Beyond Wall Street: Inside the Legal Battles of Private Companies

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Boardroom battles on Wall Street command national attention. Yet the vast majority of business disputes in the United States do not take place on Wall Street and do not involve public companies. Nearly all American companies are privately held, and the disputes between the owners of these Main Street businesses seldom make headlines. Nor do they receive much attention in legal scholarship. While scholars have examined these disputes from a theoretical perspective, there have been no empirical studies analyzing lawsuits between the owners of private companies. As a result, we do not know why these business relationships fail or the specific risks these business owners face.

This Article aims to fill that gap through the first empirical study of litigation between the owners of private companies. This study analyzes hand-collected data from over 700 lawsuits filed in 31 U.S. states and territories. It reveals significant differences between public-company disputes and their private-company counterparts. Most importantly, emotions take center stage in private company disputes, with plaintiffs often alleging that emotional bonds with their business partners caused them to forgo crucial protections. When these bonds break down, the disputes devolve into claims rarely seen on Wall Street: allegations of self-dealing through theft, freeze-outs, unlawful competition, or dilution of ownership interests. Recognizing these unique attributes of Main Street disputes will allow lawyers, judges, and lawmakers to approach business law in ways that more directly serve its largest constituency.

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INTRODUCTION

When the owners of public companies fight, it makes national news. Elon Musk's war with the board of Twitter was covered endlessly in the press.[1] Disney's boardroom battles

1. *See, e.g.*, Walter Isaacson, *The Real Story of Musk's Twitter Takeover*, WALL ST. J. (Aug. 31, 2023), https://www.wsj.com/tech/elon-musk-twitter-x-takeover-walter-isaacson-5f553fa (on file with the *Journal of Corporation Law*); Anirban Sen & Tom Hals, *Musk Reverses Course, Again: He's Ready to Buy Twitter, Build 'X' App*, REUTERS (Oct. 4, 2022), https://www.reuters.com/markets/europe/musk-said-go-ahead-with-5420-share-twitter-deal-bloomberg-reporter-2022-10-04/ (on file with the *Journal of Corporation Law*); Kate Conger & Lauren Hirsch, *Twitter Sues Musk After He Tries Backing Out of $44 Billion Deal*, N.Y. TIMES (July 12, 2022), https://www.nytimes.com/2022/07/12/technology/twitter-lawsuit-musk-acquisition.html (on file with the *Journal of Corporation Law*); Lauren Hirsch & Mike Isaac, *How Twitter's Board Went From Fighting Elon Musk to Accepting Him*, N.Y. TIMES (Apr. 30, 2022), https://www.nytimes.com/2022/04/30/technology/twitter-board-elon-musk.html (on file with the *Journal of Corporation Law*); Faiz Siddiqui & Aaron Gregg, *Elon Musk Attempts Hostile Takeover of Twitter, Calling Path 'Painful'*, WASH. POST (Apr. 14, 2022), https://www.washingtonpost.com/technology/2022/04/14/elon-musk-twitter-takeover-bid/ (on file with the *Journal of Corporation Law*); Salvador Rodriguez, *Elon Musk Decides Not to Join Twitter's Board*, WALL ST. J. (Apr. 11, 2022), https://www.wsj.com/articles/elon-musk-reverses-decision-to-join-twitters-board-twitter-ceo-says-11649648263 (on file with the *Journal of Corporation Law*).

were turned into a bestselling book.[2] And the fights between hedge fund activists and corporate directors have become legendary.[3] Corporate law scholars are similarly drawn to disputes inside public companies. When it comes to these Wall Street lawsuits, scholars have testified before Congress,[4] offered valuable theoretical insights,[5] and conducted decades of empirical research.[6]

Yet most business disputes take place far from Wall Street. The vast majority of businesses in the United States are Main Street businesses—small, private companies in cities and towns across the country.[7] They might be a barbeque restaurant in Dallas, a small medical practice in Boston, a plumbing company in Sacramento, or a real estate partnership in the Bronx. Most Main Street businesses have only a few employees,[8] raise capital locally,[9] and rely on simple agreements to govern their affairs.[10] When owners of these types of businesses fight, it rarely makes headlines.

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2. *See* JAMES B. STEWART, DISNEYWAR (2005); *see also Best Sellers: March 27, 2005*, N.Y. TIMES (Mar. 27, 2005), https://www.nytimes.com/2005/03/27/books/arts/best-sellers-march-27-2005.html (on file with the *Journal of Corporation Law*) (stating that DisneyWar spent four weeks on the New York Times best sellers' list when it first came out).

3. *See* Alison Frankel, *How Activist Hedge Fund Politan Won $18 Million in Legal Fees Against Masimo*, REUTERS (Nov. 27, 2023), https://www.reuters.com/legal/transactional/column-how-activist-hedge-fund-politan-won-18-million-legal-fees-against-masimo-2023-11-27/ (on file with the *Journal of Corporation Law*); Lauren Thomas, *More Activists Lay Down Arms in Battles for Boardroom Control*, WALL ST. J. (Apr. 21, 2023), https://www.wsj.com/articles/more-activists-lay-down-arms-in-battles-for-boardroom-control-354632d4 (on file with the *Journal of Corporation Law*); Crystal Tse, *Activist Fights Tick Up, Along With Settlements*, BLOOMBERG (July 10, 2023), https://www.bloomberg.com/news/articles/2023-07-10/activist-fights-tick-up-along-with-settlements-to-head-them-off (on file with the *Journal of Corporation Law*).

4. *See* S. Rep. No. 105-182, at 14 (1998) (listing the law professors who testified in connection with the Securities Litigation Uniform Standards Act); S. Rep. No. 104-98, at 44 (1995) (listing the law professors who testified in connection with the Private Securities Litigation Reform Act of 1995).

5. *See* JOHN C. COFFEE, JR., ENTREPRENEURIAL LITIGATION: ITS RISE, FALL, AND FUTURE (2015) (examining the strengths and weaknesses of entrepreneurial litigation against public companies).

6. *See* Stephen J. Choi, Adam C. Pritchard & Jessica M. Erickson, *The Business of Securities Class Action Lawyering*, 99 IND. L.J. 775 (2024) (presenting data on securities class actions against public companies); Matthew D. Cain et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. 603 (2018) (analyzing data on merger litigation for public company deals over $100 million completed between 2003 and 2017); Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 TEX. L. REV. 557 (2015) (examining the impact of non-monetary relief in merger lawsuits against public companies).

7. *See* Hal Weitzman, *Is the US Economy 'Going Dark'?*, CHI. Booth REV. (May 30, 2023), https://www.chicagobooth.edu/review/is-us-economy-going-dark [https://perma.cc/GHN6-ZSZ7] ("Private companies have always dominated the US economy. Of the 33 million businesses in the US, more than 99 percent are privately held.").

8. *See* U.S. SMALL BUS. ADMIN. OFF. OF ADVOC., SMALL BUSINESS PROFILES FOR THE STATES, TERRITORIES, AND NATION 2023 2 (2023), https://advocacy.sba.gov/wp-content/uploads/2023/11/State-Profiles-2023.pdf [https://perma.cc/9RK8-SKYW] (presenting data on the number of employees employed by small businesses).

9. *See* VICTOR HWANG, SAMEEKSHA DESAI & ROSS BAIRD, ACCESS TO CAPITAL FOR ENTREPRENEURS: REMOVING BARRIERS (2019), https://www.kauffman.org/wp-content/uploads/2019/12/CapitalReport_042519.pdf [https://perma.cc/G8L5-ELUE] (discussing capital sources for small businesses).

10. *See infra* Part II.B.1 (discussing the light governance model used by many companies in this study).

These disputes have also gotten less attention in legal scholarship. There have been theoretical discussions about the risks facing owners of Main Street businesses,[11] including the unique risks inside family-owned businesses.[12] Scholars have also debated the legal standards that should apply when business relationships between the owners of private companies fall apart.[13] Yet, although more than 99% of all businesses in the United States are private,[14] there is not a single empirical study examining lawsuits between the owners of these companies. As a result, we do not have any data on why business relationships in private companies break down. Nor do we know what makes some owners of private companies particularly vulnerable to exploitation by their business partners. When it comes to litigating business disputes on Main Street, we know very little.

This gap in the empirical literature matters. Transactional lawyers cannot effectively represent private companies if they do not fully understand the specific types of disputes they are trying to prevent.[15] Lawmakers cannot draft laws that fit the needs of private companies unless they understand the governance challenges that these companies face. Judges cannot easily decide these disputes without appreciating the vulnerabilities of certain types of investors. By focusing almost exclusively on public company litigation, empirical scholars have missed an opportunity to provide needed guidance that could benefit smaller companies.

This Article provides the first study of litigation between the owners of private companies. Using hand-collected data from complaints filed in state and federal courts across the country, it examines more than 700 lawsuits from 31 U.S. states and territories. In the past, this type of study was not possible due to limitations on the availability of court records.[16] Recent innovations, however, have expanded the availability of these records. These innovations have not solved all of the challenges of litigation research, but they have provided greater access to complaints filed in civil cases. As a result, it is now possible to collect detailed data on why relationships between business owners break down and the specific types of wrongdoing alleged in these lawsuits.

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11. *See* Benjamin Means, *A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation*, 97 GEO. L.J. 1207, 1209 (2009) ("The potential for minority shareholder oppression should be understood, therefore, as an inherent structural characteristic of the close corporation form."); Meredith R. Miller, *Challenging Gender Discrimination in Closely Held Firms: The Hope and Hazard of Corporate Oppression Doctrine*, 54 IND. L. REV. 123 (2021) (discussing the risks to female owners in smaller, private companies); Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 272 (1986) (analyzing the risks posed by conflicts of interest in closely-held businesses).

12. *See* Benjamin Means, *The Contractual Foundation of Family-Business Law*, 75 OHIO ST. L.J. 675, 711–13 (2014) [hereinafter Means, *Contractual Foundation*] (explaining that family run businesses face different economic and contractual issues than other companies.); Benjamin Means, *Nonmarket Values in Family Businesses*, 54 WM. & MARY L. REV. 1185 (2013) [hereinafter Means, *Nonmarket Values*].

13. *See* Mary Siegel, *Fiduciary Duty Myths in Close Corporate Law*, 29 DEL. J. CORP. L. 377, 378 (2004) (arguing in favor of a narrower view of fiduciary duties in closely held companies); Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 FORDHAM L. REV. 1161, 1179 (2010) (arguing that a broader view of contract can protect minority investors in private companies).

14. *See* Weitzman, *supra* note 7.

15. Transactional lawyers who regularly represent small businesses likely understand many of these dynamics. The goal of this Article is to help these lawyers by adding data and analysis to their experience in practice.

16. *See infra* Part I.B.

From this data, three important insights emerge. First, emotions are front and center in private company disputes. Investors invest in large public companies for a variety of reasons, but these reasons rarely include an emotional bond with the other owners.[17] Private companies, however, are often built on a foundation of trust and optimism. Time and again, the plaintiffs make specific allegations about their emotional connection to the other owners of the business and how this connection caused them to forego greater contractual and governance protections.

Second, when these business relationships fall apart, the ensuing litigation almost always centers on allegations of self-dealing. In more than 90% of the cases, the plaintiffs allege that the defendants engaged in self-dealing to get greater financial benefits from the company than they were entitled to. In this way, private company disputes differ markedly from public company disputes. In many cases involving public companies, shareholders allege that the board failed to properly oversee the company's affairs or failed to disclose necessary information to shareholders.[18] These claims are largely absent from private company litigation. Moreover, even when public shareholders allege self-dealing, their allegations tend to focus on a specific transaction, rather than a broader pattern of theft or freeze-outs.

Third, the owners of private companies are creative when it comes to lining their own pockets. Although many defendants allegedly stole money directly from the company, other types of self-dealing were more imaginative. Some defendants froze the plaintiff out of the business, denying them any financial benefits from their ownership interest. Other defendants used company assets, from office space to customer lists and social media accounts, to open competing businesses. Others engaged in transactions to dilute the plaintiff's ownership interest or simply denied that the plaintiff owned any part of the company at all. By providing data on the types of self-dealing, this study highlights the specific risks that investors face in private companies.

These findings offer important lessons for lawyers, lawmakers, and judges. Given the risk of self-dealing in so many business breakups, transactional lawyers need to specifically address this risk when representing small businesses. Similarly, when drafting laws that govern private companies, lawmakers should recognize that co-owners of businesses may not adequately protect themselves through contract. Lawmakers should therefore take special care to ensure that the default rules protect investors who may fail to protect themselves. Finally, judges should not chastise plaintiffs for trusting their business partners. As this study demonstrates, owners of private companies can betray each other's trust in a variety of ways, but trust and related emotions also play a key role as businesses get off the ground.

This Article proceeds in four parts. Part I discusses why we do not know more about private companies and describes how this study's methodology starts to fill that gap. Part II presents data on the emotional foundation of private companies, including the role of trust and optimism at the start of these business relationships and how these emotions can

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17. *See* James D. Cox & Randall S. Thomas, *Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions?*, 80 WASH. U. L.Q. 855, 860 (2002) (analyzing the fiduciary duties of institutional investors to act and invest in the best interests of their investors).

18. *See* discussion *infra* notes 154–74 (alleging public corporations withhold information and other issues of self-dealing).

lead investors to leave important protections out of their formal agreements. Part III explores how defendants can take advantage of these emotions, presenting empirical findings on the specific types of self-dealing alleged in private company lawsuits. Part IV builds on these findings to offer guidance to lawyers, lawmakers, and judges in their respective roles. As we shall see, while Wall Street disputes have long dominated the headlines, litigation on Main Street deserves just as much attention.

I. THE BLACK BOX OF MAIN STREET LITIGATION

More than 99% of businesses in America are privately held,[19] yet there is remarkably little legal scholarship about why the relationships between owners of many private businesses fall apart. This Part explores why scholars do not know more about these disputes. It first offers a survey of the existing scholarship about private companies, which focuses primarily on the agreements that govern these companies rather than how these agreements can fail. It then discusses the longstanding challenges in obtaining data on private company disputes and explains how recent improvements in the availability of court records have made this study possible. Finally, it describes the methodology of the study, outlining the study's parameters and design.

A. What We Know About Main Street Litigation

Businesses in the United States are divided into two categories—private companies (often called "Main Street" companies) and public companies. The law provides a clear dividing line between these two categories. A private company is a company that has not made a public offering of securities, listed its securities on a national exchange, or reached certain thresholds concerning its assets and number of shareholders.[20] These companies do not have to file public filings such as Form 10-Ks or 10-Qs,[21] and they have more freedom to order their own affairs.[22] Public companies, in contrast, are subject to greater disclosure obligations and additional mandatory governance rules.[23]

Scholars focus nearly all their attention on public companies. There are empirical studies examining how public companies react to legal changes,[24] hire their top

19. *See* Weitzman, *supra* note 7 (discussing how private companies have always dominated the U.S. economy). Many of these businesses are sole proprietorships that, by definition, will not have disputes between the owners. Nonetheless, the vast majority of businesses are private enterprises.

20. *See* 15 U.S.C. § 78l(g) (2015); *see also Public Companies*, SEC, https://www.sec.gov/resources-small-businesses/capital-raising-building-blocks/public-companies [https://perma.cc/6XLQ-JDTG].

21. *See* 15 U.S.C § 78m (2022); *see also Going Public*, SEC, https://www.sec.gov/resources-small-businesses/going-public [https://perma.cc/WC2H-BBLT] (indicating that Exchange Act Reporting and Registration is part of going public).

22. For example, in Delaware, a private corporation that registers as a close corporation with the state is permitted to eliminate the board of directors entirely and agree by contract that the shareholders will manage the corporation. *See* DEL. CODE ANN. tit. 8, §§ 350–51 (West 2024).

23. Matthew Wansley, *Taming Unicorns*, 97 IND. L.J. 1203, 1207 (2022) (explaining that "securities regulation gives companies the choice of two regulatory regimes" under which "public companies must make periodic disclosures," while "[p]rivate companies face few disclosure requirements and less liability").

24. *See, e.g.*, Emiliano M. Catan & Marcel Kahan, *The Law and Finance of Antitakeover Statutes*, 68 STAN. L. REV. 629, 632–33 (2016) (examining how public companies reacted to the adoption of antitakeover statutes).

management[25] and spend money to lobby the government.[26] There is a vast literature debating how specific corporate governance changes impact company performance.[27] When it comes to governance disputes within public companies, we know the types of suits that are filed,[28] how these suits are resolved,[29] and the business models behind the law firms that file them.[30]

The literature on private companies is far more limited, focusing primarily on the largest and fastest-growing private companies. Several studies, for example, have analyzed unicorns, or private companies that are valued at or above $1 billion, as well as start-ups supported by venture capital or private equity funding.[31] Yet most private companies look nothing like unicorns or venture-backed start-ups. The vast majority of private companies have few, if any, employees.[32] They operate in small cities and towns across America, not Silicon Valley.[33] And they raise money from bank loans, friends, and family, rather than Wall Street financiers.[34] There have been remarkably few studies examining these types of private companies.

Moreover, the studies within the legal field that do exist focus almost exclusively on the formal agreements that govern these companies. For example, multiple studies have examined operating agreements in limited liability companies (LLCs), analyzing the

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25. *See generally* Dhruv Chand Aggarwal, *The Market for General Counsel*, 20 J. EMPIRICAL LEGAL STUD. 895 (2023) (presenting data regarding how public companies hire their top lawyers).

26. *See generally* John C. Coates IV, *Corporate Politics, Governance, and Value Before and After Citizens United*, 9 J. EMPIRICAL LEGAL STUD. 657 (2012) (analyzing how public companies reacted to the *Citizens United* decision).

27. *See, e.g.*, Jens Frankenreiter et al., *Cleaning Corporate Governance*, 170 U. PA. L. REV. 1, 3 (2021) (explaining how "empirical corporate governance research now dominates the law and finance landscape").

28. *See generally* Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465 (2004) (analyzing empirical evidence on the impact of federal legislation on the types of securities class actions filed against public companies).

29. *See* CORNERSTONE RSCH., SEC. CLASS ACTION FILINGS: 2022 YEAR IN REVIEW 22 (2022), https://www.cornerstone.com/wp-content/uploads/2023/05/Securities-Class-Action-Filings-2022-Year-in-Review.pdf [https://perma.cc/E5J3-KXXE].

