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Direct vs. Derivative, or "What's a Lawsuit Between Friends in an 'Incorporated Partnership'?"

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Direct vs. Derivative, or "What's a Lawsuit Between Friends in an 'Incorporated Partnership'?"

Abstract

In any context the distinction between direct and derivative claims carries significant consequences. The procedural requirements are different, as are the available remedies. In addition, the remedies benefit different parties. A successful derivative claim typically enriches the corporate treasury, while a successful direct claim typically puts money directly in the hands of the shareholder claimant. Moreover, derivative defendants can shelter behind several powerful bulwarks-including special litigation committees and the business judgment rule-that are unavailable to direct defendants.

Under the 'internal affairs' doctrine, Minnesota law governs the direct/derivative issue for all Minnesota corporations. Current Minnesota law provides inadequate guidance when the corporation is closely held. The inadequacy has two main sources. First, the Minnesota rule for distinguishing between direct and derivative claims in general contains a serious conceptual flaw which confuses analysis regardless of the number of shareholders. Second, Minnesota close corporation cases rarely address the direct/derivative issue, and those that do, do so in a cursory fashion. Minnesota law, therefore, lacks a comprehensive, coherent approach for making the direct/derivative distinction in a Minnesota close corporation.

This article seeks to improve matters by (1) examining and proposing a remedy for the fundamental conceptual flaw and (2) providing a conceptual framework for making the fine distinctions necessary in the close corporation context. As background, Part II describes direct and derivative claims in their pure forms. Part III describes the special problems faced by derivative plaintiffs as contrasted with direct plaintiffs and thereby shows why the direct/derivative distinction matters. Part IV explains why it is important to draw that distinction early in any litigation. Part V examines and critiques Minnesota's current approach to the direct/derivative analysis. Part VI proposes a special rule for making the distinction in the context of closely held corporations, and Part VII wraps up the analysis with some important details concerning procedure and remedies.

Keywords

Closely Held Corporations, Direct, Derivative, Minnesota

Disciplines

Organizations Law

Comments

Co-authored with Imanta Bergmanis.

**DIRECT VS. DERIVATIVE,
OR
“WHAT’S A LAWSUIT BETWEEN FRIENDS IN AN
‘INCORPORATED PARTNERSHIP?’”**

Professor Daniel S. Kleinberger[†] and Imanta Bergmanis^{††}©

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I. INTRODUCTION

In any context the distinction between direct and derivative claims carries significant consequences.¹ The procedural requirements are different,² as are the available remedies.³ In addition, the remedies benefit different parties. A successful derivative claim typically enriches the corporate treasury,⁴ while a successful direct claim typically puts money directly in the hands of the shareholder claimant.⁵ Moreover, derivative defendants can shelter behind several powerful bulwarks—including special litigation committees⁶ and the business judgment rule⁷—that are unavailable to direct defendants.⁸

1. This article focusses exclusively on the corporate context. For a discussion of derivative claims in the context of limited liability companies, see CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶10.07 (1994). For a discussion of derivative claims in the context of limited partnerships, see DEBORAH A. DEMOTT, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE § 2.03 (1994 & Supp. 1995). The direct versus derivative distinction is largely inapposite to general partnerships, because “[i]n most situations, and in most jurisdictions, [breach of duty] claims must be brought within an action for an accounting. That proceeding involves both the partnership itself and all the individual partners, and it sorts out both claims among the partners and claims between individual partners and the partnership.” BISHOP & KLEINBERGER, *supra*, ¶ 10.01[1][c]. See also DANIEL S. KLEINBERGER, AGENCY AND PARTNERSHIP: EXAMPLES AND EXPLANATIONS, § 9.10 (1995) (describing an action for an accounting).

2. See *infra* part III.A. (discussing the contemporaneous ownership requirement, adequate representation requirement and demand requirement).

3. See *infra* notes 47-48 (discussing the panoply of remedies for direct claims); see also *infra* notes 93-95 (discussing standard remedies in derivative litigation).

4. See *infra* notes 93-113 (discussing standard recoveries in derivative litigation and the exceptional circumstances in which courts order payments directly to shareholders). A successful derivative suit also benefits the attorney for the derivative plaintiff. The recovery funds the payment of attorney’s fees. See *infra* notes 114-17.

5. See *infra* note 47 (discussing standard buy-out remedy in direct litigation). In contrast to the derivative plaintiff’s attorney, the attorney for the direct plaintiff will recover attorney’s fees only in exceptional cases. See *infra* note 48.

6. See *infra* part III.B.

7. See *infra* part III.C.

8. Derivative plaintiffs also face the procedural strictures of Minnesota Rules of Civil Procedure 23.06, see *infra* part III.A.; the prospect of the corporation indemnifying the alleged wrongdoers, see *infra* part III.D.; and the possibility that the articles of incorporation have immunized the alleged wrongdoers against personal liability, see *infra* part III.E.

In the context of close corporations,⁹ distinguishing between direct and derivative suits can be especially difficult, and the stakes can be especially high. The difficulty arises from the special nature of close corporations. As modern corporate law has come to recognize, for many purposes a close corporation amounts to an "incorporated partnership"¹⁰—i.e., an aggregate of mutual fiduciaries rather than the "tripartite and hierarchical" structure that comprises an entity separate from all its owner/operators.¹¹ The mutual fiduciary relationships support direct suits in circumstances that might otherwise engender only derivative claims.¹²

The stakes can be high because direct claims in close corporations are increasingly frequent. Except for securities fraud claims,¹³ direct suits within a public corporation are unusual. Direct suits are available when significant changes in

9. Minnesota law defines a close corporation as "a corporation which does not have more than 35 shareholders." MINN. STAT. § 302A.011, subd. 6a (1994). Since this article focusses on Minnesota law, it will use this definition unless the context indicates otherwise. Many other jurisdictions use a functional approach to defining close or closely held corporations. See, e.g., *Donahue v. Rodd Electrotyping Co.*, 328 N.E.2d 505, 511-12 (Mass. 1975). See generally Daniel S. Kleinberger, *Why Not Good Faith? — The Foibles of Fairness in Closely Held Corporations*, 16 WM. MITCHELL L. REV. 1143 (1990). Generally,

[c]lose corporations have a limited number of shareholders, and most, if not all, of the shareholders are active in the corporation's day-to-day business. The corporation typically is an important (and often principal) source of income for each shareholder. Payout is frequently in the form of salary rather than dividends. The success of the business usually depends on harmony and cooperation among the co-owners.

If things go sour, exit is difficult [because there] . . . is no ready market for the shares in a close corporation.

Id. at 1148-49. Other jurisdictions permit corporations possessing specified characteristics to *opt in* to statutory close corporation status. See, e.g., DEL. CODE ANN. tit. 8, § 344 (1991); WIS. STAT. ANN. §§ 180.1801-1837 (West 1992). As to whether a corporation that fails to opt in should still be treated as a close corporation when a minority shareholder claims oppression, compare *Nixon v. Blackwell*, 626 A.2d 1366, 1380-81 (Del. 1993) (holding "no") with *Hagshenas v. Gaylord*, 557 N.E.2d 316, 322-23 (Ill. App. Ct. 1990) (holding "yes"), *cert. denied*, 561 N.E.2d 691 (Ill. 1990)).

10. For the origins of this term, see Kleinberger, *supra* note 9, at 1150-51 nn.19-21.

11. Kleinberger, *supra* note 9, at 1144.

12. See *infra* notes 341-44 and accompanying text (suggesting that direct suits be allowed when derivative harm has the purpose and effect of targeting the minority shareholder).

13. See WILLIAM L. CARY & MELVIN A. EISENBERG, *CASES AND MATERIALS ON CORPORATIONS*, 757-70 (6th ed. 1988); 2 JAMES D. COX ET AL., *CORPORATIONS* § 15.2, at 15.19 (1995).

the corporate structure give shareholders appraisal rights.¹⁴ Also, direct suits are available when the corporation itself is up for sale; in those circumstances the board of directors may owe a direct duty to shareholders to maximize the selling price.¹⁵ Otherwise, however, shareholder claims in a public corporation are derivative. In contrast, the direct suit has become the standard device for resolving disputes among owners of a close corporation.¹⁶

Under the "internal affairs" doctrine, Minnesota law governs the direct/derivative issue for all Minnesota corporations.¹⁷

14. See, e.g., MINN. STAT. §§ 302A.471 (1994) (establishing circumstances under which shareholders have appraisal rights), 302A.473 (delineating the procedures for perfecting and enforcing those rights). But see DEL. CODE ANN. tit. 8, § 262(b)(1) (Supp. 1994) (denying appraisal rights to shareholders in Delaware corporations whose interests are publicly traded).

15. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (imposing the duty on directors in a Delaware corporation); see also *infra* notes 266-68 and accompanying text (discussing *Revlon*).

16. Discussion of such suits has become a prominent feature of continuing legal education seminars. See JOSEPH W. ANTHONY & RICHARD T. OSTLAND, MINN. INST. OF LEGAL EDUC. (MILE), CLOSELY HELD CORPORATIONS: LITIGATION UPDATE 1993, LYING, CHEATING, AND STEALING (Dec. 16, 1993); TERENCE M. FRUTH & DOUGLAS L. ELSASS, MILE, CORPORATE PRACTICE INSTITUTE, LITIGATION TO PROTECT MINORITY SHAREHOLDER RIGHTS (June 9-10, 1993); F. HODGE O'NEAL, MINN. CONTINUING LEGAL EDUC., CLOSELY HELD CORPORATIONS IN MINNESOTA, SHAREHOLDER DISPUTES: OPPRESSION OF MINORITY SHAREHOLDERS (May, 1993); LAWRENCE J. FIELD & ROBERT STRIKER, MILE, LITIGATING THE SECURITIES AND THE CORPORATE ARENA, LITIGATION UNDER MINN. STAT. § 302A.751: A REVIEW OF CASES (Sept. 10, 1993); RICHARD G. WILSON, MILE, CORPORATE PRACTICE INSTITUTE, DEFENDING SHAREHOLDER AND DERIVATIVE LITIGATION (1989); ROBERT F. STRAUSS & WILLIAM J. O'BRIEN, MILE, BUYING-SELLING-MERGING CLOSELY HELD CORPORATIONS: PROTECTING MINORITY SHAREHOLDERS (1989). The importance of such suits is also established inferentially, by considering the ferocity of plaintiff lawyers when told that, even within a close corporation, some suits must be brought as derivative actions. See, e.g., Joseph W. Anthony & Karlyn Vegoe Boraas, *Minority Shareholder Rights - Revisited*, HENNEPIN LAW., Mar.-Apr. 1996, at 20 ("With a stroke of its pen, a three-judge panel of the Minnesota Court of Appeals may have done more damage to minority shareholder rights in Minnesota than 15 years of lobbying by corporate managers."). See also *infra* note 167 (discussing plaintiff counsel's vitriolic response to the appointment of a special litigation committee in *Skoglund v. Brady*, 541 N.W.2d 17 (Minn. Ct. App. 1995), *petition for review denied*, (Minn. Feb. 27, 1996)).

17. See BISHOP & KLEINBERGER, *supra* note 1, ¶ 6.08[4] n.298. Bishop and Kleinberger state that:

Under the internal affairs doctrine, disputes concerning "the relations inter se of the corporation, its shareholders, directors, officers or agents" are usually decided according to the law of the state of incorporation. The doctrine has three rationales: (1) the need for uniform rules to govern the internal structures and working of the organization; (2) the notion that participants in the organization either have tacitly selected the law of the state of incorporation

Current Minnesota law provides inadequate guidance when the corporation is closely held. The inadequacy has two main sources. First, the Minnesota rule for distinguishing between direct and derivative claims in general contains a serious conceptual flaw which confuses analysis regardless of the number of shareholders. Second, Minnesota close corporation cases rarely address the direct/derivative issue, and those that do, do so in a cursory fashion. Minnesota law, therefore, lacks a comprehensive, coherent approach for making the direct/derivative distinction in a Minnesota close corporation.

This article seeks to improve matters by (1) examining and proposing a remedy for the fundamental conceptual flaw and (2) providing a conceptual framework for making the fine distinctions necessary in the close corporation context. As background, Part II describes direct and derivative claims in their pure forms. Part III describes the special problems faced by derivative plaintiffs as contrasted with direct plaintiffs and thereby shows why the direct/derivative distinction matters. Part IV explains why it is important to draw that distinction early in any litigation. Part V examines and critiques Minnesota's current approach to the direct/derivative analysis. Part VI proposes a special rule for making the distinction in the context of closely held corporations, and Part VII wraps up the analysis with some important details concerning procedure and remedies.

II. THE PURE FORMS OF DIRECT AND DERIVATIVE CLAIMS

A. *Direct Claims*

In learning to distinguish between direct and derivative claims, it is useful to first understand each claim in its pure form. A shareholder asserts a direct claim to vindicate some right personal to the shareholder. The shareholder suffers the harm directly, rather than as a consequence of damage to the corporation. For example, the right to vote is an incident of shareholder status.¹⁸ A corporation that wrongfully denies or

to govern their internal affairs or would have done so had they considered the matter; and (3) the advantages of having a clear, easily applied rule.

Id. (citations omitted).

18. MINN. STAT. § 302A.445, subd. 3 (1994) (establishing one vote per share as the default rule). "[T]he articles [of incorporation] or . . . the terms of the shares" may

abrogates that right injures the shareholder directly and gives rise to a direct cause of action.¹⁹ Similarly, preemptive rights belong directly to each shareholder,²⁰ and wrongful interference with those rights creates a direct claim.²¹ Likewise, a shareholder has a direct right to inspect certain corporate records²² and a direct claim to remedy any wrongful denial of that right.²³

In the close corporation context, the most frequently asserted direct right is the right to continued employment.²⁴ Under Minnesota law, this right most often arises from the "reasonable expectations" of employee-shareholders.²⁵ Wrong-

create nonvoting shares, but in some circumstances even the holders of nonvoting shares have the right to vote. *Id.*; see also MINN. STAT. § 302A.137 (1994) (requiring class or series voting on certain amendments to the articles of incorporation).

19. Warthan v. Midwest Consol. Ins. Agencies, Inc., 450 N.W.2d 145, 149 (Minn. Ct. App. 1990) (defendant shareholders transferred corporate assets to another corporation without statutorily-required shareholder vote).

20. See MINN. STAT. § 302A.413 (1994).

21. Henricksen v. Big League Game Co., No. C0-95-388, 1995 WL 550935, at *1 (Minn. Ct. App. Sept. 19, 1995). Even without preemptive rights, improper dilution of a shareholder's voting power can create a direct claim. See, e.g., Whetstone v. Hossfeld Mfg. Co., 457 N.W.2d 380 (Minn. 1990); Wenzel v. Mathies, 542 N.W.2d 634 (Minn. Ct. App. 1996), *petition for review denied*, (Minn. Mar. 28, 1996).

22. MINN. STAT. § 302A.461, subd. 4 (1994).

23. Warthan, 450 N.W.2d at 149; Chabot v. Industrial Relations Council, Inc., No. 8720942 (St. Louis County Dist. Ct. Nov. 27, 1989), *aff'd*, No. C8-90-300, 1990 WL 119371 (Minn. Ct. App. Aug. 21, 1990); Frenzel v. Logistics, Inc., No. 457733 (Ramsey County Dist. Ct. Oct. 31, 1985). Shareholders also receive dividends in their capacity as shareholders, although only in extraordinary circumstances will the failure to pay dividends constitute a breach of duty. See *infra* notes 99-113 (discussing individual recovery in derivative cases). For an example of such extraordinary circumstances, see *Murphy v. Country House, Inc.*, 349 N.W.2d 289, 292 (Minn. Ct. App. 1984) (holding that "the so-called bonuses [paid to controlling shareholders] merely constituted a dividing of surplus profits" and ordering that the plaintiff be paid his share according to his percentage of stock ownership). The *Murphy* court based its holding on two key factual premises: "No evidence appears which suggests that the Board [of Directors] reviewed the quality of work performed or the number of hours worked before approving these 'bonuses' [T]he corporation instead distributed 'bonuses' only when fiscal reports showed sufficient income in the prior years." *Id.*

24. This phenomenon creates an interesting overlap with employment law. See Deborah A. Schmedemann, *Fired Employee and/or Frozen-out Shareholders*, 22 WM. MITCHELL L. REV. 1435, 1447 (1996) (accompanying symposium article in this issue).

25. See MINN. STAT. § 302A.751, subd. 3a (1994) (directing that in considering appropriate relief in the context of closely held corporations, courts should take into account the reasonable expectations of shareholders). Many other jurisdictions also use the reasonable expectations standard. See, e.g., *In re Kemp & Beatley, Inc.*, 484 N.Y.S.2d 799, 802 (N.Y. 1984); *Meiselman v. Meiselman*, 307 S.E.2d 551, 563 (N.C. 1983); *Exadaktilos v. Cinnaminson Realty Co.*, 400 A.2d 554, 571 (N.J. Super. Ct. Law Div.

ful termination injures such shareholders directly, "in their capacities . . . as officers or employees of a closely held corporation."²⁶

There are both case law and statutory sources for direct claims in Minnesota close corporations. Minnesota courts have stated that Minnesota law "imposes on each [shareholder in a close corporation] the highest standard of integrity in their dealings with each other."²⁷ The courts describe this duty as a "fiduciary duty to deal openly, honestly and fairly with other shareholders," which is akin to the duty imposed upon partners in a partnership.²⁸ As is the case with general partnerships, conduct breaching this duty entitles the victim to bring a claim directly against the malefactor.²⁹

In *Evans v. Blesi*,³⁰ for example, a minority shareholder in a close corporation brought a direct action alleging that the

1979), *aff'd*, 414 A.2d 994 (N.J. Super. App. Div. May 2, 1980), and *cert. denied*, 425 A.2d 273 (N.J. July 15, 1980); *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 662-63 (Mass. 1976).

26. MINN. STAT. § 302A.751, subd. 1(b)(3) (authorizing an action by a shareholder when those in control of the corporation have unfairly prejudiced the shareholder in any one of several specified capacities); *see also* App. A, Fig. 1. *See, e.g.*, *Pooley v. Mankato Iron & Metal, Inc.*, 513 N.W.2d 834 (Minn. Ct. App.), *petition for review denied*, (Minn. 1994); *Pedro v. Pedro*, 489 N.W.2d 798 (Minn. Ct. App.), *petition for review denied*, (Minn. 1992); *Pedro v. Pedro*, 463 N.W.2d 285 (Minn. Ct. App. 1990); *Evans v. Blesi*, 345 N.W.2d 775 (Minn. Ct. App.), *petition for review denied*, (Minn. 1984); *Sawyer v. Curt & Co.*, Nos. C7-90-2040, C9-90-2041, 1991 WL 65320 (Minn. Ct. App. Feb. 12, 1991), *petition for review denied*, (Minn. Apr. 18, 1991).

27. *Evans*, 345 N.W.2d at 779.

28. *Id.*; *see also* *Westland Capital Corp. v. Lucht Eng'g, Inc.*, 308 N.W.2d 709, 712 (Minn. 1981) (describing a close corporation as "a partnership in corporate guise").

29. *See, e.g.*, *Wenzel v. Mathies*, 542 N.W.2d 634, 639 (Minn. Ct. App.) (holding that directors breached their fiduciary duties by improperly issuing and selling new stock to themselves and thereby destroying the plaintiff-pledgees controlling interest in the closely held corporation), *petition for review denied*, (Minn. 1996); *Pedro*, 489 N.W.2d at 801-02 (holding that defendant-shareholders in close corporation breached fiduciary duties owed to plaintiff-shareholder by harassing and firing plaintiff after he insisted on resolving discrepancies in financial records); *Henricksen v. Big League Game Co.*, No. C0-95-388, 1195 WL 550935, at *2 (Minn. Ct. App. Sept. 19, 1995) (holding that directors of a close corporation breached their fiduciary duties by selling newly issued stock and corporate assets without notice to the plaintiff-shareholder and without authorization by the board of directors). As for partner versus partner claims, *see* *Prince v. Sonneson*, 222 Minn. 528, 533-34, 25 N.W.2d 468, 471-72 (1947) (holding that partner breached his fiduciary duties by using fraudulent misrepresentations to persuade other partners to agree to convert the partnership into a corporation). As indicated, *supra* note 1, most partner versus partner claims are litigated in the context of an action for an accounting.

