Shareholder Agreements - National Report of the United States of America

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Abstract

This national report on the law of shareholder agreements in the United State of America outlines the nature of corporate law regulation in the United States as it relates to shareholder agreements. Particular areas discussed in the context of shareholder agreements in the United States include: shareholder rights, transfer of shares, the constitution of the corporation, pre-insolvency, legal effects of shareholder agreements, including legal effects on the corporation, the consequences of the breach of shareholder agreements, and the enforcement of shareholder agreements.

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I. Nature of Corporate Law Regulation

Since Section 7.32 of the Model Business Corporation Act (MBCA) was passed in 1991, most US states have authorized shareholder control agreements in an effort to support the validity of such agreements. The Official Comment to that section states: "Heretofore, however, the Model Act has never expressly validated shareholder agreements. Rather than relying on further uncertain and sporadic development of the law in the courts Section 7.32 rejects the older line of cases."[1] Many US states, including the State of Delaware, have amended their statutes in the aftermath of the passing of Section 7.32 MBCA to indicate that the corporate powers rest within the board of directors, and variations from this norm are permitted if set forth in the corporation's charter.[2]

US law does not typically limit who may draft a corporate charter. While corporate codes are viewed as "enabling" statutes—providing flexibility for different enterprises—mandatory provisions cannot be changed.[3] For example, DGCL Sect. 102(a)(4) mandates a description of the corporation's stock (exception for non-stock corporation); however, it leaves considerable flexibility with regard to the types of classes, powers, preferences, rights, qualifications, limitations or restrictions on the shares issued.

II. Regulation of Shareholders' Agreements

Special legislation exists that governs shareholders' agreements. Most US states have adopted provisions in corporation codes that address the main types of shareholder agreements. Principle types of shareholder agreements include: vote pooling agreements, irrevocable proxies, voting trusts and shareholder control agreements.[4] Specific Delaware sections are discussed below. While the agreements are governed by legislation, general rules applicable to contract interpretation govern the construction of shareholder agreements.[5]

Generally, when a control and voting agreement among shareholders "aims to secure control without fraud on the corporation or others and does not sever stock ownership from stock control, it is not illegal."[6]

Shareholder agreements are generally permitted. Typical provisions in shareholder agreements specify the officers' salaries, require arbitration

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[1] Changes in the Revised Model Business Corporation Act—Amendments Pertaining to Closely Held Corporations, 46 Bus. Law 297, 302 (1990).

[2] *See* O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:5 (citing DGCL 141(a)).

[3] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 3:6.

[4] 5 Fletcher Cyc. Corp. § 2064.

[5] *See Salamone v. Gorman*, 106 A.3d 354, 367 (Del. 2014).

[6] 5 Fletcher Cyc. Corp. § 2064 (citing *Ringling v. Ringling Bros.-Barnum & Bailey Combined Shows*, 29 Del Ch 318, 49 A2d 603, mod 29 Del Ch 610, 53 A2d 441).

to resolve disputes, determine the identity of directors and officers of the corporation, set dividend amounts, and provide for share transfer restrictions.[7] Some provisions, such as specifying who the officers are, their compensation, and other financial issues, determine matters that are within the directors' statutory authority to "manage the business and affairs" of the corporation.[8] These provisions may be subject to invalidation because they encroach on the statutory authority of the directors.[9] Courts offer varying rationales for nullifying terms of shareholder agreements that limit the board's authority, but most often, courts worry the agreements "tie the hands of the directors," making it impossible for them to exercise their discretion concerning matters decided in the agreement.[10]

Courts consider a variety of factors when determining the validity of a shareholders' agreement. The treatise on corporate law by James Cox and Thomas Hazen outlines the factors courts considered in judging their validity:

> Before such agreements received based approval in most state statutes, a variety of factors were considered in judging their validity: (1) the purpose or object of the agreement, (2) the statutes in force in the particular jurisdiction in which the agreement is made, (3) the conceptions of public policy prevailing in the courts of the jurisdiction regarding the separation of voting power from the beneficial ownership of shares, (4) the situation of the corporation and the shareholders at the time the agreement was made, (5) whether or not all of the shareholders in the corporation are parties to the agreement, (6) whether the contracting shareholders are also directors or expect to be at the time of the performance of the contract, (7) the length of time during which the agreement will control the shareholders' right to vote their shares, (8) whether the person challenging the validity of the agreement is a party to it or is a creditor or shareholder not party to the agreement, (9) whether the person challenging the agreement is simply trying to "welch" on his undertaking, (10) whether or not there is consideration, other than the mutual promises of the parties to support the undertakings, to vote in accordance with the terms of the agreement, (11) how long the contract has been in operation and the extent to which action has been taken or positions have changed in reliance on it, and (12) the kind of corporation whose stock is subject to the voting arrangement.[11]

Statutes authorizing different types of shareholder agreements sometimes address the maximum length permitted for the agreements.[12] Section 7.32 provides for a maximum limit of 10 years but permits the parties to specify another term.[13] Most voting trust agreements provide for

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[7] Steven N. Bulloch, *Shareholder Agreements in Closely Held Corporations: Is Sterilization an Issue?*, 59 Temp. L.Q. 61 (1986).

[8] *Id.* (citing 15 PA. CONS. STAT. ANN. § 1401 (Purdon Supp. 1985) (board of directors shall manage business of corporation); TEX. BUS. CORP. ACT ANN. ART. 2.31 (Vernon 1980) (board of directors shall manage business and affairs of corporation).

[9] *See id.*

[10] *Id.* at 61-62; *see also id.* at notes 20-37 for discussion on court decisions related to shareholder agreement provisions limiting director discretion.

[11] 3 Treatise on the Law of Corporations § 14:7 (3d).

[12] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:37.

[13] *Id.*

a period of 10 years and often permit a renewal so that the agreement has a reach of 20 years.[14] Duration limitations in the voting trust statutes do not apply to other types of shareholders' agreements.[15] Numerous decisions have sustained shareholders' agreements which were to remain in effect indefinitely.[16]

Delaware voting trusts and other voting agreements allow stockholders to designate the right to vote "for any period of time determined by the agreement." DGCL § 218(a). Proxy agreements are limited to three years, unless the proxy provides for a longer period. DGCL § 212(b).[17]

With the permission of shareholders' agreements modifying the traditional pattern of corporate control show that in most jurisdictions individuals in a closely held enterprise can "in practical effect be partners among themselves, or nearly so, but a corporation to the rest of the world."[18] As the Second Circuit stated: "There is little logical reason why individuals cannot be 'partners inter sese and a corporation as to the rest of the world,' so long as the rights of third parties such as creditors are not involved."[19]

DGCL 350 specifically regulates close corporation agreements to restrict the discretion of directors of the company. Courts and academics have acknowledged there is a significant difference between shareholders of public and close corporations, specifically in regards to bargaining power, such that close corporation shareholders should have greater flexibility to align their affairs as they see fit.[20] Likewise, shareholders agreements authorized under MBCA 7.32 are void if the corporation becomes a public corporation.

