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Minority Shareholders Blocking Key Decisions: Legal Mechanisms to Safeguard Corporate Interests

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Minority shareholders are often perceived as insignificant members in corporate governance. However, in practice, their role may become pivotal, particularly when they hold the ability to influence or block strategic corporate decisions. This happens, for example, when the company's charter sets higher thresholds for voting at meetings of management bodies. There is a space for manipulation and conflict: even a member with a minimal share of ownership gets the opportunity to delay the development of the company, jeopardize the implementation of key initiatives. This situation negatively affects the efficiency of commercial activities, causes difficulties with the implementation of long-term plans and leads to a decrease in the investment attractiveness of the company.

The article is devoted to practical recommendations aimed at protecting the interests and ensuring the sustainable functioning of a business that has minority members.

The legislation does not contain an official definition or explanation of who exactly is considered a minority shareholder (member) of the company. In this article, we will refer to minority shareholders as owners of blocks of shares (stakes) of less than 25%, whose assets are insufficient to control the company's activities or make most important decisions but are potentially capable of blocking them or exerting significant influence on them in some cases.

The main scenarios of actions of minority shareholders include:

1. **Blocking by Negative voting**. When a minority shareholder's block of shares (stakes) exceeds a certain threshold that provides for the right of veto on certain issues of the general meeting, the minority shareholder is able to delay the process of making strategically significant decisions, such as approving major transactions, changing the charter, or electing management bodies, by voting against the agenda.
2. **Abuse of rights to receive information.** The law allows shareholders holding at least 1% of the votes in a joint-stock company, as well as all members in an LLC, to request access to various documents and information regarding the company's business activities (for example, minutes of meetings, accounting statements, information about transactions being made or completed). In practice, minority shareholders can use this right to destabilize the functioning of company — by constantly demanding documents and materials. This creates an additional operational burden and entails material costs associated with preparing copies of documents.

3. **Initiating inspections and lawsuits.** Minority shareholders can also hinder the company's activities by constantly applying to state bodies with statements about violations of certain provisions of the law. As a result, various checks are carried out, in which the company is required to provide documents and information, and spends resources on responding to requests. Regular filing of claims by minority shareholders in court instances takes up the company's time to prepare for court sessions and participate in them. The unstable position of the company negatively affects its reputation, can lead to disruption of transactions with key counterparties and reduce its profitability (for example, see the court decision in case no. A06-10191/2017).

OPTIONS FOR DEALING WITH A CONFLICT

Obviously, the problem of obstruction of the company's activities by minority shareholders (members) can be extremely acute. Next, we will consider options for resolving the conflict that has begun, if relations between shareholders (members) are regulated only by standard constituent documents.

Negotiations and mediation. The most effective way to minimize the consequences of conflict between members is through constructive negotiations and compromise. If the shareholders (members) manage to reach an agreement, they will be able to avoid expensive lawsuits and lengthy legal disputes.

Negotiations will be more effective with the mediation of a third party. This can be either a professional mediator or a specially created body in the company, the purpose of which is to establish contacts and interact with minority shareholders (members). This body is also useful outside of a dispute, and we'll discuss it in more detail in the next section on conflict prevention.

Judicial exclusion. For non-public joint-stock companies and limited liability companies, such a method of protection against unfair actions of shareholders (members) is available, such as the exclusion of a member (shareholder) from the company. Such exclusion is possible only by the court decision, and it is required to prove that the excluded shareholder (member) by his actions (inaction) grossly breaches his duties of good faith towards the company and other shareholders (members), hinders the company's activities or makes it impossible, causes significant damage to the company (paragraph 4, paragraph 1, Article 67 of the Civil Code, paragraph 2, Article 35 of the resolution of the Plenum of the Supreme Court of the Russian Federation No. 25 of 23.06.2015, hereinafter referred to as the resolution of the Plenum No. 25).

