

# MAJORITY SHAREHOLDER'S DUTIES OWED TO MINORITY SHAREHOLDERS UNDER NORTH CAROLINA LAW

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This paper explores the duties that a corporation's majority shareholder owes to its minority shareholders, either directly or indirectly. Where the duties are indirect, they arise as a result of the majority shareholder controlling the corporation and the corporation owing the duties to the minority shareholder.

By way of background, this paper will first examine whether minority shareholders generally owe other shareholders duties and then whether two shareholders, each of whom own fifty percent of the stock in the corporation, generally owe each other duties. This paper will then explore whether a minority shareholder may bring an individual action, as opposed to a derivative action, in response to violations of the duties discussed herein. The bulk of this paper will then explore fiduciary duties and other duties that the majority shareholder owes to the minority shareholder, either directly or indirectly. Finally, this paper will then briefly explore the business judgment rule as it applies to majority shareholders.

## DUTIES OF MINORITY SHAREHOLDERS, GENERALLY

As a general rule under North Carolina law, a minority shareholder owes no fiduciary duty either to the corporation or to other shareholders.<sup>1</sup> Thus, minority shareholders who are neither officers nor directors of the corporation and who do not otherwise control the corporation<sup>2</sup> “may vote their shares in any way they wish, even to serve their own adverse interests as against other shareholders, and may in other ways pursue their own interests in conflict with the corporation.”<sup>3</sup>

## DUTIES OF 50%-50% SHAREHOLDERS, GENERALLY

Where a corporation has two shareholders, with each shareholder owning fifty percent of the corporation and neither exercising control over the corporation,<sup>4</sup> the 50%-50% shareholders do not owe each other fiduciary duties by virtue of their stock ownership.<sup>5</sup> Additionally, the

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<sup>1</sup> *Freese v. Smith*, 110 N.C. App. 28, 37, 428 S.E.2d 841, 847 (1993); *see also* RUSSELL M. ROBINSON, II, ROBINSON ON NORTH CAROLINA CORPORATION LAW § 11.04, p. 11-6 (7<sup>th</sup> ed. 2007). *But see* 18A AM. JUR. 2D *Corporations* §§ 613, 643 (2009) (citing cases outside North Carolina for the idea that in some states, each shareholder in a closely held corporation owes every other shareholder a fiduciary duty).

<sup>2</sup> For a discussion of control as it relates to fiduciary duties, *see infra* notes 21-31 and accompanying text.

<sup>3</sup> ROBINSON, *supra* note 1, at § 11.04, p. 11-6. *But see* 18A AM. JUR. 2D *Corporations* § 643 (discussing *Bodio v. Ellis*, 401 Mass. 1, 513 N.E.2d 684 (1987), where a minority shareholder transferred shares to a second minority shareholder, thereby making the second shareholder a majority shareholder, and in so doing the transferor violated the fiduciary duty he owed to a third shareholder when that third shareholder had a “rightful expectation that he would have equal control”).

<sup>4</sup> For a discussion of control as it relates to fiduciary duties, *see infra* notes 21-31 and accompanying text.

<sup>5</sup> *See Aubin v. Susi*, 149 N.C. App. 320, 324-26, 560 S.E.2d 875, 879-80 (2002) (noting that minority shareholders can bring individual actions against the majority shareholders, but not extending that right to

50%-50% shareholders do not enjoy the protected status of a minority shareholder by virtue of their not owning a majority of the shares in the corporation.<sup>6</sup> In this situation, each fifty-percent owner, by virtue of his percentage ownership in the corporation, can neither dominate the other fifty-percent owner nor be dominated by the other fifty-percent owner. Thus, the reasons for protecting minority shareholders from the will of a majority shareholder<sup>7</sup> do not apply when there are two fifty-percent shareholders.

## DERIVATIVE VERSES INDIVIDUAL ACTIONS

An officer with discretionary authority and a director each owes the duties of good faith, of due care, and of loyalty *to the corporation*.<sup>8</sup> Generally, when a shareholder of a corporation wishes to sue to enforce a duty owed to the corporation, presumably because those in control of the corporation are not enforcing that duty, the shareholder must do so by bringing a derivative action in the name of the corporation.<sup>9</sup> “The *only two* exceptions to this rule are: (1) a plaintiff alleges an injury ‘separate and distinct’ to himself [and different from the injury that the corporation generally suffered<sup>10</sup>], or (2) the injuries arise out of a ‘special duty’ running from the alleged wrongdoer to the plaintiff.”<sup>11</sup> The fiduciary duty that a majority shareholder owes to a minority shareholder is a “special duty” that satisfies the second of the above two exceptions.<sup>12</sup> Thus, “minority shareholders in a closely held corporation who allege wrongful conduct and corruption against the majority shareholders in the corporation may bring an individual action against those shareholders in addition to maintaining a derivative action on behalf of the corporation.”<sup>13</sup> This ability for a minority shareholder to bring an individual action against the majority shareholder, instead of just a derivative action on behalf of the corporation, enables the minority shareholder to avoid burdensome legal requirements that arise with respect to derivative actions.<sup>14</sup>

The burdensome legal requirements that must be followed before a minority shareholder may file a derivative action include (1) making a written demand on the corporation and, through that written demand, requesting that the corporation take corrective action, and (2) then waiting up to ninety days for the corporation to respond to the written demand.<sup>15</sup> Then, if the minority

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shareholders who own fifty percent of the corporation); *Allen v. Brock Constr. Co., Inc.*, 141 N.C. App. 284, 291, 540 S.E.2d 761, 766 (2000) (noting “that the fiduciary duty owed to a minority shareholder by a majority shareholder may satisfy the special duty requirement” needed to bring an action individually, instead of derivatively, but stating that a fifty percent owner is not a minority shareholder and is not entitled to such right); *see also Outen v. Mical*, 118 N.C. App. 263, 267-68, 454 S.E.2d 883, 885-86 (1995); 18A AM. JUR. 2D *Corporations* § 645.

<sup>6</sup> *See sources cited supra* note 5.

<sup>7</sup> *See infra* text accompanying note 21.

<sup>8</sup> *See* N.C. Gen. Stat. §§ 55-8-31 (2008) (listing the duties of directors), 55-8-42 (listing the duties of officers); ROBINSON, *supra* note 1, at §§ 14.01-14.01[2] (describing the duties of directors), 16.07 (describing the duties of non-director officers).

<sup>9</sup> *See Norman v. Nash Johnson & Sons’ Farm, Inc.*, 140 N.C. App. 390, 395-96, 537 S.E.2d 248, 253 (2000); *see also Gaskin v. J. S. Procter Co., LLC*, 675 S.E.2d 115, 117-18 (N.C. App. 2009)

<sup>10</sup> *Aubin*, 149 N.C. App. at 325, 60 S.E.2d at 875.

<sup>11</sup> *Gaskin*, 675 S.E.2d at 117. *See Norman*, 140 N.C. App. at 397, 537 S.E.2d at 254, for a list of instances in which shareholders may bring individual claims.

<sup>12</sup> *See Norman*, 140 N.C. App. at 407, 537 S.E.2d at 260.

<sup>13</sup> *Id.* at 405, 537 S.E.2d at 259.

<sup>14</sup> *See id.* at 405, 537 S.E.2d at 259.

<sup>15</sup> N.C. Gen. Stat. § 55-7-42 (2009).

shareholder initiates a derivative proceeding, the “court shall dismiss [the] derivative proceeding if a majority of the “independent” directors of the corporation “determines in good faith after conducting a reasonable inquiry upon which conclusions are based . . . that the derivative proceeding is not in the best interest of the corporation.”<sup>16</sup> For the purposes of voting to dismiss the derivative proceeding, the “independent” directors can include directors who are defendants, directors who are elected by the defendants, and directors who otherwise support the majority shareholder’s actions.<sup>17</sup> Thus, the independent directors who can vote to dismiss the derivative action might not be entirely independent.

Another issue that is avoided when the minority shareholder brings an individual action is the situation where, if the minority shareholder sued on behalf of the corporation in a derivative action, the award would go to the corporation and would then be subject to the control of the very majority shareholder whose objectionable conduct caused the minority shareholder to initially file the legal action.<sup>18</sup> “It would be unrealistic to expect the interests of plaintiff minority shareholders who prevail in a derivative action to be protected by defendant majority shareholders who have allegedly converted, appropriated, and wasted corporate assets.”<sup>19</sup>

Thus, by being able to bring an individual action instead of just a derivative action, the minority shareholder can avoid burdensome legal requirements which can ultimately defeat a derivative action, and the minority shareholder, if his action results in an award, can avoid the situation where the award is paid to the same majority shareholder whose objectionable conduct induced the minority shareholder to institute the lawsuit.<sup>20</sup>

## FIDUCIARY DUTIES OF CONTROLLING OR MAJORITY SHAREHOLDERS

“When the close relationships between the shareholders in a ‘family’ or closely held corporation tragically break down, the majority shareholders are obviously in a position to exclude the minority shareholders from management decisions, leaving the minority shareholders with few remedies. The minority shareholder has neither the power to dissolve the business unit at will, as does a partner in a partnership, nor does he have the ‘way out’ which is open to a shareholder in a publicly held corporation, the opportunity to sell his shares on the open market. Thus, the illiquidity of a minority shareholder's interest in a close

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<sup>16</sup> N.C. Gen. Stat. § 55-7-44(a).

<sup>17</sup> *Norman*, 140 N.C. App. at 405, 537 S.E.2d at 259 (citing N.C. Gen. Stat. § 55-7-44(c)). N.C. Gen. Stat. § 55-7-44(c) states that

for the purposes of [the corporation dismissing a derivative suit] none of the following factors by itself shall cause a director to be considered not independent: (1) The nomination or election of the director by persons who are defendants in the derivative proceeding or against whom action is demanded; (2) The naming of the director as a defendant in the derivative proceeding or as a person against whom action is demanded; or (3) The approval by the director of the act being challenged in the derivative proceeding or demand if the act resulted in no personal benefit to the director.

<sup>18</sup> *Norman*, 140 N.C. App. at 405, 537 S.E.2d at 259.

<sup>19</sup> *Id.*

<sup>20</sup> *See id.*

corporation renders him vulnerable to exploitation by the majority shareholders.”<sup>21</sup>

“The rule of corporation law and of equity . . . is well settled and has been often applied. 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.”<sup>22</sup> This fiduciary duty applies equally to an individual who owns a majority of the shares in the corporation as it does to a “dominant or controlling group of stockholders” who act together to control the corporation.<sup>23</sup> Thus, to determine whether a fiduciary duty exists between shareholders, the appropriate inquiry is not whether a shareholder owns a majority of the shares, but whether the shareholder or group of shareholders control(s) the corporation.<sup>24</sup> In a North Carolina case, for instance, four shareholders each owned 25% of the corporation, but three of those shareholders acted in cohesion and were viewed as the “majority shareholders.”<sup>25</sup> In jurisdictions outside of North Carolina, a 50% owner is deemed a controlling shareholder.<sup>26</sup> “[P]ractical or working control” might also be deemed to exist where a single shareholder owns a large but minority block of stock and all the other shareholders own only small blocks of stock and those other shareholders are incohesive and widely disbursed as a group.<sup>27</sup>

However, if a majority shareholder does not exercise control over the corporation, he will not owe the minority shareholder this fiduciary duty.<sup>28</sup> Additionally, in some jurisdictions outside of North Carolina, and possibly within North Carolina,<sup>29</sup> this fiduciary duty is not

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<sup>21</sup> *Id.* at 404, 537 S.E.2d at 258-59 (internal quotations and citations omitted).

<sup>22</sup> *Gaines v. Long Mfg. Co.*, 234 N.C. 340, 345, 67 S.E.2d 350, 354 (1951) (quoting *Southern Pac. Co. v. Bogert*, 250 U.S. 483, 487-88, 39 S. Ct. 533, 535 (1919)); see also 18A AM JR. 2D *Corporations* §§ 644, 649 (2009) (noting, in Section 649, that a majority shareholder can exercise control through subservient officers and, presumably, subservient directors). *But see* 18A AM. JUR. 2D *Corporations* § 645 (2009) (noting that in jurisdictions outside of North Carolina, a majority shareholder does not owe the minority shareholder a fiduciary duty when the minority shareholder: acquired his stock “as a part of his or her employment compensation[.]” *Brennan v. Chesnut*, 973 F.2d 644 (8th Cir. 1992); or is an employee and “has assented to a mandatory repurchase-upon-termination clause in the shareholder’s agreement[.]” *Hoheb v. Pathology Associates of Albany, P.C.*, 146 A.D.2d 919, 536 N.Y.2d 894 (3d Dep’t 1989)); § 674 (citing *Aeronca, Inc. v. Style-Crafters, Inc.*, 546 F.2d 1094 (4th Cir. 1976), and other cases for the prospect that this fiduciary duty does not apply to a majority shareholder with respect to ownership of a subsidiary, “so long as the rights of others are not involved”).

<sup>23</sup> *Hill v. Erwin Mills, Inc.*, 239 N.C. 437, 443, 80 S.E.2d 358, 362-63 (1954) (quoting *Pepper v. Litton*, 308 U.S. 295, 306, 60 S. Ct. 238, 245 (1939)); see also *Loy v. Lorm Corp.*, 52 N.C. App. 428, 278 S.E.2d 897 (1981); *White v. Kincaid*, 149 N.C. 415, \_\_\_, 63 S.E. 109, 111 (1908).

<sup>24</sup> See *Hill*, 239 N.C. at 443, 80 S.E.2d at 362-63 (quoting *Pepper*, 308 U.S. at 306, 60 S. Ct. at 245); see also *Loy*, 52 N.C. App. 428, 278 S.E.2d 897; *White*, 149 N.C. at \_\_\_, 63 S.E. at 111.

<sup>25</sup> See *Loy*, 52 N.C. App. 428, 278 S.E.2d 897.

<sup>26</sup> 18A AM. JUR. 2D *Corporations* § 655. *But see supra* notes 4-7 and accompanying text.

<sup>27</sup> 18A AM. JUR. 2D *Corporations* § 655 (citing *Daniels v. Thomas, Dean & Hoskins, Inc.*, 246 Mont. 125, 804 P.2d 359 (1990) (where a minority shareholder was deemed a majority shareholder by virtue of his wife owning a 39% interest in the corporation)).

<sup>28</sup> 18A AM. JUR. 2D *Corporations* § 656 (citing *Swinney v. Keebler Co.*, 480 F.2d 573, 577-78 (4th Cir. 1973), in which the court stated that “[a] dominant or majority stockholder does not become a fiduciary for other stockholders merely by owning stock . . . . But majority stockholders who assume the management of the corporation . . . can be said to stand in fiduciary relation to the minority under certain circumstances”).

<sup>29</sup> See *supra* notes 153-155 and accompanying text.

absolute and “the majority shareholders must[, at least in some circumstances,] have some room to maneuver in establishing the corporation’s business policy.”<sup>30</sup>

While this paper focuses on the duties that a majority “shareholder” of a corporation owes to the minority shareholders, the North Carolina courts have been willing to extend the fiduciary duties discussed herein to majority owners of other entities, such as limited liability companies and limited partnerships.<sup>31</sup> Thus, although the term “majority shareholder” is used herein, to the extent the majority shareholders owe duties that are based on common law and not on the North Carolina Business Corporation Act, those duties might also apply to controlling owners of other entities.

