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FAIR PRICE AND FAIR PLAY UNDER THE MONTANA BUSINESS CORPORATION ACT

John J. Oitzinger*

I. INTRODUCTION

The Montana Legislature, with the able assistance and support of the Montana State Bar Association and several special law revision committees, has worked very hard over the past ten years to provide Montanans with modern, up-to date versions of basic corporate laws. In 1991, with only a single negative vote,¹ the legislature enacted an essentially unchanged version of the American Bar Association's Revised Model Business Corporation Law² and revised the Montana Nonprofit Corporation Act,³ based on the American Bar Association's Model Nonprofit Corporation Act. These laws were preceded by the Close Corporation Supplement in 1987⁴ and followed by the Montana Limited Liability Company Act in 1993.⁵ The legislature also extensively amended Montana's partnership law in 1993 and 1995 to allow the creation of "limited liability partnerships."⁶ Legislative efforts to conform Montana laws to the uniform acts continued in 1997 with the enactment of Senate Bill 329, which adopted the 1985 amendments to the Uniform Limited Partnership Act and made several conforming changes to the Montana Business Corporation Act and the Montana Limited Liability Act.⁷

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1. See Stephen C. Bahls, *Montana's New Business Corporation Act: Duties, Dissension, Derivative Actions and Dissolution*, 53 MONT. L. REV. 3, 4 n.1 (1992).

2. See Montana Business Corporation Act, ch. 368, 1991 Mont. Laws 876 (codified as amended at MONT. CODE ANN. §§ 35-1-112 to -1312 (1995)).

3. See Montana Nonprofit Corporation Act, ch. 411, 1991 Mont. Laws 1291 (codified as amended at MONT. CODE ANN. §§ 35-2-113 to -1402 (1995)).

4. Montana Close Corporation Act, ch. 432, 1987 Mont. Laws 950 (codified as amended at MONT. CODE ANN. §§ 35-9-101 to -504 (1995)). See generally Stephen C. Bahls & Marcelle Compton Quist, *The ABA Model Statutory Close Corporation Act: A New Opportunity for "Made in Montana" Corporations*, 49 MONT. L. REV. 66 (1988).

5. See Montana Limited Liability Company Act, ch. 120, 1993 Mont. Laws 269 (codified at MONT. CODE ANN. §§ 35-8-101 to -1307 (1995)).

6. See Registration of Limited Liability Partnerships, ch. 449, 1995 Mont. Laws 2092 (codified at MONT. CODE ANN. §§ 35-10-701 to -710 (1995)).

7. See S.B. 329, 55th Leg. (Mont. 1997).

The 1991 Montana Business Corporation Act,⁸ the centerpiece of these legislative initiatives, was derived from the Revised Model Business Corporation Act, which reflected a decade or more of work by the American Bar Association's Committee on Corporate Laws. At the same time, the Reporters of the American Law Institute's Project on Corporate Governance were making a parallel effort to state the corporate common law.⁹ These efforts took on special urgency because of the flood of litigation that was occurring throughout the county. The authors of a book on the business judgment rule commented that between their third edition in 1989 and their fourth edition in 1993, more than 550 new cases had been decided. Of those, 330 were decided between 1991 and 1993.¹⁰

While this furious activity occurred in other states, shareholder litigation before the Montana Supreme Court was considerably less frequent.¹¹ In a 1992 article in the *Montana Law Review*, Professor Stephen C. Bahls identified five "major" decisions since 1980.¹² However, from 1992 to 1995, the Montana Supreme Court decided no cases involving corporate law issues and, in 1996, decided only two.¹³ While cases in the early 1980s were favorable to minority shareholders, it has been fourteen years since the supreme court decided a case in favor of a minority shareholder.¹⁴

8. See MONT. CODE ANN. §§ 35-1-112 to -1312 (1995).

9. See American Law Institute, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (1994) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE]. Unlike the Restatements, the Principles of Corporate Governance presents analysis and recommendations, recognizing that the law is evolving rapidly and, in many cases, is not settled. The Notes accompanying the "black letter" recommendations distinguish between situations in which the law is clear and those in which there is a split of authority or a need for legislation to implement the recommendations.

10. See DENNIS J. BLOCK, ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS, preface (4th ed. 1993) [hereinafter BLOCK, THE BUSINESS JUDGMENT RULE].

11. The number of corporate law cases decided in the 1980s, nevertheless, far exceeds the number of cases decided in earlier decades and, so far, in the 1990s.

12. See Bahls, *supra* note 1, at 17 (citing Daniels v. Thomas, Dean & Hoskins, Inc., 246 Mont. 125, 804 P.2d 359 (1990); Gray v. Harris Land & Cattle Co., 227 Mont. 51, 737 P.2d 475 (1987); Maddox v. Norman, 206 Mont. 1, 669 P.2d 230 (1983); Fox v. 7L Bar Ranch Co., 198 Mont. 201, 645 P.2d 929 (1982); Skierka v. Skierka Bros., Inc., 192 Mont. 505, 629 P.2d 214 (1981)).

13. See McCann Ranch, Inc. v. Quigley-McCann, 276 Mont. 205, 915 P.2d 239 (1996); Stufft v. Stufft, 276 Mont. 310, 916 P.2d 104 (1996).

14. See Maddox, 206 Mont. 1, 669 P.2d 230 (remanding district court's determination of value of minority shares); see also Fox, 298 Mont. 197, 645 P.2d 939 (ordering liquidation based on continuing deadlock); Skierka, 192 Mont. 505, 629 P.2d 214

Although the 1991 Montana Business Corporation Act does not seem to have contributed to the unfavorable decisions for minority shareholders, several of the new provisions do increase the barriers to a successful challenge to managerial conduct by minority shareholders. The drafters intended to balance these changes with the more readily available relief provided by dissenters' rights and, at least in the case of close corporations, by court-ordered dissolution or other alternatives, usually a forced buy-out of the minority shareholder. These remedies depend upon a valuation policy that treats the minority shareholder with entire fairness, which consists of two basic aspects: fair dealing and fair price.¹⁵

Unfortunately, the Montana Supreme Court may have upset this balance with its 1996 decision in *McCann Ranch, Inc. v. Quigley-McCann*.¹⁶ In *McCann Ranch*, the court held that a twenty-five percent discount was appropriate in determining the fair value of the minority stock interest in question.¹⁷ Unless carefully limited to its facts, the decision puts Montana among a minority of states that allow such a discount in a transaction between a minority shareholder and a controlling shareholder or the corporation itself.

Given the sweeping changes in the Montana Business Corporation Act and the recurring legislative efforts to provide uniform and up-to-date statutes, the judiciary should strive toward the most uniform and up-to-date interpretations of the law. The Principles of Corporate Governance represents the companion interpretive guide to the Model Act, and Montana courts should draw upon the analysis and recommendations expressed therein. If a satisfactory decisional framework still cannot be developed, guidance should be sought in the recent decisions in other states, particularly those in which the courts have regular experience in considering the issues. Prior decisions of the Montana courts should be weighted according to how closely they approximate the results that would be obtained under the current statutory and analytic framework. Courts and litigants should pay particular attention to conflicting interest transactions as defined in the

(finding oppression of minority shareholder). *But see McCann Ranch, Inc.*, 276 Mont. 205, 915 P.2d 239; *Daniels*, 246 Mont. 125, 804 P.2d 359.

15. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

16. 276 Mont. 205, 915 P.2d 239 (1996).

17. See *McCann Ranch, Inc.*, 276 Mont. at 208-11, 915 P.2d at 241-43. The decision also stated, in dictum, that the conduct of the controlling shareholders did not amount to oppression. See *id.* at 211, 915 P.2d at 243.

Montana Business Corporation Act and the Principles of Corporate Governance.

Part II of this Article provides background on the Model Act and the Principles of Corporate Governance as a framework for analyzing business conduct and judicial decisions. Part III describes remedies available under Montana's Business Corporation Act, including a determination of fair value, discusses the majority and minority views in other states, and concludes with a detailed analysis of the *McCann Ranch* decision. Part III further analyzes the application of discounts in arriving at fair value for shares, separately and in combination with breaches of the duty of fair dealing by directors, officers, and controlling shareholders. Part IV describes the common law and statutory duties of directors, officers, and controlling shareholders as embodied in the Model Act and the Principles of Corporate Governance. Part IV then applies these principles to Montana cases and speculates how these cases may have been decided under the new law and principles.

II. REVISED MODEL ACT AND PRINCIPLES OF CORPORATE GOVERNANCE

The first Model Business Corporation Act, drafted in 1950, was based on the Illinois Business Corporation Act of 1935.¹⁸ In 1968, Montana adopted the 1960 version of the Model Business Corporation Act¹⁹ and, in 1991, adopted the substantially different Revised Model Business Corporation Act (hereinafter "Model Act").²⁰ Although the initial Model Business Corporation Act tried to embody a middle-of-the-road corporate scheme,²¹ the

18. See Ray Garrett, *History, Purpose and Summary of the Model Business Corporation Act*, 6 BUS. LAW. 1 (1950).

19. See Hugh V. Shaefer, *The Status of the Adoption of the Model Business Corporation Act in Montana—A Commentary*, 36 MONT. L. REV. 29 (1975).

20. See Bahls, *supra* note 1, at 4. The Model Act was first adopted in 1984 and was amended significantly in 1988 with the adoption of subpart F, directors conflicting interest transactions, and in 1990 with the adoption of subchapter D, termination of derivative actions (now MODEL BUS. CORP. ACT, ch. 7, subch. D (1994)). See Committee on Corporate Laws, *Changes in the Revised Model Business Corporation Act—Amendment Pertaining to the Liability of Directors*, 45 BUS. LAW. 695 (1990).

21. MODEL BUS. CORP. ACT (1960), Off. Cmts. The Comments state:

The Committee on Corporate Laws presented the Model Act as a modern statute that preserves in proper balance the interest of the state and the rights and interests of corporations, shareholders and management The Model Act is not designed for particular application to large or small corporations but on the premise that a corporation statute, properly drawn, could and should serve equally the requirements of large and small corpo-

Model Act is the product of the American Bar Association (ABA) Committee on Corporate Laws, a group dominated by large firm lawyers and corporate counsel for several Fortune 500 companies.²² The closed twenty-five member Committee on Corporate Laws is able to make final decisions without prior approval of the ABA Section on Corporation, Banking and Business Law or its Board of Governors.²³ Not surprisingly, the Committee's decisions have tended to favor corporate management.²⁴

The Model Act makes three major changes that affect director and officer liability.²⁵ First, it authorizes provisions in the articles of incorporation that effectively eliminate director liabili-

rations and the fair treatment of the shareholders of each.

See also, Douglas M. Branson, *Recent Changes to the Model Business Corporation Act: Death Knells for Main Street Corporation Law*, 72 NEB. L. REV. 258, 259 (1993); Melvin A. Eisenberg, *The Model Business Corporation Act and the Model Business Corporation Act Annotated*, 29 BUS. LAW. 1407 (1974).

22. *See* Branson, *supra* note 21, at 260.

23. *See* Robert W. Hamilton, *Reflections of a Reporter*, 63 TEX. L. REV. 1455, 1458 (1985).

24. Although it does not mention any of the activities of the Committee on Corporate Laws, a recent book catalogs instances of excessively zealous representation of large corporate clients, primarily relating to discovery abuses. RALPH NADER AND WESLEY J. SMITH, *NO CONTEST: CORPORATE LAWYERS AND THE PERVERSION OF JUSTICE IN AMERICA* (1996). "Until the early 1970's the members of the Committee on Corporate Laws were almost exclusively lawyers from a handful of big cities and from major firms whose clients were predominantly large, publicly held corporations." *Supra* note 23, at 1458. As of 1984-85, when the Revised Business Corporation Act was published, the Committee included one or two attorneys who represent plaintiffs in derivative litigation and two or three law professors. "However, even with these changes, corporate attorneys from large firms continue their numerical dominance of the Committee on Corporate Laws membership." *Id.*

25. At present, Montana is one of only a handful of states that have adopted the derivative suit provisions in their entirety. 2 MODEL BUS. CORP. ACT ANN., subch. D, *Derivative Proceedings* (3d ed., 1985) (Supp. 1996). Montana and North Carolina adopted in full section 7.40 (MONT. CODE ANN. § 35-1-541 (1995)). *See* MODEL BUS. CORP. ACT ANN. at 7-262. Montana, Indiana, Kentucky, Virginia and Wisconsin, adopted section 7.41 (MONT. CODE ANN. § 35-1-542 (1995)). *See* MODEL BUS. CORP. ACT ANN. at 7-341. Montana, Virginia and Wisconsin adopted section 7.42 virtually unchanged, *Demand* (MONT. CODE ANN. § 35-1-543 (1995)). *See* MODEL BUS. CORP. ACT ANN. at 7-345. Montana, Iowa, Kentucky, Mississippi, North Carolina, Oregon, Tennessee, Utah, Virginia, Washington, Wisconsin and Wyoming adopted section 7.43, *Stay of Proceedings* (MONT. CODE ANN. § 35-1-544 (1995)). *See* MODEL BUS. CORP. ACT ANN. at 7-346. Only Montana and Wisconsin have adopted with little substantive change, the key dismissal provision, section 7.44 (MONT. CODE ANN. § 35-1-545 (1995)). *See* MODEL BUS. CORP. ACT ANN. at 7-356. Montana, Arkansas, Indiana, Iowa, Kentucky, Mississippi, North Carolina, Oregon, Tennessee, Utah, Virginia, Washington, Wisconsin and Wyoming adopted the uncontroversial section 7.45, *Discontinuance or Settlement* (MONT. CODE ANN. § 35-1-546 (1995)). *See* MODEL BUS. CORP. ACT ANN. at 7-358. Only Montana and Wisconsin adopted unchanged the attorney fee provision, section 7.46, *Payment of Expenses* (MONT. CODE ANN. § 35-1-547 (1995)). *See* MODEL BUS. CORP. ACT ANN. at 7-360.

ty for breaches of the duty of care.²⁶ Second, it creates a safe harbor procedure for conflicting interest transactions, which narrows and weakens shareholder protection from breaches of the duty of loyalty (or the duty of fair dealing).²⁷ Finally, it authorizes directors to terminate derivative suits and limits judicial review of their decision to terminate.²⁸ As a result of these changes, some have criticized the Model Act for catering excessively to the needs of the Fortune 500 and attacked it as the "death knell" for main street business applications.²⁹

During the decade or so in which the ABA Committee on Corporate Laws redrafted the Model Act, the American Law Institute (ALI) Project on Corporate Governance sought to "codify," in restatement-like rules, the common law of corporations.³⁰ The effort followed on the heels of the ALI's drafting of the Federal Securities Code from 1969 to 1978. While the Federal Securities Code considered the scope of the responsibilities of officers and directors of publicly-held corporations, it was necessarily limited by the nature of federal securities law, which stresses disclosure and governs substantive corporate law only tangentially.³¹ Under the direction of Ray Garrett, Jr., former chairman of the Securities and Exchange Commission, the Project on Corporate Governance evolved into a restatement of the law,

26. See MONT. CODE ANN. § 35-1-216(2)(d) (1995). This section allows the articles of incorporation to include:

[A] provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any actions taken or any failure to take any action, as a director, except liability for: (i) the amount of a financial benefit received by a director to which the director is not entitled; (ii) an intentional infliction of harm on the corporation or the shareholders; (iii) a violation of 35-1-713 [unlawful distributions]; or (iv) an intentional violation of criminal law.

MONT. CODE ANN. § 35-1-216(2)(d) (1995).

27. See MONT. CODE ANN. §§ 35-1-461 to -464 (1995). The corresponding portion of the Model Act is located at MODEL BUS. CORP. ACT §§ 8.60 through 8.64 (1994).

28. See MONT. CODE ANN. § 35-1-545 (1995). The universal demand provision overrules *S-W Co. v. John Wight, Inc.*, 179 Mont. 392, 587 P.2d 348 (1978). The new law also conflicts with the Delaware Supreme Court decision in *Zapata v. Maldonado*, 430 A.2d 779 (Del. 1981). There, the scope of review included the normal review of the special litigation committee's independence and diligence as well as a "second step" to review of the merits of the allegations and the committee's analysis of them. See *id.*; MONT. CODE ANN. § 35-1-545(1) (1995); MODEL BUS. CORP. ACT § 7.44(a) (1994) (stating that "section 7.44 does not authorize the court to review the reasonableness of the determination . . . the phase in section 7.44 . . . limits judicial review to whether the determination has some support in the findings of the inquiry"); 2 MODEL BUS. CORP. ACT ANN. § 7.44, at 7-355 (Supp. 1996).

29. See Branson, *supra* note 21, at 279.

30. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at XVIII-XIX.

