Planning to Avoid Shareholder Disputes

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Table of Contents

RIGHTS, RESPONSIBILITIES, AND REMEDIES OF SHAREHOLDERS 5

A. SHAREHOLDERS IN CLOSELY HELD CORPORATIONS 5

1. Generally 5

a. Closely Held Corporation Shareholders Owe a Higher Fiduciary Duty 5

b. Oppression of Minority Shareholders 5

c. Protection from Oppression Under the MBCA 5

2. Rights and Remedies 6

a. Dissolution and Mandatory Buyout 6

b. Issues Presented by Section 302A.751 7

c. Valuation of Shares in a Mandatory Buyout 9

3. Dissenters' Rights 10

a. Generally 10

b. Events Triggering Dissenters' Rights 11

c. An Exclusive Remedy 11

d. Dissenters' Rights: Legal or Equitable 12

e. Procedure for Asserting Dissenters' Rights 12

f. Valuation of Shares in a Dissenters' Rights Action 12

4. Other Equitable Remedies 14

a. Generally 14

b. Limitations 15

5. Shareholder Derivative Suits 15

a. Generally 15

b. Which Claims are Derivative 15

c. Derivative Suit Requirements 16

d. Special Litigation Committees 19

e. Standard of Judicial Review for SLC Decisions 19

B. DUTIES OF SHAREHOLDERS 20

1. Generally 20

2. Fiduciary Duty Among Shareholders 20

a. The Duty 20

b. Existence and Scope of the Duty 21

3. Elimination or Limitation of Director Liability 21

CONFLICT OF INTERESTS: LAWYER REPRESENTING MULTIPLE SHAREHOLDERS 22

A. GENERALLY 22

B. REPRESENTATION OF MULTIPLE SHAREHOLDERS IN CONNECTION WITH THE FORMATION OF A BUSINESS . 22

C. JOINT REPRESENTATION AS AN INTERMEDIARY: MINNESOTA RULES OF PROFESSIONAL CONDUCT 23

1. Generally 23

2. Minn. R. Prof. Conduct 1.7, Conflict of Interest 23

3. Minn. R. Prof. Conduct 2.2, Intermediary 24

4. Attorney's Requirements Before Acting as an Intermediary 24

a. Evaluate the individual circumstances of each investor's interest 25

b. Rule 2.2 then requires that the lawyer disclose potential conflicts, including an explanation: 25

c. Finally, Rule 2.2 requires that the lawyer obtain each client's consent to joint representation. 25

5. Rule 2.2 Commentary; Circumstances Where Joint Representation May Be Inappropriate 25

6. Attorney's Duties As An Intermediary 25

D. REPRESENTATION OF THE CORPORATE ENTITY AND THE CORPORATION'S SHAREHOLDERS 26
1. Minn. R. Prof. Conduct 1.13; Organization as Client 26
2. Closely Held Corporations 26
3. Discovery of Communications with the Corporation's lawyer 27

DEVICES TO PROTECT SHAREHOLDER INTERESTS 27

A. BUY-SELL AGREEMENTS 27
B. EMPLOYMENT AGREEMENTS FOR SHAREHOLDER EMPLOYEE 27
C. TRANSFER RESTRICTIONS ON STOCK 29
D. DISPUTE RESOLUTION AGREEMENTS 30
1. Agreements requiring arbitration 30
2. Other Shareholders' Agreements 30
E. PAYING DIVIDENDS 31
F. VETO POWER OR SUPER-MAJORITY VOTING REQUIREMENTS 31
1. Caveat: The Tyranny of the Minority 31

RIGHTS, RESPONSIBILITIES, AND REMEDIES OF SHAREHOLDERS

A. SHAREHOLDERS IN CLOSELY HELD CORPORATIONS

1. Generally

Under Minnesota law, a closely held corporation is defined as a corporation with 35 or fewer shareholders. Minn. Stat. § 302A.11 (2001). To date, over 90 percent of Minnesota corporations are closely held. Closely held corporations are typically formed by family, friends, and other business associates with the purpose of combining their common capital, skills, labor, and business experience in a new enterprise. Participants in closely held corporations wear many hats, often assuming the concurrent roles of shareholder, employee, officer, and director. This dynamic often creates difficult issues in the management of the corporation.

a. Closely Held Corporation Shareholders Owe a Higher Fiduciary Duty

Because minority shareholders often own only a small part in the corporation, and because closely held shares are not generally marketable, minority shareholders are often susceptible to the tyranny of the majority. The issue is further complicated in light of the many roles that shareholders, minority and majority alike, assume in their respective roles in the corporation's day-to-day management As a result, shareholders in a closely held corporation owe one another a higher fiduciary duty than shareholders in large public companies. See Minn. Stat. § 302A.751, subd. 3(a).

b. Oppression of Minority Shareholders

A typical tool for the oppression of minority shareholders is the "freeze out." One typical freeze out technique has been the termination of the minority shareholder's employment or the termination of the shareholder's expected return on his or her investment. The result is that the shareholder's investment is locked into a company that fails to fulfill the shareholder's expectations, both in terms of his or her employment and in terms of the value of the investment itself.

c. Protection from Oppression Under the MBCA

Minnesota law under the Minnesota Business Corporation Act (MBCA) protects minority shareholders by providing several measures an oppressed shareholder may take. Judicial interpretations of the MBCA have further developed the rights of minority shareholders.

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2. Rights and Remedies

The MBCA and the Minnesota Rules of Civil Procedure provide a number of remedies to oppressed minority shareholders, including: (1) Dissolution and Mandatory Buyout; (2) Statutory Rights; (3) Equitable Remedies; and (4) Derivative Suits on behalf of the corporation.

a. Dissolution and Mandatory Buyout

The MBCA protects a minority shareholder by providing various forms of equitable relief. In an extreme case, the court may order dissolution of the corporation. Statutory remedies may be ordered under any of the following circumstances:

(1) Where the board has reached a deadlock in the management of corporate affairs and shareholders are unable to break the deadlock;

(2) Where board members have acted fraudulently or illegally toward one or more shareholders in their capacities as shareholders or directors and in the case of a closely held corporation, in their capacities as officers or employees;

(3) Where the directors have acted in a manner that is unfairly prejudicial toward one or more of the shareholders in their capacities as shareholders or directors of any corporation or in their capacities as shareholders, directors, officers, or employees of a closely held corporation;

(4) Where shareholders are divided in voting power such that the corporation has failed to elect directors for two consecutive regular meetings;

(5) Where corporate assets are misapplied or wasted;

(6) Where the duration of the corporation's existence as provided in the articles of incorporation has expired and has not been extended.

Minn. Stat. § 302A.751, subd. 1(b).

