence of duties is best read as dicta in that the court determined that there were not facts sufficient to undertake an inquiry as to the propriety of the sale at issue.[20] Third, and most crucial to the matter here under consideration, in light of subsequent

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[14] *Id.* at 381.

[15] Kirwan v. Parkway Distillery, 148 S.W.2d 720, 723 (Ky. 1941) (citation omitted) (quoting Windmuller v. Standard Distilling & Distrib. Co., 114 F. 491, 495 (N.J. Cir. Ct. 1902)).

[16] *See, e.g.*, HOWARD HILTON SPELLMAN, A TREATISE ON THE PRINCIPLES OF LAW GOVERNING CORPORATE DIRECTORS 53–54 (1931) ("Since the right to vote is inherent in the ownership of stock, a stockholder cannot be prevented from voting, upon the theory that he will use his vote to further his selfish interests, against the general corporate welfare.").

[17] Kaye v. Kentucky Pub. Elevator Co., 175 S.W.2d 142 (Ky. 1943).

[18] *Id.* at 143–45 ("There is no doubt that holders of a majority of the stock in a corporation in selling all its property and dissolving it owe the duty of exercising diligence and good faith to the minority to obtain the largest amount possible and to protect their interests. . . . In such matters the majority stockholders and the directors will not be permitted to further their own selfish interests to the detriment of the minority.") (citations omitted).

[19] *See id.*

[20] *See id.* at 145.

developments in Kentucky's statutory law of corporations, and in particular the exclusivity of the dissenters' rights remedy, *Kaye* certainly has been in part, and may well have been in its entirety, overridden.[21]

The *Haldeman*/*Kirwan* rule, possibly qualified by *Kaye*, remained the only direction on the topic[22] until the Court of Appeals again visited it in *Estep v. Werner*.[23] Therein the court considered whether there was a breach of fiduciary duty, purported to be owed by the majority shareholder to the minority, occasioned by the termination of the minority shareholder's employment with the corporation.[24] Ultimately the court determined there was no need to reach the question because the majority shareholder's employment with the corporation was also terminated.[25] However, and tellingly for our purposes, Justice Leibson, writing in dissent, lamented that Kentucky was not adopting the rule of *Donahue v. Rodd Electrotype Co. of New England, Inc*.[26] that, in closely held corporations, shareholders should be deemed to stand in a fiduciary relationship with another.[27] At least Justice Leibson was of the view that the law in Kentucky was that shareholders did not stand in a fiduciary relationship with one another, and he wanted that state of affairs changed.[28] Where the common law had been that shareholders may act in a self-interested manner,[29] he desired a rule that shareholders "may not act out of . . . self-interest . . . ."[30] The majority of the Kentucky Supreme Court rejected the opportunity to so alter the law.[31]

Almost a decade after *Estep*, a shareholder in a professional-service corporation, Dahlenburg, argued that shareholders, like partners, should as to one another stand in a fiduciary relationship, a position squarely rejected by the Court of Appeals:

> Dr. Dahlenburg knew or should have known he was joining a Personal Service Corporation (P.S.C.) as an at-will employee and later a shareholder. His rights and duties are clearly set out in his employment agreement, other applicable corporate documents and the Kentucky

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[21] *See infra* notes 45–47 and accompanying text.

[22] Or at least the only published direction; unpublished rulings on the topic may well have been issued, but they are, at least as of today, unavailable to us.

[23] Estep v. Werner, 780 S.W.2d 604, 605–06 (Ky. 1989).

[24] *Id.*

[25] *Id.* at 607.

[26] Donahue v. Rodd Electrotype Co. of New Eng., 328 N.E.2d 505, 512 (Mass. 1975).

[27] *Estep*, 780 S.W.2d at 609 (Leibson, J., dissenting).

[28] *Id.*

[29] *See generally* Kirwan v. Parkway Distillery, 148 S.W.2d 720 (Ky. 1941); Haldeman v. Haldeman, 197 S.W. 376 (Ky. 1917).

[30] *Estep*, 780 S.W.2d at 609 (quoting *Donahue*, 328 N.E.2d at 515).

[31] *Id.* at 606–07.

> Revised Statues. Dr. Dahlenburg argues that shareholders in a closely-held corporation are analogous to partners. He reasons that because partners have fiduciary duties to each other—shareholders in a closely-held corporation should likewise have the same fiduciary duties. *We disagree*.[32]

Most recently, in *Vinson v. Koerner*,[33] the Court of Appeals discussed the existence of inter-shareholder fiduciary obligations and the import of Justice Leibson's dissent in *Estep v. Werner*, as well as the refusal of the Supreme Court to adopt his proposal as to that issue. As to the existence of the duties, the *Vinson* court wrote:

> Vinson has not cited controlling Kentucky statutory or case law which impose a fiduciary duty between shareholders in a closely-held corporation. These duties which are recognized by law create liability upon corporate directors or officers *to the corporation*, not individual directors, officers, or shareholders.[34]

Turning then to Justice Leibson's dissent in *Estep*, the *Vinson* court wrote:

> While the issue of whether one shareholder in a closely-held corporation may bring a direct cause of action against another shareholder for a violation of a duty owed by one shareholder to another was not definitively resolved by the Kentucky Supreme Court in *Estep*, nevertheless, in light of the rejection of Justice Leibson's position proposed in his dissent, we must reject Vinson's invitation to adopt it now.[35]

Clearly the Court of Appeals did not believe itself competent to, in effect, adopt Justice Leibson's *Estep* dissent and find that shareholders stand in a fiduciary relationship with one another.

Another decision, *Krebs v. McDonald's Ex'x*,[36] does need to be considered, but it may be addressed out of order in this otherwise chronological discussion, as it does not actually address fiduciary duties

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[32] Dahlenburg v. Young, Nos. 96-CA-0443-MR, 96-CA-0550-MR, 1998 Ky. App. Unpub. LEXIS 1, at *4 (Ky. Ct. App. Mar. 20, 1998) (emphasis added). That same court went on to observe that "Dr. Dahlenburg [could not] cite any controlling Kentucky statutory or case law imposing a fiduciary duty between shareholders in a closely-held corporation." *Id.* at *4.

[33] Vinson v. Koerner, No. 2000-CA-001217-MR, slip op. (Ky. Ct. App. Nov. 9, 2001).

[34] *Id.* at 7 (emphasis in original).

[35] *Id.* at 9.

[36] Krebs v. McDonald's Ex'x, 266 S.W.2d 87 (Ky. 1953).

among shareholders. This case, involving the enforcement of the terms of a shareholder buy-sell agreement, contains the throw-away line, "The shareholders in closely held corporations bear a personal relationship to one another similar to that of a partnership," a statement that some have interpreted as indicating the existence of fiduciary duties among shareholders.[37] In fact it does not indicate such, as is evident when the court's entire statement is read in full:

> The shareholders in closely held corporations bear a personal relationship to one another similar to that of a partnership and, as a consequence, the shares in such corporations signify more than a mere property interest.[38]

The decision goes on to explain why, in closely held corporations, shareholder buy-sell agreements are often utilized. A buy-sell is not needed in a partnership, as (i) the right to participate in management is not freely assignable,[39] thereby relieving the partners of concern as to who might gain voting rights in the partnership, and (ii) upon dissociation, the partnership undergoes a dissolution and the withdrawing partner is able to liquidate his or her interest,[40] thereby relieving a partner of concerns as to liquidity. The *Krebs* decision nowhere suggests that shareholders in a closely held corporation stand in a fiduciary relationship with one another; in fact, the term "fiduciary" does not appear in the decision.[41]

At this point we find the state of Kentucky's decisional law to be: (i) no case holding, as a general proposition, that shareholders stand in a fiduciary relationship with one another; (ii) a single decision holding that in the context of a corporate asset sale followed by dissolution the majority shareholder owes a duty to the minority; (iii) several decisions recognizing the right of individual shareholders to vote in a self-interested manner; and (iv) at least a trio of decisions affirmatively rejecting the opportunity to impose fiduciary obligations among shareholders.[42]

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[37] *Id.* at 89.

[38] *Id.*

[39] *See* KY. REV. STAT. ANN. § 362.280(1) (West, Westlaw through 2012 legislation); *see also id.* § 362.1-503(1)(c).

[40] *See id.* § 362.355. This statute reflects the law as it existed at the time of the *Krebs* decision. Under the modern partnership law, a partner's dissociation does not necessarily dissolve the partnership, but the dissociating partner is entitled to the "buyout value" of his or her interest in the partnership. *See id.* § 362.1-701; *see also* THOMAS E. RUTLEDGE & ALLAN W. VESTAL, RUTLEDGE & VESTAL ON KENTUCKY PARTNERSHIPS AND LIMITED PARTNERSHIPS § 2.8 (2010).

[41] Even were *Krebs* to have said that the relationship of shareholders, based upon a partnership model, was fiduciary in nature, the decision has fallen to a subsequent statutory provision. *See infra* notes 48–50 and accompanying text.

[42] That shareholders are permitted to vote in a self-interested manner is proven as well by the

Obviously the single departure from an otherwise consistent chorus of "no fiduciary duties between shareholders" decisions is *Kaye v. Kentucky Public Elevator Co*.[43] It bears noting, however, that the *Kaye* decision's continuing viability as good law is significantly in doubt. Initially, *Kaye* is a very limited decision, finding inter-shareholder fiduciary obligations in the context of a sale of corporate assets.[44] Under the law as it exists today, in the context of almost any asset sale, a minority shareholder dissatisfied with the terms of the transaction may exercise dissenter rights.[45] With respect to a sale transaction as to which the shareholder may exercise dissenter rights, and absent extraordinary circumstances, those dissenter rights are the minority shareholder's exclusive remedy, and the shareholder may not as well challenge the transaction.[46] In the current regime, in which the General Assembly has exclusively defined the remedy available to a minority shareholder in the context of an asset sale, *Kaye*'s holding that fiduciary duties should in that context attach[47] is no longer good law.