31. See *id.* at XVI.

which included recommendations.³² The Project on Corporate Governance was intended to lead, rather than merely follow, the development of the law, as clearly expressed by Chairman Garrett:

Where there is no judicial authority, or where the cases are unsatisfactory by modern standards—either because of their antiquity, or the absence of compelling analysis, or because today, they just seem wrong—resort must be had to other sources. These may include the literature on the subject, the better corporate practice in the view of those experienced in the field, not limited to lawyers, and ultimately to the judgment of the Institute, aided by the Reporter and his Advisers. Where the Project is not in fact restating the cases, the Institute's views should take the form of recommendations, which may include recommended statutory provisions, state or federal.³³

Each section is followed by two comments: Comment a, which describes the current state of the law, gives analysis and recommendations, and notes where there is a split of authority; and Comment b, which states whether the analysis and recommendations can be implemented by judicial decision or whether new legislation is necessary.³⁴

The overlapping efforts by the ABA Committee on Corporate Laws and the reporters of the ALI Corporate Governance Project required these two groups to interact and led to a certain amount of friction where their objectives have differed. The ABA formed an ad hoc committee, CORPRO, to act as liaison with the ALI Project on Corporate Governance. CORPRO sought to influence the ALI proposals by claiming they were beyond the scope of existing case law. Ironically, the ABA Committee on Corporate Laws' amendments to the Model Act were at least as much on the cutting edge, and outside established case law, as those proposed by the ALI Project on Corporate Governance. The Committee on Corporate Laws attempted to cut the ALI "off at the pass" by pushing states to adopt the Model Act before the ALI's annual meeting in 1992.³⁵ The ALI needed the approval of its broad and diverse membership, which includes judges, general practitioners and academics practicing in fields other than corporate law, to complete the Project. CORPRO and the Business

32. *See id.* at XVIII-XIX.

33. *Id.* at XIX.

34. *See id.* at XXV-XXVI.

35. *See Branson, supra* note 21, at 281-84.

Roundtable, an organization of the Chief Executive Officers of the 100 largest companies in the United States, conducted a "get out the vote" campaign and actively lobbied the membership of the ALI to kill the Corporate Governance Project.³⁶

In response, the Director of the ALI, Geoffrey C. Hazard, Jr., sent a letter to the membership before the annual meeting in May 1992, reminding members of the need to formulate balanced positions and asking any members attending the meeting with voting instructions from corporate clients to leave the meeting.³⁷ Perhaps reflecting the intensity of this struggle, Professor Hazard inflated the importance of the ALI's work somewhat:

This statement of Principles of Corporate Governance is a major contribution to the fundamental law of economic systems that operate through privately owned business enterprises. Viewing the American political economy in broad perspective, the law of corporate governance is a part of our constitutional law, that is, the legal structure of our basic social order. To be sure, corporate law is not entrenched in clauses of the United States Constitution. However, this body of law reflects common understanding of the key legal relationships in the corporation, particularly the publicly-held corporation—those among the shareholders, directors, and management. These legal relationships are fundamental to the American capitalist system.³⁸

In light of this tumultuous history, it is not surprising that the two major corporate law efforts of the second half of this century are not always harmonious. While the reporters of the Principles of Corporate Governance were obviously very concerned about the management of large and medium-sized publicly-held corporations, they clearly expressed their intention that the analysis and recommendations apply to all corporations. The drafters of the Model Act expressed a similar intention,³⁹ and one may assume that the drafters of the Montana Business Corporation Act intended it to apply to closely-held corporations as well as large public companies.⁴⁰ Because the Model Act consid-

36. See *id.* at 282.

37. See *id.* at 282 n.91.

38. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at IX.

39. See MODEL BUS. CORP. ACT XVII (1994) ("Act is designed for use by both publicly held and closely held corporations, and takes into account the rights and duties of their shareholders, officers, directors, and the corporation itself, as well as the interests of the state.").

40. Since virtually all Montana corporations are closely held, the 1991 amendments were obviously intended to apply to small as well as large corporations.

erably weakens the protections offered minority shareholders for breaches of fiduciary duties, the reporters of the ALI Project on Corporate Governance recognized the need to counterbalance majority control by providing an entirely fair appraisal remedy.⁴¹ The reporters noted and encouraged judicial efforts to strengthen the fair price determination in the appraisal process, particularly where the transaction in question is not a true arms-length transaction.⁴²

III. FAIR PRICE

A. Dissenters' Rights

Under the common law of corporations in the late nineteenth and early twentieth centuries, a corporation could not undertake certain fundamental changes, such as a merger or sale of assets, without unanimous shareholder approval.⁴³ The U.S. Supreme Court recognized this "vested" right of a shareholder in its much-cited opinion in *Voeller v. Neilston Co.*:⁴⁴

At common law, unanimous shareholder consent was a prerequisite to fundamental changes in the corporation. This made it possible for an arbitrary minority to establish a nuisance value for its shares by refusal to cooperate. To meet the situation, legislatures authorized the making of changes by majority vote. This, however, opened the door to victimization of the minority. To solve the dilemma, statutes permitting a dissenting minority to recover the appraised value of its shares, were widely adopted.⁴⁵

In 1976, the drafters of the Model Act attempted to remove technical and procedural barriers to its dissenters' rights provisions, while still addressing the criticism from corporate management that shareholders' demands for appraisals were an attempt to coerce the corporation into making a nuisance settlement or were driven by fanciful concepts of valuation.⁴⁶ The drafters

41. See 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 291-96.

42. See *id.* § 7.22, at 291-96, 316-18 cmt. c.

43. See generally *Voeller v. Neilston Co.*, 311 U.S. 531 (1941); *Breniman v. Agricultural Consultants, Inc.*, 829 P.2d 493, 495 (Colo. App. 1992); 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 296; 3 MODEL BUS. CORP. ACT ANN. 13-8 to 13-9 (Supp. 1996); W. FLETCHER, CYCLOPEDIA OF CORPORATIONS § 5906.1 (1984).

44. 311 U.S. 531, 535 (1941).

45. *Voeller*, 311 U.S. at 535 n.6.

46. See 3 MODEL BUS. CORP. ACT ANN. 13-3 (Supp. 1996). The 1976 amendments to the Model Act were adopted in Montana in 1981. See MONT. CODE ANN. §

intended to provide a method for shareholders to receive fair value for their shares without having to resort to litigation.⁴⁷ The Principles of Corporate Governance states that the intent of the appraisal remedy "is to specify the fundamental elements of an effective appraisal remedy that will reduce litigation, facilitate efficiency-promoting transactions, ensure reasonably fair procedures, and provide a forum in which the focus will appropriately be on the central question of fair value, rather than on collateral issues of motive or purpose."⁴⁸

The Model Act defines "fair value," but does not state how value is to be determined.⁴⁹ Further, the Official Comment to the Model Act states only:

The definition of fair value in section 13.01(3) leaves to the parties (and ultimately to the courts) the details by which "fair value" is to be determined within the broad outlines of the definition. This definition thus leaves untouched the accumulated case law about market value, value based on prior sales, capitalized earnings value, and asset value.⁵⁰

While the Model Act leaves the method of determination of fair value to the courts, it sets forth the procedural aspects of dissenters' rights in great detail. If a corporation proposes an action that gives rise to dissenters' rights, such as a merger or adoption of an amendment to the articles of incorporation that would change fundamental rights of the shareholders, it must notify the shareholders.⁵¹ The burden then shifts to the shareholders to give notice of their intent to exercise the right to dissent before the vote is taken and to not vote in favor of the proposal.⁵² If the proposal is adopted, the corporation must notify qualifying shareholders within ten days after the corporate action is taken.⁵³ The notice must comply with the technical requirements of the Act, including setting a date within thirty to sixty days by which the shareholder must make a further de-

35-1-812 (1981).

47. See 3 MODEL BUS. CORP. ACT ANN. 13-3 (Supp. 1996).

48. 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 296.

49. See MONT. CODE ANN. § 35-1-826(4) (1995) (stating that "'fair value,' with respect to a dissenter's shares, means the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable").

50. 3 MODEL BUS. CORP. ACT ANN. 13-6 (Supp. 1996).

51. See MONT. CODE ANN. § 35-1-829 (1995).

52. See MONT. CODE ANN. § 35-1-830 (1995).

53. See MONT. CODE ANN. § 35-1-831 (1995).

mand for payment. The burden then shifts again to the shareholder to demand payment and tender the stock certificate within the time specified.⁵⁴ Failure to follow these procedures extinguishes the shareholder's right to dissent.⁵⁵

Fortunately for the dissenter, jumping through these procedural hoops entitles him or her to payment of the "fair value" of the shares. The corporation is required to pay what it estimates to be a fair value and to provide its balance sheet, income statement and other information required by law.⁵⁶ A dissenter may keep the amount paid and notify the corporation that it does not represent fair value.⁵⁷ However, the dissenter is required to state the minimum amount that he or she is willing to accept and, if this demand is unreasonable, could be assessed litigation expenses.⁵⁸ Within sixty days after receiving the payment demand, the corporation must commence a proceeding for a judicial determination of the fair value of the shares⁵⁹ or pay the dissenter the full amount demanded.⁶⁰

A demand for payment by the shareholder triggers the sixty-day default period, but what if the corporation never gives notice of dissenters' rights to the shareholder? In *McCann Ranch, Inc. v. Quigley-McCann*,⁶¹ the majority shareholders voted to convert the corporation to a statutory close corporation without notifying the shareholders that this action gave rise to dissenters' rights. Instead of proceeding under section 35-1-838 of the Montana Code, the corporation filed suit under the Declaratory Judgment Act and successfully side-stepped the issue of its default under the dissenters' rights statute.⁶² The minority shareholder accepted jurisdiction by the district court and stipulated that the issue was limited to valuation of the shares.⁶³ The Montana Supreme Court refused to let the shareholder reopen the dissenters'

54. See MONT. CODE ANN. § 35-1-832 (1995).

55. See MONT. CODE ANN. § 35-1-832(3) (1995).

56. See MONT. CODE ANN. § 35-1-834 (1995).

57. See MONT. CODE ANN. § 35-1-837 (1995).

58. See MONT. CODE ANN. § 35-1-839 (1995).

59. See MONT. CODE ANN. § 35-1-838 (1995); see also *Gold Reserve Corp. v. McCarty*, 228 Mont. 512, 744 P.2d 160 (1987) (excusing an attorney's late signature on the petition to uphold the policy of favoring adjudication on the merits wherever possible).

60. See MONT. CODE ANN. § 35-1-838(1) (1995); see also *Breniman*, 829 P.2d 493 (holding that a corporation that failed to file a proceeding within 60 days was deemed to have waived any objection to dissenter's claim).

61. 276 Mont. 205, 915 P.2d 239 (1996).

62. See MONT. CODE ANN. § 35-1-829 (1995).

63. See *McCann Ranch, Inc.*, 276 Mont. at 207, 915 P.2d at 241.

rights issues on appeal, noting that the shareholder had failed to institute proceedings to challenge [the corporation's] failure to notify her of such dissenter's rights."⁶⁴

Under similar facts in other states, failure by a corporation to follow the statutory dissenters' rights procedures has resulted in a full recovery by the shareholder.⁶⁵ In an Idaho case, shareholders were informed of the corporate action but not of their right to dissent or to demand payment.⁶⁶ Their attorney sent a demand letter reminding the corporation that it was required to commence an action, but the corporation failed to do so. The court found that "[b]y failing to file a petition, the corporation defaulted, giving rise to the dissenters' entitlement to payment of the sum demanded."⁶⁷ Similarly, in a Colorado case, the court held that the corporation's failure to act within sixty days effectively waived its right to dispute the amount of the plaintiff's demand.⁶⁸ While the dissenting shareholder may need to commence proceedings, as pointed out by the Montana Supreme Court,⁶⁹ the corporation is required to pay the cost of the proceedings, assuming the court does not find that the "dissenters acted arbitrarily, vexatiously, or in bad faith in demanding payment."⁷⁰

A further incentive for the corporation to closely follow the dissenters' rights procedures is that once the rights have been invoked, the right of the shareholders to commence other proceedings or to seek to enjoin the corporate action is extinguished.⁷¹ A shareholder who is entitled to dissent may not challenge the corporate action in any other way, unless the action is unlawful or fraudulent.⁷² However, because the shareholder is only excluded from taking action further against the corporation for the action which gave rise to the dissenters' rights, the shareholder may still be able to bring an action based on prior conduct for a breach of fiduciary or other duty.⁷³

64. *Id.* at 210, 915 P.2d at 242.

65. *See, e.g., Breniman*, 839 P.2d at 495; *Waters v. Double L, Inc.*, 755 P.2d 1294 (Id. Ct. App. 1987).

66. *See Waters*, 755 P.2d at 1297.

67. *Id.* at 1304.

68. *See Breniman*, 839 P.2d at 495.

69. *See McCann Ranch, Inc.*, 276 Mont. at 210, 915 P.2d at 242.

70. *See* MONT. CODE ANN. § 35-1-839(1) (1995).

71. *See* MONT. CODE ANN. § 35-1-827(2) (1995).

72. *See* MONT. CODE ANN. § 35-1-827(2) (1995).

73. *See* 3 MODEL BUS. CORP. ACT ANN. § 13.02 cmt. 2, and cases cited at §§ 13-27 to -32 (Supp. 1996). *See also infra* note 126 and accompanying text.

B. Judicial Dissolution and Alternative Remedies

While the exercise of dissenters' rights is a no-fault proceeding, actions for judicial dissolution or alternative equitable relief require findings of some misconduct. The grounds for judicial dissolution of a conventional corporation are that "the directors or those in control of the corporation have acted, are acting, or will act in a manner that is "illegal, oppressive, or fraudulent."⁷⁴ This includes any misconduct amounting to a breach of fiduciary duty.⁷⁵

In *Maddox v. Norman*,⁷⁶ the Montana Supreme Court recognized that a complete dissolution at the request of the owner of a seven and one-half percent interest in the corporation was not practical. Instead, the court took the laudable step of creating an alternative remedy, ordering a compulsory buy-out of the minority shareholder. The decision was subsequently codified at section 35-1-939 of the Montana Code.⁷⁷ Similar provisions applicable to statutory close corporations authorize a court to order a compulsory purchase of a petitioner's shares as an alternative remedy.⁷⁸ Court-ordered dissolution might be avoided under section 35-9-503 of the Montana Code if the corporation or one or more of the shareholders purchases the shares of the complaining shareholder for their fair value.⁷⁹

While the degree and measure of culpability that gives rise

74. See MONT. CODE ANN. § 35-1-938(2)(b) (1995); *Maddox v. Norman*, 206 Mont. 1, 669 P.2d 230 (1983).

75. See, e.g., *Daniels v. Thomas, Dean & Hoskins, Inc.*, 246 Mont. 125, 804 P.2d 359 (1990); *Fox v. 7L Bar Ranch Co.*, 198 Mont. 201, 645 P.2d 929 (1982); *Skierka v. Skierka Bros.*, 192 Mont. 505, 629 P.2d 214 (1981).

76. 206 Mont. 1, 669 P.2d 230 (1983).

77. See MONT. CODE ANN. § 35-1-939 (1995). This section states:

Discretion of court to grant relief other than dissolution. (1) In any action filed by a shareholder or director to dissolve the corporation on the grounds enumerated in 35-1-938, the court may make any order to grant the relief other than dissolution as, in its discretion, it considers appropriate, including, without limitation, an order . . .

(d) providing for the purchase at fair value of shares of any shareholder, either by the corporation or by other shareholders.

(2) Relief under subsection (1) may be granted as an alternative to a decree of dissolution or may be granted whenever, under the circumstances of the case, relief but not dissolution would be appropriate.

Id.

78. See MONT. CODE ANN. § 35-9-207(2)(a) (1995) (stating that "[t]he court shall determine the fair value of the shares subject to compulsory purchase in accordance with the standards set forth in section 35-9-503, together with terms for the purchase").

79. See MONT. CODE ANN. § 35-9-503(1) (1995).

to a court-ordered repurchase of minority shares may differ, the statutes and case law all require that the price reflect fair value.⁸⁰ Section 35-9-503 of the Montana Code contains a comprehensive statutory listing of factors to be considered in determining fair value:

- (i) the going concern value of the corporation;
- (ii) any agreement among some or all of the shareholders fixing the price or specifying a formula for determining share value for any purpose;
- (iii) the recommendations of appraisers, if any, appointed by the court; and
- (iv) any legal constraints on the corporation's ability to purchase the shares.⁸¹

This list seemingly supports the view that the parties should consider all shares to be of equal value rather than discount certain shares to reflect minority status or lack of marketability.

C. Majority View of Fair Value

Given free reign to interpret the dissenters' rights and dissolution statutes, courts have split on the question of whether discounts should be taken into account in determining the fair value of shares in closely-held corporations. Three basic approaches have evolved: (1) no discounts should be taken to reflect either the minority status or the lack of a public market; (2) a discount for minority status is inappropriate, but a discount for lack of marketability is allowable; or (3) discounts for both minority status and for lack of marketability are appropriate.

A majority of the courts conclude that no discounts should be taken in determining fair value, reasoning that for most purposes the enterprise should be valued as an entity and any discounts should be taken at the enterprise level.⁸² The market

80. Professor Bahls advocated flexible application of a "reasonable expectations" test to measure oppression, separate from the duties of care and loyalty. See Bahls, *supra* note 1, at 16-22. Another commentator suggested that dissolution-at-will is an effective self-policing mechanism. See Scot Schermerhorn, *Efficiency vs. Equity in Close Corporations*, 52 MONT. L. REV. 73, 87 (1991).

