Nancy Fallon-Houle ©

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**Minority Shareholder Agreement Analysis – Illinois Section 12.56**

**Memo addressed to a Minority Shareholder of 30 to 40%**

1. **Conclusions**
2. **What If You Leave Company - Terminate Employment?  Company Required to Buy Your Shares**

If you Terminate Employment (Section 7), Company is required to buy your shares, and you are required to sell them to Company. (Section 7.1, and Explanatory Statement D and E.)

Nowhere in the Agreement does it say that if you voluntarily quit, you lose your shares with no value. The only requirement is that Company buy them from you if you are Terminated.   Interesting that there is not a separate provision for Voluntary Termination of Employment, as these agreements sometimes provide. The result from this provision is that you can force the company to buy your shares by quitting or by getting fired.

The Closing to buy your shares is required to occur between 10 days and 90 days after your termination date. (Section 7.3)

Section 7.3 requires that the Cash for the Aggregate Termination Purchase Price, be paid at the Closing date, unless Company elects to pay in Installments. Installments covered in Section 8. As you and I discussed at the meeting, the installment payments are without deadlines Vague, nebulous, with no firm dates or times, as. Hmmm, that could be a problem.

At least you are permitted to see the books and records as if a Shareholder, unit you get paid. (Section) 8.3.2.

If I were working on this Closing Transaction, I would include a provision in the Purchase Agreement that the Shares only transfer back to Company in increments paid for.  I would also file a UCC Financing Lien on the shares or company property secured by them, so you are assured of getting paid. (UCCFL is filed and is of public record.)

They wouldn’t want you to stay on as a shareholder after termination, so they will pay for it more quickly!

1. **What Price Do you Receive for Your Shares? Termination Purchase Price**.  The “Termination Purchase Price” is the Agreed Value (Section 7.2 and 1.3), annually determined value by 75% of shareholders.

**Questions, Issues, Problems, Observations, With Section 7.2 Termination Purchase Price**

1. Does your brother, the other Minority Shareholder (10%) typically vote with your Dad, the Controlling Shareholder (66%)? Together than have more than the 75% needed to value the company. Is he with you at all on any of these concerns?
2. When was the last time the Company did an “Agreed Value” and what was the value? (Section 1.3.) You mentioned that Company has not done a value determination for a while.
3. The last Valuation shown in the Agreement’s attached Exhibits, for the year 2000, provides that $200,000 is the value of the entire company, for all 100% of the shares. As you and I both know with the revenue at $30 million, the book value far exceeds that now.
4. What is the current Book Value of the company?
5. If the Company hasn’t prepared an “Agreed Value” in the past 18 months, then the Book Value becomes the Agreed Value. This is a positive for you Minority Shareholders [you and your brother], since the Book value is likely more than the Agreed Value, unless all the outstanding debt to shareholders reduces net worth substantially.
6. The Accountant and the valuation experts I referred to you would need to review and comment on the financial books and records and on the valuation.
7. Book Value is determined by “the Accountants”.  “The Accountants” in this Agreement, means the company accountant, “the CPA firm examining the books and accounts at the relevant time, or the CPA firm who last performed that service”.  I strongly advise hiring your own impendent accountant, to protect your own personal interests, just like hiring your own lawyer. My concern is that Accountants for the company might have Controlling Shareholder’s (your Dad’s) best interest in mind, rather than the Shareholders as a group. And you’ve said that the accounting firm has stated that. (Here is where the Illinois Statute would kick in to protect you, as the court can force an outside 3rd party valuation.)
8. Interesting and unique deductions or exclusions from Book Value in Sections 1.5 to 1.55.
9. Seems to be a focus on using accrual basis, rather than cash basis, even if the company’s financials or tax returns are prepared on a different basis. I’m not sure why, but the accountants, or your own accountant, would know.
10. Not allowed to include intangible assets in BV, which means the valuation can’t include the intellectual property, customer list, vendor list and the relationships, all of which you described as the meat of the value of the company. Therefore it’s only the value of the equipment, AR, inventory and cash that would be considered in the valuation.
11. **Agreement Excerpts.** I attach a word document into which I had excerpted the relevant sections mentioned in this email memo. This also includes some of my raw notes from last week.
12. **Other Sections to Perhaps Use for Interpretation.**  If Section 7 has any absent provisions, then the Parties, or perhaps a court, might look to Section 3 Restrictions on Transfer (“especially common stock”), or Section 4 Voluntary Transfers – Conditions and Procedures – Offer from outside 3rd party), to interpret. Not a sure bet, but just thought I’d point that out, since for example, the time frame for payment is missing in Section 7 and 8.
13. **Minority Shareholder Oppression – Your Rights Under Illinois Law Section 12.56**.

Illinois statue, Section 12.56 (new since 2007, and just revised in 2010) protects “oppressed minority shareholders”, and allows a minority shareholder to get a court to “move the mountain”. (See attached Section 12. 56).

It’s a clear, concise road map to direct action for the minority shareholders. Courts now have a clear path to solve these issues quickly in any manner the court sees fit, regardless of what the agreement says. Therefore, it tends to be fast and efficient to get relief under this statute.

It allows the court to force the company to buy the minority shareholder’s shares. It allows the minority shareholder to obtain its OWN valuation, or it allows the court to determine its OWN valuation. (Which would not be Controlling Shareholder’s valuation).

Enforcing 12.56 requires either litigation, or the threat of litigation, or I have also found it rather effective to simply name-drop the Section 12.56 “Minority Shareholder Oppression” statute to the Majority Shareholder (i.e. you would mention it to Controlling Shareholder), or have a lawyer write a letter citing 12.56 and describing the waste of corporate assets. The majority shareholder has his lawyer read the law and says “uh oh, they could force you to buy them out”; “Just do the buyout and spare the litigation”.

