

# advisory

## MINORITY SHAREHOLDERS' RISKS AND RIGHTS IN A COMPANY SALE

Minority shareholders of a business face unique challenges. Unlike majority owners, a person or entity that owns less than 51% of a company's shares lacks the voting power to directly influence the company's direction, giving them limited control over business decisions. This is why it is critical for minority shareholders to understand their risks, and their rights.

Here's a scenario: The minority shareholders of a company owned by an investment banking firm ("Owner") have been informed that the company is about to be sold, and a new fund is being formed to acquire the Owner, which may include members (shareholders) of the initial fund. How are the interests of the minority shareholders being protected in this transaction?

### Minority Shareholders: Rights to Information

Majority shareholders owe a fiduciary duty to the minority to provide financial information and processes.

Information is power. Therefore, the following are key questions that should be addressed and answered:

### Valuation

In the scenario above, it will be important to understand the Owner's strategic rationale for selling the company to another fund managed directly or indirectly by the same hedge fund vs. selling on the open market, even though the latter would likely bring a higher purchase price and more value to the minority interests.

- *What metrics were used, and factors considered, to arrive at a fair market valuation of the company?*
- *How did the Owner determine the value of the minority's interest?*
- *Did the Owner solicit outside buyers to compare the valuation determined internally?*
- *How does the Owner's valuation compare to any alternative bids from the open market?*



## Disclosure & Transparency

Another crucial aspect of protecting minority shareholders lies in the disclosure requirements mandated by law. Transparency is vital in enabling minority shareholders to make informed decisions.

- *What are the payment terms, timelines, closing conditions?*
- *How will the proceeds from the sale be distributed among the shareholders?*
- *Were there any potential conflicts of interest relating to the transaction that were disclosed and vetted?*
- *What regulatory approvals are required for the transaction to close?*
- *What assurances have been made that the transaction meets fairness and ethical standards?*
- *Is there a mechanism for expressing dissent to the price or structure of the transaction?*

## Exit Strategy

Majority shareholders can legally force minority shareholders to sell stock under “drag-along” clauses, buyout provisions, and court orders. Under the drag-along clause, minority shareholders must sell 100% of their stock when the majority shareholder decides to sell the company. To protect the minority’s rights and interests, they should push for some ability to exit the business and to control circumstances in which their equity is sold. “Tag-along” clauses give the minority the right to sell their shares/interest in the business on the same terms as the majority. It is important for the minority shareholder to ask:

- *Will there be an opportunity for the minority shareholders to participate in the acquiring entity? If not, is there an alternative exit strategy?*
- *Under what scenarios can the minority sell their interest in the company?*
- *Is the majority able to force the minority to sell?*
- *Does the minority have the right to sell on the same terms as the majority?*

## Statutes That Protect Minority Shareholders’ Rights

While majority shareholders tend to have the upper hand in decision-making during transactional deals, minority shareholders have several rights that they should exercise and protect, including:

**Dissenter and Appraisal Rights** - If a minority shareholder is not satisfied with the terms of an acquisition, they may be able to force an appraisal of their shares and receive the fair market value rather than being bound to the terms negotiated in the sale. This right must be exercised in a timely manner and is forfeited if the shareholder votes in favor of the acquisition.

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**Preemptive Rights** - Minority shareholders may have the right to purchase additional shares before the company offers them to outside parties. This prevents dilution of ownership and voting power.

**Non-Oppression Rights** - Oppression occurs when majority shareholders exercise their power and position in the company to take action that appears to unfairly prejudice minority shareholders and harm their interest in the business. If oppression occurs, minority shareholders have the right to pursue litigation.

### Conclusion

Company acquisitions can disproportionately affect minority shareholders, which is why it is important to thoroughly review shareholder agreements, understand the common or statutory laws that protect minority shareholders' rights, and proactively require that provisions are in place to ensure fair and equitable treatment, particularly in the event of an acquisition.

If you have questions or would like further information, please contact PLDO Principal Gary R. Pannone at 401-824-5100 or email [gpannone@pldolaw.com](mailto:gpannone@pldolaw.com).



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