The court may order "any equitable relief it deems just and reasonable in the circumstances" upon the happening of any of the above. Minn. Stat. § 302A.751, subd. 1.

Subdivision 2 gives a court the power to order a buyout of shares. If the plaintiff can show any of the circumstances above, the court may, upon the motion of a shareholder or the corporation, order the sale of shares held by either party to either the corporation or to the moving shareholders. Minn. Stat. § 302A.751, subd. 2.

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Subdivision 3(b) gives a court the power to order dissolution as a remedy. Subdivision 3(b) states:

> In deciding whether to order dissolution, the court shall consider whether lesser relief suggested by one or more parties, such as any form of equitable relief, a buy-out, or a partial liquidation, would be adequate to permanently relieve the circumstances established [above]. Lesser relief may be ordered in any case where it would be appropriate under all the facts and circumstances of the case. Minn. Stat. § 302A.751, subd. 3(b).

b. Issues Presented by Section 302A.751

(1) Unfairly Prejudicial Conduct

Under Minn. Stat. § 302A.751, subd. 1(b)(2), the trial court has broad discretion in "granting equitable relief when the directors of a closely held corporation act in a manner unfairly prejudicial towards one of the shareholders." Sawyer v. Curt & Co., 1991 WL 65320 at *3, 1991 Minn. App. Lexis 117 at *3 (Minn. Ct. App. 1991).

According to the Sawyer court, a forced buyout may occur even upon a single instance of "unfairly prejudicial conduct." Sawyer, 1991 Minn. App. Lexis at *7, also citing, Minn. Stat. 302A.751, subd 1(b)(3), Reporter's Notes 1982-1984 ("The term 'unfairly prejudicial' is meant to be interpreted liberally"). In Sawyer, the court held that the employee-shareholder's termination without proposal for compensation provided a sufficient showing of unfairly prejudicial conduct. Sawyer, 1991 Minn. App. Lexis at *7.

However, the Court of Appeals recently defined unfairly prejudicial conduct as "conduct that frustrates the reasonable expectations of shareholders in their capacity as shareholders or directors of a corporation that is not publicly held or as officers or employees of a closely held corporation." Berreman v. West Publ'g Co., 615 N.W.2d 362, 374 (Minn. Ct. App. 2000) (defendant board's failure to disclose future plans of company prior to employee-shareholder's retirement did not rise to the level of unfairly prejudicial conduct).

Another recent case, Gunderson v. Alliance of Computer Professionals, Inc., 628 N.W.2d 173 (Minn. Ct. App. 2001), pet. for rev. granted (July 24, 2001), was recently granted further review by the Minnesota Supreme Court. The issue in Gunderson was whether defendant's conduct was unfairly prejudicial as to the plaintiff in his roles as (1) shareholder, and (2) employee-shareholder. The Court of Appeals held that (1) termination of an at-will employee was not unfairly prejudicial to plaintiff in his capacity as a shareholder, but remanded for further findings as to whether (2) plaintiff's termination was unfairly prejudicial to an employee-shareholder. Thus, the court created more than one reasonable expectation for the plaintiff based on his role within the corporation.

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(2) Reasonable Expectations of All Shareholders

Subdivision 3(a) outlines the circumstances the court should consider in determining whether to grant relief. Subdivision 3(a) states,

In determining whether to order equitable relief, dissolution, or a buy-out, the court shall take into consideration the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner in the operation of the corporation and *the reasonable expectations of all shareholders* as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other. Minn. Stat. § 302A.751, subd. 3(a) (emphasis added).

In Berreman, 615 N.W.2d at 375, the Court of Appeals held that the defendant board's failure to inform plaintiff employee-shareholder of the company's future plans did not frustrate the reasonable expectations of an at-will employee who purchased his non-voting shares through a discretionary stock purchase program.

Prior to the statute's amendment in 1994, Minnesota courts appeared to consider only the reasonable expectations of complaining shareholders. See Pedro v. Pedro, 489 N.W.2d 798, 802 (Minn. Ct. App. 1992) (the reasonable expectations of a shareholder and brother in a family-owned business included an implied agreement to provide lifetime employment); cf. McCallum v. Rosen's Diversified, Inc., 153 F.3d 701 (8th Cir. 1998) (complaining CEO and shareholder's reasonable expectations included an active role in the management of the corporation).

(3) Presumption for Written Shareholder Agreements

Under the 1994 amendment to § 302A.751, written shareholder agreements are presumed to reflect the parties' intentions. The amendment strengthened the effect of and the need for an accurate articulation of the parties' intentions as shareholders or employees in closely held corporations. The statute now reads, in pertinent part:

> For purposes of this section, any written agreements, including employment agreements and buy-sell agreements, between or among shareholders or between or among one or more shareholders and the corporation are presumed to reflect the parties' reasonable expectations concerning matters dealt with in the agreements.

Minn. Stat. § 302A.751, subd. 3(a). The Gunderson court concluded that courts may rely on written or oral agreements among shareholders or between shareholders and the corporation in determining whether shareholder expectations in a particular action are reasonable. Gunderson, 628 N.W.2d at 185 ("written agreements should . . . be honored to the extent they specifically state the terms of the parties' bargain." *Id* at 186.). In the absence of an express agreement, courts may envision or make assumptions about the expectations a shareholder would have reached if, at the corporation's formation, they had bargained over how their investments would be protected.

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c. Valuation of Shares in a Mandatory Buyout

Generally, when the court orders a buyout under Section 751, the buyout price is the "fair value" of the shares as of the date of the action or any other date the court deems equitable. Minn. Stat. § 302A.751, subd. 2. The Minnesota Supreme Court recently defined "fair value" as "the pro rata share of the value of the corporation as a going concern." Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285, 290 (Minn. 2000).

According to the Follett court, fair value determinations may be proven by "any technique that is generally accepted in the relevant financial community." Whatever technique is employed, it should consider "all relevant factors." Id. Finally, the result must be "fair and equitable" to all parties. Id.

(1) "Fair Value" is Not "Fair Market Value"

An important distinction should be made between the fair value of the corporation "as a going concern" and the fair market value of a plaintiff's shares. Fair value is the plaintiff's pro rate share of the corporation valued as a going concern.

(2) An Early Estimation of Fair Value

The Delaware Supreme Court provided an early articulation of "fair value" in Tri-Continental Corp. v. Battye, 74 A.2d 71 (Del. 1950):

> The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him–his proportionate interest in a going concern. The value of the stockholder's proportionate interest in the corporate enterprise is the true or intrinsic value of the stock which has been taken by the merger. In determining what figure represents this true or intrinsic value, the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value. Thus, market value, asset value, dividends, earnings, prospects, the nature of the enterprise, and any other facts which were known or which could be ascertained as of the date of merger and which throw any light on future prospects of the merged corporation are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing value.

