

Remedies: What are We Fighting For?

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**REMEDIES IN SHAREHOLDER DISPUTES:
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Minority shareholders seeking relief through the courts for claimed violations of their rights argue that they only want what is “fair.” Majority owners and corporations respond with a similar refrain: any remedy must be “fair” to us. Of course, what is fair and equitable in a particular case is often in the eye of the beholder – more importantly, in the eye of the trial court judge – and, is generally highly dependent on the facts and circumstances of the case. One of the primary remedies utilized in shareholder oppression and deadlock cases is the so-called “fair value” buy-out of the complaining shareholder’s stock in the corporation. But determining “fair value” of stock in a closely held company is itself an exercise that involves substantial discretion by the trial court. Moreover, a buy-out is not the exclusive available remedy. Rather, courts are granted broad discretion to grant “any equitable relief it deems just and reasonable in the circumstances.” Minn. Stat. § 302A.751, subd. 1. Since granting equitable relief is within the sound discretion of the trial court, such relief will be reversed on appeal only if there has been a clear abuse of that discretion. Henricksen v. Big League Game Co., 1995 WL 550935 (Minn. Ct. App. Sept. 19, 1995); see also, Bolander v. Bolander, 703 N.W.2d 529 (Minn. Ct. App. 2005) (appellate court will not disturb grant of equitable relief unless trial court abused its discretion); Shoemaker v. Murnane, Conlin, White, 1999 WL 970381 (Minn. Ct. App. Oct. 26, 1999) (no abuse of discretion for denying buy-out remedy under Minn. Stat. § 302A.751); Wiltse v. Boarder Financial Services, Inc., 2004 WL 771493 (Minn. Ct. App. Apr. 13, 2004).

I. The Key Statutes.

Minnesota’s Business Corporations Act contains specific statutory authority for a variety of potential remedies in cases involving minority shareholder disputes in closely held corporations. Most important are Minn. Stat. § 302A.751 and § 302A.467. (The parallel provisions of the Minnesota Limited Liability Company Act are found at Minn. Stat. § 322B.833

and § 322B.83. This outline will generally refer to the corporate statutes and related case law. However, the principles addressed herein are generally applicable to limited liability companies, as well, under Chapter 322B.)

A. Minn. Stat. § 302A.751/§ 322B.833 (“Section 751”).

Entitlement to relief under Section 751 is predicated on the establishment of the existence of one or more triggering events. This usually involves a finding that controlling owners have engaged in conduct that is “unfairly prejudicial” toward one or more shareholders in their capacity as shareholders, directors, officers, and/or employees of the corporation, but relief can also be granted in cases of fraud or illegal conduct, deadlock, and misapplication or waste of corporate assets. Upon establishment of one or more triggering events, a court may grant:

- “any equitable relief [the court] deems just and reasonable in the circumstances”
- dissolution of the corporation
- a buy-out (on motion or following trial)
- attorneys’ fees and litigation expenses

In determining whether to order equitable relief, dissolution, or a buy-out, Section 751 directs the court to 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.” Section 751, subd. 3. Moreover, any written agreements, such as employment agreements and buy-sell agreements, “are presumed to reflect the parties’ reasonable expectations concerning matters dealt with in the agreement.” Id.

B. Minn. Stat. § 302A.467/§ 322B.38 (“Section 467”).

Under Section 467, if a corporation, or its officer or director, violates a provision of Chapter 302A,¹ the Court may, in an action brought by a shareholder:

- “grant any equitable relief it deems just and reasonable in the circumstances”
- award attorneys’ fees and litigation expenses

Violations of a provision of Chapter 302A that give rise to a remedy under Section 467 can also be triggering events for relief under Section 751. See, *Henrickson v. Big League Game Co.*, 1995 WL 550935 (Minn. Ct. App. Sep. 19, 1995) (violation of Minn. Stat. § 302A.401, involving issuance of stock without authority, and § 302A.551, involving distribution of corporate funds without authorization of the Board, constituted breach of fiduciary duty and justified buy-out under Section 751).

II. Potential Remedies.

As reflected by the broad language of Section 751 and Section 467 – providing for “any equitable relief” the court finds to be “just and reasonable” under the circumstances – the range of potential remedies available to a court to resolve shareholder oppression claims and other shareholder disputes is exceedingly broad. While a “fair value” buy-out is often the remedy sought in Section 751 cases, courts can (and do) grant other relief instead of or in addition to a buy-out remedy.