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[14] *Id.*

[15] *Id.*

[16] *Id.* (collecting cases with the string-citation provided here in full). *See, e.g., Glazer v. Glazer*, 374 F.2d 390 (5th Cir. 1967); *Weil v. Beresth*, 154 Conn. 12, 220 A.2d 456 (1966) (statute limiting shareholders' voting agreement to ten years, enacted after agreement was entered into, held inapplicable); *Compton v. Paul K. Harding Realty Co.*, 6 Ill. App. 3d 488, 285 N.E.2d 574, 579 (5th Dist. 1972); *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964) (shareholders' agreement enforced as long as one of the contracting parties was alive); *Leventhal v. Atlantic Finance Corp.*, 316 Mass. 194, 55 N.E.2d 20, 154 A.L.R. 260 (1944); *E.K. Buck Retail Stores v. Harkert*, 157 Neb. 867, 62 N.W.2d 288, 45 A.L.R.2d 774 (1954) (1954 ("It is also contended that the control agreement is void because it was to remain in effect so long as Buck retained any stock in the corporation. We think not. The purpose of the agreement was to give Buck such protection against mismanagement as to induce him to bring needed money into the corporation. It is reasonable that such protection should be afforded so long as he is a stockholder. It is not a contract which binds the parties in perpetuity), as defendants allege. It is definite as to the term of its existence."); *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1936); 721 *Corp. v. Morgan Guaranty Trust Co. of New York*, 40 Misc. 2d 395, 397, 243 N.Y.S.2d 198, 200 (Sup 1963) ("The fact that the agreement [to vote shares of stock in the corporation in a particular manner] does not contain a termination date does not make it any less valid.")

[17] *See also, e.g.*, Minn Stat § 302A.453 subd. 1 (voting trust can be created for a period not exceeding 15 years unless connected with a debt of the corporation).

[18] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:4.

[19] *Id.* (quoting *Arditi v. Dubitzky*, 354 F.2d 483, 486 (2d Cir. 1965).

[20] *See* O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:4.

Advance planning can avoid many of these problems that arise in closely held businesses.[21] Planning may take many forms, ranging from the formal election to be treated as a close corporation to a more customized shareholder agreement such as is permitted under MBCA § 7.32.[22] To be specific, MBCA § 7.32(a) permits a shareholder agreement that:

(1) eliminates the board of directors or restricts the discretion or powers of the board of directors,

(2) governs the authorization or making of distributions whether or not in proportion to ownership of shares, subject to the limitations in section 6.40,

(3) establishes who shall be directors or officers of the corporation, or their terms of office or manner of selection or removal,

(4) governs, in general or in regard to specific matters, the exercise or division of voting power by or between the shareholders and directors or by or among any of them, including use of weighted voting rights or director proxies,

(5) establishes the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation and any shareholder, director, officer or employee of the corporation or among any of them,

(6) transfers to one or more shareholders or other persons all or part of the authority to exercise the corporate powers or to manage the business and affairs of the corporation, including the resolution of any issue about which there exists a deadlock among directors or shareholders,

(7) requires dissolution of the corporation at the request of one or more of the shareholders or upon the occurrence of a specified event or contingency, or

(8) otherwise governs the exercise of the corporate powers or the management of the business and affairs of the corporation or the relationship among the shareholders, the directors and the corporation, or among any of them, and is not contrary to public policy.[23]

Although the stockholders of any corporation may enter into an agreement under Model Business Corporation Act (MBCA) § 7.32, the agreement ceases to be effective when the stock of the corporation is listed on a national securities exchange or regularly traded in a market maintained by one or more members of a national or affiliated securities association.[24]

One of the most profound changes in state regulation of corporations over the past twenty years has been the passage of statutes specifically

[21] Financing the Corporation § 5:33.
[22] *Id.*
[23] Model Bus. Corp. Act § 7.32(a).
[24] Model Bus. Corp. Act § 7.32(d).

governing the operation of closely held corporations.[25] Almost all statutes regulating closely held corporations include provisions limiting the common law restrictions on shareholder agreements concerned with impinging on the powers of the board of directors.[26]

Section 7.32 contains several requirements. Most importantly the agreement must be unanimous, so that agreements that do not involve all shareholders, such as agreements designed to keep control within a block, must look elsewhere for their authorization.[27] The agreement must be in writing, but unlike some earlier statutes, the written agreement does not have to be in the articles or bylaws—stand-alone written agreements are specifically allowed.[28] The section specifies a 10 year limit, a similar period to voting trusts, but unlike voting trusts, this period is just a default rule, so that if the parties specify a longer period it is permitted.[29] Finally, the Model Act language requires that a legend appear on the stock certificates flagging the agreement for purchasers who buy shares covered by such an agreement.[30]

Galler v. Galler was the first case that a court acknowledged the unique characteristics of a closely held corporation in determining the validity of a shareholder agreement.[31] In upholding the agreement, the *Galler* court explained that a shareholder agreement is of particular importance in a closely held corporation.[32] Minority shareholders in a closely held corporation are likely to have invested substantial time or capital in the enterprise, but those dissatisfied with the corporation's operation cannot sell their shares easily because the shares are not readily marketable.[33] The *Galler* court viewed the "shareholder agreement as a helpful tool in a closely held corporation," rather than "with suspicion and disfavour."[34] The court concluded: "Where. . . no complaining minority interest appears, no fraud or apparent injury to the public or creditors is

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[25] Steven N. Bulloch, *Shareholder Agreements in Closely Held Corporations: Is Sterilization an Issue?*, 59 Temp. L.Q. 61 (1986).
[26] *Id.* (collecting statutes with the string-citation provided here in full). *See, e.g.*, FLA. STAT. ANN. § 607.107(2) (West 1977) (no qualifying shareholder agreement invalid on ground that it attempts to restrict discretion of board of directors in its management of business of corporation); OHIO REV. CODE ANN. § 1701.59.1(F)(3) (Page 1985) (no qualifying agreement invalid on ground that it interferes with discretion of directors). Many statutes permit the total abandonment of the typical corporate structure by allowing the shareholders to dispense with a board of directors and to manage the business of the corporation themselves. *See, e.g.*, ALA. CODE § 10-2A-308 (1980); DEL. CODE ANN. tit. 8, § 351 (1983); KAN. STAT. ANN. § 17-7211 (1981).
[27] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:6.
[28] *Id.*
[29] *Id.*
[30] *Id.*
[31] Steven N. Bulloch, *Shareholder Agreements in Closely Held Corporations: Is Sterilization an Issue?*, 59 Temp. L.Q. 61, 69 (1986) (citing *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964)).
[32] *Id.*
[33] *Id.* (citing *Galler*, 32 Ill. 2d at 27-28, 203 N.E.2d at 583).
[34] *Id.* at 70.

present, and no clearly prohibitory statutory language is violated, we can see no valid reason for precluding the parties from reaching any arrangements concerning the management of the corporation which are agreeable to all."[35]

III. Forms of Shareholders' Agreements

1. Shareholders' Agreements on Shareholder Rights

Agreements regarding voting rights include voting trusts, pooling agreements, and proxy agreements. Under Delaware law, each of these types are governed by DGCL §§ 212 and 218. A voting trust is set up when an individual transfers stock and the associated voting rights to a trustee. Pooling agreements do not require a transfer to a trustee, but rather individuals agree to vote their shares according to their agreement or procedure provided within. Proxy agreements allow shareholders to confer their voting rights upon another person subject to the procedural requirements in DGCL § 212. In addition, MBCA 7.30 regulates voting trusts, and MBCA 7.31 regulates voting agreements. MBCA 7.32 likewise governs shareholder agreements that govern the exercise or division of voting rights.