B. The Kentucky Statutes

Turning from Kentucky's decisional law, we now focus upon whether the imposition of fiduciary duties among shareholders is dictated by statute. In light of the fact that the General Assembly is clearly well aware of the mechanisms by which such duties may be imposed, and its election not to

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requirement that in certain instances a shareholder is required to abstain from participation in a vote where he or she might otherwise consent to an action that furthers his or her individual interests as a director. *See* KY. REV. STAT. ANN. § 271B.8-310(4) (West, Westlaw through 2012 legislation).

[43] Kaye v. Kentucky Pub. Elevator Co., 175 S.W.2d 142 (Ky. 1943).

[44] *Id.* at 145 (noting the existence of inter-shareholder fiduciary obligations "in selling all of [a corporation's] property and dissolving it").

[45] *See* KY. REV. STAT. ANN. § 271B.13-020(1)(c) (West, Westlaw through 2012 legislation) ("A shareholder shall be entitled to dissent from, and obtain payment of the fair value of his shares in the event of . . . [c]onsummation of a sale or exchange of all, or substantially all, of the property of the corporation other than in the usual and regular course of business . . . ."). The only time a shareholder is not permitted to exercise dissenter rights from an asset sale is a sale upon which he or she does not have the right to vote, when the sale is pursuant to court order, or when the sale is pursuant to a plan by which the cash proceeds will be distributed to all shareholders within a year of the sale. *See id.* § 271B.12-020 (defining when shareholders have the right to vote on a sale of assets). Even then a right to dissent may be created by the articles of incorporation, the by-laws, or board resolution. *See id.* § 271B.13-020(1)(g).

[46] *See id.* § 271B.13-020(2). As explained in the official commentary released in connection with the 1988 adoption of KRS Chapter 271B, this provision was intended to reduce to statute what had been the case law regarding the exclusivity of the dissenter rights remedy. *See* Keith G. Hanley & Alan K. MacDonald, *Revised Model Business Corporation Act: Kentucky Updates Its Corporation Statutes* at 12, *printed in* 1988 Kentucky Acts; *see also* Yeager v. Paul Semonin Co., 691 S.W.2d 227, 228–29 (Ky. Ct. App. 1985) (minority shareholders objecting to terms of freeze-out merger are restricted to exercise of dissenter rights as their sole remedy).

[47] *Kaye*, 175 S.W.2d at 145.

do so, it must be concluded that the General Assembly has rejected inter-shareholder fiduciary duties.

1. By Statute, Partnership Law Does Not Apply to Corporations

The General Assembly has rejected the notion of applying partnership law to corporations. Both the Kentucky Uniform Partnership Act and the Kentucky Revised Uniform Partnership Act (2006) provide that partnership law does not apply to business structures formed under other statutes.[48] In that the General Assembly has rejected the application of partnership law in the context of a corporation, principles of partnership law, including the imposition of partner-like fiduciary obligations among the shareholders, have also been rejected. The *Krebs* decision, rendered in 1953, predated by a year Kentucky's adoption of the Uniform Partnership Act[49] and the statutory dictate that partnership law does not apply to, *inter alia*, corporations. Therefore, even if *Krebs* did seek to hold shareholders to the same fiduciary duties by which partners are bound, that holding has been superseded by statute.[50]

2. Where Inter-Owner Fiduciary Duties Are Desired, the General Assembly Knows How to So Provide

The Business Corporation Act[51] is silent as to inter-shareholder fiduciary duties. When contrasted with Kentucky's other business organization statutes, this silence speaks volumes.

Kentucky's business entity statutes provide, in numerous instances, for fiduciary duties owed by an owner. By statute, the partners in a partnership owe fiduciary duties.[52] By statute, the general partners in a limited partnership owe fiduciary duties.[53] By statute, the members in a member-managed limited liability company owe fiduciary duties.[54] There can be no

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[48] *See* KY. REV. STAT. ANN. § 362.175(2) (West, Westlaw through 2012 legislation) (providing that "any association formed under any other statute of this state . . . is not a partnership"); *id.* § 362.1-202(2) ("An association formed under a statute other than this subchapter, a predecessor statute, or a comparable statute of another jurisdiction is not a partnership under this subchapter.").

[49] *See* 1954 Ky. Acts ch. 34.

[50] *Id.*; *see generally* Krebs v. McDonald's Ex'x, 266 S.W.2d 87 (Ky. 1953).

[51] *See* KY. REV. STAT. ANN. § 271B.1-010 (West, Westlaw through 2012 legislation).

[52] *See id.* § 362.250(1); *id.* § 362.1-404(1) (establishing the fiduciary duties owed by partners to one another and the partnership).

[53] *See id.* § 362.250(1); *id.* § 362.447; *id.* § 362.2-408 (establishing the fiduciary duties owed by a general partner to a limited partnership and other partners).

[54] *See id.* § 275.170(1)–(2). Such determinations of fiduciary status are not restricted to the law of business organizations. *See, e.g.*, 201 KY. ADMIN. REGS. 11:121(1)(4)(e) (2012) (reciting the "fiduciary

question that the General Assembly is well aware of the statutory mechanism for defining owners qua owners as bearing fiduciary obligations. In the context of the corporation, be it for profit or nonprofit, the General Assembly, by statute, has provided that the directors and officers owe fiduciary duties.[55] The General Assembly has not defined shareholders qua shareholders as owing fiduciary duties. There are certainly models for statutory inter-shareholder fiduciary duties to which the General Assembly (and the drafters of Kentucky's corporate laws) could look and adopt as the law of Kentucky; [56] it has not done so. Having by statute defined the class of persons owing fiduciary obligations, and having not so defined shareholders, the statute "acts to exclude other unmentioned classes by application of the legal maxim of statutory construction, '*expressio unius est exclusio alterius*,' which means that the inclusion of specific things implies the exclusion of those not mentioned."[57]

The General Assembly has expressly rejected the application of partnership law *inter se* business organizations formed under other organizational statutes.[58] Within the corporate context the statutes clearly define a class of persons, namely directors and officers, who are bound by fiduciary duties.[59] Those same statutes make no mention of fiduciary obligations among shareholders even as other entity statutes passed by the General Assembly expressly and affirmatively address the topic in those other organizational forms. Only one conclusion is possible: The statutory scheme does not contemplate fiduciary duties among shareholders.[60]

In the absence of an affirmative imposition by statute of inter-shareholder fiduciary obligations, the question of their existence should be considered against other aspects of positive corporate law. Essentially, this aspect of the inquiry focuses upon whether the structure of corporate law

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duties" owed by a real estate agent to clients).

[55] *See id.* § 271B.8-300(1)(a)–(c); *id.* § 271B.8-420(1)(a)–(c); *id.* § 273.215(1)(a)–(c); *id.* § 273.229(1)(a)–(c).

[56] *See, e.g.*, MINN. STAT. § 302A.751(1)(a)(3) (West, Westlaw through 2012 Regular Session chapter 10); *id.* § 302A.751(3)(a); N.J. STAT. ANN. § 14A:12-7(1)(c) (West, Westlaw through L.2013, c. 35 and J.R. No. 2); N.D. CENT. CODE § 10-19.1-115(1)(b)(3) (West, Westlaw through 2011 regular and special sessions); *see also* N.Y. BUS. CORP. LAW. § 1104-a (West, Westlaw through L.2013, chapter 6) (allowing a petition for corporate dissolution to be filed by a minority shareholder or shareholders holding 20% or more of the stock on the basis of "oppressive" conduct by "those in control of the corporation"; no such provisions have been added to the Kentucky Business Corporation Act).

[57] Willis v. Louisville/Jefferson Cnty. Metro. Sewer Dist., No. 2009-CA-001874-MR, 2010 Ky. App. LEXIS 198, at *19 (Ky. Ct. App. Oct. 22, 2010) (citing Fiscal Court of Jefferson Cnty. v. Brady, 885 S.W.2d 681, 685 (Ky. 1994)).

[58] *See supra* note 48 and accompanying text.

[59] *See* KY. REV. STAT. ANN. § 271B.8-300(1)(a)–(c) (West, Westlaw through 2012 legislation); *id.* § 271B.8-420(1)(a)–(c); *id.* § 273.215(1)(a)–(c); *id.* § 273.229(1)(a)–(c).

[60] *See supra* note 42 and accompanying text.

would be violated were shareholders held to stand in a fiduciary relationship with one another. There would in fact be such violation, lending further support to the conclusion that shareholders are not in a fiduciary relationship with one another.

3. Inter-Shareholder Fiduciary Obligations Would Overturn the Statutory Rule of Majority Control

Under the corporate form the majority controls, a rule recognized in Kentucky as long ago as 1873. "Each and every stockholder contracts that the will of the majority shall govern in all matters coming within the limits of the act of incorporation . . . ."[61]

A simple majority of the shareholders may amend the articles of incorporation or the bylaws, approve a merger, or approve the corporation's voluntary dissolution.[62] In 2002 the Kentucky General Assembly recommended to the voters, and the voters approved, an amendment to the Kentucky Constitution deleting a provision requiring cumulative voting, a provision that had the effect of enhancing the ability of minority shareholders to gain board representation.[63] In place of the prior statute requiring cumulative voting the General Assembly substituted a provision allowing the entirety of the board to be elected by a plurality of the shareholders.[64] These alterations in the law evidence a movement away from a requirement of minority-shareholder participation in the control of the corporation.