### **Fiduciary Duty of Good Faith**

In North Carolina, majority shareholders owe a fiduciary duty of good faith, care, and diligence to the minority shareholders and to the corporation.<sup>32</sup> This duty arises because

[t]he devolution of unlimited power imposes on holders of the majority of the stock a correlative duty, the duty of a fiduciary or agent, to the holders of the minority of the stock, who can act only through them—the duty to exercise good faith, care, and diligence to make the property of the corporation produce the largest possible amount, to protect the interests of the holders of the minority of the stock, and to secure and pay over to them their just proportion of the income and of the proceeds of the corporate property . . . . It is the fact of control of the common property held and exercised, and not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation on the part of the majority stockholders in a corporation for the minority holders. *Actual fraud or mismanagement, therefore, is not essential to the application of the rule.*<sup>33</sup>

This fiduciary duty requires that “[a] majority shareholder . . . not . . . misuse his power by promoting his personal interest at the expense of the corporate interests.”<sup>34</sup> The North Carolina

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<sup>30</sup> 18A AM. JUR. 2D *Corporations* § 645.

<sup>31</sup> See, e.g., *Kaplan v. O.K. Techs., L.L.C.*, 675 S.E.2d 133, 137 (N.C. App. 2009) (noting (1) “[m]embers of a limited liability company are like shareholders in a corporation in that members do not owe a fiduciary duty to each other or to the company”; (2) “[a]n exception to this rule is that a controlling shareholder owes a fiduciary duty to minority shareholders”; and (3) in this case, the member against whom a breach of fiduciary duty was alleged only owned 41.5% of the limited liability company and was thus “a minority shareholder with no fiduciary duty to the other members”); *Gaskin v. J. S. Procter Co., LLC*, 675 S.E.2d 115, 119 (N.C. App. 2009) (declining to find a fiduciary duty owed by the defendant-partners where “plaintiffs collectively own ninety percent (90%) of the shares in the limited partnership”); ROBINSON, *supra* note 1, at § 34.03[3].

<sup>32</sup> *Hill v. Erwin Mills, Inc.*, 239 N.C. 437, 443, 80 S.E.2d 358, 362 (1954); see also *Freese v. Smith*, 110 N.C. App. 28, 37, 428 S.E.2d 841, 847 (1993); *Loy*, 52 N.C. App. at 432-33, 278 S.E.2d at 901; *Gaines v. Long Mfg. Co.*, 234 N.C. 340, 344-455, 67 S.E.2d 350, 353 (1951).

<sup>33</sup> *Loy*, 52 N.C. App. at 432-33, 278 S.E.2d at 901 (citing *Gaines*, 234 N.C. at 344-45, 67 S.E.2d at 353) (emphasis added).

<sup>34</sup> *Farndale Co., LLC v. Gibellini*, 176 N.C. App. 60, 67, 628 S.E.2d 15, 19 (2006) (quoting *United States v. Byrum*, 408 U.S. 125, 137, 92 S. Ct. 2382, 33 L. Ed. 2d 238, 248 (1972)).

cases which focus on this fiduciary duty typically focus either on (1) a fiduciary duty generally,<sup>35</sup> without qualifying it as being a fiduciary duty of good faith, care, or diligence; or (2) a fiduciary duty of good faith.<sup>36</sup> Irrespective of those two descriptions of the fiduciary duty, the cases that consider that duty generally do so as it relates to self-serving transactions entered into between the majority shareholder and the corporation which is controlled by the majority shareholder.<sup>37</sup> In considering these cases, a majority shareholder's

dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the . . . [self-dealing] stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.<sup>38</sup>

Once the minority makes out a prima facie case against the majority shareholder with respect to the majority shareholder's engaging in a self-serving transaction at the expense of the corporation, the burden shifts to the majority shareholder to "establish the fairness and good faith of its actions."<sup>39</sup> At the point where that burden shifts, "judicial scrutiny may be extended to the purpose for which an otherwise lawful course was undertaken and the results achieved."<sup>40</sup> In considering the good faith and inherent fairness of the majority shareholder's actions, the test is "whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain."<sup>41</sup> Similarly, when considering whether the transaction is entered into in good faith and is inherently fair to the corporation, the North Carolina courts have inquired as to whether the transaction benefits the corporation, and where it does not, the courts are more likely to set it aside.<sup>42</sup> The North Carolina courts have also considered, as some evidence that the majority shareholders breached their fiduciary duty, interconnected operations and inadequate

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<sup>35</sup> See, e.g., *Freese*, 110 N.C. App. at 37-38, 428 S.E.2d at 847-48; *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 903.

<sup>36</sup> See, e.g., *Loy*, 52 N.C. App. at 432, 278 S.E.2d at 901; *Hill*, 239 N.C. at 444, 80 S.E.2d at 363; *Gaines*, 234 N.C. at 345, 67 S.E.2d at 353-54.

<sup>37</sup> See, e.g., *Loy*, 52 N.C. App. at 432, 278 S.E.2d at 901 (stating that "majority shareholders owe a duty and obligations of good faith to minority shareholders as well as to the corporation" but then citing the North Carolina Supreme Court in a passage that identifies "good faith, care, and diligence"); *Hill*, 239 N.C. at 444, 80 S.E.2d at 363; *Gaines*, 234 N.C. at 345, 67 S.E.2d at 353-54.

<sup>38</sup> *Hill*, 239 N.C. at 444, 80 S.E.2d at 363 (quoting *Pepper v. Litton*, 308 U.S. 295, 306-07, 60 S. Ct. 238, 245, (1939)) (applying the above standard to a director and to a majority shareholder on the basis of them both being fiduciaries). Presumably this would also apply to officers with discretionary authority, since those officers have fiduciary duties similar to those of the directors. Compare N.C. Gen. Stat. § 55-8-30 (2008) with § 55-8-42.

<sup>39</sup> *Freese*, 110 N.C. App. at 37-38, 428 S.E.2d at 847-48; *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 903; see also 19 AM. JUR. 2D *Corporations* § 2118 (2009). But see 18A AM. JUR. 2D *Corporations* § 644 (citing *Smith v. Tele-Communication, Inc.*, 134 Cal. App. 3d 338, 184 Cal. Rptr. 571 (1st Dist. 1982), for the prospect that a complaint against the majority shareholder for a breach of his fiduciary duty must be liberally construed).

<sup>40</sup> *Farndale Co., LLC v. Gibellini*, 176 N.C. App. 60, 68, 628 S.E.2d 15, 20 (2006).

<sup>41</sup> *Hill*, 239 N.C. at 444, 80 S.E.2d at 363 (quoting *Pepper*, 308 U.S. at 306-07, 60 S. Ct. at 245).

<sup>42</sup> See *Gaines*, 234 N.C. at 345-47, 67 S.E.2d at 353-54 (for a discussion of the facts of this case, see *infra* text accompanying note 66); *White v. Kincaid*, 149 N.C. 415, \_\_\_, 63 S.E. 109, 111 (1908) (considering a questionable dissolution that was initiated by the majority shareholder and stating that judicial scrutiny and control is more likely if an action is "not taken for the benefit of the corporation, or in furtherance of its interests, but for the mere purpose of unjustly oppressing the minority of the stockholders, or any of them, and causing a destruction or sacrifice of their pecuniary interests or holdings"); see also *Vernon v. Cuomo*, 2009 WL 690242, 12 (N.C. Super. 2009); 19 AM. JUR. 2D *Corporations* § 2198.

record keeping between the company that the majority and minority shareholders jointly owned and a company that the majority shareholder independently owned.<sup>43</sup>

If the majority shareholder fails to meet his burden of demonstrating that the transaction was entered into in good faith and is inherently fair to the corporation and all of its shareholders, as would be the case in an arms length bargain between two unrelated parties, “equity will set it aside.”<sup>44</sup> Additionally, where the breach of the fiduciary duty was the proximate cause of damages, the court may award damages.<sup>45</sup> In more extreme cases,<sup>46</sup> the minority shareholder may seek, and the court may grant, judicial dissolution or lesser alternative forms of relief as deemed appropriate by the court,<sup>47</sup> as discussed below.<sup>48</sup>

Under the principles discussed above, the North Carolina courts have been willing to consider intervening in self-serving transactions that the majority shareholder allegedly enters into with the corporation that he controls. These claims usually involve allegations of multiple self serving transactions,<sup>49</sup> and have included, but are not limited to, transactions where the majority shareholder:

1. Awards himself an “unreasonable and improperly high salary[y]”;<sup>50</sup>
2. Issues himself stock at discounted prices in an effort to dilute the value and percentage of the minority’s ownership in the company;<sup>51</sup>

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<sup>43</sup> See *Powell v. Omlil*, 110 N.C. App. 336, 349, 429 S.E.2d 774, 780 (1993); see also 18A AM. JUR. 2D *Corporations* § 658.

<sup>44</sup> *Hill*, 239 N.C. at 444, 80 S.E.2d at 363 (quoting *Pepper*, 308 U.S. at 306-07, 60 S. Ct. at 245); *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 903.

<sup>45</sup> *Farndale*, 176 N.C. App. at 68, 628 S.E.2d at 20; see also *Keener Lumber Co., Inc. v. Perry*, 149 N.C. App. 19, 35, 560 S.E.2d 817, 828 (2002) (expressing concern that a jury would not limit damages for a breach of a fiduciary duty to those damages that were proximately caused by that breach); *Norman v. Nash Johnson & Sons’ Farm, Inc.*, 140 N.C. App. 390, 405, 537 S.E.2d 248, 259 (2000).

<sup>46</sup> In still more extreme cases, the court might offer other forms of relief. It might pierce the corporate veil where “the corporation is so operated that it is a mere instrumentality or alter ego of the sole or dominant shareholder and a shield for his activities in violation of the declared public policy or statute[.]” See *Henderson v. Sec. Mortg. & Fin. Co.*, 273 N.C. 253, 260-61, 160 S.E.2d 39, 44-45 (1968); *Clark v. B. H. Holland Co. Inc.*, 852 F. Supp. 1268, 1267 (E.D.N.C. 1994) (interpreting North Carolina law). Additionally, one North Carolina case has stated, when considering a multiple possible breaches of a fiduciary duty by a majority shareholder, that “allegations of fraud or breach of fiduciary duty will support a claim for unfair or deceptive trade practices.” *Norman*, 140 N.C. App. at 417, 537 S.E.2d at 266; see also 18A AM. JUR. 2D *Corporations* § 651 (citing *Holi-Rest, Inc. v. Treloar*, 217 N.W.2d 517 (Iowa 1974), for the prospect that exemplary damages might be awarded where the majority engages in “flagrantly wrongful acts, omissions and concealments which are injurious to the corporation and its shareholders”). But see *Powell*, 110 N.C. App. 336, 429 S.E.2d 774 (disallowing punitive damages under Georgia law, which the Court noted as being similar to North Carolina law).

<sup>47</sup> See *Meiselman v. Meiselman*, 309 N.C. 279, 307 S.E.2d 551 (1983) (where a shareholder brought an action to dissolve a corporation in order to protect his rights and interests or reasonable expectations, and the court determined that it could grant such other lesser relief as it deemed appropriate).

<sup>48</sup> See *infra* notes 135-159 and accompanying text.

<sup>49</sup> E.g., *Norman*, 140 N.C. App. at 414, 537 S.E.2d at 264.

<sup>50</sup> *Vernon v. Cuomo*, 2009 WL 690242, 15 (N.C. Super. 2009); *Isley v. W. F. Isley & Co., Inc.*, 248 N.C. 417, 419, 103 S.E.2d 495, 496 (1958); see also 18A AM. JUR. 2D *Corporations* § 658.

<sup>51</sup> *Vernon*, 2009 WL 690242 at 15; *Gaines v. Long Mfg. Co.*, 234 N.C. 340, 67 S.E.2d 350 (1951); see also 18A AM. JUR. 2D *Corporations* § 663.

3. Seeks dissolution of the company as a mechanism to continue the “same or similar business” without the minority shareholder;<sup>52</sup>
4. Makes favorable loans to himself;<sup>53</sup>
5. Transfers corporate assets to himself at discounted prices or for no consideration;<sup>54</sup>
6. Has the company purchase services from himself when the company can otherwise provide those services itself, and presumably provide them at a lower cost;<sup>55</sup>
7. Uses for his own personal benefit business concepts that were developed by the company;<sup>56</sup>
8. Uses company assets without appropriately compensating the company;<sup>57</sup>
9. Rents property to the corporation at inflated prices;<sup>58</sup>
10. Repays loans that he made to the corporation and “preferentially repay[s]” corporate debts that he personally guaranteed, all when the corporation is otherwise experiencing financial trouble;<sup>59</sup>
11. Uses company funds to pay his own “personal obligations and benefits”;<sup>60</sup>
12. “[A]llows irregularities in the keeping of the corporate books and records”;<sup>61</sup>
13. Usurps a corporate opportunity;<sup>62</sup>
14. Does not cause the company to pay dividends when dividend payment would otherwise be appropriate;<sup>63</sup>
15. Merges the corporation into another “solely for the benefit of controlling stockholders, without regard to the welfare of the corporation or the minority”;<sup>64</sup> and
16. Oppresses the minority shareholders, such as through the use of “harsh, dishonest, or wrongful conduct, and a visible departure from the standards of fair dealing[.]”<sup>65</sup>

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<sup>52</sup> See *White v. Kincaid*, 149 N.C. 415, \_\_\_, 63 S.E. 109, 111 (1908) (suggesting that intervention in a dissolution is more likely if the dissolution is clearly not for the benefit of the corporation, such as when the corporation is a profitable and ongoing concern, and dissolution is done as a scheme by which the majority shareholders unfairly profit at the expense of the corporation). For instance, the majority shareholder could, in the course of dissolution, distribute the key assets of the corporation to himself, thereby depriving the minority shareholder of the ability to use and profit from those assets, and then the majority shareholder can use those assets so that he alone can profit in a manner much like the corporation formerly did. However, in a *proper* dissolution and liquidation, the majority shareholder is not prohibited from purchasing assets of the corporation during a foreclosure sale. *Boyd v. Howard*, 2003 WL 1873510, 3 (N.C. App. 2003); see also 18A AM. JUR. 2D *Corporations* § 665; 19 AM. JUR. 2D *Corporations* § 2363.

<sup>53</sup> *Norman*, 140 N.C. App. at 414, 537 S.E.2d at 264; see also 18A AM. JUR. 2D *Corporations* §§ 658, 660.

<sup>54</sup> *Norman*, 140 N.C. App. at 414, 537 S.E.2d at 264; *Loy v. Lorm Corp.*, 52 N.C. App. 428, 430, 433, 278 S.E.2d 897, 900-01 (1981).

<sup>55</sup> *Norman*, 140 N.C. App. at 414, 537 S.E.2d at 264.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> *Loy*, 52 N.C. App. at 430, 433, 278 S.E.2d at 900-01.