30. *See* Choi, Pritchard & Erickson, *supra* note 6, at 7; Lynn A. Baker, Michael A. Perino & Charles Silver, *Is the Price Right? An Empirical Study of Fee-Setting in Securities Class Actions*, 115 COLUM. L. REV. 1371, 1372 (2015).

31. *See generally* Anat Alon-Beck & John Livingstone, *Mythical Unicorns and How to Find Them: The Disclosure Revolution*, 2023 COLUM. BUS. L. REV. 69, 71 (analyzing the reaction of unicorn companies to changes in the federal securities laws); Jennifer S. Fan, *The Landscape of Startup Corporate Governance in the Founder-Friendly Era*, 18 N.Y.U. J.L. & BUS. 317 (2022) (providing an "empirical analysis of corporate governance in startups post-Great Recession and how the pandemic impacted said corporate governance"); Will Gornall & Ilya A. Strebulaev, *Squaring Venture Capital Valuations with Reality*, 135 J. FIN. ECON. 120, 121 (2020).

32. *See* U.S. SMALL BUS. ADMIN. OFF. ADVOC., *supra* note 8, at 2. (presenting data on small businesses (defined as businesses with fewer than 500 employees, which includes 99.9% of businesses in the United States) and finding that 81.6% have no employees, while 16.4% have less than 20 employees but at least one employee).

33. *See id.* (presenting data on the number of small businesses in each state).

34. *See* HWANG, DESAI & BAIRD, *supra* note 9, at 5 (finding that the most common funding sources for new businesses are personal or family savings, business loans, and personal credit cards, while only 0.5% of businesses receive venture capital funding).

provisions that owners of LLCs put in place at the start of their business relationships.[35] Other studies have conducted interviews of attorneys who represent LLC owners, exploring how attorneys help their clients set up their companies and negotiate with their business partners.[36]

These studies provide important insights into the governance of private companies. We know, for example, that businesses vary dramatically in their level of sophistication and planning. Some sophisticated business owners have the time, money, and knowledge to negotiate complicated agreements to protect their interests.[37] In contrast, many small business owners do not engage in this type of bargaining. In one study, over two-thirds of transactional lawyers stated that many LLC agreements are based on "form agreements that are not extensively negotiated."[38] A separate study of family businesses indicates that "while a majority of family business owners anticipate transferring control to the next generation, only 15% of them have anything resembling a succession plan in place."[39]

Scholars have long theorized that relationships and social norms influence how these *ex-ante* bargains play out in practice.[40] Some scholars have argued that small business owners may not need formal agreements because they are more intimately involved in the business's operations.[41] Others have maintained that companies where the owners have personal relationships may structure their business dealings through a broader array of evolving formal and informal bargains, rather than relying on a single operating or shareholder agreement.[42] Although these theoretical discussions are valuable, there is little empirical data on how trust and relationships influence business dealings within private companies. Formal agreements are an aspirational statement of how parties want to conduct their business, but they do not tell us how these business relationships play out in practice.

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35. *See, e.g.*, Peter Molk, *How Do LLC Owners Contract Around Default Statutory Protections?*, 42 J. CORP. L. 503, 505 (2017) (explaining common contractual terms in LLCs); Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879, 883 (2012) (examining the fiduciary duty and governance provisions in LLC operating agreements).

36. *See, e.g.*, Sandra K. Miller, *A New Direction for LLC Research in A Contractarian Legal Environment*, 76 S. CAL. L. REV. 351, 355–56 (2003) (analyzing survey evidence from lawyers who regularly represent or otherwise work with LLCs and their owners).

37. *See, e.g.*, Allison Anna Tait, *The Law of High-Wealth Exceptionalism*, 71 ALA. L. REV. 981, 990 (2020) (explaining how high-wealth individuals can enter into detailed agreements that govern employment, compensation, and distributions to shareholders in their businesses, among other issues).

38. Miller, *supra* note 36, at 356.

39. Benjamin Means, *Solving the "King Lear Problem"*, 12 U.C. IRVINE L. REV. 1241, 1243 (2022); *see also* Allison Anna Tait, *Corporate Family Law*, 112 NW. U. L. REV. 1, 4 (2017) ("Corporate family members do not bargain in the way that laws and norms expect them to bargain.").

40. *See* Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1805–06 (2001) (arguing that "an understanding of the role of trust and of the variables that encourage or discourage it is essential for understanding both the business world and much of corporate law").

41. Howard M. Friedman, *The Silent LLC Revolution-the Social Cost of Academic Neglect*, 38 CREIGHTON L. REV. 35, 80–81 (2004) ("In the small business, owners are often present on a day-to-day basis so they can directly monitor the performance of their co-owners, [standing] in sharp contrast to the publicly held corporation").

42. *See* Means, *Contractual Foundation*, *supra* note 12, at 678 (arguing that the law of family business should expand to "[include] not just business contracts, but all bargains among participants that affect the business enterprise.").

Nor do they tell us the specific pitfalls that await these businesses when their professional and personal relationships break down.

These gaps in the literature have important implications for lawyers, lawmakers, and courts. Transactional lawyers are supposed to help their clients think through future business risks. Yet this ex-ante lawyering requires understanding the primary risks that business owners will face down the road, including disputes that may arise between the owners. Transactional lawyers typically do not handle litigation,[43] so without empirical data, it is difficult for them to know the specific risks they should address in governance agreements. Similarly, lawmakers are charged with drafting the rules that govern private companies, despite knowing little about the governance structure or dealings within these companies.

Moreover, even the best transactional lawyer cannot prevent every business dispute,[44] so courts need to be prepared to handle these disputes as well. The central challenge that courts face in these cases is the extent to which they should step in to protect minority or other vulnerable shareholders.[45] Some jurisdictions are willing to protect these owners from overreaching or other oppressive conduct by majority owners.[46] Other jurisdictions take a more modest approach, focusing primarily on enforcing parties' agreements and leaving business owners to bear the consequences of their contractual failings.[47] Deciding between these two approaches is not just a policy decision. It also reflects underlying assumptions about the types of litigation risks that individuals face when they start businesses with others, as well as whether these risks can adequately be addressed through ex-ante contracts or other formal governance structures. Without understanding how business relationships work on the ground, courts cannot effectively resolve disputes between business owners.

B. Why We Don't Know More

There are few studies on private company disputes in part because the litigation records from these disputes are very difficult to access. This study relies on recent improvements in the accessibility of court dockets in many state and federal courts. This subsection discusses these improvements in detail because they are not well-known throughout the academy and may open additional avenues for litigation research more generally.

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43. *See* Miller, *supra* note 36, at 394 (presenting data that approximately three-quarters of transactional lawyers have not litigated a dispute between majority and minority shareholders).

44. *See id.* at 400 ("An operating agreement cannot be expected to resolve all of the conflicts that may arise in a swiftly changing competitive economy.").

45. *See* Siegel, *supra* note 13, at 379 (discussing the "dilemma minority shareholders face when they are 'frozen out' of receiving any financial benefits from the corporation, while simultaneously 'frozen in' because they are unable to sell their stock").

46. *See* Means, *Nonmarket Values*, *supra* note 12, at 1201 (explaining that "in cases of shareholder oppression, courts are asked to protect minority shareholders who failed to negotiate adequately to protect their own interests").

47. *See* Robert A. Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L.Q. 1099, 1129 (1999) (explaining that Delaware expects shareholders to protect themselves via contract, "rather than expecting courts to provide protection"). Even in these jurisdictions, however, shareholders can bring claims under traditional common-law principles. *See id.* at 1136 (stating that the entire fairness test has been "applied rigorously by the Delaware courts" when majority shareholders disproportionately take benefits for themselves).

Litigation research has long been difficult and subject to significant limitations. Until fairly recently, researchers had two options when it came to studying litigation. First, they could rely on published decisions in commercial databases such as Westlaw or Lexis.[48] These databases are widely available in academic settings, and they provide easy access to published decisions. Yet they are also incomplete in important ways. One study, for example, found that commercial databases only include 3% of district court orders.[49] As a result, scholars have noted that studies that rely on commercial databases are "vulnerable to serious selection biases"[50] and, given these "obvious and well known"[51] limitations, researchers should exercise "great caution" in relying on them.[52]

Scholars who want to avoid these selection biases can try to get case records directly from courts. This approach, however, poses its own challenges. Historically, dockets and other case records from state and federal courts were not available electronically.[53] Researchers who wanted to study court records had to travel to individual courthouses and review case files by hand, an approach that was time-consuming and cost-prohibitive.[54] In 1988, the Judicial Conference of the United States made federal court dockets and filings available electronically.[55] This system, while an improvement,[56] is still clunky and can be expensive to access.[57] Additionally, it does not include state court filings. Given that the vast majority of litigation in America occurs in the state courts,[58] this limitation meant that researchers and the public more broadly still could not access most case filings.

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48. I use the term "published" broadly to include both decisions reported by an individual court, as well as decisions included on commercial databases such as Westlaw or Lexis.

49. *See* David A. Hoffman, Alan J. Izenman & Jeffrey R. Lidicker, *Docketology, District Courts, and Doctrine*, 85 WASH. U. L. REV. 681, 727 (2007) ("An astonishingly low 3% of all orders are available on the databases; more than 80% of difficult orders are similarly 'hidden' without explanation.").

50. Alexander A. Reinert, *Measuring Selection Bias in Publicly Available Judicial Opinions*, 38 REV. LITIG. 255, 258 (2019).

51. Hoffman, Izenman & Lidicker, *supra* note 49, at 728.

52. *Id.* at 727.

53. Max M. Schanzenbach & Emerson H. Tiller, *Reviewing the Sentencing Guidelines: Judicial Politics, Empirical Evidence, and Reform*, 75 U. CHI. L. REV. 715, 728 (2008) ("Until recent developments in electronic recordkeeping by courts . . . [m]ost decisions were not published in reporters; the only way to get the information was to make a trip to the courthouse and collect data by hand.").

54. *Id.*

55. *About Us*, PUB. ACCESS TO CT. ELEC. RECS., https://pacer.uscourts.gov/about-us [https://perma.cc/LFX6-8FG2].

56. *See, e.g.*, David Freeman Engstrom, *The* Twiqbal *Puzzle and Empirical Study of Civil Procedure*, 65 STAN. L. REV. 1203, 1209 (2013) (arguing that "the ready availability of electronic docket materials has permitted a degree of technical sophistication in the construction and analysis of datasets—and, with it, a scale of empirical inquiry—that were unheard of a decade ago").

57. Court filings through PACER are available at $0.10 per page with a maximum per-page cost of $3 per document. *PACER Pricing: How Fees Work*, PUB. ACCESS TO CT. ELEC. RECS., https://pacer.uscourts.gov/pacer-pricing-how-fees-work ([https://perma.cc/6N2K-XDQN]. Academics can request fee exemptions for "defined research projects intended for scholarly work." *Fee Exemption Request for Researchers*, PUB. ACCESS TO CT. ELEC. RECS., https://pacer.uscourts.gov/my-account-billing/billing/fee-exemption-request-researchers [https://perma.cc/M6QX-TM8M].

58. *See* Diego A. Zambrano, *Federal Expansion and the Decay of State Courts*, 86 U. CHI. L. REV. 2101, 2103 (2019) ("Federal courts host less than three hundred thousand civil cases a year while state courts bear the brunt of nearly seventeen million civil cases.").

More recently, some state courts have started to make their dockets, filings, and orders available online. Bloomberg Law, for example, has nearly all records from the Delaware Court of Chancery.[59] In other jurisdictions, however, access is far more limited. Some charge a steep per-page fee for accessing their case records.[60] Many state courts still do not make any of their case records available online,[61] while still others do not make their case records searchable, which means that any researcher looking for a particular type of case would have to look through every case filed in that particular court, which is not a feasible research strategy.[62]

Given the challenges of accessing state court records, litigation research has disproportionately focused on the federal courts or, in corporate law, Delaware courts.[63] This bias necessarily limits and even skews our understanding of litigation across the country. Scholars have bemoaned this limitation, stating for example that "staggeringly little legal scholarship focuses on state courts and judges."[64] Yet it has been seen as an unfortunate reality that litigation researchers must accept.[65]

Although access to state court records has been sorely lacking, this is slowly starting to change. First, in jurisdictions with electronic record access, Bloomberg Law is typically willing to obtain specific filings or judicial orders at the request of one of its customers.[66] Customers can make these requests easily through Bloomberg Law, and Bloomberg will only charge them a small fee to obtain the document.[67] Once Bloomberg has obtained the document and put it into its database, it is then available for other Bloomberg customers to

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59. *See Dockets Coverage & Outages*, BLOOMBERG L., https://www.bloomberglaw.com/dockets/coverage (on file with the *Journal of Corporation Law*) (follow "Delaware Court of Chancery" over to find that Bloomberg has over twenty-three thousand documents).

60. The Superior Court of California in the County of Los Angeles, for example, charges $1 for the first 5 pages of a court document, plus $0.40 for each additional page. *See Fee Information*, SUPER. CT. OF CAL., CNTY. OF L.A., https://www.lacourt.org/paonlineservices/pacommerce/feeInformation.aspx [https://web.archive.org/web/20210616172930/https://www.lacourt.org/paonlineservices/pacommerce/feeInformation.aspx].

61. *See, e.g.*, MONT. JUD. BRANCH DIST. CT., https://courts.mt.gov/Courts/dcourt/#dc-converted [https://perma.cc/945C-57FF] (listing the courts in the state that have not converted to electronic access).

62. As one example, in Virginia, members of the public can access some case records from some courts. To do so, however, they must first select a specific court within the state and then search that court's records by party name, case number, or other relevant information. *See, e.g.*, *Circuit Court Case Information*, VA. CTS. CASE INFO., https://eapps.courts.state.va.us/CJISWeb/circuit.jsp [https://perma.cc/5CDP-UB53]. It is not possible to search a single court website for all Virginia cases involving, for example, private company disputes or automobile accidents. *See id.*

63. *See* E-mail from Chris Herring, Bloomberg L., to Jessica Erickson, Nancy Litchfield Hicks Professor of L. (Feb. 16, 2023) (on file with author).

64. Anna E. Carpenter et al., *Studying the 'New' Civil Judges*, 2018 WIS. L. REV. 249.

65. *See, e.g.*, John Coyle & Katherine C. Richardson, *Enforcing Inbound Forum Selection Clauses in State Court*, 53 ARIZ. ST. L.J. 65, 141 (2021) ("A growing number of scholars have urged empiricists to look to court dockets—rather than judicial opinions—in order to get a more accurate measure of how judges behave. As even these 'docketologists' acknowledge, however, looking to court dockets as a source of data is only possible when researching the behavior of the federal district courts.").

66. *See Product Help & Walkthrough: Dockets*, BLOOMBERG L., https://www.bloomberglaw.com/help/dockets#docket-coverage—-us-and-international (on file with *the Journal of Corporation Law*) ("Docket items where the action is listed as Request have not yet been loaded into Bloomberg Law. Depending on the court, such documents can be requested electronically or via courier and additional charges may apply.").

67. *See Dockets Pricing*, BLOOMBERG L., https://www.bloomberglaw.com/product/blaw/document/X6V22H78000000 (on file with *the Journal of Corporation Law*).

review for free. Bloomberg has long offered this service for many federal court records through PACER, but it now offers it for a significant number of state court records as well.[68]

Second, and most importantly for this study, in select other jurisdictions that do not make their case records available online, Bloomberg sends couriers to individual courthouses to manually collect complaints.[69] The couriers typically do not collect other types of case filings, which means that this expanded coverage is limited to complaints. As a result, through Bloomberg Law, litigation researchers can now access complaints (but not other case records) filed in a fairly large number of jurisdictions.[70]

Conducting litigation research in this way is still not perfect. If litigation researchers want to access documents from the widest number of jurisdictions, they must rely on complaints collected by Bloomberg Law or a similar service. Only having access to complaints privileges the plaintiffs' version of events. In an ideal world, litigation studies would include a broader analysis of both sides' positions, as well as relevant judicial rulings. These additional court records, however, are only available in a small number of jurisdictions, including Delaware and the federal courts, which have already gotten disproportionate attention in business law scholarship.[71] As a result, litigation researchers have to choose between the depth available in these few jurisdictions and the breadth of analyzing complaints across a far wider range of jurisdictions.

Despite these limitations, however, litigation researchers now have access to more case records than ever before. This study relies on this expanded access to provide the first glimpse into private company disputes.

C. Studying These Cases

This study examines litigation between the owners of private companies in state and federal courts across the country. This Part first provides an overview of the study's methodology before briefly discussing the forums and types of companies included in the study.

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68. *See* E-mail from Chris Herring to Jessica Erickson, *supra* note 63 (attaching a spreadsheet listing all of the jurisdictions from which Bloomberg Law collects dockets, complaints and other pleadings).

69. *See id.* (providing a list of jurisdictions from which Bloomberg Law manually collects complaints). These documents are typically designated as "Manually Collected Complaints" in the dockets.

70. Specifically, according to this author's correspondence with representatives of Bloomberg Law, it offers electronic retrieval of pleadings from 264 state courts, as well as manual collection of pleadings from an additional 1262 state courts. It also automatically collects complaints from 153 state courts. *See id.* The coverage is not complete in these jurisdictions, however, so challenges certainly remain in accessing state court filings.

71. Nearly all research on securities class actions against public companies is focused on federal court, as federal courts have exclusive jurisdiction over most such cases. *See* 15 U.S.C. § 78aa(a) (2010). Moreover, most studies of other types of shareholder lawsuits have also focused on federal courts or the Delaware Court of Chancery. *See, e.g.*, Jessica Erickson, *Corporate Governance in the Courtroom: An Empirical Analysis*, 51 WM. & MARY L. REV. 1749 (2010) (analyzing data on shareholder derivative lawsuits filed in federal court); Randall S. Thomas, Robert B. Thompson & Harwell Wells, *Delaware's Shifting Judicial Role in Business Governance*, 77 BUS. L. 971, 975 (2022) (presenting data on shareholder lawsuits filed in the Delaware Court of Chancery); Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747 (2004) (examining shareholder lawsuits filed in the Delaware Court of Chancery).

1. Study Methodology

This study analyzes complaints in private company disputes filed in state and federal courts. As discussed above, for most state courts, only complaints are available through Bloomberg Law.[72] Scholars have studied shareholder litigation in Delaware and the federal courts,[73] but there are few insights into how these cases differ from the cases filed in other courts across the country. The best way to capture a broader range of jurisdictions is to focus the study on the plaintiffs' complaints. This decision limits the analysis in certain ways, leaving space for future work in this area, but it also sheds important light on the personal experiences of a diverse range of business owners.

