BEING AN OWNER DOESN'T GUARANTEE YOU A JOB

Not true: 'I'm a shareholder — you can't fire me!'

BY Michael Raum and Kristy L. Albrecht

In closely-held businesses, shareholders often work for the company. It can be tricky when a group of shareholders/employees decide they want to terminate one of the other shareholders as an employee. As explained below, there is nothing inherent in being a shareholder that entitles you to a job, but firing a shareholder can still have corporate-level implications.

Fredrikson & Byron Attorney Michael Raum focuses his practice on commercial law, with a specific emphasis on tax matters. He works with public and privately-held companies on business transactions, including structuring, financing and advising on general corporate matters. He can be reached at mraum@fredlaw.com.

Kristy Albrecht is a Fredrikson & Byron shareholder in Fargo, and a member of the Employment & Labor, Litigation, Transportation and Appellate Groups. She advises employers on a variety of employment law issues, including hiring, firing, discipline, employee leave and accommodation laws, employee handbooks, drug and alcohol policies, wage and hour compliance and separation agreements. She also defends employers in litigation on these issues. She can be reached at kalbrecht@fredlaw.com.

Can a shareholder be fired?

Yes. Being a shareholder does not inherently guarantee a job with the company, and being a shareholder does not by itself change the status of "at will" employment, which means that either party can terminate the employment relationship at will. Of course, a shareholder could have an employment contract with the company, or there could be a shareholder agreement regarding employment, and that may alter the "at will" relationship. In addition, firing any particular shareholder might be problematic because of generally applicable employment law (like prohibitions on sex discrimination). Everything else being equal, however, a shareholder does not have a right to a job just because he or she is a shareholder.

Who can decide to fire a shareholder?

In the absence of an agreement, a shareholder-employee is like any other employee. He or she can be terminated according to the company's usual system. As a general matter, a company should have clear expectations for employees

and a system for evaluating and communicating with them. In such situations, however, it is usually a good idea for the board to vote, since the termination is likely to trigger litigation as discussed below, and the board should know what to expect. In addition, shareholder-employees tend to be high ranking within the company, and thus, high-level action is usually required or recommended.

Does a shareholder who was on the board stop being a director when he or she is fired?

No, a shareholder-employee who was on the board and is terminated as an employee does not stop being a director, unless he or she resigns or is voted off the board. If there is an ongoing dispute, this can make for awkward board meetings. Despite this, unless and until he or she is removed as a director, which commonly happens, he or she has the right to receive notice of, attend, and vote at board meetings. This even includes notice of meetings where the topic of discussion is his or her termination, so care should be taken to plan those meetings to avoid as much difficulty as possible.

Does a shareholder stop being a shareholder when he or she is fired?

No, a shareholder-employee who is terminated as an employee does not stop being a shareholder. Assuming there is no buy-sell agreement that deals with the situation, he or she continues to own his or her shares. The shareholder has the same rights as he or she had before the termination, including the right to have notice of and attend shareholder meetings; vote the shares; obtain basic corporate information; and receive any dividends paid on the stock.

Does a fired shareholder have any rights different from other employees?

Yes, a fired shareholder does have a set of rights different from other employees. Both North Dakota and Minnesota law provides that in a closely-held company, the shareholders owe the company and each other a fiduciary duty of care. This has generally been interpreted to mean that while they owe their primary loyalty to the company and not to each other, they still cannot take any actions which are "unfairly prejudicial" to a shareholder-employee's reasonable expectations.

Courts are generally (although not always) sympathetic to a terminated shareholder-employee's claim that he or she had a reasonable expectation of employment so long as he or she was an investor. This makes sense in many circumstances, because an investor into a closely-held company may well expect to use that investment to ensure her own employment, particularly when the company is in her field.

However, the court's decision will be based on the facts of each case, and a company could potentially show that the shareholder did not reasonably expect to be employed. Each case will differ, but the inquiry will be the same: what were the reasonable expectations of the terminated shareholder employee with respect to employment?

What is the remedy a court would award for such a claim?

Both North Dakota and Minnesota law give courts wide leeway to fashion equitable remedies to address this sort of case. The most common remedy, however, is to order the company or other shareholders to buy out the terminated shareholder employee at the fair market value of the shares, determined following evidence at trial if the parties cannot agree on it.

This makes sense, because there is no real way to force an exit from a closely-held company without court intervention; the shares cannot reasonably be sold on the open market. Therefore, when a court finds that a terminated shareholder employee had reasonable expectations of continued employment, it makes the most sense to provide a mechanism to allow him or her to exit the investment.

Isn't that the same as being able to sue for wrongful termination?

No, the remedy is fundamentally different. Wrongful termination damages would usually include the claimant's lost wages. On the other hand, a buyout claim centers around the value of the investment, which is fundamentally different.

Is there a way to avoid this kind of dispute?

Yes, this issue can be anticipated and addressed in a buy-sell agreement. We addressed this in a June 2018 article on buy-sell agreements written for this publication, but it is worth repeating that a well-drafted buy-sell agreement will deal with what happens to shares in the event of termination and, if the result is a buyout, will also set forth a price (or formula for determining the price) that applies to the buyout. Courts will generally enforce such agreements in these circumstances, which will spare the parties the cost and burden of litigation.

What should a board consider when terminating a shareholder employee?

When deciding whether to terminate a shareholder employee, the board should ask the following questions:

First, does the shareholder have an employment contract? If so, that contract will govern the situation, and a well-written employment contract will include terms describing the circumstances supporting termination, as well what remedies, if any, exist for termination. If the basis for the termination is not well documented and/or will be disputed under the contract, the board should seek advice from employment counsel.

Second, are there risks associated with this potential termination under various employment laws, such as discrimination, retaliation, or whistleblower laws? If so, the board should seek advice from employment counsel.

Assuming the answer to both questions is "no," then the board can fire the shareholder but should be prepared for a lawsuit demanding relief, likely in the form of a buyout at the fair market value of the shares.