Voting arrangements may take a variety of forms, including voting trusts; voting agreements or pooling agreements; and irrevocable proxies.[36] For example, a shareholders' agreement could provide that actions of the board and shareholders will not be effective unless they are approved by one of the shareholders designated as the managing shareholder.[37] Voting arrangements may be used as a method for allocating control in the corporation.[38] For example, different shareholder groups may be provided with the ability to elect directors by issuing various classes of stock.[39] Voting arrangements are not self-executing, and the mere existence of a voting arrangement does not mean that the corporation should dispense with the legal formalities of director and shareholder actions.[40]

All US states now have statutes which expressly authorize the creation of voting trusts.[41] The MBCA, followed by a majority of states, provides that one or more shareholders may create a voting trust by signing an agreement and transferring their shares to the trustee.[42] Most voting trust statutes place a maximum on the duration of such a trust—usually 10 years—and also permit renewals or extensions for the maximum period of

[35] *Galler v. Galler*, 32 Ill. 2d at 30, 203 N.E.2d at 585.
[36] Business Transactions Solutions § 35:4.
[37] *Id.*
[38] *Id.*
[39] *Id.*
[40] *See id.*
[41] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:17.
[42] *Id.* (citing MBCA 7.30).

time.[43] Most of the states placing a maximum on the duration of a voting trust also permit extension or renewal of the trust for varying periods of time.[44] Statutes typically require that the trustee file the agreement at the corporation's office and be subject to inspection by shareholders.[45]

Additionally, if all shareholders of a corporation are parties to a valid agreement, courts have held the corporation bound by the agreement even if it is not formally a party to it.[46] Other courts have not found the corporation to be bound.[47]

Typically, shareholder claims are enforced through derivative actions, whereby the shareholders pursue claims in a representative capacity on a cause of action that derives from the corporation. However, individuals may sue in their individual capacity as a party to a shareholder agreement for breaches under the agreement by other contracting parties. Enforcement is usually through litigation which can be expensive.[48] When the corporation is harmed, it is the corporation that has the claim, but directors are often unwilling to pursue claims, especially when they are the wrongdoers.[49] Shareholders will often enforce these claims via a derivative action, where the corporation is the real party in interest as the entity injured and recovery belongs to the corporation.[50] The shareholders are simply suing on the corporation's behalf and cannot maintain actions on their own behalf to redress an injury to the corporation even if the value of their stock is impaired as a result of the injury.[51]

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[43] *See id. E.g.*, Del. Code Ann. tit. 8, § 218(a); NY Bus Corp Law § 621(a); Ohio Rev Code Ann § 1701.49(B) (maximum length of an "irrevocable" voting trust agreement is ten years "unless the voting or consenting rights granted thereby are coupled with an interest in the shares to which such rights relate").

[44] *Id.* (collecting statute examples with the string-citation provided here in full). *See, e.g.*, Cal Corp Code § 706 (voting trust limited to a 10-year term; may be renewed for additional 10-year terms by written agreement of the beneficiaries and with written consent of the voting trustees; the renewal is limited to the shares of those beneficiaries agreeing to the renewal); Me Rev Stat Ann tit 13-C, § 741 (period not to exceed 21 years, may be extended for an additional 21 years); *Smith v. Wembley Industries, Inc.*, 441 So. 2d 392 (La. Ct. App. 4th Cir. 1983) (court held that a 10-year extension of a 10-year voting trust entered into the same day that the trust was created did not violate the statutory limitation of voting trusts to ten years).

[45] *See id.*

[46] *See* O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:33.

[47] *Id.* (collecting case examples with the string-citation provided here in full). *See Nordin v. Kaldenbaugh*, 7 Ariz. App. 9, 435 P.2d 740 (1967) (where stockholders who agreed to issuance of stock were also directors, managers, and officers of the corporation, their agreements were binding on the corporation); *Merlino v. West Coast Macaroni Mfg. Co.*, 90 Cal. App. 2d 106, 111, 202 P.2d 748, 751 (1st Dist. 1949) ("There can be no question but that an agreement between stockholders who own substantially all of the stock of a corporation is enforceable against the contracting parties and the corporation."); *Moss v. Waytz*, 4 Ill. App. 2d 296, 124 N.E.2d 91 (1st Dist. 1955).

[48] Arthur R. Pinto, *Protection of Close Corporation Minority Shareholders in the United States*, 62 Am. J. Comp. L. 361, 377 (2014).

[49] *See id.*

[50] *Id.*

[51] *See id.*

To avoid some of the procedural hurdles of derivative litigation and enable direct recovery, shareholders must convince the court that individuals abusing control of the corporation were directly harming the shareholders.[52] These direct suits usually involve contractual or statutory rights of the shareholders, the shares themselves, or rights relating to the ownership of shares.[53] Examples include actions to recover dividends and to examine corporate records.[54] Delaware courts inquire as to who suffered the harm and who would receive the recovery to decide whether the action should be a direct or derivative action.[55]

Many state statutes provide for the specific enforcement of shareholders' agreements,[56] as does the MBCA, which expressly states that voting agreements are specifically enforceable.[57] In general, a court may specifically enforce any of the substantive terms of a shareholders' agreement, which may require the buyout of a shareholder or compelled arbitration.[58] Under the MBCA, rescission may also be available to a purchaser of shares who did not have knowledge of the existence of a shareholder control agreement at the time of purchase.[59]

Shareholder agreements regarding financing of the corporation are regulated under the MBCA§ 6.27 and DGCL § 202. These statutes expressly authorize the most common types of agreements: option agreements permitting the corporation or other shareholders to purchase and binding the selling shareholder; mandatory buyout agreements, in which the corporation or other purchasers are obligated to purchase; and consent agreements that require the corporation or other persons to approve the transfer, or prohibit the transfer to designated persons.[60]

Shareholder agreements routinely cover matters in addition to buy-sell provisions, including loans by shareholders, methods of making and using capital contributions, shareholder salaries for employment, and matters involving control of corporate affairs.[61] For example, minority shareholders may refuse to provide capital contributions unless they are granted veto powers over major corporate decisions such as asset sales,

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[52] *See id.*
[53] *Id.* at 378.
[54] *See id.*
[55] *See id.* at n. 98 (citing *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004)).
[56] 5 Fletcher Cyc. Corp. § 2067 (citing Ariz Rev Stat § 10–731; Cal Corp Code § 706; 805 ILCS 5/7.70; Ind Code Ann § 23–1–31–2).
[57] *Id.* (citing MBCA 7.31(b)).
[58] *See id.*
[59] Model Bus Corp Act § 7.32(c). However, this section also provides that a purchasing shareholder will be deemed as having received notice of the shareholder agreement should the stock certificate note the existence of such agreement or an information statement is provided at or before the time of purchase that indicates the shares are subject to a shareholder agreement.
[60] *See* Model Bus Corp Act § 6.27(d)(1)-(4); and DGCL § 202(2)(1)-(4) respectively.
[61] *See* William R. Christian et al, ¶ 33.07 *OTHER TYPES OF PROVISIONS FOR SHAREHOLDERS' AGREEMENTS*, Subchapter S Taxation, 1999 WL 630786, 1.

mergers, liquidation, or distributions to shareholders.[62] This is often done by requiring that these decisions obtain approval of shareholders holding considerably more than a majority of the stock.[63]

The distinct needs of close corporations is also shown as courts have recognized an enhanced fiduciary duty among participants in closely held corporations.[64] Courts have held that majority shareholders have a fiduciary duty not only to the corporation but also to minority shareholders as a class[65]:

