



PROGRAM MATERIALS

Program #35136

September 9, 2025

When the Love is Gone: Small Business Divorce & Shareholder Disputes

Copyright ©2025 by

- **Brandon Schwartz, Esq.- Schwartz Law Firm**

All Rights Reserved.

Licensed to Celesq®, Inc.

Celesq® AttorneysEd Center
www.celesq.com

5301 North Federal Highway, Suite 150, Boca Raton, FL 33487
Phone 561-241-1919

When the Love is Gone: Small Business Divorce & Shareholder Disputes

Brandon M. Schwartz
SCHWARTZ LAW FIRM
988 Inwood Avenue North
Oakdale, MN 55128
(651) 528-6800
brandon@mdspalaw.com



Key Provisions.

- Often, by the time a dispute between shareholders reaches me, there has been a breakdown in the expectations that result in litigation to sever the business marriage.
- Some of these disputes may be inevitable. But most could have been avoided, or at least tempered, by ensuring that the governing documents define what the shareholders expect from each other.
- So what are the most common causes of fights from what was, or more likely was not, included in a shareholder agreement or bylaws?

Key Provisions.

- When setting up your corporation, it is vital to clearly define who is doing what. Is this going to be a full-time gig, or is this a side hustle? Is there a recognition that one shareholder has other ownership interests and business ventures, or is there an expectation that all future business opportunities will be consummated through the corporation?
- These are discussions that, if not had when the corporation is formed, often lead to allegations of breaches of fiduciary duty later on.

How Business Disputes Typically Start and Evolve.

- Usurpation of corporate opportunities.
 - Factors.
 - Reasons for asserting claims.
- Owners on both sides of the transaction.
 - When and why.
- Breaches of fiduciary duties.
 - What claims are encompassed.

Introduction to Shareholder Disputes:

- Definition of shareholder disputes.
- Importance of understanding shareholder disputes.
- Types of shareholder disputes: majority vs. minority, deadlock, oppression.
- Fiduciary duties owed:
 - Shareholders of closely held corporations owe one another the duty to act in an honest, fair, and reasonable manner in the operation of the corporation.
 - The common law fiduciary duty, sometimes called the “duty of good faith and fair dealing,” embraces substantive obligations that focus on the outcomes of shareholder conduct and procedural obligations that focus on process.

Introduction to Shareholder Disputes:

- Fiduciary duties owed (continued):
 - All close-corporation shareholders also have a procedural obligation not to engage in oppressive or unfair negotiating tactics that may otherwise “conform to the rough ‘moral[s] of the marketplace.’” quoting Justice Cardozo’s famous admonition in *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928)).
 - Cannot use surprise, bluster, and intimidation to persuade a minority shareholder to sell out.
 - Close-corporation shareholders must similarly refrain from arbitrarily exercising discretion or veto power.
 - Close-corporation shareholders owe each other a duty of loyalty, which encompasses an obligation to act with complete candor in their negotiations with each other.

Introduction to Shareholder Disputes:

- Fiduciary duties owed – Majority Shareholders:
 - Long ago, the United States Supreme Court held that majority shareholders “have the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much as the corporation itself or its officers and directors.” *S. Pac. Co. v. Bogert*, 250 U.S. 483, 487-88 (1919).
 - Those in control of closely held corporations have a substantive obligation, for instance, not to withhold dividends or use corporate assets preferentially.
 - It is substantively unfair and a breach of fiduciary duty for a controlling shareholder or group of shareholders to appropriate overmuch of the enterprise’s economic benefits or to “‘freeze out’ minority shareholders, either directly (e.g., by cutting dividends and selectively cutting salaries) or indirectly (e.g., by siphoning off assets to other ventures)”.