81. MONT. CODE ANN. § 35-9-503(2)(a) (1995).

82. See, e.g., *Foy v. Klapmeier*, 992 F.2d 774 (8th Cir. 1993) (applying Minnesota law); *Brown v. Corrugated Box Co.*, 154 Cal. Rptr. 170, 173-76 (Cal. Ct. App. 1979); *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137 (Del. 1989); *Woodward v. Quigley*, 133 N.W.2d 38 (Iowa 1965); *Institutional Equip. & Interiors, Inc. v. Hughes*, 562 N.E.2d 662, 667-68 (Ill. App. Ct. 1990) (holding that fair market value is not the appropriate measure of fair value where dissenting minority shareholder is bought

value of the enterprise should already be determined, and providing for further discounts at the shareholder level is inherently unfair to the minority who did not pick the timing of the transaction and is not in the position of a willing seller. Because the shares are being purchased by the corporation rather than being sold into a market, the case law rejects the assumption that fair value means fair market value. Accordingly, the value of the shares is their value to the corporation. "Any rule of law that gave the shareholders less than their proportionate share of the whole firm's fair value would produce a transfer of wealth from the minority shareholders to the shareholders in control. Such a rule would inevitably encourage corporate squeeze-outs."⁸³

In its leading opinion in *Cavalier Oil Corp. v. Harnett*,⁸⁴ the Delaware Supreme Court stated the reasoning behind the majority view in the form of a fairly tidy syllogism: the first premise is that appraisals require the company to be viewed as an ongoing concern; the second premise is that the shareholders would be willing to maintain their investment position in the company; and the conclusion is that dissenting shareholders should be put in as equivalent a position had the merger not occurred.⁸⁵ To effect this equivalency of position, the court rejected a market value discount as an effort to reconstruct a *pro forma* sale, which was not appropriate due to the shareholder's assumed willingness to continue his investment. The court also rejected a discount for lack of control to avoid allowing the majority to reap a windfall. The court noted that the objective of a dissenters' rights statute is "to value the corporation itself, as distinguished from a specific fraction of its shares as they may exist in the hands of a particular shareholder."⁸⁶ By so ruling, the Delaware Supreme Court applied to a merger of closely-held corporations the "proportionate share of the enterprise value" test adopted by the same court in 1983 in the context of a merger of two publicly-held companies.⁸⁷ While appraisers are instructed to consider

out by majority shareholder); *In re McLoon Oil Co.*, 565 A.2d 997 (Me. 1989); *BNE Mass. Corp. v. Sims*, 588 N.E.2d 14 (Mass. App. Ct. 1992); *MT Properties, Inc. v. CMC Real Estate Corp.*, 481 N.W.2d 383 (Minn. Ct. App. 1992); *Rigel Corp. v. Cutchall*, 511 N.W.2d 519 (Neb. 1994); *Woolf v. Universal Fidelity Life Ins.*, 849 P.2d 1093 (Okla. Ct. App. 1992); *Robblee v. Robblee*, 841 P.2d 1289 (Wash. Ct. App. 1992) (applying dissenters' rights law to a contractual settlement).

83. *McLoon Oil Co.*, 565 A.2d at 1005.

84. 564 A.2d 1137 (Del. 1989).

85. See *Cavalier Oil Corp.*, 564 A.2d at 1145.

86. *Id.* at 1144.

87. See *Weinberger*, 457 A.2d 701. In that case, the court stated:

all factors that could be used to fix a value for the enterprise as a whole, no discounts to such value are to be considered at the shareholder level.

The ALI Principles of Corporate Governance adopt the position of the majority of state courts and of many commentators,⁸⁸ stating that the fair value of shares "should be the value of the eligible holder's . . . proportionate interest in the corporation, without any discount for minority status or, absent extraordinary circumstances, lack of marketability."⁸⁹ The ALI statement of fair value is substantially the same as the rule stated in the Uniform Partnership Act for determining the value of a partnership interest.⁹⁰ This lends substance to the policy of treating

The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern. By value of the stockholder's proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger. In determining what figure represents this true or intrinsic value, the appraiser and the courts must take into consideration all factors and elements which might reasonably enter into the fixing of value.

Id. at 713 (quoting *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950)).

88. See, e.g., Thomas J. Bamonte, *Measuring Stock Value in Appraisals Under the Illinois Business Corporation Act*, 80 ILL. B.J. 236 (1992); Bahls, *supra* note 1, at 32 (stating that "[s]hareholders whose shares are purchased should not be forced to sacrifice any element of value representing the going concern value of the firm"); Robert B. Heglar, Note, *Rejecting the Minority Discount*, 1989 DUKE L.J. 259; Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact Upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425 (1990). The ALI standard was followed in an appraisal action involving a publicly-held company in *Spinnaker Software Corp. v. Nicholson*, 495 N.W.2d 441 (Minn. Ct. App. 1993).

89. 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at § 7.22. Valuation is a cornerstone of the appraisal process, particularly in view of the exclusivity clause. See MONT. CODE ANN. § 35-1-619 (1995). "This preference for exclusivity is, however, premised on the availability of an appraisal remedy with the fundamental characteristics specified in §§ 7.21-7.23, which gives dissenting shareholders a fair and effective recourse." 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 296.

90. See MONT. CODE ANN. § 35-10-619(2) (1995) which states:

(a) The buyout price of a dissociated partner's interest is the amount that would have been distributable to the dissociating partner under 35-10-629(2) if on the date of dissociation the assets of the partnership were sold at a price equal to the greater of:

(i) the liquidation value; or

(ii) the value based on a sale of the entire business as a going concern without the dissociated partner and the partnership were wound up as of that date.

(b) In either case, the selling price of the partnership assets must be determined on the basis of the amount that would be paid by a willing buyer to a willing seller, neither being under any compulsion to buy or sell, and with knowledge of all relevant facts.

shareholders in a close corporation as partners.⁹¹

In 1994, the Nebraska Supreme Court reviewed the post-*Cavalier Oil* cases in other jurisdictions at length and concluded that "[t]he real objective is to ascertain the actual worth of that which the dissenter loses because of his unwillingness to go along with the controlling stockholder, that is to indemnify him."⁹² To uphold Nebraska's statutory policy of fully compensating minority shareholders, the court held that no minority discount or deduction for lack of marketability should be given.⁹³

Cases addressing fair value in the context of judicial dissolution or alternative remedy statutes generally follow the majority view expressed in the more frequently litigated dissenters' rights cases.⁹⁴ Because dissolution cases require the minority shareholder to show some degree of culpability by majority shareholders, the conduct is often such that should not be rewarded by allowing a discount.

D. Minority View—Allowing Discounts

Cases allowing discretionary discounts for both minority status and marketability interpret fair value to mean fair market value.⁹⁵ Accordingly, these courts hold that for purposes of dissenters' rights statutes, stock may be valued in the same manner as in other valuations involving a hypothetical arms-length sale, such as for tax, marital dissolution, or estate purpos-

91. See, e.g., *Fox*, 198 Mont. at 212-13, 645 P.2d at 935; see generally 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 199.

92. See *Rigel Corp.*, 511 N.W.2d at 524 (citing *Warren v. Baltimore Transit Co.*, 154 A.2d 796, 799 (Md. 1959)).

93. See *Rigel Corp.*, 511 N.W.2d at 526 (stating that "in the event of a merger, neither a minority discount nor a deduction for lack of marketability is to be given in determining the fair value of a dissenter's shares. . . . Only by not doing so can the statutory policy of fully compensating a dissenting minority shareholder be achieved").

94. See *Laserage Tech. Corp. v. Laserage Lab., Inc.*, 972 F.2d 799 (7th Cir. 1992) (applying Illinois law to a settlement agreement which stated that the majority shareholders would purchase the minority shareholder's shares); *Charland v. Country View Golf Club, Inc.*, 588 A.2d 609 (R.I. 1991); *Robblee*, 841 P.2d 1289. *But see* *McCauley v. McCauley & Son, Inc.*, 724 P.2d 232 (N.M. Ct. App. 1986) (allowing minority discount despite argument that it would allow defendants to benefit from their own wrongdoing); *Blake v. Blake Agency, Inc.*, 486 N.Y.S.2d 341, 349 (N.Y. App. Div. 1985), *app. den.*, 484 N.E.2d 671 (N.Y. 1985) (allowing a marketability discount but not a minority discount).

95. See, e.g., *Perlman v. Permonite Mfg. Co.*, 568 F. Supp. 222 (N.D. Ind. 1983); *Atlantic States Const., Inc. v. Beavers*, 314 S.E.2d 245 (Ga. Ct. App. 1984); *Moore v. New Ammest, Inc.*, 630 P.2d 167 (Kan. 1981).

es.⁹⁶ This line of cases contains little analysis, but appeals somewhat to common sense. In a decision applying Indiana law, the federal district court justified a discount as customary and necessary because the minority could not force a liquidation or dividend nor could it dictate or control corporate policy.⁹⁷ Such emphasis on the element of control is itself problematic, particularly in cases involving close corporations. In these cases, the expense and uncertainty of litigation may create a potential for the controlling shareholders to breach their fiduciary duties.⁹⁸

Those cases that allow a marketability discount while disallowing a minority discount are somewhat contradictory.⁹⁹ The court will not allow a minority discount because it would cause the majority to reap a windfall or profit at the expense of the minority; however, by allowing a discount for lack of marketability, the court is allowing just such a windfall. The majority shareholders are able to acquire or have the corporation buy stock at a discount from the proportionate share of the enterprise, thereby increasing the value of the remaining shares.

In *Columbia Management Co. v. Wyss*,¹⁰⁰ the Oregon Court of Appeals allowed a marketability discount because the discount applied to both the majority and minority shares.¹⁰¹ In that case, the appraisal experts first determined that the enterprise value of the successful financial services company was \$50 million—more than seven times its book value. The minority shareholder's fourteen percent proportionate share was \$7.185 million. The appraisers then applied successive thirty-three percent discounts, first for minority status, and then for lack of marketability, concluding that fair value of the shares was \$3.196 million or forty-four percent of the proportionate share of enterprise value.

While agreeing with the trial judge's acceptance of the \$50

96. See *Breniman*, 829 P.2d 493 (stating, in dicta, that by failing to commence a proceeding within the statutory 60-day period, the corporation had waived the right to object to the dissenters' price demand); *McCauley*, 724 P.2d 232 (holding that a 25% discount was appropriate to reflect minority and marketability factors).

97. See *Perlman*, 568 F. Supp. at 226; see also *Moore*, 630 P.2d 167 (similarly stressing the importance of control).

98. See *Heglar*, *supra* note 88, at 274.

99. See *Ford v. Courier-Journal Job Printing Co.*, 639 S.W.2d 553 (Ky. Ct. App. 1982); *Blake*, 486 N.Y.S.2d at 349 (decreasing discount from 40% to 25% to reflect only a marketability discount and not minority interest discount); *Columbia Mgmt. Co. v. Wyss*, 765 P.2d 207 (Or. Ct. App. 1988).

100. 765 P.2d 207 (Or. Ct. App. 1988).

101. See *Columbia Management Co.*, 765 P.2d at 214 (citing *Blake*, 486 N.Y.S.2d at 341).

million enterprise value, the appellate court noted that the business was less stable than other less volatile businesses because clients and employees could leave at any time.¹⁰² The court reasoned that this volatility would "make the shares unmarketable if the price were simply their proportionate share of the enterprise value."¹⁰³ The court concluded that "[t]he marketability discount . . . sufficiently reflects the difference between the shares' proportion of the enterprise value and their fair value"¹⁰⁴ and applied a marketability discount to the shares instead of to the enterprise as a whole, apparently disagreeing with the appraisers generous valuation of the enterprise.

While Montana's courts generally look to Oregon decisions for guidance, *Columbia Management* should not be followed. The Oregon court may have reached a proper result for the wrong reasons. If the appraisers had applied a more substantial discount at the enterprise level to reflect the risks of the business, the court may not have been inclined to apply a further discount at the shareholder level to reflect essentially the same risk factors. In light of its apparent discomfort with the valuations of the appraisers, the court should have remanded for further proceedings, rather than accept the appraisals and distort the legal analysis to fit the needs of the case.

E. Fair Value in Montana

In *McCann Ranch, Inc. v. Quigley-McCann*,¹⁰⁵ the Montana Supreme Court concluded that a discount was appropriate in determining the fair value of a minority interest in a close corporation, reasoning that minority shares are simply worth less than control stock.¹⁰⁶ In that case, the corporation initiated the action for a declaratory judgment of the fair value of the stock.¹⁰⁷ The action was not brought under the dissenters' rights statute¹⁰⁸ or for relief from oppression under the statutory close

102. See *Columbia Mgmt Co.*, 765 P.2d at 212-13.

103. *Id.*

104. *Id.* at 214.

105. 276 Mont. 205, 915 P.2d 239 (1996).

106. See *McCann Ranch, Inc.*, 276 Mont. at 210-11, 915 P.2d at 242-43; see also *Humphreys v. Winous Co.*, 133 N.E.2d 780, 783 (Ohio 1956) (relating a story told to the Ohio State Bar Association by its president, John H. Doyle, in which a prominent Eastern newspaperman, in response to the question of what the shares of his company were worth, replied, "There are 51 shares that are worth \$250,000. There are 49 shares that are not worth a —.")

107. See *McCann Ranch, Inc.*, 276 Mont. at 207, 915 P.2d at 241.

108. See MONT. CODE ANN. § 35-1-838 (1995). The minority shareholder asserted

corporation statute,¹⁰⁹ and the parties stipulated that the only issue was a judicial declaration of the fair value of the stock.¹¹⁰

In theory, the court's holding may have been correct and was consistent with a prior Montana case that held that in determining the measure of damages for breach of contract, the term "value" standing alone means "market value."¹¹¹ At most, *McCann Ranch* should be considered an application of contract law to the interpretation of the terms of the particular agreement, not as an application of corporate law to determine the fair value of stock. Further, the trial court and the Montana Supreme Court may have felt constrained by the fact that the appraisal experts for both sides viewed the minority discounts as appropriate.¹¹² However, valuation experts are trained primarily to respond to tax-driven gift or estate tax situations in which a conservatively low valuation is highly desirable from the perspective of the potential taxpayers and, presumably, an acceptable result from the point of view of the IRS as well.¹¹³

Courts in other jurisdictions that have construed stipulations or settlement agreements between the parties to a shareholder dispute have not reached consistent results. Rather, the outcome largely depends upon whether the court considered the corporate context in which the cases arose. In a corporate context, some element of coercion by the majority often compels the minority shareholder to seek liquidation of the investment at a particular time. Additionally, because the buyer in the corporate context is either the corporation or the majority shareholders, concerns about the shares not being "control stock" or not being marketable are not properly part of the equation for establishing

rights as a dissenting shareholder for the first time in her post-trial brief. Brief of Respondent at 29, *McCann Ranch, Inc. v. Quigley-McCann*, 276 Mont. 205, 915 P.2d 239 (1996) (No. 95-416).

109. See MONT. CODE ANN. § 35-9-501 (1995).

110. See *McCann Ranch, Inc.*, 276 Mont. at 207, 915 P.2d at 241.

111. See *Orford v. Topp*, 136 Mont. 227, 231, 346 P.2d 566 (1959).

112. See Brief of Respondent at 11-12, *McCann Ranch, Inc.* (No. 95-416); see also *Independence Tube Corp. v. Levine*, 535 N.E.2d 927, 931 (Ill. 1988) (supporting minority discounts in cases in which both sides employed an expert). Illinois subsequently rejected the view that fair value means fair market value. See *Institutional Equip. & Interiors, Inc.*, 562 N.E.2d at 667-68 (holding that fair market value is not an appropriate measure of fair value in cases in which a dissenting minority shareholder is bought out by a majority shareholder).

113. See generally Harry J. Haynsworth IV, *Valuation of Business Interests*, 33 MERCER L. REV. 457 (1982) (citing Rev. Rul. 59-60, 1959 C.B. 237, as the "most complete statement of the relevant factors to consider in valuing a closely held business").

value.¹¹⁴ The Seventh Circuit Court of Appeals considered the facts in their corporate context and held that no minority discount should have been applied where the majority shareholder agreed to buy out the minority shareholder at fair value, rejecting the argument that fair value is synonymous with fair market value.¹¹⁵ The court noted that a minority discount should be applied if the shares are being sold to a third party, but not when the majority shareholder is the purchaser.¹¹⁶

The Montana cases that the court relied upon in *McCann Ranch* had no necessary relationship to corporate law principles, but rather arose in marital dissolution proceedings.¹¹⁷ In cases in which the court allowed a minority interest discount, the transactions, *i.e.*, an inter-spousal settlement of relative values, did not involve a sale from a minority shareholder to a controlling shareholder or to the corporation.¹¹⁸ Rather, the transaction involved a transfer from one minority shareholder to another. On the other hand, even in marital dissolution cases in which the purchaser is the corporation or part of a group that controls the corporation, neither the Montana Supreme Court nor the district courts has allowed minority discounts.¹¹⁹ These results are consistent with *Cavalier Oil* and other state court decisions that hold that discounts are not appropriate in dissenters' rights or

114. See, *e.g.*, *Charland*, 588 A.2d at 612 (stating that "when a corporation elects to buy out the shares of a dissenting shareholder, the fact that the shares are noncontrolling is irrelevant").

