Shareholder Rights in Minnesota

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Minnesota has some of the nation's most protective shareholder rights laws in the country, favoring owners of corporations, limited liability companies (LLCs) and limited partnerships. If you have an ownership interest in a small or closely-held company, it is important to know your rights and obligations, not only to protect yourself from the misconduct of your fellow owners but to ensure that you do not end up having to defend an expensive lawsuit. Unless otherwise indicated, references to "shareholders" in this article shall apply equally to LLC members or general partners.

- **Fiduciary duties -** Shareholders in closely held corporations, defined as companies having 35 or fewer shareholders, owe each other fiduciary duties of loyalty and good faith. As a practical matter, this means that an owner may not divert to himself or herself a business opportunity that the company would be able to take advantage of. It also means that the shareholder must act honestly, faithfully and candidly with fellow owners.

- **Shareholder oppression remedies -** Shareholder oppression often takes the form of one or more owners holding a majority stake in the company excluding a fellow owner or group of meaningful participation in the company, whether economically or in terms of control over company governance. This is sometimes referred to as a "freeze out" or "squeeze out." Under Minnesota law, an oppressed shareholder who has suffered from "unfairly prejudicial" conduct may sue for damages (compensatory, consequential and punitive), as well as attorney fees. Another statutory remedy available to an oppressed shareholder is a buy-out by motion, under which the company must pay "fair value" for the owner's proportionate share of the company valued as a going venture, as determined through expert testimony. Fair value differs from "fair market value" because, among other things, it is normally calculated without applying a minority or marketability discount.

- Minnesota's corporate law statutes also provide for broad equitable relief, which may take many forms, including a judicial dissolution of the company, placement of the company in receivership or removal of wrongdoers from positions of authority in the company.

- **Rights to a job** - An owner of a closely-held company may have a right to perpetual employment. The key inquiry is whether the individual has a "reasonable expectation" of continued employment. Factors to consider include conversations between owners at the start-up phase, written documentation of their expected roles (including business plans), method of compensation, equity contributed to the venture, number of shares held and how they were acquired. To avoid the uncertainty and expense of litigation, it is helpful for the parties to enter into formal employment contracts which specify their rights in advance. Language to the effect that the employee/owner is employed "at will" often, but not always, will defeat a "reasonable expectation" argument in court.

- **Derivative rights -** A key factor considered by courts in evaluating shareholder oppression claims is whether the injury in question is to the shareholder personally, thereby authorizing the relief described in the previous paragraph, versus to the company as a whole. In the latter scenario, the aggrieved shareholder must notify the company of the claim and submit it to a special litigation committee, before bringing a derivative action on behalf of the company itself against the owner or officer who has caused the harm. Under a recent ruling of the Minnesota Supreme Court, courts have very limited authority to question any settlement of the claim by the special litigation committee in response to a potential derivative action, in deference to the business judgment rule. See *In re UnitedHealth Group Inc. Shareholder Derivative Litigation*.

- **Judicial dissolution -** A shareholder may petition the court to dissolve a corporation, LLC or limited partnership if the company's leadership is deadlocked. This "nuclear option" should be a tactic of last resort, for the obvious reason that nobody benefits if a profitable venture is forced to go out of business due to managerial gridlock.

- **Corporate governance documents** - Minnesota's corporate statutes provide a variety of "default" provisions stipulating rules for the operation and management of companies, including ones effecting voting rights, frequency of meetings, and corporate indemnification of directors and officers. Many of these provisions apply only in the event that the company has not established rules of its own in its bylaws or articles of incorporation. To maximize control over your investment, it is advisable to consult with an experienced corporate lawyer when starting up a company.

- **Shareholder control agreements** - Minnesota law permits shareholders to execute a "control agreement" which constitutes the agreement of the shareholders of the closely-held corporation as to certain matters. For example, many companies have in place control agreements amongst shareholders specifying that loans, contracts or other obligations having a certain value must be approved by a specified percentage or fraction of shareholders. Without such agreement, the corporation's board of directors (whose composition might not be identical to the ownership group) may be able to enter into transactions without prior review and approval by ***all*** owners.

- **Dissenters Rights** - Perhaps the most powerful mechanism available to minority shareholders in a closely-held corporation is the exercise of dissenters' rights. By exercising these rights, minority owners may effectively "opt-out" of certain proposed transactions, including a sale of all of the corporation's assets, a merger and certain amendments to the articles of incorporation. When properly exercised, the corporation must purchase the dissenting shareholders' stock at a predetermined price. If a shareholder meeting is called for a matter which is subject to dissenters' rights, all shareholders must be provided with copies of Minnesota's dissenters' rights statutes and given the opportunity to exercise these rights as provided therein.

- **Disposition of assets -** One way for business owners to protect themselves from potentially ruinous litigation is to establish a buy-sell agreement designating in advance the amount that may be paid to a departing shareholder. Buy-sell agreements are, in a manner of speaking, “prenuptial agreements” for businesses. They are agreements between the owners of the business and the company that specify certain “triggering events” which allow or obligate the company or the other owners to buy another owner’s interest in the company. Common triggers are a voluntary transfer to a third party, an involuntary transfer (such as a transfer arising out of a divorce or a bankruptcy) and the death of an owner. In the case of death, buy-sell agreements have an estate planning function, and owners can fund the obligation to buy the others’ interests on death with life insurance. When family members or friends go in to business without a buy-sell and the relationship sours, the cost of unwinding the business can lead to a financial train wreck. A buy-sell avoids this in part by providing predetermined valuation formulas for the purchase of an owner’s interest. Companies having shareholder control agreements (or a member control agreements, in the case LLCs) often include buy-sell provisions of this sort.

Whether you are a minority owner in a closely-held company who feels that you are being oppressed, a member of a group of owners with possible claims against other owners for misconduct, or one of a group of owners looking to be proactive by entering into a control agreement with buy-sell provisions, the attorneys at Mansfield Tanick & Cohen are available to assist you.

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