<sup>59</sup> See *Freese v. Smith*, 110 N.C. App. 28, 38, 428 S.E.2d 841, 848 (1993).

<sup>60</sup> 18A AM. JUR. 2D *Corporations* § 658 (2009) (citing authority from states other than North Carolina).

<sup>61</sup> For a discussion of fiduciary duties of a majority shareholder with respect to corporate record keeping: under North Carolina law, see *supra* note 43 and accompanying text; and outside of North Carolina, see 18A AM. JUR. 2D *Corporations* § 658.

<sup>62</sup> For a discussion of fiduciary duties of a majority shareholder with respect to usurping a corporate opportunity: under North Carolina law, see *infra* notes 75-102 and accompanying text; and outside of North Carolina, see 18A AM. JUR. 2D *Corporations* § 666.

<sup>63</sup> See *infra* notes 211-223 and accompanying text.

<sup>64</sup> For a discussion of duties of a majority shareholder with respect to mergers: under North Carolina law, see *supra* notes 103-128 and 254-274 and accompanying text; and outside of North Carolina, see 18A AM. JUR. 2D *Corporations* § 665.

Illustrative examples follow.

In *Ganies v. Long Manufacturing Company*,<sup>66</sup> the majority shareholder sought to induce the company to issue its remaining authorized stock to him at a price of \$100 per share when the book value of the stock was about \$30,000 per share. The stated purpose was to bring in working capital so that the company could repay its debts, but evidence showed that the debts could be repaid without the extra capital. This transaction would have reduced the value of minority shareholder's ownership from about \$60,000 to \$800, and the court allowed an injunction against the proposed stock issuance.

In *Isley v. W. F. Isley & Co., Inc.*,<sup>67</sup> the minority shareholder asserted that the majority shareholders conspired to defraud the minority shareholder by (1) paying themselves excessive salaries, thus reducing corporate profits that could be distributed to all of the shareholders, including the minority shareholder, and (2) failing to pay dividends from surplus corporate earnings.<sup>68</sup> However, the minority shareholder failed to allege sufficient facts to suggest that the salaries were unreasonable or that the company had surplus funds to distribute, so the burden did not shift to the majority shareholders to show the fairness of their actions.<sup>69</sup>

### **Fiduciary Duty of Loyalty**

In enumerating the fiduciary duties that a majority shareholder owes to a minority shareholder, some jurisdictions include a duty of loyalty.<sup>70</sup> North Carolina has not expressly included the duty of loyalty as part of the fiduciary duty that a majority shareholder owes to a minority shareholder.<sup>71</sup> However, even if the North Carolina courts have not expressly included the duty of loyalty among the fiduciary duties that a majority shareholder owes a minority shareholder, the majority shareholder does, in most circumstances, owe that duty in effect, if not in name.

A duty of loyalty, when considered with respect to the duties that an officer with discretionary authority or a director owes a corporation, "prohibits [that person] from using his

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<sup>65</sup> See 18A AM. JUR. 2D *Corporations* § 665 (citing authority from states other than North Carolina); see also *Ganies v. Long Mfg. Co.*, 234 N.C. 340, 361, 67 S.E.2d 350, 361 (1951) (stating that "some courts" will consider "extreme cases of arbitrary, oppressive, or wrongful conduct" when considering whether to compel the payment of dividends").

<sup>66</sup> 234 N.C. 340, 67 S.E.2d 350 (1951).

<sup>67</sup> 248 N.C. 417, 103 S.E.2d 495 (1958).

<sup>68</sup> *Id.* at 419, 103 S.E.2d at 496.

<sup>69</sup> See *id.* at 419, 103 S.E.2d at 496.

<sup>70</sup> See 18A AM. JUR. 2D *Corporations* §§ 613, 654.

<sup>71</sup> See *supra* note 32 and accompanying text. See also Strong's North Carolina Index 4th *Corporations* § 134 (2009) (noting that "[m]ajority shareholders owe a fiduciary duty and obligation of good faith to minority shareholders, as well as to the corporation, but not noting that the majority shareholders owed a duty of loyalty). *But see Norman v. Nash Johnson & Sons' Farms, Inc.*, 140 N.C. App. 390, 420, 537 S.E.2d 248, 267 (2000) (Green, J., concurring in part and dissenting in part and stating that "[p]laintiffs acknowledge in their complaint, however, that the fiduciary duty owed by the majority shareholders to plaintiffs is the same fiduciary duty of "good faith, due care and/or loyalty" that the majority shareholders owe to the Company").

position for his own personal gain to the detriment of the corporation or its shareholders.”<sup>72</sup> This includes prohibitions against (1) entering into unapproved<sup>73</sup> transactions with the corporation where the director or officer profits at the expense of the corporation,<sup>74</sup> (2) usurping corporate opportunities,<sup>75</sup> and (3) competing with the corporation.<sup>76</sup> The first part of the duty of loyalty, the duty not to enter into a transaction with the corporation and thus profit at the expense of the corporation, is incorporated under the fiduciary duty of good faith that a majority shareholder owes a minority shareholder, as discussed above.<sup>77</sup> Thus, the majority shareholder owes that portion of the duty of loyalty to the minority shareholder in spirit, if not name, by virtue of his owing a duty of good faith to the minority shareholder.

The second part of this duty of loyalty, which relates to usurping a corporate opportunity,<sup>78</sup> obligates the person bound by this duty “not [to] appropriate to himself an opportunity that rightfully belongs to [the] corporation.”<sup>79</sup> The third part of this duty of loyalty prohibits the person bound by the duty from competing with the corporation. Those two parts of the duty of loyalty will apply to a majority shareholder if the majority shareholder (1) *serves as a director*, or (2) *acts in place of the board of directors*.

A director, as well as an officer with discretionary authority, owes the duty of loyalty *to the corporation*<sup>80</sup> but not directly to the shareholders.<sup>81</sup> A majority shareholder who serves as a

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<sup>72</sup> ROBINSON, *supra* note 1, at §§ 14.04, 16.07.

<sup>73</sup> N.C. Gen. Stat. § 55-8-31 (2008) provides a mechanism to “approve” a transaction entered into by a director when the director had a conflict of interest with respect to that transaction. There is no parallel statutory provision with respect to a similar transaction entered into by a majority shareholder, but a minority shareholder might not be able to bring a successful action to recover from that transaction if the minority shareholder approved or acquiesced in that transaction. *See infra* note 169 and accompanying text. Additionally, even if a transaction is “approved,” the director, officer, or majority shareholder still may not make an unfair profit at the expense of the corporation, or he will violate his duty of good faith. *See supra* notes 32-69 and accompany text.

<sup>74</sup> *See* ROBINSON, *supra* note 1, at § 14.04; N.C. Gen. Stat. § 55-8-31(a) (providing that a transaction in which a director has a conflict of interest is not voidable if it is approved by certain directors or certain shareholders or if it is “fair to the corporation”); *Meiselman v. Meiselman*, 309 N.C. 278, 309, 307 S.E.2d 551, 569 (1983) (stating that “a transaction between a corporation and its director or officer is presumed to be invalid unless those seeking to sustain it prove it was ‘just and reasonable’”).

<sup>75</sup> ROBINSON, *supra* note 1, at § 14.04[2]; *Meiselman*, 309 N.C. at 307-08, 307 S.E.2d at 568 (noting that “[t]he doctrine of corporate opportunity is a species of the duty of a fiduciary to act with undivided loyalty”).

<sup>76</sup> ROBINSON, *supra* note 1, at § 14.04[2]; *Meiselman*, 309 N.C. at 307, 307 S.E.2d at 567-68 (noting that “[t]he law would not permit him [a corporate officer] to act in any such double capacity to appropriate business for himself belonging legitimately to his corporation and then reap the profits of it[,]” but describing that duty both as one of good faith and of loyalty (quoting *Bright v. Penny*, 157 N.C. 110, 72 S.E. 964 (1911)); *see Norman*, 140 N.C. App. at 414, 537 S.E.2d at 264 (offering some support for the concept that competition could also result from the majority shareholder using business concepts that are developed by the company); *Long v. Vertical Tech. Inc.*, 113 N.C. App. 598, 600, 605, 439 S.E.2d 797, 799, 802 (1994) (where employees who were officers owed a duty of loyalty which prevented them from competing with the corporation); *Dalton v. Camp*, 353 N.C. 647, 653-54, 548 S.E.2d 704, 709 (2001) (interpreting *Long*, 113 N.C. App. 598, 439 S.E.2d 797).

<sup>77</sup> *See supra* notes 32-69 and accompanying text.

<sup>78</sup> For a more detailed discussion on usurping a corporate opportunity and tests to determine whether an opportunity has been usurped, *see Meiselman*, 309 N.C. 279, 307 S.E.2d 551.

<sup>79</sup> *Meiselman*, 309 N.C. at 308, 313, 307 S.E.2d at 568, 571; *see also Norman v. Nash Johnson & Sons’ Farm, Inc.*, 140 N.C. App. 390, 406, 537 S.E.2d 248, 259 (2000) (where the majority shareholders were also directors and violated their fiduciary duty by, among other things, “depriving the [c]ompany of corporate opportunities”).

<sup>80</sup> *See* N.C. Gen. Stat. §§ 55-8-31(a)(3) (listing the duties of directors and stating that a director “shall discharge his duties as a director . . . [i]n a manner he reasonably believes to be in the best interests of the

director of the corporation owes a fiduciary duty *to the minority shareholders* not to breach the duty of loyalty which he owes to the corporation by virtue of his being a director.<sup>82</sup> Thus, if a director violates the duty of loyalty that he owes to the corporation, and the director is a majority shareholder, the majority shareholder has violated the fiduciary duty that he owes to the minority shareholder.<sup>83</sup> Presumably, this would also apply to a majority shareholder who also serves as an officer with discretionary authority.<sup>84</sup>

Under the North Carolina General Statutes, *all* of the shareholders<sup>85</sup> may enter into an agreement that “vests authority of the board of directors in an individual or group other than the board of directors.”<sup>86</sup> When this occurs, the “individual or group in the exercise of such authority shall be deemed to be acting as the board of directors for all purposes of” the North Carolina Business Corporation Act.<sup>87</sup> Thus, if all of the shareholders agree to eliminate the board of directors and allow the majority shareholder to act in place of the board of directors, the standard discussed in the previous paragraph should still apply.<sup>88</sup> That is, a majority shareholder who serves as a member of the board of directors or who serves in lieu of the board of directors owes the corporation a duty of loyalty not to unfairly profit from the corporation, not to usurp a corporate opportunity, and not to compete with the corporation. If he violates that duty, he simultaneously violates the fiduciary duty he owes to the minority shareholder by virtue of his being a majority shareholder.<sup>89</sup>

Even if the majority shareholder is not acting in the capacity of an officer with discretionary authority or a director, the duty of loyalty should effectively apply when the majority shareholder (1) usurps a corporate opportunity and, as a result of that usurped opportunity, profits at the expense of the corporation, or (2) competes with the corporation and,

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corporation” ), 55-8-42(a)(3) (listing the duties of officers and stating that “[a]n officer with discretionary authority shall discharge his duties under that authority . . . [i]n a manner he reasonably believes to be in the best interests of the corporation”); ROBINSON, *supra* note 1, at §§ 14.01-14.01[2] (describing the duties of directors), 16.07 (describing the duties of non-director officers).

<sup>81</sup> See *infra* note 100.

<sup>82</sup> See *Freese v. Smith*, 110 N.C. App. 28, 37-38, 428 S.E.2d 841, 847-48 (1993).

<sup>83</sup> *Freese*, 110 N.C. App. at 38, 428 S.E.2d at 848; see also 18A AM. JUR. 2D *Corporations* § 644 (2009) (noting that when the majority shareholder is also a director, fiduciary duties apply in both capacities).

<sup>84</sup> As sources cited in note 80, *supra*, show, the statutory language used by N.C. Gen. Stat. §§ 55-8-30(a)(3) and 55-8-42(a)(3) (2008) that imposes the duty of loyalty on the directors and officers with discretionary authority is identical, and thus the duties that arise from those statutes should be similar, if not identical.

<sup>85</sup> N.C. Gen. Stat. § 55-7-31(a) states that

no written agreement to which *all* of the shareholders have actually assented, whether embodied in the articles of incorporation or bylaws or in any side agreement in writing and signed by *all* the parties thereto, and which relates to any phase of the affairs of the corporation, whether to the management of its business or division of its profits or otherwise, shall be invalid as between the parties thereto, on the ground that it is an attempt by the parties thereto to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate between partners.

(emphasis added).

<sup>86</sup> N.C. Gen. Stat. §§ 55-8-01(d), 55-7-31(b).

<sup>87</sup> N.C. Gen. Stat. § 55-8-01(d).

<sup>88</sup> See *Freese*, 110 N.C. App. at 37-38, 428 S.E.2d at 847-48.

<sup>89</sup> See *id.*

as a result of that competition, profits at the expense of the corporation. This occurs because, as discussed above,<sup>90</sup> the North Carolina courts extend to a majority shareholder the fiduciary duty of good faith, which obligates the majority shareholder not to unfairly profit from the corporation. Indeed, in the North Carolina cases that have addressed instances in which a majority shareholder allegedly usurped a corporate opportunity, either directly or indirectly through another entity that he owned, the majority shareholder appears to have unfairly profited from that usurped corporate opportunity.<sup>91</sup>

Thus, in most instances the duty of loyalty should apply to the majority shareholder. This arises by virtue of the majority shareholder (1) unfairly profiting as a result of a self-serving transaction that he enters into with the corporation, (2) serving as a director or in place of the directors and violating the duty of loyalty that the director owes the corporation, or (3) usurping a corporate opportunity or competing with the corporation and thereby unfairly profiting at the expense of the corporation.<sup>92</sup> There are two situations where it is unclear if a duty of loyalty even exists and, if it does, whether the North Carolina courts would extend that duty to the majority shareholder. Those situations are where the majority shareholder is not an officer with discretionary authority or a director and he either (1) usurps an opportunity that rightfully belongs to the corporation, but he does not profit from that opportunity,<sup>93</sup> or (2) competes with the corporation, but he does not profit from that competition. Presumably, those two situations would be more likely to violate the duty of loyalty, irrespective of who owed that duty, if the usurped opportunity or the competition was detrimental to the corporation.

Illustrative cases follow.

In *Freese v. Smith*,<sup>94</sup> the majority shareholder was also a director, and he induced the corporation, when the corporation appeared to be having financial trouble, to repay loans that the majority shareholder had made to the company, repay loans that a separate entity owned by the majority shareholder had made to the company, and “preferentially repay a corporate debt which he had personally guaranteed.”<sup>95</sup> The court noted that the majority shareholder, by virtue of his being a director,<sup>96</sup> was under “a statutory mandate to act in good faith and not engage in self dealing.”<sup>97</sup> The above-mentioned facts were sufficient to show that the defendant, as a director, breached the duty of loyalty that he *owed to the corporation*.<sup>98</sup> The court held “that this evidence

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<sup>90</sup> See *supra* notes 32-69 and accompanying text.