The complaints in this study were typically lengthy, with plaintiffs providing detailed narratives about how and why their business relationships fell apart. Plaintiffs often traced the parties' history from the initial formation or investment in these companies through the deterioration of the business relationships. They also outlined how their allegations fit within specific legal claims. Focusing on these complaints therefore has limitations, but it still offers far more insight into business disputes in private companies than prior studies.

In selecting complaints, the study focuses on cases that include at least one derivative claim. A derivative claim is a claim brought on behalf of the company alleging that the defendants hurt the company in some way.[74] They are typically filed by one or more owners of a company against other owners or managers of the company.[75] Thus, these claims are at the heart of many disputes between business owners. Given that Bloomberg has collected millions of documents from various courts, researchers need to use one or more keywords to identify the documents they want. Focusing on derivative claims allowed the identification of relevant complaints in Bloomberg Law.[76]

The study includes cases filed in two particular years—2019 and 2021.[77] This focus offered a review of one full year under normal economic conditions (2019) and another full year when businesses were under particular financial and operational stress (2021). The study did not include 2020 because the COVID-19 pandemic closed many courthouses across the country, limiting access to court records. By including one year before the pandemic and one year during the pandemic, I was able to analyze private company litigation

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72. *See* E-mail from Chris Herring to Jessica Erickson, *supra* note 63.

73. *See* sources cited and discussion *supra* note 71.

74. *See* Jacobs v. Cartalemi, 67 N.Y.S.3d 63, 66 (N.Y. App. Div. 2017) ("Members of a limited liability company (LLC) may bring derivative suits on the LLC's behalf. In a derivative suit, the remedy sought is for wrong done [to the company]."); Webre v. Sneed, 358 S.W.3d 322, 329–30 (Tex. App. 2011) ("Thus, to recover for wrongs done to the corporation, the shareholder must bring the suit derivatively in the name of the corporation so that each shareholder will be made whole if the corporation obtains compensation from the wrongdoer.").

75. *See, e.g.*, 13 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5941.10 (perm. ed., rev. vol. 1995) ("The derivative proceeding is an equitable device to protect shareholders against abuses by the corporation, its directors, officers and controlling shareholders and is a vehicle to insure corporate accountability.").

76. The study also included any direct claims that were included in the same complaint as derivative claims, but all cases in the study included at least one derivative claim.

77. If the case was removed from state court to federal court, I used the date of removal as the relevant filing date.

in two different social and economic periods.[78] The cases filed across these two years were remarkably similar, as we will see.

To identify complaints with derivative claims, I began by searching the Dockets databases in Bloomberg for any variation of the term "derivative" in the two relevant years.[79] I then culled from this list any cases that did not include derivative claims, cases that were filed before the relevant period, duplicate cases, and cases brought on behalf of public companies. This culling left a total of 720 cases—366 filed in 2019 and 354 filed in 2021.

From these 720 complaints, I hand-collected nearly 200 variables. I coded data regarding the companies, including the type of entity, the year the companies were founded, their industry, and states of registration and headquarters. I also coded data regarding ownership of the companies, including the parties' respective ownership interests, how the parties acquired their ownership interests, the number of owners, and whether any single party owned a majority ownership stake in the company. Additionally, I coded how the companies were governed, including whether the plaintiff referenced a board of directors or manager, whether any party was also an employee of the company, and whether the complaint mentioned an operating agreement, shareholder agreement, or other relevant governance document.

On the allegations, I coded details on the alleged wrongdoing, as well as the specific legal claims brought by the plaintiff(s). I also coded whether the plaintiff brought direct claims in addition to their derivative claims and whether the plaintiff alleged that they were denied access to the company's books and records. Finally, I coded the remedies sought by the plaintiff.

From this coding, we have a detailed picture of the plaintiff's account of the deterioration of their business relationship. I supplemented this coding by collecting narrative details about the case where these details were available, including the plaintiffs' motivations for entering into the business relationship, why they think it deteriorated, and specific facts about this deterioration. These aspects of the plaintiffs' stories were not always amenable to quantitative analysis, but they provided rich qualitative insight into these disputes.

This methodology has important limitations. As noted above, the study only includes complaints, so it is limited to the plaintiff's version of events. It also only includes information that the plaintiffs chose to include in their complaint, so not all variables could be coded for every case. It focuses exclusively on disputes between the owners of private companies and does not examine other types of disputes that private companies may face, such as disputes with employees, suppliers, or regulators. Finally, the study only includes cases filed in the jurisdictions from which Bloomberg Law collects complaints, either

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78. Litigation in these two years could still be different from litigation in other years. As Bloomberg, other commercial databases, and courts themselves make more case filings available to researchers, we will be able examine cases for broader trends.

79. There are a handful of jurisdictions where this term was ubiquitous and therefore this search did not sufficiently narrow the scope of cases to review, including in Florida where the term "shareholder derivative" appears on every civil cover sheet. In these jurisdictions, I narrowed the search results with the following search terms: "fiduciary or contract or breach or agreement or invest! or "nominal defendant" or oppress! or stockholder or shareholder or fraud or manager or partner or dividend or director! or unjust or waste."

electronically or manually. Courts in large urban areas are overrepresented in their collection,[80] and private company lawsuits in more rural jurisdictions may look different than lawsuits in more urban areas. Nonetheless, as we shall see, the study includes significant detail on private company disputes from a broad array of jurisdictions, shedding more light on these disputes than any prior analysis.

2. Study Overview

This Part briefly provides an overview of the forums and companies included in the study, setting the stage for a broader analysis of the disputes in these cases in subsequent parts.

a. The Geography of Private Company Disputes

The study includes lawsuits from a wide variety of jurisdictions. Unlike prior studies of corporate litigation that are limited to cases from Delaware or the federal courts, this study includes cases from 31 states and U.S. territories.[81]

Within these 31 states, the study includes cases from a total of 94 different courts.[82] Bloomberg collects a significant number of complaints from California and New York, so these two states comprise nearly 50% of the cases in the study. Other top states include Texas, Delaware, Illinois, and Florida.

The vast majority of the cases in the study (87.1%) were litigated in state court. Moreover, 79.2% of the total sample was litigated in state courts in states other than Delaware.[83] These figures illustrate an important point about business disputes in the United States: Delaware does not dominate private company litigation. Indeed, this study likely drastically underestimates the percentage of business disputes that occur outside of the federal courts and Delaware because complaints from these two jurisdictions are overrepresented on Bloomberg Law.[84] Business disputes are litigated in courts across the country, and the narrow focus of prior empirical scholarship has clouded our view of these cases.

There did not appear to be much forum shopping in this study. In 80% of the cases, the plaintiff corporation was registered and headquartered in the same state, and 97% of these cases were litigated in that state. In the cases in which the plaintiff corporation was

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80. *See* E-mail from Chris Herring to Jessica Erickson, *supra* note 63 (referencing communication from Bloomberg Law listing the jurisdictions from which Bloomberg Law collects complaints).

81. These states included (in order of the percentage of cases in the study) New York, California, Texas, Illinois, Delaware, Florida, Massachusetts, Minnesota, Ohio, Pennsylvania, South Carolina, Virginia, Washington, Washington, D.C., Connecticut, Nevada, New Jersey, Georgia, Oregon, Arizona, Kansas, Oklahoma, Colorado, Hawaii, Indiana, Tennessee, Maryland, Mississippi, Missouri, Puerto Rico, and Wyoming. Some of these jurisdictions had only a few cases, while others had dozens.

82. These jurisdictions all have their own laws that govern these disputes. That said, most states other than Delaware follow the Model Business Corporation Act, so there is considerable uniformity. *See MBCA Enactments by States*, AM. BAR ASSOC. (Nov. 13, 2023), https://www.americanbar.org/content/dam/aba/administrative/business_law/mbca-resource-center-page-documents/corporate-laws-mbca-resource-centerlist-of-mbca-enactments-by-states.pdf [https://perma.cc/BAL9-LT4J] (Listing states that follow the MBCA and their codes). This Article does not address legal differences between jurisdictions, leaving this analysis for future work.

83. Delaware state cases comprised 7.9% of the total sample.

84. *See* E-mail from Chris Herring to Jessica Erickson, *supra* note 63.

registered and headquartered in different states, 84 (60%) were litigated in the state where the plaintiff corporation was headquartered, 43 (31%) were litigated in the state where the plaintiff corporation was registered (typically Delaware), and only 12 cases (9%) were litigated in a different state. Overall, therefore, 96% of the cases in the study were litigated in a state where the plaintiff corporation was registered, headquartered, or both. As these figures demonstrate, most business disputes are local.

b. The Real Private Companies

The companies in this study do not look like the unicorns or venture-backed companies that are the focus of most empirical studies of private companies. The companies at the heart of these disputes are relatively small and reflect the kinds of private companies seen all over the United States. Service companies were the most common type of business represented in the study (29%), followed by real estate investment/development companies (21%), stores or restaurants (14%), and manufacturing companies (13%).

These figures, however, mask the sheer breadth of businesses covered by this study. There were the types of businesses that one would expect to see in any city or town in America, including restaurants, bookstores, plumbing companies, bike shops, hotel franchises, trucking companies, and funeral homes. Other businesses in the study were more unusual, such as a tattoo coworking space, a southern kosher chicken restaurant, an online retail platform for high-end sneakers, and an adult entertainment company owned by a father and son. Still, other companies reflected the modern economy, from cannabis and vaping businesses to bitcoin mining companies, COVID-19 testing facilities, and influencer marketing companies. Numerous companies were involved in the TV and movie industry, from a company that owned the rights to the TV show Hoarders to a company that fell apart after an investor promised he could get Keanu Reeves to star in their movie.[85] There was even a fight for control over the company that owns the rights to manufacture RU486, the oral abortion pill.[86]

For the most part, these companies were small. The plaintiffs specified the number of owners in the company in approximately 75% of the cases, and most of these companies had only a few owners.[87] More than half (58%) had only two owners.[88] Another 31% had three or four owners, and only 2% had more than ten owners.[89]

A slight majority (55%) of the cases in this study involved at least one LLC as the plaintiff company, reflecting the growing popularity of the LLC form among small

85. He didn't get Keanu Reeves, and he also allegedly stole from the company. *See generally* Complaint, Reel Life Pictures Ltd. v. Wells, No. 19-926796 (Ohio C.P. Dec. 18, 2019).

86. *See* Hawkins v. Daniel, 273 A.3d 792 (Del. Ch. 2022), *aff'd*, 289 A.3d 631 (Del. 2023).

87. *See supra* Part I.C (describing the methodology of the study).

88. *Id.*

89. *Id.* We do not know the ownership of approximately 25% of the companies, and, in many of the cases in which the plaintiff did not include the number of owners, the companies in these cases appeared to have more owners than the typical companies in the study, including a greater number of passive investors, as well as more complex governance structures. Even including these companies, however, at least 71% of the cases involved companies with 5 or fewer owners.

businesses in the United States.[90] Another 40% involved for-profit corporations. Approximately 4% were limited partnerships, and 4% were non-profit corporations. Less than 2.5% were other types of business entities, including unincorporated associations, trusts, general partnerships, or LLPs.

This data reflects the wide variety of companies covered by modern business law. The same core legal principles govern lucrative real estate investment firms, mom-and-pop restaurants trying to survive in a small town, technology companies backed by venture capital funds, family farms passed down through generations, homeowner associations, and local non-profit organizations. Given this variety, one would expect that the disputes between the owners of these businesses would also be quite different. As we will see, however, this is not the case. Regardless of the specific type of business, the owners in these cases almost always started their relationship from a place of trust and optimism and ended with allegations of betrayal and self-dealing.

II. The Emotional Foundation of Private Companies

We imagine businesses as impersonal entities where managers make decisions driven by the bottom line and human emotions and desires take a back seat.[91] Yet, emotions took center stage in the companies studied here, and these emotions often contributed to the owners' eventual disputes. This Part explores the emotional foundations of private companies. It starts by examining the emotional ties that connect business owners as they build their companies, before turning to how these ties unravel as business relationships start to fall apart.

A. Emotions at the Founding

Businesses are run by people, and people bring the same relationships, dreams, and vulnerabilities to their business lives that they bring to other areas. As discussed below, in many of the cases in this study, the plaintiff referenced their own emotions when discussing the founding of the business. In a minority of cases, these emotions reflected a pre-existing relationship between the plaintiff and co-owners. In most cases, however, the parties referenced these emotions even if they did not have a pre-existing relationship with their business partners. This section explores how emotions impacted the founding of the businesses in this study and later set the stage for their unraveling.

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90. *See* IRS, Table 1 Number of Returns, Total Receipts, Business Receipts, Net Income (less deficit), Net Income, and Deficit, by Form of Business, Tax Years 1980–2015 (2020), https://www.irs.gov/pub/irs-soi/15otidb1.xls [https://perma.cc/8TQB-CYBU] (listing numbers of kinds of business and demonstrating increased popularity of LLCs).

91. *See* Mae Kuykendall, *No Imagination: The Marginal Role of Narrative in Corporate Law*, 55 Buff. L. Rev. 537, 539, 550 (2007) (explaining that narratives about business disputes in popular culture are "filled with boring details about finance and dominated by the figure of money . . . where emotions are banished from the cognizable discourse").

1. *Family, Friends, and Romantic Relationships*

As the adage goes, one should never mix business with pleasure.[92] Our business relationships should be serious and detached, while in our personal relationships, we can let our guard down and reveal our emotions. Yet this imagined dichotomy does not reflect the real world where business and personal relationships are often intermingled. This section explores the subset of cases (21%) in which there was a close personal relationship between the business owners, while the next section examines the trust and optimism that can arise between business owners even without these relationships.

Even though family businesses are a "clear majority of all businesses,"[93] only 16% of the cases in my study involved a family business. As this data reflects, while most businesses in the United States are family businesses, a far smaller percentage of business *disputes* in the United States involve families. This discrepancy may be because families are less likely to hurt one another in their businesses, or because they are less likely to sue when they do hurt one another. Another 5% involved prior business relationships, while 4% of the cases involved pre-existing friendships between the parties. These friendships were often quite close, with the parties serving in each other's weddings,[94] attending the same church,[95] and spending holidays and vacations together.[96] A final 3% involved romantic relationships.

The plaintiffs in these cases stressed again and again the trust they placed in their family, friends, or romantic partners, as the following examples illustrate:

- In one case, the plaintiff did not question the defendant, who was her romantic and business partner, when he gave her a Form 1099 that indicated that she was an employee of the business rather than a co-owner. The plaintiff alleged that, at this time, "she was living with [the defendant] in a romantic, personal relationship in which their finances and households were combined. Therefore, because of the nature of the parties' personal relationship, [the plaintiff] believed him" when he said she was a co-owner of the business.[97]
- In another case, the 87-year-old plaintiff alleged that he had acted as a "father figure" to his much younger sister throughout their lives, later entrusting her to run their joint real estate holdings. He stated in his complaint that "[f]or

92. *See, e.g.*, *In re* Ochello, No. 20-00717, 2022 WL 963755, at *1 (Bankr. S.D. Miss. Mar. 30, 2022) (referencing the "maxim to never mix business with pleasure").

93. *See* Means, *Nonmarket Values*, *supra* note 12, at 1192 (explaining the importance of small business in the U.S. economy).

94. *See* Complaint and Jury Demand at 11, Vosotas v. Muhl, No. 130219574 (Fla. Cir. Ct. July 7, 2021) ("He decided to go into business with his close friend at the time. . . [who] was a college friend of James, and even a groomsman at his wedding.").

95. *See* Plaintiff's Original Petition at 4, Morrison v. InterMcKinney, LLC, No. DC-21-12947 (Tex. Dist. Ct. Sept. 10, 2021) ("[The plaintiff and the defendant] had been long time friends, having first met many years ago in the late 1990's when Morrison was a Sunday school teacher at Prestonwood Baptist Church where Redeker attended.").

96. *See* Complaint at 5, Stiffelman v. Rubin, No. 19SMCV01908 (Cal. Super. Ct. Oct. 29, 2019) ("The [] families first met over twenty-five years ago when they were neighbors on Arden Drive in Beverly Hills, California. They even spent holidays together and took family vacations together.").

97. Verified Complaint at 21, Stohler v. Ebeyer, No. 19-cv-00098 (S.D. Ind. Jan. 11, 2019).

years [the plaintiff] trusted [the defendant] to the point that he literally did not oversee [the defendant's] management of the [b]uilding or its finances in any form or fashion, trusting instead that [the defendant] would always 'do right' by him and look out for his best interests."[98]

- In a third case, the defendant "leaned heavily" on the plaintiff, "repeatedly stating that Plaintiff and [the defendant] were both alumni of the same school back in China and that schoolmates like them should work together and trust each other."[99]

These cases illustrate the foundation of trust and optimism in business relationships between family, friends, and romantic partners. As we will later see, some defendants allegedly used this trust to convince plaintiffs to accept contractual terms that benefitted the defendants or to agree to informal or unwritten agreements in the business relationship.

2. Broader Trust and Optimism

Although family and other personal relationships can imbue a business relationship with emotions, the vast majority of cases did not involve these types of relationships. In most cases, the parties' primary connection was simply a business relationship. Even in these cases, however, the parties were often motivated by trust and optimism when they entered into business. In some of these cases, the plaintiff referenced these emotions explicitly,[100] while in other cases, the emotions borne of personal interactions were implicit in the narrative. Plaintiffs typically have considerable freedom to tell their stories in their complaints,[101] and some complaints were more bare-bones than others. The point here is not that business owners are always influenced by emotions, or even that a specific percentage of plaintiffs are influenced by these emotions, but rather that these emotions are often present at the start of a business relationship.

Plaintiffs frequently referenced their optimism when they went into business with their co-owners. The complaints reflect that people have a deep desire to see business opportunities as a chance to change their lives. One set of plaintiffs, for example, stated that, upon hearing about the business proposal, they "immediately recognized that [it] represented the best business opportunity of their lives."[102] In several cases, the defendants confidently maintained that the plaintiff's investment was "100% safe" or made other similarly bold promises.[103] The plaintiffs believed these promises, perhaps reflecting what is known

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98. Verified Complaint at 5, Assejew v. Assejew, No. 700465/2021, § 18 (N.Y. Sup. Ct. Aug. 30, 2021).