- The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors. *Southern Pacific Co. v. Bogert*, 250 U.S. 483, 39 S.Ct 533, 63 L. Ed. 1099 (1919).
- The Seventh Circuit certified to the Delaware Supreme Court the question of "whether majority shareholders in a Delaware Corporation have a fiduciary duty of loyalty to a minority shareholder, who is also an employee under a written contract, with respect to issues affecting that employment." *Nagy v. Riblet Products Corp.*, 79 F.3d 572 (7th Cir.), *certified question answered*, 683 A.2d 37 (Del. 1996). The court determined that because there was an employment contract, it governed the relationship in the shareholder's capacity as an employee. The shareholder is still owed the fiduciary duty in his capacity as a shareholder.
- Under California law, a majority shareholder breaches a fiduciary duty if the ability to control the corporation is used to the majority shareholder's own benefit and to the detriment of the minority shareholders. *Eagle v. American Tel. & Tel. Co.*, 769 F2d 541 (9th Cir. 1985).
- Controlling shareholders of national bank were in fiduciary capacity with respect to minority shareholders as well as to the bank. *Garrett v. United States*, 396 F2d 489 (5th Cir. 1968).
- The majority owe to the minority the duty to act in good faith, neither to cause the corporation to act ultra vires or to breach valid shareholder agreements to the detriment of the minority shareholders. *Blanchard v. Commonwealth Oil Co.*, 294 F2d 834 (5th Cir. 1961).

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[62] *See id.*
[63] *See id.*
[64] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 1:29. Statutes also govern duties among close corporation shareholders. *See* O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 9.42 (citing Minn. Stat. § 302A.751(3)(a) as an example statute that authorizes courts "to consider the duty that shareholders in a close corporation owe to one another to act in an honest, fair, and reasonable manner in the operation of the corporation").
[65] 12B Fletcher Cyc. Corp. § 5811.

- Director and dominant shareholder stood in a fiduciary relationship to the corporation and to the minority shareholders as beneficiaries. *Perlman v. Feldmann*, 219 F2d 173 (2d Cir 1955).[66]

Likewise, shareholders who dominate the company, although not officers, are viewed as fiduciaries to other shareholders as would a director or other officer.[67] If a shareholder "exercises absolute de facto control over a corporation, such actual dominion carries with it fiduciary responsibility regardless of the presence or absence of de jure titles."[68] Majority shareholders occupying the role of president or chief officer of the corporation will also generally be considered a fiduciary.[69]

The importance of the fiduciary relationship between majority and minority shareholders was shown in *Coleman v. Taub*, 638 F.2d 628 (3d Cir. 1981), where a minority shareholder sued a corporation and its majority shareholders based on his discharge as an employee.[70] The district court had concluded that a merger into a newly-created parent corporation was designed to eliminate the minority shareholder.[71] The merger agreement allowed the company to give the minority shareholder cash in exchange for shares, but the Third Circuit determined that even if a minority shareholder agrees to a cash out, he may still object to the merger on grounds of a breach of fiduciary duty.[72] The court made clear that the fiduciary duty among shareholders in close corporations goes beyond simply protecting shareholders' financial interests.

2. Shareholders' Agreements on the (Limitation for the) Transfer of Shares

US law gives considerable latitude to corporate participants when imposing share transfer restrictions, as restrictions will usually be sustained unless the terms are unreasonable under the circumstances.[73] Restrictions may be imposed by the articles of incorporation, the bylaws, or a shareholders' agreement.[74] However, authorities are split as to whether a transfer restriction imposed by an amendment to the articles or bylaws is binding on all the shares or only on those shares that were voted in favor of the amendment.[75] Important discussion on this issue is found in *Tu-Vu Drive-In Corporation v. Ashkins*, 391 P.2d 828 (Cal. 1964), where the California Supreme Court held a transfer restriction applied to all the

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[66] *Id.* at n. 3.
[67] *See id.* (collecting cases).
[68] *Id.* (collecting cases).
[69] *See id.* (collecting cases).
[70] Julian J. Garza, *Rethinking Corporate Governance: The Role of Minority Shareholders-A Comparative Study*, 31 St. Mary's L.J. 613, 634 (2000).
[71] *See id.*
[72] *See id.* (citing 638 F.2d at 638).
[73] 3 Treatise on the Law of Corporations § 14:9 (3d).
[74] *Id.*
[75] *See id.*

shares.[76] California corporate code has since been amended to prohibit the application of any transfer restriction to previously issued shares unless the shares were voted in favor of the restriction.[77] Likewise, Delaware does not allow transfer restrictions "unless the holders of the securities are parties to an agreement or voted in favor of the restriction."[78] Courts have also refused to allow transfer restrictions to be applied retroactively to nonconsenting shares.[79]

Minority shareholders make seek tag-along rights to protect them against the possibility that majority owners decide to sell their interests.[80] Tag-along rights allow minority shareholders to sell their interest at the same price and terms that the majority shareholders receive. Drag-along rights protect majority shareholders who plan to sell their interests by requiring that all other shareholders sell their interests in the same transaction.[81] Drag-along rights allow majority shareholders to maximize the chance of receiving full value for their shares because the prospect of having to work with the remaining minority shareholders may lead an interested party to offer a discounted price for the majority stake.[82] Because these govern the transfer of ownership interests, buy-sell agreements are a logical place to provide for tag-along and drag-along rights.[83]

It is unclear, however, how courts will handle drag-along rights if dissenting shareholders believe they are being forced out and are entitled to other statutory remedies, such as appraisal rights. Absent issues of fraud or duress, it seems likely drag-along rights will be enforced for Delaware corporations.[84] Because Delaware does not follow the practical merger doctrine, statutory formalities such as appraisal rights are not implicated.[85] Additionally, in *Shields v. Shields*, a Delaware Chancery court noted that Delaware's statutes permitting shareholder agreements may include agreements on a "forced sale."[86]

Tag-along rights—also referred to as take-me-along provisions or rights of co-sale—also right belong in shareholder agreements and are implicated when a third party attempts to purchase control of the company.[87] If a group of shareholders together hold enough shares for a controlling position, a purchaser may be inclined to only offer to purchase

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[76] *See id.*
[77] *Id.* (citing Cal. Corp. Code § 204(b) (West 1990)).
[78] *See* DGCL § 202(b) (2016).
[79] *See* 3 Treatise on the Law of Corporations § 14:9 (3d) (*B & H Warehouse, Inc. v. Atlas Van Lines, Inc.*, 490 F.2d 818 (5th Cir. 1974); *Sandor Petroleum Corp. v. Williams*, 321 S.W.2d 614 (Tex. Civ. App. 1959)).
[80] *See* 2 Advising Small Businesses § 21:52 (2017).
[81] *See id.*
[82] *See id.*
[83] *Id.*
[84] EQFIN § 10.15.
[85] *See id.*
[86] *Id.* (citing *Shields v. Shields*, 498 A.2d 161, 168 (Del. Ch. 1985)).
[87] *See* EQFIN § 10.12.

a block of shares sufficient to take a majority of the board.[88] Not only would minority shareholders be left out of the transaction, the current majority may not receive as high of a price for their shares. As such, tag-along rights are commonly included in shareholder agreements and provide that when the majority sells their shares, a term of the sale must be that the offer is extended to all other shareholders.[89]

3. Shareholders' Agreements on the Constitution of the Corporation

The Official Comment to the MBCA underscores the broad reach of the statute: "Section 7.32(a) validates virtually all types of shareholder agreements that in practice, normally concern shareholders and their advisors." The statute provides that an agreement among shareholders that complies with the section will be effective even though it may be inconsistent with one or more other provisions of the act.[90] It specifically lays out seven substantive categories that rightly fit in shareholder agreements:

- eliminating the board or restricting the board's power;
- making distributions;
- naming directors or officers or providing rules relating to their status;
- dividing voting power among directors and shareholders or among either group;
- governing conflict transactions;
- permitting transfer of corporate power to a person to resolve deadlock or in a broader context;
- requiring dissolution of the corporation.[91]

The section further expands the breadth of permission with a catch-all category that permits other provisions governing corporate affairs that "not contrary to public policy."[92] While the DGCL does not list topics for shareholders' agreement, DGCL 141 provides all corporate power to be conferred upon the board, subject to limitations set forth in the articles.