<sup>91</sup> See, e.g., *Meiselman v. Meiselman*, 309 N.C. 279, 313, 307 S.E.2d 551, 571 (1983), in which the majority shareholder jointly owned a company with the minority shareholder and purchased for himself stock in a second company after that stock was offered to the jointly owned company. The majority shareholder then profited by the operation of that second company, and the minority shareholder complained that the majority shareholder had usurped a corporate opportunity by purchasing the second company for himself and had thus unfairly profited by virtue of his owning that second company. *Id.*

<sup>92</sup> See also ROBINSON, *supra* note 1, at § 14.04.

<sup>93</sup> See *supra* notes 78-79 and accompanying text.

<sup>94</sup> 110 N.C. App. 28, 37, 428 S.E.2d 841, 847 (1993).

<sup>95</sup> *Id.* at 38, 428 S.E.2d at 848.

<sup>96</sup> See *id.* at 38, 428 S.E.2d at 848 (citing N.C. Gen. Stat. § 55-8-30, which expressly relates to directors and not officers); see also N.C. Gen. Stat. § 55-8-42 (2008) (which expressly relates to officers and not directors); *supra* notes 80-89 and accompanying text.

<sup>97</sup> *Freese*, 110 N.C. App. at 38, 428 S.E.2d at 848.

<sup>98</sup> *Id.*

is sufficient to establish a breach of defendant's fiduciary duty [owed] to plaintiff as minority shareholder[.]”<sup>99</sup> which duty he owed by virtue of being a majority shareholder.<sup>100</sup>

In *Norman v. Nash Johnson & Sons' Farm, Inc.*,<sup>101</sup> the minority shareholders were able to bring an action against the majority shareholders for, among other things, usurping or “diverting corporate opportunities,” which is a violation of the duty of loyalty.<sup>102</sup> Those majority shareholders either served as directors or controlled the board of directors. However, the court did not speak of a duty of loyalty as it applies to the director or the majority shareholder, so this case is not overly helpful in discerning to what extent a majority shareholder who is not a director might owe an express duty of loyalty directly to the minority shareholder.

### **Fiduciary Duty with respect to Statutory Duties to Include All Shareholders when Approving Certain Corporate Transactions**

#### *Fundamental Changes and the Duty to Include All Shareholders.*

Robinson notes that the equitable limitations and potential damages that arise when a majority shareholder violates the fiduciary duties that he owes the minority shareholders “are especially applicable to fundamental changes.”<sup>103</sup> This can apply both to situations where the majority shareholder unfairly profits from the corporation, as discussed above,<sup>104</sup> and to situations where the company and/or the board of directors has a statutory duty to include the minority shareholder in the decision making process but fails to do so. While the cases that consider this duty and are discussed herein have not specifically labeled this fiduciary duty, it is presumably the duty of due care, by which the director or officer is bound,<sup>105</sup> and by which the majority shareholder is bound when acting as a director or when acting in place of the directors, if not generally.<sup>106</sup>

The North Carolina General Statutes require that all shareholders be included in the process by which a corporation approves certain fundamental changes,<sup>107</sup> such as mergers,<sup>108</sup>

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<sup>99</sup> *Id.* (emphasis added).

<sup>100</sup> See ROBINSON, *supra* note 1, at § 14.02[2], p. 14-4 (noting that the North Carolina statutes were altered around 1989 to eliminate the suggestion that an express fiduciary duty ran from a director to a shareholder).

<sup>101</sup> 140 N.C. App. 390, 537 S.E.2d 248 (2000).

<sup>102</sup> *Id.* at 408, 537 S.E.2d at 261.

<sup>103</sup> See ROBINSON, *supra* note 1, at § 11.04[1], p. 11-7.

<sup>104</sup> See *supra* notes 32-69 and accompanying text.

<sup>105</sup> See *supra* note 8 (identifying fiduciary duties owed by directors), notes 32-69 (discussing the duty of good faith), and notes 70-102 (discussing the duty of loyalty).

<sup>106</sup> See *supra* notes 80-89 (discussing the majority shareholder as being bound by the director's fiduciary duties when serving as or in place of a director) and note 32 (listing the duty of “care” as being one by which majority shareholders are bound) and accompanying text.

<sup>107</sup> See *Loy v. Lorm Corp.*, 52 N.C. App. 428, 435, 278 S.E.2d 897, 902 (1981). *But see* N.C. Gen. Stat. §§ 55-10-03(b), 55-14A-01 (2008) (allowing fundamental changes without shareholder approval if ordered by the court).

<sup>108</sup> N.C. Gen. Stat. §§ 55-11-01, 55-11-03(a), (g) (requiring shareholder approval for the target corporation in a merger but providing instances where the shareholders of the surviving corporation in a merger are not required to vote); *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 902. *But see* N.C. Gen. Stat. § 55-11-04 (providing exceptions to shareholder approval when the transaction involves merging a subsidiary into a parent and the parent owns at least ninety percent of the subsidiary prior to the merger); N.C. Gen. Stat. § 55-112 (1980); *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 903 (noting exceptions to the above-mentioned rules under former N.C. Gen. Stat. § 55-112 (1980)).

share exchanges,<sup>109</sup> transfers of substantially all of the assets of the company other than in the normal course of business,<sup>110</sup> making fundamental changes to the articles of incorporation,<sup>111</sup> and dissolution.<sup>112</sup> When the directors, or those who are acting in place of the directors, such as the majority shareholders,<sup>113</sup> seek to cause such fundamental transactions, they must: (1) adopt a resolution recommending that the shareholders approve the plan,<sup>114</sup> or, for present-day statutes, forgo making that recommendation and state why they are giving no recommendation, which could be because they have a conflict of interest or for some other reason;<sup>115</sup> (2) submit the plan of the fundamental change to *all* shareholders;<sup>116</sup> (3) provide written notice to *all* shareholders of a shareholder meeting to vote on the plan;<sup>117</sup> and (4) at the shareholder meeting, submit the proposal to a vote of those shareholders who are entitled to vote on the plan.<sup>118</sup>

The above procedures were required in *Loy v. Lorm Corp.*,<sup>119</sup> where three majority shareholders were also directors and transferred assets out of the corporation on such a scale that it represented a fundamental transaction.<sup>120</sup> In doing so, they failed to include all of the shareholders in the approval process,<sup>121</sup> as outlined immediately above and as then required by

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<sup>109</sup> N.C. Gen. Stat. §§ 55-11-02, 55-11-03 (2008). A share exchange occurs where all of the shareholders of the target corporation are compelled, as a result of the shareholder approval process, discussed below (*see infra* notes 113-118 and accompanying text), to exchange all of the shares in that target corporation for cash or other consideration, such as stock in the acquiring corporation, as part of a corporate combination, and the target corporation then continues its existence as a subsidiary of the acquiring corporation. *See* N.C. Gen. Stat. § 55-11-02 (Official Comment and North Carolina Commentary).

<sup>110</sup> N.C. Gen. Stat. §§ 55-11-03(a) (detailing shareholder participation in approving transfers of assets other than in the course of business as usual), 55-12-01 (allowing for transfer of all or substantially all of the assets of the corporation in the normal course of business and allowing for the mortgage of all of the property of the corporation without shareholder approval unless the articles of incorporation or bylaws adopted by the shareholders provide otherwise), 55-12-02 (requiring shareholder approval to transfer substantially all of the corporation's assets other than as business as usual); N.C. Gen. Stat. § 55-112 (1980) (dealing with transfers of substantially all of the corporation's assets); *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 903.

<sup>111</sup> *See* N.C. Gen. Stat. §§ 55-10-02, 55-10-03(b) (2008) (allowing certain minor amendments to the articles of incorporation without shareholder approval), 55-10-03 (requiring shareholder approval to make material changes to the articles of incorporation).

<sup>112</sup> *See* N.C. Gen. Stat. § 55-14-02 (requiring shareholder approval for dissolution).

<sup>113</sup> *See supra* notes 85-89 and accompanying text.

<sup>114</sup> N.C. Gen. Stat. §§ 55-10-03(a)-(b) (amendments to articles of incorporation) 55-11-03(a)-(b) (mergers and share exchanges), 55-12-02(a)-(b) (transfers of assets), 55-14-02(a)-(b) (dissolution); N.C. Gen. Stat. § 55-112(c)(1) (1980) (transfers of assets); *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 902.

<sup>115</sup> N.C. Gen. Stat. §§ 55-10-03(a)-(b) (2008) (amendments to articles of incorporation), 55-11-03(a)-(b) (mergers and share exchanges), 55-12-02(a)-(b) (transfers of assets), 55-14-02(a)-(b) (dissolution).

<sup>116</sup> *See* N.C. Gen. Stat. §§ 55-10-03(b) (amendments to articles of incorporation), 55-11-03(a) (mergers and share exchanges), 55-12-02(a)-(b) (transfers of assets), 55-14-02(a)-(b) (dissolution); N.C. Gen. Stat. § 55-112(c)(1) (1980) (transfers of assets); *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 902.

<sup>117</sup> N.C. Gen. Stat. §§ 55-10-03(d) (2008) (amendments to articles of incorporation), 55-11-03(d) (mergers and share exchanges), 55-12-02 (transfers of assets), 55-14-02 (dissolution); N.C. Gen. Stat. § 55-112(c)(2) (1980) (transfers of assets); *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 902.

<sup>118</sup> *See* N.C. Gen. Stat. §§ 55-10-03(d) (2008) (amendments to articles of incorporation), 55-11-03(b)(2) (mergers and share exchanges), 55-12-02(b)(2) (transfers of assets), 55-14-02(b)(2) (dissolution); N.C. Gen. Stat. § 55-112(c) (1980) (transfers of assets); *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 902.

<sup>119</sup> 52 N.C. App. 428, 278 S.E.2d 897 (1981).

<sup>120</sup> *Id.* at 435, 278 S.E.2d at 902.

<sup>121</sup> *Id.* at 435, 278 S.E.2d at 902-03.

Section 55-112 of the North Carolina General Statutes.<sup>122</sup> The court noted that “[f]ailure to conform to [those] mandates of the statute constitutes a breach of a director’s fiduciary duty as well as a breach of the majority stockholders’ duty to the minority.”<sup>123</sup>

Section 55-112 of the North Carolina General Statutes, as it applied to transfers of substantially all of the assets of the corporation and as applied in *Loy*, has been superseded by Section 55-12-02 with respect to sales of substantially all of the assets of the corporation other than in the course of business as usual.<sup>124</sup> As shown above,<sup>125</sup> both of those statutes, old and new, have the same requirements with respect to including minority shareholders in the approval process. Additionally, as discussed above,<sup>126</sup> the statutes that govern the approval of fundamental amendments to the articles of incorporation, mergers, share exchanges, and dissolutions also have the same requirements and much of the same language with respect to including the minority shareholders in the process of approving those fundamental transactions.<sup>127</sup> Thus, the “[f]ailure to conform to [those] mandates of the statute[(s)]”<sup>128</sup> to include the minority shareholders in the approval process should constitute a breach of the director’s fiduciary duty to the corporation and, when the directors and the majority shareholders are the same, a breach of the fiduciary duty that the majority stockholders’ owe to the minority shareholders. That should apply irrespective of whether the fundamental transaction is a sale of substantially all of the assets of the corporation other than as business as usual, merger, share exchange, material change to the articles of incorporation, or dissolution.

### Guaranteeing Debts.

In *Norman v. Nash Johnson Sons’ Farms, Inc.*,<sup>129</sup> the minority shareholder successfully alleged that the majority shareholder violated his fiduciary duty owed to the minority shareholder, which included, among the list of offenses, having the company guarantee debts that the majority shareholder *and* director owed to third parties.<sup>130</sup> The Court did not separately comment on that alleged offense, but the North Carolina General Statutes provide a statutory process by which the directors or the shareholders must specifically approve guarantees and loans given to the *directors*.<sup>131</sup> Failure to follow this statutory approval process could possibly

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<sup>122</sup> See *supra* text accompanying notes 113-118.

<sup>123</sup> *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 902-03 (emphasis added); see also *Freese v. Smith*, 110 N.C. App. 28, 37, 428 S.E.2d 841, 847 (1993).

<sup>124</sup> See N.C. Gen. Stat. § 55-12-02 (2008) (North Carolina Commentary); compare N.C. Gen. Stat. §§ 55-12-01 (allowing sales of substantially all of the assets in the normal course of business without shareholder approval) and 55-12-02 (requiring shareholder approval for sales of substantially all of the assets other than as part of business as usual) with N.C. Gen. Stat. § 55-112 (1980) (discussing these statutory duties with respect to transfers of substantially all of the assets of the company).

<sup>125</sup> See *supra* text accompanying notes 113-118.

<sup>126</sup> See *supra* text accompanying notes 113-118.

<sup>127</sup> Compare N.C. Gen. Stat. §§ 55-10-03, 55-11-03, 55-12-02, and 55-14-02 (2008) with N.C. Gen. Stat. § 55-112 (1980).

<sup>128</sup> *Loy*, 52 N.C. App. at 435, 278 S.E.2d at 902-03 (emphasis added); see also *Freese*, 110 N.C. App. at 37, 428 S.E.2d at 847.

<sup>129</sup> 140 N.C. App. 390, 537 S.E.2d 248 (2000).

<sup>130</sup> *Id.* at 393, 405-06, 414, 537 S.E.2d at 252, 259, 264.

<sup>131</sup> See N.C. Gen. Stat. § 55-8-32 (2008) (listing requirements with respect to corporate guarantees of a director’s debts).

be a violation of the majority shareholder's fiduciary duties owed to the minority shareholders, just as is the case when the statutory approval process is ignored with respect to fundamental transactions, as discussed above.<sup>132</sup> However, the North Carolina courts have not specifically commented on this and in *Norman*, this was but one of multiple offenses alleged.<sup>133</sup> Additionally, the North Carolina courts have not specifically commented on whether the corporation guaranteeing a debt of a majority shareholder, without more, would be a violation of the majority shareholder's fiduciary duty that he owes the minority shareholder. That fiduciary duty would be more likely violated if the corporation actually had to pay on that guarantee, because the majority shareholder would then be more likely to have unfairly profited at the expense of the corporation.<sup>134</sup> If the corporation does not pay on a guarantee of the majority shareholder's debts, it is unclear whether any duty has been violated.

### **OTHER DUTIES OWED TO MINORITY SHAREHOLDERS BY EITHER THE MAJORITY SHAREHOLDER OR THE CORPORATION**

This section continues to explore the duties owed to a minority shareholder. As noted in the introduction of this paper, these duties can be owed by the majority shareholder either directly or indirectly to the minority shareholder. Where the duties are indirect, they arise as a result of the majority shareholder controlling the corporation and the corporation owing the duties to the minority shareholder.