The statute dictates that decisions as to the activities of the corporation, when vested in the shareholders, are made by a majority. Justice Leibson, in his dissent in *Estep v. Werner*, sought adoption of a fiduciary rule, namely that shareholders "may not act out of . . . self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation."[65] A rule requiring the majority to treat the minority as the beneficiary of a fiduciary obligation would turn the statutory rule on its head, in effect

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[61] Dudley v. Kentucky High Sch., 72 Ky. (9 Bush) 576, 578 (Ky. 1873).

[62] KY. REV. STAT. ANN. § 271B.10-030(5) (West, Westlaw through 2012 legislation) (majority of shares may amend articles of organization); *id.* § 271B.11-030(5) (majority of shares may approve a merger); *id.* § 271B.14-020(5) (majority of shares may approve voluntary dissolution of the corporation).

[63] 2002 Ky. Acts ch. 341.

[64] KY. REV. STAT. ANN. § 271B.7-280(1) (West, Westlaw through 2012 legislation) (board of directors elected by plurality of votes cast); *see also* Cynthia Young, *Modernizing Kentucky's Corporate Laws*, BENCH & BAR, May 2003, at 12, 15.

[65] Estep v. Werner, 780 S.W.2d 604, 609 (Ky. 1989) (Leibson, J., dissenting) (quoting Donahue v. Rodd Electrotype Co. of New Eng., 328 N.E.2d 505, 515 (Mass. 1975)).

affording the minority control of the corporation. As such, the fact that the statutes conclusively vest control in the majority of the shareholders evidences the absence of an inter-shareholder fiduciary obligation.

4. Fiduciary Burdens Follow the Right to Manage the Business and Affairs of the Venture

As a consistent statutory construct, where the owners of the venture, in their capacity as owners, manage and control its business and affairs, those owners, as owners, bear fiduciary obligations. Where, in contrast, management of the venture is delegated to persons other than owners as owners, the owners do not bear fiduciary obligations, and those with management authority do have fiduciary duties.[66] In that management of the business and affairs of a corporation are vested not in the shareholders but rather in the board of directors,[67] it follows that shareholders are not burdened with fiduciary obligations.[68]

The management and affairs of both a partnership and a limited partnership are vested in the general partners.[69] Under the statutes governing general partnerships, the partners in a partnership govern, as owners, the partnership[70] and owe fiduciary duties.[71] Likewise, under the statutes governing limited partnerships, the general partners in a limited partnership govern, as owners, the limited partnership[72] and owe fiduciary

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[66] *See, e.g.*, KY. REV. STAT. ANN. § 275.170(4) (West, Westlaw through 2012 legislation).

[67] *Id.* § 271B.8-010(2).

[68] To that end, Kentucky law is clear that a corporate officer or director (each being a fiduciary) is precluded from competing with the corporation. *See*, *e.g.*, Steelvest, Inc. v. Scansteel Serv. Ctr., Inc., 807 S.W.2d 476, 483 (Ky. 1991); Stewart v. Kentucky Paving Co., 557 S.W.2d 435, 437–39 (Ky. Ct. App. 1977); Aero Drapery of Ky., Inc. v. Engdahl, 507 S.W.2d 166, 168–70 (Ky. 1974). At the same time, shareholders are permitted to compete with the corporation. *See* Bennett v. Mack's Supermarkets, Inc., 602 S.W.2d 143, 147 (Ky. 1979) ("[T]here is no authority which holds that a shareholder cannot legitimately be involved in a business which competes with the corporation."); *see also* Keeneland Ass'n v. Pessin, 484 S.W.2d 849, 852 (Ky. 1972). As competition and a fiduciary relationship are mutually exclusive, and as shareholders may compete, it follows that shareholders are not fiduciaries.

[69] *See, e.g.*, KY. REV. STAT. ANN. § 362.2-406 (West, Westlaw through 2012 legislation).

[70] *Id.* § 362.235(5) ("All partners have equal rights in the management and conduct of the partnership business."); *id.* § 362.1-401(6) ("Each partner has equal rights in the management and conduct of the partnership business.").

[71] *See id.* § 362.250(1); *id.* § 362.1-404(1) (setting forth the fiduciary duties owed by a partner to the partnership and other partners).

[72] *Id.* § 362.235(5) ("All partners have equal rights in the management and conduct of the partnership business."); *id.* § 362.437 (providing, *inter alia*, that a limited partner who is active in the management of the limited partnership will be treated as a general partner); *id.* § 362.2-302 ("A limited partner does not have the right or the power as a limited partner to act for or bind the partnership."); *id.* § 362.2-406(1) ("Each general partner has equal rights in the management and conduct of the limited partnership's activities.").

duties.[73] As detailed in the Kentucky Uniform Limited Partnership Act (2006), limited partners do not owe fiduciary obligations.[74]

A limited liability company ("LLC") organized under Kentucky law may have one of two statutorily defined structures for its management. Every LLC must elect, in its articles of organization, whether to be managed by its members or managed by managers.[75] Where the election is that the LLC will be managed by its members, they, qua owners of the venture, govern the LLC.[76] In so acting, the members are bound by the statutorily defined fiduciary duties.[77]

In contrast, where management of the business and affairs of the venture is vested in a group or body other than the owners qua owners, it is that management group or body that is by statute expressly burdened by fiduciary obligations. By statute, the members in a manager-managed limited liability company do not govern the LLC[78] and do not owe fiduciary duties.[79] Rather, the LLC is managed by the managers,[80] and they owe fiduciary duties.[81] This absence of fiduciary obligations upon the members in a manager-managed LLC applies even as the members retain the authority to approve organic transactions such as amendment of the operating agreement or a merger.[82] In the limited partnership we see an express statement that one who is a limited partner is not by reason thereof bound by fiduciary obligations.[83] This provision exists in order to avoid an overbroad application of KRS 362.2-102(16), defining a "partner" as being

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[73] *See id.* § 362.250(1); *id.* § 362.447; *id.* § 362.2-408 (setting forth the fiduciary duties owed by a general partner to a limited partnership and other partners).

[74] *Id.* § 362.2-305(1).

[75] *See id.* § 275.025(1)(d); *see also* Thomas E. Rutledge, *A Positive Law Election*, *in* LIMITED LIABILITY COMPANIES IN KENTUCKY 108 (Scott Dolson ed., 2011).

[76] KY. REV. STAT. ANN. § 275.165(1) (West, Westlaw through 2012 legislation) ("Unless the articles of organization vest management of the [LLC] in a manager or managers, management of the business and affairs of the [LLC] shall vest in the members.").

[77] *See id.* § 275.170(1)–(2) (reciting duty of care and duty of loyalty).

[78] *Id.* § 275.165(2) ("If the articles of organization vest management of the [LLC] in one (1) or more managers, . . . the manager or managers shall have exclusive power to manage the business and affairs of the [LLC].").

[79] *See id.* § 275.170(4) ("A member of a limited liability company in which management is vested in managers under KRS 275.165(2) and who is not a manager shall have no duties to the limited liability company or the other members solely by reason of acting in his or her capacity as a member."); *see also* Thomas E. Rutledge & Thomas Earl Geu, *The Analytic Protocol for the Duty of Loyalty Under the Prototype LLC Act*, 63 ARK. L. REV. 473, 477–81 (2010).

[80] *See* KY. REV. STAT. ANN. § 275.165(2) (West, Westlaw through 2012 legislation).

[81] *Id.* § 275.170(1)–(2) (reciting duty of care and duty of loyalty).

[82] *See id.* § 275.175(2)(a) (majority-in-interest of the members may approve amendment of the operating agreement); *id.* § 275.350(1) (majority-in-interest of the members may approve a merger).

[83] *See id.* § 362.2-305(1).

both a general and a limited partner, [84] and KRS 362.2-408, reciting the fiduciary obligations of the general partners, [85] to the effect that limited partners, in that role, are subject to fiduciary obligations.

Kentucky's two most recent entries in business organization law continue this pattern. A statutory trust organized under the Kentucky Uniform Statutory Trust Act (2006)[86] must be governed by trustees,[87] and those trustees are subject to statutorily defined fiduciary obligations.[88] While the beneficial owners are the ultimate residual owners of the statutory trust and retain authority over material transactions, such as the amendment of the governing instrument or a merger,[89] nowhere is it provided that the beneficial owners are subject to fiduciary obligations. A limited cooperative association formed pursuant to the Kentucky Uniform Limited Cooperative Association Act[90] is governed by a board of directors,[91] and those directors, as directors, are subject to fiduciary duties defined by statute.[92] Even as the ultimate decision as to the approval (or not) of major transactions, such as amendment of the articles of association or approval of a merger, are in the hands of the members,[93] they being the ultimate residual owners of the limited cooperative association, nowhere is it provided that the members are bound by fiduciary obligations.

By statute, the shareholders of a corporation do not manage the corporation. The corporation is managed by the directors,[94] and the directors owe fiduciary duties.[95] Consistent with other business forms that separate ownership and management, in the corporation the shareholders qua shareholders are not bound by fiduciary obligations.

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[84] *Id.* § 362.2-102(16).

[85] See *id.* § 362.2-408, as well as the balance of subchapter 4 of KRS Chapter 362.2, which recites rules applicable only to the general partners.

[86] *See id.* § 386A.1-010.

[87] *Id.* § 386A.5-010(1).

[88] *Id.* § 386A.5-050.

[89] *Id.* § 386A.6-020(1).

[90] *See id.* § 272A.1-010.

[91] *Id.* § 272A.8-010(2).

[92] *Id.* § 272A.8-180.

[93] *Id.* § 272A.4-020; *id.* § 272A.16-050.

