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Scrap the Minnesota Business Corporation Act!

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SCRAP THE MINNESOTA BUSINESS CORPORATION ACT!

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I. INTRODUCTION

A number of years ago, the board of directors of one of our closely held, Minnesota-based corporate clients made the difficult decision to terminate the chief executive officer of the company. The CEO had founded this Internet technology company (let's call it "YouBetcha.com") and still owned a substantial percentage of the outstanding stock. YouBetcha.com had done numerous rounds of

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venture capital financing and was now controlled by the venture capitalists. Under the direction of the CEO, however, the company had drifted sideways for years. It was not realizing its early promise and seemed to be making no progress toward an initial public offering or being bought out on terms attractive to the venture capitalists. The company now faced a financial precipice. So, the decision was finally made: the CEO has got to go.

Only a few days after the termination, one of my partners received a letter from a well-known member of the Minnesota corporate plaintiffs bar. He had been retained by the former CEO. They were now claiming that the CEO's termination had been "unfairly prejudicial" under section 302A.751 of the Minnesota Business Corporation Act[1] and that the CEO's shares must be bought out by the corporation at an exorbitant price or a claim would be filed immediately and a Minnesota court would surely grant the CEO the requested buyout under section 302A.751.

Section 302A.751 of the Minnesota Business Corporation Act is the darling of the Minnesota corporate plaintiffs bar.[2] The section has the ominous title: "Judicial intervention; equitable remedies or dissolution." This metastasized judicial dissolution statute gives Minnesota courts explicit authority not only to dissolve Minnesota corporations, but also to "grant any equitable relief they deem just and reasonable in the circumstances" if a shareholder succeeds in proving that "the directors or those in control . . . have acted in a manner unfairly prejudicial" toward the shareholder in his or her capacity as shareholder or director or, in the case of a closely held

1. MINN. STAT. § 302A.751 (2000).

2. Corporate plaintiffs bar members and their academic supporters rhapsodize in their descriptions of the provision, portraying it as a miracle cure for combating the pathologies of close corporate greed or as the slingshot in the hands of little David as he squares off against management Goliaths. *E.g.*, Joseph Edward Olson, *A Statutory Elixir for the Oppression Malady,* 36 MERCER L. REV. 627 (1985) [hereinafter Olson, *Elixir*]; Joseph W. Anthony & Karlyn Vegoe Boraas, *Betrayed, Belittled . . . But Triumphant: Claims of Shareholders in Closely Held Corporations,* 22 WM. MITCHELL L. REV. 1173 (1996) [hereinafter Anthony & Borass, *Betrayed*]. For a brief description of the 1983 legislative amendments that gave section 302A.751 most of the troublesome qualities it has today by the principal author of the amendments, see Joseph Edward Olson, *Statutory Changes Improve Position of Minority Shareholders in Closely-Held Corporations,* THE HENNEPIN LAWYER (September-October 1983), at 10-11 [hereinafter Olson, *Minority*]. *See also* William Z. Pentelovitch & Cynthia F. Gilbertson, *Upholding Shareholders' Interests: 20 Years with the Minnesota Business Corporation Act*, MINNESOTA BENCH & BAR, Oct. 2001, at 19; Deborah A. Schmedemann, *Fired Employees and/or Frozen-Out Shareholders (An Essay),* 22 WM. MITCHELL L. REV. 1435, 1449 (1996).

Minnesota corporation, as officer or employee.[3] In deciding whether to order relief, the statute requires a court to consider the "reasonable expectations" of shareholders.[4] For purposes of section 302A.751, a shareholder's reasonable expectations are not necessarily bound by the terms of buy-sell or employment agreements to which the shareholder is a party[5] and are not necessarily affected by a shareholder's misconduct, even egregious misconduct.[6] In other words, section 302A.751 provides potential statutory justification for a court to order a buyout on terms more favorable than provided for in an existing buy-sell agreement to a shareholder-employee who has been terminated for incompetence

3. MINN. STAT. § 302A.751(1)(b)(3) (2000). The right to seek equitable relief under the "unfairly prejudicial" standard of section 302A.751(1)(b)(3) applies only to shareholders of a Minnesota corporation that is not "publicly held" (defined in section 302A.011(40) as having a class of equity securities registered pursuant to section 12 of the Securities Exchange Act of 1934 or being subject to section 15(d) of such Act). To be actionable under section 302A.751(1)(b)(3), the behavior must be "unfairly prejudicial" to the shareholder in his or her capacity as shareholder or director unless the Minnesota corporation is also a "closely held corporation" (defined in section 302A.011(6)(a) as a corporation which does not have more than thirty-five shareholders), in which case the behavior may be "unfairly prejudicial" to the shareholder in his or her capacity as officer or employee as well as shareholder or director. MINN. STAT. §302A.751(1)(b)(3) (2000). For further discussion of section 302A.751, see *infra* notes 145 - 223 and accompanying text.

4. MINN. STAT. §302A.751(3)(a) (2000) ("In determining whether to order equitable relief, dissolution, or a buy-out, the court shall take into consideration . . . 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 each other.") For further discussion of the "reasonable expectations" standard in section 302A.751, see *infra* notes 164 - 180 and accompanying text.

5. The statute provides a presumption that written employment or buy-sell agreements embody the shareholders' reasonable expectations. MINN. STAT. § 302A.751(3a) (2000). But courts may override that presumption, s*ee infra* notes 186 - 212 and accompanying text, and the statute invites a court to do so if it finds that "price or terms are unreasonable under all the circumstances of the case." MINN. STAT. § 302A.751(2).

6. *See, e.g.,* Pooley v. Mankato Iron & Metal, Inc., 513 N.W.2d 834 (Minn. Ct. App. 1994) (finding that a shareholder, director and officer who was removed as director and officer following multiple criminal convictions for assault and damage to property in the course of employment was entitled to section 302A.751 buy-out of shares at fair value without equitable reduction for misconduct). Admitting that the plaintiff's behavior in *Pooley* was "fairly egregious," proponents of section 302A.751 view the case as "a good example of the strong protections that minority shareholders have been given." Anthony & Borass, *Betrayed, supra* note 2, at 1181. For further discussion, see *infra* notes 178 - 181 and accompanying text.

or even criminal misconduct in complete conformity with all other law as well as any existing employment agreement.

Section 302A.751 is, in my view, one of the most potentially disruptive provisions in all of U.S. corporate statutory law. It stands as a monument to unpredictability and uncertainty.

My partner showed me the section 302A.751 demand letter. He let me read it as he stood in front of my desk with a little hint of a smile on his face.

"Ugh. What a mess!" I commiserated. "Just what a struggling company needs: long, drawn-out litigation over an expensive buyout of shares from the guy that ran the company into the ground."

My partner's little smile broadened until his face was beaming. He brought another piece of paper from behind his back and handed it to me to read.

"Nope. I've already taken care of the whole thing with one letter."

I looked at the letter he handed me. It was addressed to the well known corporate plaintiffs attorney. It had only one sentence: "Responding to your recent letter, please be advised that YouBetcha.com is a Delaware corporation."

My partner took the rest of the day off. He had done a tremendous day's work for the shareholders and other constituencies of our client. The real lawyering, however, had not been done that day by writing the silver-bullet letter. It had been done years before when he advised that YouBetcha.com should incorporate in Delaware and not in Minnesota, in part to avoid the unpredictability of section 302A.751.

Minnesota has become a poor choice for incorporation in nearly all cases beyond that of a one-person, one-shareholder incorporated proprietorship. That is a shame. Citizens of this state have the right to expect that our state's corporate laws embody a flexible and balanced set of rules under which entrepreneurs and investors can come together to establish and then realize their reasonable expectations with the greatest possible predictability and certainty. Making a business succeed is tough enough without our corporate laws adding unnecessarily to the unpredictability and uncertainty.

One reason lawyers frequently cite for incorporating a business in Delaware instead of their own state is that Delaware courts have produced extensive case law precedent interpreting Delaware's corporation statute, the Delaware General Corporation Law (the "DGCL"), and fleshing out the primarily non-statutory areas of corporate governance law.[7] Better definition may mean greater predictability and certainty in the law. Minnesota certainly lacks a comprehensive body of corporate case precedent, and that may be a very important reason for preferring Delaware.[8] But all states other than Delaware have this same problem to a greater or lesser extent.

7. "Corporate lawyers across the United States have praised the expertise of the Court of Chancery, noting that since the turn of the century, it has handed down thousands of opinions interpreting virtually every provision of Delaware's corporate law statute. No other state can make such a claim." E. Norman Veasey, *An Economic Rationale for Judicial Decisionmaking in Corporate Law,* 53 BUS. LAW. 681, 682 (1998) (quoting Chief Justice Rehnquist in William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 BUS. LAW. 351, 354 (1992)).

8. The absence of case law precedent under the Minnesota statute is remarkable. According to a Westlaw search conducted on October 24, 2001 ("302A" and "corporation" in the MN-CS-ALL database), there were only 205 Minnesota Supreme Court, Minnesota Court of Appeals or federal court cases citing chapter 302A in the twenty years since its adoption in 1981. Upon examination, only 118 of these could be said to address substantive issues under the MBCA, as opposed to simply citing the statute incidentally. Of those 118 substantive cases, a total of 46 addressed primarily issues under section 302A.751 (with 18 other cases dealing with Section 302A.751 but also addressing other issues). That leaves only 72 cases decided by state or federal courts that have really interpreted parts of the Minnesota statute (other than section 302A.751) or otherwise addressed substantive, non-statutory aspects of Minnesota corporate law. Although these 72 cases provide authority on a number of significant points that should be relevant in choosing a corporate home, what they do not provide is even more telling. Case law explaining the duty of care in Minnesota is scarce. Although a number of cases refer to the existence of the business judgment rule in Minnesota, there is little in the way of clear articulation of the rule. There are no cases interpreting the practical scope of protection afforded by a Minnesota charter option provision exculpating directors from liability for monetary damages to the corporation and its shareholders. No cases have interpreted the meaning of the "other constituencies" provision in section 302A.251. There is little authority interpreting Minnesota's indemnification provisions. It is unclear whether Minnesota courts have adopted the *Unocal*, *Revlon* or *Blasius* standards articulated by the Delaware courts. In fact, there is no clear Minnesota authority for the proposition that Minnesota courts, when lacking their own authority, will consistently follow Delaware's lead. Case law interpreting important elements of the merger and asset sale provisions relevant to M&A practice is almost nonexistent. There is almost no case authority interpreting the arcane complexities of the various Minnesota anti-takeover statutes. Memorandum from James K. Moeller, to Bryn R. Vaaler (Jan. 4, 2002) (on file with author); Memorandum from Michael J. Kroll, to Bryn R. Vaaler (Nov. 11, 2001) (on file with author).

The problems that really set Minnesota apart relate to the Minnesota Business Corporation Act, chapter 302A of the Minnesota Statutes (the "MBCA" or "chapter 302A"). The MBCA was adopted in 1981 and went into effect for all Minnesota business corporations on January 1, 1984.[9] Although based in large part on the Model Business Corporation Act (the "Model Act")[10] as it existed *circa* 1979, chapter 302A contained, from the start, an eclectic mix of other disparate currents in corporate statutory law as well as a number of home-grown novelties.[11] In the two decades

9. MINN. STAT. § 302A.001 (2000); JOHN H. MATHESON & PHILIP S. GARON, MINNESOTA CORPORATION LAW & PRACTICE § 1.1, at 1-3 (1992).

10. The Model Act was developed by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association and first published in 1950. The ongoing amendment and refinement of the Model Act is the continuing job of the Committee on Corporate Laws. After nearly thirty years of amendments, the Committee on Corporate Laws undertook a complete revision and restatement of the Model Act. This task was completed in 1984 with the publication of what became known as the Revised Model Business Corporation Act. As the Revised Model Business Corporation Act became widely known and adopted over the next six years, the Revised Model Business Corporation Act was re-named simply the Model Business Corporation Act. Today, the Model Act is the most influential source of corporate statutory law in the United States. Approximately half of the states have adopted the Model Act more or less verbatim as their corporation statute. As the Committee on Corporate Laws considers and adopts further amendments and refinements, such changes are published in *The Business Lawyer* in proposed and final form and are considered and acted upon by legislatures throughout the country. *See generally* 1 MODEL BUS. CORP. ACT ANN. xxvii-xxxix (3d ed. 2000); Richard A. Booth, *A Chronology of the Evolution of the MBCA*, 56 BUS. LAW. 63 (2000). For a recent comparison of the Model Act and the Delaware General Corporation Law, see Michael P. Dooley & Michael D. Goldman, *Some Comparisons between the Model Business Corporation Act and the Delaware General Corporation Law,* 56 BUS. LAW. 737 (2001). The Model Act is published in its entirety along with the extensive *Official Commentary* and annotations of case precedent drawn from states that have adopted the Model Act in *The Model Business Corporation Act Annotated*, which is currently in its third edition.

11. Advisory Task Force on Corporation Law Report to the Senate and Preface to Reporter's Notes *reprinted in* Reporter's Notes to Section 302A.001, WEST'S MINNESOTA CORPORATION, LIMITED LIABILITY COMPANY, AND PARTNERSHIP LAWS 62 (2001-2002 Special Pamphlet).

> [P]ortions of the proposed new Minnesota Business Corporation Act were derived from provisions [of the previous Minnesota act]. Most of these provisions were rewritten in whole or in part for clarity and consistency with other provisions in the proposed act. Other portions of the proposed new business corporation act were similarly derived from the Model Business Corporation Act and the business corporation laws of California, Connecticut, Delaware, Georgia, Illinois, Maryland, Michigan, New Jersey, and New York. However, other provisions in the proposed new act have no counterpart elsewhere and represent innovations in

since its adoption, more novelties have been added and little attention has been paid to important changes and new directions in U.S. corporate statutory law as embodied in ongoing amendments to the Model Act. As a result, the idiosyncrasies of the MBCA have become more and more exaggerated.

Today, I believe that the best advice Minnesota lawyers can give their clients, whether their businesses are to be closely or publicly held, is to avoid incorporating in Minnesota.[12]

Minnesota deserves better than this. The MBCA should be scrapped in its entirety. Years of inattention, fuzzy thinking, sloppy drafting and bad choices have resulted in a statute that is really beyond patchwork repair even by an informed and interested legislature acting under the advice and close direction of an expert and active corporate bar. Instead, Minnesota should do what nearly half the states in the United States have done: adopt the Model Act as it exists today in its entirety and commit to a disciplined program of prompt consideration of, and action on, future amendments and improvements to the Model Act with a view toward keeping Minnesota in the mainstream of corporate statutory law.

II. WHY THE MBCA SHOULD BE SCRAPPED

What makes the MBCA such a bad corporation statute? Here are some of the reasons in no special order:

business corporation law.

Id. at 68-69. *See also* MATHESON & GARON, *supra* note 9, § 1.1, at 1-3.

12. As noted, the only exception to this rule would be an incorporated sole proprietorship in which there will never be more than one shareholder. If that is the case, none of the problems with the MBCA (or for that matter any other state corporate statute) really make much difference. The reason most often given for incorporating a closely held business locally instead of in Delaware is cost: the cost of maintaining a registered agent and office for service of process in Delaware, the cost of foreign qualification in the home state of the business and the cost of Delaware franchise and filing taxes. *E.g.,* ROBERT W. HAMILTON, BUSINESS ORGANIZATIONS: UNINCORPORATED BUSINESSES AND CLOSELY HELD CORPORATIONS § 8.17, at 213 (1996); WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 143 (7th ed. 2000); ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW § 1.08[A], at 13 (1999). With proper planning such as limiting the number of authorized shares to avoid high franchise taxes, these additional costs can easily be kept under $1,000 annually for most closely held corporations.

A. *Wrong-headed Defaults*

A corporation statute consists of two kinds of provisions: absolute rules and default rules.[13] Absolute rules are invariable. For example, the MBCA provides that owners of ten percent or more of the outstanding shares of a corporation have the right to call a special meeting of shareholders with or without the consent of the board.[14] This right may not be varied by providing to the contrary in the articles of incorporation, the bylaws or otherwise.

Default rules may be varied by making provision in the articles or certificate of incorporation, in the bylaws, by board resolution or by contract, all as specified in the relevant corporation statute. For example, the MBCA provides that shareholders take action by the affirmative vote of a majority of the votes at a meeting at which a quorum is present, unless the articles of incorporation provide for a greater vote requirement.[15] Minnesota corporations may therefore have super-majority voting by provision in their articles of incorporation.

