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COMMERCIAL INDEMNITY CLAUSES IN MINNESOTA: A PRACTITIONER’S GUIDE
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400 South First Street #600
St. Cloud, MN 56302
(320) 251-1414

VICE PRESIDENT
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250 Second Avenue South, #120
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PAST PRESIDENTS

EXECUTIVE DIRECTOR
Monte Abeler
1000 Westgate Drive, Suite 252
St. Paul, MN 55114
(651) 290-6293
www.mdla.org
e-mail: director@mdla.org

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Closely-held corporations are unique in that it they take many different forms. In Minnesota, a “closely-held corporation” is defined by the Minnesota Business Corporations Act as a corporation which does not have more than 35 shareholders. A variety of companies fit neatly within that definition, including two person start-ups, established companies producing hundreds of millions of dollars a year, and everything in between. But closely-held corporations share one very important attribute: they are owned and operated by a small group of people.

Of course it is not surprising that small groups of people, operating companies in which they share ownership, but for which they have different levels of authority and responsibility, don’t always get along. One common scenario involves a start-up turned successful company. Everyone works together while the company is fighting for survival, but then the company attains a measure of sustainability, and shareholders develop a belief that they played a bigger role in its success than is commensurate with their ownership or income. Another common example is the company in which everyone gets along until the inevitable bad times roll around. Bad times lead to questions regarding whether shareholders are doing their share, and controversy ensues. Other times, it is simply a matter of personality conflict taking over a working relationship. And, of course, the inheritance of a successful business by siblings is a recipe for disaster for a number of reasons. In short, it is not uncommon for shareholders in closely-held corporations to have a falling out.

Disputes between shareholders in closely-held corporations can be especially bitter. In many cases, the owners either founded the company or received their stock based on significant personal contributions. In other words, the company is not just an investment or a job — it’s something they helped build and something they are emotionally invested in. So when business disputes arise, they often become personal disputes. When this happens it is not uncommon for majority shareholders to exert their will on the minority, leaving minority shareholders on the outside looking in, or feeling like they have no say in “their” company. Minority shareholders rely heavily on Minn. Stat. § 302A.751 to provide relief in such circumstances, because it gives district courts broad authority to grant the equitable remedies necessary to protect minority shareholders.

But what happens when a minority shareholder turns Section 302A.751 on its head and uses it to demand more, or to exact revenge based upon a disputed business decision? The fact that Section 302A.751 allows for attorney’s fees makes this course of action especially prevalent. And the nature of Section 302A.751 makes frivolous suits difficult to defeat, especially early in litigation. The bottom line is that Section 302A.751, while providing necessary protection, also opens the door to frivolous lawsuits by disgruntled minority shareholders. This article seeks to provide a few ways for closely-held corporations to close that door at an early stage in the litigation.

MINN. STAT. § 302A.751
In 1981, the Minnesota Legislature adopted Minn. Stat. § 302A.751 to protect minority shareholders in closely-held corporations from majority shareholders. Section 302A.751 was passed in recognition of the vulnerable position created by the lack of a market for shares in closely-held companies. And in fact, few dispute that abusive practices

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by majority shareholders could leave minority shareholders without an adequate remedy. To fix that problem, the legislature gave courts broad equitable authority to fashion relief and protect minority shareholders. The two most significant grants of authority are: (1) to “grant any equitable relief [the court] deems just and reasonable in the circumstances,” and (2) “upon motion . . . [to] order the sale by a plaintiff or a defendant of all shares of the corporation.” Minn. Stat. § 302A.751, subds. 1, 2. In other words, district courts can grant any relief they want, including forcing the sale of shares.

Section 302A.751 provides an enumerated list of circumstances under which the court has authority to grant such relief, including when the directors or those in control of the corporation have acted: (1) fraudulently or illegally, or (2) in a manner unfairly prejudicial, toward one or more shareholders. Minnesota courts have consistently followed Berreman v. West Publishing, 615 N.W.2d 362, 374 (Minn. Ct. App. 2000), which interpreted “unfairly prejudicial” conduct to mean “conduct that frustrates the reasonable expectations of shareholders in their capacity as shareholders or directors.” Of course, the term “reasonable expectations” is nearly as vague as the term “unfairly prejudicial,” and the language can be used to create fact questions as to what is reasonable and what happened to set expectations. Based on the statute and case-law, it is not difficult to understand why Section 302A.751 has led to significant amounts of litigation: it allows a court to grant any relief it deems just, based on the denial of “reasonable expectations.”