30. 345 N.W.2d 775 (Minn. Ct. App. 1984).

majority shareholder had used intimidating and abusive tactics to coerce the minority shareholder into transferring stock to the majority shareholder and then into resigning.³¹ From 1955 to 1977, the plaintiff and defendant had been equal shareholders in the Blesi-Evans Company.³² In 1977, however, the plaintiff had transferred a share of stock to the defendant, giving the defendant a majority interest.³³ In 1981, the plaintiff acquiesced to the defendant's demands that the plaintiff resign from his employment with the corporation.³⁴ The plaintiff later claimed that the defendant had forced him to transfer the stock by throwing tantrums and threatening to liquidate the corporation should the plaintiff refuse.³⁵ The plaintiff also testified that the defendant had threatened to fire his son (who worked for the company) unless the plaintiff resigned.³⁶ The court found that the defendant's actions constituted a breach of a fiduciary duty owed directly to the plaintiff and that the plaintiff had suffered a correspondingly direct injury.³⁷

More recent cases tend to rest primarily on a statute enacted in 1981, Minnesota Statutes section 302A.751.³⁸ Recognizing

31. *Id.* at 777.

32. *Id.*

33. *Id.* at 778.

34. *Id.* at 777.

35. *Id.* at 778.

36. *Id.*

37. *Id.* at 775. In addition to ordering the defendant shareholder to buy out the minority shareholder, the court awarded the minority shareholder \$381,136 in compensatory damages for lost salary and \$250,000 in punitive damages. *Id.* at 781.

38. 1981 Minn. Laws ch. 270, § 108. The legislature amended section 302A.751 four times from 1981 to 1996. See 1982 Minn. Laws ch. 497, § 65 (amending § 302A.751, subd. 2 by instructing the court when ordering a buy-out to defer to negotiated buy-out agreements, unless the terms or conditions are unreasonable); 1982 Minn. Laws ch. 497, § 66 (amending § 302A.751, subd. 3 by inserting reference to equitable relief and buy-outs); 1983 Minn. Laws ch. 368, § 9 (amending § 302A.751, subd. 1(b) by substituting as grounds for relief the phrase "in a manner unfairly prejudicial" for the phrase "persistently unfair"); 1983 Minn. Laws ch. 368, § 9 (amending § 302A.751, subd. 2 by substituting "closely held corporation" for "corporation having 25 or fewer shareholders"); 1983 Minn. Laws ch. 368, § 11 (amending § 302A.751 by inserting subd. 3a which instructs courts to take into consideration the "reasonable expectations of the shareholders"); 1986 Minn. Laws ch. 431, § 3 (amending § 302A.751 by inserting subd. 3b which instructs the courts to consider lesser relief before ordering dissolution as a remedy); 1994 Minn. Laws ch. 417, § 9 (amending § 302A.751, subd. 1 by deleting action relating to unfairly prejudicial acts from clause 2 and adding clause 3 regarding actions relating solely to unfairly prejudicial acts toward shareholders); 1994 Minn. Laws ch. 417, § 10 (amending § 302A.751, subd. 2 substituting "a corporation that is not a publicly held corporation"

the vulnerability of minority shareholders in a close corporation, the statute accords them special protections. It specifies several grounds for judicial intervention and provides a panoply of equitable remedies.³⁹ For the close corporation claimant, the key grounds are found in clauses 2 and 3 of subdivision 1(b). Under these clauses:

A court may grant any equitable relief it deems just and reasonable in the circumstances or may dissolve a corporation and liquidate its assets and business:

. . . .

(b) In an action by a shareholder when it is estab-

for "a closely held corporation"); 1994 Minn. Laws ch. 417, § 11 (amending § 302A.751, subd. 3a by adding a presumption that written agreements, including employment agreements and buy-sell agreements, reflect the parties' reasonable expectations).

For cases invoking Minnesota Statutes § 302A.751, see *McCallum v. Rosen's Diversified, Inc.*, 41 F.3d 1239, 1241 (8th Cir. 1994); *Foy v. Klapmeier*, 992 F.2d 774, 779 (8th Cir. 1993); *PJ Acquisition Corp. v. Skoglund*, 453 N.W.2d 1, 5-6 (Minn. 1990); *Skoglund v. Brady*, 541 N.W.2d 17, 21-22 (Minn. Ct. App. 1995), *petition for review denied*, (Minn. Feb. 27, 1996); *Pooley v. Mankato Iron & Metal, Inc.*, 513 N.W.2d 834, 837 (Minn. Ct. App. 1994), *petition for review denied*, (Minn. May 17, 1994); *Pedro v. Pedro*, 489 N.W.2d 798, 802-04 (Minn. Ct. App. 1992), *petition for review denied*, (Minn. Oct. 20, 1992); *In re Telesports Prod., Inc.*, 476 N.W.2d 798, 800 (Minn. Ct. App. 1991); *Pedro v. Pedro*, 463 N.W.2d 285, 289-90 (Minn. Ct. App. 1990); *Warthan v. Midwest Consol. Ins. Agencies, Inc.*, 450 N.W.2d 145, 148-49 (Minn. Ct. App. 1990); *Sundberg v. Abbott*, 423 N.W.2d 686, 687 (Minn. Ct. App. 1988), *petition for review denied*, (Minn. June 29, 1988); *Casey v. Bonded Collections, Inc.*, 392 N.W.2d 650, 652 (Minn. Ct. App. 1986), *petition for review denied*, (Minn. Oct. 29, 1986); *Sundberg v. Lampert Lumber Co.*, 390 N.W.2d 352, 355-56 (Minn. Ct. App. 1986), *petition for review denied*, (Minn. Sept. 22, 1986); *Schaub v. Kortgard*, 372 N.W.2d 427, 430 (Minn. Ct. App. 1985); *Henricksen v. Big League Games Co.*, No. C0-95-388, 1995 WL 550935, at *1 (Minn. Ct. App. Sept. 19, 1995); *Olsen v. Drozdek*, No. C2-92-1706, 1993 WL 107756, at *2 (Minn. Ct. App. Apr. 13, 1993); *Wheeler v. McGee*, No. C5-92-680, 1992 WL 383460, at *4 (Minn. Ct. App. Dec. 29, 1992), *petition for review denied*, (Minn. Feb. 12, 1993); *Kelley v. Rudd*, No. C7-91-1142, 1992 WL 3651, at *3 (Minn. Ct. App. Jan. 14, 1992), *petition for review denied*, (Minn. Mar. 26, 1992); *Dullea v. Dullea Co.*, No. C8-91-498, 1991 WL 271479, at *3 (Minn. Ct. App. Dec. 24, 1991), *petition for review denied*, (Minn. Feb. 19, 1992); *Sawyer v. Curt & Co.*, Nos. C7-90-2040, C9-90-2041, 1991 WL 65320, at *1-3 (Minn. Ct. App. Feb. 12, 1991); *Bowman v. MWCG Export Co.*, No. C4-90-1654, 1991 WL 30342, at *2 (Minn. Ct. App. Mar. 12, 1991); *Zenanko v. Vukelich*, No. C2-90-1264, 1991 WL 6379, at *1 (Minn. Ct. App. Jan. 29, 1991); *Johnson v. Dolphin*, No. CX-90-718, 1990 WL 194991, at *1-2 (Minn. Ct. App. Dec. 11, 1990), *petition for review denied*, (Minn. Feb. 6, 1991); *Blaeser v. Dufour*, No. CO-89-2102, 1990 WL 128296, at *1 (Minn. Ct. App. Sept. 11, 1990), *petition for review denied*, (Minn. Nov. 9, 1990); *Chabot v. Industrial Relations Council, Inc.*, No. C8-90-300, 1990 WL 119371, at *1-2 (Minn. Ct. App. Aug. 21, 1990); *Koropchak v. Multicare Assoc.*, No. C7-89-2047, 1990 WL 48538, at *1 (Minn. Ct. App. Apr. 24, 1990).

39. Joseph E. Olson, *Statutory Changes Improve Position of Minority Shareholders in Closely-Held Corporations*, HENNEPIN LAW., Sept.-Oct. 1983, at 10.

lished that:

-
- (2) the directors or those in control of the corporation have acted fraudulently or illegally toward one or more shareholders in their capacities as shareholders or directors, or as officers or employees of a closely held corporation; [or]
- (3) the directors or those in control of the corporation have acted in a manner unfairly prejudicial toward one or more shareholders in their capacities as shareholders or directors of a corporation that is not a publicly held corporation, or as officers or employees of a closely held corporation.⁴⁰

A direct suit typically names not only the corporation but also individual directors and shareholders as defendants. The corporation is a proper and often even a necessary party, because often the corporation takes the formal action which effects the injury. Moreover, the corporation is typically the source or focus of the requested relief. For example, although as a practical matter it will be the majority shareholder who decides to fire a minority shareholder,⁴¹ formally speaking it is the corporation that terminates the shareholder's employment.⁴² A fired shareholder might respond by seeking to dissolve the corporation⁴³ or to compel the corporation to redeem the shareholder's stock.⁴⁴ As for individual defendants,

40. The syntax of these two clauses makes their meaning and relationship difficult to decipher. The charts contained in Appendix A analyze and restate these clauses to make them more accessible. As for clause 3's reference to "unfair prejudice," the cases interpret the term in light of § 302A.751, subd. 3, which discusses considerations in granting relief involving closely held corporations. See, e.g., *Pedro*, 489 N.W.2d at 802; *Warthan*, 450 N.W.2d at 149; *Kelley*, 1992 WL 3651 at *3; *Sawyer*, 1991 WL 65320 at *2.

41. See, e.g., *McQuade v. Stoneham*, 189 N.E. 234, 239 (N.Y. 1934) (Lehman, J., concurring in the result) ("The theory that directors [in close corporations] exercise in all matters an independent judgment in practice often yields to the fact that the choice of directors lies with the majority stockholders and the thus gives the stockholders a very effective control of the action by the board of directors.").

42. See *supra* notes 24-26.

43. See *infra* note 47.

44. Minnesota Statutes § 302A.751, subdivision 2 provides "[i]n an action . . . involving a corporation that is not a publicly held corporation . . . the court may upon motion of . . . a shareholder . . . order the sale [by an injured shareholder] of all shares of the corporation held by [such injured shareholder to] the corporation." MINN. STAT. § 302A.751, subd. 2. For either of these remedies, due process and the rules of civil procedure require that the corporation be a party. See TIMOTHY P. BJUR

section 302A.751 specifically refers to misconduct by "the directors or those in control of the corporation"⁴⁵ and expressly recognizes direct, shareholder-to-shareholder duties.⁴⁶

Remedies from a direct claim benefit the shareholder plaintiff directly and vary depending upon the severity of the misconduct and the other circumstances of the case. A court may order a buy-out of the injured shareholder's shares or grant any other equitable relief, including dissolution of the corporation.⁴⁷ Plaintiff's counsel is not automatically entitled to attorney's fees. The statute provides that, "[i]f the court finds that a party to a proceeding brought under this section has acted arbitrarily, vexatiously, or otherwise not in good faith, it may in its discretion award reasonable expenses, including attorneys'

& JAMES SOLHEIM, 13 FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 4473, at 78 (perm ed. 1995).

45. MINN. STAT. § 302A.751, subs. 1(b)(2), (3). See also *infra* App. A, Fig. 1.

46. Minnesota Statutes § 302A.751, subdivision 3a refers to "the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner in the operation of the corporation." See also *Chabot v. Industrial Relations Council, Inc.*, No. C8-90-300, 1990 WL 119371, at *2 (Minn. Ct. App. Aug. 21, 1990). The court found that:

Under the Business Corporations Act, the remedies of Minn. Stat. § 302A.751 are made readily available to the district court. 'Abuse of non-controlling shareholders is not to be tolerated under this act; section 302A.467 and this section stand as evidence of that policy.' Minn. Stat. Ann. § 302A.751, general comment, 1981.

The trial court followed this directive and Minn. Stat. § 302A.467 in imposing remedies against Jones individually.

Id.

47. MINN. STAT. §§ 302A.751, subd. 1 (recognizing broad equitable powers), subd. 2 (delineating the buy-out remedy). In 1986, the Minnesota Court of Appeals held that subdivision 2's then reference to "closely-held corporation" confined the buy-out remedy to cases involving closely held corporations. *Sundberg v. Lampert Lumber Co.*, 390 N.W.2d 352, 356 (Minn. Ct. App. 1986), *petition for review denied*, (Minn. Sept. 22, 1986). See Kleinberger, *supra* note 9, at 1157 n.40 (criticizing *Lampert Lumber*). Arguably at least, the 1986 enactment of subdivision 3b overturned *Lampert Lumber*. That subdivision mentioned buy-outs without any reference to closely held corporations. 1986 Minn. Laws ch. 431, § 3. In any event, in 1994 the legislature settled the matter beyond doubt, amending subdivision 2 to make the buy-out remedy available in any corporation other than a publicly held corporation. 1994 Minn. Laws ch. 417, § 10.

Both case law and the statute disfavor the extreme remedy of liquidation. See, e.g., *In re Involuntary Dissolution of Lakeland Dev. Corp. v. Anderson*, 277 Minn. 432, 442, 152 N.W.2d 758, 765 (1967) ("the court should grant the drastic remedy of dissolution with great caution and not in doubtful cases"); MINN. STAT. § 302A.751, subd. 3b (providing that "[i]n deciding whether to order dissolution, the court shall consider whether lesser relief suggested by one or more parties, such as any form of equitable relief, a buy-out, or a partial liquidation, would be adequate to permanently relieve the circumstances").

fees and disbursements, to any of the other parties."⁴⁸

B. *Derivative Claims*

In contrast, a shareholder asserts a derivative claim to vindicate the rights of the corporation. A wrongful act has depleted or devalued corporate assets or has undercut the corporate business. The shareholder has suffered harm only indirectly, as a consequence of damage done to the corporation. The wrongful conduct relates to the shareholder only through the medium of the corporation, i.e., by reducing the value of the shareholder's stock. For example, when those in control of the corporation act negligently,⁴⁹ or waste or misappropriate corporate assets, it is the corporation, not the shareholder, that first suffers the loss.⁵⁰ Likewise, if a corporate director takes for

48. MINN. STAT. § 302A.751, subd. 4; *see also* *Pedro v. Pedro*, 489 N.W.2d 798, 804 (Minn. Ct. App. 1992) (holding award of attorneys' fees to plaintiff minority shareholder under § 302A.751, subdivision 4 was not an abuse of discretion), *petition for review denied*, (Minn. Oct. 20, 1992); *Sawyer v. Curt & Co.*, Nos. C7-90-2040, C9-90-2041, 1991 WL 65320, at *3 (Minn. Ct. App. Feb. 12, 1991) (holding that Minnesota Statutes § 302A.467 (1988) "permits a court, in its discretion, to award attorney fees for any violation of chapter 302A if it finds such an award will be reasonably equitable under the circumstances. No specific findings as to bad faith, arbitrary, or vexatious conduct are required."), *petition for review denied*, (Minn. Apr. 18, 1991).

49. *Warner v. E. C. Warner Co.*, 226 Minn. 565, 571-72, 33 N.W.2d 721, 726 (1948); *Horn Silver Mining Co. v. Ryan*, 42 Minn. 196, 198-99, 44 N.W. 56, 57 (1889); *Lampert Lumber Co.*, 390 N.W.2d at 357. In theory, the standard of care for directors of Minnesota corporations is higher than the standard for Delaware directors. *Compare* MINN. STAT. § 302A.251, subd. 1 (requiring "the care an ordinarily prudent person in a like position would exercise under similar circumstances") with *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985) (establishing a standard of gross negligence).

The difference may be more apparent than real, however. Minnesota's statutory standard seems not to have disturbed caselaw's historic deference to the business judgment of directors, *see infra* part III.C. (discussing the business judgment rule), and Delaware has applied its seemingly more lax standard in ways that have shocked the corporate bar. *See, e.g.*, Committee on Corporate Law, *Changes in the Revised Model Business Corporation Act - Amendment Pertaining to the Liability of Directors*, 45 BUS. LAW 695, 696 (1989-1990); Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1, 7 (1989) (explaining how *Smith v. Van Gorkom* shocked corporate practitioners and led to the enactment of statutes protecting directors against negligence-based liability); *see also* *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 370-71 (Del. 1993) (rejecting the notion that plaintiffs must prove a causal link between directors' negligence and damage to the corporation and holding that, once plaintiffs have established a breach of directors' duty of care, directors have the burden of proving the entire fairness of the challenged transaction). Moreover, exculpatory provisions, discussed *infra* part III.E., may moot any difference.

50. *See, e.g.*, *Westgor v. Grimm*, 318 N.W.2d 56, 58 (Minn. 1982) (involving, *inter alia*, waste of corporate assets); *Winter v. Farmers Educ. & Coop. Union*, 259 Minn. 257,

him or herself a business opportunity that properly belongs to the corporation, it is the corporation, not the shareholder, that has lost the opportunity and any attendant profits.⁵¹

In essence, a derivative plaintiff seeks to derive standing from the injury to the corporation and to represent the corporation's interests in the derivative lawsuit.⁵² In ordinary circumstances, "[w]hether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors."⁵³ A derivative lawsuit, therefore, necessarily impugns the management of the corporation and inevitably involves two distinct fights. One fight concerns the underlying transaction or conduct, which is alleged to have caused some harm or breached some duty to the corporation. The other fight concerns who will control the corporation for the limited purpose of seeking a remedy for the alleged misconduct.⁵⁴

The typical derivative suit alleges that, with regard to the underlying transaction, the corporation's own directors have acted improperly.⁵⁵ To support such claims, a derivative plaintiff, like a direct plaintiff, can turn to both common and

261, 107 N.W.2d 226, 230 (1961) (involving misappropriation of corporate assets); Warner v. E. C. Warner Co., 226 Minn. 565, 569, 33 N.W.2d 721, 724 (1948) (involving, *inter alia*, waste of corporate assets); Eriksson v. Boyum, 150 Minn. 192, 194, 184 N.W. 961, 962 (1921) (involving, *inter alia*, misappropriation of corporate assets); Seitz v. Michel, 148 Minn. 80, 83, 181 N.W. 102, 103 (1921) (involving, *inter alia*, misappropriation of corporate assets); Black v. NuAire, Inc., 426 N.W.2d 203, 206 (Minn. Ct. App. 1988) (involving, *inter alia*, misappropriation of corporate assets), *petition for review denied*, (Minn. Aug. 24, 1988).

51. Miller v. Miller, 301 Minn. 207, 220-21, 222 N.W.2d 71, 79 (1974).

52. Warner, 226 Minn. at 569, 33 N.W.2d at 724 ("In a representative suit [by a stockholder in behalf of his corporation], . . . the stockholder bringing the action is merely a representative party so far as the corporation is concerned.")

53. Westgor, 318 N.W.2d at 59.

54. See Auerbach v. Bennett, 393 N.E.2d 994 (N.Y. 1979). The Auerbach court's inquiry had "a two-tiered aspect." *Id.* at 1000. The plaintiff's "complaint initially asserted liability on the part of defendants [the corporate directors] based on [bribes,] . . . i.e., the focus was on first-tier bribes and kickbacks." *Id.* The second-tier inquiry involved the report of a special litigation committee, its appointment "by the [defendant] corporation's board of directors to consider the merits of the present and similar shareholders' derivative actions, and its determination that it would not be in the best interest of the corporation to press claims against defendants based on their possible first-tier liability." *Id.* For a discussion of the dynamics of this latter fight, see *infra* part III.A-B.