Big-ticket default rules may generally be varied only by provision in the articles or certificate of incorporation. This makes important default elections a matter of public record (since the articles or certificate of incorporation, unlike bylaws, resolutions or contracts, must be on file in the office of the Secretary of State or other government official charged with oversight of corporations in a particular state). It also makes such elections subject to change only with both board and shareholder approval.[16]

Two of the biggest-ticket default rules in the MBCA—the rules on cumulative voting for directors and preemptive rights—are set the wrong way. They provide by default for a rule that no knowledgeable corporate lawyer would ever advise for his or her

13. JAMES D. COX, THOMAS LEE HAZEN & F. HODGE O'NEAL, CORPORATIONS § 3.10, at 3.29 to 3.30 (2001).

> Under most corporate statutes, certain rules as to corporate organization, meetings, and management are mandatory and cannot be varied by the articles, while other rules apply only in the absence of some variation, which must be stated in the articles (in some cases, the variation may be in either the articles or the bylaws).

Id. (parenthetical included in original, footnotes omitted).

14. MINN. STAT. § 302A.433(1)(e) (2000).

15. MINN. STAT. § 302A.437(1) (2000).

16. For a description of the corporate charter as a sort of public contract between and among the shareholders, the corporation and the state, see COX, HAZEN & O'NEAL, *supra* note 13, § 3.11, at 3.30 to 3.32.

client. For the uninitiated, this makes the MBCA a trap for the unwary. For those who know better, this makes it necessary to provide opt-out language in every single set of Minnesota articles prepared. *Every single one.* Why would a corporation statute provide a default rule that no knowledgeable practitioner would ever leave as is?

Cumulative voting. The MBCA provides that shareholders of a Minnesota corporation may vote cumulatively for election of directors unless an opt-out provision is contained in the articles of incorporation.[17]

Under normal voting for directors, the holders of a majority of the shares of voting stock of the corporation can elect the entire board of directors.[18] Cumulative voting is an alternative method of voting for directors designed to give minority shareholders some representation on the board.[19] How many shares it takes to ensure the ability, through cumulative voting, to elect one board member turns on a complex formula dependent on the number of shares present and voting, the number of board seats open for election and other factors.[20] Every time the number of outstanding shares or the number of directors on the board changes, the minimum number of shares required to elect one director also changes. In order for minority shareholders to use cumulative voting to their benefit, they must give timely notice of intent to vote cumulatively

17. MINN. STAT. § 302A.215(1) (2000). The default in favor of cumulative voting was retained from the predecessor statute to the MBCA. *Id.* (Reporter's Notes - 1981, General Comment).

18. COX, HAZEN & O'NEAL, *supra* note 13, § 13.21, at 13.45 ("Without cumulative voting, holders of a bare majority of the shares may elect the full board and thus control the corporation without any representatives of other interests being present at board meetings.").

19. "Cumulative voting is the privilege of multiplying the number of shares held by the number of directors to be elected and casting the product for a single candidate or distributing the product among two or more candidates." *Id.*

20. *Id.*

> The following algebraic formula is sometimes used to determine how many votes of those present is sufficient under cumulative voting to elect a specified number of directors:
>
> $$x = \frac{a \times b}{c + 1} + 1$$
>
> with *a* representing the number of directors [a shareholder] desires to elect, *b* the number of shares present and voting, *c* the total number of vacancies to be filled, and *x* the number of shares necessary to achieve the desired objective.

Id. at 13.46 n.4.

and must cumulate their votes in exactly the right manner, otherwise it does not work.[21]

For these reasons, no knowledgeable corporate lawyer ever intentionally advises a client to build cumulative voting into the corporation. If the shareholders have agreed to minority representation on the board, that result can be achieved with much greater precision and certainty through use of multiple classes of stock or voting agreements. If the shareholders have not agreed to minority representation on the board, most people doing business in corporate form would probably expect that the majority shareholders can elect the entire board[22] and would be, to put it mildly, unpleasantly surprised to be bushwhacked by a minority shareholder exercising statutory rights to cumulative voting.[23]

The MBCA got it wrong by making cumulative voting an opt-out measure. The Delaware General Corporation Law and the corporation statutes of most other jurisdictions make cumulative voting an opt-in provision.[24] So does the Model Act.[25] The reasoning offered for the Minnesota opt-out approach is stated in the Reporter's Notes to section 302A.215: "shareholders of a close corporation would probably bargain for the inclusion of such a provision in the articles."[26] What exactly does this mean? Does it mean that shareholders of a Minnesota corporation would probably have an unspoken expectation that there would be in place an uncertain and unwieldy rule that would permit minority shareholders at some constantly changing percentage level some representation on the board? To me, that seems pretty unlikely

21. This is why most corporate statutes require advance notice (*e.g.,* twenty-four or forty-eight hours) by any shareholder who intends to use cumulative voting. *Id.* at 13.47. The Model Act, for example, requires forty-eight hours of advance notice if cumulative voting is permitted. MODEL BUS. CORP. ACT § 7.28(d) (2000). The MBCA has eliminated an advance notice requirement. *See* MINN. STAT. § 302A.215 (2000) (Reporter's Notes).

22. At least that has been the conclusion in most states, since cumulative voting is an opt-in provision (*i.e.,* no cumulative voting unless provided to the contrary in the articles) in most jurisdictions. COX, HAZEN & O'NEIL, *supra* note 13, § 13.21, at 13.48.

23. Bushwhacked is the operative term in Minnesota. The twenty-four hour advance notice requirement under the previous statute was eliminated in section 302A.215. MINN. STAT. § 302A.215 (2000) (Reporter's Notes). All that is required now is written notice to any officer before the meeting. *Id.*

24. DEL. CODE ANN. tit. 8, § 214 (2000). With respect to other jurisdictions, see COX, HAZEN & O'NEAL, *supra* note 13, § 13.21, at 13.48.

25. MODEL BUS. CORP. ACT § 7.28(b) (2000).

26. MINN. STAT. § 302A.215 (Reporter's Notes).

(and pretty bad legal policy). I think the far more likely expectation (and far better legal policy) would be that minority shareholders with a real expectation of ability to elect one or more directors would want some certainty and predictability. That's how the drafters of the Model Act and the legislatures in most states see it.

You may be saying: "Big deal. All you have to do is negate cumulative voting in your articles." That is basically true.[27] But the problem is that even good lawyers forget. When they realize their mistake (for example, at the point when due diligence is being done in connection with a financing transaction), they invariably want to eliminate the problem as soon as possible. The MBCA makes this very difficult. A minority shareholder with enough shares to ensure election of one director under cumulative voting can veto an amendment of the articles for the purpose of negating

27. Actually, in Minnesota, this is not quite true. The MBCA does not explicitly state what the voting rule for election of directors is if cumulative voting is eliminated. *Compare* MODEL BUS. CORP. ACT § 7.28(a) (2000) (explicitly stating that directors are elected by plurality vote unless otherwise provided in the articles of incorporation) *with* MINN. STAT. §§ 302A.215 & 302A.437 (2000) (indicating that election of directors would be subject to the basic majority-of-a-quorum voting rule). This means that, in a Minnesota corporation opting out of cumulative voting, directors must probably receive a majority vote to be duly elected and, consequently, that all director seats open for election may not be filled. MATHESON & GARON, *supra* note 9, § 3.9, at 3-18 to 3-19. It is unlikely that an articles or bylaw provision providing for plurality voting would be effective under the MBCA, since section 302A.437(1) makes provision only for increasing shareholder voting requirements, not decreasing them, in the articles. MINN. STAT. § 302A.437(1) (2000). This is a perfect example of shoddy drafting in the MBCA and a good illustration of why the whole statute should be scrapped. A Minnesota corporation simply cannot achieve the full flexibility available under a Model Act statute by negating cumulative voting!

cumulative voting.[28] An amendment of Minnesota articles to eliminate cumulative voting also triggers appraisal rights.[29]

Preemptive rights. The MBCA also makes preemptive rights an opt-out default. Section 302A.413 of the MBCA provides that shareholders of a Minnesota corporation have preemptive rights unless provided to the contrary in the articles of incorporation.[30] Statutory preemptive rights give each shareholder the right to acquire a fraction of all new securities or rights to purchase securities of the same type owned by the shareholder before the corporation may offer such securities or rights to others.[31] The fraction is equal to the shareholder's pro-rata ownership of the securities of the relevant type before the proposed issuance.[32] There are important exemptions to Minnesota's version of statutory preemptive rights. For example, preemptive rights do not apply to securities issued for consideration other than money or issued in a merger transaction or issued in a public offering.[33]

28. Section 302A.215(2) provides for this supermajority vote with respect to any amendment to the "articles or bylaws which has the effect of denying, limiting or modifying the right to cumulative voting for directors." MINN. STAT. § 302A.215(2) (2000). Since cumulative voting can only be effectively negated in the articles, it is clear from the reference to "bylaws" and from the "limiting or modifying" language that the supermajority voting requirement is intended to apply to adoption of other measures that could be viewed as lessening a shareholder's director election potential through cumulative voting. For example, an articles amendment to classify the board or reduce board size would arguably be subject to the supermajority vote in section 302A.215(2) if the Minnesota corporation has cumulative voting. For an extensive discussion of the broad but ambiguous reach of section 302A.215, see MATHESON & GARON, *supra* note 9, § 3.8, at 3-14 to 3-18.

29. Section 302A.471(1)(a)(4) triggers dissenter's rights if an articles amendment "excludes or limits" a shareholder's right to cumulative voting. The reach of this provision is as vague as the reach of the supermajority voting requirement in section 302A.215(2). MINN. STAT. § 302A.471(1)(a)(4) (2000). *See* MATHESON & GARON, *supra* note 9, § 3.8, at 3-17. *See also supra* note 28. In *Whetstone v. Hossfeld Mfg. Co.,* the Minnesota Supreme Court confirmed that under section 302A.471(1)(a)(4), dissenter's rights are triggered in a closely held Minnesota corporation with cumulative voting by an amendment to the articles decreasing the maximum board size from five to three. 457 N.W.2d 380, 385 (Minn. 1990).

30. MINN. STAT. § 302A.413(1) (2000). *See generally* MATHESON & GARON, *supra* note 9, §§ 5.9-5.11, at 5-32 to 5-37.

31. MINN. STAT. § 302A.413(2) (2000). *See* MATHESON & GARON, *supra* note 9, § 5.9, at 5-32.

32. MINN. STAT. § 302A.413(5) (2000). *See* MATHESON & GARON, *supra* note 9, § 5.9, at 5-34.

33. MINN. STAT. § 302A.413(4) (2000). *See* MATHESON & GARON, *supra* note 9, § 5.11, at 5-35 to 5-37.

Once again, no knowledgeable lawyer would ever advise in favor of statutory preemptive rights. If minority shareholders truly have an expectation and agreement that they will be afforded the opportunity to maintain their percentage ownership through a right of refusal to acquire securities in subsequent issuances, that expectation and agreement may be embodied with much greater certainty and precision in an agreement with the corporation.[34] From the corporation's standpoint, statutory preemptive rights may interfere greatly with the ability to finance the corporate business.

For these reasons, the DGCL, the Model Act and the corporate statutes in a majority of U.S. jurisdictions make preemptive rights an opt-in provision.[35] No preemptive rights exist unless explicitly so provided in the certificate or articles of incorporation.

Once again, the MBCA provides a treacherous trap for the unwary. I have seen even good Minnesota lawyers forget to negate preemptive rights in the articles of incorporation. The results can be absolutely devastating. The corporation may have existed and financed itself without complying with the preemptive rights requirements for years before the existence of the rights are discovered. More than once in the course of performing a due diligence review of a Minnesota corporation on behalf of an investor group, we have discovered that preemptive rights exist and have not been complied with. The corporation must then go to its shareholders and beg them to waive their rights with respect to past issuances and agree to amend the articles of incorporation to opt out of statutory preemptive rights for the future. Any shareholder so inclined can use this occasion to blackmail everyone else involved by insisting on their pound of flesh with respect to prior issuances. Removing preemptive rights for the future requires an amendment to the articles of incorporation.[36] Such an amendment triggers appraisal rights.[37]

34. Such agreements are explicitly authorized by section 302A.413(10) of the MBCA, which provides that denial of statutory preemptive rights in the articles of incorporation in no way limits the power of the corporation to grant any type of contractual rights of first refusal. MINN. STAT. § 302A.413(10) (2000). Contractual rights of first refusal can also protect shareholders in ways that statutory preemptive rights, with all their exemptions, cannot. COX, HAZEN & O'NEAL, *supra* note 13, § 16.22, at 16.62.

35. DEL. CODE ANN. tit. 8, § 102(b)(3) (2000); MODEL BUS. CORP. ACT § 6.30(b) (2000). With respect to the majority of U.S. jurisdictions being opt-in, see COX, HAZEN & O'NEAL, *supra* note 13, § 16.22, at 16.56; PINTO & BRANSON, *supra* note 12, § 4.04[A], at 73.

36. If the corporation has cumulative voting, a minority shareholder with

B. Misguided Policy Underpinnings

The wrong-headedness behind the Minnesota approach to cumulative voting and to preemptive rights is the result, I believe, of some fundamental philosophical or policy positions taken by those who have been responsible for the MBCA. These positions explain many of the worst problems in the statute.

Protecting "widows and orphans" as a first priority. First, the MBCA is overly protective of minority shareholders. In a well-meaning, but misguided, example of prairie populist thinking, those responsible for the MBCA have somehow equated minority shareholders to political, racial or religious minorities or other segments of the population needing special protection. One of the most active contributors to the minority protection provisions of the MBCA, in an article on the 1983 amendments to the MBCA aimed at stiffening minority protections, maintained that "the classic victims" of shareholder abuse are "widows and orphans."[38] The equation is questionable at best. Minority shareholders generally do not become such by accident of birth or death but by

enough shares to ensure election of one director can veto an amendment of the articles "which has the effect of denying, limiting, or modifying" preemptive rights. MINN. STAT. § 302A.413(9) (2000). As originally added in the 1983 amendments to the MBCA, this supermajority voting requirement applied even if the corporation did *not* have cumulative voting. *See* MATHESON & GARON, *supra* note 9, § 5.9, at 5-33. This bizarre aberration was corrected in 1993 amendments to the MBCA. However, even in a corporation that has cumulative voting, it is hard to see a logical reason why elimination of preemptive rights should turn on a cumulative-voting-based supermajority. The principal author of the 1983 amendments offers no explanation of the logic beyond need to protect minority shareholders. *See* Olson, *Minority*, *supra* note 2, at 25. Because the supermajority requirement applies to any articles amendment having the "effect of denying, limiting or modifying" preemptive rights, it has the same problems of vagueness of reach as the supermajority requirement for elimination of cumulative voting discussed *supra* in notes 28 and 29. *See* MATHESON & GARON, *supra* note 9, § 5.9, at 5-33 n.119.

37. Section 302A.471(1)(a)(3) triggers dissenter's rights if an articles amendment "alters or abolishes" a shareholder's preemptive rights. The reach of this provision is as vague as the reach of the supermajority voting requirements in sections 302A.215(2) and 302A.413(9) and the analogous dissenter's rights trigger for "excluding or limiting" cumulative voting. MINN. STAT. § 302A.471(1)(a)(3) (2000). *See supra* notes 28, 29 & 36.

38. Olson, *Elixir*, *supra* note 2, at 629; Olson, *Minority, supra* note 2, at 10. Although I have not done a close review of the dozens of cases decided under section 302A.751 of the MBCA, I would bet that most of them do not involve widows or orphans as plaintiffs. In fact, I would speculate that widows and orphans are involved no more often than incompetent or unfaithful employees and managers, quarrelsome siblings and convicted wrongdoers.

volitional act and agreement. Although any corporation statute must balance the good of the majority with the good of the minority,[39] the balance struck in the MBCA is substantially out of line with the current mainstream of corporate statutory law.

Clarity, predictability and certainty as lesser priorities. The MBCA seems consistently to undervalue clarity, predictability and certainty. The nexus of contracts that comprises the law of corporations is more complex than a purely contractual relationship. Of necessity, it must include somewhat vague, extra-contractual duties and rights (like the fiduciary obligations and duty of fairness protecting minority shareholders from those wielding power). However, the more our corporate law builds vagueness, unpredictability and uncertainty into the nexus of contracts and the more it vests the power to unleash that vagueness, unpredictability and uncertainty in those who may have a disproportionately small investment in the enterprise, the less well it serves the enterprise and its economic goals.[40]

39. "The history of the corporation evidences a tension between the impulse to let people contract freely, and a concern for those harmed by such contracts." David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?*, 51 OKLA. L. REV. 427, 433 (1998).

40. *See infra* notes 165 to 180 and accompanying text. In assessing the DGCL, three practitioner-commentators have noted:

> The Delaware bar and legislature have fashioned a statute that, for the most part, fulfills the criteria for a good corporation statute: (i) Technical flaws are eliminated quickly. (ii) Corporate transactions are made easier to accomplish, successfully bypassing the idea that difficulty is more moral. (iii) A large role is left to private contract through charter amendment. (iv) There are few obstacles to majority rule.