Disputes of this category usually take from six months to a year, and the court needs to provide sufficient justification that the minority shareholder really does not allow the company to make strategically important decisions. This situation is easier to prove if the minority shareholder has a" blocking " package on issues that require a unanimous decision. For example, case no. A41-81896/2022 dealt with a dispute concerning the exclusion of a citizen of the Republic of Lithuania with a 20% ownership interest from the company's membership. The relevant person repeatedly evaded participation in meetings of the general meeting of shareholders, including the annual meeting and the extraordinary meeting, where the issue of liquidation of the company was considered, without valid reasons. The court granted the claim.

Forced redemption. In public joint-stock companies, a mandatory buyout (squeeze-out) of minority shareholders by the majority shareholder is permitted. However, for its use, it is necessary that the acquirer, together with its affiliates, hold more than 95% of the shares and receive the specified package as a result of a voluntary or mandatory offer, under which at least 10% of the shares were purchased. In practice, the implementation (or even artificial creation) of these conditions can be quite difficult.

Both public and non-public joint-stock companies allow repurchase of shares at the request of a shareholder, if he / she voted against such a decision or did not participate in the voting (for example, when making a decision to consent to a major transaction, the value of which exceeds 50% of the book value of the company's assets). In similar cases, a member in a limited liability company has the right to withdraw from the company, even if such withdrawal is not provided for in the charter. However, only the minority shareholder can initiate the specified buyout/exit, but not the company or other members.

Reorganization. If the business allows, in the event of a conflict, the majority and minority shareholders can decide to reorganize it in the form of a spin-off or division in accordance with the interests of each. For example, select a separate business line or non-core assets for a minority group.

Liquidation. If the resulting corporate conflict cannot be resolved by any means, any of the shareholders (members) may file a claim for liquidation of the company. This method is exclusive and is applied only if continuation of the company's activities is impossible or significantly impeded (Article 29 of the resolution of the Plenum No. 25).

WAYS TO PREVENT A CONFLICT

In order not to find yourself in a conflict situation, when granting minority shareholders a share in a business, you should assess the possible risks in advance and correctly structure the distribution of rights to manage the company.

For example, if a small block of shares is given to top managers as an incentive and is aimed at generating income from the company with good performance, including through a stock option plan, you should consider limiting voting rights for the specified block of shares, for example, by issuing preferred shares for this purpose.

When acquiring a minority stake in a business by a strategic investor, it is necessary to discuss in detail the parameters of future joint activities within the company in advance.

In particular, to record what decisions he will be granted the right of veto, how the company's profit distribution and financing will be made, what information he can receive, and how disputes will be resolved.

The most flexible and effective way to prevent corporate disputes is to conclude a shareholders' (members') agreement. This tool allows shareholders (members) to agree in advance on a wide range of issues, including potential mechanisms for resolving conflicts.

Thus, in order to reduce the risk of blocking a minority shareholder from making key decisions, a shareholders' (members') agreement may provide for its obligation to vote on certain issues on the agenda in the same way as the majority shareholder (member).

For violation of this obligation, sanctions are imposed, for example, a penalty option on the entire block of shares (stakes) of a minority shareholder at a price determined in advance by the agreement.

To reduce the risk of too frequent requests for information, you can specify in the shareholders' (members') agreement a list of information that is provided to the minority by default at a specific time. For example, interim financial statements are sent to all shareholders (members) at the end of each quarter.

The shareholders' (members') agreement may also specify the frequency with which a minority shareholder (member) may request other information in order to avoid abuse of this right.

If there are many minority shareholders in the company, which is especially important for public joint-stock companies, it may consider creating a special body for interaction with minority shareholders.

Such a body could centrally provide minority shareholders with information and documents about the company's activities and plans, as well as communicate the position of all or part of the active minority shareholders to the main business management partners. Alternatively, such a role could be performed by a member of the Board of Directors specially elected by minority shareholders.

CONCLUSION

Despite their apparent insignificance in the corporate governance structure, minority shareholders may pose serious challenges to the effective functioning of the company, significantly complicate or even suspend its activities.

Legislation offers many ways to resolve conflicts after they have already occurred, but all of them, as a rule, have a negative impact on business.

We recommend that you think about preventive regulation in advance by entering into a shareholders' (members') agreement or creating a special body for interaction with minority shareholders, which will be able to identify hotbeds of conflict and extinguish them at the very beginning of their occurrence.