115. See *Laserage Tech. Corp.*, 972 F.2d at 805.

116. See *id.* Similarly, a Washington state court held that in dividing assets pursuant to a letter agreement, a minority fair market value discount should not have been applied and examined the issue as though the appraisal rights statute applied. See *Robblee*, 841 P.2d at 1289. However, an Indiana case held that an agreed entry between shareholders directing the court to consider any and all issues that relate to determination of price did not warrant deviation from fair market valuation. See *Battershall v. Prestwick Sales, Inc.*, 585 N.E.2d 1 (Ind. Ct. App. 1992).

117. See, *e.g.*, *In re Milesnick*, 235 Mont. 88, 765 P.2d 751 (1988); *In re Jorgensen*, 180 Mont. 294, 590 P.2d 606 (1979).

118. See *In re Milesnick*, 235 Mont. 88, 765 P.2d 751 (finding that a discount is appropriate where a husband and wife together owned 10% of a ranching corporation (received as gifts from the husband's parents) because neither the husband nor the wife were part of the control group.); *In re Jorgensen*, 180 Mont. at 300, 590 P.2d at 610 (valuing minority stock pursuant to shareholders' agreement).

119. See *In re Johnston*, 223 Mont. 383, 387, 726 P.2d 322 (1986) (stating that this is not "a situation where a discount would accurately reflect a minority shareholder's lack of ability to control salaries, dividends or other corporate benefits." In other words, because of the family relationships the shares were really part of a control group and not truly minority shares); *Buxbaum v. Buxbaum*, 214 Mont. 1, 692 P.2d 411 (1984) (stating that "[t]his is not a situation where the minority stock should be discounted. . . . In this case the value of the corporation was arrived at by the market value of the underlying assets.").

dissolution cases in which the corporation or a controlling shareholder is the buyer.¹²⁰ The court in *McCann Ranch* erred in not focusing on the critical factual distinction: that the corporation itself was the purchaser of the shares.¹²¹

When faced with deciding the propriety of minority discounts, the Montana Supreme Court should take a careful and considered look at the determination of fair value under the dissenters' rights and judicial dissolution statutes.¹²² In the meantime, practitioners may want to advise clients that the only sure way to avoid the minority issue discount in Montana is through an appropriately-worded shareholders' agreement.¹²³ Attorneys representing the corporation and/or the controlling shareholders should keep in mind the difficult conflict of interest issues that can arise.¹²⁴ If the majority shareholders are not

120. See, e.g., *In re McLoon Oil Co.*, 565 A.2d at 1004 (stating that "methods used in valuing stock for tax, probate, ERISA, and like purposes in which market value is the essence are inappropriate to the determination of the fair value owed to dissenting shareholders").

121. See *McCann Ranch, Inc.*, 276 Mont. at 207, 915 P.2d at 241.

122. The Montana Supreme Court has not considered the valuation of minority shares. *But see Maddox*, 206 Mont. at 17, 669 P.2d at 238. There, the Montana Supreme Court rejected a district court decision valuing the shares of a minority shareholder by reference to a purchase by the corporation of shares from another minority shareholder. The court stated that the issue was whether the transaction was an arms-length transaction because the other minority shareholder was a party to the litigation. Because the case was remanded, the court did not reach the further question of whether a minority discount would have been appropriate.

123. See, e.g., 2 F. HODGE O'NEAL AND ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 10.50 (3rd ed. 1996). The authors suggested such a provision:

The parties further agree that in any appraisal or valuation of shares of this company, whether in the purchase of a shareholder's stock in the corporation under a buy-and-sell agreement or stock-purchase agreement, in an appraisal proceeding under a dissenter's rights statute, in a judicially ordered purchase of a shareholder's interest, in a valuation of shares of a holder who petitions for involuntary dissolution and the corporation or the other shareholders assert a statutory right to buy out the petitioner, or otherwise, each share of stock in this corporation shall be treated as of equal value to every other share in the corporation, and that a minority interest in the corporation shall not be discounted for purposes of transfer to the corporation, a successor to the corporation or the other shareholders either because the interest does not control the corporation (lack of control) or because the interest is lacking in marketability.

Id.

124. *Cf. Skierka*, 192 Mont. 509, 629 P.2d 214; see also O'NEAL AND THOMPSON, *supra* note 123, § 2.02, at 2-2. The authors stated:

When an attorney is asked to represent prospective shareholders (if more than one) in organizing a close corporation, or when the attorney is later asked to represent all the shareholders in preparing a shareholders' agreement or any other document affecting corporate control or the transfer of shares, he should discuss with them possible conflicts of interests and let

inclined to treat the minority shareholders equally, the Rules of Professional Conduct may preclude representation of both parties.¹²⁵

IV. FAIR PLAY

Claims for breaches of fiduciary duty by directors, officers, and majority shareholders are present in many actions for appraisal rights,¹²⁶ dissolution, and court-ordered buy-out¹²⁷ as well as in derivative actions, which are the primary vehicle for challenging breaches of fiduciary duty.¹²⁸ The standard for determining acts of oppression or those that violate a shareholder's reasonable expectations is highly flexible but difficult to define, leading to inconsistent results.¹²⁹ Courts may be reluctant to

each participant decide if he wants the attorney to serve, which for monetary or other reasons is the usual response, the attorney must be particularly careful to point out to them the advantages and disadvantages to each in the various courses of action.

Id. § 2.02, at 2-2.

125. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7(a) (stating that "[a] lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless . . . the lawyer *reasonably believes* the representation will not adversely affect the relationship with the other client . . ." and each client consents); see also MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(e).

126. See, e.g., *Laserage Technology Corp. v. Laserage Laboratories, Inc.*, 972 F.2d 799 (7th Cir. 1992) (interpreting a settlement agreement resolving claims for breach of fiduciary duties).

127. See, e.g., *Charland v. Country View Golf Club, Inc.*, 588 A.2d 609 (R.I. 1991) (involving a petition for dissolution on grounds of illegal activities by an officer); *Robblee v. Robblee*, 841 P.2d 1289 (Wash. Ct. App. 1992).

128. A number of interesting decisions have come out of other jurisdictions from cases in which a derivative claim was combined with appraisal claims. For example, in *Breniman v. Agricultural Consultants, Inc.*, 829 P.2d 493 (Colo. Ct. App. 1992), a shareholder brought an action asserting derivative claims as well as claims for an appraisal. The court dismissed the derivative claims, reasoning that once the shareholder tendered his stock to the corporation he was no longer a shareholder and had no standing to pursue the derivative claims. See *id.* at 497. Also, the Eighth Circuit Court of Appeals held that damages for breaches of fiduciary duty could be included as assets in the valuation process under the dissenters' rights claim. See *Foy*, 992 F.2d at 780 (applying Minnesota law).

The Delaware courts have struggled with the issue in light of an earlier case that held that a separate action must be maintained where there are allegations of fraud and breach of fiduciary duty in connection with a merger. See *Cede & Co. v. Technicolor Inc.*, 542 A.2d 1188 (Del. 1988). The *Cede & Co.* decision was distinguished in *Cavalier Oil Corp.*, in which the court considered corporate opportunity claims that related directly to the value of the stock in an appraisal action as one of the elements in determining value. See *Cavalier Oil Corp.*, 564 A.2d at 1143; see also *In re Radiology Assoc., Inc. Lit.*, 611 A.2d 485, 501 (Del. Ch. 1991).

129. See O'NEAL AND THOMPSON, *supra* note 123, § 9.30, at 9-141 (stating that "oppression and other similar terms in the statutes provide broad amorphous grounds for relief which cannot be defined with precision in advance without destroying their

extend the "reasonable expectations" standard due to the difficulties with the subjective nature of the proof, the remoteness in time of the events being tested and the prospect of conflicting "expectations" where there are more than two or three shareholders.¹³⁰ Proof of a breach of fiduciary duty would normally focus on a recent event giving rise to the cause of action and would be more objectively verifiable. Fiduciary duties are also more commonly understood and, thus, are applied more consistently. While certain acts of oppression disappoint the expectations of a minority shareholder, such as refusing to include them in management or elect them to the board, they may not amount to a breach of duty; however, all breaches of duty are oppressive. Moreover, whether a single breach of duty is sufficient to justify relief depends on the circumstances; however, if it occurs in conjunction with other oppressive conduct, even conduct that does not amount to a breach of duty, a court may still be inclined to grant relief.

A. *Statutory Standards of Conduct*

The Montana Business Corporation Act expresses the standards of conduct for directors as follows:

A director shall discharge his duties as a director, including the director's duties as a member of a committee:

- (a) in good faith;
- (b) with the care an ordinarily prudent person in a similar position would exercise under similar circumstances; and
- (c) in a manner the director reasonably believes to be in the best interests of the corporation.¹³¹

The same standards apply to corporate officers.¹³² Directors and officers are entitled to rely broadly on information and re-

utility in new and unforeseen situations").

130. See Sandra K. Miller, *Should the Definition of Oppressive Conduct by Majority Shareholders Exclude A Consideration of Ethical Conduct and Business Purpose?*, 97 DICK. L. REV. 227, 233 (1993).

131. MONT. CODE ANN. § 35-1-418(1) (1995). This provision was preceded by, and is similar to, section 35-1-401(2) of the Montana Code which states: "A director shall perform his duties . . . in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances." MONT. CODE ANN. § 35-1-401(2) (repealed 1991).

132. See MONT. CODE ANN. § 35-1-443(1) (1995). This provision is applicable to officers with "discretionary authority," a term that is not defined in the statute, but one which should not be difficult to interpret.

ports furnished by others; however, an officer or director is not acting in good faith if he has knowledge that makes such reliance unwarranted.¹³³ A director or officer who performs his duties in compliance with the statutory standards is not liable for any action taken as a director or officer.¹³⁴

While courts and commentators alike continue to speak in terms of the fiduciary duties of directors and officers, neither the current Montana Business Corporation Act nor its predecessor uses the term "fiduciary" to describe the duties of directors.¹³⁵ The Model Act uses the term "standard" in place of "duty." The Official Comment to the Model Act explains this shift by distinguishing the standards applicable to directors and officers from the fiduciary duties arising under the law of trusts.¹³⁶ The Principles of Corporate Governance refers to "duties" or "duty of care standards" and notes:

Directors, officers and other persons who control corporations have fiduciary duties that are not necessarily the same as those owed by trustees. In closely held corporations, however, such persons may be deemed to have a relationship similar to that of partners, with duties analogous to those stemming from that relationship.¹³⁷

133. See MONT. CODE ANN. §§ 35-1-418(2), -443(2) (1995). Apparently, the movement toward gender neutrality in statutory terminology has yet to reach the business corporation act.

134. See MONT. CODE ANN. §§ 35-1-418(4), -443(4) (1995); see also MODEL BUS. CORP. ACT § 8.42 Off. Cmt. This comment states:

This section provides that a nondirector officer with discretionary authority must meet the same standards of conduct required of directors under section 8.30. But his ability to rely on information reports, or statements, may, depending upon the circumstances of the particular case, be more limited than in the case of a director in view of the greater obligation he may have to be familiar with the affairs of the corporation.

Id.

135. See MONT. CODE ANN. § 35-1-418(2) (1995); MONT. CODE ANN. § 35-1-401(2) (repealed 1991).

136. See MODEL BUS. CORP. ACT § 8.30 Off. Cmt. (stating that the term "fiduciary duty . . . could be confused with the unique attributes and obligations of a fiduciary imposed by the law of trusts, some of which are not appropriate for directors of a corporation"). In one of the leading Montana cases favoring the rights of minority shareholders in the face of "oppression," the majority shareholders were subject to fiduciary duties under trust law as well as corporate law. See *Skierka v. Skierka Bros.*, 192 Mont. 505, 629 P.2d 214 (1981).

137. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 199. The Principles of Corporate Governance states:

To avoid confusion about terminology, the word 'function' is used herein to include the powers exercised by, and to delineate the corporate tasks that are to be performed by, a corporate body (e.g., the board of directors) or by an individual (e.g., a director). Courts have often used the word "duty" to

Notwithstanding the shift in statutory terminology, the expression "fiduciary duty" is so ingrained in our corporate lexicon that it continues to be used by courts and commentators without any suggestion that a change in meaning is in order.¹³⁸

B. Common Law Duties and the Principles of Corporate Governance

The brief statutory statements of standards of conduct give rise to the massive body of law defining and refining the fiduciary duties owed by directors and officers to their corporations or, in the case of controlling shareholders, both to the corporation and to minority shareholders. Most analysts describe these duties in terms of a duty of care to which the business judgment rule applies,¹³⁹ and a duty of loyalty or fair dealing to which the business judgment rule does not apply.¹⁴⁰ Courts sometimes refer to other corollaries to these duties, such as a duty not to seize corporate opportunities,¹⁴¹ a duty not to compete with the corporation,¹⁴² a duty of disclosure,¹⁴³ and even a duty to pay attention.¹⁴⁴

refer to these powers and tasks as well as to the standard of care under which the performance of a director or officer is to be judged. As used herein, however, the words "duty" and "duty of care" refer solely to the obligation of all corporate directors and officers to perform their functions in the manner set forth in Parts IV-VI.

Id. at 145.

138. See, e.g., BLOCK ET AL., *supra* note 10.

139. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 4.01; BLOCK ET AL., *supra* note 10, at 52-108.

140. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at Part V. After stating the general principle in section 5.01 that directors, officers, and controlling shareholders are under a duty of fair dealing that includes an obligation of appropriate disclosure, separate sections in Part V deal with transactions with the corporation (§ 5.02); compensation (§ 5.03); use of corporate property (§ 5.04); corporate opportunities (§ 5.05); competition with the corporation (§ 5.06); and transactions between corporations with common directors or officers (§ 5.08); see also, BLOCK ET AL., *supra* note 10, at 124-51.

141. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.05; BLOCK ET AL., *supra* note 10, at 138-145.

142. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.06; BLOCK ET AL., *supra* note 10, at 138.

143. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, §§ 5.02, 5.10; BLOCK ET AL., *supra* note 10, at 197-215.

144. See Bayless Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1492 (1984). The duty to pay attention was offered as an alternative to the duty of care and the business judgment rule.

In broad terms, the duty of care is breached by "neglect, mismanagement, and intentional decisions to do wrongful acts,"¹⁴⁵ and the duty of fair dealing is breached by "fraud, self-dealing, misappropriation of corporate opportunities, improper diversions of corporate assets, and similar matters involving potential conflicts between a director's or officer's interest and the corporation's welfare . . ."¹⁴⁶ The distinction between breaches of the duty of care on one hand and breaches of the duty not to self-deal or otherwise deal unfairly on the other has been said to be "fundamental to . . . the preservation of state corporate law."¹⁴⁷

Determining when a person has a conflicting interest is the touchstone of assessing responsibility for breaches of corporate duties. The presence or absence of a conflict determines whether the duty of care (and the business judgment rule) or the duty of fair dealing applies.¹⁴⁸ As one study pointed out, a court's choice of standard to apply is often dispositive of the litigation.¹⁴⁹ Under the business judgment rule standard of review, "the plaintiff bears the burden to establish each element of the claim he asserts . . . by a preponderance of credible evidence."¹⁵⁰ But, under the fairness standard, "it is the defendant who is called upon to establish that the transaction attacked was on terms entirely fair to the corporation or, in some circumstances, to the corporation's shareholders."¹⁵¹

1. *Duty of Care and The Business Judgment Rule*

The business judgment rule is an integral part of the duty of care.¹⁵² The traditional justification for the business judgment

145. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 137.

146. *Id.*

147. *Gaines v. Haughton*, 645 F.2d 761, 776-78 (9th Cir. 1981), *cert. denied*, 454 U.S. 1145 (1982).

148. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 137; *cf.* Part IV (Duty of Care and the Business Judgment Rule) and Part V (Duty of Fair Dealing). "These rules [Part V] reflect the underlying obligation of [a director, officer or controlling shareholder] when interested in a matter affecting the corporation, to act fairly toward the corporation and its shareholders." *Id.* at 199.

149. BLOCK ET AL., *supra* note 10, at 16-17.

150. *Cinerama, Inc. v. Technicolor, Inc.*, 1991 WL 111134 (Del. Ch. 1991) *quoted in* BLOCK ET AL., *supra* note 10, at 16.

151. BLOCK ET AL., *supra* note 10, at 16.

152. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 4.01. This section states:

(a) A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she

rule is that it ensures that directors and corporate managers are free to take risks in the ordinary conduct of business that may turn out to be unwise or the result of a mistake of judgment.¹⁵³ The Official Comment to section 8.30 of the Model Act states that "a director is not liable for injury or damage caused by his decision, no matter how unwise or mistaken it may turn out to be, if in performing his duties he met the requirements" of the statutory standard of conduct. After an initial effort to codify the business judgment rule, the ABA Committee on Corporate Laws ultimately concluded that the matter should be decided by the courts.¹⁵⁴ The commentary to the ALI Principles of Corporate Governance states candidly that the business judgment rule is "based on a desire to limit litigation and judicial intrusiveness with respect to private-sector business decisionmaking."¹⁵⁵ To accomplish this goal, the ALI reporters removed any remnants of an ordinary negligence standard of reasonable care from the business judgment standard:

Courts have generally recognized the difficulties inherent in making post hoc judgments about the duty of care exercised by

reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. This Subsection (a) is subject to the provisions of Subsection (c) (the business judgment rule) where applicable

(c) A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer:

- (1) is not interested . . . in the subject of the business judgment;
- (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
- (3) rationally believes that the business judgment is in the best interests of the corporation [cross references omitted].