[94] *Id.* § 271B.8-010(2) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation.").

[95] *Id.* § 271B.8-300.

C. A Positive Analysis: Conclusion

No published and no available unpublished decision of a Kentucky court has held, as a categorical matter, that shareholders stand in a fiduciary relationship to one another. The one case that has found a duty in a particular fact situation has been at minimum almost entirely superseded by statute.[96] When invited to find fiduciary obligations among shareholders, the recent decisions have not done so. At the same time, although there are models in the laws of the other states and models in other Kentucky business organization statutes for doing so, the Business Corporation Act does not impose fiduciary duties among shareholders, even as it has exhaustively addressed the fiduciary duties owed by directors and officers.[97] Imposition of fiduciary duties among shareholders would also violate the consistent statutory model in which it is those (and only those) charged with the management and affairs of the venture who are bound by fiduciary obligations. The only possible conclusion is that as a matter of positive law shareholders in a Kentucky corporation do not stand in a fiduciary relationship with one another.

II. SHAREHOLDERS ARE NOT VIS-À-VIS ONE ANOTHER FIDUCIARIES: A NORMATIVE ANALYSIS

Against the weight of these authorities to the effect that there is not, in a Kentucky corporation, a fiduciary duty among shareholders (a conclusion from the positive law), a minority shareholder could assert that fiduciary obligations should (a normative argument) bind the majority shareholders consequent to the nature of their relationship in the corporation.[98] These arguments should fail. The relationship among shareholders lacks the hallmarks of a fiduciary relationship, especially an undertaking by the majority shareholder to self-abnegate his or her interests in favor of those of the minority. In addition, in that the characteristics of the partnership and the corporation are so dissimilar, there is not a valid basis for importing into corporate law the fiduciary duties that exist among partners.[99]

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[96] *See supra* notes 45–47 and accompanying text.

[97] *See* KY. REV. STAT. ANN. § 271B.8-300 (West, Westlaw through 2012 legislation); *id.* § 271B.8-420.

[98] Of course, whether any lower court may properly recognize such duties in contravention of the *Estep* decision is open to dispute. *See supra* note 35 and accompanying text.

[99] This normative conclusion is in addition to the positive analysis set forth above regarding the statutory inapplicability of partnership law to the corporation. *See infra* Part II.B.

A. The Inter-Shareholder Relationship Lacks the Hallmarks of a Fiduciary Relationship

A fiduciary relationship begins with a relationship of unequal position, knowledge or skill.

> The [fiduciary] relation[ship] may exist under a variety of circumstances; it exists in all cases where there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence.[100]

It is necessary to ascertain the aspects of the particular relationship to determine whether or not it is fiduciary in nature. As addressed by the Sixth Circuit, applying Kentucky law, in *Sallee v. Fort Knox National Bank*:

> To make out a claim that a fiduciary relationship existed, the party claiming the fiduciary relationship must first show the relationship existed before the transaction that is the subject of the action. Second, the party claiming a fiduciary relationship must show that reliance was not merely subjective. Third, the party claiming a fiduciary relationship must show that the nature of the relationship imposed a duty upon the fiduciary to act in the principal's interest, even if such action were to the detriment of the fiduciary.
>
> As to the second requirement, the party seeking to have a fiduciary relationship recognized must show more than mere subjective trust. An aggrieved party must also show that he trusted the other party to act as a fiduciary and that such trust was reasonable under the circumstances. Only in rare commercial cases is it reasonable to believe the other party will put your interests ahead of their own.[101]

The Kentucky Supreme Court observed:

> A fiduciary, moreover, is one who has expressly undertaken to act for the plaintiff's primary benefit. Although fiduciary relationships can be informal, a fiduciary duty does not arise from the universal business duty to deal fairly nor is it created by a unilateral decision to repose trust and

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[100] Steelvest, Inc. v. Scansteel Serv. Ctr., Inc., 807 S.W.2d 476, 485 (Ky. 1991) (quoting Sec. Trust Co. v. Wilson, 210 S.W.2d 336, 338 (Ky. 1948)).

[101] Sallee v. Fort Knox Nat'l Bank, 286 F.3d 878, 892 (6th Cir. 2002) (citations and footnotes omitted). The quoted language has been subsequently adopted by the Kentucky Court of Appeals. *See* Holmes v. Couch, No. 2007-CA-000445-MR, 2008 WL 2468764, at *7–8 (Ky. Ct. App. June 20, 2008).

> confidence; it derives from the conduct or undertaking of the purported fiduciary.[102]

In particular instances it may be possible, upon the facts there demonstrated,[103] to show that a shareholder stands in a fiduciary relationship with another shareholder, but that argument will be tenable only where these elements of a fiduciary relationship are satisfied. Therefore, it is not enough to say that "a majority shareholder owes a fiduciary duty to a minority shareholder"; as a matter of positive law that statement is erroneous. Rather, the proponent of the fiduciary relationship will need to demonstrate that "based on the particular facts of this situation this shareholder owes a fiduciary duty to that shareholder."[104] In most circumstances, at least one, and likely many, of the elements of a fiduciary relationship, particularly the shareholder accepting an obligation of self-abnegation, will be absent. Another limiting factor will be the requirement that the fiduciary elements predate the co-shareholder relationship.[105] Absent a demonstration that a shareholder undertook to place the interests of another shareholder above his or her own, there is no fiduciary relationship upon which a claim may be based.[106]

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[102] Flegles, Inc. v. TruServ Corp., 289 S.W.3d 544, 552 (Ky. 2009) (citations omitted); *see also Sallee*, 286 F.3d at 892.

[103] The burden of showing the existence of a fiduciary relationship rests upon the party asserting its existence.

[104] Of course, even where that burden is satisfied, it will remain the burden of the proponent to identify, at minimum, what are the fiduciary duties owed by this fiduciary. *See* SEC v. Chenery Corp., 318 U.S. 80, 85–86 (1943).

> But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?

Id.

[105] *Sallee*, 286 F.3d at 892 ("To make out a claim that a fiduciary relationship existed, the party claiming the fiduciary relationship must first show the relationship existed before the transaction that is the subject of the action.").

[106] Whether there exists a fiduciary duty is a question of law to be resolved by the court. *See* Goodman v. Goldberg & Simpson, P.S.C., 323 S.W.3d 740, 746 (Ky. Ct. App. 2009) (finding that no fiduciary duty existed as a matter of law); Ostendorf v. Clark Equip. Co., 122 S.W.3d 530, 533 (Ky. 2003) ("In Kentucky, the existence of a duty is a matter of law for the court . . . ."); *see also* Rosenbaum v. White, 692 F.3d 593, 605 (7th Cir. 2012).

B. There Is No Basis for Treating Close Corporations as a Species of Partnership

The closely held corporation is not a species of partnership to which the laws of partnerships may be applied. First, and as reviewed above, by express statutory directive partnership law does not apply to other organizational forms.[107] Second, the corporation and the partnership are vastly dissimilar structures. As recognized by a leading authority in the field, "In theory, the archetypical corporation and partnership occupy opposite ends of the spectrum of legal forms of business."[108] The following table comparing aspects of the partnership and the corporation demonstrates the dissimilarity of the two organizational forms:

	Corporation	Partnership
Continuity of Life:	A corporation's existence may be perpetual; its existence is not tied to that of the shareholder body.[109]	Traditionally a partnership's existence ceased upon the dissociation of any partner.[110]
Limited Liability:	Shareholders enjoy limited liability from the corporation's debts and obligations.[111]	Partners are personally liable for all of the partnership's debts and obligations.[112]
Free Transferability of Interests:	Corporate shares are freely and unilaterally transferable.[113]	Right to participate in management not freely alienable.[114]

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[107] *See supra* note 48 and accompanying text.

[108] 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS AND LLC MEMBERS § 2.10 (2012).

[109] KY. REV. STAT. ANN. § 271B.3-020(1) (West, Westlaw through 2012 legislation).

[110] *Id.* § 362.290.

[111] *Id.* § 271B.6-220(2).

[112] *Id.* § 362.220(1); *id.* § 362.1-306(1).

[113] *See, e.g.*, 12 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF

	Corporation	Partnership
Centralized Management:	Control of the corporation is vested in the board of directors; directors need not be shareholders.[115]	Control of the partnership is vested in the partners.[116]
Capital Lock-In:	Shareholder may not withdraw from and thereby liquidate the investment in the corporation.[117]	Partner may unilaterally withdraw from the partnership and liquidate interest in the partnership.[118]
Agency:	A shareholder is not an agent for the corporation.[119]	A partner is an agent for the partnership.[120]
Major Decisions:	Major decisions require approval of a majority of the shareholders.[121]	Major decisions require unanimous approval of the partners.[122]

CORPORATIONS § 5452 (2012) ("The owner of the shares, as in the case of other personal property, has an absolute and inherent right, as an incident of his or her ownership, to sell or transfer the shares at will, except insofar as the right may be restricted by the articles of incorporation, bylaws, an agreement among shareholders, or between shareholders and the corporation. In the absence of such restrictions, a transfer of shares does not require the consent of the corporation and cannot be prohibited.") (citations omitted); CHARLES B. ELLIOTT, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 427 (3d ed. 1900) ("A transferee of shares acquires the rights of the transferrer . . . .").

[114] KY. REV. STAT. ANN. § 362.280(1) (West, Westlaw through 2012 legislation); *id.* § 362.1-503(1)(c).

[115] *Id.* § 271B.8-010.

[116] *Id.* § 362.235(5); *id.* § 362.1-401(6).

[117] *Id.* § 274.095.

[118] *Id.* § 362.335(1); *id.* § 362.1-701(1).

