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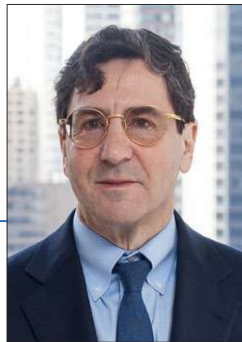
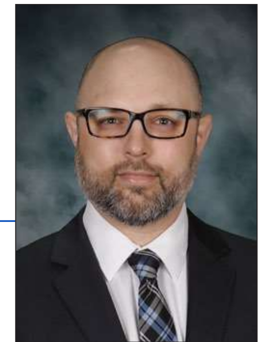
Business Divorces and the Shareholder Primacy Norm





By Gerard V. Mantese[1], Nicole B. Lockhart[2], and Brian P. Markham[3]

Ever since there have been siblings, there have been sibling rivalries. Just outside Eden, Cain and Abel set the bar early on. Closer to home, most rivalries won't end in such extreme tragedy, but they can nevertheless burn with the intensity of a hundred suns. And when those petty squabbles of youth—who can run the fastest? Who's the smartest?—bleed into adulthood, the stakes can be significant. When the battle over "who does mom love most" ages into "who would mom have wanted to run the business she left us," the road to shareholder litigation has been paved.

Shareholder fights touch every industry, every state, and the work of a great number of lawyers, accountants, and business advisors. That is probably one of the reasons for the success of TV series like *Succession* and *Empire*, which detail power struggles and intrigue among generations of business owners. As long as businesses continue to be formed, they will also continue to break up and shareholders will continue to fight for their fair share of company assets.

Shareholders are the owners of corporations, so it may be said that directors "work for" the shareholders. Statutory and case law establish that directors have enforceable duties to shareholders—including a duty to maximize shareholder profits. The principle that those in control of a corporation, and directors in particular, owe rigorous fiduciary duties to shareholders is the foundation of the shareholder primacy norm. This concept states that directors and other fiduciaries must operate a company in the shareholders' best financial interests.

The Intersection of Shareholder Primacy, Fiduciary Duty, and Oppression

The shareholder primacy norm has not received extensive discussion in the caselaw across the country. Instead, courts in Michigan and elsewhere rely on the concepts of fiduciary duties and shareholder oppression to articulate the rights of shareholders to be free of abusive, fraudulent, and willfully unfair treatment at the hands of directors and others in control of a corporation. The shareholder primacy norm is worthy of discussion in its own right as it places in the forefront the rule that directors have a duty to specifically advance shareholders' financial interests.

Of course, directors have strong fiduciary duties to shareholders. These duties include the obligations to act: (1) honestly and in good faith;[4] (2) with full disclosure and transparency;[5] (3) with loyalty;[6] and (4) with the utmost due care.[7] These duties require the fiduciary to act in the best interests of the beneficiary. There is no balancing of interests. Fiduciaries who breach their duties have significant exposure for any damages their actions cause.

Likewise, directors and those in control of a corporation may be liable for their intentional actions that substantially interfere with or harm shareholders' ownership interests.[8] In the typical oppression scenario, the oppressors act to significantly limit the oppressed shareholders' opportunities to see any financial benefit from their shares. Examples of oppressive acts include situations where those in control unfairly limit or cut

off dividends, engage in discriminatory redemptions, limit access to information, or engage in self-interested transactions.[9]

So, it is the case that the shareholder primacy principle is similar to and complementary to the concepts of fiduciary duty and shareholder oppression. All of these concepts protect shareholders' financial interests but do so from independent philosophical and theoretical perspectives. Fiduciary principles measure an actor's conduct against four specific duties of loyalty, honesty and good faith, full disclosure, and due care. Each duty is significant, and each is significantly different.[10] In contrast, oppression analysis focuses on whether those in control are intentionally and oppressively interfering with the shareholding interests of the shareholder.[11] The oppression cause of action is an equitable one,[12] and a court of equity has broad power to do justice in oppression scenarios:

> That solvent corporations are wrecked for purely selfish and illegal purposes, that minority interests are "frozen out," that business immorality has run amuck under the assumption that courts are powerless, is too true. But the assumption is wrong. Judicial hesitancy does not mean judicial atrophy or paralysis. The board of directors of a corporation are but trustees of an estate for all the stockholders, and may not only be amenable to the law, personally, for a breach of trust, but their corporate power under color of office to effectuate a contemplated wrong may be taken from them when, by fraud, conspiracy, or covinous conduct, or extreme mismanagement, the rights of minority stockholders are put in imminent peril, and the underlying, original, corporate *etente cordiale* is unfairly destroyed.[13]

This is similar to the fiduciary duty analysis for sure, as both concepts are concerned with protecting shareholders from financial abuse.

