Protecting the rights of minority shareholders

By H. Joel Newman

Informal interactions among owners of small businesses often make it difficult for those with little or no control -- such as minority owners -- to protect themselves and their interests.

In many cases, small businesses are the brainchild of friends and relatives who trust one another, and operational and financial control changes as ownership transfers because of inheritance, divorce, new investors or changes in loyalties and alliances.

Owners with controlling interest have the ability to oppress minority stakeholders in a variety of ways and advance their own agendas. But many common types of shareholder or member oppression are grounds for legal action under the Michigan Business Corporation Act.

A few examples of actionable conduct include interfering with voting rights, withholding information or dividends, eliminating employment or benefits, self-dealing or conducting unfair business transactions with other companies they own, making loans with high interest rates to the company, snagging for themselves business opportunities in the company's line of business, voting for unreasonable compensation for themselves or making improper capital calls -- requesting funds from investors -- and other bad-faith maneuvers to dilute minority ownership shares and squeeze them out.

Minority owners have to protect themselves by hiring a lawyer, who specializes in commercial litigation and can review and draft key documents that will govern the operation. Articles of incorporation, bylaws, and operating and partnership agreements are minority owners' first line of defense, and must be tailored to suit each situation. They can cover voting rights for electing directors and amending documents, powers and limitations of directors and managers, classes of ownership, and regulations for capital calls and dilution, and many other issues. Provisions controlling the transfer of stock also can be very important in protecting minority holders.

Still, minority owners must know the business of the company by attending shareholder meetings, asking questions, and reviewing notices and documents. Shareholders have a statutory right to receive company balance sheets, income statements, and sources and application of funds.

Shareholders, their attorneys and agents also have a statutory right to inspect the company's list of shareholders, stock ledger, and other records related to their interests. And directors have the right to inspect any documents relevant to their position. If the company fails to provide such requested documents, the shareholder or director can bring a court action. The court will require the company to cover attorney's fees if the shareholder or director prevails, unless the company shows it acted on a good-faith belief that the demand was improper.

Directors and managers have a fiduciary duty to remain informed and recognize misconduct. And they are obligated to vote against any action they think is improper. Failing to oppose a potentially oppressive issue as a director could mean waiving the option to file a lawsuit later.

The Michigan Business Corporation Act permits a shareholder to sue if the acts of directors or others exercising control are "illegal, fraudulent, or willfully unfair and oppressive to the corporation or to the shareholder," which means "a continuing course of conduct or a significant action or series of actions that substantially interferes with the interests of the shareholder as a shareholder." This broad language in the statute could include almost any unfair activity, including termination or other limitations on benefits that disproportionately affect the shareholder; self-dealing; usurping corporate opportunities; or keeping information from minority owners. Actions specifically authorized by the articles of incorporation, bylaws, or consistently applied written policies or agreements, however, are not subject to court action.

Michigan’s circuit courts have far-reaching powers to fashion a remedy. They can dissolve the company, order a buyout at a fair price, undo or prohibit unfair acts, and award damages and attorney’s fees. But it’s up to shareholders and members to ensure their legal rights are protected.

It is important to note that statutes of limitation for minority owner oppression claims in Michigan are brief. Though some conflicting cases and circumstances exist, the statutes provide a 2-year window for filing a suit when actionable wrongdoing is discovered or reasonably should have been discovered, or within three years of the occurrence of any wrongdoing, regardless of when or if it is discovered.

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