Shareholder and Member Disputes: The Consequences and Avoiding Them

By Brian A. Nettleingham

In the beginning, optimism and enthusiasm abound. The new business will be an unqualified success. It seems only fair that everyone who contributes should own a piece, even if only a small one. Soon, your company has a number of shareholders – perhaps friends, family, or business colleagues – all acting reasonably, motivated to create a successful company.

Then, some sort of new reality sets in: the markets collapse, a new competitor emerges, the business model does not quite pan out, or perhaps interests simply wane. Suddenly, the shareholders – the owners of the new company or a particular shareholder – no longer share a single vision of success. Often, there is a dispute regarding whether money paid to the company is a loan or a capital contribution. Perhaps a minority shareholder, who also happens to be an employee, proves inadequate to the task.

Welcome to the world of shareholder disputes in closely held companies – whether a corporation or a limited liability company – the consequences of which can be devastating to a corporation.

For example, Michigan law allows a shareholder to file a lawsuit claiming that the other owners have engaged in illegal, fraudulent, or unfair and oppressive conduct. Among other available remedies, the court may force a buyout of the minority shareholder's interest, appoint a receiver or even dissolve the corporation. Even if the claim is unsuccessful, the damage to goodwill, clients, and the expense of litigation can be severe.

Moreover, when dealing with a minority shareholder, a corporation must be careful not to take any action that could be construed as "minority shareholder oppression." Michigan law recognizes that minority shareholders sit in a precarious position, and there are statutory protections that must be observed to avoid serious penalties.

Many pitfalls can be avoided through carefully drafted shareholder or operating agreements. Such agreements should contain thoughtfully designed dispute resolution processes, non-compete/non-solicitation agreements, and buy-out provisions that help avoid the potential for litigation and help improve the chance for success if it becomes necessary. Corporate business should be conducted in accordance with the relevant by-laws, and minute books should be kept up to date. Even if the entity is an LLC, it is prudent to hold formal meetings and keep minutes of those meetings.

If a dispute does arise, it must be closely managed from the start, with legal counsel involved at each step in the process to minimize the impact on the company.

Maddin Hauser regularly counsels clients in this area, through careful business entity planning and, when necessary, through dispute resolution or rigorous and tactical litigation.

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