Leo Herzel et al., *Contents to Trouble*, 42 BUS. LAW. 135, 135 (1986). The major proponents of the minority shareholder "protections" in the MBCA obviously do not agree with these criteria for a good statute. They have promoted minority shareholder rights by intentionally inserting confusion and litigation-generating ambiguity into the statute, all the while arguing that their intention is to simplify, clarify and reduce wasteful litigation. For example, the principal author of the 1983 amendments to section 302A.751 apparently promoted those changes to the legislature as a means of removing uncertainty and reducing litigation. Professor Olson notes that "section 751 is designed to reduce litigation by removing questions of law as obstacles to relief for noncontrolling shareholders. The *law* is now clear – minority shareholders have a right to relief from 'mistreatment' that exploits their vulnerability and defeats their reasonable expectations." Olson, *Elixir, supra* note 2, at 633. In a footnote to this statement, Professor Olson defines what he means by "mistreatment:" it is "a general term that encompasses all acts of the controlling group which leave other shareholders at a disadvantage." *Id.* at 633 n.43. So, section 302A.751 in its present form was apparently sold to the

Hardwiring it into the statute. The MBCA favors hardwiring rules into the statute. The unmistakable direction of evolution in corporate law (and in business association law generally) has been away from the mandatory, structured, vested rights of the shareholder and toward a more purely enabling, contractual approach.[41] Where a shareholder invests in an enterprise with little or no explicit contractual specification, our corporate laws should provide a nexus of contract that should have its default switches set on relative simplicity, certainty, predictability and ability of the majority to move forward with maximum flexibility. Minority protections, where needed, should be as clear and crisp as possible. Where a shareholder invests in an enterprise with more explicit contractual specification (e.g., preferred stock, buy-sell agreement), the rules of corporate law ought generally to yield to, not override, the contractual specification.

legislature as a litigation-reducing cure for mistreatment of minority shareholders, but was intended by its author to really be a no-fault right to recovery whenever a minority shareholder is disappointed. The confusing language of section 302A.751 reflects this lack of clarity in purpose, and it is not surprising that this litigation-reducing "elixir" has produced more litigation (judging from the number of reported cases) than any other provision in the MBCA. *See supra* note 8.

41. "This movement toward enabling statutes has accelerated within the last twenty-five years, as the contractarian view of corporations has gained more of a following. As corporation statutes have become more enabling, there has been a similar effect upon other business entity statutes." Thomas F. Blackwell, *The Revolution Is Here: The Promise of a Unified Business Entity Code*, 24 J. CORP. L. 333, 338 (1999). "Critics and advocates agree that a revolution, under the banner 'nexus of contracts,' has in the last decade swept the legal theory of the corporation." Lewis A. Kornhauser, *The Nexus of Contracts Approach to Corporations: A Comment on Easterbrook and Fischel*, 89 COLUM. L. REV. 1449, 1449 (1989). For additional support for the contractarian evolution or revolution in corporate statutory law, see COX, HAZEN & O'NEAL, *supra* note 13, § 25.7, at 25.29; PINTO & BRANSON, *supra* note 12, at 114; William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1395 (1993); Robert C. Clark, *Contracts, Elites, and Traditions in the Making of Corporate Law*, 89 COLUM. L. REV. 1703, 1705 (1989); Frank H. Easterbrook & Daniel R. Fischel, *Contractual Freedom in Corporate Law: Articles & Comments; The Corporate Contract*, 89 COLUM. L. REV. 1416, 1416 (1989); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1549 (1989); Michael J. Phillips, *Reappraising the Real Entity Theory of the Corporation*, 21 FLA. ST. U. L. REV. 1061, 1061 (1994); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 251 (1977). The Model Act recognized the importance of this contractarian trend as it applies to privately held corporations in adopting section 7.32 in 1990. Section 7.32 recognizes the validity of agreements among all shareholders of a privately held corporation even though such agreements may be inconsistent with one or more provisions of the Model Act, so long as such agreements are not contrary to public policy. MODEL BUS. CORP. ACT § 7.32(a) (2000).

The MBCA was written with too much power and uncertainty vested in minority shareholders in ways that cannot be varied by agreement among the participants to the corporate enterprise. The wrong-headed defaults with respect to cumulative voting and preemptive rights reflect all three of these problems. Cumulative voting and preemptive rights are both, supposedly, minority protective defaults. They both entail such uncertainty and unpredictability, however, that no one knowledgeable would ever count on them to truly protect a minority shareholder, and no one concerned with the majority's ability to function efficiently would ever knowingly permit them to remain the operative rules. Nevertheless, cumulative voting and pre-emptive rights are baked into the MBCA as opt-out defaults.

C. *Onerous Class and Series Voting Requirements*

All U.S. corporation statutes have provisions giving outstanding shares of a class or series of stock mandatory voting rights with respect to certain types of amendments to the articles or certificate of incorporation even if the articles or certificate of incorporation negates the right of such shares to vote.[42] Such provisions are intended to give holders of a class or series a veto power over amendments that would adversely affect their rights even if such a voting power is denied in the terms of their class or series.[43]

The MBCA list of consequences requiring separate vote is considerably more extensive than the Delaware list (ten items versus three).[44] Except in certain situations involving stock splits, the MBCA requires a separate vote if the number of authorized shares of the class or series would be increased or decreased.[45] The DGCL requires a separate vote on such increases or decreases unless the certificate of incorporation denies it.[46] Minnesota also requires a separate vote if the amendment would, among other things, effect an exchange or reclassification of the class or series,

42. COX, HAZEN & O'NEAL, *supra* note 13, § 25.5, at 25.18.
43. *Id.*
44. *Compare* MINN. STAT. § 302A.137 (2000) *with* DEL. CODE ANN. tit. 8, § 242(b)(2) (2000). *See also* COX, HAZEN & O'NEAL, *supra* note 13, § 25.5, at 25.19 ("Delaware is distinctive in the brevity with which its statute proscribes amendments triggering a class vote.").
45. MINN. STAT. § 302A.137(a) (2000).
46. DEL. CODE ANN. tit. 8, § 242(b)(2) (2000).

create a new class or series (or increase the authorized shares of an existing class or series) with prior or superior rights or preferences or change the rights or preferences of the class or series in any way.[47] Delaware requires a separate vote only if a change would affect the rights or preferences of the class or series so as to affect them adversely.[48]

The MBCA class or series voting triggers are therefore more numerous and substantially broader than their DGCL counterparts, giving shareholders of classes or series that may constitute minority participations in the corporation a veto power over important changes that may go beyond any self-defense justification. The result is a significant potential for obstructionism by minority investors under the MBCA that may be troublesome for management and majority investors.

The Model Act provides nearly as many triggers as the MBCA, but has eliminated entirely the trigger for increases or decreases in the aggregate number of authorized shares of the class or series.[49] So, if Minnesota follows the advice of this article and adopts the Model Act as it currently exists, there will not be a huge improvement in onerous class and series voting requirements.[50] However, the Model Act has been moving away from overloading minority protections connected with articles amendments, as shown by the important reduction in appraisal rights made to the Model Act in 1999.[51]

D. Expansive Appraisal Rights Provisions

All modern corporation statutes grant shareholders the right to dissent from certain corporate actions and be paid in cash by the

47. MINN. STAT. § 302A.137(b)-(i) (2000).

48. DEL. CODE ANN. tit. 8, § 242(b)(2) (2000).

49. MODEL BUS. CORP. ACT § 10.04 (2000).

50. The Model Act does, however, lessen the potential for obstructionism by requiring that classes or series that are similarly affected by an amendment must vote together and not as separate classes or series. *Id.* § 10.04(c). For illustrations of how this provision operates, see *id.* § 10.04 (Official Comment). The MBCA does not have a comparable provision.

51. *See* Committee on Corporate Laws, *Changes in the Model Business Corporation Act Pertaining to Appraisal Rights and to Fundamental Changes – Final Adoption*, 55 BUS. LAW. 405, 405-406 (1999) [hereinafter Committee on Corporate Laws, *Changes in the Model Act*]; Committee on Corporate Laws, *Proposed Changes in the Model Business Corporation Act—Appraisal Rights*, 54 BUS. LAW. 209 (1998) [hereinafter Committee on Corporate Laws, *Proposed Changes in the Model Act*]. *See also infra* notes 62 through 66 and accompanying text.

corporation the fair value of their shares.[52] Dissenter's rights of appraisal were devised as a statutory escape valve for minority investors. The majority can have flexibility in making fundamental changes in the corporation and the terms of the investment contract, but the minority shareholder can liquidate and escape if they so choose.[53] The Minnesota provision is substantially more favorable to dissenting shareholders than the Delaware provision for two major reasons:

Actions triggering appraisal rights. Delaware appraisal rights only arise in the case of mergers or consolidations, and there is an exclusion for any merger or consolidation in which the dissenter owns shares traded on a national securities exchange or the Nasdaq Stock Market and will receive publicly traded shares in the merger or consolidation.[54] A much larger number of actions trigger appraisal rights in Minnesota, namely, (1) a merger (with no market exclusion comparable to the Delaware exclusion for publicly traded shares); (2) a plan of exchange; (3) a sale of all or substantially all of the assets of the corporation; and (4) any amendment to the articles that materially and adversely affects the rights or preferences of the dissenter's shares by altering or abolishing a preferential, redemption, preemptive or voting right.[55]

Procedures for asserting appraisal rights. Under the DGCL, a shareholder asserting appraisal rights does not receive any payment for his or her shares until the court determines the fair value or the parties otherwise agree to a value, which may require years of costly discovery and litigation.[56] Costs of the proceeding may be determined by the court and assessed against the parties as the court deems equitable under the circumstances.[57]

52. "Every state grants such rights upon the occurrence of certain mergers, and most states also provide for dissenters' rights in the event of a corporation's transfer of substantially all of its assets." MATHESON & GARON, *supra* note 9, § 7.22, at 7-47. *See also* COX, HAZEN & O'NEAL, *supra* note 13, § 22.24, at 22.72.

53. For a brief history of the development of appraisal rights statutes, *see* COX, HAZEN & O'NEAL, *supra* note 13, § 22.24, at 22.72-22.80.

54. DEL. CODE ANN. tit. 8, §§ 262(a) - 262(b) (2000). *See generally* 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 9.43[B], at 9-89 to 9-92 (3d ed. Supp. 2001).

55. MINN. STAT. § 302A.471. "The MBCA dissenters' rights provisions are among the most liberal." MATHESON & GARON, *supra* note 9, § 7.22, at 7-47. *See generally id.* § 7.22, at 7-47 to 7-51.

56. DEL. CODE ANN. tit. 8, § 262(i) (2000).

57. *Id.* at § 262(j).

Under the MBCA, however, the dissenting shareholder is paid up front the value of his or her shares as determined by the corporation.[58] The dissenting shareholder continues the proceeding only to recover the amount, if any, by which fair value of his or her shares exceeds what has already been paid by the corporation.[59] Costs are assessed against the corporation unless the court determines that the dissenting shareholder's action in seeking value above that paid up front by the corporation was arbitrary, vexatious or not in good faith.[60] In its discretion, the court may also award attorneys' fees to the lead dissenter from the amount payable to all dissenters.[61]

Important changes to Model Act not reflected in MBCA. Until 1999, the Model Act provisions were nearly identical to the MBCA provisions both with respect to actions triggering appraisal rights and procedures for asserting appraisal rights.[62] In that year, however, the Model Act was amended to radically reduce the triggering actions and bring the Model Act closer in line with the Delaware provision and a contractual approach to corporate law.[63] Most importantly, the Model Act revision eliminated appraisal rights resulting from any articles amendment (other than amendments to effect a reverse stock split) and added a market out similar to the Delaware market out.[64] Although the 1999 revisions to the Model Act retained appraisal rights in connection with certain sales of corporate assets,[65] such revisions were accompanied by revisions to section 12.02 of the Model Act replacing the old "all

58. MINN. STAT. § 302A.473(5)(a) (2000). *See generally* MATHESON & GARON, *supra* note 9, § 7.27, at 7-54 to 7-57.

59. MINN. STAT. § 302A.473(6) (2000). *See generally* MATHESON & GARON, *supra* note 9, § 7.28, at 7-57.

60. MINN. STAT. § 302A.473(8) (2000). *See generally* MATHESON & GARON, *supra* note 9, § 7.31, at 7-60 to 7-61.

61. MINN. STAT. § 302A.473(8).

62. Committee on Corporate Laws, *Changes in the Model Act*, *supra* note 51, at 405-06; Committee on Corporate Laws, *Proposed Changes in the Model Act*, *supra* note 51, at 209.

63. Committee on Corporate Laws, *Changes in the Model Act*, *supra* note 51, at 405-06; Commitee on Corporate Laws, *Proposed Changes in the Model Act*, *supra* note 51, at 209.

64. MODEL BUS. CORP. ACT § 13.02(a) (2000). For a closer description of the 1999 changes, see Historical Background to section 13.02 in 3 MODEL BUS. CORP. ACT ANN. 13-28 to 13-29 (3d ed. 2000); Bryn R. Vaaler, *Major Revisions to the Mississippi Business Corporation Act – Fundamental Changes and Appraisal Rights*, MISS. LAW., July-Aug.-Sept. 2000, at 28.

65. MODEL BUS. CORP. ACT § 13.02(a)(3) (2000).

or substantially all" language with a more concrete safe-harbor test intended to reduce the uncertainty involved in determining which sales of corporate assets require a shareholder vote and trigger appraisal rights.[66] The 1999 Model Act revisions also added a specific provision that appraisal rights may be eliminated entirely or restricted with respect to any class or series of preferred stock, if such elimination or restriction is included in the terms of such class or series.[67]

As of the end of 2001, no initiatives had been undertaken in Minnesota to bring the expansive appraisal rights provisions of the MBCA into line with the 1999 revisions to the Model Act. As the 1999 revisions are adopted in more and more Model Act states, the MBCA appraisal rights provisions will become even more exaggeratedly out of line with the balancing of rights in mainstream corporate law.

E. Unilateral Shareholder Approval of Articles Amendments

The Model Act and the DGCL require approval by both the board of directors and the shareholders to amend the articles or certificate of incorporation once stock has been issued.[68] The MBCA also requires both board and shareholder approval for amendments to the articles, but has a troubling exception to this rule. If holders of shares aggregating 3% of the outstanding voting power of the shares entitled to vote propose an articles amendment

66. *Id.* § 12.02(a). *See also* Committee on Corporate Laws, *Changes in the Model Business Corporation Act – Fundamental Changes*, 54 Bus. Law. 685 (1999). For a closer description of the 1999 changes to section 12.02 and discussion of the uncertainty surrounding the old "all or substantially all" test, see MODEL BUS. CORP. ACT § 12.02 (Official Comment); Historical Background to section 12.02 in 3 MODEL BUS. CORP. ACT ANN. 12-17 to 12-18 (3d ed. 2000):

> As amended in 1999, section 12.02 represents an entirely different statutory approach to defining asset dispositions that represent such a fundamental change in the corporation's business as to require shareholder approval. As the Official Comment states, however, the basic test employed in section 12.02(a) – whether the disposition "would leave the corporation without a significant continuing business activity" – more accurately captures the way in which many courts apply the "all or substantially all assets" test used in other corporation statutes, including section 12.02 of the Model Act, prior to the 1999 amendments. The quantitative safe-harbor provision in the second sentence of 12.02(a) is also unique to the Model Act, as amended.

Id. See also Vaaler, *Major Revisions, supra* note 64, at 28, 30 n.2.

67. MODEL BUS. CORP. ACT § 13.02(c) (2000).

68. *Id.* § 10.03(b); DEL. CODE ANN. tit. 8, § 242(b) (2000).

in Minnesota, that proposal must be submitted to shareholders for approval regardless of whether the board approves it.[69] In essence, this means that shareholders of a Minnesota corporation have the unilateral ability (*i.e.,* without board approval) to amend the articles of incorporation if a proposal to do so is initiated by a holder or holders or 3% of the outstanding stock.[70] Although all U.S. corporate statutes permit shareholders the unilateral ability to adopt bylaw amendments, only a small minority of states permit unilateral shareholder approval of *articles* amendments.[71]

The ability of shareholders to restrict the residual authority of directors to manage the business and affairs of the corporation through binding, unilateral shareholder action in the form of bylaw amendments has been a front-line corporate governance issue for U.S. public companies in recent years.[72] Although the

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69. Section 302A.135(2) of the MBCA provides in pertinent part:

> A resolution approved by the affirmative vote of a majority of the directors present, or proposed by a shareholder or shareholders holding three percent or more of the voting power of the shares entitled to vote, that sets forth the proposed amendment shall be submitted to a vote at the next regular or special meeting of the shareholders of which notice has not yet been given but still can be timely given.