[119] 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 30 (2012) ("The mere fact that one is a shareholder or a majority or principal shareholder gives the individual no authority to represent the corporation as its agent in dealing with third persons.") (citations omitted).

[120] KY. REV. STAT. ANN. § 362.190(1) (West, Westlaw through 2012 legislation); *id.* § 362.1-301(1) (each partner is an agent of the partnership); *id.* § 362.220(1); *id.* § 362.1-306(1) (partner liability for partnership debts). Under the Kentucky Revised Uniform Partnership Act (2006), while each partner is an agent of the partnership, a partner is not an agent of any other partner. *See id.* § 362.1-301(1).

[121] *See supra* note 62.

[122] KY. REV. STAT. ANN. § 362.235(8) (West, Westlaw through 2012 legislation); *id.* § 362.1-401(10) ("An act outside the ordinary course of business of a partnership and an amendment to the

	Corporation	Partnership
Voting Rights:	Shareholders vote in proportion to share ownership.[123]	Partners vote on a per capita basis.[124]

Clearly Professor Thompson's general observation is fully applicable in Kentucky; the partnership and the corporation are at opposite ends of the spectrum from one another as to a significant number of characteristics. These distinctions are as they should be—different forms of organization are intended to embody a different menu of characteristics, a fact recognized by our courts:

> The selection of the form of business (i.e., sole proprietorship, partnership or corporation) is a decision of utmost importance in establishing a business. That decision requires weighing numerous factors including tax laws and the consequences thereof, limitation of personal liability, and spreading the amount of potential risk and profit among one or more principals to determine which form is best for a given individual, group or company.[125]

As to the suggestion that the rights and obligations of owners, whether they be partners or shareholders, should be the same (followed then by the suggestion that it is the rules of the partnership paradigm that should control), two titans in the field have observed:

> Proponents of the partnership analogy assume that participants in closely held corporations are knowledgeable enough to incorporate to obtain the benefits of favorable tax treatment or limited liability but ignorant of all other differences between corporate and partnership law.[126]

Neither the case law nor the scholarly commentary has demonstrated that participants in corporate ventures desire, at the time they enter into the corporation ventures, an inter-owner fiduciary relationship. While an allegedly wronged minority shareholder may after the fact assert that he or she expected such a relationship (and here setting aside the requirement of a prior demonstration of that expectation and its undertaking by the majority), he or she does so in opposition to a willing acceptance of the corporate

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partnership agreement may be undertaken only with the consent of all of the partners.").

[123] *Id.* § 271B.7-210(1).

[124] *Id.* § 362.235(5); *id.* § 362.1-401(6).

[125] Vinson v. Koerner, No. 2000-CA-001217-MR, slip op. at 6–7 (Ky. Ct. App. Nov. 9, 2001).

[126] Frank Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 298 (1986).

structure and all of its distinctions from the partnership form. This position is in opposition to Kentucky case law properly holding that partnerships and corporations are distinct forms of organization affording the participants different rights.[127]

Further, even were it appropriate to treat the partnership and the corporation as closely related, doing so would not compel a conclusion that the inter-partner fiduciary obligations should apply equally among shareholders. The analytic source of fiduciary duties among partners is their mutual agency combined with their unlimited liability.[128] Shareholders, in contrast, are not agents for either the corporation or the other shareholders and shareholders enjoy limited liability.[129]

C. The Role of the Board

It is the responsibility of the board to exercise control over the business and affairs of the corporation.[130] In so doing, the statutes direct that the directors are to discharge their duties "in the best interests of the corporation."[131] Shareholders, in contrast, may act selfishly and be concerned with only their personal and even selfish interests.[132] An individual shareholder may have objectives adverse to those of the corporation or for that matter adverse to those of the other shareholders.[133]

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[127] *See, e.g.*, Laine v. Commonwealth, 151 S.W.2d 1055, 1058 (Ky. 1941) (holding that a one-third shareholder in a corporation is not treated as a partner and does not have the rights of a partner vis-à-vis corporate property); *see also* KNC Invs., LLC v. Lane's End Stallions, Inc., No. 11-107-JBC, 2011 WL 5507395, at *4 (E.D. Ky. Nov. 10, 2011) (refusing to apply the provision of Kentucky's Business Corporation Act governing record inspection rights to an unincorporated association: "No justification exists to extend Kentucky law that by its own terms is strictly limited to corporations to non-corporate entities such as the LDK Syndicate.").

[128] *See* KY. REV. STAT. ANN. § 362.190(1) (West, Westlaw through 2012 legislation) (each partner is an agent of the partnership); *id.* § 362.220(1); *id.* § 362.1-306(1) (partner liability for partnership debts); *see also* REV. UNIF. PART. ACT § 404 cmt. 1 (2001) ("[T]he law of partnership reflects the broader law of principal and agent, under which every agent is a fiduciary.").

[129] *See* KY. REV. STAT. ANN. § 271B.6-220 (West, Westlaw through 2012 legislation) (shareholder limited liability); FLETCHER, *supra* note 119 (a shareholder is not an agent).

[130] KY. REV. STAT. ANN. § 271B.8-010(2) (West, Westlaw through 2012 legislation) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation."); *id.* § 272.171(1); *id.* § 273.207; *see also* Allied Ready Mix Co. v. Allen, 994 S.W.2d 4, 8 (Ky. Ct. App. 1998) ("Directors rather than shareholders manage the business and affairs of a corporation.").

[131] KY. REV. ANN. STAT. § 271B.8-300(1)(c) (West, Westlaw through 2012 legislation); *id.* § 273.215(1)(c).

[132] *See, e.g.*, Kirwan v. Parkway Distillery, 148 S.W.2d 720, 723 (Ky. 1941) (citations omitted); Haldeman v. Haldeman, 197 S.W. 376, 381 (Ky. 1917); SPELLMAN, *supra* note 16, at 53–54.

[133] *Haldeman*, 197 S.W. at 381; SPELLMAN, *supra* note 16, at 53–54.

The directors are not agents of the shareholders subject to their direction and control; rather, the directors are tasked to determine and promote/protect the interests of the corporation.[134] In doing so, the directors consider and, as they deem appropriate in their judgment, balance those competing interests.[135] The directors undertake to accomplish this balance under the burden of the fiduciary obligations imposed upon them by statute.[136] Within the confines of the corporate structure, the board, and not the shareholders, is charged with the discharge of fiduciary obligations.

D. Other Forms Provide for Direct Duties

No doubt some will lament, on a normative basis, that fiduciary duties should be owed by those who are in control to those who are the ultimate residual owners of the venture. In effect, so goes the argument, "partners owe fiduciary duties to one another, and therefore shareholders should likewise owe fiduciary duties to one another." This argument fails because it is based upon a pair of flawed premises, namely that the corporation is controlled by the shareholders qua shareholders and that the fiduciary duties owed among partners are a normative standard that should apply irrespective of the form of organization. The first point has been addressed above.[137] As to the second, there is absolutely no support for that argument. Rather, different organizational forms exist for the purpose of providing a range of different answers to the various questions that may be asked as to how the structure will operate.[138] Do the owners qua owners enjoy limited

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[134] *See* KY. REV. STAT. ANN. § 271B.8-010(1)(c) (West, Westlaw through 2012 legislation); *id.* § 273.215(1)(c).

[135] *See* MODEL BUS. CORP. ACT § 8.30(a) cmt. at 8-35 (2008).

> The phrase "best interests of the corporation" is key to an explication of a director's duties. The term "corporation" is a surrogate for the business enterprise as well as a frame of reference encompassing the shareholder body. In determining the corporation's "best interests," the director has wide discretion in deciding how to weigh near-term opportunities versus long-term benefits as well as in making judgments where the interests of various groups within the shareholder body or having other cognizable interests in the enterprise may differ.

Id.

[136] *See supra* note 131 and accompanying text.

[137] *See supra* note 130 and accompanying text.

[138] *See* Campbell, *supra* note 1, at 553 n.6 ("It is hard to argue against the idea that parties, in this case owners and managers, should be free to construct the terms of their own arrangement when, as seems to be the case, there are no significant externalities or third-party effects to the contract. 'Just as there is no right amount of paint in a car, there is no right relation among managers, investors, and other corporate participants.'") (citations omitted).

liability from the debts and obligations of the venture? In a corporation yes, and in a partnership no. Do the owners qua owners have apparent agency authority on behalf of the venture? In a corporation no, and in a partnership yes. To adopt Professor Ribstein's refrain, "a corporation is not a partnership" and, likewise, a partnership is not a corporation.[139]

Different forms of business organization provide different rules for a wide variety of different situations; those rules are selected when one form or another is adopted.[140] That the outcome in a particular circumstance in one form of organization is different from what would be the outcome were those facts applied in a different form of organization in no manner indicates that one form or the other is deficient. The Wendy's commercial featuring the Soviet fashion show highlighted the absence of distinction between "daywear" and "eveningwear."[141] That lack of distinction is the antithesis of the desired choice-of-entity calculus. Corporations and partnerships (as well as limited liability companies, limited partnerships, statutory trusts, and limited cooperative associations) are all different organizational forms that define rules, procedures, and outcomes for that form of organization. Different answers are the intended consequence of a robust menu of organizational forms; if different answers were not the desired result, we would have no need for alternative forms. Participants in a venture elect different rules by selecting a different form of organization;[142] those desiring inter-owner fiduciary obligations should not select the corporate form. Having chosen a form, however, the participants in the venture are bound by its rules and should not be heard to lament that the rules should be different than they are.[143] Need it even be stated that not

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[139] Larry Ribstein, *A Corporation Is Not a Partnership*, TRUTH ON THE MARKET (Aug. 2, 2010, 2:36 PM), http://truthonthe market.com/2010/08/02/a-corporation-is-not-a-partnership.