99. Verified Derivative Complaint at 8, Zhou v. Li, Case No. 21STCV40055 (Cal. Super. Ct. Nov. 1, 2021).

100. These emotions were not coded separately in the study because they appeared so differently from case to case. In some cases, the plaintiffs spoke at length about their trust in the defendant or their optimism in the business relationship. In some cases, the plaintiff mentioned it briefly, including in what could feel like boilerplate in the counts themselves. In still other cases, the plaintiff's trust, optimism, or other emotions were implicit or even a key part of the narrative, even if not mentioned explicitly. This spectrum of emotions does not lend itself to precise quantitative coding, but it was palpable in reading the complaints.

101. *See* Scimone v. Carnival Corp., 720 F.3d 876, 884 (11th Cir. 2013) (referencing "the general principle that plaintiffs [are] masters of their complaints").

102. First Amended Complaint at 5, Kealey v. Russell, No. 19-CV-00741 (D. Nev. June 18, 2020).

103. Verified Complaint at 9, Ohana v. Gilad, No. 510681/2019 (N.Y. Sup. Ct. May 14, 2019).

as the "egotistic bias," which is that "those with the most self-confidence will be able to induce the most trusting behavior by others."[104]

The plaintiffs often alleged that the defendants preyed on their trust when convincing the plaintiff to invest in the business and/or negotiating the terms of the investment. In one business, for example, the defendant convinced the plaintiff that "her proposed [cannabis] venture would be a once-in-a-lifetime opportunity to get in on the ground floor of a billion dollar industry."[105] In another case, the parties negotiated the terms over text messages, and the defendant leaned hard on the parties' nascent relationship in convincing the plaintiff to invest, stating, "It's people you meet in life bro that become brothers immediately. You became my bro from day 1. . . We family bro . . . Now let's get this money."[106] A third plaintiff stated that he had "the utmost trust and confidence" in his business partners when opening up a set of restaurants and lounges, relying on them to "act fairly and in good faith regarding any and all business dealings that they pursued together."[107]

This last statement might seem like legal boilerplate, but one would not find similar statements in shareholder complaints involving public companies. The shareholders of public companies may trust the overall integrity of the market or the validity of a company's financial documents, but they rarely have this level of *personal* trust in a public company's officers or directors.[108] Yet people invest in private companies because they trust their fellow founders or investors. To be clear, some private company investments were complex commercial transactions negotiated at arm's length, but as described in the next section, trust and optimism were often substitutes for formal bargaining.

In a small number of cases, the plaintiffs pointed to specific reasons that they were vulnerable to the defendants' emotional appeals. For example, in 2% of cases, the plaintiff noted that they were elderly and had to rely more on the defendants. In another 1.4% of cases, the plaintiff alleged language or health challenges that made them more susceptible to self-dealing. These plaintiffs were often vulnerable members of society and relied on the defendant's representations to help them navigate financial decisions. One plaintiff described himself as "illiterate in English and . . . unable to read complex English sentences," and alleged that he therefore trusted the defendant to explain the terms of the operating agreement for their jointly owned deli.[109] Another plaintiff immigrated to the United States from Bangladesh where he met a food distributor who acted as "his brother" and convinced him to borrow $50,000 from friends and family to invest in the business, later denying that the plaintiff had any ownership interest in it.[110] These cases, however, were relatively rare,

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104. Donald C. Langevoort, *Taking Myths Seriously: An Essay for Lawyers*, 74 CHI.-KENT L. REV. 1569, 1576 (2000).

105. Complaint at 3, Ramlie v. Ashby, No. 19STCCV06338 (Cal. Super. Ct. Feb. 25, 2019).

106. Original Petition and Application for Temporary Restraining Order and Temporary and Permanent Injunctive Relief at 8, Donsino Enters., LLC v. Settles, No. DC-21-17029 (Tex. Dist. Ct. Nov. 23, 2021).

107. Complaint at 7, Bueno v. Benhamou, No. 21-cv-04595 (C.D. Cal. June 3, 2021).

108. I use the term "trust" here as it has been used in the legal and psychological literature to include both affective and cognitive elements. Affective trust is grounded in morality and "an optimistic view of others, whereas cognitive trust is more strategic and is based on "a cost-benefit analysis of the act of trusting someone." Frank B. Cross, *Law and Trust*, 93 GEO. L.J. 1457, 1465 (2005).

109. Verified Complaint at 4, Byun v. Baek, No. 652660/2021 (N.Y. Sup. Ct. Apr. 21, 2021).

110. Complaint at 5, 13–14, Rahman v. Mannan, No. 721040/2021 (N.Y. Sup. Ct. Sept. 21, 2021).

with most of the plaintiffs presenting themselves as average people hoping to use their business venture to find their path to financial success.

It would be easy to think that celebrities would be immune to these emotional appeals or that they would be shielded from these appeals by a cadre of business advisors. Yet a surprising number of cases in this study involved celebrities, both as plaintiffs and defendants. The baseball player Alex Rodriguez got into a business dispute with his ex-wife's brother when Rodriguez's marriage broke up.[111] The Hollywood talent manager Scooter Braun was sued by his business partner after he pulled out of a deal to form his own private equity company.[112] Shaquille O'Neal invested in a cannabis company and later sued the company's manager.[113] Russell Simmons sued his ex-wife Kimora Lee and her husband after the defendants loaned out their stock in a company jointly owned by the three to pay the husband's bond and other expenses in a criminal trial.[114] These celebrity cases illustrate the ubiquitousness of personal disputes in business. Investors often start as optimists, whether they are among the more vulnerable members of our society or the most famous.

The type of optimism that often exists at the founding of a private company is fairly unique in the business world. When someone invests in the public markets, they may hope that the corporate managers overseeing their investments will act faithfully. They are optimistic that their investments will pay off and may believe that they can beat the market.[115] But investing money in a retirement account or mutual fund still does not have the emotional tenor that one feels when opening a restaurant, starting a medical practice, or taking over the family business. These business decisions are also decisions about an individual's career and the way they hope to spend their day-to-day lives, so they are infused with more emotion than typical investment decisions. Even the passive investments in this study were often negotiated personally with company insiders, sparking an emotional connection that seldom exists in the public markets.

This point is consistent with Margaret Blair and Lynn Stout's influential work on the role of trust in corporate law. As they have persuasively argued, "trust play[s] an important

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111. Complaint, Scurtis v. Rodriguez, No. 2021-000701-CA-01 (Fla. Cir. Ct. Jan. 8, 2021).

112. Complaint for Damages for Fraud, Breach of Fiduciary Duty, Aiding and Abetting of Fiduciary Duty, and Breach of Contract, Comisar v. Braun, No. 21STCV20461 (Cal. Super. Ct. June 1, 2021). And yes, this is the same Scooter Braun of Taylor Swift fame. *See* Brittany Spanos, *Taylor Swift vs. Scooter Braun and Scott Borchetta: What the Hell Happened?*, ROLLING STONE (July 1, 2019), https://www.rollingstone.com/music/music-news/taylor-swift-scooter-braun-scott-borchetta-explainer-853424/ [https://perma.cc/WP6N-YZ96].

113. Complaint for Breach of Oral Contract and Breach of Fiduciary Duty, O'Neal v. Campbell, No. 21-cv-09158 (C.D. Cal. Nov. 22, 2021).

114. Complaint for: Breach of Contract; Declaratory Judgment; Fraudulent Concealment; Conversion; Breach of Fiduciary Duty; Breach of Confidential Relations/Constructive Fraud; and Quantum Meruit at 2, Simmons v. Leissner, Case No. 21STCV18852 (Cal. Super. Ct. May 18, 2021) ("While awaiting his plea deal and sentencing in 2018, Defendants [], knowing full well that they would be required to pay tens of millions for bail and a victim compensation plea-deal, conspired with each other, and with all Defendants, to effectuate the unlawful fraudulent scheme set forth herein.").

115. *See, e.g.* Sergio Alberto Gramitto Ricci & Christina M. Sautter, *The Educated Retail Investor: A Response to 'Regulating Democratized Investing'*, 83 OHIO ST. L.J. ONLINE 205, 208 (2022).

role in the success of many business firms,"[116] especially in closely held companies.[117] Unlike the shareholders in public companies, minority owners of closely held companies often cannot rely on voting or exit rights to protect them. They can try to bargain for additional protections, but as scholars have noted, even the best-written contracts cannot fully protect business owners.[118] Moreover, the owners of small businesses cannot easily sell their ownership interest, so they have fewer exit opportunities than shareholders of public companies and need to rely more on their fellow owners. As a result, trust helps to fill in this gap. When the owners of a company trust each other, this trust can reduce the risk of opportunism and shirking. Put another way, "people aren't 'credulous idiots.'"[119] Instead "they are rational actors who depend on a measure of trust to play in the commercial economy."[120]

Trust, however, only works if the owners of a company are trustworthy. Trust may make people more likely to agree to power imbalances within businesses and less likely to insist on formal protections, both of which can backfire when people turn out not to be trustworthy or when the relationship deteriorates. This point does not mean that Blair and Stout were wrong to highlight the benefits of trust in corporate governance. For the vast majority of companies, business owners benefit from their trust in each other. In some companies, however, this trust opens the door to self-dealing.

B. Trust and Optimism in the Trenches

When parties trust each other, it can change the way that they do business. This Part explores the governance of the companies in the study. It first presents data on contracting and power dynamics in the cases. This data supports what I call a "light governance" model in which business partners rely on a mix of simple agreements and informal understandings to govern their relationships. It then describes the imbalances of power in many of these cases that leave plaintiffs vulnerable to alleged exploitation by the defendants. This discussion sets the stage for data on the messy business breakups in the next section.

1. Light Governance

In thinking about formal agreements in private companies, it is easy to fall into all-or-nothing thinking. Either the parties sat down and negotiated complex agreements that tried to anticipate every eventuality, or they had no formal documentation at all, relying on trust and a handshake. Some companies in the study did fall into these extremes. In several cases, especially in Delaware, the parties entered into written agreements covering nearly every aspect of their business relationship. One plaintiff, for example, wanted to make clear

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116. Blair & Stout, *supra* note 40, at 1780.

117. A closely held corporation is one with relatively few shareholders, limited exit rights, and little separation between the owners and managers. *See, e.g.*, JOEL SELIGMAN, CORPORATIONS: CASES AND MATERIALS 533 (1995). Most of the corporations in this study fall within this definition.

118. *See* Means, *Contractual Foundation*, *supra* note 12, at 731 (2014) (explaining that, when forming businesses, "parties cannot be expected to anticipate and adequately address all eventualities that may occur over time").

119. David Adam Friedman, *Impostor Scams*, 54 U. MICH. J.L. REFORM 611, 617 (2021).

120. *Id.*

to the court that their bargain was not a "deal on a napkin" but instead "included a multi-month negotiation of long[-]form contractual agreements drafted by attorneys."[121] At the other end of the spectrum, other plaintiffs stressed that they had not entered into any written agreements, had no bylaws or charter, and had never elected directors or officers, instead operating entirely informally.[122]

Most cases, however, fell somewhere between these two extremes. These companies followed what might be called a "light governance" model. They did not follow all of the formalities of public companies, but they took at least some time to think through their governance structure. As discussed above,[123] nearly all of the businesses in this study were a type of registered entity, such as an LLC, corporation, or limited partnership, so these owners all formally registered their businesses with the state. Moreover, in 67% of cases, the plaintiff referenced some sort of written agreement or other documentation relevant to the business. References to these written documents were far more common in cases involving LLCs or limited partnerships than corporations. 70% of cases involving an LLC referenced an operating agreement, and 76% of cases involving a limited partnership referenced a partnership agreement. In contrast, only 25% of cases involving a for-profit corporation referenced a shareholder agreement, while 10% referenced the corporation's bylaws or charter.

In 23.9% of cases, the plaintiffs referred to other types of documents as well. The agreements most commonly cited in the complaints were purchase or investment agreements, loan agreements, term sheets, employment agreements, agreements related to intellectual property, and management agreements. These agreements rarely existed in isolation. In cases where the parties had a loan agreement, for example, they often also had another type of agreement, such as an operating agreement, shareholder agreement, or employment agreement. This phenomenon has been documented in public companies where scholars have explored why parties memorialize the terms of complex mergers and acquisitions in multiple separate but related agreements.[124] The scholarship on this topic is not nearly as robust in the private company sphere, but the data here suggests that parties in private companies can similarly rely on interrelated contracts, especially when a party anticipates playing multiple roles at the company, such as an investor, lender, employee, and/or manager.

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121. Complaint for Damages for Fraud, Breach of Fiduciary Duty, Aiding and Abetting of Fiduciary Duty, and Breach of Contract, *supra* note 114, at 3.

122. *See, e.g.*, Verified Complaint at 5, Inglese v. Black Swan Technologies, LLC, No. 2:21-cv-00822 (M.D. Fla. Nov. 4, 2021) ("[T]here was never an operating agreement, membership agreement, shareholder agreement, voting rights agreement, bylaws, or any other corporate document drafted and either signed or filed for, by, or on behalf of, Black Swan Technologies, with the exception of the original Articles of Incorporation for Black Swan Technologies filed with the State of Florida."); Verified Derivative Complaint and Petition for Equitable Dissolution at 4, Grgurev v. Licul, No. 157551/2019 (N.Y. Sup. Ct. Aug. 2, 2019) ("The Corporation has never had legitimate governance. There is no written shareholder agreement and there are no duly-elected directors. There have never been any shareholder meetings, corporate resolutions or elections of officers or directors.").

123. *See* discussion *supra* Part I.C.2.

124. *See* Cathy Hwang, *Unbundled Bargains: Multi-Agreement Dealmaking in Complex Mergers and Acquisitions*, 164 U. PA. L. REV. 1403, 1405 (2016) (exploring "why deals are memorialized with constellations of agreements, rather than with just one").

These companies also typically adopted other formal governance structures. In the cases involving corporations, for example, 76.1% referenced a board of directors. In cases involving LLCs, 71.7% of the complaints specified that the LLCs were manager-managed. These figures mean that the parties took the time, either at the company's founding or later in the company's trajectory, to put basic governance arrangements into place.

Despite these governance structures, however, time and again, plaintiffs stressed that their businesses were run informally. The following are representative quotes from cases in the study:

- In a case involving a fairly large corporation that owned multiple hospice centers, the plaintiffs alleged that "there has never been an election of officers of Solace Hospice. There have been no annual meetings of Solace Hospice. Corporate formalities have not been followed."[125]
- In a case involving an "island-themed party vessel" in Florida, the parties agreed to their respective responsibilities and filed Articles of Incorporation with the state, but the plaintiff alleged, "[u]pon information and belief, no Bylaws for Mermaid Island Vibes were created" and the defendant "named herself the sole director of Mermaid Island Vibes." The plaintiff also stated that she had "no knowledge as to whether any certificate for shares was issued to [the defendant] and, if so, for how many shares or what percentage of Mermaid Island Vibes."[126]
- In a case involving a sandblasting company owned equally by two individuals engaged to be married, the parties filed Articles of Incorporation, elected a board of directors (composed of the engaged couple and the future husband's mother and father), and appointed officers. Yet "the corporate practices and meetings were as informal as one would expect them to be at a small corporation . . . . While no formal meetings occurred, the conduct of the business was discussed throughout the year, during family meetings, meals, and the like."[127]

As these examples indicate, many of these companies had at least a minimal governance structure, but it was far from complete.

Light governance can play out in a variety of ways. In several cases, for example, the parties drafted governance documents but then never executed them. In one medical practice, for example, the founding doctor hired a lawyer in 2004 to draft a shareholder agreement to allow a new doctor to become a shareholder in the practice. Yet the parties did not execute the agreements until 2016, although both doctors worked at the practice and carried on as co-owners for the intervening dozen years.[128] In another case, the plaintiff

125. Complaint at 4, Dillon v. Davis, No. 1:21-cv-00109 (S.D. Miss. Apr. 5, 2021).

126. Complaint at 4, Anderson v. Colsant, No. 137542477 (Fla. Cir. Ct. Oct. 29, 2021).

127. Verified Complaint at 14, Novack v. McDermott, Case No. 19SMCV00968 (Cal. Super. Ct. May 28, 2019).

128. Complaint for Declaratory Judgment and Derivative Relief at 3, Zelkowitz v. South Suburban Neurology, LTD, No. 2019-CH-06685 (Ill. Cir. Ct. May 31, 2019).

remembered that the parties had hired a lawyer to draft an operating agreement but couldn't find any record that any of the LLC members had ever signed it.[129]

In other cases, the parties had formal documentation but did not follow the governance scheme laid out in these documents. For example, the governing documents might contemplate a board of directors and officers, each with specified responsibilities, but then one or more individuals end up running the company without adhering to these formal roles.[130] Alternatively, the parties might put one set of rules in their written agreements but then verbally agree to different rules. As one example, the parties might agree to a split that gives one party a larger ownership interest, but then agree to run the company as "equal partners."[131] As discussed more in Part IV, transactional lawyers should advise smaller, private companies with this light governance model in mind.

2. Connecting Light Governance and Trust

This light governance model is likely related to the trust and optimism discussed in Part II. Investors want some protections but may not see the need for more formal arrangements because they trust their co-founders or other investors. It is admittedly difficult to present precise data connecting the role of these emotions to parties' willingness to adopt light governance models. In some cases, the plaintiff explicitly discussed the trust they had in their co-founders or co-investors, explaining in detail how this trust caused them to agree to certain arrangements. More commonly, however, trust was referenced only briefly in the plaintiffs' recounting of events or was simply implicit in the narrative. The point of this section, therefore, is not to present quantitative data; instead, it is to make a more qualitative argument about the role of trust in companies with light governance.

The connection between trust and light governance is the easiest to see in cases in which the parties had a pre-existing personal relationship. In a family business, for example, it is natural that the parties would rely more on family bonds than lengthy contracts. Some parties made this point explicitly. For example, in a case involving a jewelry and pawn shop owned by two cousins, each of whom owned half of the company, the plaintiff stated that "[d]ue to their familial relationship, the arrangement between Benitez and Iturrey was informal: there is no LLC operating agreement, and there are no LLC bylaws."[132] In other cases, the plaintiff did not read the documents they signed because, as they stated in their complaints, they trusted their family members to treat them fairly.[133]

Trust can also develop throughout the parties' working relationship, making them more vulnerable when it comes to deciding operational details or re-negotiating contractual

129. Verified Complaint at 3, Armored Combat League, LLC v. Brooks No. 2019-0463 (Del. Ch. June 18, 2019).

130. *See, e.g.*, Verified Complaint, Jordan v. Sagar, No. 654315/2019 (N.Y. Sup. Ct. July 29, 2019) (providing an example of a case where formal documentation existed but was not followed).