MINN. STAT. § 302A.135(2) (2000).

70. MATHESON & GARON, *supra* note 9, § 2.19, at 2-34 to 2-37.

71. "All but 15 jurisdictions provide that the procedure for amending the articles of incorporation is initiated by the board of directors adopting a resolution setting forth the proposed amendment." 3 MODEL BUS. CORP. ACT ANN. § 10.03, at 10-30 (3d ed. 2000) (Statutory Comparison). Of those that do not restrict initiation to the board, some still require both board and shareholder approval for effectiveness of the amendment. *See, e.g.,* ALASKA STAT. § 10.06.504(A)(2) (Michie 2000); CAL. CORP. CODE § 902(C) (West 2000); N.Y. BUS. CORP. LAW §§ 801 & 802 (McKinney 2000). Others are unclear on the required approvals. *See, e.g.,* LA. REV. STAT. ANN. § 12:31 (West 2000); MASS. GEN. LAWS ch. 156B, §§ 70, 71 & 72 (2000); MICH. COMP. LAWS ANN. § 450.1611 (West 2000); OHIO REV. CODE ANN. § 1701.71 (Anderson 2000). Arizona permits shareholder initiation and unilateral approval, but only if so provided in the articles of incorporation. ARIZ. REV. STAT. § 10-1003(B) (2000). Pennsylvania permits shareholder initiation and unilateral approval, but also permits an opting out of this right in the articles of incorporation. PA. CONS. STAT. ANN. tit. 15 § 1912 (West 2000). South Carolina's provision permitting shareholder initiation and unilateral approval is applicable only to corporations that are not publicly traded. S.C. CODE ANN. § 33-10-103 (Law. Co-op. 2000). Only Colorado and North Dakota have clear and absolute (no opt out possible) provisions like Minnesota's permitting holders of a designated percentage of shares (10% in Colorado; 5% in North Dakota) to initiate an amendment to the articles that may be unilaterally approved by shareholders. COLO. REV. STAT. § 7-110-103 (2000); N.D. CENT. CODE § 10-19.1-19 (2000).

72. For descriptions of the binding bylaw controversies, see generally John C. Coates IV & Bradley C. Faris, *Second-Generation Shareholder Bylaws: Post-Quickturn*

Oklahoma Supreme Court has held that such a restrictive bylaw amendment is permitted under the Oklahoma statute,[73] notwithstanding language indicating that board authority may only be restricted in the articles or certificate of incorporation,[74] the Delaware courts have not yet spoken clearly on the issue.[75]

Alternatives, 56 BUS. LAW. 1323 (2001); Lawrence A. Hamermesh, *Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street,* 73 TUL. L. REV. 409 (1998); Kate Margolis, *Binding Shareholder Bylaw Amendments: An Antidote for the Poison Pill?,* 67 MISS. L. J. 817 (1998).

73. *See* International Bhd. of Teamsters Gen. Fund v. Fleming Co. Inc., 975 P.2d 907, 908 (Okla. 1999).

74. At issue in *Fleming*, 975 P.2d at 908, was the legitimacy under the Oklahoma statute of a bylaw proposed and adopted unilaterally by shareholders that required the board to eliminate the Fleming shareholders rights plan or poison pill and not to adopt another without shareholder approval. The relevant provisions of the Oklahoma statute were nearly identical to the analogous provisions in the DGCL. Coates & Faris, *supra* note 72, at 1329 n.27. On one hand, the Oklahoma equivalent of section 141(a) of the DGCL, provides that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors, except as maybe otherwise provided in this chapter or in its *certificate of incorporation*." DEL. CODE ANN. tit. 8, § 141(a) (2000) (emphasis added). Section 157 of the DGCL adds further specification of the board's authority to adopt options and rights to issue stock, as in the case of a poison pill. *See Fleming*, 975 P.2d at 910. On the other hand, the Oklahoma equivalent of section 109 of the DGCL gives the stockholders explicit authority to amend the bylaws unilaterally to contain any provision "not inconsistent with law or with the certificate of incorporation." DEL. CODE ANN. tit. 8, § 109(b); *accord Fleming*, 975 P.2d at 910. In essence, Fleming argued that the language in the section 141(a) and 157 equivalents meant that the board could only be so restricted in the certificate of incorporation and that a bylaw purporting to do so was invalid. *Fleming*, 975 P.2d at 910. The Teamsters argued that, absent a clear statutory mandate in favor of poison pills or a clearly contradictory provision in the certificate of incorporation, the provisions equivalent to sections 141(a), 157 and 109 did not restrict the stockholders from adopting such a restrictive bylaw. *Id.* The Oklahoma Supreme Court agreed with the Teamsters and upheld the legitimacy of binding stockholder bylaws under the Oklahoma statute so long as there was not an explicitly contradictory provision in the certificate of incorporation. *Id.* at 912. The Oklahoma Supreme Court noted that its interpretation might have been different if Oklahoma had a pill endorsement statute of the type contained in the Model Act and in the corporation statutes of many states. *Id.* at 912-13. *See generally* Hamermesh, *supra* note 72, at 421-25.

75. In Quickturn Design Systems, Inc. v. Mentor Graphics, Inc., 721 A.2d 1281 (Del. 1998), the Delaware Supreme Court ruled that a so-called "no-hand" or "slow-hand" poison pill was invalid under section 141(a) of the DGCL because it purports to restrain the authority of the board (to redeem a poison pill) outside the certificate of incorporation:

> One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of the corporation. Section 141(a) requires that any limitation on the board's authority be set out in the certificate of incorporation.

Id. at 1291. Some commentators have viewed *Quickturn* as indicating that

Whether shareholders may act unilaterally to restrict the board by binding bylaw amendments may be largely irrelevant in Minnesota, since shareholders can clearly act unilaterally to amend the articles.[76] Amendments to the MBCA in 1999 made a backhanded effort to address this idiosyncrasy by purportedly clarifying that unanimous shareholder approval would be required for any unilateral shareholder amendment of the articles that has the effect of restricting board authority.[77] But it is unclear whether

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Delaware courts would view binding stockholder bylaws as being invalid. *E.g.*, Coates & Faris, *supra* note 72, at 1331 ("Attempts to distinguish the board's actions in *Quickturn* from shareholders' action to adopt bylaws face long odds."). However, that precise issue was not before the court in *Quickturn*. *See* General DataComm Indus., Inc. v. Wisconsin Inv. Bd., 731 A.2d 818, 821-22 (Del. Ch. 1999) (indicating that *Quickturn* had not resolved the issue of validity under Delaware law of binding anti-option-repricing bylaw proposal). In the last several years, the corporate law validity of binding shareholder bylaw proposals has been contested most frequently in no-action letter requests by corporate management seeking to exclude such proposals from their proxy materials pursuant to SEC Rule 14a-8(i)(1) ("not proper subject for action by shareholders" under applicable state law) or SEC Rule 14a-8(i)(2) ("would, if implemented, cause the company to violate any state, federal, or foreign law to which it is subject."). 17 C.F.R. §§ 240.14a-8(i)(1) & 240.14a-8(i)(2) (2001); *see also* Mark J. Loewenstein, *Delaware as Demon: Twenty-Five Years after Professor Cary's Polemic*, 71 U. COLO. L. REV. 497, 532-36 (2000). Until recently, the SEC staff had generally refused to concur in exclusion of such proposals under either Rule 14a-8(i)(1) or 14a-8(i)(2) on grounds that the validity of such bylaws involves an "unsettled point of Delaware law." PLM Int'l Inc., SEC No-Action Letter (Apr. 28, 1997). More recently, the staff has concurred in exclusion of one such proposal in reliance on the opinion of Delaware counsel based on *Quickturn*. *See* General Dynamics Corp., SEC No-Action Letter (Mar. 5, 2001).

76. The Minnesota equivalent of section 141(a) of the DGCL does not directly refer to the articles of incorporation. Section 302A.201(1) provides in pertinent part: "The business and affairs of a corporation shall be managed by or under the direction of a board, subject to the provisions of subdivision 2 and section 302A.457." MINN. STAT. § 302A.201(1) (2000). Subdivision 2 of section 302A.201 provides that "[t]he holders of the shares entitled to vote for directors of the corporation may, by unanimous affirmative vote, take any action that this chapter requires or permits the board to take." *Id.* § 302A.201(2). Section 302A.457 provides for shareholder control agreements pursuant to which the management structure of a Minnesota corporation may be customized by contract signed by all shareholders. *Id.* § 302A.457.

77. The 1999 amendments to the MBCA came in part, no doubt, in response to an attempted binding anti-pill bylaw proposal at one of Minnesota's most well known public companies, Dayton Hudson Corporation (which changed its name in 2000 to Target Corporation). *See* Dayton Hudson Corp., SEC No-Action Letter (Mar. 25, 1999); Target Corp., SEC No-Action Letter (Apr. 3, 2000). The proponent argued that the reasoning in *Fleming* should be followed even though the MBCA contains a pill endorsement statute in section 302A.409(3). *See supra* note 74. The company argued that the reasoning of the Delaware Supreme Court's *Quickturn* decision should instead be followed and that, in any case,

a Minnesota court would read the amended provisions in this restrictive a manner.[78] Consequently, it remains to be seen whether the balance of power between managements and shareholders at public companies incorporated in Minnesota is set entirely differently than at public companies incorporated in almost any other state.

F. Who Can Call a Special Meeting of Shareholders

The default rule under Delaware law is that only the board of directors can call a special meeting of shareholders.[79] Section 228 of the DGCL permits shareholders to approve a measure by non-unanimous written consent without a meeting, but this right to non-unanimous consent solicitation may be negated in the certificate of incorporation.[80] The certificates of incorporation of well counseled Delaware public corporations contain a negation of non-unanimous consent solicitations under section 228.[81] So, in a

section 302A.201 indicated that any charter amendment – bylaw or articles – pursuant to which the shareholders took action required or permitted to be taken by the board must be adopted unanimously. *See supra* note 76. To bolster this last argument, the legislature amended sections 302A.111(5) (optional provisions in articles) and 302A.181(1) (bylaw amendments) in 1999 to make specific cross-reference to section 302A.201. 1999 Minn. Laws ch. 85, art. 1. The intent of the amendments, apparently, is to give greater force to the argument that the unanimity requirement for shareholders to take action normally reserved to the board in section 302A.201(2) is meant to cover the full range of all possible restrictions on board activity imposed by shareholder action. A more natural reading would be that shareholders in a closely held corporation, if they are going to wholesale supplant the board's management role in one or more areas, must do so by unanimous action. The SEC staff permitted exclusion of the proposal in 1999 based on a technical glitch unrelated to the unanimity requirement. In 2000, the same proponent corrected the glitch and re-proposed. Although the legislature had bolstered the unanimity argument in the 1999 amendment, the company settled with the proponent before the SEC staff could resolve the dispute over the validity of the proposal. In the settlement, Target Corporation agreed to let its current pill expire in 2001 and not to adopt another pill without majority approval by independent directors. Target Corp., SEC No-Action Letter (Apr. 3, 2000).

78. Would a shareholder articles amendment that prevents the board from adopting a poison pill or re-pricing an option constitute the taking of an action that this chapter requires or permits the board to take within the meaning of section 302A.201(2)? Is prevention of an action by the board the same as taking an action? Would a Minnesota court find that the ambiguous language of sections 302A.201(2) would really prevent less than all shareholders from making any charter amendment that somehow restricted the residual authority of the board?

79. DEL. CODE ANN. tit. 8, § 211(d) (2000).

80. *Id.* § 228(a).

81. *See* R. FRANKLIN BALOTTI, ET AL., MEETINGS OF STOCKHOLDERS 11-42 (3d ed.

well-counseled Delaware corporation, a matter may be presented for shareholder vote only with the cooperation of the board of directors. This is an important point in the corporate governance balance of power in public corporations. Hostile bidders must unseat the board in order to put a matter to shareholder vote at a special meeting, or they must present their proposals at the annual meeting.[82]

As already noted, the MBCA contains an absolute provision giving the right to call a special meeting to shareholders possessing 10% of the outstanding voting power.[83] The MBCA provides that the ownership level increases to 25% (unless a lower threshold is prescribed in the articles or bylaws) if the meeting is being called "for the purpose of considering any action to directly or indirectly facilitate or effect a business combination, including any action to change or otherwise affect the composition of the board of directors for that purpose."[84]

Since most state statutes give an absolute right to shareholders at some percentage ownership level to call a special meeting,[85] this attribute of the MBCA is not an idiosyncrasy of Minnesota and cannot in fairness be part of an indictment of the MBCA. In fact, the inability of shareholders to call a special meeting is perhaps more properly viewed as an idiosyncrasy of Delaware. But the Minnesota 10% threshold is low and increases to 25% only if the somewhat ambiguous "business combination" purpose test is met.[86]

Supp. 2002) ("From management's perspective, recent developments have demonstrated the desirability of eliminating or restricting the right to act by written consent."); Herzel, *supra* note 40, at 142 ("Elimination of consents can reasonably be considered a mild antitakeover measure, but, unlike other antitakeover devices, it does not appear to encounter much (if any) resistance from large stockholders."). Cases in which the failure to negate non-unanimous consent solicitation has had dire consequences are numerous. *See generally* Herzel, *supra* note 40, at 138-42. Delaware courts reserve their most withering standard of review for board actions found to be aimed primarily at impeding a shareholder vote once underway. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

82. For discussion of the importance of eliminating the non-unanimous consent procedure from the context of hostile bids for public companies, see Herzel, *supra* note 40, at 138-42.

83. *See supra* note 14 and accompanying text.

84. MINN. STAT. § 302A.433(1)(e) (2000).

85. COX, HAZEN & O'NEAL, *supra* note 13, § 13.3, at 13.27.

86. It is almost guaranteed that, if the issue ever becomes important, the ambiguity of the "business combination" purpose will be an issue in litigation as it was in *Banco Panamericano, Inc. v. Health Risk Mgmt.*, Inc., 78 F. Supp.2d 804 (N.D. Ill. 1999). In that case, a party related to a hostile bidder attempted to call a

Under the Model Act, the level may be increased in the articles of incorporation to 25% without regard to the action to be taken at the meeting.[87]

I can certainly understand arguments in favor of permitting shareholders to call special meetings. But the managements of our public corporation clients generally want to retain the control inherent in having the sole right to call such meetings. Although the Delaware level of control may be used to further management entrenchment in the face of hostile bidders or dissident shareholders, it is tempered by the fiduciary obligations of management under the enhanced scrutiny standards devised by the Delaware courts.[88]

The point is this: under Delaware law, my clients have the option of retaining this control or permitting shareholders to call special meetings or solicit non-unanimous consents. Under the Model Act, my clients at least have greater leeway to increase the required threshold. Under the MBCA, there is no option and no leeway.

G. *Limit on Bylaw Amendments*

The Model Act, the DGCL and the MBCA all generally permit either the board or the shareholders to amend the corporation's bylaws unilaterally.[89] The MBCA has, however, a bothersome overlay of limitation on the board's power. Section 302A.181(2) provides:

> After the adoption of the initial bylaws, the board shall not adopt, amend, or repeal a bylaw fixing a quorum for

special meeting for shareholders to vote on removal of the company's poison pill. The federal district court certified to the Minnesota Supreme Court the question of whether a meeting called by such a shareholder for such a purpose was subject to the 10% or 25% threshold. *Id.* The case was settled before the Minnesota Supreme Court could decide the issue.

87. MODEL BUS. CORP. ACT § 7.02(a)(2) (2000).

88. Delaware courts reserve their most withering standard of review for board actions found to be aimed primarily at impeding a shareholder vote once underway. *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988); Wisconsin Inv. Bd. v. Peerless Sys. Corp., No. CIV.A. 17637, 2000 WL 1805376 (Del. Ch. Dec. 4, 2000).

89. Under the Model Act and the MBCA, the board has the unilateral ability to amend the bylaws as a default rule. MINN. STAT. § 302A.181(2) (2000); MODEL BUS. CORP. ACT § 10.20 (b) (2000). Under the DGCL, an opt-in provision must be included in the certificate of incorporation in order for the board to have this ability. *See* DEL. CODE ANN. tit. 8, § 109(a) (2000).

> meetings of shareholders, prescribing procedures for removing directors or filling vacancies in the board, or fixing the number of directors or their classifications, qualifications, or terms of office, but may adopt or amend a bylaw to increase the number of directors.[90]

This prohibition is not qualified by materiality of the change or by its adverse effect on the rights of shareholders. It is just a blunderbuss prohibition on any change, including – one must assume – simple wording changes or typographical corrections having no substantive effect on shareholder rights.