55. See *infra* notes 59-69.

statutory law. Minnesota case law has long recognized that "directors or controlling shareholders stand in a fiduciary relationship to the corporation."⁵⁶ The courts have described this fiduciary relationship as "one imposing upon them the duty to exercise their powers as directors solely for the benefit of the corporation and its stockholders."⁵⁷ In addition, case law recognizes a duty of care, although the requirements of that duty vary somewhat within the cases.⁵⁸

A pair of cases reflecting a director's duty of loyalty (i.e., selflessness) illustrate the power of case-law-based claims. In *Westgor v. Grimm*, the plaintiff argued *inter alia* that the directors had wrongfully enriched themselves through corporate actions.⁵⁹ The Minnesota Supreme Court stated that, in order to establish a claim of breach of fiduciary duty, "a plaintiff must allege facts which show that the action attacked is so far opposed to the true interests of the corporation as to lead to the clear inference that no officer thus acting could have been influenced by an honest desire to secure such interest."⁶⁰ The trial court had dismissed plaintiff's claim, finding no breach of fiduciary duty. The supreme court reversed and remanded, directing the trial court to determine whether the defendants had breached a fiduciary duty by paying themselves back salaries and selling a model home to a director.⁶¹

The plaintiff's allegations suggested that the directors had acted with a conflict of interest. Once such a conflict is estab-

56. *Westgor*, 318 N.W.2d at 59. See *Seitz v. Union Brass & Metal Mfg. Co.*, 152 Minn. 460, 462, 189 N.W. 586, 587 (1922) ("This court has continually insisted upon the recognition of the fiduciary relation between officers and directors and stockholders . . ."); *Green v. National Advertising & Amusement Co.*, 137 Minn. 65, 67, 162 N.W. 1056, 1057 (1917) ("The position is one of trust and confidence, the duties thereof must be performed with fidelity . . ."); *Horn Silver Mining Co. v. Ryan*, 42 Minn. 196, 198, 44 N.W. 56, 56 (1889) ("The directors of a corporation are its agents and occupy a fiduciary relation to it").

57. *Diedrick v. Helm*, 217 Minn. 483, 493, 14 N.W.2d 913, 919 (1944).

58. See *infra* notes 172-74 and accompanying text (discussing the schizoid attitude of Minnesota law with regard to the business judgment rule and the duty of care).

59. *Westgor*, 318 N.W.2d at 58. The plaintiff also argued that the directors had breached a duty by failing to sue the corporation's attorney for negligent tax advice. *Id.* The supreme court rejected that claim, stating that "[w]hether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors." *Id.* at 59.

60. *Id.*

61. *Id.* at 58-59.

lished, the court explained, the burden of proof shifts to the defendant directors:

[The directors'] dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain.⁶²

*Miller v. Miller*⁶³ reflects another aspect of the duty of loyalty—the corporate opportunity doctrine. A minority shareholder brought a derivative suit alleging that two of the shareholder-managers had appropriated for themselves a business opportunity properly belonging to the corporation. The defendants had formed other corporations and a partnership which then performed tasks related to the first corporation's business.⁶⁴

The supreme court articulated a two-part test for determining when liability exists for usurpation of a corporate opportunity. The first part determines whether the business opportunity at issue is a "corporate" opportunity.⁶⁵ To constitute a "corporate" opportunity, the business taken must be sufficiently associated with the existing or prospective activities of the corporation as to be in fact in its "line of business."⁶⁶ If not,

62. *Id.* at 59. *Westgor* was both a derivative and direct suit. The court dismissed plaintiff's direct claim, finding that plaintiff had "no individual cause of action because a right of action for diversion of corporate funds is in the corporation, not the individual." *Id.* at 58 (citing *Seitz v. Michel*, 148 Minn. 80, 181 N.W. 102 (1921)).

63. 301 Minn. 207, 222 N.W.2d 71 (1974).

64. *Id.* at 208, 222 N.W.2d at 72-73.

65. *Id.* at 225, 222 N.W.2d at 81.

66. *Id.* Significant factors to be considered when making this determination include:

[1] whether the business opportunity presented is one in which the complaining corporation has an interest or an expectancy growing out of an existing contractual right; [2] the relationship of the opportunity to the corporation's business purposes and current activities—whether essential, necessary, or merely desirable to its reasonable needs and aspirations—; [3] whether, within or without its corporate powers, the opportunity embraces areas adaptable to its business and into which the corporation might easily, naturally, or logically expand; [4] the competitive nature of the opportunity—whether prospectively harmful or unfair—; [5] whether the corporation, by reason of insolvency or

the analysis ends with a finding of no liability.⁶⁷ If so, the analysis proceeds to the second part. The second part of the test determines whether the corporate director, in acquiring the corporate opportunity, violated his or her fiduciary duties of loyalty, good faith and fair dealing toward the corporation.⁶⁸ Significant factors to be considered when making this determination include:

[T]he nature of the officer's relationship to the management and control of the corporation; whether the opportunity was presented to him in his official or individual capacity; his prior disclosure of the opportunity to the board of directors or shareholders and their response; whether or not he used or exploited corporate facilities, assets, or personnel in acquiring the opportunity; whether his acquisition harmed or benefited [sic] the corporation, and all other facts and circumstances bearing on the officer's good faith and whether he exercised the diligence, devotion, care, and fairness toward the corporation which ordinarily prudent men would exercise under similar circumstances in like positions.⁶⁹

lack of resources, has the financial ability to acquire the opportunity; and [6] whether the opportunity includes activities as to which the corporation has fundamental knowledge, practical experience, facilities, equipment, personnel, and the ability to pursue.

Id.

67. *Id.* Liability could, however, be imposed on some other, independent theory. For example, an opportunity might be outside a corporation's line of business as defined by *Miller* but still come within the confines of a non-competition obligation established by contract. *See id.*

68. *Id.* at 225-26, 222 N.W.2d at 81-82.

69. *Id.* Neither bad nor good faith is dispositive in the fairness analysis:

We are not to be understood, by adopting this two-step process, as suggesting that a finding of bad faith is essential to impose liability upon the acquiring officer. Nor, conversely, that good faith alone apart from the officer's fiduciary duty requiring loyalty and fair dealing toward the corporation, will absolve him from liability.

Id. at 226, 222 N.W.2d at 82.

The first part of the *Miller* test conforms with the standards used in many other jurisdictions. The second part is unique. In other jurisdictions, taking a corporate opportunity is per se wrongful, unless the director can show that the corporation knowingly consented. *See, e.g., Guth v. Loft, Inc.*, 2 A.2d 225, 238-39 (Del. Ch. 1938), *aff'd*, 5 A.2d 503 (Del. 1939). The *Guth* court held:

Such are the fiduciary duties and obligations of an officer and director of a corporation that if a business opportunity comes to him which is in the line of his corporation's activities and of advantage to it . . . the law will not allow him to divert the opportunity from the corporation and embrace it as his own.

Id. The second part of the *Miller* test has been severely criticized. *See* Victor Brudney & Robert C. Clark, *A New Look at Corporate Opportunities*, 94 HARV. L. REV. 997, 998-99

A derivative suit may also assert statute-based claims, because Minnesota Statutes sections 302A.251 and 302A.255 impose duties of care and loyalty on those who control and manage the corporation. Section 302A.251, subdivision 1 establishes a general standard of both loyalty and due care: "A director shall discharge the duties of the position of director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care of an ordinarily prudent person in a like position would exercise under similar circumstances."⁷⁰

The provision clearly contemplates judicial enforcement,⁷¹ and Minnesota courts have acted accordingly. For example, in *PJ Acquisition Corp. v. Skoglund*,⁷² the court remanded to allow further consideration of breach of fiduciary claims and referred to section 302A.251 as one of several grounds on which the plaintiffs might challenge the defendants' actions.⁷³

Section 302A.251 figured in both the trial court and appeals court decisions in *Sundberg v. Lampert Lumber Co.*⁷⁴ An extended family owned a controlling interest in the corporation, and the plaintiffs claimed that the defendants had violated section 302A.251 by redeeming stock owned by a member of the controlling family without giving the decision adequate consideration.⁷⁵ The trial court found that the directors had breached section 302A.251, but the court of appeals reversed. The appeals

n.2 (1981).

70. MINN. STAT. § 302A.251, subd. 1 (1994). Section 302A.361 provides an identical standard for the conduct of officers: "An officer shall discharge the duties of an office in good faith, in a manner the officer reasonably believes to be in the best interests of the corporation, and with the care of an ordinarily prudent person in a like position would exercise under similar circumstances." MINN. STAT. § 302A.361 (1994).

71. MINN. STAT. § 302A.251, subd. 1. The subdivision's last sentence states: "A person who so performs those duties is not liable by reason of being or having been a director of the corporation." *Id.*

72. 453 N.W.2d 1 (Minn. 1990).

73. *Id.* at 13. The alleged breaches related to transfers of corporate stock and a right of first refusal. *Id.* at 3.

74. 390 N.W.2d 352 (Minn. Ct. App. 1986), *petition for review denied*, (Minn. Sept. 22, 1986).

75. *See id.* at 356. The board redeemed the family member's stock for \$1.2 million. *Id.* at 354. The minutes of the board reflected no discussion concerning the particulars of the redemption, and no information or reports were prepared or presented to the board for its consideration. *Id.* The board's decision to redeem was precipitated by the shareholder's increasing use of her corporate account to pay for personal items. *Id.* at 354-55. No shareholder vote was taken on the matter. *Id.* at 354.

panel did not dispute the relevance of section 302A.251 but rather concluded that the plaintiffs had failed to prove causation.⁷⁶ The court of appeals explained: "Even when the required duty of care has not been exercised, the directors, officer, or controlling shareholders are only liable, under causation rules of negligence law, for such loss to the corporation as was caused by their negligence."⁷⁷

Causation is not an issue under Minnesota Statutes section 302A.255, which speaks specifically to director conflict-of-interest problems and rests on a common law background that presumed self-dealing transactions to be voidable at the instance of the corporation.⁷⁸ The statute's first subdivision identifies "conflicts" and addresses the proper "procedure when conflict arises."⁷⁹ The statute provides three protections against voidability. Two are effectively safe-harbors: (i) informed consent by disinterested shareholders,⁸⁰ and (ii) informed consent by disinterested directors.⁸¹ The third protection

76. *Id.* at 357.

77. *Id.* (citations and internal quotations omitted). Compare *Lampert Lumber with Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 370-71 (Del. 1993) (sharply criticizing the causation approach and holding that, under Delaware law, once the plaintiffs prove a breach of the duty of care the defendants have the burden of proving entire fairness).

78. Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW 35, 36 (1966) ("In 1880 it could have been stated with confidence that in the United States the general rule was that any contract between a director and his corporation was voidable at the instance of the corporation or its shareholders, without regard to the fairness or unfairness of the transaction.").

79. MINN. STAT. § 302A.255, subd. 1 (1994). The quoted language is from the caption. Subdivision 2 further defines conflicts by excluding certain transactions and by establishing family attribution rules. *Id.* at subd. 2.

80. Section 302A.255, subdivision 1 provides that a conflict-of-interest transaction "is not void or voidable" if:

(b) The material facts as to the contract or transaction and as to the director's or directors' interest are fully disclosed or known to the shareholders and the contract or transaction is approved in good faith by (1) the holders of two-thirds of the voting power of the shares entitled to vote which are owned by persons other than the interested director or directors, or (2) the unanimous affirmative vote of the holders of all outstanding shares, whether or not entitled to vote.

Id. at subd. (1)(b). Clause 2 is evidently intended to allow this safe-harbor to function when all the outstanding voting shares are held by interested directors.

81. Section 302A.255, subdivision 1(c) provides that a conflict-of-interest transaction "is not void or voidable" if:

(c) The material facts as to the contract or transaction and as to the director's or directors' interest are fully disclosed or known to the board or a committee, and the board or committee authorizes,

requires "the person asserting the validity of the contract or transaction [to sustain] the burden of establishing that the contract or transaction was fair and reasonable to the corporation."⁸²

As is the situation with section 302A.251, the language of section 302A.255 bespeaks judicial enforceability. The introductory language in subdivision 1 alludes to "void or voidable transactions," which argues ultimately for a judicial determination. Moreover, paragraph (a) of subdivision 1 refers specifically to a burden of proof.⁸³

Minnesota courts have invoked section 302A.255 on a number of occasions. For example, in *PJ Acquisition* the court refers to section 302A.255 as one of several grounds on which the plaintiffs might challenge the defendants' actions.⁸⁴ In *Chabot v. Industrial Relations Council, Inc.*,⁸⁵ the court held that a board member deemed interested under section 302A.255 could not be counted toward a quorum when the board voted to have the corporation acquire her shares.⁸⁶

Whatever the source of claim, a derivative action will necessarily involve both the corporation and individual defendants as parties. Since it is the corporation that has been directly harmed, its interests are fundamentally involved in any attempt to remedy those harms. By case law, the corporation is

approves, or ratifies the contract or transaction in good faith by a majority of the board or committee, but the interested director or directors shall not be counted in determining the presence of a quorum and shall not vote.

Id. at subd. 1(c).

82. *Id.* at subd. 1(a). This provision is not a safe-harbor because it provides no clearly defined, mechanical rule under which a transaction's proponents can act *ante hoc* to follow clearly specified procedures or satisfy clearly specified requirements. Actions taken *ante hoc*, such as independent fairness opinions, can increase the likelihood of a transaction being fair and, more importantly, being adjudged as having been fair, but cannot inspire the level of confidence created by compliance with the mechanical requirements of a true safe-harbor.

83. *Id.*

84. *PJ Acquisition Corp. v. Skoglund*, 453 N.W.2d 1, 17-18 (Minn. 1990).

85. No. C8-90-300, 1990 WL 119371 (Minn. Ct. App. Aug. 21, 1990).

86. *Id.* *2. See *Possis Corp. v. Continental Mach., Inc.*, 425 N.W.2d 286 (Minn. Ct. App. 1988), *petition for review denied*, (Minn. July 28, 1988). In *Possis*, the parties disputed whether section 302A.255 disqualified "interested" directors from being counted towards a quorum when the board voted to exercise a purchase option. *Id.* at 289-90. The court avoided the issue and based its decision on other grounds. *Id.*

a necessary party.⁸⁷ The individual defendants will be those who have allegedly harmed the corporation. In the typical derivative suit, those individuals are or have been in control of the corporation.⁸⁸ In such situations, the same defendants will figure in both of the two aspects of the derivative suit⁸⁹—i.e., in the allegations that the defendants have harmed the corporation through their misconduct, and in the allegations that defendants cannot be relied on to pursue those miscreants who have harmed the corporation (i.e., themselves).⁹⁰ A derivative suit can also target an outsider to the corporation. In that event, the derivative suit asserts that the outsider has harmed the corporation and that those in control of the corporation have wrongfully failed to pursue the outsider.⁹¹

Whoever the parties may be, remedies granted in a derivative suit ordinarily benefit the corporation. As the Minnesota Supreme Court explained in the context of a suit claiming a breach of the duty of loyalty, “[t]he wrongs complained of are wrongs against the corporation. The funds diverted should be restored to the corporations [sic].”⁹² The same is true regardless of whether the suit recovers damages for breach of the duty of care,⁹³ imposes a constructive trust or requires disgorgement

87. *BJUR & SOLHEIM*, *supra* note 44, § 5998, at 245. The corporation is styled as a nominal defendant. *Warner v. E. C. Warner Co.*, 226 Minn. 565, 569, 33 N.W.2d 721, 724 (1948). As the supreme court explained:

In a representative or derivative suit, the real controversy is between the corporation and the officer whose acts are complained of. The corporation is the beneficial plaintiff, even though it is made a defendant, while the stockholder bringing the action is merely a representative party so far as the corporation is concerned.

Id. (citations omitted).

88. See Charles W. Murdock, *Corporate Governance - The Role of Special Litigation Committees*, 68 WASH. L. REV. 79, 102, 134 (1993); Carol B. Swanson, *Juggling Shareholder Rights and Strike Suits in Derivative Litigation: The ALI Drops the Ball*, 77 MINN. L. REV. 1339, 1344 (1993).

89. See *supra* note 54 and accompanying text.

90. See, e.g., *Auerbach v. Bennett*, 393 N.E.2d 994, 998 (N.Y. 1979) (involving a derivative suit against directors for breach of fiduciary duty). In *Auerbach*, the plaintiff shareholder contended that “any committee authorized by the board of which defendant directors were members must be held legally infirm.” *Id.* at 1001.

91. *Westgor v. Grimm*, 318 N.W.2d 56, 59 (Minn. 1982) (plaintiff alleged controlling shareholders “breached their fiduciary duties to the corporation by failing to assert a claim against [the corporation’s] former attorney”).

92. *Seitz v. Michel*, 148 Minn. 80, 87, 181 N.W. 102, 105 (1921).

93. *Lake Harriet State Bank v. Venie*, 138 Minn. 339, 347, 165 N.W. 225, 229 (1917) (stating that corporate directors “are liable to the corporation for any losses resulting from . . . neglect of duty”); *Horn Silver Mining Co. v. Ryan*, 42 Minn. 196, 198-

for a usurpation of corporate opportunity⁹⁴ or effects rescission of a transaction tainted by self-dealing.⁹⁵ Just as the claim belongs to the corporation, so too does the relief.

There are some exceptions, however. In rare cases, courts have ordered that dividends be paid out to shareholders from the funds recovered by the corporation.⁹⁶ Such an order intrudes into the core of directors' discretion and reflects a judicial determination that dividends have been or will be withheld for unlawful reasons.⁹⁷ As the Minnesota Supreme Court explained:

While it is true that the courts cannot ordinarily compel a corporation to declare a dividend at the suit of minority stockholder, yet it is not to be doubted that where dividends are withheld for an unlawful purpose—to deprive a particular stockholder of his rights—he may have the aid of equity for adequate protection.⁹⁸

99, 44 N.W. 56, 56 (1889) (ruling that “directors of a moneyed corporation . . . are . . . liable if they suffer the corporate funds or property to be lost or wasted by gross negligence and inattention to the duties of their trust”).

94. *Klinicki v. Lundgren*, 678 P.2d 1250, 1254 (Or. Ct. App. 1984) (holding that a constructive trust is an appropriate remedy in a derivative suit where defendants wrongfully usurped a corporate opportunity), *aff'd*, 695 P.2d 906 (Or. 1985). Several Minnesota cases assert the principle that if “a business opportunity is usurped for personal gain, . . . the opportunity and any property or profit acquired becomes subject to a constructive trust for the benefit of the corporation.” However, these cases found no usurpation. See *Miller v. Miller*, 301 Minn. 207, 219-20, 222 N.W.2d 71, 78 (1974); *Diedrick v. Helm*, 217 Minn. 483, 493, 14 N.W.2d 913, 919 (1944); *Boxrud v. Ronning Mach. Co.*, 217 Minn. 518, 520, 15 N.W.2d 112, 114 (1944).

95. *Shaw v. Staight*, 107 Minn. 152, 157-58, 119 N.W. 951, 953 (1909) (ordering the defendant directors to rescind the transfer of stock to another director, where the transfer had been made in exchange for worthless assets).

96. See, e.g., *Crowley v. Communications for Hosps., Inc.*, 573 N.E.2d 996, 1006 (Mass. App. Ct. 1991) (holding trial court erred in ordering direct relief to minority shareholder for misappropriated corporate funds and instead ordering majority shareholders to declare a dividend once misappropriated funds were returned to the corporation), *petition for review denied*, (Mass. July 30, 1991).

