

*Shareholder Fiduciary Duties for
both minority and majority
shareholders*

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Seminar Objectives:

- Introduction to shareholder disputes.
- Define fiduciary duties.
- Explore obligations of majority and minority shareholders.
- Analyze duties of loyalty, care and good faith.
- Discuss litigation risks and compliance strategies.

Fiduciary Duty – Core Principles:

- Duty of Loyalty: Act in the best interest of the corporation and shareholders.
- Duty of Care: Make informed, prudent decisions.
- Duty of Good Faith: Act honestly and fairly, avoiding improper motives.

Fiduciary Duties:

- 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.

Fiduciary Duties:

- 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.

Fiduciary Duties:

- 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)”.

Fiduciary Duties:

- 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).

Fiduciary Duties:

- 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.

Fiduciary Duties:

- 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.

Fiduciary Duties:

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

Duty of Loyalty:

- Prohibits:
 - Self-dealing
 - Fiduciaries must not use their position to benefit personally at the expense of the corporation
 - Conflicts of Interest
 - Any personal interest in a transaction must be fully disclosed
- Requires:
 - Disclosure of material interests
 - Fairness in related-party transactions
- Entire fairness review.
 - Fair price and fair dealing

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Duty of Care:

- Requires:
 - Informed decision-making
 - Considerations of alternatives
- Protected by business judgment rule:
 - Grants a degree of deference to the decision of the directors
 - Presumption protecting conduct by directors that can be attributed to any rationale business purpose
 - If disinterested director(s) made an informed decision, in good faith, without an abuse of discretion, he or she will not be liable for corporate losses resulting from his or her decision
 - No armchair quarterbacking

Duty of Care:

- Maintain detailed board minutes and records
- Seek expert advice when necessary (e.g. financial valuations)
- Avoid rubberstamping decisions without review

Duty of Good Faith:

- Often treated as part of the duty of loyalty
- Requires:
 - Honest motives
 - Decisions must be made with genuine intent to benefit the corporation
 - No intentional misconduct
 - Fiduciaries must not act with intent to harm the corporation
 - Avoidance of grossly inequitable outcomes
 - Passive neglect or failure to act can breach this duty
- Courts may hold directors to higher standards based on expertise

Duty of Good Faith:

- Courts may find a breach of good faith where:
 - Fiduciaries act with gross negligence
 - There is a conscious disregard for responsibilities
 - There is a failure to monitor or supervise
- Practical implications:
 - Ensure active participation in governance
 - Avoid decisions that appear arbitrary or capricious
 - Monitor executive actions and corporate compliance

Corporate Opportunity Doctrine:

- Disclosing opportunities that belong to the corporation
 - Why
 - How
- Implications of corporate governance documents
- Financial ability to consummate the opportunity
- Use of independent board / vote regarding such opportunity

Lawsuit Implications:

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

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

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.
- Case study 1: Litigation in a high-profile shareholder dispute.
- Case study 2: Lessons learned from litigation.

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).
- Case study 1: Preparing for the SLC investigation.
- Case study 2: Effective use of SLCs in resolving disputes.
- Case study 3: Judicial review of SLC decisions.