REASONABLE EXPECTATIONS

Courts have held that shareholders in closely-held corporations often have reasonable expectations that go beyond the expectations of a shareholder, employee, director or officer in a non-closely-held company. The Berreman court held that in the typical close corporation, a shareholder may have an expectation of, among other things, a job, a share of corporate earnings, and a place in management. Berreman, 615 N.W.2d at 374-75. Fortunately for companies defending Section 302A.751 suits, the case law also provides courts with opportunities to dismiss suits where a minority shareholder does not have a reasonable expectation in the relief they are seeking.

SHAREHOLDER AGREEMENTS

Courts can dismiss claims by minority shareholders based on the existence of shareholder agreements. The statute explicitly states that “any written agreements, including employment agreements and buy-sell agreements . . . are presumed to reflect the parties’ reasonable expectations.” Minn. Stat. § 302A.751, subd. 3a. The court in Gunderson v. Alliance of Computer Prof’ls, 628 N.W.2d 173, 185 (Minn. Ct. App. 2001) recognized that shareholder agreements set the “reasonable expectations” of shareholders because “defereence to the parties’ actual associative bargain is among the fundamental functions of a sound business corporation law.” In determining a shareholder’s reasonable expectations, Minnesota courts have repeatedly followed the Gunderson court’s guidance that written agreements should “be honored to the extent they specifically state the terms of the parties’ bargain.” Id. at 186.

Courts often dismiss Section 302A.751 claims based on the existence of shareholder agreements, reasoning that minority shareholders cannot acquiesce to an agreement and then later file a complaint alleging that the agreement does not set their reasonable expectations. This is especially true where the shareholder participated in the decision making process. For instance, where the complaining shareholder took an active role in drafting or negotiating an agreement, that agreement is almost certain to set the reasonable expectations of that shareholder. Moreover, conduct that does not rise to the level of contract can set reasonable expectations where the complaining shareholder has acquiesced. As stated in Gunderson, “[plaintiff] cannot now conveniently premise a claim of unfairly prejudicial conduct on the very practice in which he participated routinely without objection.” Id. at 188.

The existence of shareholder agreements allows courts to dismiss shareholder claims at an early stage in litigation. In fact, where a particular written agreement represents the “reasonable expectations” of the shareholder, Minnesota courts, in Bolander v. Bolander, 703 N.W.2d 529, 552-53 (Minn. Ct. App. 2005) and Drewitz v. Motorwerks, Inc., 728 N.W.2d 231, 234 (Minn. 2007), have dismissed claims under Section 302A.751 even where the written agreement at issue may have been breached. In other words, just because a contract that sets the “reasonable expectations” of shareholders may have been breached, doesn’t mean a Section 302A.751 claim survives summary judgment. The reasoning behind dismissal of such claims is that the intent of Section 302A.751 is to provide courts with power to grant equitable relief where there is not an adequate remedy at law. The existence of a valid contract provides an adequate remedy at law.

The existence of an employment agreement, buy-sell agreement or any other shareholder agreement is the easiest way to defend a claim brought under Section 302A.751. Where minority shareholders have previously agreed or acquiesced, in the form of written agreement or otherwise, the courts are well within their authority to dismiss Section 302A.751 claims.

OBJECTIVE REASONABLENESS

Case law provides two ways to defend claims based on objective reasonableness: (1) a lack of objectively reasonable expectations by the minority shareholder, or (2) the objective reasonableness of the actions taken by majority shareholders.

Claims can be dismissed where the expectations of the minority shareholder are not objectively reasonable. Courts have repeatedly followed the Gunderson court holding that “oppression should be deemed to arise only when the majority conduct substantially defeats expectations that, objectively viewed, were both reasonable under the circumstances and . . . central to the minority shareholder-
Courts have also held that weight must be given to the corporation’s need to effectively run its business. While falling short of adopting the business judgment rule under these circumstances, courts have stated that expectations must be “balanced against the controlling shareholder’s need for flexibility to run the business in a productive manner.” Id. For example, even where a minority shareholder had a reasonable expectation of continuing employment, the court in Haley v. Forcella, 669 N.W.2d 48, 59 (Minn. Ct. App. 1984) held that the corporation could terminate employment for misconduct or incompetence. The Haley court stated that even in the context of suits brought by minority shareholders, “Minnesota courts are generally reluctant to interfere with corporate decision-making.” Id. at 58. The court in Wilse v. Boarder Financial Socs., Inc., 2004 WL 771493 (Minn. Ct. App. Apr. 13, 2004) explicitly held that a minority shareholder had not been denied reasonable expectations where the other shareholders had used business judgment. The court stated that the minority shareholder’s “reasonable expectation [was] that the board would consider the best interests of the [corporation],” Id. at *3. Taken together, this case-law provides a good argument that where majority shareholders act in an objectively reasonable manner for the good of the company, minority shareholder claims under 302A.751 should be dismissed.