97. See *Dodge v. Ford Motor Co.*, 170 N.W. 668, 682 (Mich. 1919). This classic case first notes that the decision whether to declare dividends is at the core of the directors' discretion, but then adds:

[I]t is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others, and no one will contend that, if the avowed purpose of the defendant directors [is] to sacrifice the interests of shareholders, it would not be the duty of the courts to interfere.

Id. at 684.

98. *Keough v. St. Paul Milk Co.*, 205 Minn. 96, 121, 285 N.W. 809, 823 (1939) (internal quotation marks omitted) (quoting *Anderson v. W. J. Dyer & Bro.*, 94 Minn.

Sometimes the same rationale leads courts to provide direct, individual recovery in a derivative suit.⁹⁹ As the court explained in *Backus v. Finkelstein*:¹⁰⁰

For obvious reasons, it may be highly improper to direct that the moneys here recovered on behalf of the corporation shall be paid into the treasury thereof. That might be paying the moneys back into the custody and control of those from whom the recovery is had. It might defeat effectually the purpose of the suit and be the beginning of another prolonged cycle of litigation.¹⁰¹

Perlman v. Feldmann reflects a variation on that theme.¹⁰² Minority shareholders brought a derivative action against the majority shareholder who had sold his control block at a premium.¹⁰³ The corporation manufactured steel, and the stock sale occurred during the Korean War.¹⁰⁴ Steel was in short supply, and the government had imposed price controls.¹⁰⁵ The majority shareholder sold his stock to a consortium of steel users, who were then able to control to their benefit the allocation of the corporation's steel production.¹⁰⁶ Due to the price controls, the corporation lost no money. It did,

30, 35, 101 N.W. 1061, 1062 (1904)).

99. *Lynch v. Patterson*, 701 P.2d 1126, 1130-31 (Wyo. 1985) (ordering direct recovery because corporate recovery would simply return funds to the control of the wrongdoers and would risk necessitating a subsequent suit by minority shareholders to compel directors to declare dividend); *Backus v. Finkelstein*, 23 F.2d 357, 366 (D. Minn. 1927) (ordering the appointment of a trustee to act under the direction of the court and receive the funds recovered from the defendants and disburse those funds among the plaintiffs and others who prove that they are within the same class as the plaintiffs). *But see Crowley*, 573 N.E.2d at 1004 (holding the "finding of a 'freeze out' scheme may well be an element of a case for direct relief, but it is not necessarily sufficient to preclude the need for derivative relief"); *Wilderman v. Wilderman*, 315 A.2d 610 (Del. Ch. 1974) (derivative action to recover excess compensation received by defendant as president of corporation and direct action to compel payments of dividends; defendant ordered to repay excess compensation and the decision whether to pay dividends out of reconstructed net profits of the corporation left to the board of directors, which the defendant president still dominated).

100. 23 F.2d 357 (D. Minn. 1927).

101. *Id.* at 366 (applying South Dakota law in a derivative suit, ordering rescission of stock sale and return of dividends and providing that the recaptured funds be paid to the plaintiffs directly).

102. *Perlman v. Feldmann*, 219 F.2d 173 (2nd Cir. 1955), *cert. denied*, 349 U.S. 952 (1955).

103. *Id.* at 174.

104. *Id.* at 175.

105. *Id.*

106. *Id.*

however, lose the opportunity to build goodwill by strategically allocating its product during a time of shortage.¹⁰⁷ To the extent the stock sale premium reflected this diversion of a corporate opportunity, the selling stockholder was liable for a breach of fiduciary duty.¹⁰⁸ A corporate recovery would not have benefitted the selling shareholder—i.e., “those from whom the recovery is had”—but would have benefitted the parties who had induced the very breach that occasioned the recovery.¹⁰⁹ The court accordingly ordered direct relief to the minority shareholders.¹¹⁰

Direct recovery cases are rare, however, and those that exist have been criticized on the grounds that individual recovery impairs the rights of creditors and other shareholders.¹¹¹ In *Interlake Porsche & Audi, Inc. v. Buchholz*,¹¹² for example, the court refused to award individual recovery stating that “creditors’ rights would be prejudiced by a direct recovery.”¹¹³

Even though the derivative plaintiff rarely gains a direct benefit from a successful derivative claim, the same cannot be said of the plaintiff’s attorney. Since the attorney’s actions have created a fund to the benefit of the corporation, the “common fund” theory mandates that the attorney’s reasonable fees and expenses be paid from that fund.¹¹⁴ The court will thus order payment where the shareholder prevails in a derivative action that confers a substantial benefit on the corporation.¹¹⁵ A

107. *Id.* at 177.

108. *Id.* at 177-78.

109. *Id.* at 178.

110. *Id.* at 180.

111. *See, e.g.*, *Glenn v. Hoteltron Sys., Inc.*, 547 N.E.2d 71, 74 (N.Y. 1989) (rejecting any special consideration for close corporations and explaining that, “[w]hile awarding damages directly to the innocent shareholder may seem equitable with respect to the parties before the court, other interests, particularly those of the corporation’s creditors should not be overlooked.”).

112. 728 P.2d 597 (Wash. Ct. App. 1986), *petition for review denied*, (Wash. Jan. 6, 1987).

113. *Id.* at 609. The court, however, recognized that the defendant, “as a shareholder, would profit from his wrongdoing if the corporation recovered the judgment amount.” *Id.* The court therefore compromised, appointing the plaintiff-shareholder as trustee for the corporation and its creditors and shareholders. *Id.*

114. *See* BJUR & SOLHEIM, *supra* note 44, § 6045, at 363.

115. *Bosch v. Meeker Coop. Light & Power Ass’n*, 257 Minn. 362, 365, 101 N.W.2d 423, 426 (1960) (remanding the case to determine whether or not the finding that the managing officers acted unreasonably resulted in a substantial benefit to the corporation); *In re* Dissolution of E. C. Warner Co., 232 Minn. 207, 45 N.W.2d 388

“substantial benefit” means an outcome that “corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder’s interests.”¹¹⁶ Sometimes the attorney’s recovery seems the most remarkable outcome of the litigation.¹¹⁷

III. THE DERIVATIVE DISADVANTAGES: BARRIERS TO RECOVERY

A plaintiff in a derivative case faces at least four significant disadvantages when compared with a plaintiff in a direct case: the procedural strictures of Rule 23.06, including the demand requirement; the potentially dispositive report of a special litigation committee; the protective presumption of the business judgment rule; and the difficulties, already discussed, of gaining something from a litigation victory.¹¹⁸ In addition, derivative plaintiffs may face troubles with indemnification obligations and exculpatory provisions that arguably ought not bedevil direct plaintiffs.

A. *The Procedural Strictures of Rule 23.06*

Rule 23.06 of the Minnesota Rules of Civil Procedure imposes three procedural requirements on would-be derivative plaintiffs: (1) the “contemporaneous ownership” requirement; (2) the “adequate representation” requirement; and (3) the

(1950); *Eriksson v. Boyum*, 150 Minn. 192, 184 N.W. 961 (1921); *Black v. NuAire, Inc.* 426 N.W.2d 203, 211-13 (Minn. Ct. App. 1988) (holding partial attorneys’ fees were properly awarded where derivative action provided impetus for rescission of key executive’s deferred compensation agreement), *petition for review denied*, (Minn. Aug. 24, 1988).

116. *Bosch*, 257 Minn. at 366-67, 101 N.W.2d at 427.

117. For example, in 1988, shareholders of First Bank System, Inc., commenced a derivative suit against the directors and officers of the bank claiming negligence in the management of the bank’s bond portfolio. Two years later the case settled, with the directors’ and officers’ liability insurer paying approximately \$2.1 million, of which \$1.1 million was allocated to attorney’s fees and expenses. Neal St. Anthony, *Settlement of FBS Shareholders’ Suit OK’d; Legal Fees Cut*, STAR TRIB. (Minneapolis), Aug. 4, 1990, at 1D. The recovery to the corporation amounted to less than 1.3 cents per outstanding share of common stock. *Form 10-K Yearly Report of First Bank System, Inc.*, Dec. 31, 1990, available in LEXIS, Fedsec Library, 10-K File (stating that for the fourth quarter of 1990, First Bank had an average 76,964,065 shares outstanding). The availability of attorney’s fees is one area in which the derivative plaintiff has an advantage over the direct plaintiff. The latter can recover attorney’s fees only in extraordinary situations. See *supra* note 48 and accompanying text.

118. See *supra* notes 111-17 and accompanying text.

demand requirement.¹¹⁹ Under the contemporaneous ownership requirement, "the [derivative] complaint shall allege that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law."¹²⁰ The requirement prevents individuals from purchasing shares of stock solely for the purpose of bringing a derivative action.¹²¹

The "adequate representation" requirement protects the interests of shareholders not personally involved in the derivative litigation. A decision on the merits will be *res judicata* and will preclude any further derivative litigation on the same claims.¹²² Therefore, "[t]he derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interest of the shareholders . . . similarly situated in enforcing the right of the corporation."¹²³ The fact that a

119. The rule states:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall allege that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interest of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

MINN. R. CIV. P. 23.06.

120. *Id.*

121. EDWARD BRODSKY & M. PATRICIA ADAMSKI, *LAW OF CORPORATE OFFICERS AND DIRECTORS - RIGHTS, DUTIES AND LIABILITIES*, § 9:03, at 9-9 (1995). The contemporaneous ownership requirement may also apply to direct actions. See *PJ Acquisition Corp. v. Skoglund*, 453 N.W.2d 1, 6 n.12 (Minn. 1990) (suggesting that shareholder in a direct action must have owned shares at the time of the alleged wrongdoing). At least one commentator appears to have so assumed. Joseph E. Olson, *A Statutory Elixir for the Oppression Malady*, 36 *MERCER L. REV.* 627 (1985). Indeed, this position seems inevitable because a direct claimant must assert a direct injury suffered as a shareholder in order to have a claim.

122. *BJUR & SOLHEIM, supra* note 44, § 5959, at 124.

123. MINN. R. CIV. P. 23.06.

plaintiff owns a minimal number of shares does not necessarily prevent that shareholder from providing fair and adequate representation.¹²⁴ However, a shareholder who is pursuing direct claims may be an inadequate representative in a simultaneous derivative suit.¹²⁵

The demand requirement, the most substantial of Rule

124. See *Lewis v. Curtis*, 671 F.2d 779, 788 (3rd Cir. 1982) (holding that plaintiff who owned 100 of the nearly eight million shares in the defendant corporation fairly and adequately represented the other shareholders), *cert. denied*, 459 U.S. 880 (1982). In *March v. Miller-Jesser, Inc.*, 559 N.E.2d 844 (Ill. App. Ct. 1990), the court held that:

Precluding a single shareholder from pursuing a derivative claim merely because other shareholders do not seek to enforce the same rights would frustrate the fundamental purpose of a derivative action, which is to remedy a wrong to the corporation in cases where the corporation itself . . . refuses to take appropriate action for its own protection.

Id. at 851. See also *Larson v. Dumke*, 900 F.2d 1363, 1369 (9th Cir. 1990) (holding that shareholder owning 23.41% of the stock was an adequate representative), *cert. denied*, 498 U.S. 1012 (1990). See generally COX ET AL., *supra* note 13, § 15.11, at 15.99-101 (discussing minority shareholder plaintiff as an adequate representative); Mary E. Matthews, *Derivative Suits and the Similarly Situated Shareholder Requirement*, 8 DEPAUL BUS. L.J. 1, 36 (1995) (stating that "[i]f Rule 23.1 is interpreted to bar a derivative suit by a single shareholder, a shareholder objecting to blatant self-dealing or waste by corporate management would have no relief if similarly situated shareholders simply failed to exist, or were willing to suffer the corporate injury"). *But see* *Smith v. Ayres*, 977 F.2d 946, 948 (5th Cir. 1992) (holding that "[o]nly in the rarest instances may there be a shareholder derivative action with a class of one"), *cert. denied*, 508 U.S. 910 (1993); *Kuzmickey v. Dunmore Corp.*, 420 F. Supp. 226, 230-31 (E.D. Pa. 1976) (holding that a plaintiff who owned 16% of a corporation's outstanding shares did not fairly and adequately represent the interests of other similarly situated shareholders where the remaining shareholders contended that plaintiff did not represent their interests).

125. See *Smith*, 977 F.2d at 949 (stating that a court "should beware allowing a derivative suit to proceed where the 'representative could conceivably use the derivative action as "leverage" in other litigation . . .") (quoting *Blum v. Morgan Guar. Trust Co.*, 539 F.2d 1388, 1390 (5th Cir. 1976)); *First Am. Bank & Trust v. Frogel*, 726 F. Supp. 1292, 1298 (S.D. Fl. 1989) (holding that "the conflict in bringing both a derivative and class action is theoretical rather than real" and that no actual conflict existed between the derivative action and the class action); *Ruggiero v. American Bioculture, Inc.*, 56 F.R.D. 93, 95 (S.D.N.Y. 1972) (holding that a plaintiff could not bring both a class action and a derivative action); *Keyser v. Commonwealth Nat'l Fin. Corp.*, 120 F.R.D. 489, 492 (M.D. Pa. 1988) (holding that "the theoretical distinction between individual and derivative stockholder suits. . . is just that, a theoretical one, not rooted in the realities of most individual and derivative suits, which usually are 'equally contingent upon the proof of the same nucleus of facts'") (quoting *Bertozzi v. King Louie Int'l, Inc.*, 420 F. Supp. 1166, 1180 (D.R.I. 1976)); *Schupack v. Covelli*, 512 F. Supp. 1310 (W.D. Pa. 1981) (holding that defendants had failed to establish conflict). The cases finding no conflict tend to involve plaintiffs who have brought both derivative and class action direct suits. *Cf.* COX ET AL., *supra* note 13, § 15.11, at 15.99-100 (stating that "smallness of the plaintiff's holdings may well confirm the court's belief that the plaintiff is seeking to serve a distinct and private agenda through the derivative suit").

23.06's procedural hurdles, protects the primacy of the board of directors in managing the corporation.¹²⁶ A would-be plaintiff must try "to obtain the desired action from the directors or comparable authority" before going to court, or be able to establish that such efforts would have been futile.¹²⁷ This requirement affords "the management of the corporation an opportunity to consider the merits of the dispute and to determine, in the interests of the corporation and shareholders, whether it might be disposed of without the expense and delay of litigation."¹²⁸ That opportunity is meaningless and demand is excused when the alleged wrongdoers control the board of directors.¹²⁹

The decision whether to make demand is a crucial one for the derivative plaintiff. If the plaintiff omits demand and a court

126. COX ET AL., *supra* note 13, § 15.7, at 15.58.

127. The derivative complaint must "allege with particularity the efforts, if any, made by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort." MINN. R. CIV. P. 23.06. Under Minnesota law, the standard for establishing demand futility is uncertain. No case has articulated a specific, all-embracing standard. *Winter v. Farmers Educ. & Coop. Union*, 259 Minn. 257, 107 N.W.2d 226 (1961), comes closest, stating that "[o]rdinarily a demand should be made on the board of directors unless the wrongdoers constitute a majority of the board." *Id.* at 266-67, 107 N.W.2d at 233. In most cases the courts have seemed to consider the futility to be self-evident, and so the courts have seen no need to state a general rule. See cases cited *infra* note 129.

128. *Winter*, 259 Minn. at 267, 107 N.W.2d at 233.

129. See *Savory v. Berkey*, 212 Minn. 1, 6, 2 N.W.2d 146, 148 (1942) (holding that demand would have been futile where defendants owned a majority of stock in the corporation); *Weiland v. Northwestern Distilleries, Inc.*, 203 Minn. 600, 281 N.W. 364 (1938) (holding that demand was futile in case alleging that the corporation's general manager/president had through fraud and misrepresentation obtained sufficient stock to give him majority control); *Meyers v. Smith*, 190 Minn. 157, 159, 251 N.W. 20, 21 (1933) (holding, in an action brought by a minority shareholder against two directors to recover misappropriated corporate funds, that "it would be futile to ask or attempt to have [the two controlling directors] bring an action against themselves, by the corporation"); *Tasler v. Peerless Tire Co.*, 144 Minn. 150, 153, 174 N.W. 731, 732 (1919) (holding that "[a]n application to [the majority shareholders] to bring suit against themselves would be futile and such application is not required"); *National Power & Paper Co. v. Rossman*, 122 Minn. 355, 142 N.W. 818, 821-22 (1913) (holding that demand is futile where directors had already moved to dismiss the suit the intervenor shareholders were seeking to have reinstated). Demand is also excused where the board has ceased to function. *Winter*, 259 Minn. at 266-68, 107 N.W.2d at 233-43 (holding that where the corporation, although a legal entity, was nevertheless a loose nonstock cooperative without salaried officers or employees and for many years had been inactive and neglected, it would be unrealistic to require the same demand as would be expected in the case of the ordinary business corporation).

later determines that demand was required, the plaintiff loses.¹³⁰ If plaintiff makes demand, much time can be lost while the board studies the matter. Moreover, if the board decides to pursue the claim, the corporation will seek to control any further proceedings, thereby removing the would-be plaintiff from any further significant participation.¹³¹ Only if the board rejects the demand does the plaintiff obtain, albeit somewhat belatedly, what it wanted in the first place—i.e., the opportunity to assert aggressively the interests of the corporation.¹³²

B. *The Special Litigation Committee*

Regardless of whether the derivative plaintiff initially makes a demand, these days any derivative suit is likely to encounter a special litigation committee (SLC).¹³³ An SLC is a committee of the board of directors, consisting only of disinterested individuals and charged with the authority to investigate the alleged misconduct and to determine whether the best interests of the corporation warrant pursuing or eschewing litigation.¹³⁴ Committee members need not be members of the board,¹³⁵

130. See *Grobow v. Perot*, 539 A.2d 180, 192 (Del. 1988) (dismissing suit for failure to make demand because plaintiffs failed to plead particular facts sufficient to show directors were disinterested); *Bazata v. National Ins. Co.*, 400 A.2d 313, 316 (D.C. 1979) (finding that previous dismissal for failure to make required demand barred subsequent derivative suit; determination is on the merits and thus *res judicata* applies).

131. COX ET AL., *supra* note 13, § 15.7, at 15.57. A would-be plaintiff might reasonably wonder how assiduously the board might investigate and how zealously the board might pursue a remedy. Moreover, plaintiff's counsel might have mercenary reasons for disliking this outcome. See *supra* text accompanying notes 114-17 (discussing how plaintiff's counsel can recover attorney's fees).

132. Under Delaware law the making of a demand almost dooms any subsequent derivative claim. To make demand is to admit that demand was required. *Spiegel v. Buntrock*, 571 A.2d 767, 775 (Del. 1990) ("By making a demand, a stockholder tacitly acknowledges the absence of facts to support a finding of futility."). In demand-required cases, Delaware law gives great deference to the board's determination that the lawsuit does not serve the corporation's best interest. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 n.10 (Del. 1981) (holding that in demand-required cases, the business judgment rule applies to a board decision to seek dismissal). There is no comparable Minnesota authority and no parallel Minnesota rule.

133. If a would-be plaintiff makes a demand, the corporation may well establish an SLC at that time. Otherwise, the corporation will establish an SLC once suit is filed. See App. B.

134. COX ET AL., *supra* note 13, § 15.8.

135. MINN. STAT. §§ 302A.241, subd. 1 (referring to committees, including specifically special litigation committees), subd. 2 (stating generally that "[c]ommittee members shall be natural persons . . . who need not be directors"). In discharging their responsibilities, committee members have the same fiduciary duties and

and often are not.¹³⁶

An SLC has no power to terminate a derivative suit by itself, so an SLC's efficacy and impact depends on how much the court defers to the SLC's determination. That issue, as well as the status of SLCs generally, has had an eventful history under Minnesota law.