Introduction to Shareholder Disputes:

- Fiduciary duties owed – Minority Shareholders:
 - In Minnesota, only a majority or controlling shareholder generally owes a fiduciary duty to the corporation or its other shareholders. *Advanced Communication Design, Inc. v. Follett*, 615 N.W.2d 285, 293-94 (Minn. 2000). But if it is a closely held corporation AND the minority shareholder participates “equally in the management of the corporation similar to partners, they may have fiduciary duties to each other requiring them to exercise the highest degree of integrity and good faith in their dealings.” *Id.* at 94.
 - Iowa law provides that “minority shareholders not in control of the corporation do not owe a fiduciary duty to the corporation or its shareholders.” *Cookies Food Products, Inc., by Rowedder v. Lakes Warehouse Distrib., Inc.*, 430 N.W.2d 447, 451 (Iowa 1988).
 - In Wisconsin, the fiduciary duty has not been extended to non-majority shareholders. *Estate of Sheppard ex rel. McMorrow v. Specht*, 824 N.W.2d 907, 911 (Wis. Ct. App. 2012).

Introduction to Shareholder Disputes:

- Fiduciary duties owed – Minority Shareholders (continued):
 - Arizona also imposes a fiduciary duty on shareholders who can exercise control over the corporation, but not with respect to minority shareholders who lack control over the corporation. *Powers Steel & Wire Products, Inc. v. Vinton Steel, LLC*, 2021 WL 5495289 (Ariz. Ct. App. 2021).
- Whether a fiduciary duty is owed by a minority shareholder to his/her co-shareholders and the corporation comes down to control.
- If the minority shareholder cannot control the direction of the corporation, generally speaking, the law does not impose a fiduciary duty.
- It thus is essential to understand what the bylaws or shareholder control agreement provides for as it relates to decision-making authority.

Introduction to Shareholder Disputes:

- Do decisions require unanimous consent of the shareholders, supermajority consent, or majority consent?
- If unanimous consent, an argument could be made that the minority shareholder does have control and thus a duty.
- The same is true if the minority holds enough to prevent a supermajority.
- But if not, the law is much less likely to recognize a fiduciary duty.

Introduction to Shareholder Disputes:

- Differences in business vision and strategy.
- Disagreements over financial decisions.
- Conflict of interest.
- Breach of shareholder agreements.
- Personality clashes.
- Mismanagement or misconduct by directors.

Introduction to Shareholder Disputes:

- Rarely do shareholders come to the corporate table with the same financial means, same business acumen, and same goals.
- Some may have the financial backing to get the corporation off the ground.
- Some may have relationships the corporation will rely on to garner customers.
- And yet others may have the skill to get the required equipment running.
- And often, the shareholders are of different ages and with different visions of what their individual future holds.

Introduction to Shareholder Disputes:

- This is why it is critical to define in the shareholder's agreement whether shareholders have an exclusive duty to the corporation or may dedicate their efforts to other entities.
- The shareholder's agreement should also define whether there is an expectation that any business opportunity that a shareholder learns of should be presented to the corporation before the shareholder consummates the same for themselves.
- Generally, business opportunities that the corporation has the knowledge, skill, and resources to pursue should be presented to the corporation before a shareholder leverages the same for their personal gain.

Introduction to Shareholder Disputes:

- That said, at times, it makes sense to spell out in the governing documents that no shareholder has an expectation to participate in business opportunities that their co-shareholder learns of just by reason of being joint shareholders.
- The point here is to understand the different backgrounds the shareholders bring to the corporate relationship and define the expectations moving forward so that everyone is on the same page about the future.

Introduction to Shareholder Disputes:

- Operational disruptions.
- Loss of shareholder value.
- Damage to business reputation.
- Legal and financial costs.
- Employee morale and productivity issues.
- Customer and supplier relationship impact.

Capital Contributions.

- When money gets tight, or assets need to be bought, corporations may need capital infused.
- One path is a contribution from shareholders.
- The shareholder's agreement should define what vote is needed for the capital call to be approved and what happens if a shareholder does not pay their fair share.
- The shareholder's agreement or bylaws should define what vote is necessary for the capital call to be approved.

Capital Contributions.

- Is a capital call a decision for the directors or the shareholders?
- Directors generally have a better sense of when capital is needed, but shareholders are the ones putting in the money.
- Some corporations are better suited to have directors make this decision because there are passive investors involved.
- But when the corporation has actively engaged shareholders, it may be a decision vested to the shareholder.

Capital Contributions.