[140] *See, e.g.*, *supra* note 125 and accompanying text.

[141] *Wendy's Commercial–Soviet Fashion Show*, YOUTUBE (posted Sept. 3, 2006), http://www.youtube.com/watch?v=5CaMUfxVJVQ.

[142] *See generally* Thomas E. Rutledge, *Vampires and the Law of Business Organizations: The Fruitless Search for Authenticity*, J. PASSTHROUGH ENTITIES, Nov.–Dec. 2011, at 63; *see also* Campbell, *supra* note 1, at 553 n.6.

[143] *See, e.g.*, Beatty v. Melody Lake Ranch Club, Inc., No. 2003-CA-001652-MR, 2005 WL 858063, at *2 (Ky. Ct. App. Apr. 15, 2005) (rejecting effort to recharacterize a business corporation as a nonprofit corporation); CML V, LLC v. Bax, 6 A.3d 238, 249 (Del. Ch. 2010) ("[T]here is nothing absurd about different legal principles applying to corporations and LLCs."), *aff'd*, 18 A.3d 1037, 1043 (Del. 2011) ("[I]t is hardly absurd for the General Assembly to design a system promoting maximum business entity diversity. Ultimately, LLCs and corporations are different; investors can choose to invest in an LLC, which offers one bundle of rights, or in a corporation, which offers an entirely separate bundle of rights.").

appreciating the implications of choices made is not a defense to bearing those consequences?[144]

E. A Normative Analysis: Conclusion

There is no element of the corporate structure that justifies the imposition of fiduciary obligations among the shareholders. The notion of the "incorporated partnership," a corporation as to third parties but a partnership *inter se* the owners, is statutorily rejected and analytically untenable—the gulf between the two forms does not permit their melding.[145] Further, there is no objective showing that in the course of incorporation the participants in the venture sought to retain inter-owner fiduciary obligations even as they took on the balance of the perceived benefits of incorporation including limited liability. Had, in fact, they desired that outcome, other organizational structures satisfy that need. Having adopted the corporate form, it is the board that is charged with the corporation's management and affairs, with each director undertaking fiduciary obligations; corporate law does not impose upon the shareholders the burden of being an additional mediating influence in favor of the interests of the minority shareholders.

III. THE INTER-SHAREHOLDER RELATIONSHIP IS A CONTRACTUAL, NON-FIDUCIARY RELATIONSHIP

The relationship between the shareholder and the corporation is contractual in nature, that contract being embodied in the corporate statute and the corporation's articles and bylaws.[146] A fiduciary relationship does not exist between the parties to a contractual relationship.[147]

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[144] *See, e.g.*, Midwest Mut. Ins. Co. v. Wireman, 54 S.W.3d 177, 181–82 (Ky. Ct. App. 2001) ("It is axiomatic that all persons are presumed to know the law.") (citation omitted).

[145] *See, e.g.*, notes 48, 109–24 and accompanying text; *see also* Olsen v. Seifert, No. 976456, 1998 WL 1181710, at *6 (Mass. Super. Ct. Aug. 28, 1998) (applying Delaware law).

[146] *See* Toler v. Clark Rural Elec. Coop Corp., 512 S.W.2d 25, 26 (Ky. 1974); *see also* Chokel v. Genzyme Corp., 867 N.E.2d 325, 329 (Mass. 2007) ("[A] corporation's articles of organization form a contract between the corporation and its shareholders.") (citation omitted); *In re* Two Crow Ranch, Inc., 494 P.2d 915, 919 (Mont. 1972); Turner v. Hi-Country Homeowners Ass'n., 910 P.2d 1223, 1225 (Utah 1996); Rowland v. Union Hills Country Club, 757 P.2d 105, 108 (Ariz. Ct. App. 1988) (an organization's articles of incorporation and bylaws constitute a contract between the organization and its members); Jorgensen Realty, Inc., v. Box, 701 P.2d 1256, 1257 (Colo. App. 1985) ("The relationship between a voluntary association and its members is a contractual one . . . ."); First Fed. Sav. & Loan v. E. End Mut. Elec. Co., 735 P.2d 1073, 1075 (Idaho Ct. App. 1987) (citing Bridgestone/Firestone v. Recovery Credit Servs., 98 F.3d 13, 20, 1996 U.S. App. LEXIS 27115 (2d Cir. N.Y. 1996) (bylaws are binding as a contract among members of cooperative); WILLIAM SEAGLE, THE HISTORY OF LAW 269

It is the fact that the relationship is contractual, rather than fiduciary, that affords the minority shareholder viable protections. Where the corporate arrangement is understood as a contract, embodied in the articles of incorporation, the bylaws, and the corporate act, the terms of that contract, supplemented by the covenant of good faith and fair dealing[148] and other applicable law, will define what are the rights, duties, and obligations of the various parties in their various roles—such as director, officer, or shareholder.[149] Both at the time of joining a corporation and during his or her pendency as an owner, a participant may negotiate for particular protections, in effect alterations of the otherwise applicable law. In doing so, expectations as to the arrangement are made express, and a determination is made as to whether those expectations are reasonable and acceptable to all or the otherwise applicable threshold of the participants. By way of example, a minority shareholder in a state that utilizes the rule of at-will employment could request a written employment agreement. That same minority shareholder might request that the articles of incorporation be amended to create a class of stock, all of which will be issued to him or her, which has the right to elect a representative to the board of directors.[150]

(1946) ("The relation between the corporation and its stockholders rests on contract, as do the relations of the stockholders among themselves, and the relations of bondholders to the corporation and the stockholders."); 11 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5083 (2012).

[147] *See, e.g.*, Gonzalez v. Imaging Advantage, LLC, No. 11-243-C, 2011 WL 6092469, at *2 (W.D. Ky. Dec. 7, 2011) ("Gonzalez's claim for breach of fiduciary duty fails outright. Basic contractual relationships (such as the contract between Gonzalez and IA) do not give rise to fiduciary duties."); Banco Espirito Santo de Investimento, S.A. v. Citibank, N.A., 2003 U.S. Dist. LEXIS 23062, at *45–46 (S.D.N.Y. Dec. 22, 2003) ("[I]f this trust or special confidence in a person has 'solely to do with his carrying out his obligations under the contract' between the parties, no fiduciary duty exists." (citing *Bridgestone/Firestone*, 98 F.3d at 20)); Mia Shoes, Inc. v. Republic Factors Corp., 1997 U.S. Dist. LEXIS 12571, at *5–6 (S.D.N.Y. 1997) (dismissing a claim for breach of fiduciary duty and holding that "a fiduciary duty generally does not arise out of a contractual relationship between parties with comparable bargaining power where the duties of the parties are dictated by the terms of the contract") (citations omitted).

[148] *See* De Jong v. Leitchfield Deposit Bank, 254 S.W.3d 817, 823 (Ky. Ct. App. 2007) ("Within every contract, there is an implied covenant of good faith and fair dealing, and contracts impose on the parties thereto a duty to do everything necessary to carry them out." (quoting Farmers Bank & Trust Co. of Georgetown, Ky. v. Willmott Hardwoods, Inc., 171 S.W.3d 4, 11 (Ky. 2005))).

[149] This short critique of the normative basis for the absence of fiduciary duties among shareholders, here limited by space considerations, is in the nature of Cicero's assessment of Pompey Magnus, namely that he was "[a]wkward, tortuous, politically paltry, shabby, timid, disingenuous—but I shall go into more detail on another occassion." 1 MARCUS TULLIUS CICERO, LETTERS TO ATTICUS 139 (D. R. Shackleton Bailey trans., Cambridge Univ. Press 1965). For detailed critiques of the point, see Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 FORDHAM L. REV. 1161 (2011) and Paula J. Dalley, *The Misguided Doctrine of Stockholder Fiduciary Duties*, 33 HOFSTRA L. REV. 175 (2004).

[150] *See* KY. REV. STAT. ANN. § 271B.8-040 (West, Westlaw through 2012 legislation) (providing for election of directors by particular class of shareholders).

Those requests may be accepted and implemented, in which case the expectation is incorporated (no pun intended) into the corporate contract and is thereafter enforceable. Where those protections cannot be successfully negotiated into the agreement, all shareholders know that those protections are in fact not present. Protections from the otherwise applicable contractual terms that were never both sought and agreed upon (i.e., those that have remained inchoate and/or unexpressed) will not be any more enforceable than they would be under any other contract, and the covenant of good faith and fair dealing will not function to amend the agreement to include that which was neither sought nor agreed upon. In assessing and applying the corporate contract, recognition must be given to the fact that, in a hypothetical corporation with a 51% and a 49% shareholder, the minority owner has negotiated for and accepted a minority (non-controlling) position. At the same time, the majority owner has negotiated for and accepted a majority (controlling) position. Each of the parties to the corporate contract has agreed to this allocation of ultimate control. This analytic structure affords all participants in the venture predictability as to the burdens they have undertaken and the benefits they can expect;[151] in its absence we operate in a legal environment little different than the rules of Calvinball.[152]

Consider a few examples of "oppression."[153] A classic is the accumulation of cash, without a corporate purpose for doing so, to the effect that there are few, if any, funds distributed to the shareholders in the form of dividends[154] and perhaps the imposition of additional taxes upon the corporation in the form of an excess retained earnings tax.[155] There exists a

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[151] *See, e.g.*, Chokel v. Genzyme Corp., 867 N.E.2d 325, 330–31 (Mass. 2007) ("When rights of stockholders arise under a contract, however, the obligations of the parties are determined by reference to contract law, and not by the fiduciary principles that would otherwise govern. When a director's contested action falls entirely within the scope of a contract between the director and the shareholders, it is not subject to question under fiduciary duty principles." (citing Blank v. Chelmsford Ob/Gyn, P.C., 649 N.E.2d 1002, 1105 (Mass. 1995))); Knapp v. Neptune Towers Assocs., 892 N.E.2d 820, 824 (Mass. App. Ct. 2008) ("Where, however, the rights of the limited partners arose out of a contract, 'the obligations of the parties are determined by reference to contract law, and not by the fiduciary principles that would otherwise govern.'" (quoting *Chokel*, 867 N.E.2d at 330–31)).