Id. at § 4.01. Compare MONT. CODE ANN. § 35-1-418 (1995) with 2 MODEL BUS. CORP. ACT § 8.3.

153. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 135. This section states:

The basic policy underpinning of the business judgment rule is that corporate law should encourage, and afford broad protection to, informed business judgments (whether subsequent events prove the judgments right or wrong) in order to stimulate risk taking, innovation, and other creative entrepreneurial activities. Shareholders accept the risk that an informed business decision—honestly undertaken and rationally believed to be in the best interests of the corporation—may not be vindicated by subsequent success.

Id.

154. See E. Norman Veasey, *New Insights into Judicial Deference to Directors' Business Decisions: Should We Trust the Courts?*, 39 BUS. LAW 1461 (1984).

155. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 135.

directors and officers and have allowed them considerable leeway. Since the turn of the century there have been only about 40 or so cases reflected in appellate opinions—most of them involving egregious facts—where directors or officers have been found to have violated the duty of care obligations.¹⁵⁶

A 1968 study by Professor Bishop found only four cases in which directors of industrial, i.e., non-financial, corporations were held potentially liable for negligence, uncomplicated by self-dealing.¹⁵⁷ Courts may excuse even egregious conduct if the corporation has amended its articles of incorporation to eliminate liability of directors (but not officers or controlling shareholders) for conduct that is not criminal or an intentional infliction of harm to the corporation.¹⁵⁸ In so doing, corporate directors can avoid liability for all unintentional, and even some intentional, wrongdoing.

The center of debate at present is whether and to what degree director inaction or inattentiveness constitutes a breach of the duty of care.¹⁵⁹ Under the ALI Principles of Corporate Governance, directors must inquire only when the circumstances would alert a reasonable director to the need for inquiry.¹⁶⁰ However, the comment to section 4.01 of the Principles of Corporate Governance goes further and suggests the need for a corporate law compliance program.¹⁶¹ The need for compliance programs has gained new urgency following a recent decision of the Delaware Chancery Court which suggested that “a director’s obli-

156. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 155.

157. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 160 n.17 (citing Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099-100 (1968)). The reporters also cite cases decided since 1968 but concede that some of the cases with egregious facts had “duty of loyalty overtones.” 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 160 n.17.

158. See MONT. CODE ANN. § 35-1-216(2) (1995); *supra* note 26 and accompanying text.

159. See Dominic Bencivenga, *Words of Warning—Ruling Makes Directors Accountable for Compliance*, N.Y.L.J., Feb. 13, 1997; Dennis J. Block & Jonathan M. Hoff, *Duty of ‘Caremark’: Directors Oversight Function*, N.Y.L.J., Nov. 21, 1996; Edward Brodsky, *Directors’ Liability—Importance of Compliance Procedures*, N.Y.L.J., Feb. 13, 1997; Edward P. Welch & Andrew J. Turezyn, *The Del. Court of Chancery Rules on a Board’s Duty to Monitor Employees; the Legislature Amends the State’s Business Laws*, NAT’L L.J., Nov. 11, 1996, at B5.

160. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 4.01(a)(1); see also, *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125 (Del. 1963). See generally John C. Coffee, Jr., *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099 (1977).

161. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 4.01 cmt. c.

gation includes a duty to attempt in good faith to assure that a corporate information and reporting system . . . exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards."¹⁶²

*In re Caremark*¹⁶³ arose out of the 1994 indictment of Caremark International, Inc., a provider of managed health care services, two of its officers, and several mid-level employees for violations of federal health care reimbursement regulations which prohibited health care providers from paying any form of remuneration to induce the referral of Medicare or Medicaid patients. A derivative suit was filed on behalf of Caremark alleging that the directors breached their duty of care by failing to monitor activities of the company's employees, thereby exposing the corporation to substantial fines and liability.¹⁶⁴ After a four-year investigation by the federal authorities and while the derivative suit was pending, Caremark pleaded guilty to one count of felony mail fraud and agreed to pay civil and criminal fines and reimbursements amounting to \$250 million.¹⁶⁵ No directors or senior officers were charged with wrongdoing in either the indictment or the government settlement agreements.¹⁶⁶

The Delaware Court of Chancery addressed the fairness of a negotiated settlement agreement of the derivative action in which Caremark and its directors agreed to establish a new compliance program and ethics committee.¹⁶⁷ The only cash payment that the settlement required the defendants to make was the payment of plaintiffs' attorneys' fees.¹⁶⁸ In approving the settlement, the court considered that it was unlikely that the directors could be found to have breached the duty of care because they had been advised by attorneys that the questioned conduct was lawful and because they had in place a corporate information and reporting system.¹⁶⁹

Most public corporations have adopted compliance procedures for a variety of reasons, including potentially lower fines or penalties under the federal Organizational Sentencing Guide-

162. *In re Caremark Int'l Inc.*, Civ. A. No. 13670, 1996 WL 549894, at *11 (Del. Ch. Sept. 25, 1996).

163. Civ. A. No. 13670, 1996 WL 549894, at *11 (Del. Ch. Sept. 25, 1996).

164. *See In re Caremark Int'l Inc.*, 1996 WL 549894, at *5.

165. *See id.* at *1.

166. *See id.* at *6.

167. *See id.* at *7.

168. *See id.* at *13.

169. *See id.* at *12-13.

lines adopted in 1991.¹⁷⁰ These guidelines offer, among other things, reduced sanctions when a corporation has implemented a suitable compliance program. Such programs have become so common that a company with no program, or one that exists only on paper, is vulnerable to a claim that its directors were not acting in good faith.¹⁷¹ Larger and more complex close corporations should also be encouraged to adopt compliance programs or to review existing programs if they operate in an area in which violations of law by employees could arise.

2. *Duty of Fair Dealing*

Under traditional fiduciary principles borrowed from trust law, a transaction with an interested fiduciary is either void or voidable, regardless of the fairness of the transaction to the corporation.¹⁷² Parties operating in the "real business world" perceived this rule to be unworkable, and new statutory provisions were adopted that create procedures to salvage transactions between directors and their corporations while protecting corporations and their shareholders from unfair dealing.¹⁷³

The ALI Principles of Corporate Governance state that a director who is interested in a transaction cannot fulfill the duty of care even if he or she is acting honestly or in good faith if the transaction is not fair to the corporation.¹⁷⁴ However, the duty of fair dealing applies only to directors, officers, and shareholders who have an interest that conflicts in a particular transaction.¹⁷⁵ Disinterested directors who approve a transaction in which another director is interested are governed by the duty of care, including the business judgment rule, but not by the duty of fair dealing.¹⁷⁶ However, the interested director is governed by both duties.

In the absence of approval by disinterested directors or shareholders, the sole criteria for determining whether a breach

170. See Brodsky, *supra* note 159. See generally, JED. S. RAKOFF ET AL., CORPORATE SENTENCING GUIDELINES: COMPLIANCE AND MITIGATION § 5.02 (1996) (citing a survey by the Ethics Resource Center finding that 85% of 711 respondents had adopted a code of conduct or ethics statement); LOUIS M. BROWN & ANNE O. KANDEL, THE LEGAL AUDIT: CORPORATE INTERNAL INVESTIGATION, Ch. 7 (Supp. 1996).

171. See Brodsky, *supra* note 159.

172. 2 MODEL BUS. CORP. ACT ANN. at 8-385.

173. See *id.*

174. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 4.01(c).

175. See *id.* § 5.01.

176. See *id.* at 199.

of the duty of fair dealing has occurred is the entire fairness of the transaction.¹⁷⁷ In 1983, the Delaware Supreme Court stated:

There is no safe harbor for such divided loyalties in Delaware. When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.¹⁷⁸

The term "duty of fair dealing" is used instead of the more traditional term "duty of loyalty" because, under the new statutory framework, conflicting interest transactions apply primarily, if not exclusively, to persons acting with a pecuniary interest in a matter. The Model Act does not address other types of conflicts of interest; however, the reporters of the Principles of Corporate Governance expressed the hope that other types of conflict will be dealt with by the courts should they arise.¹⁷⁹

In addition to self-dealing transactions, directors and officers are broadly prohibited from using their corporate positions for personal gain. Section 5.04 of the ALI Principles of Corporate Governance states that a director or officer may not use corporate position to secure a pecuniary benefit, except as permitted by the stated exceptions.¹⁸⁰ The exceptions include compensation and benefits made proportionately available to all other shareholders.¹⁸¹ Unlike self-dealing transactions, the initial burden of proof for misuse of corporate position is on the person challenging the conduct.¹⁸² Examples of misuse of corporate position cited in the comments to section 5.04 of the ALI Principles of Corporate Governance include manipulating the corporation's dividend policy for personal objectives and using corporate property for personal benefit.¹⁸³ The improper personal benefit can be received either from the corporation or a third person.

Section 5.11 of the ALI Principles of Corporate Governance addresses the similar abuse of position by a controlling

177. See *Weinberger*, 457 A.2d 701.

178. *Id.* at 710.

179. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 200.

180. See *id.* § 5.04(a).

181. See *id.* § 5.04(a)(5).

182. See *id.* § 5.04(b); *cf. id.* § 5.02(b).

183. See *id.* § 5.04 cmt. a.

shareholder.¹⁸⁴ Misuse of position includes obtaining tax benefits, influencing dividend policy,¹⁸⁵ obtaining a profit from the sale of property to the exclusion of others, and precluding competition.¹⁸⁶ However, a controlling shareholder is generally permitted to sell shares at a premium even if the shares constitute a controlling block.¹⁸⁷ If a preliminary showing can be made that the majority intended to exploit minority shareholders with abusive or oppressive conduct, sections 5.04 and 5.11 of the ALI Principles of Corporate Governance apply. In such a case, the majority has the burden of proving the fairness of the conduct, unshielded by the business judgment rule.

C. Statutory Conflicting Interest Transactions

The 1991 Montana Business Corporation Act and the Model Act create a safe harbor for interested director transactions which consists of an outer harbor and an inner harbor.¹⁸⁸ The outer harbor protects transactions that may involve conflicts, but that do not fall within the specific terms of the definitions. For example, transactions with first cousins or more remote relatives or transactions with purely social contacts do not present a conflict under the statute.¹⁸⁹ The inner harbor protects transactions in which a director has a conflicting interest, but which

184. See *id.* § 5.11.

185. See, e.g., *United States v. Byrum*, 408 U.S. 125 (1972) (holding that the controlling shareholders have a duty to deal fairly with non-controlling shareholders in formulating dividend policy); *Gabelli & Co. Inc. Profit Sharing Plan v. Liggett Group, Inc.*, 444 A.2d 261 (Del. Ch. 1982) (holding that failure to declare a dividend is subject to the same equitable constraints as an affirmative dividend policy).

186. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 334.

187. *But see id.* § 5.16 (requiring disclosure to minority shareholders). In part, this policy is based on empirical evidence that, at least in publicly-held companies, premiums are generally not paid to obtain control for the purpose of exploiting non-controlling shareholders. See *id.* at 374-75.

188. See MONT. CODE ANN. §§ 35-1-461, -464 (1995). These sections were added to the Model Act in 1988. As of December 31, 1992, Montana, along with Georgia, Mississippi and Washington, adopted subchapter F of the Model Act. See PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 8, at 244. As of 1996, four more states, Alabama, Arizona, Utah and Vermont, have been added to the list. See 3 MODEL BUS. CORP. ACT ANN. § 8.60 (Supp. 1996).

189. See MONT. CODE ANN. § 35-1-462(1) (1995). The Official Comments to section 8.61(a) of the Model Act state that the intent of the section is to "wholly occupy and preempt the field of directors' conflicting interest transactions." MODEL BUS. CORP. ACT § 8.61 cmt. 1 (1984). Accordingly, it would be difficult to argue that Montana's constructive fraud statute, MONT. CODE ANN. § 28-2-406 (1995), is applicable to a breach of the duty of fair dealing (or loyalty) by a director or officer. However, the statutory "safe harbor" is not available to controlling shareholders, so their conduct could continue to be challenged under the constructive fraud statute.

have been approved or ratified by qualified directors¹⁹⁰ or shareholders.¹⁹¹ Where the transaction has not been approved or ratified, the interested director or officer may still establish it is fair to the corporation.¹⁹²

The definition of a conflicting interest in section 35-1-461 of the Montana Code creates the outer harbor.¹⁹³ The dense and

190. See MONT. CODE ANN. § 35-1-463(4) (1995). This section states:

For purposes of this section, 'qualified director' means, with respect to a director's conflicting interest transaction, any director who does not have either a conflicting interest respecting the transaction or a familial, financial, professional, or employment relationship with a second director who does have a conflicting interest respecting the transaction, which relationship would, in the circumstances, reasonably be expected to exert an influence on the first director's judgment when voting on the transaction.

Id.

191. See MONT. CODE ANN. § 35-1-464(5) (1995). This section provides:

For purposes of this section, 'qualified shares' means any shares entitled to be voted with respect to the director's conflicting interest transaction except shares that, to the knowledge, before the vote, of the secretary or other officer or agent of the corporation authorized to tabulate votes, are beneficially owned by or the voting of which is controlled by a director who has a conflicting interest respecting the transaction or by a related person of the director, or both.

Id.

192. See MONT. CODE ANN. § 35-1-462(2)(c) (1995). The director having the conflict of interest is normally said to have the burden of proving the transaction was fair.

193. See MONT. CODE ANN. § 35-1-461(1) (1995). This section states:

"Conflicting interest" with respect to a corporation means the interest a director of the corporation has respecting a transaction effected or proposed to be effected by the corporation or by a subsidiary of the corporation or any other entity in which the corporation has a controlling interest if:

(a) regardless of whether the transaction is brought before the board of directors of the corporation for action, the director knows at the time of commitment that he or a related person is a party to the transaction or has a beneficial financial interest in or *is* so closely linked to the transaction and the transaction is of such financial significance to the director or a related person that the interest would reasonably be expected to exert an influence on the director's judgment if the director were called upon to vote on the transaction; or

(b) the transaction is brought, or is of a character and significance to the corporation that it would in the normal course be brought, before the board of directors of the corporation for action and the director knows at the time of commitment that any of the following persons is either a party to the transaction or has a beneficial financial interest in or *is* so closely linked to the transaction and the transaction is of such financial significance to the person that the interest would reasonably be expected to exert an influence on the director's judgment if the director were called upon to vote on the transaction: (i) an entity, other than the corporation, of which the director is a director, general partner, agent, or employee;

convoluted wording of the section is more reminiscent of the Internal Revenue Code than of corporate laws, and many of the clauses in the definition should not affect smaller or medium-sized companies or close corporations. For example, the law requires that for a director to have a conflicting interest, he or she must have had knowledge of the transaction at the time of commitment;¹⁹⁴ however, the empire of most Montana companies is not so far flung nor the chain of command so long that a director would not have direct knowledge of virtually everything that occurred. Similarly, the definition distinguishes between transactions that came before the board or normally would be expected to come before the board¹⁹⁵ and those of lesser significance.¹⁹⁶ In most small or medium-sized businesses in which board meetings are informal or do not occur, determining whether a transaction would come before the board in the normal course of business may be difficult.

According to the Official Comments to the Model Act, conflicting interest may arise in only three ways.¹⁹⁷ The first, and most obvious, is a transaction in which the director is a party and has a beneficial interest.¹⁹⁸ The transaction must affect a pecuniary interest and be of such financial significance that it "would reasonably be expected to exert an influence on the director's judgment."¹⁹⁹ Statutory conflicts do not include personal friendships or other social or religious affinities.²⁰⁰ For

(ii) a person who controls one or more of the entities specified in subsection (1)(b)(i) or an entity that is controlled by, or is under common control with, one or more of the entities specified in subsection (1)(b)(i); or (iii) an individual who is a general partner, principal, or employer of the director.

Id. (emphasis added).

The drafters of the 1991 amendments to the Montana Business Corporation Act modified the Model Act slightly by adding the word "is" in subsections (a) and (b) of the definition which seems innocuous but could be read so that the "closely linked" phrase modifies the phrase "he or a related party" instead of "financial interest." This could have the effect of slightly broadening the categories of persons who have a conflicting interest.

194. See MONT. CODE ANN. § 35-1-461(1)(a), (b) (1995).

195. See MONT. CODE ANN. § 35-1-461(1)(b) (1995).

196. See MONT. CODE ANN. § 35-1-461(1)(a) (1995).

197. See REV. MODEL BUS. CORP. ACT § 8.60, Off. Cmt. 1, Conflicting Interest; 2 MODEL BUS. CORP. ACT ANN. § 8.60, at 8-396, -397 (Supp. 1996).