Shareholders agreements often not only designate who will be directors or how directors must be selected, but they even decide corporate policies that would normally be decided by the board of directors.[93] For example, shareholder agreements may designate officers, fix salaries, and specify the circumstances for when dividends will be declared.[94]

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88 *See id.*
89 *See id.*
90 Model Bus. Corp. Act § 7.32(a).
91 O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:6.
92 *See id.*
93 *See id.*
94 *Id.*

4. Shareholders ‘Agreements in pre-insolvency situation

Under US Law, bankruptcy trustees may void any agreement that is "executory," so to the extent a buy-sell agreement requires shareholders and the entity to buy and sell, it is more likely to survive bankruptcy.[95] To determine whether to enforce a buy-sell agreement, a bankruptcy court will consider whether: (1) the buy-sell agreement constitutes and executory contract, and (2) the bankruptcy trustee accepts or rejects the agreement.[96]

The case *Portnoy v. Cryo-Cell Int'l, Inc.* addresses such agreements as part of standstill agreements.[97] Additionally, the court in *Schreiber v. Carney* held that vote selling is illegal when it defrauds or disenfranchises other shareholders.[98] Voting restrictions in standstill agreements effectively disenfranchise shareholders not party to the agreement.[99] According to the *Schreiber* court's definition of fraud, standstill agreements defraud shareholders not privy to the agreement in two ways: (1) by violating a shareholder's right to the best available merger or transaction, and (2) by discouraging unsolicited tender offers where a significant control premium can be realized.[100] These agreements tend to entrench management and can lead to stagnation for the company, so they sometimes "operate prejudicially upon" shareholders' property rights.[101]

IV. Legal Effects of Shareholders' Agreements

1. Legal Effects on the Corporation

Many shareholder agreements are drafted simultaneously alongside the charter. The articles of a corporation act as a constitution, setting out the basic governance structure of the enterprise.[102] Changing the articles is intentionally made difficult and amendments generally require actions by both the directors and shareholders, unlike most other corporate decisions.[103] Shareholder agreements are often drafted simultaneously alongside the charter, and many states, including Delaware, require shareholder agreements respecting director control to be included in the charter.

Because shareholder agreements are products of negotiation, courts find that they should be construed and enforced like any other contract so as to give effect to the intent of the parties as expressed in the agreement.[104]

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[95] ACTEC® SHAREHOLDERS AGREEMENTS FOR CLOSELY-HELD CORPORATIONS OUTLINE, SY010 ALI-CLE 1367.
[96] *See id.*
[97] *See Portnoy v. Cryo-Cell Int'l, Inc.*, 940 A.2d 43, 66 (Del. Ch. 2008) (Chancellor Strine examining *Schreiber v. Carney* on vote-buying measures).
[98] *Schreiber v. Carney*, 447 A.2d 17 (Del. Ch. 1982).
[99] Steven A. Baronoff, *The Standstill Agreement: A Case of Illegal Vote Selling and A Breach of Fiduciary Duty*, 93 Yale L.J. 1093, 1098 (1984).
[100] *See id.* at 1098-99 (citing *Schreiber*, 447 A.2d at 24).
[101] *See id.*
[102] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 3:2.
[103] *See id.*
[104] *See* 6 N.C. Index 4th Corporations § 137.

This is provided that they do not violate a statute or charter provision; contemplate an illegal objective; or involve fraud, oppression, or wrong against other shareholders.[105] Shareholders' agreements may be "free-standing" or they may be incorporated into a corporation's charter or bylaws.[106] When a shareholder agreement is included in the corporate charter or bylaws, it becomes subject to amendment as provided therein or by statute.[107] Because shareholder agreements are often designed to avoid corporate formalities such as majority rule, "it is not unreasonable to require that the degree of deviation intended be explicitly set out."[108]

It is possible to transfer the obligations and/or rights arising from the shareholder agreements to another person. However, the shareholder agreement should describe the limitations on one's ability to do so. Often the rights and obligations can transfer automatically under the agreement, but it is not always the case. Shareholder agreements should specifically provide that the agreement will apply to all transferees, successors, or assigns of shares held by a party to the agreement.[109] Under the MBCA, if a purchaser of shares that has no actual or constructive knowledge of the shareholder agreement is entitled to rescission of the purchase.[110]

One of the most common shareholder agreements in a close corporation is a Buy-Sell or Share Transfer Agreement. The first governs exit from an enterprise that otherwise might provide no way out for many investors. The second protects the intimate relationship in a closely held enterprise by regulating who can become members. These agreements create further rights either to receive a specific price for their shares or limiting their whom they may sell to.

Shareholder agreements can also be used as devices to assure certain patterns of control.[111] For example, incorporators may find it useful to have a written documentation on matters such as capital contribution obligations, election of directors and officers, and compensation for stockholder-employees.[112] Ultimately, of course, these issues should be addressed in carefully drafted bylaws, corporate decisions and employment agreements.[113]

Securities regulation also comes into play on shareholder agreements. Aggregation applies when two or more persons agree to act in concert to sell an issuer's securities.[114] A shareholder voting agreement is not necessarily an agreement to "act in concert" to sell the stock, and it is a

[105] *See id.*
[106] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:33.
[107] *See* 6 N.C. Index 4th Corporations § 137.
[108] *See id.* (quoting *Blount v. Taft*, 295 N.C. 472, 487, 246 S.E.2d 763, 773 (1978)).
[109] 1-5 Corporate Attorney's Practice Guide § 5.02 (2016).
[110] *See id.*
[111] 1-3 MA Corporations and Other Business Entities § 3-2 (2016).
[112] *See id.*
[113] *Id.* Employment agreements are especially useful in addressing intellectual property concerns, non-competition, duties, and fringe benefits. *See id.*
[114] NOV-02 Koren Est. & Pers. Fin. Plan. Update art.

factual question whether aggregation applies for acting in concert when a shareholder agreement is designed to restrict or manage the amount of stock sold.[115]

Most states have statutes, such as Section 7.32 of the MBCA, authorizing shareholder control agreements; separate statutes authorizing pooling agreements, voting trusts or irrevocable proxies are almost universal among the states.[116] As discussed above, Section 7.32(a) provides seven broad categories and an eighth catch-all provision that covers most types of agreements participants in a close corporation would desire.[117] While not explicitly identified, veto provisions are covered under the category relating to the exercise of voting power among shareholders or among directors.[118]