From a substantive standpoint, shareholders are relatively able to protect themselves from truncation of their rights by unilateral bylaw amendments by the board of directors. Under all U.S. corporate statutes, the shareholders retain the right to change any amendment effected by the board.[91] Moreover, unilateral board amendments to the bylaws truncating shareholder rights are subject to enhanced scrutiny under the fiduciary duty jurisprudence of the Delaware courts.[92] So, it is hard to see why a flat prohibition of this kind is needed or particularly helpful for shareholders.

A scenario in which this prohibition proves bothersome occurs regularly in my firm's practice. A Minnesota corporate client hires us after others have performed its organizational work. A review of its bylaws reveals that they are not well put together, and the corporation would be well advised to adopt a new set of bylaws in one of our standard forms for Minnesota corporations. In other states, this could be done as a matter of routine housekeeping by the board of directors alone. In Minnesota, the limitation in

90. MINN. STAT. § 302A.181(2) (2000). *See* MATHESON & GARON, *supra* note 9, at 2-45.

91. For all its shareholder and minority protection posturing, the MBCA is less protective of shareholders with regard to bylaw amendments than the Model Act. Shareholders have the right to override board amendments under both section 10.20 of the Model Act and section 302A.181(2) of the MBCA. MODEL BUS. CORP. ACT § 10.20 (2000); MINN. STAT. § 302A.181(2) (2000). Under the Model Act, shareholders may also lock in their change by providing that the board may not amend, repeal or reinstate a bylaw that they have amended *either* in the articles of incorporation or in the bylaws. MODEL BUS. CORP. ACT § 10.20 (b)(1)-(2) (2000). Under the MBCA, such a lock-in must be contained in the articles of incorporation. MINN. STAT. § 302A.181(2) (2000). This limitation has been used by at least one Minnesota issuer to combat a binding bylaw proposal that included a lock-in provision in the bylaw text. *See* Target Corp., SEC No-Action Letter (Apr. 3, 2000).

92. *See supra* note 88.

section 302A.181(2) almost certainly means that shareholders must approve this essentially clerical change.[93]

H. *Overly Broad Control Share Acquisition Statute*

If you like anti-takeover statutes, you will love Minnesota. We have many more anti-takeover statutes than Delaware. Delaware has a business combination statute (or third generation anti-takeover statute) in DGCL section 203.[94] The MBCA has an analogous business combination statute in section 302A.673.[95]

93. Of course, this assumes that one is *complying* with the prohibition in section 302A.181(2). How many times per year would you expect that bylaws are amended in Minnesota without compliance with section 302A.181(2)?

94. DEL. CODE ANN. tit. 8, § 203 (2000). Section 203 of the DGCL restricts certain business combination transactions between a shareholder acquiring 15% or more (designated as an "interested" shareholder) of the voting stock and any Delaware corporation with securities traded on a national exchange, quoted on the Nasdaq Stock Market or owned of record by at least 2,000 shareholders. Unless an exception is available, the statute provides that for three years after the 15% threshold is exceeded, the corporation cannot have a merger, sale of substantial assets, loan, substantial issuance of stock, plan of liquidation, or reincorporation involving the interested shareholder or its affiliates. Shareholders may opt out of section 203 at any time by majority vote, but the decision is not effective for one year.

There are a number of important exceptions to the basic prohibition of section 203. First, the Delaware statute does not prohibit a business combination if, prior to becoming an interested shareholder, the board of directors has approved the business combination or the transaction which resulted in the shareholder passing the 15% threshold. Second, section 203 does not apply if the interested shareholder acquires 85% of the target's outstanding voting stock (excluding shares held by management or held in employee benefit plans in which the employees do not have a confidential right to vote) in the transaction in which the 15% threshold is exceeded. Third, a business combination is permissible if approved by the board and authorized at an annual or special meeting of shareholders, and not by written consent, by the affirmative vote of two-thirds of the outstanding shares held by disinterested shareholders. Finally, if the target corporation, with the support of the majority of its continuing directors, proposes at any time another merger or sale or does not oppose another tender offer for at least 50% of its shares, the interested shareholder is released from the three-year prohibition and free to compete with the target-supported transaction. *Id.*

95. MINN. STAT. § 302A.673 (2000). Section 302A.673 of the MBCA is quite similar to its Delaware analog, *see supra* note 94, except: (1) the interested shareholder threshold is 10% rather than 15%; (2) the prohibition period for business combinations is four years from the time the shareholder passes the threshold instead of three years; and (3) there are no equivalents to the Delaware exceptions for acquisition of 85% of voting stock, for two-thirds shareholder approval at a shareholder meeting or for management approval of a competing transaction or tender offer. Section 302A.673 applies to "issuing public corporations," defined as any Minnesota corporation with at least 100

Minnesota also has a control share acquisition statute (or second generation anti-takeover statute) in section 302A.671,[96] a so-called "other constituencies" provision in section 302A.251[97] and a "fair price" provision in section 302A.675[98] among other provisions specially applicable to takeovers.[99] Delaware has no statutory equivalents to these.

As a trap for the unwary, I believe the control share acquisition statute is the real standout in Minnesota's anti-takeover arsenal. The statute requires approval by the disinterested shareholders of any "control share acquisition" of stock of an "issuing public corporation" (defined as any Minnesota corporation with at least one hundred shareholders or with at least fifty shareholders if the Minnesota corporation is a publicly held corporation).[100] A

shareholders (or with at least fifty shareholders if the Minnesota corporation is a publicly held corporation). Issuing public corporations that are publicly held are automatically subject to section 302A.673 of the MBCA unless they opt out by charter amendment; issuing public corporations that are not publicly held are subject to section 302A.673 only if they opt in by charter amendment. MATHESON & GARON, *supra* note 9, §§ 8.14-8.20 at 8-28 to 8-44.

96. MINN. STAT. § 302A.671 (2000). *See infra* notes 100 to 114 and accompanying text.

97. MINN. STAT. § 302A.251(5) (2000). This section provides that:

> In discharging the duties of the position of director, a director may, in considering the best interests of the corporation, consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation.

Id. Although Minnesota courts have not interpreted the scope and effect of this provision, it appears to afford the board substantial flexibility to give weight to constituencies and to timeframes other than the shareholders and their immediate value gains in deciding on a course of action in connection with takeovers and otherwise. Delaware case law has indicated that such "other constituencies" may normally be considered by the board, but that enhancing value to shareholders should be the *primary* consideration in all cases and should be the *exclusive* consideration in some cases, including sale of control of the corporation. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986); Unocal v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

98. MINN. STAT. § 302A.675 (2000). This section prohibits an offeror from acquiring shares of a publicly held corporation within two years following a takeover offer except upon terms equivalent to those of the earlier takeover offer, unless approved by a committee of the board's disinterested directors before the takeover offer. MATHESON & GARON, *supra* note 9, §§ 8.21-8.25, at 8-45 to 8-50.

99. *See generally* MATHESON & GARON, *supra* note 9, §§ 8.26-8.51, at 8-51 to 8-88.

100. MINN. STAT. § 302A.671 (2000). The definition of "issuing public corporation" is contained in section 302A.011(39) of the MBCA. *Id.* §

"control share acquisition" includes any acquisition of beneficial ownership of shares that exceeds specified levels of voting power (20%, 33-1/3% and 50%) of the outstanding stock of the target "issuing public corporation."[101] There are a number of important exclusions intended primarily to distinguish hostile acquisitions from transactions negotiated and approved by management and shareholders, including exclusions for shares acquired (a) in a merger, plan of exchange or sale of asset transaction,[102] (b) directly by purchase from the target issuer,[103] (c) in a cash tender offer for all outstanding shares if the offer has been approved in advance by the board of directors of the target,[104] and (d) by employee benefit plans.[105]

If the bidder fails to obtain the required shareholder approval for a control share acquisition, the shares acquired (a) may not be voted by the bidder beyond the 20% threshold level (or such higher threshold level as shareholders have approved)[106] and (b) are subject to certain redemption rights at the option of the target.[107] The statute essentially requires the bidder to wage a proxy contest to obtain the necessary approval and delays the acquiror's purchase up to fifty-five days while a special shareholders' meeting is held.[108]

Although adopted by about half of the states in the United States,[109] control share acquisition acts are relatively ineffective and of questionable value as anti-takeover statutes.[110] They were put into place at a time when front-end loaded, two-tier takeover structures were common and were intended to prevent such coercive techniques from stampeding shareholders into a partial

302A.011(39). *See generally* MATHESON & GARON, *supra* note 9, §§ 8.3-8.12 at 8-8 to 8-27.

101. MINN. STAT. § 302A.011(38) (2000).
102. *Id.* § 302A.011(38)(d).
103. *Id.* § 302A.011(38)(e).
104. *Id.* § 302A.011(38)(h)-(i).
105. *Id.* § 302A.011(38)(g).
106. MINN. STAT. § 302A.671(4)(a) (2000).
107. *Id.* § 302A.671(6).
108. *Id.* § 302A.671(3) (requirement that meeting to vote on control share acquisition be held within fifty-five days of request).
109. *See* 1 MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS & FREEZEOUTS 5-28 n.7 (2001) (listing twenty-six states with such statutes).
110. For discussion of the reasons why the Delaware bar decided against recommending adoption of a control share acquisition statute in that state, see Lewis S. Black, Jr., *Why Delaware is Wary of Anti-Takeover Law*, WALL ST. J., July 10, 1987, at 18, col. 4.

tender offer.[111] Even then, it was far from clear that the delays required for a shareholder vote would necessarily stop a concerted bidder.[112] Many criticize the statutes as providing a ready means of putting the company in play by forcing management into a shareholder plebiscite that will very likely go against them.[113] Moreover, in an age of any-and-all-share tender offers, even if the vote goes against the bidder, it may be to no avail. A hostile bidder that has acquired at least 80.1% of the outstanding shares may still be able to circumvent the effect of the act, since the bidder can then outvote the 19.9% of outstanding shares remaining in other hands, even if the right to vote were eliminated from the bidder's shares in excess of the 20% threshold.[114]

The main problem with the Minnesota control share acquisition statute is not its dubious value in the anti-takeover context in which it was intended to operate – it is its over breadth and extension into transactions far from the takeover context. First, the statute applies to a "control share acquisition" even if it has nothing to do with a hostile takeover. Second, the definition of

111. LIPTON & STEINBERGER, *supra* note 109, at 5-28.

112. "The Delaware committee was . . . skeptical of the claim that the mere existence of a 50-day wait would deter tender offers. The market's usual creativity in connection with takeovers has extended to financing matters." Black, *supra* note 110, at 18, col. 4.

113.

> But wouldn't the result be a stockholder plebiscite on every offer, and wouldn't the stockholder vote always favor the bidder or any new bidder that offered a greater premium? . . . It seemed likely that institutions would vote for a short-term profit. So would arbitragers who could acquire shares before the record date for the stockholders meeting or purchase shares with proxies attached. . . . Almost anyone who wants to [put the company in play] or even to harass management, could simply notify the company of his intention to make a control-share acquisition and trigger the statutory stockholder plebiscite. The ensuing meeting, notice and other publicity provide a cheap means to publicize the company's availability for sale.

Id.

114. This depends on the reading given to the term "voting power" in section 302A.671 and the term "entitled to vote" in sections 302A.443, 302A.437 and elsewhere.

> No published Minnesota case has decided the issue of whether such shares acquired in a control share acquisition have "voting power" and are "entitled to vote." However, the possibility that an acquiring person could acquire absolute voting control of a corporation without receiving shareholder approval under the CSAA by acquiring more than 80% of its voting stock clearly was not envisioned by the Minnesota legislature and is contrary to the policy behind its adoption.

MATHESON & GARON, *supra* note 9, § 8.11, at 8-26 to 8-27.

"control share acquisition" (along with related definitions of "acquiring person," "beneficial owner" and "beneficial ownership") is incredibly vague and far-reaching. It includes not only acquisitions of target shares, but changes in organizational or ownership structure of the owner of the shares. A reorganization of the general partner of a limited partnership that owns a 21% interest in a Minnesota "issuing public corporation" could constitute a "control share acquisition" requiring approval by disinterested shareholders.

Finally, unlike the Minnesota business combination statute (which does not apply to issuing public corporations that are not publicly held unless they opt in by charter amendment), the Minnesota control share acquisition statute applies to *all* issuing public corporations unless they opt *out* by charter amendment. An incredibly broad range of transactions involving shares of non-public Minnesota corporations may therefore run afoul of the statute in situations having nothing to do with the anti-takeover purposes of the statute.

It is amazing how often the Minnesota Control Share Acquisition Act poses impediments to routine transactions. Given its dubious value as an anti-takeover statute and its potential for mischief, my general advice to corporate clients is to opt out. But its opt-out status is another trap for the unwary. I would bet that the Minnesota control share acquisition act is triggered unknowingly almost every day.

I would not mind seeing it repealed altogether. The Delaware Legislature, after extended study by the bar, decided to adopt a relatively balanced business combination statute and to pass on a control share acquisition statute.[115] By contrast, Minnesota's control share acquisition statute was put into its present form and most of the other Minnesota anti-takeover provisions were adopted in a fevered special session of the Minnesota Legislature specially called by the Minnesota Governor when a favorite publicly held Minnesota corporation came under siege by an out-of-state

115. *See* Black, *supra* note 110, at 18, col. 4. *See also* Arthur Oesterle, *Delaware's Takeover Statute: Of Chills, Pills, Standstills, and Who Gets Iced,* 13 DEL. J. CORP. L. 879, 880 (1988) ("[DGCL section 203] thus seems to represent a mid-course compromise between those who view hostile takeovers as destructive and those who view them as beneficial").

bidder.[116] Maybe the time has come to do some pruning in the Minnesota anti-takeover bramble.

At a minimum, the Minnesota Control Share Acquisition Act should be made an opt-in statute for Minnesota issuing public corporations that are not publicly held.

I. Unbridled Judicial Intervention

I taught Corporations in a state law school outside of Minnesota for eleven years. The statutory supplement we used in my class included the DGCL, the Model Act and selected excerpts from other state corporation statutes representing alternative approaches to common problems or unique or extremist provisions.[117] Section 302A.751 of the MBCA was included in our statutory supplement as an extremist example of statutory authorization for court intervention.[118] Its notoriety is, unfortunately, well deserved.

Dissolution statutes generally. All U.S. corporation statutes have some type of voluntary or involuntary dissolution provision.[119] The provisions in the DGCL, MBCA and Model Act governing *voluntary* dissolution by action of a majority of outstanding shares are quite comparable.[120] The provisions for involuntary dissolution by court order in a proceeding initiated by a shareholder or a creditor are very different.[121]

Statutory provisions for involuntary dissolution provide an essential escape mechanism for oppressed minority shareholders in closely held corporations who have not provided themselves with a

116. *See* MATHESON & GARON, *supra* note 9, § 8.1, at 8-5 n.1 (discussing Dayton Hudson Corporation); Douglas J. Nill, *Minnesota's Corporate Takeover and Shareholder Protection Act of 1987: Economic Folly or Constitutional Viability – Or Both?,* 11 HAMLINE L. REV. 281, 284-86 (1988).

117. MELVIN A. EISENBERG, CORPORATIONS AND BUSINESS ASSOCIATIONS: STATUTES, RULES AND FORMS (eds. 1995-1999).

118. *Id.*

119. COX, HAZEN & O'NEAL, *supra* note 13, § 26.2, at 26.4 & § 26.5, at 26.12-26.17; Robert B. Thompson, *Corporate Dissolution and Shareholders' Reasonable Expectations,* 66 WASH. U. L.Q. 193, 200-11 (1988).

120. One major difference is that Minnesota is among a minority of states permitting voluntary dissolution by shareholder action alone, whereas the DGCL and Model Act require both board and shareholder approval. *Compare* DEL. CODE ANN. tit. 8, §§ 275–285 (2000) *with* MINN. STAT. §§ 302A.721-302A.7291 (2000) *and* MODEL BUS. CORP. ACT §§ 14.02-14.08 (2000). *See also* Thompson, *supra* note 119, at 200 ("A few states exclude the board from the 'gatekeeper' function and permit dissolution by action of the shareholders alone.").