A. Dissolution.

Historically, the Minnesota corporate code provided for dissolution as the primary remedy for resolving disputes involving serious oppression of minority shareholders or

¹ A breach of a company’s by-laws, as opposed to violation of a provision of Chapter 302A, does not trigger relief under Section 467. *Isaacs v. American Iron*, 690 N.W.2d 373 (Minn. Ct. App. 2004).

irreconcilable deadlock. See, Minn. Stat. § 301.49 (repealed 1981). But even before the adoption of Section 751, courts recognized that involuntary dissolution was a drastic remedy to be used with great caution. In re Lakeland Development Corp., 152 N.W.2d 758, 764 (Minn. 1967). Most typically, decisions to dissolve a corporation were based on deadlock that was irreconcilable, under circumstances that made continuation of the business no longer advantageous to the shareholders. E.g., In re Lakeland, 152 N.W.2d at 764; In re Villa Maria, Inc., 312 N.W.2d 921, 923 (Minn. 1981); In re Hedberg-Freidheim & Co., 47 N.W.2d 424, 427 (Minn. 1951).

Since the adoption of Chapter 302A in the early 1980s, courts have been directed by statute to consider less drastic remedies. As stated in the Reporter's Notes to Section 751, dissolution can be a "drastic remedy," and one purpose of Section 751 was to cause courts to consider remedies with less drastic effects than dissolution while protecting the interests of shareholders seeking relief. Section 751 expressly directs that 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 [establishing the triggering event(s)]." Section 751, subd. 3b (emphasis added). The express statutory recognition of a buy-out and other less drastic remedies has undoubtedly contributed to the breakdown of the traditional reluctance of courts to grant relief where there is dissension among shareholders. 2 F. O'Neal and R. Thompson, O'Neal and Thompson's Oppression of Minority Shareholders and LLC Members, § 7:20 (Thompson/West 2005).

While involuntary dissolution is not a common remedy, courts will still order dissolution in some cases, generally in cases involving deadlock. Johnson v. Dolphin, 1990 WL 194991

(Minn. Ct. App. Dec. 11, 1990) (dissolution ordered where 50/50 owners were deadlocked); Signal Bank, N.A. v. Kemnitz Sand & Gravel, Inc., 2002 WL 31415422 (Minn. Ct. App. Oct. 29, 2002) (dissolution ordered where there was conflicting testimony regarding ownership and distribution of shares, the two owners were deadlocked, and the corporation was insolvent with creditor suits imminent).

B. “Fair Value” Buy-Out.

The remedy of choice under Section 751 in most cases is a “fair value” buy-out of the complaining shareholder’s stock in the corporation.² The issue for the court is one of fairness based upon the circumstances – the court can order a buy-out “if the court determines in its discretion that an order would be fair and equitable to all parties under all the circumstances of the case.” Section 751, subd. 2 (emphasis added). The issues relating to a buy-out – whether there is a right to a buy-out and, if so, the amount and terms of the buy-out – are central issues in most minority shareholder lawsuits.

1. Procedure.

The court may order a buy-out upon the establishment of any of the triggering events identified in subd. 1 of the statute. While usually ordered following a trial, Section 751 also authorizes a buy-out on motion (subd. 2). The Minnesota Court of Appeals has held that the court can order a buy-out on motion upon a showing of “at least one uncontroverted incident of unfairly prejudicial conduct . . . toward a shareholder.” Sawyer v. Curt & Co., Inc., 1991 WL 65320 (Minn. Ct. App. 1991) (buy-out on motion granted where shareholder’s reasonable expectations were frustrated by termination of her employment without any attempt to

² It is usually the plaintiff minority shareholder (or 50% owner) who seeks to have his/her shares purchased by the company and/or the controlling shareholder(s). However, under Section 751, the court can order the sale of shares held by either a plaintiff or a defendant shareholder to the corporation or the opposing shareholder(s). Section 751, subd. 2.

compensate her for the loss of status within the corporation). If the court orders a buy-out on motion, the parties have the opportunity to agree on the price and terms of the buy-out. If they cannot agree within 40 days of entry of the buy-out order, the court will determine the “fair value of the shares.” Section 751, subd. 2.

The court “may appoint appraisers to receive evidence on and to assist by recommending the amount of the fair value of the shares.” Minn. Stat. § 302A.473, subd. 7 (incorporated by reference in Section 751, subd. 2). While the court can rely on the expert’s opinion in making the ultimate determination of value, a judge cannot “delegate [to the appraiser] the court’s equitable power” to determine fair value. Zenanko v. Vukelich, 1991 WL 6379 (Minn. Ct. App. Jan. 22, 1991); see also, Schaub v. Kortgard, 372 N.W.2d 427 (Minn. Ct. App. 1985).