States that do not specifically authorize shareholder control agreements usually contain a statute allowing parties to make exceptions from the default rule of director control by making providing for it in the corporation's charter or bylaws.[119] Shareholder control agreements in those states should be implemented by charter or bylaw amendments, especially if there is minimal case law governing their interpretation and legality. Alternatively, if all shareholders are not parties to the agreement, as required under Section 7.32, the agreement should be included in the charter.[120]

State statutes also contain specific provisions permitting changes to voting rules to create a veto provision.[121] Such statutes, usually authorize a veto arrangement to be placed in the charter, and sometimes in the bylaws.[122] For example, New York permits high voting or quorum thresholds for shareholders' or directors' meetings only when they are in the corporate charter.[123]

Still, shareholders often fail to include their shareholder agreements in the charter or bylaws—whether by ignorance or inadvertence.[124] Sometimes this is intentional because charters are public records, and shareholders may not want their agreements open to outsiders.[125] Without

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[115] *See id.* (citing AMP Incorporated, SEC No-action letter (June 22, 1981); Carnation Company, SEC No-action letter (October 3, 1979)).
[116] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:33.
[117] *See id.*; *see supra* Section III (3).
[118] *See* O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:33.
[119] *See id.* (citing statute examples).
[120] *See id.* (citing NY Bus Corp Law §§ 614, 616, 707, 709).
[121] *See id.*
[122] *See id.*
[123] *See id.*
[124] *See id.*
[125] *See id.* (collecting cases) (e.g., *Roach v. Bynum*, 403 So. 2d 187 (Ala. 1981) (under the Alabama corporation code a provision mandating a greater than majority shareholder vote may be included in a corporation's certificate of incorporation but not in its bylaws); *Waggoner v. Laster*, 581 A.2d 1127 (Del. 1990) (in absence of authority in corporation's certificate of incorporation to issue convertible preferred shares with supermajority voting rights, those voting rights, used to oust other directors, were null and void); Jones v. Wallace, 291 Or. 11, 628 P.2d 388 (1981) (court held that a bylaw defining a shareholder

explicit statutory authorization, many courts have refused to enforce veto provisions in shareholders' agreements.[126] Taking New York as an example, despite the clear statutory directive to include agreements on voting requirements in the corporate charter, New York court decisions suggest that shareholders' agreements calling for high voting requirements will probably be specifically enforceable.[127] In *Adler v. Svingos*, 80 A.D.2d 764, 436 N.Y.S.2d 719 (1981), the court upheld a shareholder agreement requiring unanimous approval from all three shareholders before corporate action could be taken even though it was not in contained in the corporate charter. The court held that the veto provision was valid and did not violate the New York statute, since the court could simply order the corporation's certificate of incorporation be amended to include the veto provision.[128] While shareholders of New York close corporations may be able to set up veto provisions without amending the corporation's charter, the better practice is to amend the charter to insert such arrangements.[129]

2. Consequences of a Breach of the Shareholders' Agreements

Because shareholders' agreements are recognized by statutes and case law courts may hold that these agreements should be enforced like any other agreement.[130] However, shareholder agreement cases may not be typical of general contract cases when it comes to remedies.[131] Shareholder agreement suits are more likely to result in specific performance rather than awarding damages.[132] Damages for breaches of provisions of valid shareholder agreements are often too speculative to provide and adequate remedy, even though the individual has a direct cause of action.[133]

Remedies include[134]:

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quorum as all outstanding shares entitled to vote was invalid where Oregon corporation law required super quorum provisions to be placed in the corporate charter).

[126] *Id.*

[127] *See id.*

[128] *See id.*

[129] *See id.*

[130] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:42 (citing *e.g., Blount v. Taft*, 295 N.C. 472, 246 S.E.2d 763, 771 (1978), noted 15 Wake Forest L. Rev 531 (1979), 68 Ky. L.J. 520 to 523 (1980) ("Since consensual arrangements among shareholders are agreements—the products of negotiation—they should be construed and enforced like any other contract so as to give effect to the intent of the parties as expressed in their agreements, unless they 'violate the express charter or statutory provision, contemplate an illegal object, involve … fraud, oppression or wrong against other stockholders, or are made in consideration of a private benefit to the promisor' "); *Hughes v. Sego Intern. Ltd.*, 192 N.J. Super. 60, 469 A.2d 74 (App. Div. 1983) (court stated that shareholders' agreements are generally enforceable)).

[131] *See id.*

[132] *See id.*

[133] *Id.*

[134] The following list and corresponding footnotes were reproduced in their original form from O'Neal and Thompson's treatise.

- Voiding corporate actions taken in violation of an agreement;[135]
- Reforming the agreement, the charter or bylaws to reflect the agreement;[136]
- Having shares transferred;[137]
- Awarding a constructive trust over assets improperly sold;[138]
- Ordering an accounting;[139]
- Providing for compensatory and punitive damages.[140]

A court may specific enforce substantive terms of an agreement or remedies provided for in the agreement.[141] In *Ramos v. Estrada*, a California court ordered the buyout of a breaching shareholder as was a specified remedy in the agreement.[142] The agreement required the members to vote as a single block, and when one member broke off from the voting block, the group responded by replacing him as a director.[143] The court held the dissidents' repudiation of the agreement was a breach and constituted an election to sell their shares according to the buy/sell provisions.[144]

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[135] *Zion v. Kurtz*, 50 N.Y.2d 92, 428 N.Y.S.2d 199, 405 N.E.2d 681, 15 A.L.R.4th 1061 (1980), noted 33 Syracuse L. Rev 15 to 17 (1982) (court issued an injunction declaring valid a shareholders' agreement providing that no business or activities of a closely held corporation could be conducted without the consent of the minority shareholder; certain corporate actions taken without the consent of the minority shareholder were void)

[136] *In re Farm Industries, Inc.*, 41 Del. Ch. 379, 196 A.2d 582 (1963) (court reformed a voting trust agreement to include voting rights inadvertently omitted by an attorney, and ordering specific enforcement of the agreement as reformed if that would not harm anyone not a party).

[137] *Scheurer v. Scheurer*, 311 Minn. 546, 249 N.W.2d 181 (1976) (founder of corporation transferred his controlling block of shares to his sons, reserving by agreement the power to vote the shares during his lifetime; following a dispute with his sons the founder attempted to exercise his voting rights to elect new directors; the court enforced the agreement by rescinding the original share transfer transaction)

[138] *Butler v. Attwood*, 369 F.2d 811 (6th Cir. 1966) (the court, applying the equitable doctrine of constructive trust, compelled a third party with notice of an equal ownership agreement between two shareholders to sell to plaintiff shareholder one-half of the shares he had purchased from one of the contracting shareholders).

[139] For a case in which a minority shareholder in a close corporation who was a party to a shareholders' agreement brought suit against his two fellow shareholders and the corporation seeking an accounting and corporate dissolution as a result of a breach of his rights under the agreement, see *Wasserman v. Rosengarden*, 84 Ill. App. 3d 713, 40 Ill. Dec. 430, 406 N.E.2d 131 (1st Dist. 1980).

[140] *Sankin v. 5410 Connecticut Ave. Corp.*, 281 F. Supp. 524 (D. D.C. 1968), judgment aff'd, 410 F.2d 1060 (D.C. Cir. 1969) (punitive and injunctive relief, as well as compensatory damages awarded against the breaching shareholder and the corporation).

[141] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:42.

[142] *Id.* (citing *Ramos v. Estrada*, 8 Cal. App. 4th 1070, 10 Cal. Rptr. 2d 833 (2d Dist. 1992), *reh'g denied and opinion modified* (Sept. 11, 1992).