131. Complaint at 2, Johnson v. Carlson, No. 27-cv-7439 (Minn. Dist. Ct. May 1, 2019).

132. Complaint at 2, Benitez v. Cognati Invs. LLC, No. 2021-024893-CA-01 (Fla. Cir. Ct. Nov 10, 2021).

133. *See, e.g.*, Complaint at 16–19, Klujian v. Klujian, Case No. 2019CH04881 (Ill. Cir. Ct. Apr. 16, 2019) (alleging that his family's estate planning attorney visited him while he was in the hospital after having several strokes and convinced him to sign documents giving his brother control over certain of his business interests).

terms. A case involving a cannabis distribution company illustrates this point.[134] According to the allegations in the complaint, the plaintiff left her job as a corporate lawyer at one of the country's largest law firms to work full-time as one of the founders to get their cannabis company off the ground.[135] A few years into the business relationship, the defendants allegedly convinced the plaintiff to renegotiate their written agreements, giving the defendants more control over the business. When the plaintiff hesitated, one of the defendants convinced her that she should sign the agreements but that he would not enforce them.[136]

The exchange between the parties on this point is worth quoting at length because it shows the interconnection between trust and light governance in these small companies. The plaintiff alleged:

> At this meeting [to renegotiate the written agreement], [the defendant] begins the conversation by stating essentially that the '4-year term is just a formality that he wants on paper, but he will not enforce it.' . . . [The defendant] proceeds to repeatedly tell [the plaintiff] to trust him and states something akin to: 'Look at me . . . Hello. . . it's me. . . It's Raj. You know me. You can trust me. You not signing this tells me that I can't trust you. I promise you it will be okay. We are going to sign these documents and forget about them because they don't matter.
>
> I am a handshake kind of guy and you know my word is everything. We are going to forget about these documents the moment you finish two more beet salads and we leave here, and we will continue working together for 50 more years until you come to me and say, 'Raj, I'm done working, thank you!'[137]

When she continued to hesitate, her other business partners (one of whom was also her mentor at the law firm) similarly relied on exhortations of trust to get the plaintiff to agree to the new deal, stating "[t]rust me, I won't let him screw us."[138] The plaintiff alleged that she later learned that the defendant's statements were "all lies."[139]

This case is far from unique. Time and again, plaintiffs alleged that they went along with the light governance model because they trusted their fellow investors. In the case quoted above, the parties had worked together for a few years when the defendants made their pitch to trust them. In other cases, however, trust comes at the beginning of the relationship, illustrating that parties do not need a pre-existing relationship to trust one another.

A case involving a company that conducted clinical trials illustrates this point. The company was founded by the two plaintiffs in 2014 as a "major disrupter of the traditional clinical trial industry" to conduct "virtual, site-less FDA-regulated clinical trials."[140] After raising $42.5 million in their first three rounds of financing, they decided to raise additional

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134. *See* Verified Complaint at 2–5, Militello v. VFarms1509 Inc., No. 21SMCV00789 (Cal. Super. Ct. Apr. 29, 2021) (showing the changing nature of relationships between business partners).

135. *Id.* at 11, 19.

136. *Id.* at 28–30.

137. *Id.* at 33–34.

138. *Id.* at 32.

139. Verified Complaint, *supra* note 134, at 33–34.

140. Verified Complaint at 3, Craft v. Science 37, Inc., No. 19STCV14357 (Cal. Super. Ct. Apr. 24, 2019).

funds through Series D financing.[141] Before this last round of financing, the founders had three board seats and the outside investors had three board seats.[142] As part of the new funding round, the founders agreed to give up one of their three board seats, shifting control of the board to the investors and placing their roles as CEO and CMO at risk.[143]

Again, the founders alleged that they decided to accept this deal at least in part because they trusted the other parties. The investor "repeatedly assured [the founders] that they were the key ingredients to the success of the company" and "that he would not seek to remove them as CEO and CMO."[144] Even when this investor "slip[ped]" and mentioned his plans to replace the CEO on a conference call before the investment was finalized, the founders trusted him when he said that he had misspoken and that he intended to keep them in their officer roles.[145] The founders "believed" these representations and did not seek to formally protect their officer positions in the written agreements.[146] As this case illustrates, it is not just small family-owned businesses that rely on trust as a governance tool; trust can play a role even in sophisticated start-ups worth millions of dollars.

3. Imbalances of Power

The plaintiffs in many of these cases were also vulnerable because they agreed to minority ownership stakes or to forgo a management role. In the cases in this study, the defendants were more likely than the plaintiffs to own a majority stake in the company. The plaintiff provided the ownership percentages for both sides of the dispute in 72% of the cases. The plaintiff only owned a majority of the company in 13.5% of these cases. In another 38%, the plaintiff(s) and the defendant(s) each owned half of the ownership stake. In 38.7%, the defendants owned a majority of the company. Finally, in 9.8%, neither side owned a majority of the company. As these figures indicate, it was more common for the defendant to have a majority interest than the plaintiff, but there were plenty of cases where ownership was split or where the plaintiff owned a majority of the company.

The defendant was also more likely to have a controlling managerial or officer position. In the manager-managed LLCs, the plaintiff alleged that they were a manager of the LLC in 40% of the cases, whereas they alleged that the defendant was a manager of the LLC in 94% of the cases. Similarly, in the cases involving limited partnerships, the plaintiff alleged that they were one of the general partners in 13.8% of the relevant cases, while they alleged that the defendants were among the general partners in 79% of the cases. In corporations, the plaintiff alleged that they had served on the corporation's board of directors or had the right to appoint one or more directors at any point in 43% of cases, while they alleged that the defendant had the same power in 70.6% of cases.[147]

Finally, the plaintiffs were slightly less likely than the defendants to have formal positions as top officers of the company.[148] While a nearly identical percentage of cases

141. *See id.* at 21.
142. *See id.* at 21–22.
143. *See id.* at 31.
144. *Id.* at 6.
145. Verified Complaint, *supra* note 140, at 38–39.
146. *Id.* at 46.
147. *See supra* Part II.
148. *Id.*

involved a plaintiff or a defendant serving in some type of employee role (40.3% of plaintiffs compared to 41.9% of defendants), defendants were more likely to have top officer positions.[149] Plaintiffs, for example, only held the CEO position in 9.7% of cases, while defendants held it in 31% of the cases.[150] Plaintiffs only served as Chief Financial Officer or a similar role in 1.9% of cases, whereas defendants served in this type of role in 12.9% of cases.[151]

To summarize these findings, it is common for the founders or other owners of private companies to begin their relationship with trust in their fellow investors and optimism in their future business relationship. Perhaps because of this trust and optimism, some plaintiffs agree to business structures in which they have fewer contractual protections and less power. As we shall see, these concessions can lead to the quick and painful disintegration of business relationships.

C. The Cost of Betrayal

1. Fast Failures

When the business relationships in private companies fail, they fail fast. This finding may be at odds with the generally accepted views of transactional lawyers. When transactional lawyers help small business owners get their company off the ground, they often aim to draft agreements that can accommodate the inevitable changes as a business grows over the years.[152] In family businesses especially, lawyers often focus on helping businesses last through generations.[153]

It makes sense that lawyers want the agreements that they draft to help their clients over the long haul. Yet this long-term focus may miss the fact that, when business relationships fall apart, they tend to do so quickly. The most challenging period for business relationships is not decades down the road as the business grows and evolves. It is the first several years after the business is formed.

In approximately three-quarters of the cases in this study, the plaintiff provided the year in which the company was founded in their complaint. In these cases, the median number of years between the founding of the company and the filing of the lawsuit was six years. One might think that the COVID-19 pandemic hastened the breakdown of business relationships, but the median was nearly identical for both 2019 and 2021,[154] suggesting that this statistic may be fairly stable. Remarkably few business relationships ended up in litigation two or more decades after the business was formed. Table 1 shows the percentage of companies in the study that had a lawsuit between the owners within the specified number of years.

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149. *Id.*

150. *Id.*

151. *Id.*

152. *See, e.g.*, George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 BUS. LAW. 279, 307 (2009) (noting that "many . . . areas of business practice require extensive planning for future dealings").

153. *See* Means, *supra* note 39, at 1289 (arguing that family businesses have a duty to put succession plans in place long before the succession actually occurs).

154. In 2019, the median number of years between a company's formation and the filing of litigation was 6.5 years; in 2021, it was 6 years.

Table 1: Years Between Company Formation and Litigation

Years Between Formation and Litigation	Number of Companies	Percentage of Companies
0–2 years	91	17.2%
3–5 years	146	27.6%
6–8 years	79	14.9%
9–11 years	39	7.4%
12–14 years	52	9.8%
15–20 years	51	9.6%
21+ years	71	13.4%

This data highlights an important point for lawyers who work with small businesses. While lawyers hope that the business structures, they put in place will last for years to come, the reality is that, when business relationships fail, they typically fail fast. As a result, lawyers should pay just as much attention to conflicts that may arise over a shorter time horizon.

2. *Contentious Breakups*

When public companies fail, the dissolution can feel clinical. Bankruptcy lawyers are called, creditors are contacted, and the company's assets are distributed. The end of public companies may have significant personal repercussions for employees and other stakeholders, but the large institutional shareholders who own the majority of public company stock in America today are typically not involved in this emotional fall-out. Private companies are different. When private companies fail, or when the business relationships at the heart of these companies fail, the process is anything but clinical. The breakups in this study were messy and emotionally charged.

Many of these breakups were personally painful for the parties precisely because these relationships began with trust and optimism, as described in Part II.A. In case after case, plaintiffs shared wrenching details about how they were betrayed by people who had been close to them. In one case, for example, the plaintiff alleged that "[d]uring their partnership, [the plaintiff] treated [the defendant] like family and put additional trust in [the defendant] for that reason." Yet, "on the same day as the plaintiff's father's funeral, the defendant stole [nearly $10,000] that should have gone to the partnership."[155] Another case involved a sheet metal fabrication company co-owned by a mother and her four adult children. When the relationship between the mother and the plaintiff (one of her children) broke down, she allegedly fired him from the business, despite the fact that he was suffering from Stage 4 cancer and relied on the business for his health insurance.[156]

155. Verified Complaint for Damages and For an Accounting at 7, Norris v. Galanter, No. 19STCV17514 (Cal. Super. Ct. May 21, 2019).

156. Complaint for Retaliatory Discharge, Declaratory Relief, and Accounting at 2, Kuzelka v. Kuzelka, No. 19-cv-06408 (N.D. Ill. Sept. 26, 2019).

The disputes can also be petty. One plaintiff, for example, requested to inspect the company's books and records. The defendant allegedly agreed to allow the inspection, but "insisted the review take place standing, and in the offices he hostilely posted a photograph of [the plaintiff's] attorney with the word "LOSER" written on the forehead."[157] In another case in which the plaintiff claimed that she has a "well-known . . . phobia of lizards and iguanas," the defendant allegedly broke into her office and put "various pictures of iguanas on her computer screen."[158]

In multiple cases, the parties alleged that they had to involve the police or criminal courts. One plaintiff, for example, alleged that she had to get a restraining order after she came out of her house "to find her car window shattered" by her former boyfriend and business partner.[159] In another case, an 86-year-old plaintiff alleged that he and his business partner had a dispute about specific language in the operating agreement, which resulted in the defendant "violently striking the 86-year-old in the head, grabbing him by the collar, and then shaking him, again, violently, while he sat defenselessly in a chair."[160] In a third case, the defendant had her ex-husband who owned 49% of their metal fabrication company arrested for burglary after allegedly trespassing at the company.[161]

These cases are not isolated examples. Time and again, the business break-ups included personal grievances and insults. Here are a few sample exchanges between or about business partners as their relationship was disintegrating:

- "In response to Mr. Bannon's request for information, Mr. Hearn declared 'I am done with this partnership' and 'F you John.'"[162]

- "You're an a****** and you're a psycho. You're a f****** psycho, pal . . . . Frankly you need psychiatric help . . . We don't give a s***, Jerry. We don't give a s***. Send us all the f****** lawyer's letters you want. We got lawyers who'll take care of it. We don't give a s***. You pay for it. We don't. We'll bankrupt your ass, pal."[163]

- "The Rikers are formidable opponents . . . They have been dispatched by the devil, but we shall prevail!"[164]

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157. Complaint for Damages and Equitable Relief at 10–11, Caiozzo v. Beachwood Master Com., LLC, No. 21STCV30656 (Cal. Super. Ct. Aug. 18, 2021).

158. Verified Complaint at 31, Cohen v. Segev, No. 135785012 (Fla. Cir. Ct. Oct. 1, 2021).

159. Verified Complaint, *supra* note 129, at 20.

160. Verified Complaint, *supra* note 109, at 6 (attaching pictures of the alleged assault from the store's surveillance cameras).

161. Complaint at 8, Tommasi v. Tommasi, No. 654332/2019 (N.Y. Sup. Ct. July 30, 2019).

162. Verified Complaint and Demand for Injunctive Relief at 6, Bannon v. Hearn, No. 19-0215 (Mass. Super. Ct. Feb. 15, 2019).

163. Complaint for Damages and Injunctive Relief at 6, Block v. Humble, No. 19SMCV02000 (Cal. Super. Ct. Nov. 13, 2019).

164. Verified Stockholder Derivative Complaint at 31, Riker v. Gilbertie, No. 2021-0561 (Del. Ch. July 1, 2021).

- "Go get a f****** job. Ur always going to be a loser."[165]

These allegations reveal a deeper truth about private company disputes. These disputes are *dominated* by strong emotions and imploding personal relationships. In this way, they are starkly different from public company disputes. In public companies, there may be strong emotions behind the scenes—investors may be angry about a company's business decisions and corporate managers may disagree about the right course of action—but the disputes are still not nearly as personal. As a result, these business breakups are more likely to be negotiated events overseen by lawyers and related professionals. In contrast, by the time the disputes in private companies have escalated to the levels described above, lawyers can only do so much because the opportunity to have the parties sit calmly around the table and discuss the company's future may have passed.[166]

III. (Nearly) All Roads Lead to Self-Dealing

As we have seen, disputes between the owners of private companies are often contentious and emotionally charged. This Part discusses why these business relationships fell apart. As the data reveals, nearly all of the business disputes in this study involved alleged self-dealing.[167] This Part explores the role of self-dealing in business break-ups, documenting the four specific types of self-dealing that commonly arise. This discussion sets the stage for the discussion in Part IV on the lessons that these cases offer for lawyers, lawmakers, and judges.

A. Self-Dealing, By the Numbers

Overall, 90.1% of the cases involved some type of self-dealing. This study defines self-dealing to include allegations that the defendant benefitted financially from their ownership in and/or position at the company in unlawful ways. Of the self-dealing cases, nearly all (90%) involved alleged self-dealing by an owner with a meaningful level of control over the business through either majority ownership or operational control. This alleged self-dealing fell into four main categories, listed here in order of prevalence: (1) theft, (2) freeze-outs, (3) competition, and (4) dilution of or disputes over ownership interests. Table 2 sets out the incidence of each of these categories in the cases in the study.[168] It also breaks down the results by year to explore whether the COVID-19 pandemic changed the nature of business break-ups in private companies.

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165. Verified Derivative Complaint at 9, Herman v. Coffman, No. 21STCV46617 (Cal. Super. Ct. Dec. 22, 2021).

166. As discussed in Part IV, it is crucial for lawyers to intervene and try to prevent the type of self-destructive behavior described here.

167. It is important to note here again that this study focused on lawsuits that included at least one derivative claim. Future work is necessary to determine whether fully direct suits also include such a high percentage of self-dealing claims.

168. Individual cases could involve multiple different types of self-dealing. For example, a case might involve a defendant who allegedly stole from the company before freezing out the plaintiff or starting their own competing business.

Table 2: Types of Self-Dealing

	All Cases	Cases Filed in 2019	Cases Filed in 2021
Theft	75%	75.6%	74.3%
Freeze-out	35.1%	33.1%	37.3%
Competition	18.9%	19.7%	18.1%
Dilution or Disputes over Ownership	17.5%	16.7%	18.4%

The pandemic caused changes in nearly every aspect of society, so it would not be surprising if it also spurred new types of self-dealing or other misconduct. As Table 2 indicates, however, the prevalence of self-dealing in the 2019 cases was quite similar to the self-dealing in the 2021 cases. Theft was the most common type of self-dealing in both years, followed in order by freeze-outs, in both years. Dilution or disputes over ownership were slightly more common than competition with the business in 2021, but the difference is small. The COVID-19 pandemic did give owners new ways to carry out their self-dealing. For example, claims of theft were common in both years, but by 2021, owners were often stealing Payment Protection Program ("PPP") funds in addition to other funds from the company. The pandemic, however, did not change the core nature of the allegations.

The types of self-dealing were also fairly similar across the two most common types of entities in the study—LLCs and corporations.[169] As Table 3 details, theft was common in both types of entities, as were freeze-outs. Competition was more common in LLCs than corporations, while dilution of or disputes over ownership interests were more common in corporations. By and large, however, the owners of private companies face the same types of issues, regardless of the specific type of entity.

Table 3: Types of Self-Dealing by Type of Entity

	All Cases	LLCs (396)	Corporations (289)
Theft	75%	79.3%	74.4%
Freeze-out	35.1%	37.1%	38.1%
Competition	18.9%	21.7%	17.6%
Dilution or Disputes over Ownership	17.5%	15.9%	22.5%

169. In 91% of the cases, the plaintiff company or companies included an LLC, a corporation, or both.

In a relatively small percentage of cases (9.9%), the plaintiff did not allege that the defendant engaged in self-dealing. In some of these cases, the plaintiff suspected self-dealing, but did not have specific facts to back up their suspicions and therefore sued to obtain access to the company's books and records. In other cases, the parties had a simple contractual dispute or a dispute over the management of the company. There were also several disputes among the members of homeowners' associations in which a homeowner sued the board to compel it to take certain actions (fixing the building's roof, repairing water damage, etc.). On the whole, however, the cases in this study were overwhelmingly about alleged self-dealing.

Similarly, the results were also quite consistent across jurisdictions. In California, New York, Texas, and Delaware, plaintiffs alleged the same four types of self-dealing, and theft, followed by freeze-outs, were again the most common allegations. There were some variations between the states, as one might expect. Allegations related to theft, for example, were slightly more common in New York than in California, and allegations related to unlawful competition were more common in California. Yet, while the exact percentages varied slightly in most categories, the role of self-dealing generally in these cases, as well as the core types of self-dealing, were the same.