Id. at 72.

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(3) Minnesota Valuation Techniques

The Delaware decision noted above is consistent with Follett. Prior to Follett, the Minnesota Supreme Court articulated what some of the relevant "fair value" factors should be. In Nardini v. Nardini, 414 N.W.2d 184 (Minn. 1987), the court employed various valuation techniques used in estate and gift tax determinations. Those factors included:

(a) The book value of the corporation;

(b) The nature and history of the business;

(c) The economic outlook in general and the economic outlook of the relevant industry;

(d) The book value of the stock;

(e) The financial condition of the business;

(f) The earning capacity of the company;

(g) The dividend-paying capacity of the company;

(h) Goodwill and other intangible value;

(i) Sales of the stock and the size of the stock to be valued;

(j) Market price of the stocks in corporations in the same or similar line of business.

Nardini, 414 N.W.2d at 190.

Under Minnesota law, the court retains broad discretion in determining fair value, as the statutory purpose of Section 751 is to ensure that shareholders are fairly compensated. Minn. Stat. § 302A.751, subd. 2. Consequently, the factors noted above are neither exhaustive nor mandatory. See id. Further, under subdivision 4, the court may also award reasonable expenses, including attorney fees and disbursements, upon a showing that a party acted arbitrarily, vexatiously, or not in good faith. Minn. Stat. § 302A.751, subd. 4.

3. Dissenters' Rights

a. Generally

The dissenters' rights provisions of the Minnesota Business Corporations Act, §§ 302A.471-473, permit a shareholder to dissent from certain fundamental corporate changes by giving shareholders the right to be compensated for the fair value of their shares.

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b. Events Triggering Dissenters' Rights

Dissenters' rights are available if any of the following fundamental corporate changes occur:

(1) Any amendment of the articles that materially and adversely affects the rights or preferences of a dissenting shareholder;

(2) Dispositions or sales of substantially all of the corporation's assets not in the regular course of the corporation's business;

(3) Merger;

(4) Exchanges of shares under which the corporation will be acquired by another corporation; and

(5) Any other corporate actions taken by shareholder vote under which the articles, bylaws, or resolution provides that dissenters may receive payment for their shares.

Minn. Stat. § 302A.471, subd. 1.

In Whetstone v. Hossfeld Mfg. Co., 457 N.W.2d 380 (Minn. 1990), the court held that (1) the elimination of a 30% shareholder approval requirement for certain major decisions, (2) a reduction in the maximum number of directors from five to three, and (3) elimination of a 75% shareholder approval requirement for bylaw amendments materially and adversely affected shareholder rights under § 471, subd. 1 (a)(4). The court found the elimination of a minority shareholder's veto power determinative: "Eliminating a minority shareholder's veto power over decisions of the majority . . . unquestionably limits the voting rights of the shareholder." Id. at 384.

However, dissenters' rights may not be triggered if the dissented action is later deemed invalid. Bowman v. MWGC Export Co., 1991 WL 30342 (Minn. Ct. App. 1991).

c. An Exclusive Remedy

Once dissenters' rights have been triggered, the shareholder is prevented from alleging unfairness regarding the corporate change that gave rise to those rights. See Sifferle v. Micom Corp., 384 N.W.2d 503 (Minn. Ct. App. 1986) (rejecting the "entire fairness" doctrine and holding that dissenters have no right to rescind a corporate action unless the action was fraudulent as to the shareholder or the corporation); Popp Telcom v. American Sharecom, Inc., 210 F.3d 928 (8th Cir. 2000) (successful appraisal proceeding may be followed by fraud action, though recovery will be limited to fair value plus consequential damages). Cf. Broin v. National Computer Sys., Inc., 1991 WL 204460 (Minn. Ct. App. 1991) (dissenters' rights are the lone remedy unless the plaintiff also alleges that a corporate action was "accomplished by deception, illegality, or breach of fiduciary duty").

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d. Dissenters' Rights: Legal or Equitable

It is unclear whether Minnesota views dissenters' rights actions as actions at law or actions in equity. On the one hand, valuation findings of fact are reviewed under a "clearly erroneous" standard, suggesting the former. See Spinnaker Software Corp. v. Nicholson, 495 N.W.2d 441, 445 (Minn. Ct. App. 1993). On the other hand, the Court of Appeals has also referred to an appraisal proceeding as "equitable in nature." American Sharecom v. CDB Int'l Corp., 1995 Minn. App. Lexis 731 at *2 (Minn. Ct. App. 1991) (held that an appraisal proceeding does not grant a right to a jury trial.).

Other jurisdictions have expressly determined whether dissenters' rights actions are legal or equitable. Compare Rigel Corp. v. Cutchall, 511 N.W.2d 519, 522 (Neb. 1994) (equitable) with Seig Co. v. Kelly, 512 N.W.2d 275, 278 (Iowa 1994) (legal).

The distinction is important for two reasons. First, legal actions allow a jury trial as a matter of right. Minnesota courts have used juries in an advisory capacity for dissenters' rights actions. See, e.g., Pedro v. Pedro, 463 N.W.2d 285 (Minn. Ct. App. 1990). Second, the standard of review for equitable actions is de novo, whereas legal actions are reviewed under the "clearly erroneous" standard.

e. Procedure for Asserting Dissenters' Rights

Section 473 requires the following procedures in order to assert dissenters' rights:

(1) **Notice**. When the corporation plans to vote on actions that trigger dissenters' rights, the corporation must provide notice of the right to dissent and a brief summary of the procedure for doing so. Minn. Stat. § 302A.471, subd. 2.

(2) **Intent to Dissent**. The dissenter then notifies the corporation of his or her intent to dissent. The dissenting shareholder does so by (1) filing an intent to demand fair value for the shares, then (2) not voting in favor of the proposed action. Minn. Stat. § 302A.471, subd. 3.

(3) **Second Notice and Perfection**. If the board approves the dissented corporate action, the board must send all dissenters a second notice of their rights. This second notice describes the dissenters' statutory rights and provides procedures for the exchange of the dissenters' shares. Minn. Stat. § 302A.471, subd. 4. The shareholder must in turn demand payment and deposit his or her shares within thirty days. Minn. Stat. § 302A.471, subd. 4(b).

    If the triggering event for the assertion of the dissenters' rights occurred without a vote, the dissenter need only demand payment and deposit his or her shares.

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f. Valuation of Shares in a Dissenters' Rights Action

Under a mandatory buyout pursuant to Section 751 and under a dissenters' rights action pursuant to Sections 471-473, the "fair value" determination will be the same. As such, fair value in a dissenters' rights action will be the plaintiff's pro rata share of the corporation as a going concern. One major difference is the valuation date.: Under Section 473, subd. 1(c), the valuation date is "immediately before the effective date of the [dissented] corporate action." Under Section 751, the value is as of the date of the commencement of the action or as of another date found equitable by the court.