#### **Duty Not to Frustrate Substantial and Reasonable Expectations**

The majority shareholder, when in control of the corporation, owes a duty to the minority shareholder not to frustrate the minority shareholder's known, substantial, and reasonable expectations with respect to his ownership of the corporation.<sup>135</sup> This duty ultimately arises from Section 55-14-30(2)(ii) of the North Carolina General Statutes, which permits judicial dissolution as a result of a proceeding brought by a shareholder when the shareholder can show that "liquidation is reasonably necessary for the protection of the rights or interests of the complaining shareholder."<sup>136</sup> Thus, the "reasonable expectation" or "rights or interests" must be substantial enough for the court to consider an involuntary dissolution proceeding if those expectations are frustrated.<sup>137</sup> If those expectations are frustrated, the minority shareholder often has no power within the corporate framework to secure relief.<sup>138</sup> There might be no market for his shares, and, without court assistance, he cannot induce liquidation of the corporation to get

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<sup>132</sup> See *supra* notes 103-128 and accompanying text.

<sup>133</sup> See *Norman*, 140 N.C. App. at 414, 537 S.E.2d at 264; N.C. Gen. Stat. § 55-8-32.

<sup>134</sup> See *supra* notes 32-69 and accompanying text.

<sup>135</sup> See *Meiselman v. Meiselman*, 309 N.C. 279, 297-301, 307 S.E.2d 551, 562-64 (1983); see also 19 AM. JUR. 2D *Corporations* §§ 2370-71 (2009).

<sup>136</sup> See also *Meiselman*, 309 N.C. at 297-98, 307 S.E.2d at 562; *Norman*, 140 N.C. App. at 397, 537 S.E.2d at 254 ("a shareholder may bring an individual claim . . . to compel an involuntary dissolution" (quoting ROBINSON, *supra* note 1, at § 17.02[2])).

<sup>137</sup> See *Meiselman*, 309 N.C. 279, 307 S.E.2d 551.

<sup>138</sup> See *id.* at 291-92, 307 S.E.2d at 559.

his investment out.<sup>139</sup> He is thus at the mercy of the majority shareholder, unless he can obtain relief through the legal system.<sup>140</sup>

In considering this issue, the court is to examine the “rights and interests” or “reasonable expectations” of the minority shareholder and determine if those are in need of protection.<sup>141</sup> Those expectations will typically relate to having secure employment and to meaningfully participating in management of the company,<sup>142</sup> but the court has considered a shareholder’s reasonable expectations in fringe benefits when those fringe benefits were terminated along with the minority shareholder’s employment with the company.<sup>143</sup> The court has also found a frustration of reasonable expectations when the majority shareholders diluted the minority shareholder’s “ownership purely to benefit other shareholders.”<sup>144</sup>

The question of reasonable expectations is a fact-based inquiry.<sup>145</sup> To determine those expectations, the court should “examin[e] the entire history” between the shareholders, to include any substantial and reasonable expectations at inception of their relationship, as altered over time, and which “develop as the participants engage in a course of dealing [‘concurrent in by all of them’<sup>146</sup>] in conducting the affairs of the corporation.”<sup>147</sup> In looking at this course of dealing, the court is recognizing that a “corporation’s charter and bylaws almost never reflect the full business bargain of the” shareholders<sup>148</sup> and is willing to consider oral agreements between the parties made prior to incorporation, but not to the extent that the oral agreement relates to the sale of securities.<sup>149</sup> This examination requires that the minority shareholder prove that:

- (1) he had one or more substantial reasonable expectations known or assumed by the other participants;
- (2) the expectation has been frustrated;
- (3) the frustration was without fault of plaintiff and was in large part beyond his control; and
- (4) under all of the circumstances of the case plaintiff is entitled to some form of equitable relief.<sup>150</sup>

If the above inquiry is made and the court deems that equitable relief is appropriate, it may grant relief in the form of corporate dissolution or such other relief it deems appropriate, including, but not limited to:

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<sup>139</sup> See *id.* at 291, 307 S.E.2d at 559.

<sup>140</sup> See *id.* at 292, 307 S.E.2d at 559.

<sup>141</sup> *Id.* at 301, 306, 307 S.E.2d at 564, 567.

<sup>142</sup> *Id.* at 289, 302, 307 S.E.2d at 558, 564.

<sup>143</sup> *Id.* at 302, 307 S.E.2d at 564.

<sup>144</sup> *Vernon v. Cuomo*, 2009 WL 690242, at 12 (N.C. Super. 2009).

<sup>145</sup> *Meiselman*, 309 N.C. at 289, 307 S.E.2d at 562-63.

<sup>146</sup> *Id.* at 299, 307 S.E.2d at 563 (citing O’Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW 873, 886 (1978)).

<sup>147</sup> *Id.* at 299, 307 S.E.2d at 563.

<sup>148</sup> *Id.* (citing O’Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW 873, 886 (1978)).

<sup>149</sup> *Stancil v. Stancil*, 326 N.C. 766, 770, 392 S.E.2d 373, 376 (1990) (relating to a writing being required for the sale of securities); *Stancil v. Stancil*, 94 N.C. App. 319, 322, 380 S.E.2d 424, 426 (1989) (citing sources for the consideration of oral agreements).

<sup>150</sup> *Meiselman*, 309 N.C. at 301, 307 S.E.2d at 564.

- (1) Canceling or altering any provision contained in the charter or the bylaws of the corporation; or
- (2) Canceling, altering, or enjoining any resolution or other act of the corporation; or
- (3) Directing or prohibiting any act of the corporation or of shareholders, directors, officers or other persons party to the action; or
- (4) Providing for the purchase at their fair value of shares of any shareholder, either by the corporation or by other shareholders, such fair value to be determined in accordance with such procedures as the court may provide.<sup>151</sup>

However, if the court does determine that dissolution is the appropriate form of relief, “the court shall not order dissolution if, after such determination, the corporation elects to purchase the shares of the complaining shareholder at their fair market value, as determined in accordance with such procedures as the court may provide.”<sup>152</sup>

In granting the above or other relief, however, the court “must exercise its equitable discretion, and consider the actual benefit and injury to [all of] the shareholders resulting from” the type of relief granted.<sup>153</sup> The court must balance the rights and interests or reasonable expectations of all parties, and not simply allow a minority to use the above procedure to secure himself “relief at the expense of the corporation and without regard to the rights and interests [or reasonable expectations] of the other shareholders.”<sup>154</sup> Similarly, the court may refrain from enforcing once reasonable expectations if those expectations are no longer reasonable and are now detrimental to the survival or wellbeing of the corporation.<sup>155</sup> Thus, the majority shareholder, when in control of the corporation, owes a duty to the minority shareholder not to frustrate the minority shareholder’s known, substantial, and reasonable expectations. However, the type and amount of relief available to the minority shareholder might be unpredictable, because the court might use its discretion to grant other types and amounts of relief, and because the court might view other shareholders as having substantial but competing expectations and rights in the same corporation.

*Vernon v. Cuomo*<sup>156</sup> provides an illustrative example. In that case, the majority shareholders were also directors and engaged in a scheme whereby they “award[ed] themselves unreasonable and improperly high salaries[,]” deferred those salaries, recommended and approved an increase in the number of authorized shares, and then issued those shares to themselves at a substantial discount and in exchange for their deferred salaries.<sup>157</sup> The result was a substantial dilution in the complaining shareholders’ ownership, from 20% to 2.4%.<sup>158</sup> The

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<sup>151</sup> *Id.* at 300, 307 S.E.2d at 564.

<sup>152</sup> N.C. Gen. Stat. § 55-14-31 (2008); *see also Garlock v. Southeastern Gas & Power, Inc.*, 2001 WL 34054523 (N.C. Super. 2001) (ordering dissolution of a corporation or purchase of the complaining shareholder’s shares and discussing the determination of “fair market value” for those shares, all pursuant to N.C. Gen. Stat. § 55-14-31).

<sup>153</sup> *Meiselman*, 309 N.C. at 297, 307 S.E.2d at 562 (citation omitted).

<sup>154</sup> *Id.* at 296-97, 307 S.E.2d at 562.

<sup>155</sup> *Vernon v. Cuomo*, 2009 WL 690242, 12 (N.C. Super. 2009) (stating that “[a] company is not required to fulfill once-reasonable expectations of continued employment where the employment may be detrimental to the ongoing survival of the business”); *see also* 18A AM. JUR. 2D *Corporations* § 645 n.1 (2009).

<sup>156</sup> 2009 WL 690242 (N.C. Super. 2009).

<sup>157</sup> *Id.* at 15.

<sup>158</sup> *Id.* at 4, 15.

Court concluded that the majority shareholders “will not operate[] the company in the best interest of all the shareholders[,]” reversed the above transactions, and then ordered that the company dissolve.<sup>159</sup>

### Duty not to Engage in Ultra Vires Acts

This section relates to actions that are ultra vires in nature. Ultra vires actions exist when a corporation has its scope of authority limited by its articles of incorporation or its bylaws, and then the corporation acts beyond that limited scope of authority.<sup>160</sup> However, neither the articles of incorporation<sup>161</sup> nor the bylaws<sup>162</sup> necessarily have to limit the corporation’s purpose. If they do not limit that purpose, then the corporation will be able to engage in any legal purpose,<sup>163</sup> and, by definition, cannot engage in ultra vires acts.

The North Carolina statutes allow a shareholder to bring an individual action or claim against the corporation to challenge the power of the corporation to act.<sup>164</sup> Two North Carolina cases have stated that “[i]t is well established that courts of equity will entertain jurisdiction, at the instance of minority stockholders of a private corporation who are unable to obtain redress within the corporation and have no adequate remedy at law, to restrain threatened ultra vires acts on the part of the majority[.]”<sup>165</sup> As a result of that shareholder proceeding “to enjoin an unauthorized corporate act, the court may enjoin or set aside the act, if equitable and if all affected persons are parties to the proceeding, and may award damages for loss (other than anticipated profits) suffered by the corporation or another party because of enjoining the unauthorized act.”<sup>166</sup> Despite the courts stating that this action may be brought by the minority shareholders to “restrain ultra vires acts on the part of the majority[.]”<sup>167</sup> the North Carolina statutes appear to offer a finite list of combinations of plaintiffs and defendants when seeking to address ultra vires acts, and that finite list appears to require that the minority shareholder bring either (1) an individual action against the company itself, and not against the majority shareholders, or (2) a derivative action on behalf of the corporation and against, among others, “agents of the corporation[.]”<sup>168</sup> Presumably, those “agents of the corporation” could include the

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<sup>159</sup> *Id.* at 16-17.

<sup>160</sup> See BLACK’S LAW DICTIONARY 1559 (8th ed. 2004).

<sup>161</sup> See N.C. Gen. Stat. § 55-2-02(b)(2) (2008) (noting that “[t]he articles of incorporation *may* set forth . . . the purpose or purposes for which the corporation is organized” (emphasis added)).

<sup>162</sup> See N.C. Gen. Stat. § 55-2-06(b) (noting that “[t]he bylaws of a corporation may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with the law or the articles of incorporation”).

<sup>163</sup> N.C. Gen. Stat. § 55-3-01(a) (“[e]very corporation incorporated under [the North Carolina Business Corporation Act] has the purpose of engaging in any lawful business unless a more limited purpose is set forth in its articles of incorporation”).

<sup>164</sup> N.C. Gen. Stat. § 55-3-04(b)(1) (“[a] corporation’s power to act may be challenged . . . [i]n a proceeding by a shareholder against a corporation”); *Norman v. Nash Johnson & Sons’ Farms, Inc.*, 140 N.C. App. 390, 397, 537 S.E.2d 248, 254 (2000) (“a shareholder may bring an individual claim . . . to enjoin an ultra vires act by the corporation”).

<sup>165</sup> See *Hill v. Erwin Mills, Inc.*, 239 N.C. 437, 443, 80 S.E.2d 358, 362-63 (1954) (quoting, in dicta, 13 AM. JUR., *Corporations* § 423, page 475, *et seq.*); *Gaines v. Long Mfg. Co.*, 234 N.C. 340, 67 S.E.2d 350 (1951) (citing, in dicta, 13 AM. JUR. *Corporations* §§ 422-23, pp. 474-76); see also N.C. Gen. Stat. § 55-3-04(b)(1).

<sup>166</sup> See N.C. Gen. Stat. § 55-3-04(c).

<sup>167</sup> See sources cited *supra* note 165.

<sup>168</sup> See N.C. Gen. Stat. § 55-3-04(a)-(b), which states that

majority shareholders. However, the minority shareholder should not be able to bring a successful action to enjoin an ultra vires act if the shareholder acquiesces in that act.<sup>169</sup>

The above-mentioned statutory authority to enjoin ultra vires act does not extend to breaches of fiduciary duties, such as when a majority shareholder unfairly profits from the misuse of corporate assets.<sup>170</sup> Where an officer, director, or majority shareholder breaches his fiduciary duty, his act, when considered as an act of the corporation, may be within the corporation's powers.<sup>171</sup> If that is the case, the act cannot be attacked on the basis of it being an ultra vires act but can be attacked because of the breach of fiduciary duty.<sup>172</sup> Similarly, an *illegal* corporate act cannot be set aside by virtue of it being an ultra vires act; instead, the ability to void or rescind that illegal act “depends on the applicable statute or substantive law and is not affected by” the statutory provision enabling the courts to challenge an ultra vires act.<sup>173</sup>

### Duty to Share Data with the Minority Shareholder

A corporation must allow a shareholder who has owned his stock for at least the preceding six months or who owns at least five percent of the corporation's outstanding stock<sup>174</sup> to inspect and copy certain corporate records, but the corporation may require that the shareholder bear the labor and material costs of copying those records.<sup>175</sup> Additionally, the North Carolina General Statutes provide certain procedural requirements related to when and how a shareholder can access this information.<sup>176</sup> Assuming those procedural requirements are met, the shareholder may inspect and copy, except to the extent that the ability to copy the data is limited, as discussed below, the following data:

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- (a) Except as provided in subsection (b), the validity of corporate action may *not* be challenged . . .  
(b) A corporation's power to act may be challenged: (1) *In a proceeding by a shareholder against the corporation* . . . ; (2) *In a proceeding by the corporation, directly, derivatively, or through a receiver, trustee, or other legal representative, against an incumbent or former director, officer, employee, or agent of the corporation*; or (3) *In a proceeding by the Attorney General*[.]

(emphasis added).

<sup>169</sup> See *Hill v. Atlantic & N. C. R. Co.*, 143 N.C. 539, \_\_\_, 55 S.E. 854, 861 (1906) (stating that “if [a shareholder] has stood by until the transaction to which he objects has become executed, he will not afterwards be heard to complain”); *Spencer v. Seaboard Air Line Ry. Co.*, 137 N.C. 107, \_\_\_, 49 S.E. 96, 104 (1904) (stating that “[s]hareholders cannot lie by, sanctioning, or by their silence at least acquiescing in, an arrangement which is ultra vires of the company to which they belong, watching the result; if it be favorable and profitable to themselves, abide by it and insist on its validity, but, if it prove unfavorable and disastrous, then to institute proceedings to set it aside”).

<sup>170</sup> N.C. Gen. Stat. § 55-3-04 (Official Comment).

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> N.C. Gen. Stat. § 55-16-02. The rights of a shareholder to access information also extends to the shareholder's agent and attorney. N.C. Gen. Stat. § 55-16-03. For information relating to the rights of a member of a North Carolina limited liability company to access data from that limited liability company, see N.C. Gen. Stat. § 57C-3-04.

