

# On Voting Trusts for Family Business Governance

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A voting trust can be a long term governance solution for your family business or a temporary mechanism for business succession planning. I previously mentioned voting trusts in my October 4, 2020 post, "On Voting Rights in the Family Business (part 2 of 2)." In today's post, I will discuss the use of voting trusts in greater detail and comment on how you and your advisors can design a voting trust to best serve your family business and its owners.

### What is a Voting Trust?

A voting trust is an agreement under which one or more trustees will be appointed to exercise the voting rights of any shares of stock that are made subject to the voting trust agreement. A voting trust is like an irrevocable proxy, but it imposes fiduciary duties on the persons voting the shares (i.e., the trustees) and it continues to apply to the shares even if they are transferred to a new owner. A voting trust often applies to shares of more than one owner. In fact, it can be applied to all outstanding shares.

Under a voting trust agreement, shareholders transfer their shares to the trustees, and, in return, they receive voting trust certificates to evidence their status as beneficiaries of the voting trust. Each beneficiary retains the economic rights of share ownership (such as the right to receive dividends or the right to receive the proceeds from selling the shares),

but only the trustees can exercise the shares' voting rights. Usually, but not always, the beneficiaries of a voting trust have the power to remove and replace the trustees.

Most states' business corporation statutes expressly allow voting trusts to hold shares of stock in a corporation, but they do not provide much guidance as to the terms or administration of a voting trust. Even the trust statutes of many states expressly do not apply to voting trusts. The trust agreement that governs a voting trust, therefore, should thoroughly and specifically set forth the powers, duties, and rights of the trustees and the beneficiaries.

The trust agreement will designate the initial trustees and will provide means for removing or replacing a trustee. The trust agreement may provide minimum standards or qualifications that a person must satisfy to serve as a trustee.

### Why Use a Voting Trust?

Shareholder voting rights are limited, but important. Shareholders (as shareholders) do not run a corporation. Rather, shareholders meet to vote once a year or they can be called upon to vote at a special meeting. Shareholders can vote to do the following:

- Elect or remove directors;
- Amend the corporation's governing documents (such as articles of incorporation or bylaws); or

- Sell the corporation.

A corporation's governing documents may increase the matters on which shareholders are entitled to vote or for which shareholder approval is required.

Shareholders usually do not owe fiduciary duties to the corporation or other shareholders with respect to how they exercise their voting rights. In other words, a shareholder has no duty to vote his or her shares prudently or in a way that is in the best interests of the corporation or the other shareholders. An individual shareholder theoretically may exercise his or her voting rights in a manner that is ignorant, irresponsible, vindictive, or destructive.

In contrast, the trustee of a voting trust will act in the capacity of a fiduciary as to the beneficiaries and, therefore, will have a duty to act with due care, in good faith, and with loyalty to the beneficiaries. A voting trust agreement can impose additional or more specific duties on the trustees with respect to their power to vote the shares. (Note that if stock is split into voting and non-voting shares, the voting trust agreement should be explicit about the trustees' duties to the nonvoting shareholders.)

Therefore, a voting trust can be a way to aggregate and control shareholder voting rights to elect and maintain a stable and quality board of directors and prevent shareholder contests about whether to sell the corporation. For example, if your corporation's shares are owned across a broad spectrum of family members, some who are involved in

the business and some who are not, a voting trust can ensure that those shares will always be voted together, by knowledgeable and experienced trustees who have a duty to act in the best interests of the shareholders collectively.

A voting trust can protect minority owners and mitigate the consequences of one owner or two owners with a majority of shares from exercising their voting power, and thus exerting their influence on the board, in a way that is unfair to the other owners. Also, a voting trust (together with an appropriate shareholders' agreement) can help ensure that the shareholders who are not active in the business do not sell the corporation out from under the family members who have committed their careers to the family business.

### Can a Voting Trust be Used for an LLC?

A voting trust may not be a good fit for an LLC unless the LLC's governing documents create a governance structure that mimics a corporation, establishing a board of directors, providing for appointment of officers, and limiting member voting rights to be similar to those of shareholders in a corporation. This is because, under the statutory default rules of an LLC, the LLC members (i.e., the owners) operate the business or they appoint managers to operate the business. In either case, the owners of an LLC have much more influence over the day-to-day operations of the business than shareholders of a corporation.

A voting trust is a good vehicle for the limited decision making assigned to shareholders in a corporation, but, in a conventional LLC, it may give

the trustees too much authority and responsibility. The individuals whom you would appoint to exercise the limited voting rights of shareholders in a corporation are not necessarily the same as those whom you would appoint to be more involved in management. In the corporation context, a voting trust can maintain a useful separation of powers that is not present in a conventional LLC.

The problem is exacerbated because the law of voting trusts is not well defined by statutes in most states. In fact, voting trusts are not expressly permitted under the LLC statutes of most states. Rather, the law governing voting trusts has been developed over time by court decisions (i.e., common law), mostly in the context of corporate (not LLC) governance. Therefore, it may be uncertain how a voting trust would be enforced in the context of an LLC, or even whether a court would recognize its validity.

### Conclusion.

A voting trust can be a useful mechanism to maintain stable governance in a family-owned corporation. It may not be the right approach for an LLC, unless the LLC is organized to mimic the ownership and governance structure of a corporation.

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