[152] *See generally The Unofficially Official Rules of Calvinball*, KIM'S CALVIN AND HOBBES PAGE, http://www.picpak.net/calvin/calvinball (last visited Apr. 5, 2013). Under the Calvinball rules a player may "declare a new rule at any point in the game," doing so "audibly or silently." *Id.*

[153] The term "oppression" is placed in quotes because that label is obviously an *ex post* value judgment. One man's (that would be the plaintiff) "oppression" is another man's (that would be the defendant) realization of his rights as (typically) the board or the majority/controlling shareholder.

[154] Such was the situation in the classic *Dodge v. Ford* case. *See* Dodge v. Ford Motor Co., 170 N.W. 668, 671 (Mich. 1919).

[155] Sullivan v. Sullivan, No. 2010-CA-001961-MR, 2012 WL 1447893, at *3 (Ky. Ct. App. Apr. 27, 2012). The Kentucky Court of Appeals, in *Sullivan v. Sullivan*, recently posited that a policy of

claim by the shareholders, brought as a derivative action,[156] against the corporation's directors for breach of their fiduciary obligations to the corporation. There is no claim of "oppression" among the shareholders qua shareholders—the decision as to the declaration or not of dividends is vested in the board of directors.[157] The corporate contract, as set forth in the statute, defines who owes the duty (the directors), to whom the duty is owed (the corporation), the constraints of the duty (including but not limited to "in the best interests of the corporation"), and the mechanism by which a challenge to the actions taken may be brought (a derivative action). There is no need for recourse to fiduciary duty law for the resolution of the asserted injury.

Another charge is that excess salaries and other compensation are being paid to certain of the shareholders (typically in their positions as either employees or officers of the corporation) but not to others. In effect, the charge is that those in control are diverting what would otherwise be corporate earnings available for distribution among the shareholders as dividends into compensatory payment individually enjoyed by those in favor. A corporation is empowered to appoint officers and employees and to determine their compensation,[158] a power vested in the board of directors.[159] It is axiomatic that the directors may not waste corporate assets, and shareholders may, through a derivative action, charge that the board, through its compensation decisions, is wasting corporate assets.[160] There is no place for an inter-shareholder action; the recipient of the compensation, regardless of whether it is excessive, has violated no burden owed the objecting shareholder; in fact, the recipient need not be a shareholder. When the board determines to compensate Leah at the rate of $200,000 per annum when her services could be acquired on the open market from an equally efficient stranger to the corporation for $100,000, there exists a claim that the corporation's assets are being wasted by the board.[161] Again, this asserted wrong may be addressed and, if appropriate, remedied by a derivative action.

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retaining cash and thereby subjecting the corporation to an excess retained earnings tax could constitute a breach of duty. *Id.*

[156] *See generally* KY. REV. STAT. ANN. § 271B.7-400 (West, Westlaw through 2012 legislation).

[157] *See id.* § 271B.6-400(1) ("A board of directors may authorize and the corporation may make distributions to its shareholders . . . .").

[158] *See id.* § 271B.3-020(1)(k).

[159] *See id.* § 271B.8-010(2) ("All corporate powers shall be exercised by or under the authority of . . . its board of directors . . . ."); *id.* § 271B.8-400(1).

[160] *See id.* § 271B.7-400 (addressing rules for derivative actions).

[161] Note that I do not state that there has been a violation by the board of its fiduciary obligations. There may be factors that in fact justify this compensation level, and whether it will undergo substantive scrutiny will be first dependent upon the application (or not) of the business judgment rule.

Termination of a shareholder-employee is likely the prototypical instance of "oppression." Essentially, the shareholder (invariably a minority shareholder) asserts that he or she had an expectation of continued employment with the corporation, an expectation that was violated when his or her employment was terminated, and it was only through that employment and the salary/benefits derived therefrom that the shareholder could see the expected return on his or her investment. In the subsequent suit, the terminated employee asserts that, as a shareholder, he or she was owed a fiduciary duty violated by the termination of the employment relationship. Again, there is no need for recourse to principles of fiduciary law; these situations can (and should) be fully addressed under principles of contract law.

Initially, the nature of the corporate contract and the employment relationship are separate and distinct. The former is a mesh of overlapping agreements. For example, the corporation is in part comprised of the obligations of the shareholders to contribute capital,[162] they in return receiving stock having the rights and benefits set forth in the articles of incorporation.[163] The contract is multi-lateral; all rights of the shares of any particular class participate in the provisions governing that class, all shareholders participate in the terms applicable to all classes of stock, and by necessity the corporation is a party.[164] In another part the corporation is comprised of the rights and obligations undertaken by the persons elected to the board of directors, they being charged with its management and affairs[165] as they are subjected to fiduciary obligations,[166] those obligations perhaps being mitigated by provisions imposing enhanced standards for personal culpability.[167] Another part is comprised of the various procedural rules of the by-laws determining logistical limits and requirements for the meetings and other valid actions of the shareholders and the board.[168] Other provisions protect the rights of third-party creditors, requiring that distributions not be paid to the shareholders until their claims have been satisfied.[169] These limitations bind the corporation for the benefit of the creditors, imposing personal liability upon the directors for their breach.[170]

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[162] *See* KY. REV. STAT. ANN. § 271B.6-210(2)–(3) (West, Westlaw through 2012 legislation); *id.* § 271B.6-220(1).

[163] *See id.* § 271B.6-010(1)–(3); *id.* § 271B.6-020.

[164] *See id.* § 271B.6-010(1)–(3); *id.* § 271B.6-020.

[165] *See id.* § 271B.8-010(2).

[166] *See id*. § 271B.8-300(1).

[167] *See id.* § 271B.2-020(2)(d); *id.* § 271B.8-300(5)(b).

[168] *See id.* § 271B.2-060(2).

[169] *See id.* § 271B.6-400(3); *id.* § 271B.14-050(1)(c)–(d).

[170] *See id.* § 271B.8-330.

Notably, these contracts are not personal. The rights of a shareholder are conveyed with the transfer of shares; Bob, the owner of the shares on Monday, is on Monday entitled to the rights of a shareholder. When on Wednesday Bob sells the shares to Scott, then from Wednesday Scott has the rights of a shareholder and Bob no longer has those rights. When Julia is on Wednesday elected a director, she becomes subject to all of the burdens of being a director, even as she comes into enjoyment of the rights of a director. Hannah, a creditor in the amount of $1,000, has the rights afforded a creditor only for as long as her claim is open and outstanding; once her claim is paid, Hannah has no further claim against the corporation.

In contrast, the employment relationship is bilateral and unique. The agreement is between the corporation, it being the employer,[171] and the employee, who in this discussion is as well a shareholder thereof. None of the other shareholders, the directors, the officers, or the corporation's creditors are parties to the arrangement. It is unique in that the agreement is that the corporation will employ a particular person; there is no capacity in the employee to substitute the services of another for his or her own. Based upon these distinctions, the employment relationship of a shareholder versus his or her employer corporation needs to be assessed under the contractual principles of employment law, rather than as an aspect of the law of corporations; the employee's status as a shareholder is immaterial.[172]

Kentucky is an employment at-will state. Absent an express agreement to the contrary[173] or violation of a statutorily protected right, an employee may be terminated "for a good reason, for a bad reason, or for a reason that some might find morally indefensible."[174] While one is protected from termination for having filed a claim for worker's compensation benefits or for participating in union organizing efforts, the bases for exceptions from the rule of employment at-will are few and by design limited.[175] Notably, being a shareholder in the corporate employer is not identified as an

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[171] *See id.* § 271B.3-020(1)(k).

[172] *See* Ingle v. Gilmore Motor Sales, Inc., 535 N.E.2d 1311, 1313 (N.Y. 1989) ("It is necessary in this case to appreciate and keep distinct the duty a corporation owes to a minority shareholder from any duty it might owe him as an employee.").

[173] *See, e.g.*, Bailey v. Floyd Cnty. Bd. of Educ., 106 F.3d 135, 141 (6th Cir. 1997) ("In Kentucky, unless the parties specifically manifest their intention to condition termination only according to express terms, employment is considered 'at will.'" (citing Shah v. Am. Synthetic Rubber Corp., 655 S.W.2d 489, 491 (Ky. 1983); Nork v. Fetter Printing Co., 738 S.W.2d 824, 826–27 (Ky. Ct. App. 1987))).

[174] *See* Grzyb v. Evans, 700 S.W.2d 399, 400 (Ky. 1985) (quoting Firestone Textile Co. Div. v. Meadows, 666 S.W.2d 730, 731 (Ky. 1983)).