<sup>175</sup> N.C. Gen. Stat. § 55-16-03(c).

<sup>176</sup> N.C. Gen. Stat. §§ 55-7-20, 55-16-02.

1. Shareholder lists, provided that such lists are inspected between the period that begins two business days after sending notice for a shareholders' meeting and ends after that meeting; however, these shareholder lists (1) may be inspected by a shareholder irrespective of whether the shareholder has owned his stock for at least the preceding six months or owns at least five percent of the corporation's outstanding stock, and (2) may not be copied by the inspecting shareholder unless such copies are sought for a proper purpose, as discussed below<sup>177,178</sup>;
2. The corporation's current articles of incorporation, as amended and restated;<sup>179</sup>
3. The corporation's current bylaws, as amended and restated;<sup>180</sup>
4. Resolutions of the board of directors relating to the creation, rights, and issuance of one or more classes of stock and whether shares of those classes of stock are outstanding;<sup>181</sup>
5. "The minutes of all shareholders' meetings, and records of all action taken by shareholders without a meeting, for the past three years;"<sup>182</sup>
6. "All written communications to shareholders generally within the past three years;"<sup>183</sup>
7. Annual financial statements for the past three years, to include a balance sheet, an income statement, and data from a statement of cash flows, which financial statements may be consolidated with financial statements of the corporation's subsidiaries;<sup>184</sup>
8. The "names and business addresses of [the corporation's] current directors and officers;"<sup>185</sup> and
9. The corporations "most recent annual report[.]"<sup>186</sup>

A shareholder may bring an action against the corporation, and, perhaps, against a majority shareholder,<sup>187</sup> to compel the corporation to give the shareholder access to and the right to copy (but for the above-mentioned limitation on copying shareholder lists<sup>188</sup>) the above records.<sup>189</sup>

A shareholder may also access and copy certain information if this information is sought for a proper purpose,<sup>190</sup> which proper purpose is discussed below,<sup>191</sup> but the corporation may

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<sup>177</sup> See *infra* text accompanying note 196.

<sup>178</sup> See N.C. Gen. Stat. §§ 55-7-20, 55-16-02(c).

<sup>179</sup> N.C. Gen. Stat. §§ 55-16-01(e)(1), 55-16-02.

<sup>180</sup> N.C. Gen. Stat. §§ 55-16-01(e)(2), 55-16-02.

<sup>181</sup> N.C. Gen. Stat. §§ 55-16-01(e)(3), 55-16-02.

<sup>182</sup> N.C. Gen. Stat. §§ 55-16-01(e)(4), 55-16-02.

<sup>183</sup> N.C. Gen. Stat. §§ 55-16-01(e)(5), 55-16-02.

<sup>184</sup> N.C. Gen. Stat. §§ 55-16-01(e)(5), 55-16-02, 55-16-20.

<sup>185</sup> N.C. Gen. Stat. §§ 55-16-01(e)(6), 55-16-02.

<sup>186</sup> N.C. Gen. Stat. §§ 55-16-01(e)(7), 55-16-02.

<sup>187</sup> See *Morgan v. McLeod*, 40 N.C. App. 467, 253 S.E.2d 339 (1979) (where a minority shareholder, under an earlier version of the North Carolina General Statutes, brought an action against the *majority shareholder*, officers and directors who did not own stock, and the corporation to compel the provision of data to which the shareholder had a right without regard to whether he had a proper purpose for seeking that data).

<sup>188</sup> See *supra* text accompanying note 178.

<sup>189</sup> *Norman v. Nash Johnson & Sons' Farms, Inc.*, 140 N.C. App. 390, 397, 537 S.E.2d 248, 254 (2000) ("a shareholder may bring an individual claim . . . to enforce his right to inspect the corporate books and records" (quoting ROBINSON, *supra* note 1, at § 17.02[2])).

<sup>190</sup> N.C. Gen. Stat. §§ 55-7-20, 55-16-02(b)-(c).

<sup>191</sup> See *infra* notes 201-207 and accompanying text.

require that the shareholder bear the labor and material costs of copying these records.<sup>192</sup> Additionally, the North Carolina General Statutes provide certain procedural requirements related to when and how a shareholder can access this information.<sup>193</sup> This information includes:<sup>194</sup>

1. Shareholder lists, except that these lists may be inspected, but not necessarily copied, in connection with a shareholders' meeting even without the inspecting shareholder showing that he has a proper purpose for such inspection, as described above<sup>195, 196</sup>;
2. "Records of any final action taken with or without a meeting by the board of directors, or by a committee of the board of directors while acting in place of the board of directors on behalf of the corporation[.]"<sup>197</sup>
3. "[M]inutes of any meeting of the shareholders and records of action taken by the shareholders without a meeting, to the extent not subject to inspection" as a matter of right (i.e., without regard to whether it is sought for a proper purpose), as discussed above<sup>198, 199</sup>;
4. "Accounting records of the corporation[.]"<sup>200</sup>

A shareholder may access the above data "only if: (1) [h]is demand is made in good faith and for a proper purpose; (2) [h]e describes with reasonable particularity<sup>201</sup> his purpose and the records he desires to inspect; and (3) [t]he records are directly connected with his purpose."<sup>202</sup> A proper purpose exists when the records are sought for a purpose that is "germane to [the shareholder's] status as a shareholder[.]"<sup>203</sup> which has been deemed to include a "good faith desire to (1) determine the value of his stock; (2) investigate the conduct of the management; and (3) determine the financial condition of the corporation."<sup>204</sup> If the shareholder's written demand for this information implies such a proper purpose, then the corporation, if it wishes to not supply the information, has the burden of showing that the purpose is improper.<sup>205</sup> Such an improper purpose can be found when facts show and that the data is sought for a purpose that is "hostile to the corporation or the other stockholders . . . , or is to advance a speculative purpose, or some other improper purpose of plaintiff."<sup>206</sup> An improper purpose would include, for example, a bank shareholder seeking records to determine "the amounts on deposit in the names of the officers, directors, and employees of the [b]ank."<sup>207</sup>

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<sup>192</sup> N.C. Gen. Stat. § 55-16-03(c).

<sup>193</sup> N.C. Gen. Stat. §§ 55-7-20, 55-16-02.

<sup>194</sup> There are some limits on this provision of this data by public corporations. N.C. Gen. Stat. § 55-16-02(b).

<sup>195</sup> See *supra* text accompanying note 178.

<sup>196</sup> N.C. Gen. Stat. §§ 55-7-20, 55-16-02(c).

<sup>197</sup> N.C. Gen. Stat. § 55-16-02(b).

<sup>198</sup> See *supra* text accompanying note 182.

<sup>199</sup> N.C. Gen. Stat. § 55-16-02(b).

<sup>200</sup> *Id.*

<sup>201</sup> For a discussion of the reasonable particularity requirement, see *Parsons v. Jefferson-Pilot Corp.*, 333 N.C. 420, 429, 426 S.E.2d 685, 691 (1993).

<sup>202</sup> N.C. Gen. Stat. § 55-16-02(c).

<sup>203</sup> *Cooke v. Outland*, 265 N.C. 601, 615, 144 S.E.2d 835, 845 (1965).

<sup>204</sup> *Carter v. Wilson Const. Co., Inc.*, 83 N.C. App. 61, 65, 348 S.E.2d 830, 832 (1986).

<sup>205</sup> *Cooke*, 265 N.C. at 615, 144 S.E.2d at 845.

<sup>206</sup> *Id.*

<sup>207</sup> *Id.*

Thus, a minority shareholder is entitled by statute<sup>208</sup> to obtain certain data from the corporation. If access to that data is denied, the minority shareholder may request that the court compel the corporation to provide that access. Production of that data will generally be required unless it is data that may only be accessed for a proper purpose and either the request for the data appears to be for an improper purpose or the company can show that an improper purpose exists. Upon the shareholder winning an action to compel the production of records, the court “shall also order the corporation to pay the shareholder’s costs (including reasonable attorneys’ fees) . . . unless the corporation proves that it refused inspection in good faith because it had a reasonable basis for doubt about the right of the shareholder to inspect the records demanded.”<sup>209</sup> Finally, the court can restrict the shareholder’s use and distribution of the records.<sup>210</sup>

## Duty to Pay Dividends or Amounts Owed

### Duty to Pay Dividends once Declared.

A shareholder may bring an individual action against the corporation and/or the directors of the corporation to “recover a dividend already declared.”<sup>211</sup> “A cash or property dividend becomes a debt of the corporation as of the declaration date, and it can thereafter be recovered when due (i.e., the payment date<sup>[212]</sup>) by the shareholder entitled thereto[.]”<sup>213</sup> Thus, once a dividend has been declared, the shareholder has a property right in that dividend and may bring action to compel the payment of that dividend. Such an action must be brought within six years after the declaration of the dividend.<sup>214</sup> However, a distribution or dividend to a shareholder may not be made if, after that distribution or dividend, the corporation would not be able to pay its debts as they become due or if corporation’s liabilities would exceed its assets.<sup>215</sup>

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<sup>208</sup> ROBINSON, *supra* note 1, at § 10.04 suggests that certain common law rights of inspection that existed prior to the creation of the above-mentioned statutory rights of inspection might still exist in addition to the statutory rights of inspection.

<sup>209</sup> N.C. Gen. Stat. § 55-16-04(c) (2008).

<sup>210</sup> N.C. Gen. Stat. § 55-16-04(d).

<sup>211</sup> *Norman v. Nash Johnson & Sons’ Farms, Inc.*, 140 N.C. App. 390, 397, 537 S.E.2d 248, 254 (2000) (“a shareholder may bring an individual claim . . . to recover a dividend already declared” (quoting ROBINSON, *supra* note 1, at § 17.02[2])); N.C. Gen. Stat. § 55-6-40(h), (k).

<sup>212</sup> Initial inquiries have not found any rules under North Carolina law with respect to when a dividend payment should occur following a declaration of dividends.

<sup>213</sup> ROBINSON, *supra* note 1, at §§ 22.08, 17.02[2]; *Patterson v. Durham Hosiery Mills*, 214 N.C. 806, \_\_\_, 200 S.E. 906, 908-09 (1939) (stating (1) “[d]ividends on common stock are not segregated from the assets of the corporation, so as to become the property of the stockholder, or a debt recoverable by action at law, until declared” and (2) “the preferred stockholder is not a creditor of the corporation until the dividend is declared”); *Trs. of Univ. v. North Carolina R.R. Co.*, 76 N.C. 103, 106, 1877 WL 2652, 2 (1877) (stating that “[a] dividend declared by and due from a private corporation is a debt due to the shareholder and is recoverable as such”).

<sup>214</sup> N.C. Gen. Stat. § 55-1-50(a)(4).

<sup>215</sup> N.C. Gen. Stat. §§ 55-6-40 (placing restrictions on when dividends can be paid), 55-8-33 (holding directors personally liable if they approve dividends in violation of statutory restrictions on dividend payments).

### Duty to Pay Dividends from Available Surplus.

A shareholder may bring an individual action against the corporation and/or the directors of the corporation to compel the payment of dividends.<sup>216</sup> This duty for the corporation to pay dividends can arise after the corporation has accumulated profits and the shareholder has demanded the payment of dividends.<sup>217</sup> Thus, the shareholder who seeks dividends has the burden of showing that: (1) as of the time of the lawsuit, “the corporation ha[d] surplus or net profits available for the payment of the dividend[;]”<sup>218</sup> and (2) that he has taken reasonable action within the corporation to compel the corporation to pay dividends and the corporation has refused to do so,<sup>219</sup> or that “such efforts would be fruitless.”<sup>220</sup> However, the existence of accumulated profits alone might not be a sufficient basis to compel the payment of dividends when the corporation has a legitimate need to use those funds to finance its future operations.<sup>221</sup> If dividends are awarded by the court, it “shall be a debt of the corporation” and the shareholder who brought suit can recover reasonable expenses and attorneys’ fees.<sup>222</sup> Additionally, the courts might be more inclined to order the payment of dividends “in extreme cases of arbitrary, oppressive, or wrongful conduct amounting in effect to a breach of trust, even though no actual fraud is shown.”<sup>223</sup>

### Duty to Pay Other Amounts.

A shareholder may bring an individual action against the corporation to recover other amounts owed to the shareholder apart from dividends.<sup>224</sup> For instance, in *Way v. Carteret Ice*

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<sup>216</sup> N.C. Gen. Stat. § 55-6-40(h), (k); *Norman*, 140 N.C. App. at 397, 537 S.E.2d at 254 (“a shareholder may bring an individual claim . . . to compel the declaration of dividends” (quoting ROBINSON, *supra* note 1, at § 17.02[2])); *see also* 18A AM. JUR. 2D *Corporations* § 648 (2009) (citing cases from jurisdictions outside of North Carolina for the prospect that nonpayment of dividends could be a breach of the majority shareholder’s fiduciary duty if done “for no apparent reason except to ‘freeze out’ minority shareholders”). *See generally* 18B AM. JUR. 2D *Corporations* § 1120.

<sup>217</sup> *See Steele v. Locke Cotton Mills Co.*, 231 N.C. 636, 639, 641, 58 S.E.2d 620, 623-24 (1950).

<sup>218</sup> *Steele*, 231 N.C. 636, 58 S.E.2d 620.

<sup>219</sup> *Winstead v. Hearne Bros. & Co.*, 92 S.E. 613, 616 (1917) (stating that “[a]n action to compel the declaration of a dividend cannot be maintained, where the stockholder has not applied to the directors, and he must allege that the directors refused to entertain such application”).

<sup>220</sup> *See Alford v. Shaw*, 318 N.C. 289, 297, 349 S.E.2d 41, 46 (1986) (noting that “where demand would be futile, as where corporate management is under control of the alleged guilty parties, . . . demand is excused”); ROBINSON, *supra* note 1, at § 22.06, p. 22-19. *But see Norman*, 140 N.C. App. at 411, 537 S.E.2d at 262-63 (noting that under revised N.C. Gen. Stat. § 55-7-42 demand must still be made prior to instituting a *derivative* action because the statute clearly requires such demand and makes no provision for not making such demand when such demand would be futile).

<sup>221</sup> *See Isley v. W. F. Isley & Co., Inc.*, 248 N.C. 417, 419, 103 S.E.2d 495, 496 (1958) (not compelling the payment of dividends where the corporate records (1) “show that the directors, at the end of each fiscal year, carefully considered the financial condition of the company and its probable fiscal needs for the coming year”; and (2) “disclose that the company’s accountant and financial counselor advised against the payment of dividends, because all of the corporation’s assets were needed to continue operations”).

<sup>222</sup> N.C. Gen. Stat. § 55-6-40(h) (2008).

<sup>223</sup> *Gaines v. Long Mfg. Co., Inc.*, 234 N.C. 331, 338, 67 S.E.2d 355, 361 (1951).