2. Valuation Methods/Factors.

The statutes give the trial court broad discretion in determining fair value. The Reporter’s Notes to Minn. Stat. § 302A.473 (the dissenter’s rights statute, the valuation provisions of which are incorporated into Section 751) put it this way:

The court has complete control of the proceedings and may use any valuation method or combination of methods it sees fit, as long as the court finds the result to be the fair value of the shares as of the effective date of the action. No method is recommended because the different methods of measuring value (market, book, replacement, capitalization of earnings, etc.) are neither right nor wrong, but merely appropriate in different situations.

The Minnesota Supreme Court has stated that fair value can be calculated by “any technique that is generally accepted in the relevant financial community.” Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285, 290 (Minn. 2000); see also, Rainforest Cafe, Inc. v. State of Wisc. Inv. Board, 677 N.W.2d 443, 450 (Minn. Ct. App. 2004).

Some courts have looked to the Minnesota Supreme Court's marital dissolution decision in Nardini v. Nardini, 414 N.W.2d 184 (Minn. 1987), for guidance in determining value. Based upon Revenue Ruling 59-60, which addresses valuation for estate and gift tax purposes, the Nardini court identified the following factors to be considered in valuing a business:

- a. The nature of the business and the history of the enterprise from its inception;
- b. The economic outlook in general and the condition and outlook of the specific industry in particular;
- c. The book value of the stock and financial condition of the business;
- d. The earning capacity of the company;
- e. The dividend paying capacity;
- f. Whether or not the enterprise has good will or other intangible value;
- g. Sales of the stock and the size of the block of stock to be valued; and
- h. The market price of stocks of corporations engaged in the same or a similar line of business having their stocks traded in a free and open market.

414 N.W.2d at 190.

According to the Minnesota Supreme Court, a "sound valuation" involves not only consideration of the relevant facts but also application by the trial court of "common sense, sound and informed judgment, and reasonableness to the process of 'weighing those facts and determining their aggregate significance.'" Id. (citations omitted). The statutory scheme in governing court-ordered buy-outs provides the court with "maximum flexibility" to fashion a remedy that is "fair and equitable to all parties." Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285, 292 (Minn. 2000), quoting Minn. Stat. § 302A.751, subd. 2. See also,

Diebold v. Diebold, 1997 WL 309366 (Minn. Ct. App. June 10, 1997) (broad discretion of trial court to determine fair value).

Fair value is usually the subject of competing testimony by experts in shareholder cases. Consistent with the flexibility and discretion afforded trial court judges, Minnesota courts do not require the trial judge to choose between the competing expert valuation opinions. Rather, the valuation statute (Section 473) specifically permits the court to reject both (or all) expert valuation opinions if the court determines that the opinions are not helpful because they are overly optimistic or overly pessimistic. Rainforest Cafe, Inc. v. State of Wisc. Inv. Board, 677 N.W.2d 443, 451 (Minn. Ct. App. 2004) (relying on Section 473, subd. 7, which calls on the court to determine fair value taking into account all factors deemed relevant, "whether or not used by the corporation or the dissenter").

3. What is "Fair Value?"

- Fair value is generally defined as a shareholder's "pro rata share of the value of the corporation as a going concern without discount for lack of marketability [absent extraordinary circumstances]." Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285 (Minn. 2000).
- A fair value buy-out must be "fair and equitable to all parties." Section 751, subd. 2. According to Hennepin County Judge Richard Solum (Retired), in an in-depth analysis of Section 751 liability and valuation issues in Minnesota, this means the determination of fair value is "to protect the true value of the [minority shareholder's] shares, it [is] not to bestow at Company expense, windfalls never achievable to other shareholders in the real world." Jundt Associates, Inc. v. Knappenberger (Henn. Cty. File No. 95-1498), Order and Memorandum, dated Sept. 13, 1997, at 34.
- Discounts. One Minnesota court identified four discounts commonly used in valuation proceedings: minority discount; marketability discount; key person discount; and discount for contingent liabilities. Doerr v. Arundel (Henn. Cty. File EM 97-013502), Order dated October 1, 1999, at 14 (Judge William R. Howard).
- Minority discounts are not allowed in determining fair value. See, MT Properties, Inc. v. CMC Real Estate Corp., 481 N.W.2d 383 (Minn. Ct. App.