Shareholder primacy expresses elements of both the fiduciary and oppression concepts as a corporate maxim: directors and officers have a duty to act in the shareholders' best financial interests.

Plumbing the Shareholder Primacy Norm in More Detail

The shareholder primacy norm is embedded in the statutes in Michigan and in decades of caselaw. While this doctrine is similar to fiduciary concepts and to shareholder oppression principles, it stands independent of these concepts. Indeed, its most famous elucidation—*Dodge Brothers v. Ford*[14]—did not rely on the oppression statute (which was not enacted until decades later).

Statutory Support for Shareholder Primacy

There is no one provision in the Michigan Business Corporation Act that stands for the notion that shareholders should enjoy the primary benefit of the company's operations. Instead, several statutes patched together create the quilt of shareholder primacy.

Begin with MCL 450.1489, which provides that a shareholder may bring an action for shareholder oppression when directors or those in control take actions that wrongfully interfere with or damage their ownership interests. This is the statutory expression of the idea that the law will protect shareholders and their interests from oppressive and willfully unfair business actions.

Next, we turn to MCL 450.1541a, which provides that a director or officer must act (1) "[i]n good faith," (2) "[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) "[i]n a manner he or she reasonably believes to be in the best interests of the corporation." These are fiduciary concepts that unleash powerful obligations on officers and directors to act in the financial interests of shareholders.[15]

Finally, consider the dissenters' rights statutes.[16] Dissenters' rights exist to ensure that directors safeguard shareholder value in certain business transactions, such as mergers. The statutes accomplish this by allowing shareholders to challenge the consideration they receive for the disposition of their shares in such transactions.

Caselaw Supporting Shareholder Primacy

Michigan caselaw also solidly supports the share-

holder primacy norm, even if that phrase is not used. Just four examples will suffice. In *Miner v. Belle Isle Ice Company*,[17] the Michigan Supreme Court held that officers and directors must manage the company so as "to produce for each stockholder the best possible return for his investment."[18] Note that the phrasing is not "a reasonable return" or "a good return," but rather "the best possible return."

In the famous case of *Dodge Brothers v. Ford*, the Michigan Supreme Court held that "a business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end."[19] Note that although the Court did not use the academic phrase "shareholder primacy norm," this case is widely taught in law schools as a preeminent judicial articulation of these ideas.

In *Miller v. Magline*, the Court of Appeals declared that "where one man or family controls and dominates a corporation, [he or they] must act in the utmost good faith in the control and management of the corporation as to minority stockholders."[20]

Lastly, the Michigan Supreme Court recently affirmed that the primacy doctrine is alive and well in Michigan. In *Murphy v. Inman*, ___ Mich. ___, ___ N.W.2d ___, 2022 WL 1020127 (April 5, 2022) the Court restated its holding in *Dodge* that "directors' fiduciary duties run primarily to the shareholders of a corporation and that the essence of those duties is to obtain the best possible return on the shareholders' investments."

These and many other cases stand for the proposition that the corporation is to be operated so as to primarily benefit the financial interests of the shareholders and to provide profits to them.

The Shareholder Agreement

Beyond the statutes and the caselaw, the most significant source of a shareholder's rights and responsibilities is any existing shareholder agreement. And in construing such agreements, keep in mind that there is an implied duty of good faith and fair dealing in every contract.[21] This is especially potent where contractual duties involve a measure of discretion,[22] such as those that involve the exercise of business judgment.[23] Even when a shareholder agreement purports to provide a party with plenary authority to operate the company, they must do so in good faith and can have responsibility for abuse of that broad power.[24]

Conclusion

The shareholder primacy norm is part of Michigan's jurisprudence, even if this appellation is not used. This can be seen in various statutes and in the caselaw. Along with fiduciary concepts and the law on shareholder oppression, the shareholder primacy norm safeguards the right of shareholders to have those that work for them—the directors—advance their best financial interests.

ENDNOTES

1. Gerard V. Mantese is a trial attorney at Mantese Honigman, P.C., where he handles high-stakes business and shareholder litigation, including business breakups, in courts across the country. Mantese is CEO of the firm's Michigan and New York offices and was recently appointed Chair of the Corporation Law Committee of the New York County Lawyers Association.
2. Nicole B. Lockhart is an associate at Mantese Honigman, P.C., in the Business Litigation Practice Group. Lockhart focuses on shareholder disputes involving closely held companies, franchise and other contract disputes, real estate matters, and disputes concerning entities regulated under Michigan's Medical Marihuana Facilities Licensing Act.
3. Brian P. Markham is an associate at Mantese Honigman, P.C., in its Business Litigation Group and Appellate Practice Group. Markham focuses on business breakups, complex business matters, and, with Mantese, appeals in the United States Supreme Court. *See, e.g.*, Petition for Writ of Certiorari, *Jones v. City of Detroit*, filed March 21, 2022 (No. 21-1292).
4. *See Thomas v. Satfield Co.*, 363 Mich. 111, 927 N.W.2d 741 (1961).