<sup>224</sup> *Norman*, 140 N.C. App. at 397, 537 S.E.2d at 254 (“a shareholder may bring an individual claim . . . to recover . . . any . . . amount actually due him from the corporation on his shares or otherwise” (quoting ROBINSON, *supra* note 1, at § 17.02[2])).

*Transp. & Storage Co.*,<sup>225</sup> the first corporation dissolved, transferred its assets to a second corporation, and the shareholders of the first corporation had the option of receiving cash or stock in the second corporation as consideration for their shares in the first corporation. Those shareholders were allowed to bring an individual action against both corporations to recover cash for their shares in the first corporation, instead of receiving stock in the second corporation.<sup>226</sup> In another example from the United States Supreme Court, *Southern Pac. Co. v. Bogart*,<sup>227</sup> the company reorganized, all the stock in the new company went to the majority shareholder, and the minority shareholder received nothing. The Supreme Court noted that if, by virtue of the majority shareholder exercising control over the corporation, “a sale of the corporate property is made and the property acquired by the majority, the minority may not be excluded from a fair participation in the fruits of the sale.”<sup>228</sup>

### Duty to Honor Shareholder Agreements

The majority shareholders and minority shareholders may enter into separate agreements, or shareholder agreements, between themselves. Those agreements are “construed like other contracts[.]”<sup>229</sup> and, to enforce a shareholder agreement, a minority shareholder who is a party to the agreement may bring an individual action against a majority shareholder who is a party to the agreement.<sup>230</sup> These agreements can take the form of agreements between the shareholders “to vote their shares so as to cause their corporation to take certain action[, and such agreements] are generally enforceable against the shareholders.”<sup>231</sup> Thus, where the majority and minority shareholder “agree that a corporation shall do a certain thing, which they can compel it to do, because they hold a majority of the stock, or otherwise, the corporation is not bound by their agreement, but they bind themselves individually[.]”<sup>232</sup> Provided, however, that such agreements will not be enforceable where they “violate the [corporate] charter or statutory provision, contemplate an illegal object, involve any fraud, oppression or wrong against other stockholders, or are made in consideration of a private benefit to the promisor.”<sup>233</sup> Additionally, such agreements might not be enforceable against the parties if the parties “expressly [agree to look] to the corporation [for relief] and not to the persons controlling the corporation.”<sup>234</sup>

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<sup>225</sup> 186 N.C. 244, 119 S.E. 232 (1923).

<sup>226</sup> *Id.*

<sup>227</sup> 250 U.S. 483, 486, 39 S. Ct. 533, 535 (1919).

<sup>228</sup> *Id.* at 488, 39 S. Ct. at 535.

<sup>229</sup> *Snyder v. Freeman*, 300 N.C. 204, 220, 266 S.E.2d 593, 603 (1980) (citation omitted).

<sup>230</sup> *Norman v. Nash Johnson & Sons' Farms, Inc.*, 140 N.C. App. 390, 397, 537 S.E.2d 248, 254 (2000) (“a shareholder may bring an individual claim . . . to enforce an agreement among shareholders” (quoting ROBINSON, *supra* note 1, at § 17.02[2])).

<sup>231</sup> *Snyder*, 300 N.C. at 222, 266 S.E.2d at 605 (citing *Wilson v. McClenny*, 262 N.C. 121, 132-34, 136 S.E.2d 569, 578 (1964)).

<sup>232</sup> *Id.* at 222-23, 266 S.E.2d at 605 (quoting *Morse v. Tillotson & Wolcott Co.*, 253 F. 340, 351 (2d Cir. 1918)).

<sup>233</sup> *Wilson v. McClenny*, 262 N.C. 121, 129, 136 S.E.2d 569, 575 (1964); *see also Snyder*, 300 N.C. at 215-16, 266 S.E.2d at 600-01; *Blount v. Taft*, 295 N.C. 472, 484, 246 S.E.2d 763, 771 (1978).

<sup>234</sup> *Snyder*, 300 N.C. at 222-23, 266 S.E.2d at 605 (quoting *Morse*, 253 F. at 351) (internal quotations and brackets omitted).

## Duties when Engaging in Insider Trading with Shareholders

There are securities laws that prohibit or limit a majority shareholder or other corporate insider from trading in securities of the company while he is in possession of material, non-public information about that company.<sup>235</sup> These laws can even give a presumption that the majority shareholder or insider was in possession of material, inside information when he traded in those securities.<sup>236</sup> However, limitations under the securities laws are beyond the scope of this paper.

Under North Carolina law, “[w]here a transferee of property stands in a confidential or fiduciary relationship to the transferor, it is the duty of the transferee . . . to disclose to the transferor all material facts relating thereto and his failure to do so constitutes fraud[,]”<sup>237</sup> unless the transferee otherwise has equal access to that information.<sup>238</sup> As discussed above,<sup>239</sup> a majority shareholder owes a fiduciary duty to a minority shareholder. Thus, when *purchasing* securities in the corporation from a minority shareholder, the majority shareholder has a duty to disclose all previously undisclosed material facts relating to the affairs of the company.<sup>240</sup> In support of this proposition, the American Jurisprudence, Second Edition, noted that

a majority stockholder may be held accountable as a fiduciary, where he or she is in active charge of corporate affairs and induces a minority stockholder to sell his or her holdings, concealing the true condition of corporate finances for the purpose of making a personal profit, or failing to reveal an offer from a prospective purchaser for the purchase of all of the stock of the corporation at a price which is higher than that offered to the minority holder.<sup>241</sup>

The above-mentioned duty of disclosure also appears to exist when the majority shareholder *sells* securities in the corporation to a minority shareholder.<sup>242</sup> This duty of the majority shareholder to disclose all material facts when he trades in securities in the corporation with a minority shareholder could possibly extend to personal information about the majority shareholder, if that personal information relates to management integrity and a reasonable

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<sup>235</sup> See ROBINSON, *supra* note 1, at § 15.04, p. 15-9; THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 530-34 (revised 5<sup>th</sup> ed. 2006).

<sup>236</sup> See HAZEN, *supra* note 235, at 577.

<sup>237</sup> *Lazenby v. Godwin*, 40 N.C. App. 487, 494-95, 253 S.E.2d 489, 493 (1979) (quoting *Link v. Link*, 278 N.C. 181, 192, 179 S.E.2d 697, 704 (1971)); see also 18B AM. JUR. 2D *Corporations* § 1577 (2009).

<sup>238</sup> See *Lazenby*, 40 N.C. App. at 495, 253 S.E.2d at 493.

<sup>239</sup> See *supra* notes 22-65 and accompanying text.

<sup>240</sup> See *Lazenby*, 40 N.C. App. at 494-95, 253 S.E.2d at 493 (quoting *Link*, 278 N.C. at 192, 179 S.E.2d at 704); 18B AM. JUR. 2D *Corporations* § 1577 (citing *Swafford v. Berry*, 152 Colo. 493, 382 P.2d 999 (1963), for the prospect that if a minority shareholder sells his shares after having been appraised of the inside information, he has “no standing to attack such transaction”).

<sup>241</sup> 18A AM. JUR. 2D *Corporations* § 669 (citing *Levy v. American Beverage Corp.*, 265 A.D. 208, 38 N.Y.S.2d 517 (1st Dep’t 1942), and *Jacobson v. Yaschik*, 249 S.C. 577, 155 S.E.2d 601 (1967)).

<sup>242</sup> See *Lazenby*, 40 N.C. App. at 493-94, 253 S.E.2d at 492; *Ragsdale v. Kennedy*, 22 N.C. App. 509, 516, 207 S.E.2d 301, 306 (1974) (considering disclosure duties as they relate to *purchases* of stock and noting that “the same reasoning applies to sales by an officer or director of his own stock in the corporation to a stockholder”), *rev’d on other grounds*, 286 N.C. 130, 209 S.E.2d 494 (1974).

investor would consider that data material when deciding to invest in the company.<sup>243</sup> This could include situations where there is a risk of a change in the management, as could be the case if the majority shareholder/manager pledges substantially all of his shares in the company as collateral for a personal loan, and a default on that loan could then lead to a change in control of the company.<sup>244</sup> This duty of disclosure could also extend to situations that call into question the integrity of the majority shareholder/manager, such as his being investigated for paying commercial kickbacks.<sup>245</sup> Additionally, even where there is no duty of disclosure, the majority shareholder may not “omit to state a material fact necessary to make the statements made, in light of the circumstances under which they are made, not misleading[.]”<sup>246</sup> Thus, if the majority shareholder “does speak [when trading in securities of the corporation,] then he must make a full and fair disclosure of the matters” about which he speaks.<sup>247</sup>

### LIMITED DUTIES OWED BY A MAJORITY SHAREHOLDER TO A MINORITY SHAREHOLDER

#### Possible Duties with Respect to Stock Purchases by the Corporation

“Cases in other states have recognized that the directors and controlling shareholders of a corporation are limited by their ordinary fiduciary obligations in having the corporation purchase its shares.<sup>[248]</sup> The North Carolina Supreme Court has at least intimated its recognition that these same equitable principles would apply to share acquisitions by North Carolina corporations.”<sup>249</sup>

When considering the above, if a majority shareholder causes the company to purchase its own stock, the majority shareholder could unfairly profit, directly or indirectly, from that transaction with the corporation if either (1) he sold his shares to the corporation at an inflated price or (2) he caused the corporation to purchase a minority shareholder’s shares at a deflated price.<sup>250</sup> As discussed above,<sup>251</sup> when a majority shareholder unfairly profits from a self-serving transaction with the corporation, he breaches the fiduciary duty he owes the minority shareholder, and the minority shareholder can obtain injunctive relief and/or damages. These

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<sup>243</sup> See HAZEN, *supra* note 235, at 147 (relating to disclosure duties when the corporation issues securities and noting “that an investor’s evaluation of management is an important part of any investment decision”).

<sup>244</sup> HAZEN, *supra* note 235, at 146-47 (citing *In the Matter of Franchard Corp.*, 42 S.E.C. 163 (S.E.C. 1964) (relating to disclosure duties when the corporation issues securities)).

<sup>245</sup> HAZEN, *supra* note 235, at 147 (citing *SEC. v. Joseph Brewing Co.*, 452 F. Supp. 824 (E.D. Wis. 1978) (relating to disclosure duties when the corporation issues securities)).

<sup>246</sup> N.C. Gen. Stat. § 78A-8 (2008); see also ROBINSON, *supra* note 1, at § 15.04, p. 15-10.

<sup>247</sup> *Freese v. Smith*, 100 N.C. App. 28, 35, 428 S.E.2d 841, 846 (1993).

<sup>248</sup> See also 18A AM. JUR. 2D *Corporations* § 369 (2009).

<sup>249</sup> ROBINSON, *supra* note 1, at § 22.03 (citing *Park Terrace, Inc. v. Burge*, 249 N.C. 308, 106 S.E.2d 478 (1959); *Pender v. Speight*, 159 N.C. 612, 75 S.E. 851 (1912)); see also ROBINSON, *supra* note 1, at § 17.02[2]; *Norman v. Nash Johnson & Sons’ Farms, Inc.*, 140 N.C. App. 390, 397, 537 S.E.2d 248, 254 (2000) (“a shareholder may bring an individual claim . . . to enforce preemptive rights, to recover for damage done directly to his ownership interest in the corporation, or to preserve the rights of his particular class of stock against a prejudicial reorganization” (quoting ROBINSON, *supra* note 1, at § 17.02[2])).

<sup>250</sup> ROBINSON, *supra* note 1, at § 22.03.

<sup>251</sup> See *supra* notes 32-69 and accompanying text.

corporate purchases could also be used to dilute the minority shareholder's ownership in the corporation.<sup>252</sup> However, when considering the sale of a minority shareholder's stock to an individual or entity other than the company, the minority shareholder may only be entitled to limited relief when forced to sell *all* of his shares for cash, as discussed below with respect to "freeze-out" mergers.<sup>253</sup>

### **Limited Duty with respect to "Freeze-Out" Mergers and Other Fundamental Transactions**

#### Freeze-Out Mergers.

A freeze-out merger occurs when the majority shareholders, or those in control of the company, use a cash purchase of all of the outstanding shares of a corporation to "freeze-out," "squeeze-out," or eliminate the minority shareholders.<sup>254</sup> For instance, the majority shareholder could, through an entity owned solely by him, offer to purchase all of the shares of the jointly owned company for cash, and then have the jointly owned company approve that purchase as required by statute.<sup>255</sup> All of the shareholders would then be compelled to sell their shares to the acquiring entity for cash, and the majority shareholder would then end up owning all of those shares indirectly by virtue of his owning all of the shares in the acquiring entity. If the minority shareholders object to the freeze-out merger, then unless they can show that merger as *unlawful or fraudulent*, their sole remedy is through a statutory process whereby they can dissent and receive "fair-value" for their shares.<sup>256</sup> The unlawful or fraudulent conduct required for the minority shareholder to have access to some remedy other than the statutory dissent process could possibly include a breach of a fiduciary duty, in which case the court could intervene in the freeze-out merger.<sup>257</sup> To secure that court intervention, the minority shareholder "must allege specific acts of fraud, misrepresentation, or other items of conduct to demonstrate the unfairness of the merger terms to the minority."<sup>258</sup> But, where the minority shareholder's complaint ultimately relates to the price he receives, particularly in those situations where those in control of the company "properly investigate the worth of the company[.]"<sup>259</sup> the minority shareholder's only remedy is to use the statutory dissent process to obtain an alternative, but not necessarily higher,<sup>260</sup> price for his stock. That price is not necessarily going to be higher, because it is based on the value of the stock prior to the impact of the proposed merger,<sup>261</sup> and (1) the prospect of

<sup>252</sup> ROBINSON, *supra* note 1, at § 22.03.

<sup>253</sup> See *infra* notes 254-266 and accompanying text.

<sup>254</sup> See *Osher v. Ridinger*, 162 N.C. App. 155, 156, 589 S.E.2d 905, 907(2004); *Oppenheimer v. Brenner Cos., Inc.*, 107 N.C. App. 16, 17-18, 416 S.E.2d 354, 355-56 (1992). See generally 19 AM. JUR. 2D *Corporations* §§ 2179, 2196 (2009).

<sup>255</sup> See *supra* notes 103-128 and accompanying text.

<sup>256</sup> N.C. Gen. Stat. § 55-13-02 (2008) (including Official Commentary § 2); *Osher*, 162 N.C. App. at 158-59, 589 S.E.2d at 908; *Werner v. Alexander*, 130 N.C. App. 435, 438, 502 S.E.2d 897, 900 (1998).

<sup>257</sup> See N.C. Gen. Stat. § 55-13-02 (Official Commentary § 2).

<sup>258</sup> *Werner*, 130 N.C. App. at 439, 502 S.E.2d at 900. But see 19 AM. JUR. 2D *Corporations* § 2196 (citing *Schulwolf v. Cerro Corp.*, 86 Misc. 2d 292, 380 N.Y.S.2d 957 (1976), for the prospect that "[t]he use of corporate funds to purchase the stock is improper only where a merger is for the sole benefit of insiders").