The biggest variations were between cases in Delaware and federal court, compared to cases elsewhere. Although self-dealing was still common in these jurisdictions,[170] the exact types of self-dealing were often different. Cases in Delaware state court, for example, were less likely to involve claims of theft, or competition than the sample as a whole and far more likely to involve claims of dilution or denial of ownership interests. Cases in federal court were more likely to involve theft, but the theft was not as likely to involve outright theft or payment of personal expenses using company funds and more likely to involve claims that the defendant transferred assets to a separate entity that they controlled. This difference reflects in part the fact that Delaware and federal cases were more likely to involve private companies that had taken on outside investors, and this outside funding may have brought greater financial controls that made outright theft and other overt types of self-dealing more difficult.

Finally, claims that are common in public company disputes are almost nonexistent in private companies. For example, prior research has shown that nearly 90% of public company derivative suits include "*Caremark* claims or related allegations that the defendants failed to exercise proper oversight over the affairs of the corporation."[171] Yet less than 1% of plaintiffs in private company disputes raised oversight claims. Similarly, it is quite common for public companies to be sued for fraud,[172] but only 14% of private company cases in this study alleged fraud, and even in these cases the alleged fraud was typically related to one of the core types of self-dealing, rather than serving as the focus of the litigation.

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170. Overall, 84.7% of cases in Delaware state court and 90.3% of cases in federal court involved allegations of self-dealing by an owner with a controlling interest or role in the company.

171. Erickson, *supra* note 71, at 1777 (emphasis added).

172. *See id.* at 1774 (stating that "more than 90 percent of public company complaints included claims that the corporations or its officers or directors made false or misleading statements to the market").

The subsections that follow explore the four core types of self-dealing. In exploring these categories, however, it is important to recognize the common connections between them. All claims of self-dealing involve defendants allegedly trying to get greater financial benefits from the company than they are entitled to. The most obvious way to get an unfair financial benefit is to steal money directly from the company, but this is not the only way. The defendant may instead freeze the plaintiff out of the business, use company assets to start a competing business, or dilute the plaintiff's ownership interest. In the end, a defendant who is motivated to get more than their fair share of the company's profits has a variety of options, and as we shall see, people are ever-creative when it comes to lining their own pockets.

B. Types of Self-Dealing

1. Theft

In 75% of the cases, the plaintiff alleged that the defendant stole money from the company. Theft seems like a simple concept. We imagine a defendant surreptitiously taking money from the cash register or writing checks from the company bank account. Such theft happened in some cases, as with the company where a defendant "loot[ed] the safe" and was allegedly seen carrying "a large bag of cash in the trunk of his personal vehicle . . . [that] went to [the defendant's] personal residence."[173] Another individual who was a partial owner of an industrial refrigeration business allegedly used company funds to buy hundreds of thousands of dollars in gold bullion that he then took for himself.[174] More commonly, however, the defendants in this study were quite inventive in how they took company funds. Table 3 details myriad ways in which defendants allegedly stole money from these companies.

173. Complaint for Damages and Equitable Relief at 19–20, Seltzer v. ACC Enters. LLC, No. 19STCV20438 (Cal. Super. Ct. June 12, 2019) (specifically under the heading "To Refrain from Unduly Benefiting Themselves and Other Insiders at the Expense of ACC").

174. Complaint at 7, Lohr v. Alliance Indus. Refrigeration Servs., Inc., No. 21STCV02577 (Cal. Super. Ct. Jan. 21, 2021).

Table 4: Forms of Alleged Theft

	Number of Cases	Percentage of Cases
Payment of Personal Expenses Using Company Funds	250	34.7
Improper Dividends or Failure to Pay Dividends	214	29.7
Transferring Assets to or Co-mingling Assets with Separate Business Connected to the Defendant	146	20.3
Excessive Compensation	149	20.7
Other Unfair Transaction with Separate Business Connected to Defendant	138	19.2
Hiring of Friends or Relatives	69	9.6
Outright Theft of Cash or Other Funds	59	8.2
Failure to Pay Wages	55	7.6
Theft of COVID-19 Relief Funds[175]	17	4.8

As this Table demonstrates, defendants do not need to raid the cash register to take money from the company. They can use their company credit card to pay for personal expenses. They can improperly increase their own salary or hire their family or friends as employees. They can refuse to pay the salary of the plaintiff or other employees. Or they can transfer company assets to other businesses that they own.

The most common type of theft in this study was using company funds to pay for personal expenses, which occurred in 35% of the total cases in the study.[176] The allegations here were often remarkable in their brazenness. Defendants used company funds to pay for fancy cars such as Lamborghinis and McLarens.[177] They expensed trips to Morocco,

175. These funds were only available in the second year of the study, so the percentage provided here is out of 354 total cases (i.e., the number of cases filed in 2021).
176. *See supra* Part III (providing statistics regarding corporate self-dealing).
177. *Id.*

Cannes, Atlantic City, the Cayman Islands, and Paris.[178] They bought their wives fancy jewelry, bankrolled campaigns for public office, paid for plastic surgery, and wrote checks to cover their family members' nannies, college tuition, and weddings.[179] They used company funds at gentlemen's clubs, casinos, and concerts.[180] And they used company credit cards for far more mundane household purchases at grocery stores, gas stations, home improvement stores, Amazon, Netflix, and fast food restaurants.[181]

The light governance described in Part II made it easier for defendants to steal this money. Time and again, the plaintiff claimed that the defendant treated the company's bank accounts as their own personal "piggy bank,"[182] and in most companies, there were few financial controls to prevent this. For example, the defendant may have had sole access to the company's bank accounts and, therefore, could easily steal cash before it was deposited into these accounts. In one case involving a store that sold New York City souvenirs, for example, the plaintiff alleged that "[t]he Business is largely a cash business with no accountability and no means of verifying daily receipts," allowing the defendants "to understate the amounts collected and divert the balance to themselves."[183] In other cases, the defendant allegedly diverted insurance reimbursements or client payments to their own accounts rather than depositing them into the company's bank account.[184]

Similarly, defendants could take advantage of lax controls by paying themselves or their family members allegedly excessive salaries. In many cases, the owners had no formal agreements or policies related to salary, and the defendants simply decided to pay themselves an amount that the plaintiff claimed was too high. Even in cases where the parties did have a formal agreement related to compensation, it did not always offer much protection. In one Delaware technology company, for example, the majority owner had an employment agreement that stated that her salary would be "reviewed annually by the Board in accordance with the Board's normal performance review policies for senior level executives."[185] Yet, the majority owner was the only board member, and therefore the owner "alone decided whether she was entitled to annual salary increases, and there were no policies or guidance keeping her self-dealing in check."[186]

An allegation of theft seems like it would be fairly straightforward. Either the defendant took the money from the company, or she did not, and indeed in many cases, the case

178. *Id.*

179. *Id.*

180. *Id.*

181. *See supra* Part III

182. *See, e.g.*, Verified Complaint for Dissolution and Other Related Relief at 6, Mehta v. Gawrysiak, No. 2021-0134 (Del. Ch. Feb. 16, 2021) ("[The defendant] has treated 7 Leaf as his personal 'piggy bank' and diverted 7 Leaf's assets for his own personal use and benefit . . . ."); Complaint, *supra* note 161, at 4 ("Upon information and belief, [the defendant] has also grossly mismanaged the finances of Interior Metals and treated the Company as her own personal piggy bank, withdrawing over $600,000 for her personal use.").

183. Verified Complaint at 7, Khan v. Hussain, No. 650547/2021 (N.Y. Sup. Ct. Jan. 25, 2021).

184. *See, e.g.*, Verified Complaint at 5, Tsibelman v. Krivosheyeva, Case No. 655412/2021 (N.Y. Sup. Ct. Sept. 10, 2021) ("Defendant engaged in a fraudulent scheme whereby she would divert checks and money concerning insurance and other company reimbursements and, rather than deposit the checks into the corporate business account, would instead deposit the checks into other bank accounts which the Plaintiff did not have access to.").

185. Verified Amended Complaint at 12, Schoenmann v. Irvin, No. 2021-0326 (Del. Ch. July 19, 2021).

186. *Id.*

did seem this simple. In other cases, however, especially those involving allegations of theft through excessive compensation or illicit transfers to other companies, it was more difficult to tell whether the defendant's actions were improper. In a case involving a family-owned Kansas manufacturing company, for example, the branch of the family that had a majority stake in the company appointed one of their immediate family members as Chief Executive Officer at a salary of $280,000, even though he allegedly did not have manufacturing experience, only worked at the company on a part-time basis, and did not live near the company's business office or manufacturing facilities.[187] This salary seems high, to be sure, but the company was profitable and also made distributions to shareholders during at least some of the relevant periods.[188] As a result, as in many other cases, it was difficult to tell whether the defendant's salary constituted improper theft of company assets or simply a well-deserved wage.

The same problem exists when the defendant orchestrates transactions between the company and another company that she controls. In several cases, the defendant had the company purchase goods or services at an allegedly inflated price from a separate company that the defendant also owned. For example, in one case, a construction company needed to build a fence for one of its construction projects. According to the plaintiff, "the general contractor intended to purchase fencing from the lowest bidder," but the defendant "angrily demanded that Sky Water purchase fencing from a fencing company he had an ownership interest in at more than twice the cost of other suppliers."[189] In another case, the parties co-owned a surgical center, and the defendants arranged for the center to use their company for the center's billing and collections, charging fees that were "far above the market rates."[190]

These examples are different from the cases involving allegations of outright theft. It is hard to imagine a legitimate reason for one owner of a business to take bags of cash out of the business without telling the other owners, but business owners often receive salaries from the business or set up transactions between different businesses that they own. There is certainly no per se rule against these sorts of arrangements. Nonetheless, they offer an opportunity for self-dealing similar to more obvious instances of theft. Whether a defendant steals $10,000 from the company's cash register or causes the company to pay a salary that is $10,000 too high, the financial impact on both parties is the same. Yet a plaintiff may have a more difficult time establishing wrongdoing in these latter cases because they will have to establish that the salaries or other payments were unfairly high,[191] an inquiry that can be fact-intensive and calls for judicial judgment calls. As we will see, our second type of self-dealing— freeze-outs—involves similarly challenging issues.

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187. *See* Verified Shareholder Derivative Complaint at 7–8, Vance v. Vance, No. 19-cv-1136 (D. Kan. May 22, 2019).

188. *See id.* at 22. The complaint did allege that the defendants stopped the dividends after the plaintiff objected to the majority's managerial decisions. *See id.*

189. Amended Complaint at 2, Zibrowski, v. Unterseher, No. 27-cv-21-2627 (Minn. Dist. Ct. Mar. 5, 2021).

190. Complaint for Derivative Damages, Declaratory Relief, and Permanent Injunction at 10, Anchored Invs., LLC v. Jafari Invs., LLC, No. 2019CH05172 (Ill. Cir. Ct. Apr. 23, 2019).

191. *See* Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.").

2. *Freeze-Outs*

a. *Defining Freeze-Outs*

The second most common type of self-dealing seen in private company disputes are freeze-outs. Before delving into the data on freeze-outs in private companies, it is important to define a freeze-out in a way that distinguishes it from the other common types of alleged misconduct described in this study. The judicial definition of a freeze-out varies widely across jurisdictions and can be quite broad. For example, the Supreme Judicial Court of Massachusetts has stated that "freeze-outs can occur when a minority shareholder is deprived of employment, or more generally, when the reasonable expectations of a shareholder are frustrated."[192] The Mississippi Supreme Court has stated that "[i]n its most classic form, a freeze-out of the minority shareholders by the majority occurs when the majority purposefully denies the minority member from sharing proportionally in corporate earnings or gains."[193] These expansive definitions could describe the vast majority of disputes between business owners, including many of the theft cases in the prior section.

This study uses a narrower definition of the term "freeze-out" to distinguish it from the other categories of self-dealing. Under this definition, a freeze-out has two requirements. First, the plaintiff must allege that they were deprived of all or nearly all of the financial benefits of their ownership interest. Second, the plaintiff must allege that they received little or no information about the company's management or finances. This definition provides a more concrete way to identify freeze-outs within the sample cases, and it differentiates freeze-outs from other common ways in which the defendant deprived the plaintiff of their proportional share of profits.

An illustrative case shows this definition in action. In this case, two individuals started an ambulette company that transported Korean and Chinese-speaking patients to medical appointments.[194] The plaintiff owned 49% of the company's stock, while the defendant owned 51%,[195] although the parties informally agreed that "operational responsibilities" would rest with the plaintiff.[196] In the company's first year of operations, it expanded to 15 vehicles and had approximately $2 million in gross sales.[197] Within just a few years, however, the parties had a falling out, and the defendant froze the plaintiff out of the company.[198] The defendant allegedly refused to hold any board or shareholder meetings for five years, refused to distribute any of the profits to the plaintiff, and did not respond to the plaintiff's request for an accounting.[199] The plaintiff claimed that the defendant "used corporate funds to pay excessive salary and benefits to himself alone" and "methodically

192. Selmark Assocs., Inc. v. Ehrlich, 5 N.E.3d 923, 933 (2014).

193. Boatright v. A&H Techs., Inc., 296 So.3d 687, 697–98 (Miss. 2020).

194. *See* Verified Petition for Corp. Dissolution Including Addition Direct and Derivative Claims at 1, Lee v. Chang, No. 706465/2019 (N.Y. Sup. Ct. Apr. 11, 2019) (discussing a claim of judicial dissolution).

195. *Id.* at 8.

196. *Id.* at 3.

197. *Id.* at 3.

198. *Id.* at 5. The parties also had a legal battle over their respective ownership interests. According to the plaintiff's complaint, the court ultimately affirmed that the plaintiff owned 49% of the company. *See* Verified Petition, *supra* note 194, at 5.

199. *Id.* at 11–12.

drain[ed]" the company's assets to reduce the amount the plaintiff could receive through a buyout or distribution at dissolution."[200] This case shows the two elements of freeze-out outlined above, as the defendant allegedly refused to give the plaintiff any financial benefit from the company and refused to share information related to the company.

b. Understanding Freeze-Outs

Using the definition set out above, 35% of the cases included allegations that the plaintiff was frozen out of the company. This subsection delves deeper into these cases, explaining common facts alleged by many plaintiffs. First, in most (but certainly not all) freeze-out cases, the plaintiff was a minority owner in the business.[201] In 57.5% of freeze-out cases, the plaintiff owned less than half of the company. In another 36%, the plaintiff and the defendant each owned half of the company. In the remaining cases, the plaintiff owned more than half of the company. As these figures demonstrate, minority shareholders are especially vulnerable to freeze-outs, but even shareholders with ownership interests that are equal to or greater than the defendant's interest can find themselves locked out of their business.

Second, plaintiffs often lose managerial power in addition to financial benefits in a freeze-out. In slightly more than half of the freeze-out cases (58.9%), the plaintiff was involved in managing or operating the business before they were frozen out. In another 9.1% of the freeze-out cases, the plaintiff was promised a managerial role but was frozen out before taking on this role. These figures reflect the precarious role of minority owners within corporations. In the remaining freeze-out cases, the plaintiff did not have or expect a management role. Typically, in these cases, the plaintiff was a passive investor in a company where the majority owners allegedly stopped communicating after taking the plaintiff's money.

Third, many defendants relied on the light governance described in the prior Part.[202] In some cases, for example, the defendant allegedly made promises to the plaintiff that were never put in writing, making it easier for the defendant to later claim a right to exclude the plaintiff.[203] In other cases, the parties had formal written agreements but allegedly did not follow these agreements, so the plaintiff did not have the power that they were promised.[204]

Finally, defendants often used their control over the company's property and accounts to exclude the plaintiff. In some cases, the plaintiff claimed that the defendant physically

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200. *Id.* at 10.

201. The plaintiff provided the parties' ownership interests information in 87.4% of the freeze-out cases. The percentages in this paragraph are out of this subset of cases.

202. *See supra* Part II.B.1 (discussing how the majority of cases fall between the two extremes of anticipating every eventuality and napkin deals).

203. *See, e.g.*, Complaint, *supra* note 111, at 3 (alleging that the defendant was promised a 50% share in the business in exchange for a financial investment and sweat equity working 16 hours per day 7 days per week, but the parties did not put their agreement into writing and the defendant later froze the plaintiff out of the company).

204. *See, e.g.*, Verified Complaint at 12, Mamounas v. Mamounas, No. 656348/2018 (N.Y. Sup. Ct. Dec. 20, 2018) (alleging that the plaintiff is entitled to serve as co-manager, but this power had been "thwarted" by the defendant and his children, who "exercised sole day to day authority . . . over the management and affairs of the Owner LLCs").

excluded the plaintiff from the business's premises, either by changing the locks or enlisting the help of police or other individuals.[205] More commonly, however, the plaintiff alleged that the defendant excluded the plaintiff from the business by seizing control of the company's electronic records. An owner who controls access to a company's electronic business records can more easily freeze out other investors in the business. They can cut off the investors' access to their email accounts or to business records on the company's servers. They can also eliminate investors' access to the company's bank account or change the passwords to the company's Facebook, Twitter, or other social media accounts.

A case involving an app development company illustrates the importance of electronic access to business records and accounts. In this case, the two owners each owned 50% of the business.[206] When they had a falling out, the defendant allegedly took several steps to remove the plaintiff's access to the company's records, such as removing the plaintiff as an authorized user of the company's Apple Developer Account and redirecting all payments from Apple to a bank account solely controlled by the defendant.[207] The defendant also allegedly hacked into the plaintiff's personal email account to reset the passwords for the company's website hosting account and its Wyoming LLC registration and then cut off the plaintiff's access to her business email account and app analytics accounts.[208] These steps took away the plaintiff's sources of information about the business and allowed the defendant to take control of the company's revenue. Cases like this one illustrate how important it is for business owners to set up clear systems around access to financial and other business records, a point discussed further in Part IV.

3. *Unlawful Competition*

The third type of self-dealing seen in private company disputes occurs when the defendant unlawfully competes with the company. The plaintiff alleged unlawful competition in 18.9% of the cases in the study.[209] From a legal perspective, these claims can operate in a gray area. Absent a covenant not to compete or a similar agreement, individuals are permitted to leave one business and open a competing business.[210] They typically cannot, however, use the company's assets, trade secrets, or other confidential information to compete against it.[211] As a result, these cases often involve factual disputes about when the owner started to compete, as well as the assets and information that they used.