(1) Fair Value Procedure

(a) Court Determination

If the parties are unable to agree on a fair value for the shares, the determination is left to the court. As with a mandatory buyout, the court retains broad discretion in determining fair value.

(b) Appointment of Appraiser

Under subdivision 7 of the statute, "The court may appoint appraisers, with powers and authorities the court deems proper, to receive evidence on and recommend the amount of the fair value of the shares." Minn. Stat. § 302A.473, subd. 7. Although the court may rely on a court-appointed appraiser, it may not delegate its authority to actually determine fair value without making findings of its own. See Zenanko v. Vukelich, 1991 WL 6379 at *2 (Minn. Ct. App. 1991); Schaub v. Kortgard, 372 N.W.2d 427 (Minn. Ct. App. 1985).

As a practical matter, each party generally submits its own expert's valuation either directly to the court (which is the most common) or to the court-appointed appraiser.

(2) Valuation Method: All Relevant Factors

According to the Minnesota Supreme Court's recent decision in Follett, noted above, fair value determinations may be proven by "any technique that is generally accepted in the relevant financial community." and should consider "all relevant factors." Follett, 615 N.W.2d at 290.

This approach considers all proven, non-speculative elements of value, and often includes techniques capturing income, assets, intangibles, and market values.

Fair value determinations in Minnesota do not impose discounts based on lack of control or marketability except in extraordinary circumstances.

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(3) Minority Discounts

Minority discounts reflect the shareholder's lack of voting power by reducing the fair value of the stock. Because the minority shareholder may have only a small amount of control over corporate decision making (and may thus be subjected to the tyranny of the majority), his or her pro rata share in the corporation should be less than that of majority shareholders.

Under Minnesota law, however, such discounts are improper in dissenters' rights cases. MT Properties, Inc. v. CMC Real Estate Corp., 481 N.W.2d 383 (Minn. Ct. App. 1993); followed by, Pooley v. Mankato Iron & Metal, Inc., 513 N.W.2d 834 (Minn. Ct. App. 1994); Foy v. Klapmeier, 992 F.2d 774 (8th Cir. 1993).

(4) Marketability Discounts

Marketability discounts reflect the lack of an active market for closely held shares. Without an active market, shares in such corporations lack the liquidity (the ability to exchange shares for cash) of shares traded on an organized exchange.

In Minnesota, fair value is generally interpreted to mean "a pro rata share of the value of the corporation as a going concern *without discount for lack of marketability*." Follett, 615 N.W.2d at 292 (emphasis added). However, according to the Follett court, trial courts may discount for marketability in "extreme circumstances" and always in light of the policy that buyouts are to be "fair and equitable to all parties." Id. at 292-93.

To determine whether "extreme circumstances" are present, a court should consider the following:

- Whether either party acted in an oppressive manner or has acted to reduce the value of the corporation;
- The availability of other remedies to the oppressed shareholder;
- Whether circumstances surrounding the buyout would prejudice other shareholders by burdening the corporation.

Id.

4. Other Equitable Remedies

a. Generally

Courts retain broad discretionary power to grant equitable relief outside §§ 751 and 471-73. In order to grant relief, the court need only find a violation of the Minnesota Business Corporations Act. The pertinent provision granting this power states,

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If a corporation or an officer or director of the corporation violates a provision of this chapter, a court in this state may, in an action brought by a shareholder of the corporation, grant any equitable relief it deems just and reasonable in the circumstances and award expenses, including attorneys' fees and disbursements, to the shareholder. Minn. Stat. § 302A.467.

b. Limitations

Section 467 does not necessarily provide relief where there is an adequate remedy at law, i.e. a statutory remedy exists. See Westgor v. Grimm, 381 N.W.2d 877, 881 (Minn. Ct. App. 1986) (buyout not available under section 467 when unavailable under section 471); Bowman v. MWCG Export Co., 1991 Minn. App. Lexis 227 at *4 (Minn. Ct. App. 1991) (following Westgor). Additionally, relief under section 467 is likely subject to a contemporaneous ownership requirement. See PJ Acquisition Corp. v. Skoglund, 453 N.W.2d 1, 6 (Minn. 1990).

5. Shareholder Derivative Suits

a. Generally

A derivative action allows shareholders to bring an action for an alleged breach by officers or directors of their fiduciary duties.

b. Which Claims are Derivative

Derivative claims are those claims which belong directly to the corporation, but which can be asserted indirectly by a shareholder, on behalf of the corporation under certain circumstances.

Under Minnesota law, a court should "look not to the theory in which the claim is couched, but instead to the injury itself." Wessin v. Archives Corp., 592 N.W.2d 460, 464 (Minn. 1999) (where plaintiffs alleged waste and misappropriation of corporate assets, the injury affected plaintiffs only as shareholders) (Cf. Northwest Racquet, Swim, & Health Clubs, Inc. v. Deloitte & Touche, 535 N.W.2d 612, 619 (Minn. 1995)).

The Minnesota Supreme Court has held that Minn. Stat. §302A.751 does not create direct rights of action for minority shareholders in closely held corporations where a direct action does not exist on its own. Wessin, 592 N.W.2d at 466.

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c. Derivative Suit Requirements

(1) Contemporaneous Ownership Requirement

A derivative plaintiff must have been a shareholder "at the time of the transaction of which the plaintiff complained or that the plaintiff's ownership thereafter devolved on the plaintiff by operation of law." Minn. R. Civ. P. 23.06. The Minnesota Supreme Court discussed the contemporaneous ownership requirement in PJ Acquisitions Corp. v. Skoglund, 453 N.W.2d 1, 4-5 (Minn. 1990):

> Since the allegations of the amended complaint addressing those issues fail to allege any direct injury to the appellant, as shareholders, but rather only to Vikings II, the corporation, itself, and because appellant seeks relief in favor of Vikings II rather than itself, the trial court concluded the action in reality was a shareholder's derivative action, and, accordingly, was subject to the procedural requirements of Minn. R. Civ. P. 23.06 governing such actions. That rule precludes the maintenance of a shareholder's derivative action unless the plaintiff alleges it was a shareholder at the time the acts occurred of which it complains and has made a demand on the board. The parties concede PJ became a shareholder on July 21, 1986. Thus, the complaint did not, nor could it, contain an allegation that PJ was a shareholder at the time when the acts alleged to have resulted in diversion and dissipation of corporate assets occurred before than date. Hence, if Rule 23.06 is applicable, the trial court correctly held that appellant lacked standing to assert claims for alleged wrongful acts that occurred before it became shareholder.