121. *See infra* notes 127 to 132 and accompanying text.

contractual means of extracting the value of their investment and exiting.[122] Since a closely held corporation has no active trading market for its shares, a shareholder who wants to sell shares may have little or no ability to find a buyer.[123] A shareholder who has a falling out with other shareholders in a closely held corporation may find that the only market for his or her shares consists of those other shareholders with whom he or she is at odds. The economic pressure on an outcast shareholder in a closely held corporation may be even greater if the outcast's primary income is derived as an employee of the corporation.[124]

Putting contractual buy-sell mechanisms in place at the outset is an essential part of closely held corporate planning and organization and can help reduce the risk of hardship and disputes.[125] Buy-sell arrangements can provide for purchase of shares upon changes in circumstances such as death, disability or termination of employment.[126] Even well conceived buy-sell agreements may not, however, anticipate all problems arising from a falling out among shareholder-participants.

The only general-purpose provision for involuntary dissolution in the DGCL empowers the Court of Chancery to revoke or forfeit the charter of any corporation for "abuse, misuse or nonuse of its corporate powers, privileges or franchises."[127] Delaware has a special provision, however, for court-ordered dissolution in the event of disagreement between the two shareholders of a Delaware corporation that serves as a 50/50 joint venture.[128] The DGCL also permits the shareholders of a corporation electing to be treated as a Delaware close corporation to provide in the charter for court-ordered dissolution at the will of any shareholder or upon any specified event or contingency.[129] With careful planning, therefore,

122. Thompson, *supra* note 119, at 194–99. *See also* Anthony & Boraas, *Betrayed, supra* note 2, at 1174-76; Olson, *Elixir, supra* note 2, at 627-29.

123. Thompson, *supra* note 119, at 196 ("In a close corporation setting, the norm of free transferability of shares is illusory.").

124. *Id.* at 197.

125. *See generally* HODGE O'NEAL & ROBERT B. THOMPSON, O'NEALS'S CLOSE CORPORATIONS § 7.03, at 7-13 to 7-16 (2001).

126. *Id.*

127. DEL. CODE ANN. tit. 8, § 284(a) (2000). *See* BALOTTI & FINKELSTEIN, *supra* note 54, § 10.24, at 10-58 to 10-59.

128. DEL. CODE ANN. tit. 8, § 273 (2000). *See* BALOTTI & FINKELSTEIN, *supra* note 54, § 10.11, at 10-29 to 10-31.

129. DEL. CODE ANN. tit. 8, § 355 (2000). *See* BALOTTI & FINKELSTEIN, *supra* note 54, § 14.10, at 14-8.

a Delaware close corporation can provide for dissolution as liberal as in a partnership. And, of course, contractual buy-sell arrangements can provide desired exits for shareholders without bringing dissolution into play at all.

The Model Act provision on involuntary dissolution in section 14.30 embodies the standard for current involuntary dissolution provisions in U.S. corporate statutes.[130] Section 14.30 provides that a court has discretion to order the involuntary dissolution of the corporation in a proceeding by a shareholder who establishes that (1) the directors are in deadlock that cannot be broken by the shareholders; (2) "the directors or those in control . . . have acted, are acting or will act in a manner that is illegal, oppressive or fraudulent;" (3) the shareholders are deadlocked and have been unable to elect directors for at least two consecutive annual meetings; or (4) "the corporate assets are being misapplied or wasted."[131] "Oppression" is the most frequently cited ground in petitions for dissolution by minority shareholders who have not provided for an exit strategy in a buy-sell agreement.[132]

As many commentators have observed, courts have been reluctant to dissolve a going concern even when faced with a clear case of "oppression" of a minority shareholder without a contractual exit strategy.[133] In most cases, such an oppressed shareholder's problems may be satisfactorily remedied by a buyout at fair value of his or her shares instead of the dismantling of the corporation.[134] In fact, most dissolution proceedings actually result

130. Dooley & Goldman, *supra* note 10, at 747 ("The Model Act's involuntary dissolution remedy, section 14.30(2), is typical of like provisions found in most state statutes.").

131. MODEL BUS. CORP. ACT § 14.30(2)(i)-(iv) (2000).

132. Dooley & Goldman, *supra* note 10, at 747.

133. *Id.* at 748. *See also* MODEL BUS. CORP. ACT § 14.34 (2000) (Official Comment) ("If the petitioning shareholder proves one or more grounds under section 14.30(2), he is entitled to some form of relief but many courts have hesitated to award dissolution, the only form of relief explicitly provided, because of its adverse effects on shareholders, employees, and others who may have an interest in the continuation of the business.").

134. MODEL BUS. CORP. ACT § 14.34 (2000) (Official Comment) ("Commentators have observed that it is rarely necessary to dissolve the corporation and liquidate its assets in order to provide relief: the rights of the petitioning shareholder are fully protected by liquidating only his interest and paying the fair value of his shares while permitting the remaining shareholders to continue the business. In fact, it appears that most dissolution proceedings result in a buyout of one or another of the disputants' shares either pursuant to a statutory buyout provision or a negotiated settlement.").

in a buyout of one or another of the parties involved either pursuant to a statutory provision or a negotiated settlement.[135] Some courts have interpreted their states' involuntary dissolution statutes as implicitly including authority to order a buyout as a sort of "alternative" remedy.[136] Other states have included explicit authority in their dissolution statutes for courts to order a buyout as a discretionary alternative remedy.[137]

In 1990, the Model Act introduced new section 14.34 to provide explicitly for a court-ordered shareholder buyout.[138] If a shareholder files a petition for involuntary dissolution under section 14.30, the corporation or one or more other shareholders have ninety days under section 14.34 to file with the court an irrevocable election to purchase the petitioner's shares.[139] Once the election is filed, the parties have sixty days to agree on a purchase price.[140] If they fail to do so, the court must "determine the fair value of the petitioner's shares."[141] The corporation then has ten days to accept the court's fair value determination or to file for voluntary dissolution.[142]

Section 14.34 does not alter the grounds upon which a shareholder may file for involuntary dissolution.[143] If the corporation and other shareholders believe the petitioner's claims of "oppression" are weak, they may choose not to make a buyout election under section 14.34 and just fight out the action for involuntary dissolution.[144] Section 14.34 authorizes neither the court nor the petitioning shareholder to initiate the statutory buyout; it is a purely optional, defensive response to the dissolution petition that may be exercised by those most concerned with continuation of the corporate business.[145]

135. *Id.*
136. Thompson, *supra* note 119, at 194.
137. *Id.*
138. Historical Background to section 14.34 in 3 MODEL BUS. CORP. ACT ANN. 14-154 to 14-155 (3d ed. 2000).
139. MODEL BUS. CORP. ACT § 14.34(a)-(b) (2000).
140. *Id.* § 14.34(c).
141. *Id.* § 14.34(d).
142. *Id.* § 14.34(g).
143. Bringing a claim alleging one of the grounds for dissolution under section 14.30(2) is a prerequisite to applicability of Section 14.34. *Id.* § 14.34 cmt. 1.
144. *Id.* § 14.34 cmt. 2.
145. *Id.* ("The election to purchase is wholly voluntary.").

MBCA section 302A.751. Section 302A.751 is, at its base, an involuntary dissolution statute very comparable to section 14.30 of the Model Act.[146] It has two very major differences.

First, section 302A.751 explicitly expands the court's authority beyond dissolution and empowers it also to "grant any equitable relief it deems just and reasonable in the circumstances."[147] The

146. Section 302A.751 was, in its original form, based largely on the involuntary dissolution provisions of section 97 of the Model Act (the predecessor to current section 14.30), although material from a New Jersey statute was fused to the initial form of the statute as well. *See* MINN. STAT. § 302A.751 (2000) (Reporter's Notes); MATHESON & GARON, *supra* note 9, § 10.8, at 10-18 n.73. "The only remedy explicitly mentioned in the predecessor statute [to section 302A.751] was dissolution." *Id.* at 10-18 n.76.

147. MINN. STAT. § 302A.751(1) (2000). The principal author of the 1983 amendments to Section 302A.751, Professor Joseph Olson, lists "[a]t least fifteen types of remedies . . . available to the court," including:

> (1) Cancelling, altering or enjoining any resolution or other act of the corporation; (2) Directing or prohibiting any act of the corporation or of shareholders, directors, officers or other persons party to the action; (3) Canceling or altering any provision contained in the articles of incorporation or by-laws of the corporation; (4) Removing from office any director or officer, or ordering that a person be appointed a director or officer; (5) Requiring an accounting with respect to any [business] matters in dispute; (6) Appointing a custodian to manage the business and affairs of the corporation; (7) Appointing a 'special fiscal agent' to report to the court relating to the continued operation of the corporation, as a protection to its minority stockholders, and the retention of jurisdiction of the case by the court for that purpose; (8) Retention of jurisdiction of the case by the court for the protection of the minority stockholders without appointment of custodian [receiver] or 'special fiscal agent'; (9) Appointing a provisional director who shall have all the rights, powers, and duties of a duly elected director and shall serve for the term and under the conditions established by the court; (10) Awarding damages to any aggrieved party in addition to, or in lieu of, any other relief granted; (11) Ordering the payment of dividends; (12) Issuing an injunction to prohibit continuing acts of unfairly prejudicial conduct; (13) Permitting minority stockholders to purchase additional stock under conditions specified by the court; (14) Ordering dissolution of the corporation at a specified date, to become effective only in the event that the stockholders fail to resolve their differences prior to that date; (15) Ordering that the corporation be liquidated and dissolved unless either the corporation or one or more of the remaining shareholders has purchased all of the shares of another shareholder at their fair value by a designated date.

Olson, *Elixir, supra* note 2, at 643-45 (footnotes omitted). Section 302A.751 does not explicitly limit remedies to those that operate on the corporation itself, and the Minnesota Court of Appeals recently found authority in section 302A.751 to impose on a majority shareholder *personal* liability for (1) damages relating to *corporate* obligations to pay sales commissions to a terminated shareholder-employee as well as (2) buyout of the terminated shareholder-employee's shares.

statute goes on to specify the buyout remedy in actions involving Minnesota corporations that are not publicly held.[148] The court may order a buyout upon motion of *either* the corporation or *any* shareholder, if the court finds a buyout "would be fair and equitable to all parties under all of the circumstances of the case."[149] The buyout is to be at the "fair value of the shares as of the date of the commencement of the action or as of another date found equitable by the court."[150] If the shares in question are subject to a buy-sell arrangement, the statute specifies that the buyout shall be at the price and terms set forth in such arrangement "unless the court determines that the price or terms are unreasonable under all the circumstances of the case."[151]

Unlike sections 14.30 and 14.34 of the Model Act, therefore, section 302A.751 empowers a court to employ a seemingly limitless range of equitable remedies when a shareholder has proven one of the grounds specified for relief. Unlike the Model Act provisions, section 302A.751 explicitly vests the power to move for the buyout remedy in *either* the corporation or *any* shareholder, *including the petitioning shareholder*. Consequently, a buyout is not exclusively a shield under the MBCA, it is also a sword in the hands of every shareholder.[152] Unlike the Model Act provisions, section 302A.751 *explicitly* authorizes a court to override an existing buy-sell agreement in a buyout remedy based on the court's second-guessing of reasonableness rather than any grounds under contract law for finding the buy-sell agreement invalid or unenforceable.[153]

See Billigmeier v. Concorde Mktg., Inc., C4-01-324 (Minn. Ct. App. Dec. 4, 2001) discussed *infra* at notes 214 to 222 and accompanying text.

148. MINN. STAT. § 302A.751(2) (2000). "One particular remedy, the buy-out of the complaining shareholder, is of such importance that it is spelled out in some detail." Olson, *Elixir, supra* note 2, at 645.

149. MINN. STAT. § 302A.751(2) (2000).

150. *Id.*

151. *Id.*

152. The exclusively defensive availability of the buyout provision in section 14.34 was meant to provide a countervailing balance to section 14.30. Minority shareholders with strong oppression claims will tend to be bought out; those with weak claims will not. MODEL BUS. CORP. ACT § 14.34 cmt. 2 (2000) ("These provisions are intended to reduce the risk that either the dissolution proceeding or the buyout election will be used for strategic purposes."). Section 302A.751 does little or nothing to discourage "strategic" use of the buyout remedy and has such vague and confusing grounds for granting a remedy that any terminated shareholder-employee has little to lose by taking a parting shot.

153. The Official Comment to section 14.34 notes, however, that a court should not be bound in fashioning a buyout remedy to the terms of a buy-sell agreement if doing so would be "unjust or inequitable in light of the facts and

Section 302A.751 also empowers a court to award reasonable expenses, including attorneys' fees and disbursements to any party if the other party has acted "arbitrarily, vexatiously or otherwise not in good faith."[154] Section 14.34 links fee and expense awards to the strength of the petitioning shareholder's underlying claim of oppression.[155]

The second major difference between the Model Act provisions and section 302A.751, is that section 302A.751 adds a new and incredibly vague ground for relief to the standard repertory of deadlock, oppression, fraud, illegality and waste. Section 302A.751(1)(b)(3) permits the grant of any remedy out of the court's equity arsenal if the shareholder proves "the directors or those in control of the corporation have acted in a manner unfairly prejudicial toward one or more shareholders in their capacities as shareholders or directors of a corporation that is not a publicly held corporation, or as officers or employees of a closely held corporation."[156] Before the "unfairly prejudicial" language was

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circumstances of the particular case." MODEL BUS. CORP. ACT § 14.34 cmt 4(b) (2000). The checks-and-balances built into sections 14.30 and 14.34 build in some assurance that only those cases involving relatively meritorious claims of oppression will proceed to the buyout phase. *See supra* note 152. Only in those cases in which the corporation or other shareholders have elected the buyout remedy would a buy-sell agreement be subjected to this second-guessing by the court. Again, section 302A.751 offers none of these assurances. A terminated shareholder-employee subject to a buy-sell agreement has little or nothing to lose by petitioning the court to second-guess the terms of a buyout.

154. MINN. STAT. § 302A.751(4) (2000) ("If the court finds that a party to a proceeding brought under this section has acted arbitrarily, vexatiously, or otherwise not in good faith, it may in its discretion award reasonable expenses, including attorneys' fees and disbursements, to any of the other parties.").

155. MODEL BUS. CORP. ACT § 14.34(e) (2000) ("If the court finds that the petitioning shareholder had probable grounds for relief under paragraphs (ii) or (iv) of section 14.30(2), it may award to the petitioning shareholder reasonable fees and expenses of counsel and of any experts employed by him."). This provision once again helps ensure some balance in use of the buyout remedy. *See supra* notes 152 & 153. A petitioning shareholder with a strong oppression claim will be met by a buyout response, but will be eligible for a fee and expense award.

156. MINN. STAT. § 302A.751(1)(b)(3) (2000). For discussion of the derivation of the "unfairly prejudicial" standard by the principal author of the 1983 amendments that added this language to section 302A.751, *see* Olson*, Elixir, supra* note 2, at 638-42.

> The legislative intent was to lower the threshold for relief by eliminating any need to establish a continuing course of abuse, to define the lower threshold by using a term that has not been subjected to narrow judicial interpretation, and to allow consideration of the injuries suffered by shareholders other than solely as investors.

Id. at 638.

added in 1983, section 302A.751 had authorized equitable relief if "the directors or those in control of the corporation have been guilty of fraud or mismanagement, or abuse of authority, or of persistent unfairness toward minority shareholders."[157] The "unfairly prejudicial" standard in section 302A.751 was meant to broaden these grounds to permit relief in a wider variety of cases.[158] Among other things, the new standard was intended to negate the notion that there had to be anything "persistent" or repeated about the unfairness.[159] One instance is all it takes.

Section 302A.751(3)(a), also added in 1983, provides a court with even more troubling "guidance" regarding when to order relief in claims involving a closely held Minnesota corporation:

> 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.[160]

According to one of the main proponents of the 1983 amendments, this language was intended to provide guidance to Minnesota courts in applying the "unfairly prejudicial" standard.[161] It should be applied when there has been a "breach of the fiduciary duty which shareholders owe to each other in the operation of the corporation" (statutory recognition of the fiduciary duty of

157. MINN. STAT. § 302A.751(1)(b)(2) (1982).

158. MINN. STAT. § 302A.751 (2000) (Reporter's Notes – 1982-1984).

> This is a more liberal rule than 'persistently unfair,' which required repeated adverse results before a shareholder could sue. Now only one instance is required. Moreover, the law now takes into account the treatment of the shareholder in ways outside traditional shareholder rights, i.e., the right to ownership. That is, it includes, for example, the discharge of a shareholder-employee as a ground, if that discharge was 'unfairly prejudicial.

Id. *See also* MATHESON & GARON, *supra* note 9, § 10.11[b], at 10-25 to 10-26; Anthony & Boraas, *Betrayed, supra* note 2, at 1177-78; Olson, *Elixir, supra* note 2, at 638-39; Pentelovich & Gilbertson, *supra* note 2, at 21.