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205. *See, e.g.*, Complaint for Retaliatory Discharge, Declaratory Relief, and Accounting, *supra* note 156, at 1 (alleging that the plaintiff was "frozen out" and fired from his position "under police escort and surveillance").

206. *See* Verified Complaint for Money Damages and Injunctive Relief at 3–5, Sesodia v. Young, No. CACE-21-022467 (Fla. Cir. Ct. Dec. 22, 2021).

207. *Id.* at 3.

208. *Id.* at 4.

209. In another 1.1% of the cases, the plaintiff alleged that the defendant(s) abandoned the business without opening a competing business.

210. *See* UNIF. LTD. LIAB. CO. ACT § 409(b)(3) (UNIF. L. COMM'N 2013) (providing that a managing member of an LLC may not compete with the business before the dissolution of the business).

211. *See, e.g.*, Mach v. Connors, 979 N.W.2d 161, 170 (S.D. 2022) (finding that a 50% owner of a business may have breached her fiduciary duty to her co-owner by using the company's customer information for a competing business); Risk Mgmt. Servs., L.L.C. v. Moss, 40 So. 3d 176, 185 (La. Ct. App. 2010), *writ denied*, 44 So. 3d 683 (La. 2010) (finding that a co-owner of a business engaged in unfair trade practices by attempting to take the business's clients and employees to his new competing business before leaving the first business).

Some of the unlawful competition cases look a lot like the freeze-out cases described in the prior part. In a freeze-out, the defendant denies the plaintiff information and profits from the business. The unlawful competition cases, however, show that a defendant can accomplish the same objective by opening a new company with all of the old company's name, assets, and customers. This type of extreme action is obviously illegal; taking an entire company and rebranding it as a new company does not fall within the gray area described above.

In one case, for example, two individuals started a company in the "extremely competitive business of supplying inscribed military headstones to military cemeteries."[212] The plaintiff objected because the defendant, who owned 51% of the business, was allegedly siphoning profits through higher salaries for himself and his daughter.[213] Rather than buy out the minority owner, the defendant allegedly opened a new company called VETS II.[214] The plaintiff claims that the defendant then signed a resolution as majority owner that "unilaterally transferred all assets of VETS I to VETS II," with no compensation for VETS I.[215] Such allegations fall into the category of unlawful competition, but they look quite similar to the freeze-out cases described earlier.

Most unlawful competition cases, however, did not involve a wholesale transfer of the company's assets. Instead, the defendant typically formed a new business that was mostly separate from the original business but allegedly used certain assets from the original business, such as its customer lists, trademarks, or physical space. A case filed in federal court in California illustrates this type of unlawful competition case. In this case, three individuals founded a company to operate an upscale club called JUNGL.[216] The plaintiff was a one-third owner of the company,[217] and he alleged that he invested in the company and helped design the interior of the club because of the "longstanding relationship" between his family and the family of one of the defendants, which caused him to have the "utmost trust and confidence" in the defendants.[218] Despite this strong foundation, the parties soon started to disagree about the direction of the company. The defendants then allowed the club's lease to lapse and then entered into a new lease on behalf of a new club called TRIBL.[219] The plaintiff alleged that TRIBL operated at a new location but used the same client and mailing lists, intellectual property, and physical assets as the original JUNGL club.[220]

Cases like these show the similarities between unlawful competition cases and the theft and freeze-out cases discussed in prior sections. In many ways, unlawful competition cases are variants of theft claims. The defendant is allegedly stealing assets of the company—trademarks, trade secrets, or physical locations—with the specific goal of opening a new, competing company. Unlawful competition cases also resemble freeze-outs, just

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212. Complaint at 5, VETSUSA, LLC v. Worthington No. 2019-13455 (Va. Cir. Ct. Sept. 30, 2019).
213. *Id.* at 6–7.
214. *Id.* at 8–9.
215. *Id.* at 10.
216. Complaint, *supra* note 107, at 1.
217. *Id.*
218. *Id.* at 7.
219. *See id.* at 13–15.
220. *See id.* at 14–15.

with the exclusion occurring through a new competing company. This overlap reflects the core self-dealing at the heart of each of these categories. Whether the defendant chooses to engage in self-dealing through overt theft, a freeze-out, or unlawful competition, they are trying to take more of the money from the business for themselves. As a result, while these categories reflect different tactics, they involve the same underlying goal. The same can be said for the last type of self-dealing in the study—dilution and other disputes over ownership.

4. Dilution and Denial

In the final category of self-dealing in the study, plaintiffs alleged that the defendants either unlawfully diluted their ownership percentage or denied that they owned their claimed share of the company. Overall, only 17.5% of the cases involved these allegations, but it is worth noting the similarity of these allegations to the allegations discussed in the prior sections. In all of the self-dealing cases, the plaintiff claimed that the defendants took more of the financial spoils of the company for themselves. In these dilution or denial of ownership cases, the plaintiff is again making this argument, but through the specific argument that the defendant tried to shrink or outright deny the plaintiff's ownership stake.

The cases in this category tended to involve larger companies with more complex ownership structures, especially if the plaintiff alleged a dilution transaction. If, for example, a defendant in a small plumbing company with two owners wanted to take more of the profits for himself, he would likely just take the money directly or freeze-out his co-owner, which would put the case into one of the other self-dealing categories.[221] To justify the trouble of diluting the plaintiff's ownership stake, the company typically has to be large enough and have enough financial or governance controls that more overt self-dealing would be too difficult to pull off.

For example, one case in the Delaware Court of Chancery involved a Linux software company that took on millions of dollars in venture capital financing.[222] The plaintiffs were two of the venture capitalists who together owned nearly 40% of the company.[223] They alleged that the defendants—who held top officer and director positions at the software company—put in place an equity incentive plan through which they received "2.5 million shares of unrestricted common stock."[224] Unlike more traditional incentive plans, the defendants received the stock upfront before the company met any performance goals, although this stock was subject to repurchase if the company did not meet its goals.[225] The

221. The one exception seen in the data is where the two parties each own 50% of the company and the defendant dilutes the plaintiff's ownership stake to claim majority control over the business. *See, e.g.*, Complaint, Muradyan v. New Road, Inc., No. 21STCV02849 (Cal. Super. Ct. Jan. 25, 2021).

222. Verified Complaint for Breach of Fiduciary Duty, Beloussov v. Bauert, No. 2021-0512 (Del. Ch. June 15, 2021).

223. *See id.* at 6–7 (explaining that one plaintiff holds approximately 20.1% membership in the entity and the other plaintiff holds approximately 19.2% in the entity).

224. *Id.* at 8, 13.

225. *See id.* at 13–15 ("Defendants implemented a program by which they purported to issue 2.5 million shared of unrestricted common stock to the Cloud Linux management team-principally to themselves-before the Company met any performance benchmarks, subject to repurchase only if CLS fails to reach its goals.").

plaintiff alleged that, through this plan, the defendants "positioned themselves . . . to take over immediately majority stockholder voting control of the Company."[226]

In many ways, this case feels fundamentally different than cases alleging other types of self-dealing. The company had taken on millions of dollars in outside investments.[227] It also had a far more complex governance structure with a holding company, a board of directors, corporate officers, and detailed agreements governing the outside investments.[228] Yet at its heart, the complaint is like many others involving far simpler companies. The plaintiff alleged that they were entitled to a greater share of the profits and a greater say in company operations and that the defendants took these entitlements away from them. In this way, self-dealing is self-dealing, even if the specific allegations vary across the cases.

IV. Lessons from Main Street Litigation

By the time the companies in this study ended up in court, the relationships between their owners were beyond saving. Yet these cases can offer valuable insights for lawyers, lawmakers, and judges in preventing and addressing future business disputes. Given that self-dealing is the most common reason that business relationships between the owners of private companies fall apart, transactional lawyers should address this risk specifically with their clients. Similarly, lawmakers should draft rules with the specific goal of protecting investors who may fail to protect themselves. Finally, judges should recognize the role of emotions in business relationships and decide disputes with these emotions in mind, rather than chastising plaintiffs for trusting their business partners.

A. Lessons for Lawyers

The findings in Part III illustrate the diverse tactics that business owners can use to take more than their fair share of money from the business. Yet, whether the defendant allegedly steals money out of the company's cash register, freezes out other owners, sets up a competing business using company assets, or dilutes the plaintiff's ownership stake, the impact is largely the same: the plaintiff does not get the share of the profits to which they were entitled. These claims were raised in litigation as the companies were unraveling, but they offer lessons for transactional lawyers advising clients throughout the lifecycle of their businesses. This section outlines two specific ways that transactional lawyers can help their clients address the risk of self-dealing in their businesses.

1. Lawyers as Compliance Engineers

Preventing self-dealing within businesses is ultimately a compliance issue. In theory, therefore, lawyers can use lessons from the field of compliance to design systems to help ensure that co-owners of a business comply with their legal obligations to the business and

226. *Id.* at 15.

227. *See* Verified Complaint for Breach of Fiduciary Duty, *supra* note 222, at 11 ("CLH ultimately raised $8,050,000 in capital contributions and subsequently purchased 4,800,000 of the outstanding shares of CLS.").

228. *See id.* at 7–8, 11 (describing the approximate capital contributions of each named plaintiff).

each other.[229] The compliance field, however, focuses almost exclusively on the needs of public companies. It has much less to say about how the owners of small, private companies can prevent self-dealing. This emphasis is reflected in the American Law Institute's draft "Principles of the Law, Compliance and Enforcement for Organizations," which addresses the key components of internal controls within business organizations.[230] The current draft of the Principles makes clear that it is focused on "complex organizations," with its "main audience . . . large, publicly traded corporations."[231] The comments to the draft do reference smaller businesses in some places,[232] but the draft does not purport to offer detailed guidance to these businesses.[233]

This gap matters on the ground. Compliance within public companies is now a recognized career path, with a vast array of resources, guidelines, and training available to individuals in these roles.[234] As one article noted, "[t]here soon will be as many enterprise-wide risk, audit, legal, and compliance professionals on the payroll of corporations in the United States as municipal police officers keeping our streets safe."[235] There is still work to be done to enhance compliance in public companies, but every public company is at least thinking about compliance issues.[236] In contrast, the owners of private companies do not have these types of resources, and these businesses are typically too small to have specific employees devoted to this function.[237] As a result, business owners are left to address the risk of self-dealing on their own.

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229. *See* Veronica Root Martinez, *Complex Compliance Investigations*, 120 COLUM. L. REV. 249, 249 (2020) ("The importance of the compliance function is accepted within corporations, but the reality is that all types of organizations—private or public—must ensure their members comply with legal and regulatory mandates, industry standards, and internal norms and expectations.").

230. *See* PRINCIPLES OF THE LAW, COMPLIANCE AND ENFORCEMENT FOR ORGANIZATIONS FOREWARD (AM. L. INST., Tentative Draft No. 2, 2021) (ALI Director Richard L. Revesz detailing that [t]he topics covered by this set of Principles have "emerged as fundamental components of internal controls in complex organizations, both in the United States and around the world.").

231. *Id.*

232. *See, e.g.*, *id.* § 4.03 cmt. a ("A smaller organization may need to make greater use of third parties, including outside risk specialists, in assessing its exposure and possible responses to compliance and other risk."); *id.* § 4.04 cmt. l ("A smaller organization may decide to allocate compliance risk-management tasks to employees who are engaged primarily in other tasks in order to have compliance risk-management considerations present in those employees' areas of focus.").

233. Compliance issues for small businesses get even less attention in legal scholarship. Although corporate compliance is a growing area of focus among legal scholars, nearly all of this scholarship focuses on public corporations. *See, e.g.*, Miriam H. Baer, *Confronting the Two Faces of Corporate Fraud*, 66 FLA. L. REV. 87, 143 (2014) (stating how "both 'compliance' and 'risk management' have become key functions within public corporations"); H. Lowell Brown, *The Corporate Director's Compliance Oversight Responsibility in the Post Caremark Era*, 26 DEL. J. CORP. L. 1, 29 n. 87 (2001) (discussing the "well-received practice among public corporations of designing, installing, and enforcing legal-compliance systems").

234. *See* Stavros Gadinis & Amelia Miazad, *The Hidden Power of Compliance*, 103 MINN. L. REV. 2135, 2138 (2019) ("Compliance departments in most public companies today engage hundreds of employees on average and retain thousands of staff in highly regulated industries such as finance.").

235. William S. Laufer, *A Very Special Regulatory Milestone*, 20 U. PA. J. BUS. L. 392, 393 (2018).

236. *See* Miriam H. Baer, *Corporate Compliance's Achilles Heel*, 78 BUS. LAW. 791, 791–92 (2023) (stating that compliance is "an essential, prominent function of any publicly held company").

237. *See* Andrew K. Jennings, *The Market for Corporate Criminals*, 40 YALE J. ON REG. 520, 568 (2023) ("Private companies are unlikely to have the sorts of compliance programs and internal controls that their public

This gap creates an opportunity for lawyers. While lawyers cannot fully substitute for dedicated compliance professionals, they can help business owners think through key compliance questions and set up their businesses in a way that minimizes the risk of self-dealing. For example, they could talk to the founders about ways to ensure that both parties have access to the company's bank accounts. They could also create safeguards to ensure that each owner is required to approve any changes to the passwords to key accounts. Similarly, although many operating agreements give minority investors the right to receive copies of a company's financial records regularly,[238] this promise may not mean much without a process to ensure that the investors receive these records. In a company that relies on Facebook or Instagram to attract customers, one owner can freeze out others by seizing control of these accounts, which happened in several of the cases in the study.[239] A small business that wanted to avoid these types of problems could benefit from processes to ensure that one owner cannot exclude the other in this way.

Lawyers can take an active role in helping business owners devise these processes, turning contractual promises into compliance systems that are easy to administer and reflect the light governance in many private companies. With each of the issues above, there is not likely to be a set of one-size-fits-all rules. Two equal co-owners who want to run their business collaboratively will likely opt for very different practices than a company with one majority owner and a dozen passive investors. Business owners may also wish to allocate business functions according to their backgrounds and areas of expertise, especially if one owner has greater expertise in financial matters, for example, so a system that gives each individual equal rights and access may not be the right fit. Businesses will need to devise the right set of processes for their specific circumstances. As this study shows, however, many private businesses could benefit from the guidance of lawyers in developing these processes.[240]

2. Lawyers as Business Divorce Specialists

Transactional lawyers can also play a key role in assisting business owners with the dissolution of their businesses. As the discussion in Part II demonstrated, the dissolution of private businesses can be both complicated and emotionally fraught.[241] These businesses are often built on a foundation of trust and optimism, and the crumbling of this foundation can be incredibly destructive to businesses and individuals alike. Lawyers can help these

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peers have."); Sandra K. Miller, Penelope Sue Greenberg & James J. Tucker, *A Model for Managing Private Company Legal Risks and Harnessing Legal Opportunities*, 15 ATLANTIC L.J. 1, 2 (2013) ("Private companies surely receive legal advice, but all too frequently, the advice stops short of including suggestions as to how the legal risks can be effectively monitored by overworked owners with limited staff.").

238. *See* JOHN M. CUNNINGHAM, DRAFTING LIMITED LIABILITY COMPANY OPERATING AGREEMENTS 43, 46 (3d. ed. 2012) (explaining that operating agreements for both small and large LLCs should include information rights for the members).

239. *See supra* notes 207–09.

240. As discussed above, however, many private companies have a light governance model that suggests that they do not have regular contact with attorneys. Accordingly, these companies need compliance plans that are simple to administer and that do not rely on attorneys.

241. *See* discussion *supra* Part II.

business owners dissolve their businesses in a way that preserves the businesses' value while keeping the parties' relationships from deteriorating further.

Without this legal intervention, the cases suggest that parties often wait far too long to initiate a divorce from their business partner. Rather than discussing dissolution when they start to have serious differences of opinion, they wait until their relationship has soured to the point that they can no longer speak civilly to each other. In some cases, this tension led owners to freeze out their co-owners. In other cases, one owner simply took assets or customers from the business and opened a competing business without shutting down the original one. In still other cases, one owner decided that she contributed more to the business and therefore was entitled to more money, taking it from the business. These parties would almost certainly have been better off talking about their differences earlier and coming to a more amicable solution.

And yet business lawyers often do not focus enough on the legal needs of dissolving businesses. Statistics show that nearly as many businesses close every year as those who open.[242] Despite this fact, business law places far more emphasis on helping businesses get off the ground than helping them wind down. An introductory business law course in most law schools, for example, will devote several weeks to entity selection, formation, and drafting of key organizational documents, while only discussing dissolution in a single class period if at all.[243] Within the profession, there are resources available for dissolving businesses, but these resources often focus on the technical requirements, such as filing paperwork with the state and paying off creditors, rather than the more complex organizational and emotional challenges of business dissolutions.[244]

The emphasis is quite different in family law. While family lawyers help couples protect their assets before and during their marriages, many family lawyers focus on divorce. The American Academy of Matrimonial Lawyers, for example, states that it specializes in eleven areas, nine of which relate to divorce in some way.[245] It advertises events like Divorce Camp, which is aimed at helping family lawyers approach the difficult conversations

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242. *See* Ryan A. Decker & John Haltiwanger, *Business Entry and Exit in the COVID-19 Pandemic: A Preliminary Look at Official Data*, BD. GOVERNORS FED. RSRV. SYS. (May 6, 2022), https://www.federalreserve.gov/econres/notes/feds-notes/business-entry-and-exit-in-the-covid-19-pandemic-a-preliminary-look-at-official-data-20220506.html [https://perma.cc/525E-W25P] (finding that, between the first quarter of 2019 and the fourth quarter of 2020, approximately 2.1 million business establishments opened while approximately 2.0 million business establishments closed). The number of business closings was exacerbated by the COVID-19 pandemic, but even in 2019, the number of establishment exits was nearly 90% of the number of establishment births. *See id.*

243. *See* Robert B. Thompson, *The Basic Business Associations Course: An Empirical Study of Methods and Content*, 48 J. LEGAL EDUC. 438, 440 (1998) (listing nineteen common topics covered in the introductory business associations course, none of which include dissolution).