198. See MONT. CODE ANN. § 35-1-461(1)(a) (1995).

199. *Id.*

200. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 1.23 cmt., at 27 (stating that "[i]t is not intended that a person would be treated as subject to a controlling influence, and therefore interested, solely because of a long-time friendship or other social relationship, or solely because of a long-time business association

example, the Official Comments to the Model Act state that a transaction between a director and the president of a golf club that the director desperately wants to join is outside the conflict of interest definition and beyond judicial inquiry.²⁰¹

The second type of transaction in which a director may be interested is one in which a "related person" is a party.²⁰² Related persons include spouses and spousal equivalents, children, grandchildren and parents, but do not include cousins. The ABA Committee amended the definition to include siblings of a spouse after substantial criticism of an earlier draft, which allowed a transaction with a director's brother-in-law to be beyond the reach of the law.²⁰³ The language of the definition seems to include any transaction in which a related person has a beneficial interest or is closely linked if the facts would "reasonably be expected to exert an influence on the director's judgment."

The third category of conflicting interest includes transactions with the entities specified in section 35-1-461(1) of the Montana Code. The specified entities include: (1) an entity, other than the corporation, of which the director is a director, general partner, agent, or employee; (2) a person who controls one or more of such entities or an entity that is controlled by, or is under common control with, one or more of such entities; and (3) an individual who is a general partner, principal, or employer of the director.²⁰⁴ The director's involvement with the specified entity must be economic, not merely social, and the entity must "reasonably be expected to exert an influence on the director's judgment."²⁰⁵

The inner harbor protects transactions approved by disinter-

through service on the same board of directors or other relationship not involving direct pecuniary dealing").

201. See REV. MODEL BUS. CORP. ACT § 8.61(a) cmt 1; 2 MODEL BUS. CORP. ACT ANN. § 8.61, at 8-415 (Supp. 1996).

202. See MONT. CODE ANN. § 35-1-461(3) (1995). A "Related person" is:

- (a) the spouse or a parent or sibling of a spouse of the director;
- (b) a child, grandchild, sibling, parent or spouse of any child, grandchild, sibling, or parent of the director;
- (c) an individual having the same residence as the director;
- (d) a trust or estate of which an individual specified in this subsection (3) is a substantial beneficiary; or
- (e) a trust, estate, incompetent person, conservatee, or minor for whom the director is a fiduciary.

Id.

203. See Branson, *supra* note 21, at 269-70.

204. See MONT. CODE ANN. § 35-1-461(1)(b)(i) to (iii) (1995).

205. MONT. CODE ANN. § 35-1-461 (1995).

ested directors or disinterested shareholders, regardless of whether the transaction is unfair.²⁰⁶ However, the actions of the disinterested directors in approving a transaction are subject to the good faith and duty of care standards required of directors generally, including the business judgment rule.²⁰⁷ While the inner safe harbor is not totally removed from judicial review, the exceptions are extremely narrow.²⁰⁸ As suggested by the ALI Principles of Corporate Governance, the caveats to the bare statutory provisions include a requirement that the disinterested directors could reasonably have concluded that the transaction was fair to the corporation at the time of the approval²⁰⁹ or, if approved by disinterested shareholders, that the transaction does not constitute a waste of corporate assets.²¹⁰

If the transaction is not eligible for the inner safe harbor because disinterested directors or shareholders do not approve it, the interested director has the burden of proving that the transaction was fair to the corporation.²¹¹ A director who is also a controlling shareholder will not be able to take advantage of the safe harbor provisions because all rights of minority shareholders against a controlling shareholder are preserved.²¹²

If the corporate ship begins to take on water notwithstanding the safe harbors, it can still be bailed out by an ex post facto review of the transaction by a newly appointed special litigation committee of disinterested directors.²¹³ As noted above, the bright line test to determine who is disinterested looks at pecuniary interests, and, accordingly, the reviewing directors can include friends or acquaintances of the controlling shareholders.²¹⁴ This review opens the door to a gutting of the derivative action by directors who may be influenced by "cronism, nepotism, spite and slight" and has been sharply criticized.²¹⁵ Special litigation committees are notoriously favorable to management and rarely, if ever, recommend that a suit be pursued against an officer or director. William Lerach, a well-known leader of the plaintiffs' bar, reported a few years ago that by his

206. See MONT. CODE ANN. § 35-1-462(2) (1995).

207. See REV. MODEL BUS. CORP. ACT § 8.61 cmt. 2.

208. See REV. MODEL BUS. CORP. ACT §§ 8.61 cmt. 2, 8.61(b).

209. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.02 cmt. a.

210. See *id.* § 5.02(a).

211. See *id.* § 5.02(b).

212. See 2 MODEL BUS. CORP. ACT ANN. § 8.61, at 8-422 (Supp. 1996).

213. See MONT. CODE ANN. § 35-1-545(2)(b) (1995).

214. See *supra* notes 199-201 and accompanying text.

215. Branson, *supra* note 21, at 277.

count the score was 97-0 in favor of directorial recommendations to dismiss suits against other directors.²¹⁶

D. As Applied to Montana Cases

In general, the Montana Supreme Court has decided cases involving corporate law principles by applying, ad hoc, its sense of equity, leaving practitioners unsure of which decisional framework to apply to any case. In fairness to the court, the flood of litigation that occurred elsewhere dried up before reaching Montana, and, thus, the court did not have the opportunity to develop a coherent philosophy of its own.²¹⁷

In the early 1980s, earlier cases that tend to favor minority shareholders were followed by cases that limit minority shareholder rights. The Montana Supreme Court expanded, then subsequently contracted, tort liability for breach of the implied covenant of good faith.²¹⁸ Similarly, in other commercial areas, an initially activist attitude took on a more conservative posture. The principal explanation for the apparent inconsistency between the court's laissez-faire attitude toward the conduct of corporate directors, officers, and controlling shareholders and its willingness to impose liability under the constructive fraud statute for breaches of fiduciary duty by bank officers and other nontraditional fiduciaries is the court's deference to the business judgment rule.²¹⁹

While it is universally recognized that the business judgment rule does not apply to duty of loyalty cases, even the Delaware Supreme Court with its vast corporate case load has difficulty distinguishing the duty of care from the duty of loyalty.²²⁰

216. See *id.* at 276.

217. In addition to the sporadic case flow, there has been substantial turnover on the Montana Supreme Court throughout this period. Since 1980, 18 justices have occupied the Montana Supreme Court's seven seats.

218. See LeRoy H. Schramm, *Montana Employment Law and the 1987 Wrongful Discharge from Employment Act: A New Order Begins*, 51 MONT. L. REV. 94, 96-108 (1990) (tracing the expansion and contraction of employment tort actions). The legislature also played a part in limiting tort liability for breach of the implied covenant of good faith. See MONT. CODE ANN. §§ 39-2-901 to -915 (1995).

219. See also *Kondelik v. First Fidelity Bank*, 259 Mont. 446, 857 P.2d 687 (1993) (imposing liability on bank officer for breach of a fiduciary duty); *Deist v. Wachholz*, 208 Mont. 207, 678 P.2d 188 (1984) (imposing liability on bank officer for breach of a fiduciary duty); *Dunfee v. Baskin-Robbins, Inc.*, 221 Mont. 447, 720 P.2d 1148 (1986) (evaluating a franchisor-franchisee relationship); see generally, Jeffrey A. Monhart, *A Primer on the Developing Doctrine of Constructive Fraud in Montana*, 52 MONT. L. REV. 153 (1991).

220. See James J. Hanks, Jr., *Evaluating Recent State Legislation on Director*

Thus, the Montana Supreme Court's similar confusion at times is not surprising. Still, for the most part, the Montana Supreme Court's decisions have produced the same results that would be reached if the court had applied the analytic constructs of the new statutory definitions and the ALI Principles of Corporate Governance.

While the Montana Supreme Court has seen a full range of corporate conflict of interest situations in the past two decades, none of the cases have involved judicial review of a transaction that was approved or ratified by disinterested directors or shareholders.²²¹ Accordingly, all of Montana's conflict of interest cases have been decided solely on the basis of fairness.

1. *Use of Corporate Assets and Compensation*

Cases involving a purchase or sale of corporate assets where a director or officer is a party to the transaction have been appropriately decided by the Montana Supreme Court based on settled legal principles, and the only issues of consequence to be decided have been procedural or other issues peripheral to the issues concerning breach of fiduciary duty.²²² Similarly, the court has decided cases involving the use of corporate property such as ranch houses, equipment, fuel, and supplies with little difficulty by treating these perquisites as either *de minimis* or as an element of compensation.²²³

More difficult is applying the duty of fair dealing to director and officer compensation. While determining the amount of compensation creates a direct conflict of interest, courts have generally applied somewhat more relaxed standards than those ap-

and Officer Liability Limitation and Indemnification, 43 BUS. LAW. 1207 (1988). Hanks states:

The phrase "duty of loyalty" appears nowhere . . . in the Delaware General Corporation Law or, so far as is known, anywhere else in the corporate statute of any other state. . . . Delaware courts are unclear as to the parameters of the duty of loyalty . . . [and have] difficulty in distinguishing the duty of care from the duty of loyalty.

Id. at 1212.

221. *Cf.* MONT. CODE ANN. §§ 35-1-463, -464 (1995).

222. *See, e.g., S-W Co.*, 179 Mont. 392, 587 P.2d 348 (discussing the transfer of a residence and other assets).

223. *See, e.g., Maddox*, 206 Mont. 1, 669 P.2d 230; *Skierka*, 192 Mont. 505, 629 P.2d 214. *see generally* 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.02 cmt. c (setting forth exceptions to the rules requiring review of fairness and special disclosure obligations, including a *de minimis* exception for trivial amounts and an exception for purchases or sales that do not lend themselves to favored treatment).

plied to other interested party transactions. Unlike other transactions in which an alternative arms-length party may be available, deciding director and officer compensation is a necessary transaction in which substituting another party would present collateral difficulties. As discussed above, the ALI Principles of Corporate Governance devotes a separate section to compensation; however, the differences in its treatment of interested party transactions are procedural rather than substantive.²²⁴ While the business judgment rule applies to approval of compensation arrangements by disinterested directors, so-called "back-scratching" arrangements, in which directors vote to approve each other's compensation as officers or employees, do not constitute disinterested directors' actions.²²⁵

The Montana Supreme Court has specifically held that the appropriation of corporate assets for personal use without fair consideration is a breach of the duty of good faith and fair dealing.²²⁶ However, officers and directors often receive "perks" from the corporation which can be characterized as compensation and, thus, do not amount to a breach of duty as long as the aggregate compensation is fair to the corporation.²²⁷

Several cases involving marital dissolution illustrate the typical perquisites associated with ranch living. For example, in *In re Johnston*,²²⁸ the corporation provided each of the shareholder families with a home, food, vehicles, utilities, and insurance.²²⁹ These perquisites were treated as a substantial income supplement that was approximately equal to the monthly wages and annual bonuses.²³⁰ In a similar New Mexico case, a closely-held family corporation passed a resolution which stated that because the corporation required the around-the-clock presence of corporate employees at the ranch, it was authorized to provide its shareholders with food, housing, utilities, vehicles, gasoline, medical insurance, and other benefits.²³¹ This compensation plan worked smoothly until the husband and wife, who each

224. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.03.

225. See *id.* § 5.03 cmt. g.

226. See *Fox*, 198 Mont. at 211, 645 P.2d at 934 (grazing land rented to another corporation controlled by a 50% shareholder at far less than the reasonable rental value).

227. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.03(a)(1).

228. 223 Mont. 383, 726 P.2d 322 (1986).

229. See *In re Johnston*, 223 Mont. at 384-85, 726 P.2d at 323.

230. See *id.* at 385, 726 P.2d at 324.

231. See *McCauley*, 724 P.2d at 235 (N.M. Ct. App. 1986).

owned thirty percent of the stock, divorced.²³² The wife sued the corporation for fraud and breach of fiduciary duty.²³³ She also sought to compel an involuntary liquidation because she had been oppressed by the majority shareholders by being denied the "perks," excluded from management, and denied dividends even though funds were available.²³⁴ The New Mexico Court of Appeals agreed and found that the corporation's conduct amounted to oppression.²³⁵

In another Montana case, *Maddox v. Norman*,²³⁶ the eighty-five percent majority shareholder did not keep corporate records or bank accounts separate from his personal assets, and the evidence suggested that he was using corporate assets for personal purposes.²³⁷ The trial court excused the shareholder's "informal" method of accounting.²³⁸ However, the Montana Supreme Court remanded for further proceedings including an accounting for "corporate rental income, lease proceeds or loan proceeds" for several years.²³⁹ An accounting and return of the appropriate amounts to the corporation is an appropriate remedy for breach of the duty of fair dealing.

2. *Exercise of Creditor and Contract Rights*

While the foregoing examples of breaches of the duty of fair dealing are straightforward, more complicated issues arise when a corporation owes money to a shareholder. In *Troglia v. Bartoletti*,²⁴⁰ the owners of two-thirds of the stock of a corporation purchased the escrow account that represented the debt owed for the balance of the purchase price of a hotel, which was the corporation's sole asset.²⁴¹ The majority owners instructed

232. *See id.*

233. *See id.*

234. *See id.*

235. *See id.* at 241. The court also considered the fact that the husband falsely accused his former wife of embezzlement in a successful effort to convince the other shareholders to remove her from the board of directors. *See id.* at 239.

236. 206 Mont. 1, 669 P.2d 230 (1983).

237. *See Maddox*, 206 Mont. at 5, 669 P.2d at 232-33.

238. *See id.* at 9, 669 P.2d at 234.

239. *Id.* at 17, 669 P. 2d at 238. Presumably, on remand, the shareholder was able to demonstrate the amount that would have been due him as reasonable compensation and would only be required to return the excess, if any. However, the supreme court was more troubled by the majority shareholder's use of a portion of a Federal Land Bank loan made to the corporation to pay for land and cattle purchased in his individual capacity. *See id.* at 5-6, 669 P.2d at 232-33.

240. 152 Mont. 365, 451 P.2d 106 (1969).

241. *See Troglia*, 152 Mont. at 366-67, 451 P.2d at 107.

the escrow agent to collect only interest on the note until further notice.²⁴² After the death of one of the majority owners, the minority shareholder sued to dissolve the corporation alleging mismanagement.²⁴³ Two years after the suit was initiated, the majority shareholders instructed the escrow agent to begin collecting the interest and principal due under the escrow agreement.²⁴⁴ The minority shareholder tendered to the corporation an amount equal to the interest, conditioned on the corporation executing a note to him.²⁴⁵ The corporation refused the tender, but made no other efforts to raise the funds necessary to avoid default under the escrow.²⁴⁶ The Montana Supreme Court held "that although a director occupies a fiduciary relation to the stockholders, he is nevertheless entitled to demand payment of an honest debt due him from the corporation of which he is a director However, there are circumstances in which equity will not permit him to do so."²⁴⁷

The case was remanded to the district court for further proceedings to determine the financial condition of the corporation and, presumably, whether it was in a position to raise sufficient funds to avoid default.²⁴⁸ The court's decision was correct because the trial court record was not sufficient to determine whether the majority shareholders' attempt to take title to the asset as a consequence of the default was fair to the corporation. The corporation should be required to make a good faith effort to raise funds to avoid a forfeiture of title to the corporation's sole asset. Instead, the majority shareholder rejected an offer by the minority shareholder to fund the interest portion of the indebtedness, which is clearly a breach of the duty of fair dealing.²⁴⁹

The issue arose again in *McCann Ranch, Inc. v. Quigley*

242. See *id.* at 367, 451 P.2d at 107.

243. See *id.*

244. See *id.*

245. See *id.*

246. See *id.*

247. *Id.* at 369-370, 451 P.2d at 108 (citations omitted).

248. See *id.* at 371, 451 P.2d at 109. Similarly, the ALI Principles of Corporate Governance does not discuss the appropriate conduct of a director or officer who is acting purely as a creditor of the corporation. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.04 cmt. c, at 257.

249. Assuming the majority shareholders did not offer the corporation the opportunity to purchase the escrow in the first instance, such purchase may have been a breach of the duty of fair dealing in the form of a seizure of a corporate opportunity. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.05(b) and cmt. a. A corporate opportunity "includes the acquisition or use of any contract rights or other tangible or intangible property." *Id.*

*McCann*²⁵⁰ when the corporation repaid a \$25,000 note to the parents of the majority shareholder a number of years before it became due and resumed payments on a contract to the parents, at the rate of \$21,300 per year, though the parents may have agreed to defer payment indefinitely.²⁵¹ At the same time, the board of directors ceased paying dividends of \$2,000 per month, which had been paid for a number of years.²⁵² Because the sole issue was valuation of the minority owner's shares, the record on the issue of the corporation's breach of the duty of fair dealing may not have been fully developed. Nonetheless, the repayment of the debts to the parents of the majority shareholder was a conflicting interest transaction within the meaning of section 35-1-461(2) of the Montana Code because parents are related persons.²⁵³ In the absence of approval by disinterested directors or shareholders, the sole criteria for determining liability is the fairness of the transaction to the corporation.²⁵⁴ The fair market value of long-term debt of a private corporation would typically be discounted so that the difference between the fair value of the debt and the amount paid by the corporation could be recovered as damages for a breach of the duty of fair dealing.