1991); Pooley v. Mankato Iron & Metal, Inc., 513 N.W.2d 834 (Minn. Ct. App. 1994). While minority status of shares has a real world impact on the value of the shares, and is therefore relevant to a determination of value, such a discount is disallowed because applying a minority discount would be contrary to the aim of the statute to protect minority shareholders. MT Properties, 481 N.W.2d at 387; Jundt Associates at 51-52.

- Marketability discounts (DLOM) are only allowed in “extraordinary circumstances.” Follett, 615 N.W.2d 285. This extraordinary circumstances exception applies where failing to apply a marketability discount would result in an unfair wealth transfer from the remaining shareholders to the departing shareholder. Follett, 615 N.W.2d at 292. In assessing whether extraordinary circumstances exist, the court is to exercise “maximum flexibility” by taking into account factors relevant to fair value, including:

whether the buying or selling shareholder has acted in a manner unfairly oppressive to the other or has reduced the value of the corporation, whether the oppressed shareholder has additional remedies such as those available pursuant to Minn. Stat. § 302A.467 (1998), or whether any condition of the buy-out, including price, would be unfair to the remaining shareholders because it would be unduly burdensome to the corporation.

Follett, 615 N.W.2d at 292-93.

In Follett, a marketability discount was allowed because: rejecting the discount would result in a valuation of the minority shareholder’s stock at more than five times the net worth of the company and almost seven times its average annual cash flow, and the company’s policy of reinvesting cash flows to finance growth was a primary consideration in the appraisers’ valuation of the company. Id., at 293. Rejecting a marketability discount therefore would give the plaintiff value for his stock based on past growth, while leaving the remaining shareholders with stock in a corporation with extremely doubtful prospects for growth. Id.

When a marketability discount does apply, it can be significant – the Supreme Court in Follett directed the trial court to apply a marketability discount in the range of 35% to 55%. Id. On remand, the trial court applied a 35% marketability discount, and this was affirmed on appeal. Advanced Communication Design, Inc. v. Follett, 2001 WL 569013 (Minn. Ct. App. May 29, 2001). See also, Jundt Associates, supra at 23 (marketability discount of 20% applied where most, but not all, evidence indicated no likelihood of a future liquidity through a sale or public offering of the company).

- Other Discounts?

While most judicial attention has focused on minority discounts and marketability discounts, courts have addressed other discounts and adjustment in determining fair value. One such discount is the so-called “key person” discount, designed to recognize the risk associated with heavy dependence upon a key person in the company. In Billigmeier v. Concorde Marketing, Inc., 2001 WL 1530356 (Minn. Ct. App. Dec. 4, 2001), the trial court applied, and the court of appeals affirmed, a 10% “key-person discount” and a 40% discount based on the fact that revenues generated by the company were concentrated with a narrow group of vendors. Other courts in shareholder cases have discussed, but declined to apply, a key person discount. Doerr, supra, at 15; Jundt Associates, supra, at 24. The appropriateness of a key-person discount has also been addressed by Minnesota courts in marital dissolution cases. E.g., Feldick v. Feldick, 2004 WL 1093501 (Minn. Ct. App. May 18, 2004) (denying key-person discount), Tourniar v. Tourniar, 2002 WL 2004645 (Sep. 3, 2002) (district court did not abuse its discretion by denying use of the key-person discount); Georges v. Georges, 1992 WL 138614 (Minn. Ct. App. June 23, 1992) (no error where court denied a key-person discount); Nelson v. Nelson, 411 N.W.2d 868 (Minn. Ct. App. 1987) (30% discount for key-man/marketability was arbitrarily low); Rogers v. Rogers, 296 N.W.2d 849 (Minn. 1980) (marital property limited to that portion of the value of the company not dependent upon the continued service of appellant, who was the key-man on which much of the corporation’s profitability was dependent).

The Court of Appeals has also permitted a discount or reduction in value (approximately 33%) for contingent corporate liabilities based on concerns over possible labor and environmental litigation not reflected on the corporation’s financial statements. MT Properties, 481 N.W.2d at 389.

- Other Equitable Valuation Adjustments.

Courts have utilized their equitable authority in the basic calculations of value. For example, in Foy v. Klapmeier, 992 F.2d 774 (8th Cir. 1993), one of two shareholders had transferred a product line to a separate corporation in which the plaintiff shareholder had no interest. Relying upon its broad authority to grant equitable relief under Section 467, the court ordered that the diverted business be treated as if it were a division of the main business for the purposes of valuation.