As originally enacted, the Minnesota Business Corporation Act contained a provision focussing exclusively on special litigations committees, authorizing their use and mandating judicial deference to their determinations. Minnesota Statute section 302A.243 provided:

Unless prohibited by the articles or bylaws, the board may establish a committee composed of two or more disinterested directors or other disinterested persons to determine whether it is in the best interests of the corporation to pursue a particular legal right or remedy of the corporation and whether to cause the dismissal or discontinuance of a particular proceeding that seeks to assert a right or remedy on behalf of the corporation. For purposes of this section, a director or other person is "disinterested" if the director or other person is not the owner of more than one percent of the outstanding shares of, or a present or former officer, employee, or agent of, the corporation or of a related corporation and has not been made or threatened to be made a party to the proceeding in question. The committee, once established, is not subject to the direction or control of, or termination by, the board. A vacancy on the committee may be filled by a majority vote of the remaining members. The good faith determinations of the committee are binding upon the corporation and its directors, officers, and shareholders. The committee terminates when it issues a written report of its determination to the board.¹³⁷

In 1988, the Minnesota Court of Appeals applied section

protections as directors. *Id.* at subd. 7 (deeming committee members to be directors for the purposes of the statutes relating to director standard of conduct, director conflicts of interest and indemnification).

136. *See, e.g.,* Skoglund v. Brady, 541 N.W.2d 17, 19 (Minn. Ct. App. 1995) (explaining that the committee member selected had no "prior relationship with [the corporation], its directors, or [the plaintiff-shareholder]"), *petition for review denied*, (Minn. Feb. 27, 1996); Alford v. Shaw, 349 S.E.2d 41, 54 (N.C. 1986) (stating that defendant corporation had asked the President of the North Carolina Bar Association to recommend two persons "who [had] never been associated in any way with the Company or any of its affiliates' to serve as [committee] members.").

137. 1982 Minn. Laws ch. 497, § 28.

302A.243 in *Black v. NuAire, Inc.*,¹³⁸ a derivative action brought by a minority shareholder of a close corporation.¹³⁹ The suit challenged a number of transactions undertaken by the majority shareholders,¹⁴⁰ and the corporation established an SLC to review these actions.¹⁴¹ The committee found that "only one charge . . . appears to hold out the prospect of significant benefit to the corporation if its damage allegation are borne out."¹⁴² The committee recommended that the suit be dismissed if the arrangement giving rise to that charge was rescinded.¹⁴³

The trial court accepted the SLC's recommendation and dismissed the suit.¹⁴⁴ The plaintiff-shareholder appealed, challenging the trial court's refusal to review the propriety of the committee's decision and claiming *inter alia* that the trial court's application of section 302A.243 deprived him of property without due process of law.¹⁴⁵ The court of appeals affirmed the trial court's decision, finding that the shareholder's constitutional arguments were without merit.¹⁴⁶ Then the court applied section 302A.243 and held that, where an SLC is truly disinterested and has conducted its investigation in good faith, its recommendation to dismiss a shareholder derivative suit is not subject to judicial second-guessing.¹⁴⁷

The next year, in reaction to *NuAire*, the Minnesota

138. 426 N.W.2d 203 (Minn. Ct. App. 1988), *petition for review denied*, (Minn. Aug. 24, 1988).

139. *Id.* at 209.

140. *Id.* at 206.

141. *Id.*

142. *Id.* The committee believed that a deferred compensation agreement with one of NuAire's directors had a "definite damage potential." *Id.*

143. *Id.* at 207.

144. *Id.*

145. *Id.* at 208-09.

146. *Id.* at 209-10.

147. *Id.* The court of appeals expressly declined to apply the rule adopted by the Iowa Supreme Court in *Miller v. Register & Tribune Syndicate, Inc.*, 336 N.W.2d 709 (Iowa 1983). *NuAire*, 426 N.W.2d at 210 n.3. In *Miller*, the court virtually presumed structural bias on the part of any SLC appointed by directors who are parties to the derivative action. *Miller*, 336 N.W.2d at 718. The *Miller* "court therefore adopted a prophylactic rule prohibiting directors charged with misconduct from participating in the selection process. When a majority of directors are parties to the action, the corporation is required to apply to the court for appointment of a 'special panel' to investigate" the derivative claims and to recommend whether the shareholder derivative action should be pursued or dismissed. *NuAire*, 426 N.W.2d at 210 n.3 (construing *Miller*, 336 N.W.2d at 718).

Legislature repealed section 302A.243. However, in a manner reminiscent of Ron Ziegler's non-denial denials,¹⁴⁸ the legislature sought to undercut the meaning of its action.¹⁴⁹ The repeal legislation included the following language:

[T]he repeal of Minnesota Statutes, section 302A.243, does not imply that the legislature has accepted or rejected the substance of the repealed section but must be interpreted in the same manner as if section 302A.243 had not been enacted.¹⁵⁰

In addition, the legislature simultaneously amended Minnesota Statutes section 302A.241, relating generally to board committees, to expressly authorize special litigation committees.¹⁵¹ As then amended (and as now in effect), that provision reads in pertinent part:

A resolution approved by the affirmative vote of a majority of the board may establish committees having the authority of the board in the management of the business of the corporation only to the extent provided in the resolution. *Committees may include a special litigation committee consisting of one or more independent directors or other independent persons to consider legal rights or remedies of the corporation and whether those rights and remedies should be pursued.*¹⁵²

Until 1995, it was unclear how the legislature's 1989 action had affected SLCs in general and the *NuAire* holding in particular. In 1995, in *Skoglund v. Brady*, the court of appeals clarified matters.¹⁵³

Skoglund involved a derivative action against the corporation and its board of directors.¹⁵⁴ The plaintiff-shareholder objected to building and equipment leases authorized by the board, promissory notes issued and bonuses paid to two directors, and the issuance and sale of additional stock in exchange for

148. Ron Ziegler was White House press secretary during the Watergate scandal. As the cover-up began to unravel, Ziegler tried to repel the increasing barrage of allegations by issuing vehement denials that, upon further scrutiny, revealed themselves as not precisely denying the key parts of the allegations. CARL BERNSTEIN & BOB WOODWARD, *ALL THE PRESIDENT'S MEN* 162-69, 185 (Touchstone 2d ed. 1994) (1974).

149. See 1989 Minn. Laws ch. 172, § 12.

150. *Id.*

151. *Id.* § 5.

152. MINN. STAT. § 302A.241, subd. 1 (1994) (emphasis added).

153. *Skoglund v. Brady*, 541 N.W.2d 17 (Minn. Ct. App. 1995), *petition for review denied*, (Minn. Feb. 27, 1996).

154. *Id.* at 19.

forgiveness of debt owed to one director.¹⁵⁵ The suit alleged breach of fiduciary duties, usurped corporate opportunities, waste and fraud.¹⁵⁶

The corporation's board of directors appointed a special litigation committee consisting of one attorney who had no prior relationship with the corporation or its directors.¹⁵⁷ The committee concluded that, although the board had not obtained "safe harbor" authorization for the leases, promissory notes, or forgiveness of debt, the corporation was not damaged by these actions.¹⁵⁸ The committee did find corporate waste in the issuance of additional shares at one-half the stock's value.¹⁵⁹ The committee, however, recommended against pursuing the corporate waste claim in light of the expenses associated with the litigation.¹⁶⁰ Nonetheless, the involved director offered to rescind the stock purchase and the corporation accepted the offer.¹⁶¹

The district court dismissed the plaintiff's derivative suit, holding that the special litigation committee was independent and had conducted its investigation in good faith.¹⁶² On appeal, the plaintiff argued that the repeal of section 302A.243 had changed the judiciary's role vis-à-vis SLCs. The plaintiff asserted that the court should more strictly scrutinize the

155. *Id.*

156. *Id.* The suit initially contained direct claims as well. The corporation's board of directors appointed an SLC consisting of the lead author of this article to examine the derivative claims. Because the direct and derivative claims overlapped and because disposing of the derivative claims would have been fruitless if the direct claims had remained in place, the committee declined to proceed. It recommended instead that the corporation ask the trial court promptly to determine whether the plaintiff had a right to bring direct claims or rather was limited to a derivative suit. The corporation followed that recommendation, and the trial court dismissed the direct claims. *Id.* The court of appeals affirmed that dismissal. *Id.* at 22. See *infra* notes 163-64. Following the trial court's dismissal of the direct claims, the corporation appointed a new SLC to investigate the derivative claims.

157. *Skoglund*, 541 N.W.2d at 19.

158. *Id.*

159. *Id.*

160. *Id.*

161. Memorandum of Nominal Defendant, Instrumentation Services, Inc. in Support of Motion to Dismiss Derivative Claims at 3, *Skoglund v. Brady*, No. 92-011833 (Hennepin County Dist. Ct. April 7, 1995).

162. *Skoglund*, 541 N.W.2d at 19. The district court dismissed the plaintiff's direct claims on the grounds that "[the plaintiff] did not allege injury to himself that was separate and distinct from the an injury to the corporation." See *infra* note 248 and accompanying text.

independence of the SLC and should conduct a substantive review of the SLC's decision.¹⁶³ The court of appeals rejected these arguments, holding instead that the district court had properly limited its review to determining whether the SLC was independent and had conducted its review in good faith.¹⁶⁴ In essence, *Skoglund* reaffirmed *NuAire*.

That is a good result, since special litigation committees are a form of alternative dispute resolution. They sift facts and make recommendations in the shadow or context of litigation proceedings,¹⁶⁵ but they do not directly consume court resources and are not laden with all the procedural paraphernalia of litigation. From the corporation's perspective, they represent an opportunity to have a business dispute evaluated by one or more disinterested individuals with relevant background and expertise, who will have in mind not only abstract concepts of fairness but also the rough and tumble exigencies of running a business. Moreover, as recognized by the court of appeals, an SLC helps a corporation deal with disgruntled individual plaintiffs who seek to make personal gain out of a corporate concern: "The purpose . . . is to grant corporations the ability to respond effectively to potential abuses of strike suits, in which a single dissenting shareholder, owning only one share of stock, may file a derivative suit for its nuisance value alone."¹⁶⁶

From the plaintiff's perspective, in contrast, special litigation committees are an anathema, hand-picked by the board and possessed of at least structural bias.¹⁶⁷ SLCs do most often

163. *Skoglund*, 541 N.W.2d at 21.

164. *Id.*

165. They operate in the shadow of such proceedings when investigating a pre-suit demand. They operate in the context of such proceedings when they investigate following the filing of suit. See *supra* text accompanying note 134 and *infra* App. B.

166. *Black v. NuAire, Inc.*, 426 N.W.2d 203, 208 (Minn. Ct. App. 1988), *petition for review denied*, (Minn. Aug. 24, 1988).

167. Consider, for example, the vitriolic response of counsel for the plaintiff in *Skoglund* when informed that the corporation had appointed an SLC. That attorney not only refused to cooperate in any respect with the committee but also threatened to sue the committee's sole member. Letter from James H. Kaster to Daniel S. Kleinberger (June 10, 1993) (stating that "if you are intent on acting to interrupt this litigation, I may pursue litigation based on the personal liability you have assumed"). The SLC eventually declined to evaluate the derivative claims pending a court determination as to whether the plaintiff had standing to bring direct claims. See *supra* note 156. The court ruled that the plaintiff had no such standing, and the corporation then appointed a new special litigation committee, with a different member. That SLC eventually recommended dismissal, the trial court accepted the recommendation and the court

recommend against proceeding with a lawsuit,¹⁶⁸ but such recommendations are sometimes coupled with some recovery for the corporation. In *Skoglund*, for example, the SLC objected to the stock purchase, and the defendant director voluntarily rescinded the purchase.¹⁶⁹ In *NuAire*, the SLC recommended dismissal only if the parties reversed the one arrangement even arguably objectionable.¹⁷⁰

In any event, the special litigation committee constitutes a significant barrier to a derivative suit that is totally absent in a suit properly alleging direct claims.

of appeals affirmed. See *supra* text accompanying notes 157-64.

For a less assaultive but still impassioned opposition to SLCs, see Joseph W. Anthony & Karlyn Vegoe Boraas, *Minority Shareholder Rights—Revisited*, HENNEPIN LAW., Mar.-Apr. 1996, at 20, 22-23. For a critique of the Anthony-Boraas view, see Daniel S. Kleinberger, HENNEPIN LAW., May-June 1996, at 25 (Professor Kleinberger's letter to the editor). See also Joseph W. Anthony, *Betrayed, Belittled . . . But Triumphant: Claims of Shareholders in Closely Held Business*, 22 WM. MITCHELL L. REV. 1173, 1195-1197 (1996) (accompanying article in this symposium issue).

The Iowa Supreme Court shares at least some of this skepticism to SLCs. In *Miller v. Register & Tribune Syndicate, Inc.*, 336 N.W.2d 709 (Iowa 1983), the court saw a danger of

structural bias on the part of a litigation committee appointed by directors who are parties to derivative actions. The court therefore adopted a prophylactic rule prohibiting directors charged with misconduct from participating in the selection process. When a majority of directors are parties to the action, the corporation is required to apply to the court for appointment of a "special panel" to investigate and report on the pursuit or dismissal of a shareholder derivative action.

NuAire, 426 N.W.2d at 210 n.3 (quoting *Miller*, 336 N.W.2d at 718). For a while, even the Delaware courts flirted with this skepticism. See *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1981) (holding that, when demand is excused as futile, the court must not only require the SLC to establish good faith and reasonable investigation but may also exercise its own business judgment as to the wisdom of the SLC's recommendation). But see *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984); *Grobow v. Perot*, 539 A.2d 180 (Del. 1988) (making demand futility extremely difficult to establish and thereby substantially undercutting the impact of the *Zapata* rule); *Kaplan v. Wyatt*, 499 A.2d 1184, 1192 (Del. 1985) (holding that the trial court has the discretion to decline to judge the wisdom of the SLC's recommendation).

168. See Robert P. Mulvey, Note, *Special Litigation Committees - An Expanding and Potent Threat to Shareholder Derivative Suits*, 2 CARDOZO L. REV. 169, 170 (1980).

169. See *supra* text accompanying note 161.

170. See *supra* text accompanying notes 138-43.

C. *The Business Judgment Rule*

A cornerstone of corporation law,

[t]he "business judgment" rule is an impediment to any plaintiff who attacks the performance of business managers In its strongest form, the rule requires courts to defer almost completely to managers' exercise of business judgment, and it immunizes managers from liability unless the complainant can show dishonesty, disloyalty, a total failure to exercise judgment, or judgment so bad that it amounts to waste. The strong version of the business judgment rule virtually eliminates any enforceable duty of care. Moreover, the rule presumes that the managers have acted properly. In its milder version, the business judgement rule includes the presumption but adds something of a duty of care.¹⁷¹

Minnesota certainly honors the business judgment rule, although the state has a somewhat schizoid approach to the rule's power over duty of care claims. A 1948 Minnesota Supreme Court opinion stated the rule in its most aggressive form:

In a derivative suit, absent clear allegations of facts constituting fraud or collusion, plaintiff must allege facts which show that the action attacked is so far opposed to the true interests of the corporation as to lead to the clear inference that no officer thus acting could have been influenced by any honest desire to secure such interests, but that he must have acted with intent to subserve some ulterior purpose, regardless of the consequences to his corporation and in a manner inconsistent with its interest The law does not justify recovery in representative suits for mere errors of judgment in handling corporate affairs.¹⁷²

A 1917 opinion, in contrast, reflects the milder approach:

The directors of a corporation occupy a fiduciary relation to it which imposes upon them the duty to . . . exercise ordinary business care and diligence to see that its property is not wasted nor taken from it upon unfounded claims [If

171. BISHOP & KLEINBERGER, *supra* note 1, ¶ 10.05[1], at 10-41. The rule has a sensible rationale, recognizing "that business decision-making is not an exact science and that a regime of strict liability would chill innovation, deter risk-taking and discourage competent individuals from serving." *Id.* Moreover, the rule's "presumption in favor of managers merely reflects the law's general requirement that plaintiffs prove the elements of their case." *Id.*

172. Warner v. E. C. Warner Co., 226 Minn. 565, 573, 33 N.W.2d 721, 726 (1948).

they breach this duty] they are liable to the corporation for any losses resulting from such misuse of authority or neglect of duty.¹⁷³

The corporate statute also reflects the milder approach, requiring each director to "discharge the duties of the position of director . . . with the care an ordinarily prudent person in a like position would exercise under similar circumstances."¹⁷⁴

In any event, whichever version of the business judgment rule exists in Minnesota, the rule clearly applies in derivative litigation and constitutes a serious obstacle to any derivative plaintiff.¹⁷⁵ In contrast, the business judgment rule plays no role with direct claims made within a Minnesota close corporation. Minnesota's leading close corporation cases have featured egregious conduct and overwhelming evidence, and the decisions exhibit none of the deference to management that characterizes business judgment cases.¹⁷⁶ Moreover, the Min-

173. *Lake Harriet State Bank v. Venie*, 138 Minn. 339, 346-47, 165 N.W. 225, 228-29 (1917), *quoted in* *Sundberg v. Lampert Lumber Co.*, 390 N.W.2d 352, 357 (Minn. Ct. App. 1986), *petition for review denied*, (Minn. Sept. 22, 1986); *see also* *Horn Silver Mining Co. v. Ryan*, 42 Minn. 196, 44 N.W. 56 (1889). In *Horn*, a shareholder brought a derivative suit alleging that a director had breached his duty of care by negligently failing to prevent other officers from taking corporate funds. *Id.* at 198-200, 44 N.W. at 57. The court held that the defendant

ought to have known the truth in respect to the fraud and misconduct charged, and to have taken steps to prevent and expose the same, which he wholly failed to do so, but abstained from attending the meetings, and neglected to perform his duties to the corporation and its stockholders in the protection of the rights and property of the corporation; and that, by reason of his non-feasance and neglect, the plaintiff has been damaged as claimed.

Id. at 200, 44 N.W. at 57. The result is sensible, but the duty of care standard is at best muddy. The court first articulated a gross negligence standard, stating that directors are "liable if they suffer the corporate funds or property to be lost or wasted by gross negligence and inattention to the duties of their trust." *Id.* at 198-99, 44 N.W. at 56 (emphasis added) (citation omitted). Immediately afterwards, the court states a reasonable care standard: "The measure of care and diligence required of directors is generally held to be such as a prudent man exercises in his own affairs." *Id.* at 199, 44 N.W. at 56.

174. MINN. STAT. § 302A.251, subd. 1. Subdivision 2, dealing with justifiable reliance on information provided by others, also reflects a reasonable care standard. *Id.* at subd. 2(a)(1)-(3).

175. *Warner*, 226 Minn. at 573, 33 N.W.2d at 726. Of course, a plaintiff can overcome the presumptions of the rule and obtain a remedy. *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 10.05[1], at 10-41.