5. *See Schmude Oil Co. v. Omar Operating Co.*, 184 Mich. App. 574, 458 N.W.2d 659 (1990).
6. *See Menhennick Family Trust v. Menhennick*, 326 Mich. App. 504, 927 N.W.2d 741 (2018).
7. *See Castle v. Shoham*, No. 337969, 2018 WL 3746550 (Mich. Ct. App. August 7, 2018).
8. MCL 450.1489. Whereas Michigan's oppression standard requires a showing of oppressive intent, other jurisdictions, such as New York, will find oppression where the control group frustrates the "reasonable expectations" of a shareholder. *See, e.g., Matter of Kemp & Beatley, Inc.*, 64 N.Y.2d 63, 72-73; 473 N.E.2d 1173 (1984) ("A shareholder who reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, a place in corporate management, or some other form of security, would be oppressed in a very real sense when others in the corporation seek to defeat those expectations and there exists no effective means of salvaging the investment.").
9. *See, e.g., Miller v. Magline, Inc.*, 76 Mich. App. 284; 256 N.W.2d 761 (1977) (dividend starvation); *Madugula v. Taub*, 496 Mich. 685, 853 N.W.2d 75 (2014) (withholding information) (full disclosure: argued to the Michigan Supreme Court by Mr. Mantese); *Lozowski v. Benedict*, No. 257219, 2006 WL 287406 (Mich. Ct. App. February 7, 2006) (siphoning profits); *see generally* Gerard V. Mantese and Ian M. Williamson, *Litigation Between Shareholders in Closely Held Corporations*, 1 Wayne. St. U. J. Bus. L. 1 (2018).
10. *See* Gerard V. Mantese, *The Fiduciary Duty—Et Tu, Brute?* 99 Mich. Bus. L. J., no. 9, 2020, at 52.
11. *See generally* Gerard V. Mantese and Fatima M. Bolyea, *Shareholder Oppression Litigation—A National Perspective*, 40 Mich. Bus. L.J., no. 3, 2020, at 38; *see also generally* Gerard V. Mantese & Jordan Segal, *Can't We All Just Get Along? Fiduciary Duties in the Corporate and LLC Context*, 36 Mich. Bus. L. J., no. 1, 2016, at 20.
12. *Madugula*, 496 Mich. at 721.
13. *Levant v Kowal*, 350 Mich. 232, 240, 86 N.W.2d 336 (1957).
14. *Dodge Bros. v. Ford Motor Co*., 204 Mich. 459, 170 N.W. 668 (1919).
15. Other jurisdictions likewise have statutes imposing such duties on directors. *See*, e.g., N.Y. Bus. Corp. Law 717(1) ("A director shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances.").
16. MCL 450.1754 through MCL 450.1774.
17. *Miner v. Belle Isle Ice Co.*, 93 Mich. 97; 53 N.W. 218 (1892).
18. *Id*. at 116.
19. *Dodge*, 204 Mich. at 507.
20. *Miller*, 76 Mich. App. at 304.
21. Restatement Contracts, 2d § 205; *see Burkhardt v. City Nat'l Bank of Detroit*, 57 Mich. App. 649; 226 N.W.2d 678 (1975); *see also Vasiliadis v. Rubaii*, No. 349982, 2021 WL 70599 (Mich. Ct. App. January 7, 2021) (finding defendant's fraudulent performance under a consent judgment to be a breach of the implied covenant).
22. *Burkhardt*, 57 Mich. App. at 652.
23. Likewise, bad faith or fraudulent conduct is not protected by the business judgment rule, which otherwise precludes judicial review of business decisions. *In re Caraco Pharm. Labs.*, Docket No. 329933, 2017 WL 2562635 *9 (Mich. Ct. App. June 13, 2017); *see also* Gerard V. Mantese & Emily S. Fields, *The Business Judgment Rule*, 99 Mich. Bus. L. J., no. 1, 2020, at 30.
24. *See Berger v Katz*, No. 291663 2011, WL 3209217, at *4 (Mich. Ct. App. July 28, 2011) ("Although the bylaws gave defendants the general authority to make business decisions . . . that does not mean that defendants were permitted to act in a manner that was willfully unfair and oppressive to plaintiff, as a minority shareholder.").