- Once that decision is made, the governing documents should also define whether a shareholder who fails to put in their proportionate share is diluted or not.
- If there is a dilution of interest provision included, a shareholder who refuses or cannot put in their share will be proportionately diluted.
- The other option is to treat the funds from the shareholders who put in their shares as a loan or alternatively to increase their capital accounts.
- This should be addressed because the governing documents are so that those who contribute when called on are not taken advantage of by those who do not.

Day-to-Day Management.

- Some corporations have actively involved shareholders.
- Others have a key director that may be extremely knowledgeable in the industry when disputes arise when there is a divergent opinion on who had the authority to make decisions for the corporation.
- Often, shareholders' agreements or bylaws rest control of the day-to-day operations with a board of directors.
- The board can delegate those duties to an officer (i.e., the president).
- The reason being is that it can be difficult to make swift decisions if several or multiple shareholders have to be consulted.
- But if how these decisions are being made is not spelled out, conflicts arise.

Day-to-Day Management.

- The best practice would be to include in the shareholder's agreement or bylaws what decisions are left to the board and what decisions require a vote of the shareholders (and at what percentage).
- If it is a big-ticket decision such as selling all or substantially all the assets of the corporation, that may be one delegated to the shareholders – the people who have a financial stake in the corporation.
- Again, the important point here is to include how such decisions will be made.

Selling Your Shares.

- Most closely held corporations include transfer restrictions within either the shareholder's agreement or bylaws. And this is for obvious reasons. You do not want a shareholder selling stock to any third person.
- But this can create conflict if you have a shareholder who wants to or needs to sell their stock but has no defined buy-out process or purchase price.
- The well-drafted shareholder agreement or bylaws should contain provisions to protect the stock being transferred without first giving the corporation and other shareholders the right to purchase the stock.
- This effectuates keeping the corporation closely held but also permits the departing shareholder a path forward without resorting to litigation.

Selling Your Shares.

- And the purchase price when it comes time to sell is also vital.
- Whether it be a book value calculation, an EBITDA calculation, retaining valuation experts, or some pre-defined amount, having a clear path forward on what the purchase price will alleviate consternation.
- There is not a one-size-fits-all approach here.
- For a corporation with a lot of goodwill, an EBITDA calculation or retaining valuation experts likely is more appropriate to capture that goodwill. If it is a service entity, perhaps a book value calculation is more appropriate because the ongoing viability may be tied to one or two key people. If they leave, the goodwill goes with them.

Selling Your Shares.

- And the purchase price when it comes time to sell is also vital.
- The buy-out provision is important to take the time to get right when forming the corporation because when one shareholder feels trapped as unable to sell, and others feel handcuffed with no clearly defined purchase price, litigation may be the only way to divorce them from each other.
- Defining the buy-out process when everyone is on the same page when the corporation forms can help save the shareholders from themselves and legal fees when the need comes to sell.

Mediation:

- Overview of mediation as a dispute resolution method.
- Benefits of mediation (e.g., cost-effectiveness, confidentiality).
- Timing of mediation (pre-suit, post-suit, before discovery).
- Steps involved in the mediation process.
- Role of the mediator.
- Preparation for mediation sessions.

Mediation:

- Case study 1: Successful mediation in a shareholder dispute.
- Case study 2: Challenges faced during mediation.
- Example: Mediation agreement outcomes.

Alternative Dispute Resolution (ADR) Methods:

- Overview of other ADR methods (e.g., arbitration, negotiation).
- Comparative analysis of ADR methods.
- Best practices for selecting the appropriate ADR method.
- Role of legal advisors in ADR.

Litigation:

- When to consider litigation for resolving disputes.
- Key stages of the litigation process.
- Pros and cons of litigation.
- Costs and time considerations in litigation.

Litigation:

- Case study 1: Litigation in a high-profile shareholder dispute.
- Case study 2: Lessons learned from litigation.
- Example: Court rulings and their implications.

Special Litigation Committees (SLCs):

- Role and formation of special litigation committees.
- Authority and decision-making process of SLCs.
- Legal standards and judicial review of SLC decisions.
- Independence and impartiality of SLC member(s).

Special Litigation Committees (SLCs):

- Case study 1: Preparing for the SLC investigation.
- Case study 2: Effective use of SLCs in resolving disputes.
- Case study 2: Judicial review of SLC decisions.
- Example: SLC recommendations and outcomes.