<sup>259</sup> *Oppenheimer v. Brenner Cos., Inc.*, 107 N.C. App. 16, 17-18, 416 S.E.2d 354, 355-56 (1992); see also *Osher v. Ridinger*, 162 N.C. App. 155, 589 S.E.2d 905 (2004) (where the majority shareholder offered a price greater than the market price for the publicly traded company).

<sup>260</sup> See N.C. Gen. Stat. § 55-13-01(3).

<sup>261</sup> See *id.*

the merger could have caused an increase in the market price of the stock, or (2) the price per share offered in the merger could have been higher than the fair value of each share, as that fair value existed before the impact of the proposed merger.

Illustrative North Carolina cases follow. In *Osher v. Ridinger*,<sup>262</sup> the minority shareholder asserted that the majority shareholders, as directors, breached their fiduciary duties when approving a freeze-out merger because they (1) engaged in unfair dealing and unlawful coercion and (2) approved an unfair purchase price for the outstanding shares.<sup>263</sup> In *Werner v. Alexander*,<sup>264</sup> the minority shareholder asserted that the majority shareholders, prior to the freeze-out merger, engaged in intentional acts to reduce the value of the minority's shares and thus reduce the price per share that the majority shareholders would have to pay in the freeze-out merger.<sup>265</sup> In both of those cases, the minority shareholders failed to allege sufficient facts to support claims of unlawful or fraudulent conduct, thus the courts deemed the complaints to ultimately be about price, and the minority shareholders were left with the statutory right of dissent as their sole remedy.<sup>266</sup>

#### Other Fundamental Transactions.

The statutory dissent process whereby a shareholder can dissent and receive the fair-value for his shares, as discussed above,<sup>267</sup> applies not just to freeze-out mergers but to some other fundamental transactions, including certain: other types of mergers for cash or other property; sales of substantially all of the assets of the company other than during the normal course of business, including sales in dissolution of the company; compulsory share exchanges; and fundamental amendments to the articles of incorporation.<sup>268</sup> As discussed above,<sup>269</sup> where the shareholder is entitled to use the statutory dissent process to “obtain payment for his shares [he] . . . may not challenge the corporate action . . . unless the action is *unlawful or fraudulent* with respect to the shareholder or the corporation.”<sup>270</sup> Also as noted above,<sup>271</sup> a breach of a fiduciary duty could be sufficient grounds to meet the unlawful or fraudulent requirement and enable the shareholder to obtain relief other than that offered through the statutory dissent process. Thus, if the majority shareholder violates the fiduciary duty he owes the minority shareholder by either obtaining an unfair profit<sup>272</sup> or by failing to adhere to the requisite statutory process to approve the fundamental transaction,<sup>273</sup> then the minority shareholder might have sufficient grounds to

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<sup>262</sup> 162 N.C. App. 155, 589 S.E.2d 905 (2004).

<sup>263</sup> *Id.* at 158, 589 S.E.2d at 908.

<sup>264</sup> 130 N.C. App. 435, 502 S.E.2d 900 (1998).

<sup>265</sup> *Id.* at 438, 502 S.E.2d at 900.

<sup>266</sup> *Id.* at 438-41, 502 S.E.2d at 900-02; *see Osher*, 162 N.C. App. at 157-59, 589 S.E.2d at 907-08; *see also Oppenheimer v. Brenner Cos., Inc.*, 107 N.C. App. 16, 21, 416 S.E.2d 354, 358 (1992).

<sup>267</sup> *See supra* notes 254-266 and accompanying text.

<sup>268</sup> *See* N.C. Gen. Stat. § 55-13-02(a)-(b) (2008).

<sup>269</sup> *See supra* notes 254-266 and accompanying text.

<sup>270</sup> N.C. Gen. Stat. § 55-13-02(a)-(b) (emphasis added); *see also* cases cited *supra* note 256.

<sup>271</sup> *See supra* notes 254-266 and accompanying text.

<sup>272</sup> *See supra* notes 32-69 and accompanying text.

<sup>273</sup> *See supra* notes 103-128 and accompanying text.

seek some other form of court-ordered relief, such as having the transaction set aside and/or being awarded damages.<sup>274</sup>

### **No Duty to Maximize Sale Price for Minority when Selling Control**

Under the precedent established by *Revlon* and *Paramount*,<sup>275</sup> when the board of directors of a corporation puts the entire corporation up for sale, the board has the duty to seek the highest price for the shares of the corporation.<sup>276</sup> That will then maximize the value that the minority shareholders receive for their shares, since they would necessarily participate in the sale. However, this duty to seek the highest price for the shares of the corporation and for the benefit of all shareholders does not normally extend to majority shareholders.<sup>277</sup> A majority shareholder has “right to sell her stock to the purchaser of her choice free from any obligation to obtain the highest price for the minority shareholders in doing so.”<sup>278</sup> Thus, the “majority owner is free to consider factors other than the highest price for the minority shareholders.”<sup>279</sup> This ability to consider factors other than price “is particularly true where . . . an ongoing business relationship is contemplated between the buyer and seller.”<sup>280</sup>

*Smith v. North Carolina Motor Speedway, Inc.*<sup>281</sup> provides an illustrative example. In that case, the company (“NCMS”) received offers from two separate suitors, “PMI” and “SMI,” for the purchase of NCMS and the subsequent merger of NCMS into the winning suitor. The NCMS board of directors voted to only submit the PMI proposal, which offered the higher price per share, to the NCMS shareholders for their consideration and approval. Meanwhile, the majority shareholder for NCMS entered into an agreement to sell her shares to the other suitor, SMI, for reasons other than maximizing the price per share. A minority shareholder asked the court to enjoin and rescind the majority shareholder’s agreement to sell her shares to SMI. The court stated that the majority shareholder did not have a duty to “obtain the highest price for the minority shareholders” when she sold her controlling block of stock.<sup>282</sup> Further, the court held that the purchasing entity, as the new majority shareholder, had no duty to “‘auction’ the company before [recommending its own merger proposal and] purchasing the stock of the remaining minority shareholders” at its own, lower offering price.<sup>283</sup>

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<sup>274</sup> See *supra* notes 44-48 and accompanying text.

<sup>275</sup> *Revlon v. McAndrews & Forbes Holdings, Inc.* 506 A.2d 173 (Del. 1986); *Paramount Commc’ns, Inc. v. QVC Network, Inc.*, 537 A.2d 34 (Del. 1994)

<sup>276</sup> *Smith v. North Carolina Motor Speedway, Inc.*, 1997 WL 33463603, 5 (N.C. Super. 1997).

<sup>277</sup> See 18A AM. JUR. 2D *Corporations* § 668 (2009) for instances, at least in jurisdictions outside of North Carolina, where the majority shareholder might be under a fiduciary duty when selling his stock, such as when the majority shareholder negotiates not only the sale of his stock but also the sale of the minority shareholder’s stock.

<sup>278</sup> *Speedway*, 1997 WL 33463603 at 5 (citing *Bershad v. Curtiss-Wright Corp.*, 535 A.2d 840, 845 (Del. 1987); *Swinney v. Keebler Co.*, 480 F.2d 573, 577 (4th Cir. 1973)).

<sup>279</sup> *Speedway*, 1997 WL 33463603 at 5.

<sup>280</sup> *Id.*

<sup>281</sup> 1997 WL 33463603 (N.C. Super. 1997).

<sup>282</sup> *Id.* at 12.

<sup>283</sup> *Id.* at 11-12; see also 18A AM. JUR. 2D *Corporations* § 649 (2009) (“a fiduciary duty does not exist between the purchaser of a control block of stock and the minority shareholders of the corporation”).

## THE BUSINESS JUDGMENT RULE

The business judgment rule protects the *officers and directors* of a corporation from liability when their corporate decisions are made in “good faith . . . and with loyalty and due care[.]”<sup>284</sup> which includes being adequately informed when making such decisions.<sup>285</sup> Thus, as long as directors and officers do not violate their fiduciary duties of good faith, due care, and loyalty, they will “not be held liable for any action taken” or not taken in the performance of their duties.<sup>286</sup> North Carolina has not extended the business judgment rule to protect majority shareholders from liability that might arise from actions that they take when they control the corporation.<sup>287</sup> Where the majority shareholder also serves as a director or officer, he continues to be liable in his separate capacity as a majority shareholder.<sup>288</sup> Thus, majority shareholders, because they are not protected by the business judgment rule, could potentially be held to “a greater range of duties [or liabilities] than directors”<sup>289</sup> and officers. However, where liability arises because of a breach of the fiduciary duties of good faith<sup>290</sup> or loyalty,<sup>291</sup> the courts should not subject the majority shareholder to a greater range of duties or liabilities, for if a director or an officer violated his duties of good faith and loyalty, the director or officer would not be protected by the business judgment rule.<sup>292</sup> An example of such a violation would be where the director, officer, or majority shareholder unfairly profited from a self-serving transaction that he entered into with the corporation. Thus, to the extent that the majority shareholder might be obligated by a greater range of duties and liabilities than are the directors and officers, and that greater range of duties and liabilities arises because the majority shareholder does not enjoy the protections of the business judgment rule while the directors and officers do, that greater range of duties and liabilities would have to arise from duties other than the duties of good faith and loyalty.

## SUMMARY

A minority shareholder generally owes no duty either to the corporation or to the other shareholders. Two shareholders, each owning fifty percent of the corporation, generally owe no duty to each other as a result of their ownership in the corporation. But an owner or group of owners who control an entity owe a host of duties to the other owners. Within the context of a corporation, these controlling owners are typically the majority shareholders and are referred to as such in this paper. To the extent these duties are fiduciary duties, when they are violated and

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<sup>284</sup> *Alford v. Shaw*, 318 N.C. 289, 299, 349 S.E.2d 41, 47-48 (1986); N.C. Gen. Stat. §§ 55-8-30, 55-8-42 (2008).

<sup>285</sup> *Hammonds v. Lumbee River Elec. Membership Corp.*, 178 N.C. App. 1, 20, 631 S.E.2d 1, 13 (2006) (citation omitted).

<sup>286</sup> See N.C. Gen. Stat. §§ 55-8-30, 55-8-42. See generally ROBINSON, *supra* note 1, at § 14.04.

<sup>287</sup> See N.C. Gen. Stat. §§ 55-8-30, 55-8-42; ROBINSON, *supra* note 1, at § 14.04[1] n.5.1.

<sup>288</sup> See *supra* sources cited in note 83.

<sup>289</sup> See ROBINSON, *supra* note 1, at § 14.04[1] n.5.1.

<sup>290</sup> See *supra* notes 32-69 and accompanying text.

<sup>291</sup> See *supra* notes 70-102 and accompanying text.

<sup>292</sup> See N.C. Gen. Stat. §§ 55-8-30(a)-(d), 55-8-42(a)-(d) (2008); *Vernon v. Cuomo*, 2009 WL 690242, 14 (N.C. Super. 2009) (holding that directors were not entitled to the benefit of the business judgment rule after they engaged in a transaction that was “not fair to the corporation” and in which they “clearly received a personal financial benefit from the transactions they [alone] approved”).

owed directly to the minority shareholder, the minority shareholder may bring both an individual action against the majority shareholder and a derivative action on behalf of the corporation. Being able to bring the individual action, instead of just a derivative one, eliminates statutory requirements that can burden and undermine the action and any related award.

The majority shareholder owes the minority shareholder a fiduciary duty of good faith. This duty prevents the majority shareholder from engaging in transactions with the corporation that are not done in good faith and that are not entirely fair to the corporation. The general measure of whether a transaction is entirely fair is whether the corporation would enter into the transaction if it were an arms length transaction. Thus, this duty prohibits the majority shareholder from earning an unfair profit at the expense of the corporation.

In most instances, the majority shareholder effectively, but not expressly, owes a fiduciary duty of loyalty to the minority shareholders. This duty of loyalty prohibits the person bound by that duty from (1) entering into an unapproved transaction with the corporation and unfairly profiting, at the corporation's expense, from that transaction, (2) usurping an opportunity that rightfully belongs to the corporation and profiting, at the corporation's expense, from that usurped opportunity, and (3) competing with the corporation and profiting, at the corporation's expense, from that competition.

The majority shareholder who controls the corporation has a duty not to circumvent the statutory requirements that allow the minority shareholders to participate in the process by which the corporation approves certain fundamental transactions, such as some mergers, share exchanges, transfers of substantially all of the assets of the company other than in the normal course of business, fundamental changes to the articles of incorporation, and dissolutions.

The majority shareholders owe a duty to the minority shareholders not to frustrate the minority shareholder's known, substantial, and reasonable expectations. To enforce this right, the minority shareholder must bring an action to have the corporation dissolved or for the court to grant such other relief as it deems appropriate. The court will then balance the rights of all the shareholders when considering this complaint. This is a potentially extreme remedy, because it involves a request to dissolve the corporation. This also might be an unpredictable remedy, because the interests of non-party shareholders may be considered and because the court has the discretion to grant forms of relief that might differ substantially from that which was anticipated or requested.

When the "scope of authority," or the type of business, that a corporation may engage in is limited by the corporation's articles of incorporation or bylaws, the corporation may not then act beyond that limited scope of authority. If it does, the minority shareholder may bring an individual action against the corporation or a derivative action on behalf of the corporation to enjoin those unauthorized corporate activities.

The corporation, and indirectly the majority shareholder in control of the corporation, must allow shareholders who have owned their stock for at least the preceding six months or who own at least five percent of the shares of the corporation to access and to copy certain statutorily specified data. Some of that data is accessible as a matter of right, and some of that data is only

accessible if the requesting shareholder seeks it for a purpose related to his being a shareholder, such as valuing his stock or investigating the conduct of management.

A minority shareholder may force the corporation to pay dividends that have been declared or to pay yet undeclared dividends from the corporation's available cash surplus. However, this obligation to pay dividends may be limited by the corporation's financial condition or financial needs.

Where a majority shareholder and minority shareholder enter into a separate shareholder agreement, by which they agree to vote their shares in a certain way, the minority shareholder may bring an action against the majority shareholder to enforce that agreement, provided that they are both parties to that agreement.

When a majority shareholder sells securities in the corporation to a minority shareholder or buys securities in the corporation from the minority shareholder, the majority shareholder has an obligation to first divulge material inside information to the minority shareholder if the minority shareholder does not otherwise have equal access to that information. This could possibly extend to personal information about the majority shareholder, if such information would be material when a person is considering whether to invest in the corporation.

A majority shareholder can, if he follows the proper statutory approval process, force all the shareholders of the corporation to sell their shares for cash to some other person or entity, which could be an entity wholly owned by the majority shareholder. If this occurs, and if there is no fraud or illegal conduct associated with the transaction, then the only remedy available to the minority shareholder is to obtain the fair value for his shares. That is also the sole remedy available to the minority shareholder if he is excluded from participation in the corporation by virtue of certain types of mergers, share exchanges, sales of substantially all of the assets of the company other than in the course of business as usual, or dissolutions; provided, however, the majority shareholder must follow the statutory approval process for that transaction and must not engage in fraud or illegal conduct.

Finally, the majority shareholder may sell his shares in the corporation without regard to whether that sale enables the minority shareholder to maximize the value that he, the minority shareholder, receives when he sells his own shares in the corporation.