Additionally, the derivative plaintiff must own shares at the time the action is pursued. Vista Fund v. Garis, 277 N.W.2d 19 (Minn. 1979); Lewis v. Chiles, 719 F.2d 1044, 1047 (9th Cir. 1983).

(2) Plaintiff Fairly and Adequately Represents Shareholder Interests

Rule 23.06 provides: "The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interest of the shareholders or members similarly situated in enforcing the right of the corporation or association."

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The Supreme Court explained:

> [A] stockholder who brings suit on a cause of action derived from the corporation assumes a position, not technically as a trustee perhaps, but one of a fiduciary character. He sues, not for himself alone, but as a representative of a class comprising all who are similarly situated. The interests of all in the redress of the wrongs are taken into his hands, dependent upon his diligence, wisdom and integrity. And while the stockholders have chosen the corporate director or manager, they have no such election as to a plaintiff who steps forward to represent them. He is a self-chosen representative and a volunteer champion. The Federal Constitution does not oblige the disposal of such a representative, at least without imposing standards of responsibility, liability and accountability which it considers will protect the interests he elects himself to represent.

Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 549-50 (1949).

Factors courts will consider:

- The relative magnitude of a plaintiff's personal interest as opposed to the interest in the derivative action itself;
- The existence of other litigation between the plaintiff and the defendants;
- Whether the plaintiff has unclean hands or interests that are antagonistic to the other shareholders;
- Whether the plaintiff is vindictive toward the defendants.

See, e.g., Moore v. 1600 Downing St. Ltd., 668 P.2d 16, 20-21 (Colo. Ct. App. 1983); Fink v. Golenbock, 680 A.2d 1243, 1256 (Conn. 1996); Fuqua Indus., Inc. Shareholder Litig., 752 A.2d 126, 129-30 (Del Ch. 1999).

In some circumstances, plaintiffs who bring both individual and derivative claims may not be adequate representatives. Smith v. Ayres, 977 F.2d 946, 949 (5th Cir. 1992); Barrett v. Southern Conn. Gas Co., 374 A.2d 1051, 1057 (Conn. 1977).

(3) Demand Requirement

Rule 23.06 provides that: "The complaint shall also allege *with particularity* the efforts, if any, made by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort." (Emphasis added)

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The particularity requirement of Delaware's Chancery Rule 23.1 was discussed in Brehm v. Eisner, 746 A.2d 244 (Del. 2000). The Court struck a balance between conclusory statements and pleading evidence:

> Rule 23.1 is not satisfied by conclusory statements or mere notice pleadings. On the other hand, the pleader is not required to plead evidence. What the pleader must set forth are particularized factual statements that are essential to the claim. Such facts are sometimes referred to as "ultimate facts," "principal facts," or "elemental facts." Nevertheless, the particularized factual statements that are required to comply with the Rule 23.1 pleading rules must also comply with the mandate of Chancery Rule 8(e) that they be "simple, concise and direct." A prolix complaint larded with conclusory language, like the complaint here, does not comply with these fundamental pleading mandates.

The Delaware Courts have explained the rationale for the demand requirement:

> By its very nature the derivative action impinges on the managerial freedom of directors. Hence, the demand requirement exists at the threshold, first, to insure that a shareholder exhausts intra-corporate remedies, and then to provide a safeguard against strike suits. Thus, by promoting this form of alternative dispute resolution, rather than immediate recourse to litigation, the demand requirement is a recognition of the fundamental precept that directors manage the business and the affairs of the corporation.

Aronson v. Lewis, 473 A.2d 805, 811-12 (Del. 1984), overruled one other grounds, in Brehm v. Eisner, 756 A.2d 244 (Del. 2000).

(4) The Futility Exception

An exception to the demand requirement arises if demand is deemed "futile." The availability of the futility exception is, according to the Supreme Court, governed by the relevant state law. Kamen v. Kemper Financial Svcs., 500 U.S. 90 (1990).

Minnesota recognizes the futility exception to the demand requirement. See, e.g., Reimel, 9 F. Supp. 2d at 1066. According to the Reimel court, under Minnesota law demand should be excused only if there is no possibility that a resolution could be reached and that futility depends on the circumstances of each case. Id. The Reimel court went on to state that, "certainly, in cases involving allegations of patently egregious conduct such as converting corporate funds or self-dealing, demand almost always would be futile." Id.

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Under Delaware law, the court uses a two part test to determine futility. If either of the two prongs are satisfied, demand is deemed futile:

(i) Whether, under the particular facts alleged, a reasonable doubt is created that the directors are disinterested and independent;

(ii) Whether the pleading creates a reasonable doubt that the challenged transaction was otherwise the product of a valid exercise of business judgment. Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000).

d. Special Litigation Committees

Minnesota law allows a board of directors in a for profit corporation to establish independent special litigation committees (SLC). SLC are typically appointed by the board of directors and have the power to review allegations contained in a shareholder's complaint. The committee will generally conduct an investigation of the claims, then pass a recommendation whether to continue with the derivative suit. With the increased use of SLC, plaintiffs may have fewer reasons to seek refuge in the futility exception to the demand requirement.

The Minnesota Business Corporation Act provides:

> A resolution approved by the affirmative vote of a majority of the board may establish committees having the authority of the board in the management of the business of the corporation only to the extent provided in the resolution. Committees may include a special litigation committee consisting of one or more independent directors or other independent persons to consider legal rights or remedies of the corporation and whether those rights and remedies should be pursued. Committees other than special litigation committees and committees formed pursuant to section 302A.673, subdivision 1, paragraph (d), are subject at all times to the direction and control of the board.

Minn. Stat. § 302A.241, subd. 1.

However, there are some limitations to the use of SLC. Minnesota has recently held that SLC cannot be used by nonprofit corporations to investigate the claims of their members. Janssen v. Best & Flanagan, 2002 Minn. App. LEXIS 638 (Minn. Ct. App. 2002).

e. Standard of Judicial Review for SLC Decisions

Under Minnesota law, judicial review is limited to whether the committee was independent and conducted the investigation in good faith. Skoglund v. Brady, 541 N.W.2d 17 (Minn. Ct. App. 1995); Drilling v. Berman, 589 N.W.2d 503 (Minn. Ct. App. 1999).

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According to the Drilling court, factors to determine if the committee's investigation was completed in good faith include:

- The length and scope of the investigation;
- The committee's use of independent counsel or experts;
- The corporation's or the defendant's involvement, if any, in the investigation;
- The adequacy and the reliability of the information supplied to the committee.

Drilling, 589 N.W.2d at 509.

B. DUTIES OF SHAREHOLDERS

1. Generally

For the most part, the MBCA does not distinguish close corporations from their larger counterparts. One exception is fiduciary duties owed among shareholders:

> [A]ll shareholders in a closely held corporation owe one another [a duty] to act in an honest, fair, and reasonable manner in the operation of the corporation and [in granting equitable relief, the court shall consider] the reasonable expectations of all shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other.