[175] *See, e.g.*, *Firestone*, 666 S.W.2d at 734 (worker's compensation claim); Pari-Mutuel Clerk's Union v. Kentucky Jockey Club, 551 S.W.2d 801, 803 (Ky. 1977) (union organizing).

exception from the rule of employment at-will.[176] Without doubt a shareholder, upon joining the venture, may request or even insist that he or she be other than an employee at-will. If the shareholder insists and the other participants in the venture do not agree, the individual can either abandon the venture or join it as an at-will employee. If the request is made and accepted, there may be a modification of the otherwise applicable rule of at-will.[177] This is, however, agreement as to the terms of the bilateral agreement about the terms of employment between the employer and the employee; the fact that the employee is also a shareholder in the corporation does not enter the analysis. Attention also needs to be paid to the position of the employer, namely the corporation. Any agreement modifying the rule of employment at-will must be shown to have bound the corporation, and that requires action by the board of directors.[178] A conversation between shareholders does not bind the corporation any more than does a conversation between a shareholder and a third party.[179]

Turning last to claims regarding the termination of a shareholder from positions as an officer or director of the corporation, such are already addressed by and fail pursuant to statute. Appointment as an officer creates no right to that office,[180] and the board has the authority to "remove any

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[176] *See generally Grzyb*, 700 S.W.2d at 401 (reciting the "limitations on 'any judicial exceptions to the employment-at-will doctrine'"). It is worth recognizing that even in those states that do impose inter-shareholder fiduciary duties, termination of the employment of a shareholder-employee is not of itself a violation of those fiduciary obligations. Kentucky courts often look to Delaware for guidance in matters of corporate law. *See, e.g.*, Bacigalupo v. Kohlhepp, 240 S.W.3d 155, 157 (Ky. Ct. App. 2007) ("Additionally, this court has previously adopted Delaware case law when examining corporate statutes . . . ."). Delaware, like Kentucky, is an employment at-will state. *See generally* Teresa A. Cheek, *The Employment-At-Will Doctrine in Delaware: A Survey*, 6 DEL. L. REV. 311 (2003). The Delaware courts have found that the shareholder relationship does not set aside the applicable rule of employment at-will. *See, e.g.*, Ueltzhoffer v. Fox Fire Dev. Co., 1991 WL 271584, at *1308–10 (Del. Ch. Dec. 19, 1991) (finding no breach of duty where majority shareholders terminated the employment of the minority shareholder). In *Olsen v. Seifert*, 1998 WL 1181710, at *5 (Mass. Super. Aug. 28, 1998), applying Delaware law—and specifically *Riblet Products Corp. v. Nagy*, 683 A.2d 37 (Del. 1996)—it was held that the plaintiff's employment "contract rights were not enhanced or enlarged because of his status as a shareholder."

[177] The degree of formality required for an express modification and the degree of the modification are matters beyond the scope of this discussion.

[178] *See* KY. REV. STAT. ANN. § 271B.3-020(1)(k) (West, Westlaw through 2012 legislation); *id.* § 271B.8-010(2).

[179] *See* Haldeman v. Haldeman, 197 S.W. 376, 381 (Ky. 1917) ("An individual director has no authority as such; he can only act as agent by appointment, like other agents are appointed. Moreover, directors must act together as a board; the separate assent of a majority is not binding on the corporation."); FLETCHER, *supra* note 119 (a shareholder qua shareholder is not an agent of the corporation); SPELLMAN, *supra* note 16, at 7.

[180] *See* KY. REV. STAT. ANN. § 271B.8-440(1) (West, Westlaw through 2012 legislation).

officer at any time with or without cause."[181] As to the position as a director, absent protections set forth in the articles of incorporation,[182] the shareholders have the right to elect and to remove directors, and by statute that removal may be with or without cause.[183]

Some will no doubt object that the derivative action is inefficient in closely held corporations, that demanding bargained terms at the inception of the shareholder relationship is unreasonable, and that the obligation of good faith and fair dealing is too imprecise and limited to provide effective remedies to an oppressed shareholder. Recognize first that these objections are normative challenges to what is, at least as to the derivative action, the positive law. Wailing and gnashing of teeth[184] accompanied by lamentations of "woe is me"[185] are not the appropriate mechanism for challenges to positive law. Rather, remedy may be found by petitioning the legislature to enact changes in the law. Recall that any shift in power to the non-controlling group is zero sum—power is being taken from the majority group. Not only that, but the shift of power away from the majority group violates the otherwise applicable rule of majority control of the corporation.[186] If, as some might assert, there should in a closely held corporation be a direct, as contrasted with a derivative, cause of action for breach by a director or an officer of a duty, then the legislature may, should it see fit, enact such a change in the law.[187] Were it to do so, the legislature would need to address at least who owes the duty, to whom is the duty owed, what is the nature of the duty, what is the standard for culpability for breach of the duty, the procedural requirements for an action seeking vindication of the right and remedy for its breach, and the availability of advancement and indemnification to the person charged with having violated the duty. Of course, as of this day the General Assembly has not acted to do so.

As to objections that shareholders, upon joining a venture, should not be expected to negotiate for protections from generally applicable rules of majority control and in the instance of a shareholder who will also be an employee-at-will, such is little more than an *ex post* excuse for not having

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[181] *See id.* § 271B.8-430(2).

[182] *See, e.g.*, *id.* § 271B.8-040; *id.* § 271B.8-080(2).

[183] *See id.* § 271B.8-030(4); *id.* § 271B.8-080(1).

[184] *Matthew* 13:42.

[185] WILLIAM SHAKESPEARE, HAMLET act 3, sc. 1.

[186] *See supra* notes 61–64 and accompanying text.

[187] By way of example, the recently enacted Kentucky Uniform Statutory Trust Act (2012) provides for an individual action by a beneficial owner against a trustee for breach of an obligation owed that beneficial owner as distinct to the statutory trust. *See* KY. REV. STAT. ANN. § 386A.6-110 (West, Westlaw through 2012 legislation).

negotiated part of the relationship. Assume a prototype corporation with two shareholders, one holding 51% of the stock and the other the balance of 49%. The minority has agreed to pay $10,000 into the corporation's capital in return for those shares. The minority has agreed to be an employee of the corporation in a particular office at a particular salary. In many instances the minority shareholder will have agreed that the corporation should make an election (it requiring the unanimous consent of the shareholders) to be taxed under Subchapter S of the Internal Revenue Code. At this juncture the actor has negotiated the amount of capital to be contributed to the venture, the consideration to be received for that contribution, the fact of an employment relationship and the terms of compensation, and the tax status of the corporation. It is manifest that the minority participant is negotiating the terms of the relationship, and there is no basis for asserting he or she should not be expected to negotiate any and all terms by which he or she desires that the standard form agreement otherwise applicable at law (that being the corporate law and, as to the employment relationship, employment law) be modified.[188] If an actor chooses, whether consciously or otherwise, to not negotiate particular terms as to the relationship, then "[t]hey've only themselves to blame"[189] when it comes to pass that the default rules of the relationship do not yield him or her protections that, *ex post* the structuring of the relationship, he or she wishes were in place.[190]

As to objections that the obligation of good faith and fair dealing is too imprecise and limited to form an effective remedy to oppression, there are at least two responses. Initially, this asserted weakness indicates the need for careful planning. A shareholder joining a venture with particular expectations needs to detail those expectations and see that they are set forth in the controlling agreements. Where the expectation (and the general acceptance of that expectation) is detailed, there will be no need to reference the covenant of good faith and fair dealing. Rather, the dispute will revolve around the question of whether the agreed contract has or has not been violated. A shareholder believing that he or she, as an employee, is other than an employee at-will who causes that understanding to be

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[188] There is nothing here unique to the relationship of a minority shareholder to a corporation or the relationship of an employee/shareholder to the employer. In family law there are defined rules for the distribution of property that may be modified with a prenuptial agreement. The law of estates dictates how assets will be distributed upon death; a different result may be brought about by a will. Purchasers and sellers of goods are bound by the terms of the Uniform Commercial Code except and to the degree that they otherwise agree.

[189] GILBERT O'SULLIVAN, THEY'VE ONLY THEMSELVES TO BLAME (Decca Record Co. Ltd. 1973).

[190] *See, e.g.*, Allen v. Lawyers Mut. Ins. Co. of Ky., 216 S.W.3d 657, 661 (Ky. Ct. App. 2007) ("Persons must be free to contract; and it is for the law to enforce the agreement they have made, not to make it or to correct it for them." (quoting Ligon v. Parr, 471 S.W.2d 1, 5 (Ky. 1971))).

reflected in the corporation's organizational documents or in a separate agreement between the corporation and the shareholder/employee is not left to the obligation of good faith and fair dealing for his or her remedy. Second, a shareholder seeking to supplant the agreed contracted terms should be limited by the covenant's limited scope; the implied covenant will not provide contractual terms that are at odds with those in the agreement. Where the shareholder has not negotiated for a right to a board seat, he or she cannot, by reference to good faith and fair dealing, come into a right to elect him or herself to the board. Where an employee has not negotiated a contractual modification of employment at-will, good faith and fair dealing will not insert such a term. At the same time, the covenant will protect the terms of the agreement that is made.

III. CONCLUSION

Applying the positive law of Kentucky, a shareholder qua shareholder does not stand in a fiduciary relationship with another shareholder. Rather, the fiduciary overlay of the corporate relationship is the statutory obligations imposed upon the members of the board of directors and upon the officers. Shareholders are individual actors properly empowered to act in accordance with their own interests. From a normative perspective, there is no basis for imposing partnership-like fiduciary duties among the shareholders, especially in the absence, in a particular fact pattern, of the necessary elements of a fiduciary relationship. Instances of conduct claimed to be oppressive should be assessed and, as necessary, remedied as violations of the fiduciary obligations owed the corporation by its directors and officers or as violations of the corporate contract and, as applicable, particular contracts between the shareholder and the corporation. While everyone may be charged to do justice to widows and orphans and to assist the foreigner,[191] under Kentucky law a shareholder is not charged to protect the interests of other shareholders.

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[191] *Deuteronomy* 10:18.