159. MINN. STAT. § 302A.751 (2000) (Reporter's Notes – 1982-1984); *see also* Berreman v. West Publ'g Co., 615 N.W.2d 362, 373-74 (Minn. Ct. App. 2000) (holding that materiality is not an element of unfairly prejudicial conduct under section 302A.751).

160. MINN. STAT. § 302A.751(3a) (2000).

161. *See* Olson, *Minority, supra* note 2, at 17.

shareholders in a closely held corporation being the intent behind the "honest, fair and reasonable" language).[162] And, "[i]n addition, unfairly prejudicial conduct may be found if a shareholder's reasonable expectations with respect to his relationship to the corporation are defeated."[163]

If the "unfairly prejudicial" standard were limited by traditional notions of breach of fiduciary duty, it would be troubling enough.[164] By making defeat of "reasonable expectations" an alternative basis for finding an "unfairly prejudicial" situation and ordering a buyout, the 1983 amendments basically stunted further case law elucidation of the fiduciary duty of shareholders for purposes of section 302A.751.[165] Why should a shareholder seeking relief under section 302A.751 try to prove breach of fiduciary duty by those in control when he or she may prevail simply by proving that things did not go according to his or her reasonable expectations? The corporate plaintiffs bar went to work.

Disturbing decisions. Incredibly disturbing "reasonable expectations" decisions under section 302A.751 began to accumulate:

• ***Pedro v. Pedro.*** In Pedro v. Pedro,[166] three brothers were equal one-third shareholders in a family business and had worked in the business for many years, all receiving the same benefits and compensation.[167] In 1987, one of the brothers discovered alleged discrepancies in the corporation's financial records, and his

162. *Id.*

163. *Id.*

164. In *Berreman v. West Publishing Co.,* the Minnesota Court of Appeals affirmed that conduct insufficient to constitute a breach of fiduciary duty may nevertheless be "unfairly prejudicial" within the meaning of section 302A.751. 615 N.W.2d 362, 374 (Minn. Ct. App. 2000) (*quoting* Kiriakides v. Atlas Food Sys. & Servs., 527 S.E.2d 371, 387-88 (S.C. Ct. App. 2000)). For discussion of the derivation of the "reasonable expectations" grounds for minority relief in closely held corporations, *see* Thompson, *supra* note 119, at 211-16.

165. In 1995, the Minnesota Court of Appeals narrowed significantly the breadth of fiduciary breach claims that could serve as the basis for individual actions under section 302A.751. In *Skoglund v. Brady*, the Minnesota Court of Appeals held that a shareholder was required to show individual injury separate from the injury to the corporation in order to sustain an individual claim for relief under section 302A.751, otherwise the claim was derivative in nature. 541 N.W.2d 17 (Minn. Ct. App. 1995). *See also* Wessin v. Archives Corp., 592 N.W.2d 460, 465 (Minn. 1999) (affirming this aspect of *Skoglund*); Pentelovich & Gilbertson, *supra* note 2, at 20-21.

166. 489 N.W.2d 798 (Minn. Ct. App. 1992).

167. *Id.* at 799-800.

relationship with his brothers disintegrated as he investigated the discrepancies against their wishes.[168] The brothers eventually terminated the investigating brother and bought back his shares under an existing buy-sell agreement.[169]

The Minnesota Court of Appeals affirmed a trial court's award to the disappointed brother-shareholder-employee of damages equal to the difference between the fair value of his shares and the price at which he had been required to sell them under the buy-sell agreement, plus damages for breach of fiduciary duty and for lost future wages for lifetime employment, plus attorneys' fees, expenses and prejudgment interest.[170] In doing so, the court quoted from an article by a leading proponent of section 302A.751, stating that "[t]he reasonable expectations of [a shareholder in a closely held corporation, in addition to ownership interest,] are a job, salary, a significant place in management, and economic security for his family."[171]

• ***Sawyer v. Curt & Company.*** In Sawyer v. Curt & Company,[172] a CEO terminated by the board sued under section 302A.751. The Minnesota Court of Appeals held that the CEO's "reasonable expectations" under section 302A.751 were a continued "job, a salary and a significant place in management."[173] Consequently, any termination of employment, even if perfectly legal and in accordance with contract, defeated her expectations and required a buyout without any further proof of "unfairly prejudicial" conduct.[174] The Sawyer court held:

168. *Id.*

169. *Id.* at 800.

170. *Id.* at 800-01.

171. *Id.* at 802 (*quoting* Olson, *Elixir, supra* note 2, at 629). The leading commentators on the MBCA blamed the *Pedro* court for opening "a Pandora's box" by quoting these sweeping generalities by Professor Olson. MATHESON & GARON, *supra* note 9, § 10.11[b], at 10-29 to 10-30. For a contemporary excoriation of the *Pedro* decision and the effect it could have on established at-will employment doctrine in Minnesota, see Sandra L. Schlafge, Comment, *Pedro v. Pedro: Consequences for Closely Held Corporations and the At-Will Doctrine in Minnesota*, 76 MINN. L. REV. 1071 (1992).

172. No. C7-90-2040, C9-90-2041, 1991 WL 65320 (Minn. Ct. App. Feb. 12, 1991).

173. *Id.* at *2.

174. *Id.* at *2-3 ("It is undisputed respondent was terminated from her employment without any proposal for compensation by appellants. This one incident of unfairly prejudicial conduct is enough to justify the trial court's grant of the motion for a buy-out under [302A.751].")

> We believe when those in control of a closely held corporation terminate the employment of a moving shareholder, a good faith effort must be made to buyout the shareholder at a fair price or adjust the income distribution mechanism to insure the shareholder an equitable investment return. If this is not done, that is sufficient evidence of unfairly prejudicial conduct by the dominant corporation members.[175]

Read literally, the Sawyer decision turns section 302A.751 into an absolute right to a buyout remedy for any shareholder-employee of a closely held corporation. If the terminated shareholder-employee is not offered a buyout at a value he or she likes, there has been "unfairly prejudicial" treatment. In other words, the failure to do what section 302A.751 requires you to do if the shareholder-employee were to prove "unfairly prejudicial" conduct is, itself, "unfairly prejudicial."[176] The Sawyer case essentially removes all meaning from the "unfairly prejudicial" standard and reads it out of the statute.[177]

175. *Id.* at *2.

176. *Id.* An Eighth Circuit panel, in McCallum v. Rosen's Diversified, Inc., 153 F.3d 701 (8th Cir. 1998), followed the *Sawyer* rule, holding that a CEO who was terminated in compliance with law and all agreements and then offered a buyout at only a modest premium over current valuation, was by those actions alone "unfairly prejudiced." In the words of the court: "We simply hold that terminating the CEO – as opposed to an employee that did not have a significant role in management – and then offering to redeem his stock, which was issued partially to lure him to remain at the company, constituted conduct toward McCallum as a shareholder sufficient to invoke the requirements of the Minnesota Act." *Id.* at 704. *But see* MATHESON & GARON, *supra* note 9, § 10.11[b], at 10-32 ("Such a *per se* rule probably was not intended by the legislature.").

177. *Sawyer*, 1991 WL 65320, at *2. Creation of an absolute rule of shareholder-employee buyout is certainly consistent with what the chief proponent of the 1983 amendments to section 302A.751 intended to accomplish with the reference to "reasonable expectations." According to Professor Olson, the vague term was intended to make it clear that a shareholder would always be entitled to a buyout if events worked out to his or her disadvantage. As he put it: "Section 751 is designed to reduce litigation by removing questions of law as obstacles to relief for non-controlling shareholders. The *law* is now clear – such shareholders have a right to relief from 'mistreatment' which exploits their vulnerability and defeats their reasonable expectations." Olson, *Minority, supra* note 2, at 11. The quotation marks around "mistreatment" were added by Professor Olson to indicate that mistreatment does not really mean mistreatment, or as he explains in a note "*'Mistreatment' is a* broad general term *which emcompasses* [*sic*] *all acts of the controlling group which leave the other shareholders at a disadvantage.*" *Id.* at 11 n.24 (italics in original text). *See also* Olson, *Elixir, supra* note 2, at 633 (same tongue-in-cheek use of the word "mistreatment"). Both of Professor Olson's articles on the 1983 amendments are full of words like "mistreatment" and "abuse" in the main

• ***Pooley v. Mankato Iron & Metal, Inc.*** In Pooley,[178] a minority shareholder-employee was convicted of criminal assault and criminal damage to property in the scope of his employment and was terminated and voted out as an officer and director of the corporation.[179] The court of appeals affirmed that the shareholder-employee's misconduct should have no impact on his reasonable expectations under section 302A.751.[180] He was "unfairly prejudiced" by his termination and should be bought out with no equitable reduction in fair value resulting from his criminal behavior.[181]

Read together, these cases portray a chaotic, topsy-turvy world in which an employee owning shares in a Minnesota closely held corporation may be found to have an absolute right to *lifetime* employment or a buyout of their shares at a price deemed fair and reasonable by a court notwithstanding whatever buy-sell or employment arrangements they may have agreed to before disputes arose, notwithstanding an absence of truly oppressive conduct by majority shareholders and notwithstanding whatever egregious conduct on the part of the employee has led to his or her termination of employment. Fundamental principles of contract and employment law, rules that many would consider part of the basic glue that holds a predictable commercial world together, are subverted by section 302A.751 in favor of an unpredictable *ad hoc* regime administered by Minnesota courts.[182]

body of the text. Only by reading the footnotes does one understand what he was attempting to accomplish. It is no wonder that section 302A.751 is the vague and ambiguous nightmare that it is today. It is certainly far from clear that the Minnesota Legislature understood his idiosyncratic semantics when it adopted the 1983 amendments. *See also* MATHESON & GARON, *supra* note 9, § 10.11[b], at 10-32 ("Such a *per se* rule probably was not intended by the legislature.").

178. 513 N.W.2d 834 (Minn. Ct. App. 1994).

179. *Id.* at 836.

180. *Id.* at 838.

181. *Id.*

182. According to Professor Olson, principal draftsman of the 1983 amendments that injected most of the chaos into section 302A.751, this was the intent of the Minnesota Legislature: "The broad scope of [s]ection 751 reflects the Legislature's trust in the ability of the judiciary to achieve equitable results on the facts appearing in individual cases." Olson, *Minority, supra* note 2, at 11. Assuming that was truly the understanding and intent of the legislature, the body of case law resulting from the 1983 amendments indicates that the legislature's trust was misplaced. The principal commentators on the MBCA are charitable and understated in their assessment: "The cases decided under [s]ection 302A.751 demonstrate the difficulty of establishing a doctrine under the 'unfairly prejudicial' and 'reasonable expectations' standards that is both sufficiently

1994 amendments: too little, too late? In part as a reaction to cases like *Pedro*, *Sawyer* and *Pooley*, the Minnesota Legislature made several amendments to section 302A.751 in 1994 intended to re-insert some balance and predictability into the chaos.[183] Among other things, the 1994 amendments added the word "all" into the phrase "reasonable expectations of *all* shareholders" in section 302A.751(3a) to emphasize that it is not just the "reasonable expectations" of the shareholder seeking the buyout that should be considered.[184] So, a judge is supposed to take into consideration the fact that other shareholders who have signed the same buy-sell or employment agreement as the petitioning shareholder may have a reasonable expectation that the terms of the agreement would be respected or that a shareholder-employee convicted of criminal activity in the course of employment could be terminated without causing further damage to the corporation through an expensive buyout. This was a subtle fix at best.[185]

The 1994 amendments also added a presumption in favor of written agreements to the end of section 302A.751(3a): "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."[186] Consequently, it may now be somewhat more likely that shareholders will actually get what they bargained for in written agreements, but no guarantee exists.[187] One cannot be

flexible and sufficiently predictable." MATHESON & GARON, *supra* note 9, § 10.11[b], at 10-31 to 10-32.

183. 1994 Minn. Laws ch. 417, §§ 9-11.

184. *Id.* § 11. *See also* Anthony & Boraas, *Betrayed*, *supra* note 2, at 1179 ("The reasonable expectations of both majority and minority shareholders should now be examined by the court when determining whether to order equitable relief, dissolution or a buy-out.").

185. However, it may have had some salubrious effect on subsequent case law. *See* Advanced Communication Design, Inc. v. Follett, 615 N.W.2d 285, 292-93 (Minn. 2000) (holding that fair value for purposes of section 302A.751 must be determined based on fairness and equity to *all* shareholders, including consideration of oppressive behavior by, and burden on, all shareholders). *See also* Pentelovich & Gilbertson, *supra* note 2, at 23 ("Later decisions such as *Follett,* emphasizing that the value should be fair and equitable to all the parties, may prevent cases similar to *Pooley* in the future.").

186. MINN. STAT. § 302A.751(3a) (2000).

187. The plaintiffs bar has advertised that an arms-length negotiation requirement should be read into the presumption, although no such requirement

assured through even the most carefully drafted agreements that the presumption will hold. What we needed was a clear opt-out provision. Instead, we got a wishy-washy presumption.[188]

Continuing Problems. Three very recent decisions, while indicating a greater deference for written agreements, also illustrate the continuing problems caused by section 302A.751:

• ***Drewitz v. Walser.*** In *Drewitz,*[189] the general manager of a BMW dealership negotiated an employment contract and buy-sell agreement with his employer over a two-year period (he was represented by counsel throughout the process).[190] The employment contract was for a fixed-term with a right of earlier termination for cause (as defined in the contract).[191] The buy-sell agreement contained a buy-back right at book value upon any termination of the general manager's employment.[192] After termination, Drewitz brought a claim under section 302A.751 seeking a buyout at fair value instead of book value based on allegations of "unfairly prejudicial" treatment.[193] The trial court dismissed his claims, reasoning in essence that his reasonable expectations were bounded by the terms of his employment

appears in the statutory text. *See* Anthony & Boraas, *Betrayed, supra* note 2, at 1179-80 ("A shareholder may rebut the presumption that his or her reasonable expectations are set forth in an agreement by demonstrating that the provision regarding 'expectations' is ambiguous, being read out of context or not the product of an arms-length negotiation."). More recent cases may indicate that Minnesota courts have adopted even more stringent requirements for the presumption to hold. *See infra* notes 189 to 222 and accompanying text.

188. *See* Berreman v. West Publ'g Co., 615 N.W.2d 362, 374 (affirming that the presumption in favor of written agreements may be rebutted based on consideration of all the circumstances). Even the most ardent supporters of the "reasonable expectations" school of minority relief have pointed out the dangers inherent if there is insufficient deference to private ordering in a system of corporate law:

> A judicial role would not be attractive also if the parties by private contracting could better resolve the dispute or if the possibility of later judicial interference itself created uncertainties that increased the overall costs of participating in a closely held enterprise. On the latter point, for example, a potential majority shareholder investor (or a creditor) might be reluctant to commit funds to an entity, or may seek a greater return for doing so, because of a fear that the court would too easily force a corporation to redeem a minority investment.

Thompson, *supra* note 119, at 224.

189. No. C3-00-1759, 2001 WL 436223 (Minn. Ct. App. May 1, 2001)

190. *Id.* at *1.

191. *Id.*

192. *Id.*

193. *Id.* at *2.

contract and buy-sell agreement.[194] The court of appeals affirmed, citing the 1994 presumption language and pointing to the broad integration clauses contained in both the employment contract and buy-sell agreement (providing that these agreements "embody the entire agreement and understanding among the parties relative to the subject matter hereof and supersede all prior oral or written agreements and understanding and shall be amended or modified only by written instruments signed by all parties hereto").[195]

The *Drewitz* case is an encouraging development, but it leaves many unanswered questions. How important was it that Drewitz negotiated the terms of these agreements at length (as opposed to signing a form agreement of his employer)?[196] How important was it that he was represented by counsel? Are good integration clauses going to be the key in the future?[197]

• ***Gunderson v. Alliance of Computer Professionals, Inc.*** Gunderson joined Alliance of Computer Professionals, Inc. ("ACP") in 1994 shortly after it was founded.[198] He had responsibility for administrative and financial affairs.[199] He had no written employment contract.[200] In 1997, all shareholders signed a

194. *Id.* at *4.
195. *Id.* at *2-4.
196. *See supra* note 187.
197. Including a reference to section 302A.751 in the integration clauses of employment and buy-sell agreements used by Minnesota closely held corporations may be advisable. Such a clause could read as follows:

> **Entire Agreement; modification, amendment and waiver.** This agreement constitutes the entire agreement and understanding of the parties with respect to the subject matter hereof and supercedes all prior written or oral negotiations, agreements and understandings with respect thereto. The terms and conditions of this agreement embody the full extent of the parties' reasonable expectations regarding the [buyout of shares of the Company's stock from Shareholder][employment of Employee by the Company] for purposes of section 302A.751 of the Minnesota Statutes or otherwise. In particular, and without limitation on the foregoing, the parties represent and agree that [the Buy-Out Price specified herein is reasonable and the result of arm's length negotiation between the parties][any investment in the Company by Employee shall not create a reasonable expectation of continued employment][add further specific representations and agreements] for purposes of section 302A.751 of the Minnesota Statutes or otherwise. This agreement may not be modified or amended except in writing signed by both parties hereto. No rights hereunder may be waived except in writing signed by the party whose right is being so waived.