Minn. Stat. Ann. § 302A.751, subd 3(a).

2. Fiduciary Duty Among Shareholders

a. The Duty

In a non closely held corporation under Minnesota law, generally only a controlling or majority shareholder owes a fiduciary duty to the corporation or to other shareholders. Westgor v. Grimm, 318 N.W.2d 56, 58 (1982).

However, it is well established that in closely held corporations where shareholders participate equally in management, all shareholders owe each other a fiduciary duty. See Evans v. Blesi, 345 N.W.2d 775 (Minn. Ct. App. 1984) ("The law imposes on each the highest standard of integrity in their dealings with each other"), citing Prince v. Sonnesyn, 345 N.W.2d 775 (Minn. 1946); Follett, 615 N.W.2d at 294.

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b. Existence and Scope of the Duty

The variety of behaviors that may constitute a breach of fiduciary duty is quite broad (see, e.g., Gunderson, 628 N.W.2d at 185, discussing fiduciary duties among shareholders as including "both substantive obligations that focus on the outcomes of shareholder conduct and procedural obligations that focus on process"). However, courts have found ways to limit the classes of shareholders who may assert such claims. The Supreme Court recently declared that some sharehoders without any ability to control the corporate decision-making do not owe other shareholders a fiduciary duty:

> [W]here a shareholder has only *nonvoting* shares in a closely held corporation and is *not* a *director*, as here, clearly any significant ability to control corporate decision-making is lacking. The relationship between appellant . . . and respondent is not comparable to that of partners because at all times appellant . . . has owned all of the shares of voting stock and served as [the corporation's] only director. We therefore hold that respondent owed no fiduciary duty as a shareholder to [the corporation] or its shareholders.

Advanced, 615 N.W.2d at 294 (emphasis added).

3. Elimination or Limitation of Director Liability

Directors' liability may be limited or even eliminated by provisions in the corporation's articles. Minn. Stat. § 302A.251, subd. 4. It should be noted that this can only be done in the articles. A common mistake made is the attempt to limit or eliminate a director's liability in the bylaws. These provisions are invalid. Additionally, liability cannot be limited or eliminated for the following, even if done in the articles:

- Breach of the duty of loyalty;
- Acts or omissions not in good faith;
- Intentional misconduct;
- Knowing violation of the law;
- Conduct which generates an improper personal benefit;
- Securities violations;
- Illegal distributions.

Minn. Stat. § 302A.251, subd. 4.

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CONFLICT OF INTERESTS: LAWYER REPRESENTING MULTIPLE SHAREHOLDERS

A. GENERALLY

Lawyers are often called upon to represent multiple shareholders in organizing a business. Lawyers may, in certain circumstances, represent multiple shareholders as an intermediary. A corporation occasionally asks its own attorney to represent the corporation's shareholders. In addition, lawyers that represent a closely held corporation can be characterized as jointly representing multiple shareholders. In such situations, it is crucial the lawyer advise prospective shareholder clients of the different interests they may have between other shareholders. The attorney should warn prospective clients of the risks of proceeding without separate representation, and in many circumstances, at least recommend separate representation. In all circumstances, the attorney should take steps to ensure the parties understand that the attorney's client is the corporation.

B. REPRESENTATION OF MULTIPLE SHAREHOLDERS IN CONNECTION WITH THE FORMATION OF A BUSINESS

Some of the areas in which an attorney is called upon to render advice in connection with the organization of a business include: choice of entity, internal firm governance, finance, mechanisms to resolve disputes, and termination plans. Attorneys also face circumstances where one shareholder requests confidential communications with the attorney regarding business related matters. Potential conflicts between shareholders' interests become apparent when the attorney explores issues relating to corporate governance. Alysa Christmas Rollock, Professional Responsibility and Organization of the Family Business: The Lawyer as Intermediary, 73 Ind. L.J. 567 (1998).

A lawyer who undertakes to represent more than one party must zealously protect each client's interests as if the interests were individually represented. Hill v. Okay Construction Co., 252 N.W.2d 107, 118-9 (Minn. 1977). Each client participating in such multiple representation is entitled to protection of his or her individual confidences. However, once it becomes clear the confidences of one client are adverse to another, the lawyer must notify the client that the discussion may no longer be privileged and that the client must seek independent counsel.

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C. JOINT REPRESENTATION AS AN INTERMEDIARY: MINNESOTA RULES OF PROFESSIONAL CONDUCT

1. Generally

At times during the formation stage, or thereafter, shareholder's interests may not be perfectly aligned and they may jointly consult the corporation's attorney. Under certain circumstances, however, joint representation as an intermediary may be prohibited by the Minnesota Rules of Professional Conduct. A lawyer is generally precluded from representing a client if such representation will be adverse to the interests of another client. Such representation is governed by Minnesota Rules of Professional Conduct 1.7 and 2.2. Rule 1.7 sets forth the circumstances under which a lawyer is generally prohibited from undertaking simultaneous representation of two clients, while Rule 2.2 identifies the circumstances under which a lawyer may act as an intermediary between two clients.

2. Minn. R. Prof. Conduct 1.7, Conflict of Interest

Rule 1.7 of the Rules of Professional Conduct provides that:

(a) A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless:

- (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other clients; and
- (2) each client consents after consultation.

(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

- (1) the lawyer reasonably believes the representation will not be adversely affected; and
- (2) the client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

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3. Minn. R. Prof. Conduct 2.2, Intermediary

Rule 2.2 provides:

A lawyer may act as intermediary between clients if:

(a) The lawyer consults with each client concerning the implications of the common representation, including the advantages and risks involved, and the effect on the attorney-client privileges, and obtain each client's consent to the common representation:

   (1) the lawyer consults with each client concerning the implications of the common representation, including the advantages and risks involved, and the effect on the attorney-client privileges, and obtains each client's consent to the common representation;

   (2) the lawyer reasonably believes that the matter can be resolved on terms compatible with the clients' best interests, that each client will be able to make adequately informed decisions in the matter and that there is little risk of material prejudice to the interests of any one of the clients if the contemplated resolution is unsuccessful; and

   (3) the lawyer reasonably believes that the common representation can be undertaken impartially and without improper effect on other responsibilities the lawyer has to any of the clients.

(b) While acting as intermediary, the lawyer shall consult with each client concerning the decisions to be made and the considerations relevant in making them, so that each client can make adequately informed decisions.

