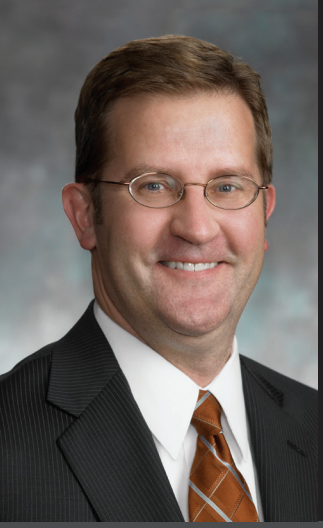

BUSINESS LITIGATION

Do Minority Shareholders Owe A Fiduciary Duty? It Depends

By Randy G. Gullickson

Minnesota courts have repeatedly held that controlling shareholders in private, closely-held corporations are akin to partners in a partnership. Partners are generally viewed to have a fiduciary duty to one another and to the partnership. Thus, majority or controlling shareholders owe a fiduciary duty to the corporation and to their co-shareholders.

But what about minority shareholders? Do they owe a similar fiduciary duty? And, does conduct that results in a *freeze-out* of a minority shareholder affect the answer to this question? These issues can be of great importance to minority shareholders, particularly those who wish to continue their careers in the same field after leaving or being forced out of the corporation in which they own stock. If minority shareholders owe a fiduciary duty, they may be prevented from competing with the corporation, thereby significantly undermining their future business and professional prospects.

The Minnesota Supreme Court addressed the fiduciary duty of minority shareholders in *Advanced Communications Design, Inc. v. Follett* in 2000. While that case is known primarily for establishing the principle that, absent extraordinary circumstances, a marketability discount should not be applied in determining the fair value of stock in a shareholder buy-out lawsuit, the opinion also discussed a secondary issue. The case addressed whether a minority shareholder, who had resigned employment after being the subject of unfair treatment, had breached a fiduciary duty by soliciting company customers for another business.

The Supreme Court held that the minority shareholder did not owe a fiduciary duty to the corporation or his co-shareholders. The court focused on the ability of the shareholder to control corporate affairs, distinguishing between shareholders who "participate equally in the management of the corporation" and shareholders like Follett, who own only non-voting shares and do not serve on the board of directors. Those participating equally in management are like partners and do owe a fiduciary duty. By contrast, Follett lacked any "significant ability to control corporate decision-making" and therefore did not owe a fiduciary duty.

Given the unique facts of that case – most shareholder disputes involve shareholders who own voting shares – the *Follett* decision left open questions about where the line is drawn between minority shareholders who do owe a fiduciary duty and those who do not. What about a shareholder who owns voting shares but as a practical matter has little or no influence over corporate affairs? Does it matter whether a shareholder owns 1 percent or 49 percent? Will the conclusion be different for a minority shareholder who voluntarily chooses to resign than for one who is wrongfully forced out of the corporation? Recent cases have spoken to some of these issues, but left a number of questions unresolved.

A 2014 decision by the Massachusetts Supreme Judicial Court may give departing minority shareholders pause in considering their options. In *Selmark Assocs., Inc. v. Ehrlich*, the controlling owner of a closely held corporation terminated the employment of a minority shareholder and effectively froze him out of the company. When the minority shareholder then took a job competing with the corporation, he was found liable for damages for breach of fiduciary duty, and the Massachusetts high court affirmed that award. Noting that shareholders in closely held companies owe fiduciary duties to the company and co-shareholders, the court reasoned that allowing a shareholder who has suffered harm within a close corporation to "seek retribution by disregarding [the shareholder's] own duties" would undermine "fundamental and long-standing fiduciary principles that are essential to corporate governance." According to the court, allowing minority shareholders to "retaliate" (by going into competition) when they believe they have been frozen out will only increase disputes in closely held companies. Instead, aggrieved shareholders should take their claims to court for judicial resolution rather than unilaterally determining to go into competition. Given how recently this Massachusetts case was decided, it is not clear whether Minnesota courts would consider a similar approach.

In a 2014 unreported decision issued just a few weeks before the Massachusetts ruling, the Minnesota Court of Appeals did not take the same approach, instead holding that a minority shareholder who is forced out of the corporation may subsequently compete with the corporation without breaching a fiduciary duty. The plaintiff in *Piche v. Braaten* was an employee who had acquired 22 percent of the outstanding

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voting shares of the corporation and was active in the management of the business. His employment was terminated after he engaged in hostile and offensive misconduct in the workplace.

The plaintiff sued, and the controlling owners brought a counterclaim, alleging that the terminated minority shareholder breached his fiduciary duty by, among other things, going to work for a competitor after he was terminated. The court recognized that the plaintiff had been a bad actor, and found that his misconduct justified the termination of his employment. But the court also concluded that the majority's post-termination conduct of excluding the plaintiff from shareholder meetings and depriving him of any ability to participate in management decisions or control the timing of shareholder distributions violated the plaintiff's reasonable expectations and minority-shareholder rights, thus entitling him to a fair value buy-out under Minnesota Statutes § 302A.751. With respect to the breach of fiduciary duty counterclaim, the court held that because the plaintiff's job with a competitor began several months after the majority owners "had successfully frozen out [the plaintiff] as a minority shareholder," that competition did not breach any fiduciary duty. Thus, according to this unreported decision, ownership of a minority block of voting stock does not by itself impose a fiduciary duty on a minority shareholder.

The bottom line is that minority shareholders who seek to compete with the corporation in which they own shares should carefully consider their options. The unique circumstances regarding the stock that they own, as well as the nature of their relationship with co-shareholders and their role, if any, in the management and control of the corporation, are likely to affect the shareholders' legal rights and obligations.