198. 628 N.W.2d 173, 179 (Minn. Ct. App. 2001).
199. *Id.*
200. *Id.* at 182.

buy-sell agreement that Gunderson had been primarily responsible for drafting (including selection of the lawyer who provided him with assistance).[201] The buy-sell agreement had a provision designed by Gunderson for involuntary withdrawal of any shareholder by a 75% vote of all outstanding shares with a formula purchase price based in part on length of time the shareholder had been at ACP.[202] In 1998, Gunderson was terminated amid allegations of dishonesty, incompetence and spending too much time on his own outside business.[203] The board offered him $2,300 for his shares (based on the buy-sell purchase price).[204] Gunderson claimed the fair value of his shares was $1,133,000.[205] Gunderson brought claims for breach of employment contract and for a buyout at fair value under section 302A.751. The trial court dismissed both claims on summary judgment.[206] Gunderson appealed.

With respect to the employment claim, the court of appeals affirmed, reasoning that Gunderson was an employee at will and certain vague statements by management (he "would always be taken care of" and "stick with me and I will make you rich when we sell the company") did not constitute an employment agreement.[207] With respect to the section 302A.751 claim, the court of appeals agreed, citing the 1994 presumption, that buying Gunderson out under the buy-sell agreement was not unfairly prejudicial to him as a shareholder.[208] However, the court of appeals remanded the

201. *Id.* at 179-80.
202. *Id.*
203. *Id.* at 180.
204. *Id.*
205. *Id.*
206. *Id.* at 180-81.
207. *Id.* at 182-84.
208. *Id.* at 186. The court's reasoning in deciding that the buy-sell agreement did embody the reasonable expectations of the parties indicates that the presumption in section 302A.751(3a) may have a high threshold if it is going to be relied upon for summary disposition of a case:

> The written agreement in this case specifically provided for the involuntary removal of shareholders with or without cause. It also set forth a method for valuing a departing shareholder's stock, which Gunderson proposed to 'protect ACP if a partner [left] in a more or less hostile manner.' The agreement was an arm's-length transaction. Gunderson spearheaded it and actively participated in drafting it. In fact, he proposed the very provision that authorized his involuntary removal, and urged the board to adopt it. He also selected the attorney who assisted the corporation in drafting the agreement. Given Gunderson's immediate and significant involvement in the preparation

302A.751 claim to the trial court for further findings of fact as to whether, despite Gunderson's employment at will, his termination might have been "unfairly prejudicial" to him as an employee.[209] In the words of the court of appeals:

> [E]ven though Gunderson was an at-will employee and, therefore, not wrongfully discharged in the breach-of-contract or tort sense, his employment termination triggers a separate inquiry into whether ACP unfairly prejudiced Gunderson in his capacity as a shareholder-employee. The doctrine of employment-based shareholder oppression is distinct from the wrongful-termination doctrine, and the analysis under the separate doctrines should attempt to protect close-corporation employment and, at the same time, respect the legitimate sphere of the at-will rule.[210]

The court of appeals indicated that this result could have been different if Gunderson had had a written employment contract along with a written buy-sell agreement defining his reasonable expectations.[211] The court of appeals also indicated that Gunderson's reasonable expectations would not have been defeated if the trial court found that his termination was indeed the result of his misconduct or incompetence.[212]

The deference for written agreements exhibited by the court of appeals is encouraging in *Gunderson*. Again, however, it leaves many questions unanswered. How important was it that Gunderson himself drafted the buy-sell agreements and designed the purchase price formula?[213]

The problem that *Gunderson* underscores with respect to section 302A.751, however, is its incredible power to single-handedly undermine entire bodies of law. For purposes of contract law and employment law, Gunderson was an employee at will and

> of the agreement, no rational factfinder could conclude that the agreement did not reflect his reasonable expectations as a shareholder.

Id.

209. *Id.* at 193.

210. *Id.* at 190. The court of appeals cited in this regard Schmedemann, *supra* note 2, at 1439-46.

211. *Id.*

212. *Id.* at 191.

213. *See supra* note 208. *See also* Pentelovich & Gilbertson, *supra* note 2, at 21 ("The *Gunderson* decision demonstrates that at the very least plaintiffs who actively participate in preparing an agreement will have a difficult time convincing a court that it does not reflect the parties' reasonable expectations.").

entitled to no remedy. Termination of his employment, however, could still entitle him to a section 302A.751 buyout. So, the *Gunderson* court is outlining the rules of a new body of meta-employment and meta-contract law applicable to determine whether a remedy is still available under section 302A.751.

• ***Billigmeier v. Concorde Marketing, Inc.*** In *Billigmeier*,[214] the Minnesota Court of Appeals demonstrated a frightening new potential in the reach of section 302A.751 by using that provision as authority to impose liability for corporate obligations *personally* on a majority shareholder without any inquiry into traditional notions of piercing the corporate veil, fraudulent conveyance or other similar doctrine.[215] In that case, the plaintiff owned one third of the stock of Concorde Marketing and served as an officer, director and sales representative.[216] Following disputes over commission amounts due to plaintiff, the plaintiff was terminated.[217] The plaintiff brought suit under section 302A.751 for buyout of his shares and for commission payments he claimed to be owing by Concord Marketing. The trial court found that Concorde Marketing owed the plaintiff nearly $281,000 plus statutory interest for unpaid commissions and frustration of reasonable expectations of continued employment and also ordered a buyout of his shares for $93,312 plus statutory interest.[218] Finding that Concorde Marketing was unable to pay such amounts and that the majority shareholder owed the company approximately $95,000 for advances, the trial court ordered the majority shareholder to pay such amounts out of his personal assets.[219] The trial court reasoned that imposition of personal liability was permitted under section 302A.751 because the majority shareholder's termination of plaintiff and intentional nonpayment of disputed commission amounts constituted "unfairly prejudicial" treatment.[220] The trial court also found that valuation of Concorde Marketing for purposes of determining the buyout price should be as of the date of termination (not the date of judgment) and should *not* take into account the amounts the court found that Concorde Marketing then owed to the plaintiff as

214. No. C4-01-324, 2001 WL 1530356 (Minn. Ct. App. Dec. 4, 2001).
215. *Id.* at *5-6.
216. *Id.* at *1.
217. *Id.* at *2.
218. *Id.*
219. *Id.* at *4-6.
220. *Id.* at *6.

commissions![221] On appeal, the court of appeals affirmed the trial court's finding of facts and its frightening imposition of personal liability on the majority shareholder.[222]

What should be done? When the Minnesota Legislature adopted the 1983 amendments to section 302A.751, they were apparently concerned about enhancing protections against oppression of minority shareholders. I cannot imagine that they realized they were unleashing a provision that (1) would subvert basic principles of corporate, contract and employment law in closely held Minnesota corporations, (2) would be interpreted by at least some courts as establishing an automatic or *per se* rule of shareholder-employee buyout regardless of the behavior of those in control or those seeking the buyout and (3) would serve as a basis for imposition of *personal* liability on majority shareholders without regard to traditional grounds for ignoring limited liability. I also cannot imagine that they realized they were putting in place a provision that would produce more litigation and more court decisions than any other provision in the MBCA.

Few entrepreneurs who really understood the troubling surprises and unexpected corporate (and, possibly, personal) liabilities awaiting them under section 302A.751 would want to incorporate in Minnesota. And if they did, they would never want to issue stock to employees.

Section 302A.751 is intended to help protect those who form closely held corporations in Minnesota without benefit of competent counsel and adequate advance planning.[223] Those who

221. *Id.* at *6-7.

222. Citing the *Pedro* decision, the court of appeals made the case sound like business as usual under section 302A.751:

> In sum, the district court found that Billigmeier's employment was terminated when he had a reasonable expectation of continued employment, that appellants intentionally withheld commissions owed to Billigmeier, and that Willing withdrew money from Concorde Marketing to fund his independent venture, Concorde Group. Those findings, taken together, are sufficient to support the finding that appellants acted in a manner unfairly prejudicial to Billigmeier . . . This court has indicated that imposing personal liability is a permissibile form of equitable relief under Minn. Stat. § 302A.751 [citing the broad remedial language of the statute]. Moreover, imposing personal liability is consistent with the broad statutory language of Minn. Stat. § 302A.751 . . . .

Id. at *6 (citations omitted).

223. *See, e.g.,* Olson, *Minority, supra* note 2, at 12.

do use competent counsel and engage in advance planning[224] should be able to opt out of section 302A.751's special provisions in the articles of incorporation and be governed by an ordinary involuntary dissolution statute that does not interfere with basic principles of corporate, contract and employment law. Even after the 1994 amendments, the ability to "opt out" through written agreements is far too uncertain and too costly.

Better yet, Minnesota should write this experiment off completely and start over with the approach taken in the Model Act.

III. CONCLUSION: THE MINNESOTA CORPORATE BAR SHOULD TAKE CHARGE

I taught law school at a state university outside of Minnesota for eleven years. During that time I had the privilege of being a member of an advisory committee serving the secretary of state of my adopted state.[225] This committee, made up of prominent corporate lawyers, law professors from the two law schools in the state and representatives of the secretary of state's office, advises the secretary of state and the legislature regarding reform initiatives in the areas of business associations, securities and commercial law.[226] The committee's first major undertaking in 1987 (before I joined it) had been to repair the state's business corporation act which had become desperately out of date. After extensive study, the committee concluded that they should recommend adoption of the Model Act as it then existed in

224. Professor Olson indicates that a "fringe benefit" of the equitable remedy provided by section 302A.751 may be to reduce the risk of malpractice liability for lawyers who launch clients into closely held Minnesota corporations without adequate planning in the form of buy-sell agreements and other contractual mechanisms! *Id.* at 12 n.25. This observation indicates an unbelievable naïveté. Section 302A.751 makes Minnesota a no-win jurisdiction for lawyers counseling entrepreneurs at the time of formation of a closely held corporation. No amount of planning will guarantee that buy-sell agreements and other contractual mechanisms will be respected. I am sure that the *last* thing the lawyer who advised a group of entrepreneurs at formation feels, when a minority shareholder hits the jackpot under section 302A.751, is relief at the existence of section 302A.751. He or she is going to be far more concerned with malpractice liability to the majority shareholders for incorporating them in Minnesota in the first place without adequately advising them of the uncertainties and potential liabilities that are unavoidable under the MBCA.

225. *See* Bryn R. Vaaler, *Revised Article 8 of the Mississippi UCC: Dealing Directly with Indirect Holding*, 66 MISS. L.J. 249, 250 n.1 (1996).

226. *Id.*

essentially verbatim form and should strive to stay in that mainstream by promptly considering and acting upon future amendments to the Model Act.[227] Their reasoning was that a state that was not in the commercial forefront and that already faced many problems in attracting businesses and encouraging economic development should at least have a corporate statute that was up-to-date and that would have the benefit of ongoing maintenance and improvement by the ABA Committee on Corporate Laws.[228]

An additional advantage of adopting the Model Act is that it comes complete with a substantial body of precedent and commentary. The Model Business Corporation Act Annotated, currently in its third edition, contains not only the extensive official commentary for each Model Act section (which is maintained and updated by the ABA Committee on Corporate Laws) but also contains annotations of hundreds of relevant cases from Model Act states in which courts have interpreted the various Model Act-derived provisions.[229] The Model Act is also studied in basically every law school in the country and has been extensively analyzed in law review and professional commentary.[230]

In my years on the secretary of state's committee, we acted diligently on every amendment made to the Model Act.[231] We did

227. E-mail from Daniel G. Hise, to Bryn R. Vaaler (Dec. 31, 2001) (on file with author). Mr. Hise, a practicing corporate lawyer in Jackson, Mississippi, has been a member of the Mississippi Secretary of State's Business Law Advisory Group since its inception and has served as chairman of the group. *See also* Robert W. Hamilton, *The Background of the New Mississippi Business Corporation Act,* 12 MISS. C. L. REV. 161, 162 (1991).

228. E-mail from Daniel G. Hise, *supra* note 227; *see also* Hamilton, *supra* note 227, at 177-78.

229. The *Model Business Corporation Act Annotated* also contains historical background discussion of each section and statutory comparisons with provisions in various states. *See* MODEL BUS. CORP. ACT ANN. *passim.*

230.

> As of January 2000, it is cited 1026 times as the source of or authority for current state statutes. It has been cited 453 times in state court opinions (most often in Delaware), four times by the United States Supreme Court, 53 times by the various United States Courts of Appeal (most often by the Seventh Circuit), and 88 times by various United States District Courts, Bankruptcy Courts, and the Tax Court. The Official Commentary has been cited in 38 cases, and the Act itself has been cited or discussed in 614 law review articles not including those appearing in ABA journals.

Richard A. Booth, *A Chronology of the Evolution of the MBCA*, 56 BUS. LAW. 63, 63 (2000).

231. *See* James L. Robertson, *The Law of Corporate Governance: Coming of Age in Mississippi*, 65 MISS. L.J. 477, 478 n.7 (1996) (noting annual updating efforts to

not make every change made to the Model Act, but we considered them all promptly and had what we thought were good reasons for not making some of the changes.[232] We had a very strong policy of making the Model Act changes in order to keep our statute close to the Model Act and within the mainstream of corporate statutory law.

The secretary of state's office did a remarkable job of promoting our recommendations at the Legislature.[233] In my years on the committee, nearly every piece of legislation we recommended was approved in essentially the form submitted by our legislative sponsors.[234] We had great credibility among legislators. Rarely did interest groups oppose our bills.[235] On those few occasions when they did, a benign compromise was quickly reached.[236]

If other states can adopt and maintain a corporate statute that embodies the best in current corporate statutory thinking through diligent work, trust and cooperation among the secretary of state's office, prominent members of the corporate bar, legal academics and the legislature, why not Minnesota?

I do not know the answer. But I have my suspicions. I believe the problem lies with the Minnesota corporate bar. The Minnesota corporate bar has permitted corporate plaintiffs attorneys and law professors too great a role in dictating Minnesota business association law.[237] Front-line Minnesota corporate practitioners

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maintain conformity to Model Act). For an account of one example of our updating efforts, see Bryn R. Vaaler, *Major Revisions*, *supra* note 64, at 28.

232. For discussion of a Model Act change that we did not make, *see* Vaaler, *supra* note 64, at 30 (discussing why we did not adopt section 6.21 of the Model Act).

233. E-mail from Daniel G. Hise, *supra* note 227.

234. *Id.*

235. *Id.*

236. *Id.*

237. Where was the Minnesota corporate bar when the 1983 amendments were made to section 302A.751? The law professor who was the primary author of the amendments indicates that the corporate bar was asleep at the switch:

> Although both the Chairman of the Advisory Task Force and the Chairman of the Section on Corporate, Business, and Banking Law of the bar association were notified of the pendency of the 1983 Amendments, neither group opposed them prior to passage. The Task Force Chairman made a number of suggestions, most notably that which led to the inclusion of the '35 shareholder' criteria for 'close corporation.' After the 1983 Amendments had become law, the Executive Council of the Corporate, Business, and Banking Law Section, rejecting a compromise, proposed a bill to completely repeal the minority shareholder protective

ought to take back our corporate statute. They ought to go to the Secretary of State and to the Minnesota Legislature and convince them that Minnesota has become a legal wasteland in the area of corporate statutory law and that radical action is required to bring it back in the mainstream.

This job should not be left to law professors. It must not be thwarted by those who profit from the chaotic uncertainties of section 302A.751. The Minnesota corporate lawyers who really have a stake in the quality of the legal environment in which Minnesota entrepreneurs operate must take charge.

The problem may be that knowledgeable Minnesota corporate lawyers simply do not think it is worth the time and effort to provide Minnesota with a corporate statute that is a reasonable alternative to Delaware incorporation. They may simply find it easier to incorporate their clients in Delaware.[238] I think that is a shame. Minnesota deserves better.

> provisions of the 1983 Amendments. At its legislative meeting on February 25, 1984, the House of Delegates of the Minnesota State Bar Association rejected the call for repeal. . . . The repeal bill was never presented to the legislature.

Olson, *Elixir, supra* note 2, at 635 n.54.

238. *See* Loewenstein, *supra* note 75, at 504-05 (ease of incorporating clients in Delaware takes away much of the incentive among corporate lawyers in other states to promote local law reform).