(c) A lawyer shall withdraw as intermediary if any of the clients so requests, or in any of the conditions stated in paragraph (a) is no longer satisfied. Upon withdrawal, the lawyer shall not continue to represent any of the clients in the matter that was the subject of the intermediation. Minn. R. Prof. Cond. 2.2

4. Attorney's Requirements Before Acting as an Intermediary

Rule 1.7(b) provides the initial standard for determining whether representation of multiple shareholders is permitted. The lawyer must first evaluate the individual circumstances of each client and determine whether representation will not be adversely affected by joint representation. Buyesse v. Baumann, 428 N.W.2d 419, 426 (Minn. Ct. App. 1988), rev'd on other grounds 448 N.W.2d 865 (Minn. 1989) ("Resolving questions of conflict of interest is primarily the responsibility of the lawyers undertaking representation"); See also Minn. R. Law. Prof. Resp. 1.7 cmt.

If the lawyer determines that such representation will not adversely affect the clients' interests, the lawyer must then explain to each client the implications of the common representation and the risks and benefits to each of the common representation. Finally the lawyer must obtain each client's informed consent.

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a. Evaluate the individual circumstances of each investor's interest

Rule 2.2 requires that the that the lawyer *reasonably believe*:

- That the matter can be resolved on terms compatible with the clients' best interests;
- That each client will be able to make adequately informed decision in the matter; and
- That there is little risk of material prejudice to any one of the client's interests.

b. Rule 2.2 then requires that the lawyer disclose potential conflicts, including an explanation:

- That the investors should be advised that the lawyer will be obligated to withdraw from representing any party if a material conflict arises;
- That their statements to the attorney will not be privileged in a dispute between the parties;
- Any other advantages or risks of joint representation.

c. Finally, Rule 2.2 requires that the lawyer obtain each client's consent to joint representation.

5. Rule 2.2 Commentary; Circumstances Where Joint Representation May Be Inappropriate

The commentary to Rule 2.2 makes clear that representation of two or more persons in the organization of a business may be permitted. However, the commentary notes that a lawyer acting as an intermediary must be mindful that failure can result in additional cost, embarrassment and recrimination. Furthermore, the commentary notes that in some circumstances the risk of failure is so great that intermediation is plainly impossible. For example, a lawyer cannot undertake common representation of clients between whom contentious litigation is imminent or who contemplate contentious negotiations.

6. Attorney's Duties As An Intermediary

A lawyer who undertakes joint representation must consult with *each* client concerning the decisions to be made and the considerations relevant in making them, so that each client can make adequately informed decisions. The following topics should be discussed:

- the operation of a closely held corporation;
- the risks associated with minority shareholder status; and
- the protections available to them order for the client to make informed decisions.

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D. REPRESENTATION OF THE CORPORATE ENTITY AND THE CORPORATION'S SHAREHOLDERS

Lawyers are often asked to represent both the corporation itself as well as the corporation's shareholders. Generally, an attorney representing a corporation is the corporation's attorney, and not that of any officers, directors, shareholders or employees of the corporation. When the lawyer representing a corporate entity deals with the entity's shareholders, the lawyer must explain the identity of the client when it is apparent that the organization's interest are adverse to those of the shareholder. Minn. R. Prof. Resp. 1.13(d). However, Minnesota Rule of Professional Conduct 1.13 permits the corporate attorney to represent the shareholders of the corporation. If the corporation's lawyer represents multiple shareholders of the corporation, he or she must follow the rules of conflict of interests and joint representation set out in Minn. Rs. Prof. Conduct 1.7 and 2.2.

1. Minn. R. Prof. Conduct 1.13; Organization as Client

Rule 1.13, subd. (e) of the Minnesota Rules of Professional Conduct specifically addresses the joint representation of a corporation and its shareholders. Rule 1.13(e) provides:

> A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

Thus, once the corporate attorney has agreed to represent the corporations' shareholders, the attorney must proceed through the steps listed in Rules 1.7 and 2.2 as to each of the shareholders.

2. Closely Held Corporations

The general rule that the attorney represents the corporation and not any constituent member of group may not apply in the context of closely-held corporations. Wolfman, Charles W., *Modern Legal Ethics* § 8.3.2 (West, 1986). In such "partnership-like" corporations, the interests of the corporation and its shareholders can be blurred. Id.; See, e.g., In re Brownstein, 602 P.2d 655, 656-57 (Or. 1979) (In closely held corporations, the attorney represents the corporate owners in their individual capacities as well as the corporation unless other arrangements are clearly made. Thus, an attorney may not represent, or appear to represent, a party with interests adverse to either of these parties.).

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3. Discovery of Communications with the Corporation's lawyer

In Miller Waste Mills v. Mackay, 520 N.W.2d 490 (Minn. 1994), the Minnesota Court of Appeals addressed the attorney-client privilege as it applies to minority shareholders involved in shareholder litigation. The court, apparently relying on the fiduciary exception to the attorney-client privilege, held that such a minority shareholder can discover legal advice on corporate matters given to management by corporate counsel. See also Evans v. Blesi, 345 N.W.2d 775 (Minn. Ct. App. 1983) (the court held that when a majority shareholder represents both the corporation and the majority shareholder and a conflict with the minority shareholder exists, the attorney's communications are not privileged from the minority shareholder.)

At present, the proper application and scope of the conflict of interest/fiduciary exception to the attorney-client privilege in Minnesota is unsettled. Because neither Blesi and Miller involved derivative claims, the exception may not be restricted to derivative claims in Minnesota. Additionally, it is arguable that Blesi and Miller have based the exception on the existence of a fiduciary relationship. If this is the case, it is reasonable to assume that it may be applied outside the corporate context. See Vincent D. Louwagie and Steven D. Olson, The Hennepin Lawyer, February 2001, Vol. 70 No. 2.

DEVICES TO PROTECT SHAREHOLDER INTERESTS

Because Section 751 focuses so heavily on the reasonable expectations of the shareholders, devices should be used to describe those reasonable expectations. Those devices include:

A. BUY-SELL AGREEMENTS

[This topic is to be covered in another portion of today's program and will not be repeated here.]

B. EMPLOYMENT AGREEMENTS FOR SHAREHOLDER EMPLOYEE

(a) Shareholders may expect to devote their full time to and earn their livelihood largely by working for the corporation. Use of employment contracts can be used as an authority to require the corporation to maintain the management or officer status of a minority shareholder.

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(b) An employment Agreement should express the following kinds of information.

(1) Title of employee and the duties he/she is required to perform, the location of where the duties are to be performed, and the ability of the corporation to modify the duties. See Miller v. Winshall, 400 N.E.2d 1306 (Mass. Ct. App.1980) (change in a corporate officer's title and position against his wishes may constitute breach of his employment contract where price specified in buy-sell agreement valued officer's stock at $4,091, in the event he resigned, compared with the forced sell price of $30,985, in the event the corporation terminated his employment).