These rights in 12.56 are explicitly spelled out and therefore easy to bring action and enforce, rather than the old vague case law interpretation**. Section 12.56 trumps the Agreement**, if the majority shareholders are acting in oppressive manner, or wasting corporate assets, or if there is a deadlock of directors or shareholders. The court has the right to ignore the Agreement, and make its own determination of what is fair.

Majority Shareholder should be shaking in his boots with this new statute out there (since 2007) when he learns all about it.

Illinois statue also includes the power in the court to force Controlling Shareholder out (I know you’ve stated this only a secondary issue on your radar.  But that is another remedy in the same statue. I also summarized these items to you in my first email on 2-22 before we met in person.

**It’s pretty effective when the Minority Shareholder lets the Majority Shareholder know that the minority person is aware of these legal rights and that the statute has laid out a clear road map to protect the Minority Shareholder:**

Under 12.56:

If the control shareholders or directors are acting oppressively, fraudulently, illegally, wasting corporate assets, or if corporate assets are being misapplied or wasted, or if the directors or shareholders are deadlocked, then:

A.         Then the court may:

1.         Order the corporation, the shareholders, the directors, officers or any party to the proceeding, to take an action or refrain from taking an action (any action the court sees fit).

2.         Remove or appoint a director, or officer, or provisional director or even a custodian, until the dispute is resolved.

3.         Order an accounting of the corporation’s financial records.

4.         Order dividend payments to the minority shareholders (or all shareholders).

5.         Award damages to the oppressed minority shareholders.

6.         Order the corporation to buy out all the shares of the oppressed or aggrieved shareholder's shares, at fair value. (The court determines the fair value, or hires an appraiser to do so)

7.         Order dissolution of the corporation.

8.         Anything other the action that the court thinks is appropriate to bring fairness to the shareholders.

B.         The corporation, or one or more shareholders, may elect to purchase all the petitioning shareholder's shares for fair value.

1.         Within 90 days after the complaint is filed.

2.         Or later with court approval.

1. **Waste of Corporate Assets Prohibited by Fiduciary Duty**

Illinois law requires that the Directors and Officers, including Controlling Shareholder, in their fiduciary duty to the corporation and all its other shareholders, act in the best interest of ALL of the shareholders, not just himself.  He has a Fiduciary Duty to not waste corporate assets or line his own pockets. He has a fiduciary duty to not put the company at risk for tax audit. From what you described, he is in direct breach of these fiduciary duties. While you can go straight to the statute now in 12.56 for relief, under old law before 2007, you could also find relief under case law. Much more time consulting, but my point is that there are still other remedies out there. It is now very clear under Illinois law that majority shareholders can’t hold the minority shareholders hostage in the fashion that is occurring to you and the other minority shareholder.

1. **Links to Statue and Articles**

Here is a link to the statute, and I also attach a copy of the statute:

<http://law.onecle.com/illinois/805ilcs5/12.56.html>

I provide links below to articles you might find interesting to read, and will give you ammo for discussions with Controlling Shareholder. I would strongly advise reading these items, and the linked articles below, so that you have these statutory law concepts in your head, and know your legal rights, when you talk with Controlling Shareholder.

<http://blog.shareholderoppression.com/2007/04/case-analysis-georgeson-v-dupage.html>

<http://www.dimontelaw.com/hanson_fair_value.htm>

<http://www.fishlawfirm.com/fiduciary>

1. **What if You Start a Similar Company**

Assuming there is no employment agreement, no employee manual, and no noncompete agreement that would prevent you from starting your own similar company, you can start your own company as long as you don’t take employees, trade secrets, intellectual property, or active customers, and as long as you don’t “tortuously interfere” with Company’s business relationships, and don’t make any disparaging statements to anyone, anywhere, about Company, the principals, officers, directors or employees. You could end up with a libel or slander suit, and you can also trip over the “tortious interference of business relationships” issue. Best to not say anything at all that could be deemed negative. The customers will eventually figure out who is the right company to go with.

If there are customers who are on their way out of Company anyway, and you have proof of that (written emails or other), keep the proof handy, as you would need it if Company sues. You would want to be able to prove that you didn’t solicit them, that they solicited you.)  If there is enough business to go around, and you wouldn’t hurt Company’s revenue by starting a business, then there is less risk.

**b.         Fiduciary Duty of Officers and Directors**

As an Officer and Director, you have a fiduciary duty to the company and the shareholders to act in the best interests of the company. Perhaps you have a solid argument that it is in the best interests of the company, the other shareholders, and even the customers, to have them serviced by a different company that is focused on reinvesting money back into the company instead of paying it out in large bonuses to the majority shareholder. This is a posture, not law, as far as I know at this point.

It’s certainly not in the best interest of the company, or even the customers, to have them being serviced by a company with some of the financial shenanigans you described.

Once you are no longer an Officer, Director you are no longer bound by the fiduciary duty obligations.

**c.         More Facts Needed to Fully Analyze this Topic**

However, to provide fleshed out advice on this topic, your lawyer would need to know more specific facts about what customers would be coming over and the relationships and situations. On this topic, I am not providing a firm conclusion here, without more facts. But please be very careful here to be respectful of the revenue of the current company, until you are gone from the company.

I advise trying to close the Share Sale before starting any competing business, since flaring tempers over a potentially competing business will cause difficulty with your getting paid for your shares.

I realize that might not be possible to quit, do the share sale (90 days in the agreement) and only THEN start your other business.