HAVE A CORPORATION'S CONTROLLING SHAREHOLDERS MANIPULATED THE CORPORATION FOR THEIR OWN SELF-INTEREST?

By Robert M. Heller

The controlling shareholders of a corporation may not manipulate the corporation for their own self-interest, without regard to the interests of the other shareholders or corporate creditors. If they cause corporate action which disadvantages the minority shareholders, or the corporation's creditors, and if objections to that action cannot be amicably resolved, the controlling shareholders may be held personally liable for any losses created by their action.

Minority shareholders can enforce their rights and recoup their losses by filing a lawsuit over controlling shareholder misconduct. Here are a few examples of actionable misconduct:

- **Issuing shares in order to dilute minority interest.** Even if the corporation's articles of incorporation provide *no* preemptive rights (preemptive rights are the rights of current shareholders to maintain their fractional ownership of a company by buying a proportional number of shares of any future stock issuance), minority shareholders are entitled to protection against "unfair" dilution of their interests. Controlling shareholders breach their fiduciary duty to the minority where they cause the corporation to issue additional shares for *inadequate consideration*, in order to dilute the minority's interest. The minority shareholders may sue directly for their damages.

- **Instituting a dividend policy that is detrimental to minority shareholders.** Controlling shareholders may be held personally liable for causing the directors to adopt dividend policies detrimental to the minority shareholders. One example is for the company to stop paying dividends (even though ample funds are available) in order to deflate the value of the minority's shares and pressure them into selling out to the majority. Moreover, directors who vote excessive "salaries" to themselves or controlling shareholders while refusing to declare dividends also may be personally liable to other shareholders.

- **Placing a corporation in bankruptcy to sell assets to a creditor owned or controlled by a majority shareholder.** A majority shareholder who uses control over the board of directors to place the corporation into bankruptcy for the purpose of selling the corporation's assets to a secured creditor that is a subsidiary of the controlling shareholder may be liable for breaching its duty to the minority shareholders. The liability theory that the controlling shareholder failed to consider other alternatives that may have yielded greater value to the corporation and all its shareholders.

- **Refusing or restricting the rights of minority shareholders to inspect the corporation's books and records.** All shareholders have rights of access to corporate records and no formal action by the shareholder is required to enforce those rights. Rather, inspection rights exist as a matter of law. Although those rights are not absolute, and instead depend on the type of records sought to be inspected, and in certain circumstances the purpose of the inspection, controlling shareholders can in some instances be held liable for arbitrarily refusing or restricting minority shareholder inspection rights.

- **Engaging in prohibited trading of the corporation's securities.** Broadly speaking, officers, directors and other "insiders," including controlling shareholders who hold such positions, may not purchase or sell shares without disclosing material inside information. This rule applies whether the corporation is large or small, and whether the securities are privately or publicly held. If controlling shareholders engage in such trading, they may be subject to liability.

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