(2) Clear and unambiguous time period of the employment. In a closely held corporation, the employment of a shareholder without any written contract may create a reasonable expectation by the employee-owner that his employment is not terminable at will. Pedro v. Pedro, 463 N.W.2d 285, 289 (Minn. Ct. App. 1990); House v. Baxter, 371 N.W.2d 26, 29 (Minn. Ct. App. 1985) (statute of frauds does not bar the extension of an employment contract after its expiration where the parties by their conduct continued to honor the terms through their course of dealings and where there is no evidence of waiver). However, statements that shareholder employee "would be taken care of" are insufficient as a matter of law to establish a life-time employment contract. Gunderson v. Alliance of Computer Prof., Inc., 628 N.W.2d 173, 182 (Minn. Ct. App. 2001) pet. for rev. granted (July 24, 2001).

(3) Compensation, time for payment, if and when it may be increased or decreased, bonuses, deferred compensation, expense accounts, and compensation proportionate to corporation success. The latter provision ensures minority shareholder employees will share in the corporations prosperity.

(4) The amount of time to be dedicated to the employment by the employee.

(5) Limitations on the outside business abilities of the employee.

(6) Contemplate the employee's disability.

(7) The effect of dissolution, merger, or sale of the corporations assets upon the employment agreement.

(8) Integration clause. See Eklund v. Vincent Brass & Aluminum Co., 351 N.W.2d 371, 376 (Minn. Ct. App. 1984) (In the absence of an integration clause, courts must consider oral and written negotiations, the employment situation, type and circumstances, to ascertain whether employment was "at will").

(9) Liquidated damages provision.

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C. TRANSFER RESTRICTIONS ON STOCK

(a) Such agreements protect the original shareholders from control of the corporation by outside purchasers.

(b) Types of Stock Transfer Restrictions:

(1) Absolute restrictions on transfer.

(2) "Consent restraints," requiring approval of transfers by other shareholders.

(3) Limitations of persons the stock may be transferred to; specific classes of persons (e.g., family members of the existing stockholders or the corporations employees), or prohibitions against transfers to certain persons (e.g., competitors of the corporation).

(4) "Right of first refusal" clause in bylaws granting the corporation, or its officers, directors, or shareholders a right to buy the stock before it is sold to another.

(5) Right of the corporation, its officers, or directors, or the other shareholders to purchase some or all of stockholders share upon the occurrence of an event (e.g., death, disability, insolvency, or acquisition of an interest in a competing entity).

(6) Provisions for the redemption of stock ("call") at the option of the corporation or its board of directors.

(c) Enforceability of Restrictions.

(1) **Statutes**: a restriction on the transfer of stock may be enforced so long as it is not "manifestly unreasonable under the circumstances" and the restriction is "noted conspicuously" on the stock certificate. Minn. Stat. § 302A.429, subd. 2; see also Del Code Ann. tit. 8, § 202 (2001).

(2) **Case law**: Stock transferability restriction that required shareholder's estate to offer shares for sale to the corporation upon shareholder's death is not unreasonable, even where price paid is significantly less than market value. Miller Waste Mills, Inc. v. Mackay, 520 N.W.2d 490, 494-95 (Minn. Ct. App. 1994); see also Shields Development Co. v. Shields, 7 Del J. Corp. L. 354, 362 (1981). Restriction requiring corporation's approval before transfer is enforceable under Delaware law. St. Louis Union Trust Co. v. Merrill, Lynch, Fenner & Smith, Inc., 562 F.2d 1040, 1045 (8th Cir. 1977). Agreement that prohibited transfers of shares to shareholders' children, spouses, or any other third party, is a total and absolute restraint against alienation, and thus, void as against public policy, because there was no first refusal option, or requirements that the shareholders purchase restricted shares or consent to a transfer. Castriota v. Castriota, 633 A.2d 1024, 1028 (N.J. Super. Ct. App. Div. 1993). A restriction on the ability to pledge stock has been held valid. Joslin v. Shareholders Servs. Group, 948 F. Supp. 627, 631 (S.D. Tex. 1996)(interpreting Delaware corporate law).

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D. DISPUTE RESOLUTION AGREEMENTS

1. Agreements requiring arbitration

"A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable, and irrevocable, save upon such grounds as exist at law or inequity for the revocation of any contract." Minn. Stat. § 572.08.

2. Other Shareholders' Agreements

The following techniques work to prevent some of the most common tools of oppression. The pattern of oppressive tactics has been described as follows:

> When dissension and disagreement arise, the majority attempts to oust the minority, not only of control, but of a fair return upon the investment. Instead of treating all of the stock alike, and distributing the profits fairly and proportionately by way of dividends, the majority first elect themselves directors, then as directors elect themselves officers, and then distribute among themselves a substantial part of the profits in the way of excessive salaries, additional compensation, and other devices.

Carr v. Kimball, 154 A.D. 825, 834, 139 N.Y.S. 253, 259 (1912), cited in O'Neal and Thompson at § 3:07. Some of the suggested techniques to avoid oppressive tactics include:

- Specific shareholders shall be elected to the board of directors.
- Shareholders shall be employed in certain key positions at certain levels of compensation.
- Shareholder, director, officer, and other key employee compensation shall not be changed without unanimous consent of the board.
- Dividends shall be paid whenever profits reach certain levels.

See O'Neal and Thompson at § 9:04. The list above represents protections against some of the most common squeeze-out techniques. The scope of protections afforded by these agreements are limited only by state law and the foresight of the parties to the agreement.

See F. Hodge O'Neal, *Minimizing Recurring Problems Through Prudent Planning Techniques,* Minority Stockholder Rights: Corporate Planning and Litigation Strategy, p. 11- 21 (1978).

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E. PAYING DIVIDENDS

Withholding dividends is a common method of squeezing out shareholders. Shareholders' agreements, the corporate charter, and the bylaws all may be written to provide for the mandatory distribution (or non-distribution) of dividends upon the occurrence of certain events, such as a certain level of profits or surplus. Suggested methods include tying dividend payment to managerial compensation and creating classes of stock that are paid mandatory dividends if, for example, management failed to pay dividends of a specified amount or for a specified period. See O'Neal and Thompson at § 9:06.

F. VETO POWER OR SUPER-MAJORITY VOTING REQUIREMENTS

Shareholder veto power is one way to prevent oppression. "Super-majority" voting requirements for certain corporate actions may also give a minority shareholder control over certain issues.

1. Caveat: The Tyranny of the Minority

Protection of a minority's interest through a veto power gives every member a "nay" vote over many important fundamental corporate actions. A disagreeable shareholder may deliberately use this power to force concessions on unrelated matters, stall action where quick decisions may be necessary, or even bring the entire board to a standstill. Thus, the types of action over which a minority shareholder should have a veto power should shrink as the number of shareholders grows larger. See O'Neal and Thompson at § 9:09.

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