

## MICHIGAN LEGISLATURE RESPONDS TO *FRANCHINO* CASE WITH RESPECT TO MINORITY SHAREHOLDER PROTECTIONS

BY VINCENT M. PECORA

Michigan law offers its minority shareholders little assistance in the way of combating the unfortunate consequences of an unbalanced corporate framework. Under the Michigan Business Corporations Act (the “MBCA”), the few rights available to minority shareholders are outlined in Section 489 of the MBCA, commonly known as the Minority Shareholder Oppression Statute (the “Statute”). Legislation passed in March 2006 (P.A. 68), however, has offered minority shareholders new protections from abusive conduct by controlling corporate owners.

As a general matter, under the Statute, a shareholder may bring an action “to establish that the acts of the directors or those in control of the corporation are illegal, fraudulent, or willfully unfair and oppressive to the corporation or the shareholder.” Until 2001, the Legislature made no attempt to define the term “willfully unfair and oppressive conduct”, and courts were faced with the daunting task of working toward a definition on a case-by-case basis.

The Statute was amended in July 2001 to include a definition of “willfully unfair and oppressive conduct”. The July 2001 amendment (the “2001 Amendment”) added subsection (3), which defined the term as “a continuing course of conduct or a significant action or series of actions that substantially interferes with the interests of the shareholder as a shareholder.”

As reported in our December 2004 *Law & Business*, in July 2004, the Court of Appeals handed down its decision in *Franchino v Franchino*, 263 Mich

App 172, 687 NW2d 620 (2004). The court in that case interpreted this new statutory definition for the first time within the context of a family business owned by a father and his son. The father, who was the majority shareholder, owned 69% of the stock in the Company, while the son owned the remaining 31% of the Company’s stock. The Company’s board of directors consisted only of the father and the son. Upon forming the Company, the father and the son entered into three agreements: two Buy-Sell Agreements and an Employment Agreement, which provided that the son could be terminated only by unanimous agreement of the Company’s board of directors.

After tensions mounted between the father and the son, the father demanded that the Buy-Sell Agreements be set aside. After the son refused to set aside the Buy-Sell Agreements, the father orally fired the son. Shortly thereafter, the father held a meeting of the Company’s Board of Directors (consisting of only himself) and amended the Company’s by-laws in such a way that it allowed the father to fire the son. The son sued the father, claiming a violation of the Statute.

The father moved to dismiss the lawsuit on the grounds that the actions against the son were based on the son’s status as an employee and board member, not because of his status as a shareholder. In response, the son argued that his rights as a shareholder were indirectly affected because he received a substantial amount of his corporate profits through his salary. He claimed that his rights as a shareholder were further affected because the firing infringed on his reasonable expectations to participate in management.

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**MICHIGAN LEGISLATURE RESPONDS TO  
FRANCHINO CONTINUED...**

The Court ultimately sided with the father. It rejected the son's "reasonable expectations" test, holding that the son had no cause of action under the Statute because the termination of his employment did not affect his interests as a shareholder. The court reasoned that while the son may have had a "reasonable expectation" of continued employment and directorship, his interests as a shareholder did not include employment or board membership, and therefore did not constitute "willfully unfair and oppressive conduct" under the Statute. The implication within the Court's decision in *Franchino* is that a shareholder does not have an inherent right to be employed or serve on the board of directors.

In March 2006, the Michigan legislature clarified the decision in *Franchino* by amending the Statute a second time (the "March 2006 Amendment"). After the March 2006 Amendment, the Statute defines "willfully unfair and oppressive conduct" as follows:

'[W]illfully unfair and oppressive conduct' means a continuing course of conduct or a significant action or series of actions that substantially interferes with the interests of the shareholder as a shareholder. **Willfully unfair and oppressive conduct may include the termination of employment or limitations on employment benefits to the extent that the actions interfere with distributions or other shareholder interests disproportionately to the affected shareholder.** The term does not include conduct or actions that are permitted by an agreement, the articles of incorporation, the bylaws, or a consistently applied written corporate policy or procedure. [emphasis added].