176. *See, e.g., Pedro v. Pedro*, 489 N.W.2d 798, 802 (Minn. Ct. App. 1992) (holding majority shareholders breached their fiduciary duties by firing minority shareholder, their brother, after he inquired into financial discrepancies in the corporation's financial records), *petition for review denied*, (Minn. Oct. 20, 1992); *Evans v. Blesi*, 345

nesota Court of Appeals has suggested that Minnesota follows the *Wilkes* test, articulated by the Massachusetts Supreme Judicial Court in *Wilkes v. Springside Nursing Home, Inc.*¹⁷⁷ Under *Wilkes*, if the plaintiff raises a plausible claim of oppression, the defendants have the burden of proving a legitimate business purpose.¹⁷⁸ If the defendants meet that burden, the plaintiff can still prevail by showing "that the same legitimate objective could have been achieved through an alternative course of action less harmful to the minority's interest."¹⁷⁹

The *Wilkes* standard is dramatically better for plaintiffs than the business judgment rule. *Wilkes*' "legitimate business purpose" prong reverses the normal presumption of good faith and requires the defendants to prove their *bona fides*. The "less harmful alternative" prong subjects corporate management to judicial second guessing reminiscent of the scrutiny applied when courts review statutes that infringe fundamental interests or use suspect classifications.¹⁸⁰

D. Indemnification

When a disgruntled shareholder brings suit, the individual defendants have an obvious advantage if they can cause the corporation to advance attorneys' fees and other costs of

N.W.2d 775, 780 (Minn. Ct. App. 1984) (holding the majority shareholder breached his fiduciary duties by using intimidating tactics to obtain majority control and plaintiff's resignation), *petition for review denied*, (Minn. June 12, 1984). Even if the business judgment rule applied to such cases, the evidence of misconduct would suffice to rebut the rule's presumptions. *See supra* note 170.

177. 353 N.E.2d 657, 663 (Mass. 1976), *cited with approval in* Harris v. Mardan Business Sys., Inc., 421 N.W.2d 350, 353 (Minn. Ct. App. 1988) (explaining that "[e]ven if [defendant majority shareholder] owed some lesser duty by virtue of [plaintiff's] stock ownership, [defendant] did not breach that duty because he has been able to demonstrate a legitimate business purpose for his action"), *petition for review denied*, (Minn. May 18, 1988).

178. *Wilkes*, 353 N.E.2d at 663.

179. *Id.* This two-part test, with its shifting burdens, resembles the test used in Title VII cases. *See* McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802-04 (1973). *Wilkes* makes no reference, however, to that line of authority.

180. JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW § 14.3(a), at 601-02 (5th ed. 1995) (explaining that strict scrutiny review requires the state to show not only that it is pursuing a compelling state interest, but also that state action is narrowly tailored to promote that compelling state interest). *Wilkes* did recognize that, even within a close corporation, management must have some leeway and that controlling shareholders have certain legitimate rights of "selfish ownership." *Wilkes*, 353 N.E.2d at 663. Nonetheless, the *Wilkes* rule is a far cry from the ordinary business judgment rule.

litigation. The defendants have an even greater advantage if the corporation will ultimately have to indemnify the defendants against any judgment or penalty. There is at least some argument that a derivative defendant has clearer access to defense costs and indemnity than does a direct defendant.

A defendant's right to indemnification and advances rests on Minnesota Statutes section 302A.521. Under specified conditions a corporate director or officer has the right to both advances and indemnification, unless the corporation's articles or bylaws provide otherwise.¹⁸¹ However, neither are available to a defendant who, "with respect to the acts or omissions . . . complained of,"¹⁸² has failed to "act[] in good faith"¹⁸³ or has received an "improper personal benefit."¹⁸⁴

Allegations of bad faith or improper personal benefit are hallmarks of both direct and derivative litigation,¹⁸⁵ but at least pending the final outcome of either type of proceeding determinations of eligibility are likely to be made by persons at least initially sympathetic to the defendants.¹⁸⁶ Still, there seems

181. MINN. STAT. §§ 302A.521, subd. 2 (purporting to mandate indemnification), subd. 3 (purporting to mandate advances), subd. 4 (permitting articles and bylaws to prohibit indemnification and advances, to set limits on them and to impose additional conditions). The purpose of indemnification is to encourage capable and responsible individuals to accept corporate management positions. *Tomash v. Midwest Technical Dev. Corp.*, 281 Minn. 21, 28, 160 N.W.2d 273, 278 (1968) (denying defendants indemnity where defendants were not completely vindicated of all misconduct in action brought against them by the SEC); *In re E.C. Warner Co.*, 232 Minn. 207, 213-14, 45 N.W.2d 388, 393 (1950) (finding no abuse of discretion in allowing attorneys' fees in sum of \$15,000 in a derivative suit against the director of corporation, where the legal services were necessary to vindicate defendant director).

182. MINN. STAT. § 302A.521, subd. 2(a).

183. *Id.* at subd. 2(a)(2).

184. *Id.* at subd. 2(a)(3).

185. *See, e.g., Pedro v. Pedro*, 489 N.W.2d 798, 800 (Minn. Ct. App. 1992) (plaintiff in a direct suit for breach of fiduciary duty testified that when he inquired about financial discrepancies in the corporate records, "he was told to cooperate, resign or be fired."), *petition for review denied*, (Minn. Oct. 20, 1992); *Evans v. Blesi*, 345 N.W.2d 775, 777 (Minn. Ct. App. 1984) (plaintiff minority shareholder in a direct suit alleged that "he had acted under fraud and duress when he transferred the stock [to the defendant] and resigned"), *petition for review denied*, (Minn. June 12, 1984); *Miller v. Miller*, 301 Minn. 207, 208, 222 N.W.2d 71, 73 (1974) (derivative action asserting defendants "wrongfully diverted corporate opportunities properly belonging to [the corporation]"); *Winter v. Farmers Educ. & Coop. Union*, 259 Minn. 257, 107 N.W.2d 226, 226 (1961) (derivative action brought "to recover for the corporation [funds] . . . wrongfully appropriated [by the corporation's president] for his own use").

186. Minnesota Statutes § 302A.521, subdivision 6 contains a detailed scheme for deciding who makes the eligibility determination. MINN. STAT. § 302A.521, subd. 6

some argument to be made that allowing the corporation to indemnify the alleged oppressor in a direct claim is merely to perpetuate a key aspect of the oppression—namely, the controlling shareholder's use of corporate assets to benefit that shareholder's interest to the unfair prejudice of the minority shareholder.¹⁸⁷

E. Exculpatory Provisions

Enacted in 1987, Minnesota Statutes section 302A.251, subdivision 4 permits a corporation to prospectively eliminate “[a] director’s personal liability to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director.”¹⁸⁸ An exculpatory provision may not, however, eliminate or limit the liability of a director: (a) for any breach of director’s duty of loyalty to the corporation or its shareholders; (b) for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law; . . . and (d) for any transaction from which the director

(1994). In the first instance the board will decide, if it can muster a quorum and majority of directors uninvolved in the underlying proceeding. *Id.* at subd. 6(a)(1). If it cannot, any two or more disinterested directors may make the determination. *Id.* at subd. 6(a)(2). If all, or all but one, of the directors are involved, the board may select a special counsel to make the determination. *Id.* at subd. 6(a)(3). The involved directors can participate in that selection. *Id.* Under each of these scenarios, the decision is made either by colleagues of the director/defendants or by someone hand-picked by a board of directors, at least a majority of whose members are director/defendants. The determination can also be left to a vote of the shareholders other than those who are parties to the underlying litigation. *Id.* at subd. 6(a)(4).

187. *But cf. Barry v. Barry*, 28 F.3d 848 (8th Cir. 1994) (applying Minnesota law). In *Barry*, the plaintiff, a former shareholder, alleged that the defendants had fraudulently induced her to sell her stock to the corporation by providing false financial information and by concealing favorable financial information. *Id.* at 850. The defendants had been shareholders and corporate officers at the time of the alleged fraud but had since sold their interest in the corporation. *Id.* at 849-50. The defendants sought indemnification and advances for legal expenses. *Id.* The corporation’s board of directors denied the request, contending that the plaintiff was suing the defendants for actions taken in their capacity as shareholders rather than in their “status as corporate directors or officers.” *Id.* at 851. The court disagreed, noting that “the mere fact that the [defendants] wore two hats in their dealings with [the corporation] and with [the plaintiff] does not compel the conclusion that they were not sued at least in part, because of their official status.” *Id.* (quoting *Barry v. Barry*, 824 F. Supp. 178, 185 (D. Minn. 1993)). *Barry* does not consider the argument offered in the text.

188. The exculpatory provision must appear in the articles of incorporation. MINN. STAT. § 302A.251, subd. 4.

derived an improper personal benefit.¹⁸⁹

As a result, exculpatory provisions will be largely irrelevant to claims of misconduct within a close corporation. Most such claims, whether direct or derivative, assert bad faith, improper personal benefit, breach of the duty of loyalty, or some combination.¹⁹⁰ Exculpation is, however, relevant to claims of waste and mismanagement, so it is worthwhile to determine whether exculpatory provisions impede the derivative plaintiff more than the direct. Section 302A.251, subdivision 4 evidently applies to derivative claims. The question is whether the subdivision applies to direct claims as well.

The statutory language suggests the answer is yes; subdivision 4(a) expressly refers to a "director's duty of loyalty to the corporation *or its shareholders*."¹⁹¹ The legislative history points in the same direction. Subdivision 4 was copied essentially verbatim from the comparable Delaware statute,¹⁹² which in turn had been enacted in response to *Smith v. Van Gorkom*.¹⁹³ In *Van Gorkom*, the Delaware Supreme Court held directors liable for having failed, through gross negligence, to obtain a fair price for the corporation in a merger transaction. The suit was a direct class action on behalf of the shareholders.¹⁹⁴ Against this background, it would make no sense to exclude direct

189. *Id.*

190. *See, e.g.*, cases cited *supra* notes 29 (direct), and 56 (derivative).

191. MINN. STAT. § 302A.251, subd. 4(a) (emphasis added).

192. The Delaware statute provides in relevant part:

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:

(7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.

DEL. CODE ANN. tit. 8, § 102 (Supp. 1994)

193. *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985). *See* BISHOP & KLEINBERGER, *supra* note 1, ¶ 10.06[2][b], at 10-45.

194. *Van Gorkom*, 488 A.2d at 863. Subsequent Delaware decisions have reiterated that directors owe a direct duty to shareholders when the corporation is up for sale. *See, e.g.*, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 179 (Del. 1986).

actions from the purview of subdivision 4.

There are, however, at least two reasons for making an exclusion for any direct actions brought within a *closely held* corporation. The first reason appears from a close reading of the statutory language. Subdivision 4 allows elimination or limitation of “[a] *director’s* personal liability . . . for breach of fiduciary duty *as a director*.”¹⁹⁵ In a close corporation, shareholders owe each other fiduciary duties *qua* shareholders.¹⁹⁶ Even if a controlling shareholder is also a director, any oppression actionable as a direct claim will almost certainly involve a breach of that shareholder’s duty *as a shareholder* and will therefore be outside the purview of any exculpatory provision.

The second reason emerges from reading subdivision 4 *in pari materia* with Minnesota Statutes section 302A.751. The latter statute makes doubtful the power of *any* agreement, exculpatory or otherwise, to irrevocably affect relationships among shareholders in a close corporation. Section 302A.751, subdivision 3a provides that, in determining a shareholder’s enforceable expectations, even written agreements personally signed by all the shareholders are merely “*presumed* to reflect the parties’ reasonable expectations.”¹⁹⁷ In addition, expectations that have evolved are likely to trump earlier-executed documents.¹⁹⁸ More particularly, section 302A.751, subdivision 2 provides that courts will respect an agreed upon buy-sell price “unless the court determines that the price or terms are unreasonable under all the circumstances of the case.”¹⁹⁹ These provisions suggest that Minnesota policy disfavors documents as planning devices

195. MINN. STAT. § 302A.251, subd. 4 (emphasis added).

196. See, e.g., MINN. STAT. § 302A.751, subd. 3a (referring to “the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner”). See *generally supra* Part II (describing the statutory and common law sources for direct claims in a close corporation).

197. MINN. STAT. § 302A.751, subd. 3(a) (emphasis added).

198. *Id.* (making enforceable shareholders’ reasonable expectations “as they exist at the inception and develop during the course of the shareholders’ relationship with the corporation and with each other”). See BISHOP & KLEINBERGER, *supra* note 1, ¶ 10.09[4][a] (discussing “statutes that undermine agreements”).

199. The court of appeals has accepted this invitation. See *Pedro v. Pedro*, 489 N.W.2d 798, 802 (Minn. Ct. App. 1992) (declining to apply the buy-out price stated in a stock redemption agreement and holding, where a minority shareholder had proven an unlawful freeze-out, that the damages included the difference between the stock redemption price and the fair value of the stock), *petition for review denied*, (Minn. Oct. 20, 1992).

in close corporations.²⁰⁰ *A fortiori* the policy cuts against using documents to exculpate a close corporation's controlling shareholders.

Thus, when section 302A.251, subdivision 4 is read closely and *in para materia*, it appears to exclude from exculpation all direct claims within a close corporation. If so, subdivision 4 joins the list of obstacles faced by a derivative plaintiff but not the direct.

IV. THE IMPORTANCE OF A THRESHOLD DETERMINATION

It is thus quite important to distinguish between direct and derivative claims in the context of a close corporation.²⁰¹ As to any particular lawsuit, it is equally important to draw the distinction early. Delay can cause the parties, the attorneys and even the court to waste time, effort and resources. Suppose, for example, that (i) a plaintiff files suit asserting direct claims, (ii) the corporation moves to dismiss asserting that, accepting the complaint's allegations are true, the claims are derivative, (iii) the claims are indeed derivative and are destined to be dismissed, but (iv) the court prefers to reserve its decision pending discovery.²⁰² As a result, discovery will have to include and perhaps even focus on matters largely, if not completely, immaterial to a derivative claim. For instance, the parties will have to explore the plaintiff's expectations, the reasonableness of those expectations, the relationship of those expectations to the expectations of the other shareholders, the reasonableness of those other shareholders' expectations, etc.²⁰³ Moreover, efficient trial preparation presupposes that the attorneys have or

200. See Kleinberger, *supra* note 9, at 1155-56 (discussing how Minnesota law may "destroy one of the most important expectations a business person can have—predictability in the rules of the game"); BISHOP & KLEINBERGER, *supra* note 1, ¶ 10.09[4][a] (discussing "statutes that undermine agreements").

201. See *infra* App. B for a chart summarizing the differences between a direct and derivative suit in the context of a close corporation.

202. Except in extraordinary circumstances, it should be possible to make the direct/derivative determination without discovery. See *infra* part VII.A.

203. See MINN. STAT. § 302A.751, subd. 3a. Section 302A.751, subdivision 3a provides that "[i]n determining whether to order equitable relief, dissolution, or a buy-out, the court shall take into consideration . . . [*inter alia*] the reasonable expectations of all shareholders . . ." *Id.* A 1994 Amendment substituted "all shareholders" for "the shareholders," indicating that courts must consider the interrelationship of shareholder expectations. 1994 Minn. Laws ch. 417, § 11. For a discussion of the interrelationship, see *Meiselman v. Meiselman*, 307 S.E.2d 551, 563 (N.C. 1983).

develop a theory of the case.²⁰⁴ To do so they must know, sooner rather than later, whether the case is direct or derivative.

Delay poses additional problems when a plaintiff brings both direct and derivative claims.²⁰⁵ The problems relate to the functioning of a special litigation committee, which a prudent corporation may wish to establish to review the derivative claims.²⁰⁶ Assuming the derivative and direct claims have a common factual basis, the best interests of the corporation will ordinarily preclude the SLC from making any investigation until the court resolves the direct/derivative issue.

This conclusion has nothing to do with the merits of the plaintiff's claims but rather reflects the fact that an SLC has no power to affect direct claims. The conclusion can be best explained by assuming, first, that: (i) the SLC proceeds with an investigation; (ii) the SLC concludes that the best interests of the corporation require dismissal of the derivative claims; (iii) the corporation presents the report of the SLC to the court and seeks dismissal of the derivative claims; and (iv) the court dismisses the derivative claims.

Even in those circumstances the corporation would not substantially benefit because the litigation would continue on the direct claims. Because the direct claims rest on the same factual allegations as the derivative claims, the same facts would remain in issue. Moreover, the corporation's key executives would remain embroiled in the litigation, and these individuals would continue to be distracted from their entrepreneurial and management activities. In addition, the corporation would remain at financial risk. If the plaintiff were to prevail, the

204. 1 ROGER HAYDOCK & JOHN SONSTENG, *PLANNING TO WIN: EFFECTIVE PREPARATION* 37-40 (1994).

205. This was the situation in the case which led to the *Skoglund* decision, one of Minnesota's most recent decisions dealing with the direct/derivative issue. *Skoglund v. Brady*, 541 N.W.2d 17 (Minn. Ct. App. 1995), *petition for review denied*, (Minn. Feb. 27, 1996). In that case the corporation appointed a special litigation committee to evaluate the derivative claim; the lead author of this article was the sole member of the committee. For the reasons stated in the text, the committee declined to conduct any investigation of the derivative claim and recommended instead that the corporation ask the court to determine whether the plaintiff could proceed with the direct suit. *Id.* at 19. The corporation followed that recommendation, and the trial court subsequently dismissed the direct claims. *Id.* The corporation then appointed another special litigation committee, with a different member, to investigate the derivative claim. The court of appeals later affirmed the dismissal of the direct claims. *Id.* at 22.

206. For a discussion of special litigation committees, see *supra* part III.B.

corporation would face possible dissolution or a mandatory buy out of the plaintiff's stock.²⁰⁷ If the individual defendants were to prevail, the corporation might well be obliged to indemnify them.²⁰⁸

Comparable complications appear assuming that the special litigation committee proceeds with an investigation and concludes that the best interests of the corporation require pressing the corporation's claims. The existence of overlapping direct claims would complicate matters significantly. Since remedies for derivative claims ordinarily inure to the corporation and remedies for direct claims inure to the plaintiff personally,²⁰⁹ the corporation's best interests might well conflict with the plaintiff's. The plaintiff personally might have a conflict of interest, given his dual roles as direct and derivative plaintiff.²¹⁰ In sum, so long as both direct and derivative claims remain in the lawsuit an investigation by the SLC will provide no substantial benefit to the corporation.

V. MAKING THE DISTINCTION: MINNESOTA'S CURRENT APPROACH

To understand how Minnesota law differentiates between direct and derivative claims within a close corporation, it is necessary to understand how Minnesota approaches that question generally. At present, the general approach is all that is available;²¹¹ there is no special rule for close corporations. Indeed, there is little, if any, recognition that special treatment might be appropriate.²¹²

There are at least two reasons for this situation. First, in the

207. MINN. STAT. §§ 302A.751, subd. 1 (providing generally for equitable relief), subd. 2 (authorizing the court to require the corporation to purchase the plaintiff shareholder's stock).

208. See *supra* part III.D. (discussing indemnification).

209. See *supra* text accompanying notes 47, 92-95 (discussing who benefits from recoveries in direct and derivative cases).

210. See *supra* notes 122-25 (discussing "fair and adequate representation" requirement).

211. See *infra* part VI (discussing if a special rule is appropriate). For the sake of conceptual consonance, the special rule should at least rest on the generally applicable rule.

212. The situation is different in some other jurisdictions. Moreover, the American Law Institute has proposed a special rule. See 2 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.01(d) (1992) (Am. Law Inst.) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE]. See *infra* text accompanying note 315.

archetypical close corporation case the direct/derivative issue does not arise; the plaintiff alleges termination of employment and a freeze-out, thereby presenting an obviously direct claim.²¹³ Second, when the direct/derivative issue has come up in close corporation cases, Minnesota courts have decided the issue either on a conclusory basis or without considering the corporation's closely held character.