The 1983 case of *Ski Roundtop, Inc. v. Hall*²⁵⁵ involved the restructuring of a corporate obligation held by a controlling shareholder. John Hall took control of Ski Yellowstone, Inc. by subscribing to a "C" issue of shares at five cents per share for a total purchase price of \$401,000, which gave him a 50.7 percent ownership of the corporation.²⁵⁶ He paid twenty-five percent of the price and agreed to pay the remainder shortly after completion of the offering.²⁵⁷ At the time of the "C" share purchase, four of the seven directors resigned and two personal friends of

250. 276 Mont. 205, 915 P.2d 239 (1996).

251. See Appellant's Opening Brief at 4-7, *McCann Ranch, Inc.* (No. 95-416).

252. See *id.*

253. See MONT. CODE ANN. § 35-1-461(3) (1995).

254. See MONT. CODE ANN. § 35-1-462(2)(c) (1995).

255. 202 Mont. 260, 658 P.2d 1071 (1983).

256. See *Ski Roundtop, Inc.*, 202 Mont. at 267-68, 658 P.2d at 1075-76. Although Ski Yellowstone, Inc., was clearly undergoing financial stress and bank notes were overdrawn, it is not clear that the corporation was insolvent, thus making its fiduciary duties to creditors a factor. See *id.* at 268, 658 P.2d at 1076; see also BLOCK ET AL., *supra* note 10, at 220.

257. See *Ski Roundtop, Inc.*, 202 Mont. at 268, 658 P.2d at 1075-76. Because the "C" issue, as well as the earlier offerings, was made to all of the shareholders in proportion to their then present holdings, there was no breach of the duty of fair dealing. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.10 cmt. e, at 329 (sales "at the same price and on the same terms" as transactions with third-parties satisfies the burden of proving fairness).

Hall were elected to fill the vacancies. As one of its first acts, the new board, consisting of Hall, his two friends and two other individuals, extended the payment date for the \$300,000 that Hall owed and adopted a two-tier budget, the effect of which was to necessitate a further issue of stock to fund the immediate needs of the corporation.²⁵⁸ An effort to raise \$450,000 through a "D" issue priced at five cents per share was unsuccessful, so the board cut the price to one cent per share with twenty-five percent of the purchase price due immediately and the remainder at the call of the directors.²⁵⁹ The minority shareholders brought a derivative action alleging misconduct by Hall and the other two directors.

Under section 35-1-461(2) of the Montana Code, the modification of the terms of the "C" issue purchase agreement with Hall was a director's conflict of interest transaction. Under present law, the disinterested directors or shareholders of Ski Yellowstone could have approved the transactions and qualified for the safe harbor of section 35-1-462 of the Montana Code.²⁶⁰ The fact that two directors were personal friends of John Hall would not have been sufficient to disqualify them from voting on the contract modification in the absence of some other pecuniary interest. If the transaction was within the safe harbor, it could only be attacked on the ground that the directors' approval violated the duty of care and the business judgment rule. However, no statutory safe harbor is available for controlling shareholder conflicting interest transactions. Therefore, even if the directors approved the transaction, it would not have been insulated from court review.²⁶¹ While the statutory safe harbor does not apply, section 5.11 of the ALI Principles of Corporate Governance would protect a similar transaction with the controlling shareholder if approved by disinterested shareholders and shift the burden of proof of the fairness issue to the party challenging the transaction.²⁶²

258. See *Ski Roundtop, Inc.*, 202 Mont. at 268, 658 P.2d at 1076.

259. See *id.* at 269, 658 P. 2d at 1076.

260. See MONT. CODE ANN. §§ 35-1-462 to -464 (1995). Two illustrations in the PRINCIPLES OF CORPORATE GOVERNANCE are based on the facts in the Ski Roundtop case. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.04 cmt. (e), illus. 11 and 12, at 268, 281 n.11. The Reporters changed the facts in Illustration 11 to include approval by disinterested directors.

261. When a director is also a controlling shareholder, section 5.10 (Transactions by a Controlling Shareholder with the Corporation) applies rather than section 5.02 (Transactions with the Corporation). See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.10 cmt. c, at 326.

262. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.11. The commentary to § 5.11 (misuse of corporate position by controlling shareholders) states

In its review of Hall's transactions with Ski Yellowstone, Inc., the Montana Supreme Court stated that "the actions of the board of directors in this case are to be measured by the business judgment rule."²⁶³ It concluded that there was a legitimate business purpose in the adoption of the two-tier budget, in making the "D" issue, and in reducing the subscription price from five cents to one cent.²⁶⁴ However, the court implied that there was no similar business purpose for the deferral of payments of the "C" issue by holding that the deferral was a breach of duty and inappropriate self-dealing.²⁶⁵ This was a hollow victory at best because the court limited the damages to the income the corporation could have earned had it received timely payment.²⁶⁶

The measure of damages for a breach of duty (in the absence of a provision in the articles of incorporation limiting liability of directors) is either that for breach of an obligation other than a contract²⁶⁷ or, at a minimum, the contract measure of damages.²⁶⁸ Under the general breach of obligation provision,

that while controlling shareholders are free to use their voting power to elect directors, "it may be difficult" for directors who are also employees to maintain that they are exercising "independent business judgment" because they may not be viewed as disinterested in the action taken. *Id.* at 336.

263. *Ski Roundtop, Inc.*, 202 Mont. at 273, 658 P.2d at 1078. The court's ringing endorsement of the rule expressed in *Nursing Home Bldg. Corp. v. DeHart*, 535 P.2d 137, 143-44 (Wash. Ct. App. 1975), follows:

The 'business judgment rule' immunizes management from liability in a corporate transaction undertaken within both the power of the corporation and the authority of management where there is a reasonable basis to indicate that the transaction was made in good faith. An excellent statement of the 'business judgment rule' is found in *W. Fletcher* § 1039 at pages 621-25: 'It is too well settled to admit of controversy that ordinarily neither the directors nor the other officers of a corporation are liable for mere mistake or errors of judgment, either of law or fact. In other words, directors of a commercial corporation may take chances, the same kind of chances that a man would take in his own business. Because they are given this wide latitude, the law will not hold directors liable for honest errors, for mistakes of judgment, when they act without corrupt motive and in good faith, that is, for mistakes which may properly be classified under the heading of honest mistakes. And that is true even though the errors may be so gross that they may demonstrate the unfitness of the directors to manage the corporate affairs. This rule is commonly referred to as the 'business judgment rule.'

Ski Roundtop, Inc., 202 Mont. at 273, 658 P.2d at 1071.

264. *See Ski Roundtop, Inc.*, 202 Mont. at 275-76, 658 P.2d at 1079.

265. *See id.* at 276-78, 658 P.2d at 1079-81.

266. *See id.* at 276, 658 P.2d at 1080.

267. *See* MONT. CODE ANN. § 27-1-317 (1995).

268. *See* MONT. CODE ANN. § 27-1-311 (1995).

damages are the amount of detriment proximately caused by the breach whether or not it could have been anticipated.²⁶⁹ Under the contract measure of damages, the proximately-caused detriment must have been likely to result from the breach "in the ordinary course of things."²⁷⁰ The ALI Principles of Corporate Governance express the measure of damages in more detail, include a causation element, a foreseeability requirement, and a provision for recovery of any gains derived by the defendant to the extent necessary to make equitable restitution.²⁷¹

Depending, of course, on facts not in the record, the breach of duty by Hall may have been the proximate cause of the corporation's inability to obtain financing from independent sources. Once Hall demonstrated that he was not going to play by the rules, his credibility could have been so damaged that other sources of financing were no longer available. Similarly, if the court could find that the breach of duty was the proximate cause of the "D" issue of stock and that it would not have been necessary if Hall had been required to pay for the "C" issue, it could cancel the "D" issue shares as the minority shareholders had requested.²⁷²

In rejecting the argument that issuing the "D" stock was also a breach of duty, the court relied on the fact that the offer at one cent per share was made to all the minority shareholders as well as to John Hall.²⁷³ However, this argument is flawed because payment was to be made "at the call of the board," and,

269. See MONT. CODE ANN. § 27-1-317 (1995).

270. MONT. CODE ANN. § 27-1-311 (1995).

271. See 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 7.18. The plaintiff must prove that proper conduct by the director or officer would have been a substantial factor in averting the loss and that the likelihood of injury was foreseeable to a similarly-situated, prudent person. The "substantial factor" element was derived from RESTATEMENT (SECOND) OF TORTS, § 431. See *id.* at 223. Losses incurred by the corporation can also be offset by any gains to the corporation arising out of the same transaction provided recognition of the gains is not contrary to public policy. See *id.* § 7.18(c).

Similar relief can be sought in an action for an accounting in a statutory close corporation. See MONT. CODE ANN. § 35-9-502(1)(e) (1995). The alternative relief provision of the Montana Business Corporation Act does not specifically provide for an accounting but the broad authorization for a court to grant the relief it considers appropriate would include the equitable remedy of an accounting to compel disgorgement of profits. See MONT. CODE ANN. § 35-1-939 (1995).

272. The "black letter" analysis and recommendations do not expressly provide that rescission is an appropriate remedy for a transaction entered into in breach of the duty of fair dealing. However, the commentary clearly recognizes the availability of this remedy. See, e.g., 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.02 cmt. a.

273. See *Ski Roundtop, Inc.*, 202 Mont. at 274, 658 P.2d at 1078-79.

therefore, the terms of the offer did not apply equally to Hall, the majority shareholder, and the minority shareholders. Accordingly, the court could have canceled the "D" issue as a rescissory remedy for a second breach of duty.²⁷⁴

The dissenting opinion by Justice Morrison correctly recognizes that the business judgment rule does not apply in this case and that Hall had the burden of proving that the questioned transactions were fair and in good faith.²⁷⁵ Moreover, under the current safe harbor provision, Justice Morrison's reliance on the constructive fraud statute would probably still be valid.²⁷⁶

3. Dividend Policy and Employment

Some courts and commentators view dividend withholding in close corporations as an element of oppression.²⁷⁷ Professor O'Neal stated:

[T]he logic which supports judicial reluctance to interfere with dividend policies in large corporations does not apply to close corporations When it is also considered that in close corporations dividend withholding may be used to force out minority shareholders, the traditional judicial restraint in interfering with corporate dividend policy cannot be justified. "In fact, it would not be too extreme to put the burden of proving the propriety of its dividend policy on the controlling shareholders."²⁷⁸

The ALI Principles of Corporate Governance also states that "a director . . . or senior executive . . . may not use corporate property, material non-public information or corporate position to secure a pecuniary benefit" unless certain conditions are satisfied, including making the benefit proportionately available to all other similarly-situated shareholders.²⁷⁹

274. The Reporters' Illustration 12 concludes that under similar facts the "D" issue would be subject to the duty of fair dealing and the burden would be on the directors to prove the fairness of the transaction. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.04 cmt. (e), at 268, 281 n.11.

275. See *Ski Roundtop, Inc.* 202 Mont. at 284, 658 P.2d at 1084.

276. See MONT. CODE ANN. § 35-1-462(2) (1995).

277. See, e.g., *Fox*, 198 Mont. 505, 645 P.2d 929.

278. 1 F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 3.05, at 26 n.2 (1985) (quoting from Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 280 (1967)).

279. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.04(a); see also *id.* § 5.11(a) (discussing the use of a controlling shareholders position to obtain a pecuniary benefit).

The ALI commentary states further:

Many Montana cases involve some element of dividend withholding, either alone or in conjunction with excluding shareholders from participating in management.²⁸⁰ In *Skierka v. Skierka Brothers*,²⁸¹ although the minority shareholder was not allowed to participate in the corporate operations or given employment and corporate perquisites, the corporation did not withhold any dividends. However, in *Fox v. 7L Bar Ranch*,²⁸² the corporation did not pay dividends, instead diverting income to other corporations owned by the controlling shareholder. In *Daniels v. Thomas, Dean & Hoskins, Inc.*,²⁸³ a real estate development corporation paid management fees to the operating corporation rather than dividends. The corporation paid these amounts to the employees and shareholders of the operating corporation as bonuses.²⁸⁴ When Thomas terminated Daniels as an employee of the operating corporation, his participation in bonuses, the functional equivalent of dividends from the related real estate development corporation, was also terminated. In *McCann Ranch*, the decision to stop paying dividends coincided with the issuance of a final divorce decree and the decision to repay debts to the parents of the other shareholders.²⁸⁵

Based on the findings of fact in *Skierka* and *Fox*, the court could have concluded that there was a breach of the duty of fair dealing described in sections 5.04 and 5.11 of the Principles of Corporate Governance through the withholding of dividends coupled with a conscious policy by the controlling shareholders to

Where the complaint is that dividends have been improperly withheld, the director will normally not have secured a benefit that would result in a violation of § 5.04(a). However, the adoption of a conscious policy to distribute benefits to shareholders other than through payment of dividends will violate § 5.04 if shareholders who are unable to take advantage of the benefits do not receive some equivalent benefit. Furthermore, under certain circumstances, failure to pay dividends may constitute a violation of § 5.04 [I]n the case of a failure to pay a dividend in order to buy stock for the benefit of a director or senior officer at an unfairly low price, a court should find a violation of § 5.04 to have occurred.

Even in the absence of an affirmative action by a director that is clearly contrary to the interests of a minority shareholder, a court should be especially sensitive to the use of dividend policy in the case of a closely held corporation as a device for disadvantaging minority shareholders to the benefit of the majority shareholders. See *id.*; see, e.g., *Donahue v. Rodd Elec. Co.*, 328 N.E.2d 505 (Mass. 1975).

280. See, e.g., *McCann Ranch, Inc.*, 276 Mont. 205, 915 P.2d 239; *Fox*, 198 Mont. 201, 645 P.2d 929; *Skierka*, 192 Mont. 505, 629 P.2d 214.

281. 192 Mont. 505, 629 P.2d 214 (1981).

282. 198 Mont. 201, 645 P.2d 929 (1982).

283. 246 Mont. 125, 804 P.2d 359 (1990).

284. See *Daniels*, 246 Mont. at 129, 804 P.2d at 361.

285. See *McCann Ranch, Inc.*, 276 Mont. at 206, 915 P.2d at 239.

distribute the benefits to themselves in some other manner, thereby securing a disproportionate pecuniary benefit. In *Daniels* and *McCann Ranch*, there were no judicial findings, but the general background of the cases suggests that because disproportionate benefits were received by the controlling shareholder, the court may have had a basis for a further finding that the controlling shareholders had a "conscious policy to divert the benefit of the dividends to themselves indirectly."²⁸⁶ As in all other cases involving the duty of fair dealing, once the party challenging the action makes a preliminary showing of a "conscious policy" to secure a disproportionate benefit, the business judgment rule should not apply.

In *Daniels*, the employment aspects of Daniels' claims against Thomas Dean & Hoskins involving wrongful discharge and breach of good faith were bifurcated from the claim for an appraisal.²⁸⁷ However, one may infer from the decision that if the employment claims were presented in the corporate context, the court would have applied the business judgment rule to the circumstances surrounding the discharge. Justice Sheehy, with the benefit of the ALI Principles of Corporate Governance, would surely have agreed that Thomas used his corporate offices and status as a controlling shareholder to obtain a pecuniary benefit and that the business judgment rule does not apply.²⁸⁸ However, the court may simply have not been satisfied that Thomas' discharge of Daniels was motivated by a conscious policy to secure a disproportionate benefit.

4. Share Repurchases

Also in *Daniels*, the Montana Supreme Court thoroughly addressed the fiduciary duties of a controlling shareholder.²⁸⁹ The court looked at the propriety of Thomas' actions as the president and thirty-nine percent stockholder in negotiating the purchase of Daniels' shares on behalf of the corporation. As an officer and a director, Thomas had a fiduciary duty to the corpora-

286. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, §§ 5.04, 5.11. Sections 5.04 and 5.11 of the ALI Principles of Corporate Governance do not expressly extend to the use of corporate position to obtain a pecuniary benefit for a related party. *See id.* Whether the repayment of debts to the parents of the majority shareholders was a direct pecuniary benefit to the majority shareholders would depend upon a detailed factual showing.

287. *See Daniels*, 246 Mont. at 130, 804 P.2d at 362.

288. *See id.* at 148-49, 804 P.2d at 373 (Sheehy, J., dissenting).

289. *See Daniels*, 246 Mont. 125, 804 P.2d 359 (1990).

tion, and, as a controlling shareholder, he also had a duty to the minority shareholders. However, the repurchase of Daniels' shares was not strictly a "director's conflicting interest transaction," as defined by the Montana Business Corporation Act, because the interests of Thomas and the corporation were not adverse. Section 35-1-461(2) of the Montana Code does not apply if the director does not have a conflicting interest. Accordingly, Thomas is protected by the outer safe harbor, with two exceptions. First, the safe harbor only protects the director from "an award of damages or other sanctions . . . in a proceeding by a shareholder or by or in the right of the corporation because a director . . . has an interest in the transaction."²⁹⁰ If the liability arises in some other manner, such as for a failure to disclose material information, the safe harbor does not protect the director. Second, the statutory safe harbor is not available to controlling shareholders.