The March 2006 Amendment expressly *rejects* any implication that the termination of employment limitations can *never* constitute "willfully unfair or oppressive conduct" under the Statute. Unfortunately, without any guidance from the Legislature or the courts at this time, minority shareholders in closely held corporations are left to surmise as to what benefits or

rights are "disproportionately" shareholder interests under the Statute.

How can minority shareholders protect themselves? Despite the lack of interpretive authority on the March 2006 Amendment, traditional forms of protection are still available. One alternative is to make sure that any employment agreements, shareholder

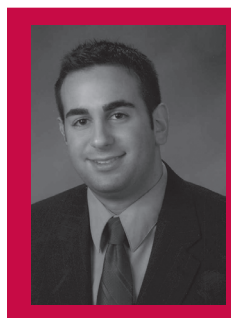
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agreements, or voting agreements expressly give minority shareholders separate legal rights. A second alternative is to provide for cumulative voting in the articles of incorporation. Still another alternative is to implement safeguards in the articles of incorporation requiring a supermajority or unanimous vote for potentially oppressive corporate actions, or preserving in the minority shareholder absolute veto power in certain situations.

Minority shareholders and legal counsel should carefully word any corporate documents, policies, and agreements to guard against events that are not expressly actionable under the Statute. Terms in these agreements should be defined in a way that specifies which conduct is, and is not, an interest disproportionately held by the shareholder as a shareholder. Contingent events like the ones arising between the father and the son in *Franchino* should also be addressed, and if they are not, the minority shareholder should take efforts to secure a bargain sufficient to protect against the accompanying risk of loss that it necessarily assumes. Ultimately, careful planning with a corporate lawyer is critical if a minority shareholder is to maximize any protections that may be available.



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## ATTORNEY ACTIVITIES OF NOTE

■ Ryan K. Kaufman and H. Kirby Albright recently mounted a successful challenge against the proposed “taking” of an easement over a client’s property by a public utility. The easement was going to be used for a new power line being installed by the utility. With the help of an expert witness and the utilities’ own maps and records, Mr. Kaufman and Mr. Albright were able to show the Court that the utility already had extensive easements in the area that could be used to accommodate this new line. Furthermore, the preferred route sought by the utility, which was to cross the client’s property, was actually longer, more costly and lacked an engineering basis over a route that would utilize the utilities’ existing easements. Mr. Kaufman and Mr. Albright argued that there was not a valid legal or factual basis for the utility to use its power of eminent domain and “take” the easement from the landowners. After an day long evidentiary hearing, the Court ruled that there was no “public necessity” for the “taking” of the client’s property and therefore, the power line will not come through the landowner’s property.

■ John D. Miller has been appointed by Governor Jennifer Granholm to serve on the Michigan Board of Occupational Therapists. The Board provides for the registration of occupational therapists and occupational therapist assistants. Mr. Miller, who is a resident of Lansing, MI, will represent the general public for a term expiring December 31, 2007.

■ Robert B. Nelson will speak at the Annual Regulatory Studies Program at Michigan State University on August 15th. His topic will be “Local Considerations in Telecommunications”.

## ANNOUNCING THE ALTERNATIVE ENERGY PRACTICE GROUP

In response to a growing need in Michigan as well as throughout the country, Fraser Trebilcock Davis & Dunlap, P.C. would like to announce the formation of the Alternative Energy Practice Group.

The attorneys in the Practice Group all have extensive experience in the alternative energy arena. They have been Michigan Public Service Commissioners,

President of the Michigan Electric and Gas Association, administrative law specialist at the Michigan Public Service Commission, Chairman of both the State Capital Global Law Firm Group’s Board of Directors and the Public Utility, Energy and Communications Section, owner of wind power developments, and have spent their professional careers practicing utility and business law.

The Alternative Energy Practice Group of Fraser Trebilcock Davis & Dunlap, P.C. is committed to serving the legal, regulatory, consulting and corporate needs of Alternative Energy providers and producers located in Michigan and across the globe. For more information regarding the Alternative Energy Practice Group, please contact Chair Robert B. Nelson at [nelson@fraserlawfirm.com](mailto:nelson@fraserlawfirm.com) or 517/377-0854.



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