244. *See, e.g.*, *Close or Sell Your Business*, U.S. SMALL BUS. ADMIN., https://www.sba.gov/business-guide/manage-your-business/close-or-sell-your-business [https://perma.cc/UP98-Q22S]; *Closing My NC Business*, N.C. SEC'Y STATE, https://www.sosnc.gov/divisions/business_registration/closing_nc_business [https://perma.cc/UG6Z-EF8M] ("If you want to close a North Carolina business, you do so by voluntarily filing Articles of Dissolution for the entity type (Business Corporation, Nonprofit Corporation, Limited Liability Company (LLC)).").

245. *See generally Mission*, AM. ACAD. MATRIMONIAL LAWS., https://aaml.org/mission/ [https://perma.cc/P4P2-FCC6].

in divorce "with confidence and skill."[246] The field of family law has even developed an entire subspecialty—collaborative divorce—focused on helping divorcing couples navigate their divorce out of court with less acrimony.[247]

Imagine if business lawyers were similarly trained to help their clients through a business divorce.[248] At the most basic level, lawyers with this training could help their clients with the legal requirements to dissolve their business. But they could also offer guidance on mediating the emotional challenges in business divorces,[249] valuing the tangible and intangible assets in the business,[250] negotiating the division of assets,[251] and navigating any other issues that arise.[252] They could also advise their clients on the legal implications of family law or inheritance law on their business dealings.[253] If business owners knew that these legal specialists existed, they might reach out to them earlier in the dissolution process, possibly avoiding some of the messier conflicts seen in this study. They could also explore creative solutions that would allow them to continue their business roles separately rather than watching the entire business come to an end.[254]

The study of private businesses highlights a broader role for transactional lawyers. Their value is not limited to minimizing transaction costs in complex deals or advising on formation issues. They can also help businesses design compliance systems over the life of

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246. *See AAML-MN's 2023 Divorce Camp*, AM. ACAD. OF MATRIMONIAL LAWS., https://aamlmn.org/divorce-camp-2023 [https://web.archive.org/web/20231020030859/https://aamlmn.org/divorce-camp-2023/].

247. *See, e.g.*, PAULINE TESLER, COLLABORATIVE LAW: ACHIEVING EFFECTIVE RESOLUTION IN DIVORCE WITHOUT LITIGATION (3d ed., 2016).

248. Resources and training exists on this topic, of course, but they are relatively rare and often do not delve into the level of detail that lawyers need. The ABA Business Law Section, for example, has more than 60 sections devoted to everything from business crimes to insurance, cyberspace, and corporate social responsibility, but none of them focus on the topic of dissolution. *Business Law Committees*, AM. BAR ASS'N, https://www.americanbar.org/groups/business_law/about/committees/ (on file with the *Journal of Corporation Law*). It does have a subcommittee on Business Divorce within the Business Litigation Committee, but this subcommittee focuses primarily on the "development and improvement of specialized business, commercial, and complex litigation courts," rather than the nuances of business divorce itself. *See Business and Corporate Litigation Subcommittees*, AM. BAR ASS'N, https://www.americanbar.org/groups/business_law/about/committees/business-and-corporate-litigation/subcommittees/ (on file with the *Journal of Corporation Law*).

249. *See* James C. Freund, *Anatomy of A Split-Up: Mediating the Business Divorce*, 52 BUS. LAW. 479, 484 (1997) (arguing that working with divorcing business partners is "often highly emotional, sometimes containing a degree of bitterness akin to that in a failed marriage").

250. *See* Claudia M. Landeo & Kathryn E. Spier, *Shotguns and Deadlocks*, 31 YALE J. ON REG. 143, 157 (2014) ("Asset valuation, which is necessary in order to complete the transfer of assets, can be a very tricky matter for closely-held businesses.").

251. *See* Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285, 306 (1990) ("Partitioning a business, when possible, has major advantages because it allows both parties to fulfill their expectations of participating in the management of a business. Dividing a business saves the business from destroying itself as a result of continued strife.").

252. *See* Kurt M. Heyman, *Business Divorce: New Practice Area or Plain Old Commercial Litigation?*, BUS. L. TODAY, Oct. 2016, at 1, 2.

253. *See* Allison Anna Tait, *Corporate Family Law*, 112 NW. U. L. REV. 1, 6 (2017) (discussing models for treating corporate partners differently based on their familial ties).

254. *See* James C. Freund, *Anatomy of A Split-Up: Mediating the Business Divorce*, 52 BUS. LAW. 479, 482 (1997) (explaining that, based on his experience as a mediator "in many business-divorce situations, both parties want to remain in business [and] continue working at what he or she has built up over the years").

the business and bring the business to a harmonious end if and when the relationship between the owners starts to break down.

B. Lessons for Lawmakers

This study also has implications for lawmakers, including the drafting committees of business law codes who propose these laws and the legislators who pass them.[255] First, the study demonstrates the importance of default rules within the statutory codes for corporations, LLCs, and partnerships. The traditional view of transactional lawyers as "transaction cost engineers" is based on a vision of lawyers creating sophisticated legal structures to achieve their clients' business objectives.[256] In this understanding of business law, the default rules act more like placeholders to be replaced by more customized rules in the company's governing documents.

Yet the data from this study suggests that many small businesses have much simpler governance models.[257] As laid out in Part II.B.1 above, the owners of most businesses in this study took some steps to establish the legal structure of their business. They registered their business with the state.[258] They set up a corporate board or appointed an LLC manager.[259] And they may have entered into one or more organizational agreements.[260] Yet, they typically did not engage in the careful planning and tailoring that drafters of business codes may envision. Instead, these companies may have a board that never meets, an operating agreement that the parties never reference, and a host of informal norms, expectations, and promises that govern their day-to-day relationships.[261]

This study suggests that the default rules will end up governing many small businesses. The owners of these businesses may never stop to examine whether these rules are right for their particular situations. The individuals charged with drafting business law statutes need to assume that many small businesses will simply default to whatever background rules the law establishes. As a result, they should have small businesses in mind in the

255. In many states, amendments to business laws are drafted by formal or informal committees composed of lawyers, judges, and academics from the state. *See, e.g.*, Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1754–55 (2006) (explaining that, in Delaware, "[f]or decades now the function of identifying and crafting legislative initiatives in the field of corporate law has been performed by the Corporation Law Section of the Delaware State Bar Association").

256. *See* Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 255 (1984) ("Lawyers function as transaction cost engineers, devising efficient mechanisms which bridge the gap between capital asset pricing theory's hypothetical world of perfect markets and the less-than-perfect reality of effecting transactions in this world.").

257. *See supra* Part II.B (explaining how that "[d]espite these governance structures . . . time and again, plaintiffs stressed that their businesses were run informally").

258. *Id.*

259. *See supra* Part II.B (noting that "[i]n the cases involving corporations, for example, 76.1% referenced a board of directors. In cases involving LLCs, 71.7% of the complaints specified that the LLCs were manager-managed").

260. See *id.* (noting that "[i]n 23.9% of cases, the plaintiffs referred to other types of documents as well. The agreements most commonly cited in the complaints were purchase or investment agreements, loan agreements, term sheets, employment agreements, agreements related to intellectual property, and management agreements").

261. *See* cases cited *supra* note 123.

drafting process, even more than the larger companies with lawyers on call who can more easily tailor the rules to suit their needs.

That said, the drafters of the statutes have done a lot of things right. State laws governing LLCs and partnerships typically prohibit many of the specific types of self-dealing seen in this study, including the taking of company property or profits and competition with the company.[262] The Model Business Corporation Act (MBCA), which has been adopted in some form in 36 states,[263] has an entire section devoted to "conflicting interest transactions," or a transaction between the corporation and one of its directors or a transaction in which a director has a material financial interest.[264] The MBCA also prohibits directors and officers from taking business opportunities that should have gone to the corporation.[265] As these examples demonstrate, the default rules ban many types of self-dealing seen in this study.

Yet, while these statutes prohibit self-dealing, they do little to *prevent* self-dealing. There may be additional room for lawmakers to adopt provisions that help prevent self-dealing in the first place. As one example, under the Uniform Limited Liability Company Act, members have the right to inspect the company's business records.[266] There are no provisions, however, that require managing members to provide other members with material information about the company regularly.[267] The members can proactively request this information, but if they have no reason to prevent wrongdoing, they may not do so, especially considering the trust in these business relationships outlined in Part II. The law might be able to prevent at least some self-dealing by ensuring that members receive regular financial and other records from the company even if they do not affirmatively ask for these records.[268]

262. *See* UNIF. LTD. LIAB. CO. ACT § 409 (UNIF. L. COMM'N 2013) (prescribing limits on the power of an operating agreement to affect fiduciary duty and obligations of good faith and fair dealing); REVISED UNIF. P'SHIP ACT § 409 (UNIF. L. COMM'N 2013) (prescribing limits on the power of a partnership agreement to affect fiduciary duty and obligations of good faith and fair dealing).

263. *See MBCA Enactments by State*, *supra* note 82. This author serves on the American Bar Association's Corporate Laws Committee, which works to promulgate, amend, and implement the MBCA. *See Corporate Laws Committee*, AM. BAR ASS'N, https://www.americanbar.org/groups/business_law/about/committees/corporate-laws/ [https://perma.cc/S3E7-JUK8].

264. *See* MODEL BUSINESS CORPORATION ACT § 8.60–8.63 (AM. BAR ASS'N 2016) (giving rules for "Director's Conflicting Interest Transaction").

265. *See id.* § 8.70.

266. *See* UNIF. LTD. LIAB. CO. ACT § 410(a)(1) (UNIF. L. COMM'N 2013) (providing that with "reasonable notice, a member may inspect and copy during regular business hours, at a reasonable location specified by the company, any record maintained by the company regarding the company's activities, affairs, financial condition, and other circumstances, to the extent the information is material to the member's rights and duties under the operating agreement or this [act]").

267. *See id.* (allowing for inspection of company records only if the member affirmatively requests to inspect these records).

268. This suggestion is not meant to be onerous, and there is no expectation that companies would prepare formal reports. Sharing bank and financial statements may be enough to put the other owners on notice of possible misconduct and discourage managing members from stealing from the company. This suggestion will not prevent all self-dealing, by any means. Managing members, for example, could falsify these records or engage in other forms of self-dealing. In reading many of the cases, however, one got the impression that at least some self-dealing started small and snowballed, with an owner putting a few personal expenses on the company credit card

Lawmakers also need to ensure that lawyers who regularly represent small, private businesses play a key role in the drafting process. Business laws are written by committees composed primarily of business lawyers at high-profile law firms in the given jurisdictions.[269] These lawyers are often highly respected by their peers, but their typical clients may be larger companies with different legal needs.[270] Accordingly, drafting committees need to ensure that they include a broad representation of attorneys, including those whose clientele consists primarily of small and mid-sized businesses.

C. Lessons for Judges

Finally, this study offers lessons for judges who preside over business disputes between the owners of private companies. Judges are charged with developing the common law rules related to fiduciary duties and oppression doctrine.[271] As discussed in Part I, in developing these rules, judges have struggled to decide when they should step in to protect minority or other vulnerable shareholders from oppressive conduct.[272] In Delaware, for example, courts have declined to create special fiduciary duties to protect minority shareholders, holding that these shareholders should bargain for contractual protections before investing in businesses.[273] Other jurisdictions have been more willing to craft equitable remedies to address overreaching by majority owners.[274]

This study provides additional context for thinking about this debate. First, there may be good reason for Delaware to approach this issue differently than other jurisdictions. Although quantitative data on the size and sophistication of the companies in this study is not available, the companies registered in Delaware appeared to be larger and more complex than the companies registered in other states. They were also more likely to have taken on outside funding. The owners of these companies may be better able to hire legal counsel and negotiate complex contracts that govern their relationships. That said, even in Delaware, there were Main Street businesses that resembled the businesses found anywhere else

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and then getting more brazen as time went on. If the managers knew that they would have to turn over the company's bank statements monthly, it could discourage these initial steps toward broader self-dealing.

269. *See, e.g.*, Dennis R. Honabach, *All That Glitters: A Critique of the Revised Virginia Stock Corporation Act*, 12 J. CORP. L. 433, 436–37 (1987) (discussing the committee that drafted the Revised Virginia Stock Corporation Act).

270. *See id.* at 438 (stating that, while "there are more than 130,000 corporations incorporated in Virginia . . . . More than ninety-five percent of these entities have fewer than ten shareholders").

271. *See* Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 6 (2007) (explaining that Delaware has "an extensive body of common law addressing fiduciary duties imposed on managers, i.e., directors and officers, in the corporate structure"). In some jurisdictions and for some types of entities, the general fiduciary duties are established by statutes, but even in these jurisdictions, judges retain considerable power to interpret these standards. *Id.*

272. *See* Means, *Nonmarket Values*, *supra* note 12, at 1201 (discussing alternative views regarding shareholder oppression).

273. *See* Nixon v. Blackwell, 626 A.2d 1366, 1380 (Del. 1993) ("The tools of good corporate practice are designed to give a purchasing minority stockholder the opportunity to bargain for protection before parting with consideration.").

274. *See* Walker v. Res. Dev. Co., 791 A.2d 799, 813 (Del. Ch. 2000) ("Thus, LLC members' rights begin with and typically end with the Operating Agreement.").

in America,[275] and Delaware should remember this part of its constituency when crafting rules as well.

Second, the rules governing private businesses need to reflect the reality of human nature. In theory, it is understandable that the legal system wants business owners to carefully negotiate the details of their agreements. Yet, as this study demonstrates, the owners of these businesses are fundamentally human when they invest in businesses, and their emotions—trust, optimism, excitement—impact how they approach their business relationships.

This study reveals the tension in how the legal system thinks about the role of emotions within businesses. On one hand, the law recognizes the benefits of emotions in business. The legal system, for example, relies on trust when it gives corporate directors broad authority under the business judgment rule to make decisions free from fear of legal liability.[276] Similarly, within smaller companies, scholars have long recognized that trust and related emotions are an essential complement to formal agreements.[277] Given that business owners cannot reduce every detail of their relationship to writing,[278] owners need to be able to trust that they will cooperate in the future and work out any issues as they arise. Indeed, trust has been called "the glue that binds corporate relationships."[279]

On the other hand, courts are also quick to disparage this trust when it turns out to be misplaced. At its essence, the debate over the scope of fiduciary duties and oppression doctrine in private companies is a debate over how much business owners should rationally trust each other. Time and again, courts remind plaintiffs that they are bound by the contracts that they signed and that they should have insisted on greater protections upfront. Delaware courts, for example, have stated that investors "can and should make their own judgments about the risk they should bear,"[280] warning that the courts "will be most chary about implying a contractual protection when the contract could easily have been drafted to expressly provide for it."[281] Even outside of Delaware, many courts have adopted narrow interpretations of oppression doctrine, holding that "[s]hareholders of closely held corporations may address and resolve [their] difficulties by entering into shareholder agreements that . . . reflect their mutual expectations and agreements."[282]

Yet, as this study shows, trust and other emotions may serve as a helpful lubricant to business relationships, but they can also have predictable negative consequences. They can lead business owners to agree to minority ownership interests and to forego ex-ante protections in their agreements. They can also cause them to give their business partner control

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275. Among the Delaware companies in this study, for example, there was a craft brewery, an electrical repair company, a bike shop, a local café owned by a married couple, a small equipment rental company, a liquor store owned by multiple generations of the same family, and two homeowners' associations.

276. *See* Blair & Stout, *supra* note 40, at 1790–99.

277. *See id.* at 1804 ("Although the firm's original founders could negotiate elaborate contracts to control their future interactions, they often do not, choosing instead to assume that they can 'work things out' if conflicts appear. And often they do work things out.").

278. *See id.* ("No matter how carefully they draft the corporate charter, participants in closely held corporations remain mutually vulnerable.").

279. Lawrence E. Mitchell, *Fairness and Trust in Corporate Law*, 43 DUKE L.J. 425, 425 (1993).

280. New Enter. Assocs. 14, L.P. v. Rich, 295 A.3d 520, 566 (Del Ch. 2023).

281. Chordia v. Lee, No. 2023-0382, 2024 WL 49850, at *35 (Del. Ch. Jan. 4, 2024).

282. Ritchie v. Rupe, 443 S.W.3d 856, 871 (Tex. 2014).

over the company's finances or other accounts. Many of the plaintiffs in these cases were not unusually naïve; they were simply human. When individuals trust the people they are working with, it may not even occur to them to insist on detailed agreements or to check their partners' actions. We cannot be grateful for the role of trust as businesses are getting off the ground and then chastise plaintiffs who were influenced by this trust if and when their business relationships fall apart.

This point does not erase the difficult legal questions in many of these cases. Courts still need to interpret parties' agreements and decide the scope of fiduciary duties and other related doctrines. Many of these cases are also factually complex and require careful examination of the events leading up to the dispute. This study, however, does provide an important frame for thinking about cases in which investors fail to fully protect themselves at the start of the business relationship. As courts interrogate the parties' relationship, they should remember the parties' likely state of mind at the start of their relationship.[283] Just because some individuals turned out not to be trustworthy does not mean that the parties were wrong to trust each other when they went into business together. As this study shows, litigating on Main Street means understanding both the benefits and burdens of human emotions in business.

CONCLUSION

The vast majority of business disputes are not covered on the front pages of national newspapers. They are not litigated in Delaware. And they do not involve Elon Musk. Instead, most business disputes are litigated in state and federal courts across the country and involve small Main Street businesses. This study offers the first empirical analysis of lawsuits between the owners of these private companies. It reveals how private companies often start from a foundation of trust and optimism and end with allegations of betrayal and self-dealing. It also presents data on the types of self-dealing alleged in these cases, documenting the specific actions that cause business relationships to end up in court.

We should know even more about these cases. Even though more than 99% of businesses in the United States are private,[284] nearly all studies of business litigation focus on public companies.[285] This emphasis reflects the fact that scholars have long been unable to access court records from most private company lawsuits.[286] As electronic access to these records increases, however, legal scholars should expand their gaze. We need more empirical research on litigation involving specific types of private companies, including family businesses, majority-owned businesses, and high-growth businesses. We also need a more detailed study of the specific legal claims, remedies, and litigation strategies in these cases. Litigation on Wall Street has long captured our attention, but the time has come to study litigation on Main Street as well.

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283. *See* Benjamin Means & Douglas Moll, *Against Contractual Formalism in Shareholder Oppression Law*, 57 U.C. DAVIS L. REV. 1867 (2024) (explaining how the doctrine of minority oppression could help address some of these concerns).

284. *See* Weitzman, *supra* note 7 (explaining that more than 99% of businesses in the United States are privately held).

285. *See supra* notes 24–30.

286. *See generally* Part I.B.