[143] *See Ramos*,8 Cal. App. 4th at 1072-74, 10 Cal. Rptr. 2d at 834-36.

[144] O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:42.

V. Enforcement of Shareholders' Agreements

Typically, shareholder claims are enforced through derivative actions, whereby the shareholders pursue claims in a representative capacity on a cause of action that derives from the corporation. However, individuals may sue in their individual capacity as a party to a shareholder agreement for breaches under the agreement by other contracting parties. Enforcement is usually through litigation which can be expensive.[145] When the corporation is harmed, it is the corporation that has the claim, but directors are often unwilling to pursue claims, especially when they are the wrongdoers.[146] Shareholders will often enforce these claims via a derivative action, where the corporation is the real party in interest as the entity injured and recovery belongs to the corporation.[147] The shareholders are simply suing on the corporation's behalf and cannot maintain actions on their own behalf to redress an injury to the corporation even if the value of their stock is impaired as a result of the injury.[148]

Many state statutes provide for the specific enforcement of shareholders' agreements,[149] as does the MBCA, which expressly states that voting agreements are specifically enforceable.[150] In general, a court may specifically enforce any of the substantive terms of a shareholders' agreement, which may require the buyout of a shareholder or compelled arbitration.[151] Under the MBCA, rescission may also be available to a purchaser of shares who did not have knowledge of the existence of a shareholder control agreement at the time of purchase.[152]

Shareholders voting agreements adjudicated under actions for declaratory judgment or specific performance.[153] This trend has supplanted more restrictive opinions as earlier courts had a general dislike and distrust for voting agreements.[154] Most often a suit for damages does not provide an adequate remedy for a breach of a shareholder agreement, so the denial of specific enforcement essentially declares the agreement invalid.[155] It is

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145 Arthur R. Pinto, *Protection of Close Corporation Minority Shareholders in the United States*, 62 Am. J. Comp. L. 361, 377 (2014).
146 *See id.*
147 *Id.*
148 *See id.*
149 5 Fletcher Cyc. Corp. § 2067 (citing Ariz Rev Stat § 10–731; Cal Corp Code § 706; 805 ILCS 5/7.70; Ind Code Ann § 23–1–31–2).
150 *Id.* (citing MBCA 7.31(b)).
151 *See id.*
152 Model Bus Corp Act § 7.32(c). However, this section also provides that a purchasing shareholder will be deemed as having received notice of the shareholder agreement should the stock certificate note the existence of such agreement or an information statement is provided at or before the time of purchase that indicates the shares are subject to a shareholder agreement.
153 *See* O'Neal and Thompson's Close Corporations and LLCs: Law and Practice § 4:42.
154 *See id.* (citing *Haldeman v. Haldeman*, 176 Ky. 635, 651 197 S.W. 376 (1917); *Sullivan v. Parkes*, 69 A.D. 221, 74 N.Y.S. 787 (1st Dep't 1902); *Gage v. Fisher*, 5 N.D. 297, 304, 65 N.W. 809, 811 (1895); *Gleason v. Earles*, 78 Wash. 491, 139 P. 213 (1914); *Kennedy v. Monarch Mfg. Co.*, 123 Iowa 344, 98 N.W. 796 (1904)).
155 *See id.*

likely that for this reason, recent court decisions have recognize that shareholders' voting agreements are enforceable by an injunction or through specific performance.[156]

Shareholder agreements also allow shareholders to contract how they will settle disputes that arise under the relationship, such as providing for arbitration or specific remedies such as dissolution or buyout.[157] Provisions for the arbitration of disputes are especially common in shareholder agreements. Pooling agreements, where shareholders agree to vote as a block on all or certain corporate matters, sometimes contain clauses where shareholders agree to vote according the decision of an arbitrator should they disagree on how to vote on a matter.[158] Shareholder agreements may even provide for management decisions to be made by arbitrators.[159]

VI. Annexes

Please provide a translation of the regulations dealing especially with Shareholders' Agreements. If general contract and/or partnership law applies, please <u>do not</u> provide a translation of this provisions.

- MBCA Sect. 7.30 on Voting Trusts
- MBCA Sect. 7.31 on Voting Agreements
- MBCA Sect. 7.32 on Shareholder Agreements
- MBCA Sect. 6.27 on Financing Agreements
- DGCL 212 on Voting Proxies
- DGCL 218 on Voting Trusts
- DGCL 202 on Financial Agreements.

List of Controlling Delaware case law on Shareholder Agreements by subject area (cases in red are leading cases):

Shareholder Agreements:

<u>Genger v. TR Investors, LLC</u>, July 18, 2011 26 A.3d 180, Acceptance by investor group of vote to enter into funding agreement with investor group by stockholder of corporation, made on behalf of trust to which stockholder had, through company he controlled, made transfer of shares that was unauthorized under his shareholder agreement did not constitute investor group's acquiescence to, and ratification of stockholder's unauthorized transfer of shares to trust; investor group agreed to enter into funding agreement because stockholder represented that he would rectify his unauthorized transfer of shares violation, the investor group never received any benefit from the funding agreement, in that, the parties never executed or performed the funding agreement because stockholder

156 *See id.*; *see also infra* section IV(2) for discussion on remedies.
157 *See* Close Corp and LLCs: Law and Practice § 4:10.
158 *See id.*
159 *See id.*

subsequently repudiated it, and the language of the agreement contemplated that the transfer of shares to trust may subsequently be determined to be void.

Enforcement of Shareholder Agreements

Julian v. Eastern States Const. Service, Inc., 2008 WL 2673300 (2008) Plain language of shareholder agreements entered into by shareholders in closely held S corporations established that shareholder and officer of such corporations was "employee" thereof, for purposes of provisions of shareholder agreements requiring sale of shares upon termination of employment; plain language of agreements established that all signatories considered themselves to be "employed by" corporations covered by such agreements in the ordinary, colloquial sense of working for corporations in some gainful capacity, irrespective of whether their status as shareholders and officers qualified them as employees in legal sense of such term for purposes of employment law.

Agreements as to Voting:

Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling, May 3, 1947 29 Del.Ch. 610 { Under agreement between two stockholders that they should act jointly in exercising voting rights, and that in case of disagreement a named arbitrator's decision should be binding, each party agreed to comply with arbitrator's decision but arbitrator was without power to enforce his decisions, and in case of refusal to abide by arbitrator's decision neither party was empowered to exercise voting rights of the other.} { Stockholders may lawfully contract with one another to vote as they or a majority of their group from time to time determine, and reasonable provisions for cases of failure of the group to reach a determination because of an even division in their ranks are unobjectionable}

Salamone v. Gorman, 106 A.3d 354 (2014).Voting agreement provision for selecting to corporation's board of directors "Two persons elected by the Key Holders," majority shareholder and two others, created per capita, rather than per share, scheme for designating nominees, and, thus, did not allow majority shareholder to remove "Key Holder," corporate officer, from board, even though agreement contemplated removal of directors by per share vote; agreement also permitted removal upon request of any party entitled to designate director, the "Key Holders" were three persons who were not required to own stock, and employee investors, including officer and their families, together invested same amount as majority shareholder's friend with right to designate board member and more than other "Key Holders."

Brady v. Mexican Gulf Sulphur Co., 1952, 88 A.2d 300.The powers of voting trustees within legal and public policy limits are to be found in the voting trust agreement, and by such agreement the stockholders constitute the trustees their irrevocable proxies for the period of the agreement.