DERIVATIVE SUITS

Finally, the Minnesota Supreme Court, in Wessin v. Archives Corp., 592 N.W.2d 460 (Minn. 1999), held that Section 302A.751 claims can be defeated if a court determines that the claims are only properly brought as part of a shareholder derivative suit. In Minnesota, only a corporation has standing to sue for wrongs committed against it. Therefore, where an individual shareholder seeks to assert a cause of action that belongs to a corporation, redress must be sought in the form of a derivative action. As held by the court in Stocke v. Berryman, 632 N.W.2d 242, 247 (Minn. Ct. App. 2001), an action belongs to the corporation, and therefore must be filed as a derivative suit, if it fails to allege an individual injury that is separate and distinct from any harm to the company. In determining whether a shareholder has suffered a separate and distinct injury, the court in Wessin held that courts must look not to the theory in which the claim is couched, but instead to the injury itself.

Claims pled under Section 302A.751 will be dismissed if they fail to allege harm to the individual shareholder that is separate and distinct from harm to the corporation. Minority shareholders often file claims under Section 302A.751 with the belief that they have been individually harmed, when in fact the alleged harm is to the corporation and only affects the shareholders indirectly. For example, the court in Vista Fund v. Garis, 277 N.W.2d 19 (Minn. 1979) held that claims for breach of fiduciary duty by corporate officers and directors must be brought as a derivative suit. In addition, Wessin held claims that corporate funds were improperly paid to corporate officers or directors are also derivative claims. Where a complaint alleges harm to a company that is not unique to an individual shareholder, the complaint is susceptible to an early motion to dismiss.

Dismissal of a claim on the basis that it must be brought as a derivative suit often ends the dispute because derivative suits are extremely difficult to pursue. Shareholder derivative suits involving Minnesota corporations are susceptible to the Rule 23.09 requirements: (1) contemporaneous ownership, (2) demand, and (3) adequate representation. The adequate representation requirement offers an opportunity for dismissal in suits brought by minority shareholders. Under the adequate representation requirement, the plaintiff must show: (1) no disabling conflicts of interest, (2) no hidden agenda, and (3) adequate counsel. The first two requirements can be very difficult for a minority shareholder to meet.

Even if a suit brought by a minority shareholder can clear the initial Rule 23 hurdles, it still faces the prospect that a corporation will appoint a special litigation committee. Minn. Stat. § 302A.241 dictates that corporations have the right to appoint a special litigation committee to determine whether the derivative suit is in the best interests of the company. If the special litigation committee determines that the suit is not in the best interests of the company, then the suit will likely be dismissed. Even though Section 302A.241 does not mandate that decisions made by special litigation committees are binding on the corporation, Skoglund v. Brady, 541 N.W.2d 17, 21 (Minn. Ct. App. 1995) held that committee decisions are reviewed only to determine if the review was independent and conducted in good faith. The Minnesota Supreme Court, in Janssen v. Best & Flanagan, 662 N.W.2d 876, 884 (Minn. 2003), held that as long as a board properly delegates its authority to a special litigation committee, the court will defer to the committee’s decision under the business judgment rule. This all but destroys the chance that a shareholder derivative suit will be successful.

CONCLUSION

Minn. Stat. § 302A.751 provides minority shareholders in closely-held corporations with an extremely broad tool for seeking relief against majority shareholders. But while Section 302A.751 can serve to provide necessary relief, it is all too often used as a catch-all claim anytime a shareholder is seeking to recover from a former employer. The broad authority given to courts by the statute, combined with the vague nature of the case law, can create difficulty in defending these claims at an early stage. The existence of shareholder agreements, the objective reasonableness of the situation, and the nature of the alleged harm, can create ways to defend frivolous claims at an early stage. So even though disputes between shareholders of closely-held corporations may be inevitable, there is reason to believe that such suits can be dispatched without causing unnecessary business disruption and cost.