

## CORPORATE GOVERNANCE

# All majority shareholders should be aware of their responsibilities

**E**very majority shareholder of a closely held corporation in Ohio needs to be aware of the duties he or she owes to minority shareholders.

Under Ohio law, majority shareholders owe heightened fiduciary duty to minority shareholders that, if breached, will allow the minority shareholders to sue for actual damages and, in extreme circumstances, punitive damages as well. Failing to recognize and respect these duties may cause the majority shareholder to be individually liable to an oppressed minority shareholder.

### CLOSE CORPORATIONS

How do you know if you're a closely held corporation? A close corporation has been defined by the Ohio Supreme Court as a corporation with few shareholders and whose shares are not generally traded on a national securities exchange or regularly quoted on an over-the-counter market. Therefore, the shares of a close corporation are rarely bought and sold and there are usually restrictions on the free alienability of shares.

Under this definition, many small and family-owned businesses are closely held corporations whose majority owners owe fiduciary duties to minority shareholders. Majority shareholders of closely held corporations oftentimes treat the business as their business with the mindset that they can take whatever action they want without thinking through how their actions may affect minority interests.

Ohio courts have likened close corporations to traditional partnerships because the ownership of a close corporation is limited to a small number of people who are dependent on each other for the enterprise to succeed.

Just like a partnership, the relationship between the shareholders must be one of trust, confidence and loyalty if the close corporation is to succeed.

While a close corporation provides the benefits of the corporate form, such as limited liability and perpetuity, the close



### BUSINESS PRACTICES

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corporation structure also gives majority or controlling shareholders opportunities to oppress minority shareholders.

For example, majority shareholders may refuse to declare dividends, may grant majority shareholders exorbitant salaries and bonuses, or pay high rent for property leased from the majority shareholders. One must be cognizant of the effect such lucrative arrangements may have on minority shareholders.

### SHAREHOLDER PROTECTION

Why do courts protect minority shareholders - they cannot control the corporation?

This protection is provided primarily because, unlike oppressed minority shareholders of large publicly owned corporations who can easily sell their shares in the event they are dissatisfied, oppressed or dissatisfied minority shareholders in a close corporation generally have no ready or available market for their stock. This presents a plight for a minority shareholder in a close corporation who can become trapped in an unpleasant situation.

In response to this problem, majority shareholders have a heightened fiduciary duty - one of complete disclosure and utmost good faith and loyalty - to the minority shareholders. Thus, a majority shareholder's fiduciary duty prohibits the use of his or her power to promote his or her personal interests at the expense of corporate interests.

Majority owners may also be on the hook for utilizing their majority control of the corporation to their own advantage without providing minority shareholders with an equal opportunity to benefit, unless they have a legitimate business purpose for taking the action.

Also, a majority shareholder has an obligation in many instances to fully disclose material facts to minority shareholders.

### SQUEEZING AND FREEZING

A typical claim brought by a minority shareholder is a squeeze-out or freeze-out claim in which a majority shareholder manipulates the use of corporate control to eliminate minority shareholders or otherwise unfairly deprive them of advantages or opportunities to which they are entitled.

Another common claim occurs when the controlling shareholders cause the company to redeem their share, but fail to provide the same opportunity to minority shareholders.

Under most circumstances, if a company redeems shares from a majority shareholder, the controlling shareholder must also cause the corporation to offer each minority shareholder an equal opportunity to sell a proportionate number of his or her shares at an identical price.

In essence, the controlling group may not, consistent with its strict duty to the minority, use its control of the corporation to obtain special advantages and disproportionate benefit from its share ownership.

It is also very important to remember that minority shareholders who are also employees of the company are not at-will employees and may not be terminated without a legitimate business purpose.

Many majority owners fail to recognize this significant exception to the at-will employment framework and fail to take the necessary action to preserve a minority shareholder's at-will employment status.

Majority owners need to take the time to understand and appreciate the fiduciary duties they owe to minority shareholders. Needless litigation and other claims by minority shareholders can be avoided by anticipating the effect that a majority owner's actions may have on minority shareholders and keeping fiduciary duties and minority shareholder rights in mind prior to taking the action.

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