Kurz v. Holbrook February 9, 2010 989 A.2d 140 A vote-buying arrangement in a shareholder vote must not be the product of fraud

Crown EMAK Partners, LLC v. Kurz, April 21, 2010 992 A.2d 377, Stockholder's purchase of other stockholder's shares, which included restricted shares subject to restricted stock grant agreement, for the purpose of giving purchasing stockholder a majority of **votes** necessary to remove certain directors violated restricted stock grant agreement, which prohibited the sale, transfer, or assignment of restricted shares, and thus, the purchase agreement did not operate as a legally valid sale of the shares and purchasing stockholder was not entitled to **vote** those shares;

Schreiber v. Carney May 11, 1982 447 A.2d 17 { An agreement involving transfer of stock voting rights without the transfer of ownership is not necessarily illegal and each arrangement must be examined in light of its object or purpose. }

Abercrombie v. Davies, March 19, 1957 36 Del.Ch. 371 { Not all stock pooling agreements of stockholders are lawful.}

Most Worshipful Prince Hall Grand Lodge of Free and Accepted Masons of Del. v. Hiram Grand Lodge Masonic Temple, April 19, 1951 32 Del.Ch. 85 { Where agreement, executed about same time that common stock in defendant corporation was issued to plaintiff corporation, made invalid attempt to suspend voting rights of stock issued to plaintiff and plaintiff abstained from voting stock for long period of time and treated agreement as valid, plaintiff was not barred by laches or acquiescence from voting its stock, since right to vote is continuing one.}

Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (2003) Deal protection devices adopted by target corporation's board of directors coerced the consummation of proposed merger and precluded consideration of any superior transaction, and thus, the deal protection devices were invalid; requirement in merger agreement that proposed merger be placed before target corporation's shareholders for a vote even if board no longer recommended it, shareholder voting agreements requiring two directors, whose stock represented majority ownership of target, to vote their shares in favor of merger, and absence of effective fiduciary-out clause in merger agreement, made it mathematically impossible and realistically unattainable for any competing proposal to succeed.

Hirschwald v. Erlebacher, Inc. July 23, 1943 27 Del.Ch. 180, Failure of voting trustees for more than two years after execution of voting trust agreement to comply with statutory provisions concerning filing of copy of agreement and issuance of stock certificates in names of voting trustees did not evidence an “abandonment” of agreement, where conduct of voting trustees evidenced exercise of their powers as such.

Shields v. Shields, July 22, 1985 498 A.2d 161, Whether merger which has effect of eliminating restrictions of shareholder agreement from stock is valid is to be tested by provisions of corporation law governing mergers, and in appropriate cases by fiduciary standards imposed upon directors and controlling shareholders, not by provisions of shareholder agreements

Voting Trusts:

Tracey v. Franklin, May 23, 1949 31 Del.Ch. 477 { Provision in voting trust agreement whereby two stockholders, owning a majority of one class of stock in corporation, conveyed stock to themselves as trustees for purpose of voting such stock jointly in order to secure competent management of corporation and put into effect beneficial policies, and agreed not to sell or transfer stock for about ten years without consent of both parties, was invalid as an unreasonable restraint on alienability}

Oceanic Exploration Co. v. Grynberg, February 26, 1981 428 A.2d 1 { In determining applicability of statute relating to creation of voting trust of stock of Delaware corporation, test is whether substance and purpose of stock arrangement is sufficiently close to substance and purpose of the statute to warrant its being subject to the restrictions and conditions imposed by that statute.}

Smith v. Biggs Boiler Works Co., 1951, 82 A.2d 372. Agreement by which the two owners of all the outstanding stock in a Delaware corporation then in escrow attempted to form a voting trust of such stock was not enforceable as a "pooling agreement", where party named as third voting trustee owned none of the stock in question, since in a pooling agreement the owners of shares combine and vote them in accordance with agreement.

Lehrman v. Cohen, July 8, 1966 43 Del.Ch. 222 { Voting trust statute regulates trusts and pooling agreements amounting to trusts, not other and different types of arrangements and undertakings possible among stockholders} { Voting trust statute does not require that all stock of a Delaware corporation must have both voting rights and proprietary interests}{ Main purpose of voting trust statute is to avoid secret, uncontrolled combinations of stockholders formed to acquire voting control of corporation to possible detriment of nonparticipating stockholders}

Aldridge v. Franco Wyoming Oil Co., July 18, 1939 24 Del.Ch. 126 { Whether a particular agreement constitutes a "voting trust" within intendment of statute must ordinarily be ascertained from the provisions of the agreement, when read as a whole, and the rights and powers given thereby.}

Foye v. New York University, May 20, 1970 269 A.2d 63 { "Beneficiary" of voting trust is stockholder concerned with, and relieved of, vote and control of corporation for purposes which seemed good and sufficient to him when he entered into voting trust agreement.}

Belle Isle Corp. v. Corcoran, September 26, 1946 29 Del.Ch. 554 { A voting trust agreement which by its terms recited that it extended the original voting trust agreement was an extension of the original agreement and not a new agreement}

Grynberg v. Burke, 1979, 410 A.2d 169,Statute, which governs voting trusts of corporate stock of a Delaware corporation, governed voting trust agreements entered into by corporation shareholders, who thereby surrendered their voting control of corporation to voting trustees for specified period of time.

Winitz v. Kline, 1971, 288 A.2d 456. Parties to voting trust may contract for terms as to both substance and mechanics of trust.

Clarke Memorial College v. Monaghan Land Co., 1969, 257 A.2d 234.Apart from limitations imposed by statute or public policy, parties to a voting trust agreement may adopt any provisions they want as to substance or mechanics. 8 Del.C. § 218.

Buy-Sell Agreements

Lawson v. Household Finance Corp., February 27, 1930 17 Del.Ch. 343, "Reasonable restrictions on transfer of corporate stock" as are necessary and convenient to attainment of objects for which company was incorporated are valid

Dolese Bros. Co. v. Brown, January 27, 1960 39 Del.Ch. 1, Agreement of stockholders, not to sell to anyone not a stockholder without first offering **shares** to other stockholders and to corporation, gave corporation some sort of expectancy in purchase of stock, and exact scope of that expectancy would not be important in determining liability of president and dominating director if, as alleged, he had recognized existence of such expectancy and had undertaken (in effect) by unilateral action to waive corporate rights for his own benefit.

Tag-Along, Drag-Along, Dhoot-Out

Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1031 (Del. Ch. 2004), The public disclosures create the impression that this was a substantial tag-along right, because the certificate provision (the "Tag–Along Provision") seems designed to make sure that Inc. would share any control premium ratably with the other International shareholders. The Tag–Along Provision does so by stripping the Class B shares of their super-voting power if they are sold, transferred or disposed of in a non-Permitted Transaction.

Stand-still

Ivanhoe Partners v. Newmont Min. Corp., October 15, 1987 533 A.2d 585, Given that dividend to shareholders to induce largest shareholder to agree to **standstill** agreement did not violate either Delaware general corporation law or corporation's certificate of incorporation or bylaws, court could interfere with corporation's board of directors' decision to pay dividend only if dividend was product of self-dealing and directors failed to prove that dividend was entirely fair, or if no self-dealing was present and corporation seeking to acquire target corporation was able to prove that dividend could not be grounded on any reasonable business objective.