For example, in *PJ Acquisition Corp. v. Skoglund*, the Minnesota Supreme Court addressed the direct/derivative issue but made nothing of the corporation's closely held status.²¹⁴ The court simply reaffirmed the trial court's conclusory findings that because the "allegations . . . fail to allege any direct injury to [plaintiff], as shareholders, but rather only to [the corporation], and because [plaintiff] seeks relief in favor of [the corporation] rather than itself, . . . the action in reality was a shareholder's derivative action."²¹⁵

The court of appeals has provided no greater guidance. In *Wenzel v. Mathies*,²¹⁶ for example, the court concluded without analysis that defendant's "actions in the context of a closely-held, single-bank holding company, provide a basis for a direct

213. See, e.g., *Pedro v. Pedro*, 489 N.W.2d 798, 800 (Minn. Ct. App. 1992) (majority shareholders fired minority shareholder and discontinued his pay and benefits when he inquired into the financial discrepancies in the corporation's records), *petition for review denied*, (Minn. Oct. 20, 1992); *Evans v. Blesi*, 345 N.W.2d 775, 778 (Minn. Ct. App. 1984) (after forcing the plaintiff minority shareholder to surrender majority control, the defendant majority shareholder demanded the plaintiff resign from his employment), *petition for review denied*, (Minn. June 12, 1984); *Sawyer v. Curt & Co.*, Nos. C7-90-2040, C9-90-2041, 1991 WL 65320, at *2 (Minn. Ct. App. Feb. 12, 1991) (defendant shareholders terminated the employment of the plaintiff who had an expectation of continued employment), *petition for review denied*, (Minn. Apr. 18, 1991).

214. *PJ Acquisition Corp. v. Skoglund*, 453 N.W.2d 1, 2-3 (Minn. 1990) (describing the parties and the case's procedural posture without mentioning close corporation status); *id.* at 14 n.1 (criticizing the majority for relying on a case that "did not involve a closely held corporation") (Yetka, J., dissenting). The case involved a dispute among owners of the corporation that owned the Minnesota Vikings. *Id.* at 2. The plaintiffs accused the defendant corporate officers and directors of having breached their fiduciary duties and of having abused corporate control by paying excessive salaries, using corporate assets for non-corporate purposes, and usurping a corporate opportunity. *Id.* at 3.

215. *Id.* at 4. See also *Westgor v. Grimm*, 318 N.W.2d 56, 58 (Minn. 1982) (holding that an alleged claim for breach of fiduciary duty stated a derivative rather than direct claim "because a right of action for diversion of corporate funds is in the corporation, not the individual" and making no reference to the corporation's closely held nature).

216. 542 N.W.2d 634 (Minn. Ct. App. 1996), *petition for review denied*, (Minn. Mar. 28, 1996).

action."²¹⁷ As the only clue to its reasoning, the panel cited *Steelman v. Mallory*, an Idaho decision holding that a direct action is permissible when "[t]he gravamen of [plaintiff's] complaint is that the majority shareholders/directors were attempting to squeeze him out."²¹⁸ *Wenzel*, however, held that minority shareholders in operational control of a corporation owed fiduciary duties to the *pledgees* of a majority block of shares and thus hardly involved a classic squeeze-out.²¹⁹

The analysis in *Skoglund v. Brady*²²⁰ was likewise cursory, although to the opposite effect. Without explanation or detail the court concluded that "[plaintiff-shareholder] does not allege an injury to himself that is separate and distinct from any injury to the corporation."²²¹ In *Hein v. Schaffer*,²²² the court was even more laconic, asserting baldly that the "claim brought for [defendant's] alleged breach of a fiduciary duty . . . is a derivative action."²²³ *Wheeler v. McGee*²²⁴ provided a little more information, recognizing that "shareholders in a closely held corporation owe one another a fiduciary duty that requires them to deal openly, honestly, and fairly with each other"²²⁵ and concluding that "[b]reach of that duty is a personal claim and

217. *Id.* at 641.

218. *Wenzel*, 542 N.W.2d at 641 (quoting *Steelman v. Mallory*, 716 P.2d 1282, 1285 (Idaho 1986)).

219. *Wenzel*, 542 N.W.2d at 640. According to the court, the controlling insiders breached those duties when they caused the corporation to issue new stock to themselves and their associates. *Id.* at 640-41. The issuance of the new shares cost the majority block its majority status, which prejudiced the pledgees' interest. *Id.* at 641. A classic freeze out involves the use of corporate control to expropriate some or all of the value of a minority shareholder's interest in a closely held corporation. F.H. O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS §§ 1:02-:03, at 1-3 to 1-7 (2nd ed. 1995). Although multifarious methods exist to accomplish the expropriation, a common tactic involves the firing of an employee shareholder. *Id.* § 3:06. Although the *Wenzel* pledgees had formerly owned a majority block of shares, at the time of the actionable misconduct they were not shareholders, much less employee-shareholders. *Id.* at 640.

220. 541 N.W.2d 17 (Minn. Ct. App. 1995), *petition for review denied*, (Minn. Feb. 27, 1996).

221. *Id.* at 22.

222. No. C6-93-360, 1993 WL 319036 (Minn. Ct. App. Aug. 24, 1993), *petition for review denied*, (Minn. Oct. 28, 1993).

223. *Id.* at *2.

224. No. C5-92-680, 1992 WL 383460 (Minn. Ct. App. Dec. 29, 1992), *petition for review denied*, (Minn. Feb. 12, 1993).

225. *Id.* at *3 (citing *Evans v. Blesi*, 345 N.W.2d 775, 779 (Minn. Ct. App. 1984), *petition for review denied*, (Minn. June 12, 1984)).

not a derivative corporate claim.”²²⁶ The case failed, however, to explain why defendant’s actions constituted a breach of that direct duty.²²⁷

Thus at present, close corporations in Minnesota partake of Minnesota’s general rule. As phrased by most recent cases that rule mandates a derivative suit unless the plaintiff-shareholder has suffered an injury “separate and distinct” from other shareholders. Unfortunately, this rule is flawed in concept and at odds with the weight of authority. Moreover, the rule has pushed the supreme court into contortions and threatens to squelch an entire category of extremely important shareholder claims.

The conceptual error reflects a misunderstanding of the essential character of a truly derivative claim and a misplacement of the “separate injury” requirement. When a shareholder derives his standing from the injury done to the corporation, the suit is derivative.²²⁸ To have a direct claim a plaintiff indeed must have a separate injury—but separate *from the corporation*, not necessarily from fellow shareholders.

The misunderstanding as to “separate from whom” arises from a misreading of Minnesota’s seminal cases on the direct/derivative issue. Those cases, both captioned *Seitz v. Michael*, were decided in 1921.²²⁹ They both involved claims that the defendant majority shareholder had misappropriated corporate funds and had conspired to freeze-out a minority shareholder from participation in management.²³⁰

226. *Id.*

227. The court may have reached the right conclusion for the wrong reason. The defendant’s misconduct did first harm the corporation; the defendant misappropriated corporate assets by transferring corporate property to himself without the plaintiff’s knowledge or consent. *Id.* at *1. It is unclear whether the plaintiff’s objection to the misconduct led to the plaintiff being fired or whether the plaintiff simply walked off the job. *Id.* If the defendant terminated plaintiff’s employment, either actually or constructively, plaintiff indeed had a direct, freeze-out claim. See *Pedro v. Pedro*, 489 N.W.2d 798 (Minn. Ct. App. 1992), *petition for review denied*, (Minn. Oct. 20, 1992); *supra* text accompanying notes 24-26 (discussing the classic freeze-out). If not, under the special circumstances of the case, the plaintiff might have been able to transmute what was essentially a derivative claim into a direct claim. See *infra* Part VI.

228. See *supra* part II.B.

229. *Seitz v. Michel*, 148 Minn. 80, 181 N.W. 102 (1921) [hereinafter *Seitz I*]; *Seitz v. Michel*, 148 Minn. 474, 181 N.W. 106 (1921) [hereinafter *Seitz II*].

230. *Seitz I*, 148 Minn. at 87, 181 N.W. at 105; *Seitz II*, 148 Minn. at 475, 181 N.W. at 106.

The supreme court held the claims to be derivative,²³¹ and most of the court's discussion focussed on the indirect nature of the plaintiff's injury. For example, in *Seitz I* the court stated, "The wrongs complained of are wrongs against the corporation."²³² *Seitz II* noted similarly, "The injury is to the corporations [sic]."²³³ Thus, as to both the wrong and the remedy, the court explained, the shareholder had only a derivative relationship: "The wrong is done when the funds are improperly expended. Such funds do not belong to the stockholders, but to the corporation."²³⁴

Seitz I did mention, almost in passing, a consequence of the indirect nature of the injury: "The wrong done [to the corporation] results in injury to the stockholders collectively. Money which might have been distributed among them as dividends has been wasted. The value of all the stock has been diminished. *The injury to each stockholder is of the same character.*"²³⁵

Unfortunately, this latter observation has become the focus of most modern Minnesota cases. These cases have simply ignored the crux of the analysis in the *Seitz* cases—i.e., the indirectness of the shareholder's injury—and have instead fixated on the "same character" notion. In *Northwest Racquet Swim and Health Clubs, Inc., v. Deloitte & Touche*,²³⁶ for example, the supreme court stated: "[T]he method in Minnesota for distinguishing between a direct and a derivative claim is to consider whether the injury to the individual plaintiff is separate and distinct from the injury to other persons in a similar situation as the plaintiff."²³⁷

The Eighth Circuit took the same view in *Arent v. Distribution Sciences, Inc.*,²³⁸ applying Minnesota law and noting: "A well-recognized method for determining whether a claim belongs

231. The *Seitz* cases predate recognition of shareholder freeze-out claims. "It is a matter of no consequence that . . . the wrongful acts alleged were done with the specific intent and fraudulent design of injuring plaintiff [minority shareholder]." *Seitz I*, 148 Minn. at 88, 181 N.W. at 105. The *Seitz* cases would be decided differently under the rule proposed in Section VI, because current law recognizes a direct claim for fraudulent conduct. MINN. STAT. § 302A.751, subd. 1(b)(2).

232. *Seitz I*, 148 Minn. at 87, 181 N.W. at 105.

233. *Seitz II*, 148 Minn. at 476, 181 N.W. at 106.

234. *Seitz I*, 148 Minn. at 87, 181 N.W. at 105.

235. *Id.* at 87-88, 181 N.W. at 105 (emphasis added).

236. 535 N.W.2d 612 (Minn. 1995).

237. *Id.* at 617 (citing *Seitz II*).

238. 975 F.2d 1370 (8th Cir. 1992).

to the corporation, rather than its shareholders, is to inquire whether "[t]he injury to each stockholder is of the same character."²³⁹ *Arent* arose from a failed merger, and the plaintiffs contended that the defendant had committed fraud, negligent misrepresentation, and breach of fiduciary duty by failing to notify shareholders that the proposed merger would fail. The court held the claims to be derivative, because any such conduct would have adversely "affected all . . . shareholders equally."²⁴⁰ A federal district court has ruled likewise in another case, holding that "under Minnesota law, a claim belongs to the corporation if the injury to each shareholder 'is of the same character.'"²⁴¹

A few modern cases have at least mentioned the *Seitz* indirect injury analysis, but have mostly failed to use that analysis to decide the direct/derivative issue. For example, *International Broadcasting Corp. v. Turner*²⁴² first noted that "[w]hether a claim is properly brought as an individual action rather than derivative turns on whether the claimant has suffered an injury *distinct from one incurred by the corporation*."²⁴³ Ultimately, however, the case characterized the claims as derivative because the "[wrongful acts] cannot be said to have inflicted an injury on [complainants] *separate and distinct from all shareholders . . .*"²⁴⁴ *Wenzel v. Mathies*²⁴⁵ perceived the two aspects of the *Seitz* analysis as interchangeable: "A derivative action is required when the shareholder has suffered a harm that is indistinct from the harm suffered by other shareholders or by the corporation itself."²⁴⁶

*Skoglund v. Brady*²⁴⁷ is a salutary exception, reflecting both strands of the *Seitz* analysis, but applying the indirect injury test. The court first notes that "[a] shareholder may bring a direct action when the shareholder alleges a direct *injury to the*

239. *Id.* at 1372 (citing *Seitz I*).

240. *Id.* at 1373.

241. *In re Nuveen Fund Litigation*, 855 F. Supp. 950, 954 (N.D. Ill. 1994) (applying Minnesota law, citing *Seitz I*, and characterizing as derivative a claim that the issuance of new shares had caused wrongful dilution).

242. 734 F. Supp. 383 (D. Minn. 1990).

243. *Id.* at 392 (emphasis added).

244. *Id.* (emphasis added).

245. 542 N.W.2d 634 (Minn. Ct. App. 1996), *petition for review denied*, (Minn. Mar. 28, 1996).

246. *Id.* at 640.

247. 541 N.W.2d 17 (Minn. Ct. App. 1995), *petition for review denied*, (Minn. Feb. 27, 1996). See *supra* notes 152-63 and accompanying text for the facts in *Skoglund*.

shareholder that is separate and distinct from the injury to the corporation."²⁴⁸ Then court then appears to change standards, asserting that "[t]o determine whether a claim belongs to the corporation rather than to its shareholders, the relevant inquiry is 'whether [t]he injury to each stockholder is of the same character.'"²⁴⁹ Finally, the court resolves the issue and decides the case on the proper grounds—stating that "[plaintiff] does not allege an injury to himself that is *separate and distinct from any injury to the corporation*. The district court properly dismissed [plaintiff's] direct action."²⁵⁰

With the exception of *Skoglund*, all the modern cases make the same mistake: the "fallacy of affirming the consequent."²⁵¹ That is, as the *Seitz* cases quite properly observed, as a matter of policy and standing an indirect injury gives rise only to a derivative suit. As those cases also observed, *as a matter of consequence* when a shareholder's injury is indirect, all shareholders have in common the same (indirect) injury.²⁵² It does not logically follow, however, that whenever shareholders have a common injury they necessarily suffered their injury indirectly.

In logical terms, the error is as follows:

if P then Q (if indirect, then necessarily common)

does not mean

if Q then P (if common, then necessarily indirect)

Besides suffering from this logical fallacy, the current Minnesota rule is at odds with authoritative decisions from other jurisdictions. For example, the Delaware Supreme Court has stated: "The distinction between derivative and individual actions rests upon the party being *directly* injured by the alleged wrongdoing."²⁵³ The California Supreme Court has taken the

248. *Skoglund*, 541 N.W.2d at 21 (emphasis added) (citing *Arent v. Distribution Sciences, Inc.*, 975 F.2d 1370, 1372-74 (8th Cir. 1992)).

249. *Id.* (emphasis added; internal quotations and citations omitted).

250. *Id.* at 22 (emphasis added).

251. STEPHEN F. BARKER, *THE ELEMENTS OF LOGIC* 69 (5th ed. 1989).

252. This consequence is reflected in rule 23.06 of the Minnesota Rules of Civil Procedure, which requires a derivative plaintiff to "fairly and adequately represent the interest of the shareholders . . . similarly situated . . ." MINN. R. CIV. P. 23.06.

253. *Kramer v. Western Pac. Indus., Inc.*, 546 A.2d 348, 351 (Del. 1988).

same view: "The individual wrong necessary to support a suit by a shareholder need not be unique to that plaintiff. The same injury may affect a substantial number of shareholders. If the injury is not incidental to an injury to the corporation, an individual cause of action exists."²⁵⁴

The defects of the current rule may be dawning on the Minnesota Supreme Court, if *Northwest Racquet Swim and Health Clubs, Inc. v. Deloitte & Touche*²⁵⁵ is any indication. The case considered a debenture holder's claim against the accounting firm which had prepared an audit report on the issuer. According to the plaintiff, the audit report had included specific misrepresentations and those representations had directly affected the decision to purchase the debentures.²⁵⁶ The court quite properly held that the claim could be maintained as a direct suit.²⁵⁷

The court's route to that eminently sensible and seemingly self-evident conclusion was not easy, however, for the court cited *Seitz II* for the notion that "the method in Minnesota for distinguishing between a direct and a derivative claim is to consider whether the injury to the individual plaintiff is separate and distinct from the injury to other persons in a similar situation as the plaintiff."²⁵⁸ Since the audit report had affected more than one debenture holder,²⁵⁹ the plaintiff in *Northwest Racquet* could clearly not make this "separate and distinct" showing. The court escaped that difficulty by analogizing the plaintiff's case to cases decided in other jurisdictions *which had allowed direct claims from groups of similarly situated individuals.*²⁶⁰

Tortured reasoning is not the only consequence of the

254. *Jones v. H.F. Ahmanson & Co.*, 460 P.2d 464, 471 (Cal. 1969); *see also* COX ET AL., *supra* note 13, § 15.3, at 15.23-24 ("Some courts have reasoned that a derivative action is the only basis for a shareholder to complain unless the shareholder has suffered a harm different from that of the other minority stockholders. This is erroneous."); DEMOTT, *supra* note 1, § 2.01, at 2-2 to 2-3 (stating that the proper distinct injury requirement demands not that each shareholder's injury be distinct from each other shareholder's, but rather that the shareholder's injury be distinct from the corporate injury).

255. 535 N.W.2d 612 (Minn. 1995).

256. *Id.* at 619.

257. *Id.* at 617.

258. *Id.*

259. *Id.*

260. *Id.* at 618 (discussing *University of Maryland v. Peat Marwick Main & Co.*, 923 F.2d 265 (3d Cir. 1991)).

Minnesota rule. Sometimes the rule produces indefensible outcomes. For example, in *Arent v. Distribution Sciences, Inc.*,²⁶¹ the plaintiffs contended that the defendant had committed fraud, negligent misrepresentation, and breach of fiduciary duty by failing to notify shareholders that a proposed merger was destined to fail.²⁶² Although the plaintiffs alleged that the fraud directly infected their investment decisions concerning their stock,²⁶³ the Eighth Circuit applied Minnesota law and held the claims to be derivative. In the court's view, any misconduct would have adversely "affected all . . . shareholders equally."²⁶⁴

Comparably dire consequences are also possible for shareholder claims brought in the context of a hostile takeover. Suppose a board of directors is resisting such a takeover for inappropriate reasons or with inappropriate measures.²⁶⁵ Or suppose the directors have been "charged with getting the best price for the stockholders at a sale of the company," but act in a way that undercuts rather than maximizes shareholder value.²⁶⁶ Under the nation's leading cases, the shareholders would have a direct claim, whether for injunctive relief or damages.²⁶⁷ Under the Minnesota rule, no shareholder would have a claim, since each shareholder would be facing the "same character" of injury.²⁶⁸

Whether or not Minnesota needs a special rule for resolving the direct/derivative distinction in close corporations, the state's general rule needs to be fixed. Courts should return to the

261. 975 F.2d 1370 (8th Cir. 1992).

262. *Id.* at 1372 (citing *Seitz I*).

263. *Id.* at 1372.

264. *Id.* at 1373.

265. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (noting the dangers of director self-interest and entrenchment and requiring directors of a Delaware corporation to justify defensive measures by proving that they have acted in good faith and upon a reasonable investigation and that the defensive measures are proportionate to the threat).

266. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (holding that once directors conclude that a Delaware corporation is up for sale, the directors have a duty to shareholders to use reasonable efforts to maximize the price the shareholders will realize from their interests); *Smith v. Van Gorkom*, 488 A.2d 858, 864 (Del. 1985) (holding directors of a Delaware corporation directly liable to the former shareholders for having failed, through gross negligence, to obtain adequate value for those shareholders when the corporation was being merged out of existence).

267. See, e.g., cases cited *supra* note 266.

268. *Arent*, 975 F.2d at 1372 (quoting *Seitz I*).

original crux of *Seitz I*, discard the "same character" test and adopt the rule prevailing elsewhere: The key to determining whether a shareholder's suit is direct or derivative is not whether other shareholders are similarly situated but rather whether the plaintiff shareholder has been injured directly.