In *Daniels*, the corporation had five stockholders: Thomas and Dean each owned thirty-nine percent; Daniels owned seven percent; and two others owned the remaining fifteen percent. Without explanation, possibly because it did not affect the result of the opinion, the Montana Supreme Court elected to treat Thomas as the majority owner.²⁹¹ The court would have reached the same result had it applied the control concepts from the ALI Principles of Corporate Governance. Under the ALI Principles, a "controlling shareholder" is defined as a person who either alone, or pursuant to an arrangement or understanding with one or more other persons, owns or has power to vote fifty percent or more of the outstanding voting stock of the corporation or who otherwise exercises a controlling influence over the management or policies of the corporation.²⁹² An owner of twenty-five percent or more of the outstanding stock is presumed to exercise control unless some other person, either alone or pursuant to an arrangement or agreement, owns or has the power to vote a greater percentage.²⁹³ Because no one owned more stock than Thomas, he would have had to show that other persons acting pursuant to an arrangement or agreement exercised

290. MONT. CODE ANN. § 35-1-462(1) (1995).

291. See *Daniels*, 246 Mont. at 138, 804 P.2d at 367 (determining "that Thomas was a majority shareholder . . . for the purpose of this appeal" and stating "[t]o hold otherwise would ignore the realities of the situation in this close corporation and rely merely upon technicalities").

292. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 1.10(a).

293. See *id.* § 1.10(b).

control.

As a further twist to the conflict of interest analysis, the Montana Supreme Court determined that Thomas did not have a conflict of interest because he offered to “step aside” and let a non-shareholder employee of the related operating corporation handle the negotiations with Daniels.²⁹⁴ Neither the Model Act nor the ALI Principles of Corporate Governance directly deals with the ability of a director or controlling shareholder to delegate the decision-making function to a subordinate employee. Due to the employment relationship, the non-shareholder employee would not be a “qualified director” who could approve a transaction with another interested director.²⁹⁵ However, he would probably be considered an “associate” of the controlling shareholder as such term is defined in section 1.23 of the Principles of Corporate Governance.²⁹⁶ Under the commentary to the ALI Principles of Corporate Governance, it would be difficult to establish that his decisions would be protected by the business judgment rule.²⁹⁷

The District Court found that Thomas breached his fiduciary duty to Daniels by inducing him to leave his employment while representing that Daniels would receive “fair value” for his stock and by not disclosing what he meant by that term.²⁹⁸ This result is supported by a Delaware case in which the facts showed a freeze-out merger at twenty-one dollars per share, and the Delaware Supreme Court held that the failure to disclose an internal corporate study recommending that the corporation could pay up to twenty-four dollars per share violated the duty of fair dealing.²⁹⁹

294. See *Daniels*, 246 Mont. at 139, 804 P.2d at 367.

295. See MONT. CODE ANN. § 35-1-463(4) (1995); see also 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 1.23 (defining “interested”).

296. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 1.23(a)(2) (including a person “with respect to whom a director, senior executive, or shareholder has a business, financial, or similar relationship that would reasonably be expected to affect the person’s judgment”).

297. See *id.* § 5.11 cmt. c, at 336 (stating that “it may be difficult for directors of the controlled corporation who are employees of the controlled or controlling corporation to defend their actions as the exercise of independent business judgment, because they may not be viewed as disinterested in the action taken”); see also *id.* § 1.23 cmt. 10 (using “associate” to describe the types of persons to whom a director, senior executive, or shareholder bears a sufficiently close familiar relationship, or has a sufficiently substantial financial, business, or similar relationship, that knowing advancement of the person’s interest by the director, senior officer, or shareholder can be treated as equivalent to knowing advancement of the director’s, senior officer’s, or shareholder’s own interest).

298. See *Daniels*, 246 Mont. at 135, 804 P.2d at 365.

299. See *Weinberger v. UOP*, 457 A.2d 701, 703 (Del. 1983) (finding that

The black letter law stated in the ALI Principles generally requires disclosure of material facts, and the comments state that interested parties are not obligated to volunteer the maximum amount they are willing to pay or the minimum amount they are willing to accept.³⁰⁰ However, this rule assumes that the corporation has an equal opportunity to access market information concerning prices and that special circumstances may change this rule.³⁰¹ The comments also point out that a fair price is often a range rather than a single number and that disclosure of a particular fact could cause the corporation to negotiate for a lower price.³⁰² The interested director has a duty to explain the implications of the transaction.³⁰³ In an appraisal rights context, the ALI Principles of Corporate Governance requires a director to disclose his or her belief as to the fair value of minority shares and the basis for such belief.³⁰⁴ By these standards, Thomas should have disclosed the internal estimate of the price before Daniels changed his position, relying on some expectation of a higher value.³⁰⁵

With respect to share repurchases, the ALI Principles of Corporate Governance are generally not as helpful in analyzing the standards of conduct of controlling shareholders in relation to non-controlling shareholders as they are in analyzing the duties of controlling shareholders to the corporation. Two sections, 5.11 and 7.25, are potentially applicable to share repurchases. Section 5.11 discusses "use by a controlling shareholder of its controlling position to secure a pecuniary advantage," but limits damages to the amount of the improper benefit received and any foreseeable harm caused by the controlling shareholders

"[m]aterial information, necessary to acquaint those shareholders with the bargaining positions of Signal and UOP, was withheld under circumstances amounting to a breach of fiduciary duty" and concluding that the merger did not meet the test of fairness).

300. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 1.14 cmt. r, at 17.

301. See *id.*

302. See *id.* § 5.02 cmt. d, at 215.

303. See *id.* The duty of disclosure is found in other contexts involving a relationship of trust and confidence. See RESTATEMENT (SECOND) OF TORTS § 551(2)(e) (1965); RESTATEMENT (SECOND) OF CONTRACTS § 161 cmt. f (1981); RESTATEMENT (SECOND) OF AGENCY § 390 (1958).

304. See 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 7.25(a)(2) (adopting the Delaware rule for freeze-out mergers).

305. See also *infra* notes 313-17 and accompanying text (discussing the duty of a controlling shareholder to make a good faith offer at fair value in a "freeze-out" merger or other transaction in control to which the controlling shareholder is a party).

conduct.³⁰⁶ In *Daniels*, while Thomas' buying out a minority shareholder at an unfairly low price would seem to confer a pecuniary benefit on him and the remaining shareholders, the question is whether Thomas' negotiating tactics amount to an abuse of power. The commentary to section 5.11 of the Principles of Corporate Governance gives examples of situations not covered by the rule, such as where the benefit resulting from the use of controlling power is made proportionately available to the other similarly-situated shareholders.³⁰⁷ Justice Barz, writing for the Montana Supreme Court in *Daniels*, expressed a similar concern, noting that Thomas had a fiduciary duty to the other minority shareholders in his negotiations with Daniels.³⁰⁸ However, because Daniels was not similarly situated, this concern for the minority shareholders does not resolve the issue.³⁰⁹ The Montana Supreme Court adopted the reasoning of two Massachusetts cases.³¹⁰ The Massachusetts cases held that while the fiduciary duty between stockholders of a close corporation is one of "utmost good faith and loyalty,"³¹¹ if the control group can "demonstrate a legitimate business purpose and the minority stockholders cannot demonstrate a less harmful alternative," it can proceed with the transaction.³¹²

Transactions in which the interests of minority shareholders are extinguished could also fall under section 7.25 of the Principles of Corporate Governance, which addresses transactions such as a "freeze-out" merger in which a controlling shareholder is a party.³¹³ Since a repurchase of minority shares under some form of coercion or pressure from the controlling shareholder, i.e., a squeeze-out, is analogous to a "freeze-out" merger,³¹⁴ section 7.25 should be helpful in determining the standards that should apply to a "squeeze-out."³¹⁵ The section requires the di-

306. Although Thomas was authorized by the board of directors to offer \$35,000, the highest offer was \$25,000. Daniels requested, and the district court awarded him, \$53,128. See *Daniels*, 246 Mont. at 139-40, 804 P.2d at 367-68.

307. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at 334.

308. See *Daniels*, 246 Mont. at 138, 804 P.2d at 367.

309. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.11(c).

310. See *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976); *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505 (Mass. 1975).

311. *Daniels*, 246 Mont. at 137, 804 P.2d at 366.

312. *Id.* at 138, 804 P.2d at 366.

313. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 5.11 cmt. a, at 344 (stating that this section is not meant to preclude transactions between parent and subsidiary corporations in which the interests of minority shareholders in the subsidiary are extinguished).

314. Freeze-out mergers are authorized by MONT. CODE ANN. § 35-1-813 (1995).

315. See also 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 7.21,

rectors approving the transaction to have a reasonable belief that the offer to the minority shareholders in the transaction constitutes fair value and disclose the basis for that belief.³¹⁶ Courts are instructed to "give substantial weight to the highest realistic price that a willing, able, and fully informed buyer would pay for the corporation as an entirety."³¹⁷

A freeze-out typically takes place through a merger, during which the minority shareholders can be paid cash, obligations or other property in exchange for their shares.³¹⁸ Assent to a merger normally requires an affirmative vote of two-thirds of the outstanding shares.³¹⁹ However, in cases in which the parent company owns eighty percent or more of the subsidiary, the merger can proceed without a vote by the shareholders of either corporation. The Official Comment to section 11.01 of the Model Act notes that under the new act, there are virtually no restrictions or limitations on the terms of the merger.³²⁰ A corporation may compel the holders of a single class of shares to receive different types of consideration: some may receive securities or

cmt. h, at 312. This section states:

A number of states have developed a remedy for oppression . . . in order to protect minority shareholders whose reasonable expectations have been frustrated and who have no adequate means of recovering their investment . . . [citations omitted] Although the remedy in such case is normally dissolution, some statutes effectively convert dissolution into an appraisal-like remedy by granting the corporation or other shareholder the right to purchase the shares of the party seeking dissolution at a judicially determined fair value . . . [citation omitted] In administering such a remedy, the court might properly look to the procedures and standards specified in this Chapter (sections 7.21-7.25) for the determination of fair value.

Id.

316. See *id.* § 7.25(a)(1) (providing standards for fair value). The section also provides that an appraisal proceeding is the sole recourse for shareholders of a publicly held corporation to challenge such a transaction, but the exclusivity provisions do not apply to close corporations. See *id.* § 7.25(d).

317. *Id.* § 7.22(c) cmt. c.

318. Under section 35-1-813(2) of the Montana Code, the plan of merger must set forth:

(a) the name of each corporation planning to merge and the name of the surviving corporation into which each other corporation plans to merge; (b) the terms and conditions of the merger; and (c) the manner and basis of converting the shares of each corporation into shares, obligations, or other securities of the surviving corporation or any other corporation or into cash or other property in whole or part.

319. See MONT. CODE ANN. § 35-1-815(5) (1995) (subject to exceptions noted in the statute).

320. See 3 MODEL BUS. CORP. ACT ANN. § 11.01, Off. Cmt. The corresponding provision of the Montana Business Corporation Act is MONT. CODE ANN. § 35-1-815 (1995).

properties while others may accept different securities, cash, or property.³²¹

Under the ALI Principles, a freeze-out merger alone amounts to a per se breach of the duty of fair dealing.³²² The Official Comment to the Model Act concedes that “merger transactions that are formally authorized by the procedures set forth in this chapter may in some circumstances constitute a breach of duty to minority shareholders where the effect of the transaction is to eliminate them from further equity participation in the enterprise.”³²³

The fiduciary duty that is applied to these transactions is uniformly the duty of fair dealing and not the duty of care with its attendant business judgment rule.³²⁴ “The danger in these transactions is that ‘a self-interested majority stockholder or control group [will rule] unfairly’ in many cases precludes business judgment rule protection.”³²⁵ The Delaware Supreme Court’s landmark decision in *Weinberger v. UOP, Inc.*³²⁶ sets out the “entire fairness test” for a freeze-out merger, which includes both substantive and procedural fairness. “[H]owever, the test for fairness is not a bifurcated one as between fair dealing and fair price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.”³²⁷

Where there is a conflict of interest and the potential for an abuse of corporate position, the “less harmful alternative” test can be read as a modification of the business judgment rule. In *Daniels*, the Montana Supreme Court applied a balancing test and determined that while Thomas had demonstrated that the corporation “could not afford” the price that Daniels was seeking, Daniels had not demonstrated a “less harmful alternative.”³²⁸ As noted above, the court determined that Thomas did not have a conflict of interest and held that he acted “prudently and in

321. See 3 MODEL BUS. CORP. ACT ANN. § 11.01, Off. Cmt. The comment and the new law recognize that essentially the same results could be achieved by structuring the transaction in a more complex matter.

322. The strict valuation rules in § 7.25 apply whether or not the case law in a particular jurisdiction requires an independent business purpose for the freeze-out merger. See 2 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 7.25 cmt. a, at 382.

323. MODEL BUS. CORP. ACT ANN. § 11.01 Off. Cmt. 1, at 11-2.

324. See generally BLOCK ET AL., *supra* note 10, at 151-159.

325. *Id.* at 158 (quoting Victor Brudney & Marvin A. Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1358 (1978)).

326. 457 A.2d 701 (Del. 1983).

327. *Weinberger*, 457 A.2d at 711.

328. See *Daniels*, 246 Mont. at 139-40, 804 P.2d at 366.

accordance with the business judgment rule.³²⁹ Despite the dicta regarding good faith and prudent business judgment, this was simply a dispute over money—Daniels wanted more and Thomas wanted to pay less. The critical finding made by the supreme court was that the corporation could not afford to pay Daniels what he wanted. This finding was contrary to the finding of the district court and was not discussed in the opinion. If the price paid to Daniels was in fact a fair price, the duty of fair dealing would be satisfied regardless of whether Thomas had a conflict of interest or breached the duty not to self-deal.³³⁰ The significant conflict issue is to determine which party has the burden of proof on the fairness issue. For example, if the transaction was an arms-length transaction, Thomas could get away with paying an unfairly low price to Daniels. The *Daniels* decision seems contrary to current analysis and should be limited to its facts, including the unaffordability of the payment.

Under the facts of *Daniels* and *McCann Ranch*, there would seem to be a basis for finding that the minority shareholders were “squeezed out” of their stock positions. Daniels was offered what seemed to be a promotion that would have necessitated his relocation to another city. He declined and was discharged a short time later. He did not initiate the series of events that led to the sale of his shares. Thomas exerted considerable leverage to extract a price concession including withholding a waiver of a non-complete agreement and threats to take action to devalue the shares if Daniels did not sell out. Similarly, the cessation of dividend payments at a time when the controlling shareholders knew the minority shareholder needed the money seemed to determine the timing of the transaction in *McCann Ranch*. If there are facts demonstrating what is essentially a forced liquidation, the rules stated in section 7.25 of the Principles of Corporate Governance for a per se breach of the duty of fair dealing should apply. The price determination would then be made at the “highest realistic price” that the experts should establish.³³¹

329. *Id.* at 139, 804 P.2d at 367.

330. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, §§ 5.10, 5.11(a)(1).

331. See *id.* §§ 7.22(c), 7.25; see also *id.* at § 5.04. Illustration 7 involves the discharge of a minority shareholder without cause coupled with a cessation of dividends for the purpose of forcing the minority shareholder to sell shares back to the corporation as a demonstration of a breach of duty under section 5.04. See *id.*

V. CONCLUSION

The legislature has attempted to adopt the most recent version of various model business organization acts. The sweeping amendments to these acts are not the result of decisions or business conditions in Montana, but reflect the broad national experience and, at times, the reaction of a particular segment of the legal community that drafts the model laws.³³² Practitioners and the Montana Supreme Court should review the prior cases with care and use the ALI Principles of Corporate Governance as an analytic guide to help determine which decisions should be followed and which should be discarded. In the words of Ray Garrett, Jr. the initial director of the ALI Corporate Governance Project, "where there is no judicial authority, or where the cases are unsatisfactory by modern standards—either because of their antiquity, or the absence of compelling analysis, or because today, they just seem wrong—resort must be had to other sources."³³³ While hard cases and difficult decisions may not be made easier, use of the terminology and logic from the ALI Principles in setting forth the rationale for decisions will make Montana's corporate jurisprudence uniform with that of the rest of the nation.³³⁴

In particular, practitioners and the court should recognize that *McCann Ranch* is contrary to the weight of authority in other states on the valuation issue. For purposes of the dissenters' rights statutes and fair value determinations in dissolution cases, all shares of the corporation should be treated as being of equal value. The proportionate share of enterprise value accords with the majority of other jurisdictions and with the ALI Principles. If the majority shareholders are determined to initiate the freeze-out, or otherwise abuse their majority status, then the standards for determining value should be based upon the highest price that a willing, able and fully informed buyer would pay for the corporation as an entity.³³⁵

Abuses of corporate position through a "conscious policy" to secure disproportionate benefits by withholding of dividends or

332. For example, the Model Act adopted in Montana in 1991 contains provisions governing the termination of derivative suits that have been adopted in only a few states. See *supra* note 25 and accompanying text.

333. 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, at XIX.

334. Montana courts should not, however, feel bound to follow the law of other jurisdictions, as indicated by an Oklahoma case. See *Woolf*, 849 P.2d 1093 (construing the Oklahoma Corporation Code, which is based on the Delaware Code).

335. See 1 PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 9, § 7.22(c).

denying participation in management is a breach of the duty of fair dealing under the ALI Principles. The application of ALI Principles in cases of abuse of corporate positions can be a substitute for the less precise “oppression” or “reasonable expectations” analysis. Under either formulation, the business judgment rule should not be applied to situations that involve self-dealing.