VI. WHETHER AND WHITHER A SPECIAL RULE

Fixing the general rule occasions the further question: Should Minnesota adopt a special rule applicable only in close corporations? Several other states have done so,²⁶⁹ as has the American Law Institute in its Principles of Corporate Governance.²⁷⁰ At least three arguments exist for doing so under Minnesota law: (i) Minnesota Statutes section 302A.751 reflects a special solicitude for minority shareholders in close corporations and that solicitude warrants relaxing whatever general rule is applicable to the direct/derivative distinction; (ii) when a corporation is closely held, there is a greater likelihood that both direct and derivative claims will arise from the same circumstanc-

269. See, e.g., *Richards v. Bryan*, 879 P.2d 638 (Kan. Ct. App. 1994). The *Richards* court held that:

If a corporation is closely held, a court, in its discretion, may treat an action raising derivative claims as a direct action . . . if it finds to do so will not (1) unfairly expose the corporation to a multiplicity of actions; (2) materially prejudice the interests of creditors in the corporation; or (3) interfere with a fair distribution of the recovery among all interested persons.

Id. at 648. See also *Watson v. Button*, 235 F.2d 235, 237 (9th Cir. 1956) (holding former stockholder may maintain a direct suit for misappropriation of corporate assets against former director of now dissolved close corporation where the reasons underlying a derivative suit are not present); *Thomas v. Dickson*, 301 S.E.2d 49, 51 (Ga. 1983) (holding suit brought by one-third minority shareholder in close corporation against majority shareholders may be brought as a direct action rather than derivative "because [plaintiff shareholder] was the sole injured shareholder and because the reasons underlying the general rule calling for corporate recovery do not exist in this case"); *W & W Equip. Co. v. Mink*, 568 N.E.2d 564, 571 (Ind. Ct. App. 1991) (holding a shareholder who held 50% of shares in a close corporation which had only two shareholders was not required to bring a derivative suit to assert breaches of fiduciary duty against fellow shareholder director where the underlying reasons for requiring a derivative action are not present and plaintiff would have no difficulty satisfying requirement for maintaining derivative action). But see *Bagdon v. Bridgestone/Firestone, Inc.*, 916 F.2d 379, 383-84 (7th Cir. 1990) (contrasting Delaware and Ohio Law, applying Delaware law and refusing to recognize any special rule for close corporations), *cert. denied*, 500 U.S. 952 (1991); *Bessette v. Bessette*, 434 N.E.2d 206, 208 n.5 (Mass. 1982) (applying traditional rule in the absence of a claim for a freeze-out).

270. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.01(d). See *infra* text accompanying note 315.

es, and that this potential overlap requires special attention; and (iii) when a corporation is closely held, the reasons for maintaining the direct/derivative distinction disappear. This Part will consider each argument in turn.

A. *The Impact of Minnesota Statutes Section 302A.751*

It has been suggested that "section 302A.751 was intended to supersede Rule 23.06 in cases involving closely held corporations"²⁷¹ and that, in effect, close corporation plaintiffs should be allowed to sue directly even where the general rule would require a derivative suit.²⁷² For at least three reasons, this

271. *PJ Acquisition Corp. v. Skoglund*, 453 N.W.2d at 14 n.1 (Yetka, J., dissenting).

272. *Id.* Justice Yetka also invoked Minnesota Statutes § 302A.467, suggesting that it too served to destroy the direct/derivative distinction in closely held corporations. *Id.* Section 302A.467 provides:

If a corporation or an officer or director of the corporation violates a provision of this chapter, a court in this state may, in an action brought by a shareholder of the corporation, grant any equitable relief it deems just and reasonable in the circumstances and award expenses, including attorneys' fees and disbursements, to the shareholder.

MINN. STAT. § 302A.467 (1994). The majority in *PJ Acquisition* ignored Justice Yetka's suggestion as to § 302A.467, and the suggestion finds no support in Minnesota case law. Indeed, while only a handful of cases have cited the provision, one of them expressly rejects the notion that § 302A.467 affects the direct/derivative issue. In *Westgor v. Grimm*, 381 N.W.2d 877 (Minn. Ct. App. 1986), after remand from the supreme court, the court of appeals stated:

The supreme court . . . already ruled in this case that Westgor "has no individual cause of action because a right of action for diversion of corporate funds is in the corporation, not the individual." Therefore, Westgor cannot personally receive any damages as a result of his claims. Furthermore, we do not agree that the equitable relief available under § 302A.467 authorizes the court to force a buyout of dissenting shareholders when such a buyout could not be obtained under the "dissenting shareholder buyout" provisions of Minn. Stat. § 302A.471 (1984).

Id. at 881 (citation omitted); see also *Bowman v. MWCG Export Co.*, No. C4-90-1654, 1991 WL 30342 (Minn. Ct. App. Mar. 12, 1991) finding that:

The trial court also properly refused to order the corporation to buy out the Bowmans' shares as equitable relief under Minn. Stat. § 302A.467 (1988). Minn. Stat. § 302A.467 does not authorize a court to order a buy-out when buy-out is not available as a dissenting shareholder right under Minn. Stat. § 302A.471. Because Minn. Stat. § 302A.471 buy-out was unavailable to the Bowmans, we affirm the trial court's refusal to order a buy-out of the Bowmans' shares as equitable relief under Minn. Stat. § 302A.467.

Id. at *2 (citations omitted).

Most of the cases citing section 302A.467 have merely referred to the section's role in authorizing equitable remedies and attorney's fees. See, e.g., *Foy v. Klapmeier*, Nos. 3-90 CIV 292, 3-90 CIV 293, 1993 WL 246127, at *9 (D. Minn. Feb. 8, 1993) ("Under

suggestion lacks merit. First, the Minnesota Supreme Court has expressly rejected the suggestion. In *PJ Acquisition* the court stated: "While [section] 302A.751, subd. 1 (1988) does expand the options of shareholders to bring actions seeking personal damages, as distinguished from derivative damages, the equitable remedy expanded does not replace the traditional derivative action."²⁷³

At the symposium that gave rise to this article, one participant did attempt to characterize *PJ Acquisition's* observations on the direct/derivative issue as mere dicta. That participant asserted in essence that (i) the court made its core holding in this aspect of the case when it decided that the contemporaneous ownership rule applied and (ii) once the court had made that unremarkable pronouncement, the rest was mere philosophizing.

The majority opinion clearly repudiates that assertion. Footnote 12 states that:

In this case we need not hold that a shareholder plaintiff alleging actions causing him direct damages under 302A.751, subd. 1, must always have to satisfy the contemporaneous ownership and demand requirements of rule 23.06. *But where proper analysis of the complaint leads to the conclusion that indeed, the action is derivative, the Rule 23.06 requirement must be met.*²⁷⁴

section 302A.467, a court may grant an award of attorneys' fees to a shareholder if a corporation or an officer or director of the corporation has violated a statutory duty toward the shareholder."), *aff'd as modified and remanded*, 992 F.2d 774, 779 (8th Cir. 1993) (holding that, given an established usurpation of corporate opportunity and the plaintiff's established right to seek appraisal, section 302A.467 authorized the court to include the value of the usurped opportunity when making the appraisal valuation); *Black v. NuAire, Inc.*, 426 N.W.2d 203, 209 n.2 (Minn. Ct. App. 1988) ("In the event an action has been pursued, section 302A.467 allows a court to fashion equitable remedies."); *petition for review denied*, (Minn. Aug. 24, 1988); *Sawyer v. Curt & Co., Nos. C7-90-2040, C9-90-2041*, 1991 WL 65320, at *3 (Minn. Ct. App. Feb. 12, 1991) (holding that § 302A.467 "permits a court, in its discretion, to award attorney fees for any violation of chapter 302A if it finds such an award will be reasonably equitable under the circumstances. No specific findings as to bad faith, arbitrary, or vexatious conduct are required."); *Chabot v. Industrial Relations Council, Inc., No. C8-90-300*, 1990 WL 119371, at *2 (Minn. Ct. App. Aug. 21, 1990) (noting that, given an established violation of section 302A.751, section 302A.467 authorized "imposing remedies against [a miscreant] individually").

273. *PJ Acquisition*, 453 N.W.2d at 5-6.

274. *Id.* at 6 n.12 (emphasis added).

As this passage demonstrates, the court first determined that the case was properly a derivative case. From that determination, the court concluded that: (a) the demand and contemporaneous ownership requirements applied in the case; and (b) it was unnecessary to determine whether those requirements apply in a direct suit.

The second and third reasons confirm that the *PJ Acquisition* holding makes good sense, both as a matter of statutory interpretation and as a matter of public policy. The direct/derivative distinction is fundamental to corporate jurisprudence.²⁷⁵ If the legislature had intended to take the radical step of overturning that distinction, it is unlikely that they would have done so *sub silentio*. This argument is especially strong given the myriad of provisions in which the legislature has *explicitly* created new or special rules for close corporations.²⁷⁶

As for public policy, if Minnesota Statutes section 302A.751 means the wholesale elimination of the direct/derivative distinction in close corporations, then a sole disgruntled shareholder will have inordinate power to disrupt the corporation. This problem transcends the issue of "strike suits"²⁷⁷ and is best explained with an example drawn from *Skoglund v. Brady*,²⁷⁸ the court of appeals' most noteworthy recent decision dealing with the direct/derivative distinction in a close corpora-

275. CARY & EISENBERG, *supra* note 13, at 943-44. Cf. COX ET AL., *supra* note 13, § 15.3, at 15.220 (discussing the rationale for continuing to distinguish the derivative suit from the individual suit); see DEMOTT, *supra* note 1, § 1:01, at 1-1, 1-2, § 2:01, at 2-1, 2-2. The distinction results from applying a concept fundamental to all U.S. jurisprudence—i.e., standing—to one of the most fundamental notions of corporate law—i.e., the relationship *inter se* the participants in a corporate enterprise.

276. See, e.g., MINN. STAT. § 302A.011, subd. 6a (defining closely held corporation); § 302A.751, subds. 1(b)(2), (3) (establishing special protections for shareholders in their capacities as officers or employees of a close corporation); § 302A.751, subd. 3a (providing considerations in granting relief involving closely held corporations); § 302A.751, subd. 2 (detailing buy-out remedy for close corporations). Subdivision 2 was amended in 1994 to expand its purview to all corporations that are not publicly held. 1994 Minn. Laws ch. 417, § 10.

277. A strike suit is a suit "maintained by irresponsible shareholders who [are] motivated by the prospect of a quick settlement rather than by the best interests of the corporation." BRODSKY & ADAMSKI, *supra* note 121, § 9:01, at 9-2. For a more narrow definition, see *PJ Acquisition Corp.*, 453 N.W.2d at 14 (Yetka, J., dissenting) (defining strike suit as "a suit brought by a plaintiff who purchased a nominal interest in a corporation in order to bring a lawsuit").

278. 541 N.W.2d 17 (Minn. Ct. App. 1995), *petition for review denied*, (Minn. Feb. 27, 1996).

tion.²⁷⁹

The plaintiff in *Skoglund* was a passive investor, who had suffered no direct injury. He had not been terminated from a corporate position²⁸⁰ and had been denied no rights incidental to his status as a shareholder.²⁸¹ He alleged and objected to corporate injuries—waste and self-dealing.²⁸² There were several other, similarly situated passive investors, none of whom chose to join the plaintiff in the suit.²⁸³

Allowing the plaintiff to proceed with his direct claims would have caused several inequities. First, in a matter that demanded considerable attention from corporate managers and considerable corporate resources,²⁸⁴ a single shareholder would have wrested control of the corporation away from its directors and, moreover, from a disinterested special litigation committee.²⁸⁵ This would have occurred even though the plaintiff had suffered no direct injury, had no personal interest directly at stake and had not garnered any support from other similarly situated investors. Second, any direct remedy accorded to the plaintiff would have benefitted him to the exclusion and detriment of the other shareholders and would have amounted

279. Other aspects of *Skoglund* are discussed *supra* notes 153-64.

280. *Cf. Pedro v. Pedro*, 489 N.W.2d 798, 802-03 (Minn. Ct. App. 1992) (shareholder terminated as employee despite reasonable expectation of life-time employment), *petition for review denied*, (Minn. Oct. 20, 1992).

281. *Skoglund*, 541 N.W.2d at 19. *Cf. Warthan v. Midwest Consol. Ins. Agencies*, 450 N.W.2d 145 (Minn. Ct. App. 1990) (involving, *inter alia*, denial of shareholders' rights to vote on asset sale and denial of access to corporate books and records); *Henricksen v. Big League Game Co.*, No. CO-95-388, 1995 WL 550935 (Minn. Ct. App. Sept. 19, 1995) (involving, *inter alia*, unauthorized issuance of stock which prevented plaintiff shareholder from exercising preemptive rights); *Chabot v. Industrial Relations Council, Inc.*, No. 8720942 (St. Louis County Dist. Ct. Nov. 27, 1989), *aff'd*, No. C8-90-300, 1990 WL 119371 (Minn. Ct. App. Aug. 21, 1990) (involving, *inter alia*, denial of access to corporate files and reduction of work hours and salary); *Frenzel v. Logistics, Inc.*, No. 457733 (Ramsey County Dist. Ct. Oct. 31, 1985) (involving, *inter alia*, denial of access to corporate books and records and elimination of cumulative voting).

282. *Skoglund*, 541 N.W.2d at 19.

283. Letter from Gene A. Hoff, attorney for Instrumentation Services, Inc. (June 18, 1996) (on file with authors).

284. *See Skoglund*, 541 N.W.2d at 19 (noting the special litigation committee's finding that "expenses associated with the lawsuit" were, prior to the trial court decision and the appeal, probably in excess of \$54,000).

285. *See id.* at 19-20 (noting (i) that neither the one-person SLC nor the accounting firm retained by the committee "had any prior relationship" with the corporation, its directors or the plaintiff, (ii) the trial court had found that the SLC "was independent and conducted its investigations in good faith" and (iii) at the trial court level the plaintiff had not even challenged the committee's independence).

to a mandatory, preferential distribution of corporate assets to the plaintiff. Such a result may be warranted when a shareholder has directly suffered oppression,²⁸⁶ but not where a shareholder is merely riding piggyback on a harm to the corporation.

The position taken by the Minnesota Supreme Court in *PJ Acquisition* thus makes good sense. Moreover, that position is consistent with decisions interpreting statutes similar to Minnesota Statutes section 302A.751. Although few cases have directly addressed the issue, they all have expressly required a direct injury.

In *Sax v. World Wide Press, Inc.*,²⁸⁷ for example, the Ninth Circuit dismissed a direct action alleging corporate waste under a statute similar to section 302A.751 because the complaining shareholder had failed to establish a direct injury.²⁸⁸ The minority shareholder had sought liquidation of the corporation, alleging that after he had stopped working for the corporation the majority shareholders had "conspired to deplete [the corporate] assets and depreciate the value of his stock"²⁸⁹ The court concluded that, although the statute allowed a shareholder to obtain liquidation through a direct action, "the shareholder must first identify illegal, oppressive, or fraudulent acts which have injured him personally."²⁹⁰ "[R]equiring a shareholder to establish personal injury and not just corporate injury in a direct shareholder action," noted the Ninth Circuit, "will . . . reduce the volume of litigation in Montana courts."²⁹¹

Likewise, in *River Management Corp. v. Lodge Properties, Inc.*,²⁹² the Colorado Court of Appeals dismissed a minority shareholder's direct claims for waste and mismanagement under a statute similar to section 302A.751, holding that such claims alleged injury to the corporation and could only be raised in a

286. See *supra* notes 44-47 (discussing buy-outs as the primary remedy in freeze-out cases).

287. 809 F.2d 610 (9th Cir. 1987).

288. *Id.* at 616 (applying MONT. CODE ANN. § 35-1-921 (repealed 1991) which provided that a corporation can be liquidated by a shareholder when it is established that the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent).

289. *Id.* at 612.

290. *Id.* at 613-16 (citations omitted).

291. *Id.* The statute involved in *Sax* was repealed in 1991 and was replaced by MONT. CODE ANN. § 35-1-938 (1995). The replacement is nearly identical, suggesting that the *Sax* analysis still applies.

292. 829 P.2d 398 (Colo. Ct. App. 1991).

derivative suit.²⁹³ *Gimpel v. Bolstein*²⁹⁴ supports the same view, albeit with more oblique language. A minority shareholder brought a direct suit seeking dissolution pursuant to a statute similar to section 302A.751 and a derivative suit alleging waste of corporate assets and oppression.²⁹⁵ The plaintiff argued that dissolution was proper under a section of the statute allowing relief “when the property or assets of the corporation are being looted, wasted, or diverted for non-corporate purposes by its directors, officers or those in control of the corporation.”²⁹⁶ The court responded that plaintiff’s “allegations, even if true, would not justify dissolution of the corporation. [The plaintiff’s] derivative action, wherein these same allegations are made, provides a sufficient remedy for any wrong that may have been done by these acts.”²⁹⁷

293. *Id.* at 403-04. The court went on to find that the majority shareholder had breached its fiduciary duties by committing acts of oppression against the minority shareholder. *Id.* at 403.

294. 477 N.Y.S.2d 1014 (N.Y. Sup. Ct. 1984).

295. *Id.* at 1016.

296. *Id.* at 1021 (quoting N.Y. BUS. CORP. LAW § 1104-a(a)(2) (McKinney, 1986)).

297. *Id.* There are a few cases which, on casual reading, might appear to take a contrary approach. However, none of these cases have actually ruled to the contrary, and in fact each case involved some direct injury to the plaintiff. For example, in *Kalabogias v. Georgou*, 627 N.E.2d 51 (Ill. App. Ct. 1993), *cert. denied*, 631 N.E.2d 709 (Ill. 1994), the court applied a statute similar to section 302A.751 and stated:

The rationale underlying this remedy is to protect the interest of minority shareholders against majority shareholders who “reap the benefits of ownership through compensation and other withdrawals not available to the minority.” Thus, direct actions for dissolution enable minority shareholders to recover their investment from the corporation when no other methods are available.

Id. at 57 (citations omitted). The court found that the minority shareholders had established sufficient evidence of illegal and fraudulent conduct and held the majority shareholders personally liable to the minority shareholders. *Id.* at 58. Some of the evidence reflected corporate harm—e.g. testimony that one of the defendants was “skimming . . . off the top of the [corporation’s] gross receipts.” *Id.* at 54. There were also significant *direct* injuries, however. The majority shareholders fired one of the minority shareholders, while the other left his position soon after the firing of the first. *Id.* In such circumstances, there is nothing remarkable about recognizing a direct claim. See *infra* part VI.B. (explaining that, when genuine direct claims co-exist with derivative claims, a shareholder has standing to assert the direct claims).

Schirmer v. Bear, 648 N.E.2d 1131 (Ill. App. Ct. 1995), *appeal granted*, 660 N.E.2d 1280 (Ill. 1995), is another Illinois case similar to *Kalabogias*. Pursuant to a statute comparable to section 302A.751, a minority shareholder brought suit seeking dissolution of the corporation, or in the alternative, an order directing the corporation to buy his shares. Although the decision does not discuss the direct/derivative issue, the facts show that the plaintiff suffered a direct injury. *Id.* at 1131. The majority shareholder “acted illegally in removing the plaintiff from the board of directors.” *Id.* at 1134.

In short, if there is a basis for setting aside the direct/derivative distinction in *some* close corporation cases, that basis lies elsewhere. It does not derive from an overexpansive reading of section 302A.751.²⁹⁸

B. The Overlap between Direct and Derivative Claims

A corporation's closely held nature can produce situations in which both derivative and genuinely direct claims are involved. Sometimes this overlap follows from the multifarious nature of the alleged misconduct.²⁹⁹ Sometimes the overlap occurs when those in control of the corporation retaliate against a shareholder who has raised a corporate concern.³⁰⁰ In either event, the result should be the same. The existence of derivative claims should not preclude a shareholder from asserting a claim that is genuinely personal and direct.

This is already the unstated rule in Minnesota, as evidenced by a string of cases involving overlaps. *Warthan v. Midwest Consolidated Insurance Agencies*,³⁰¹ for example, involved misappropriation of corporate assets through a self-dealing transaction which transferred substantially all of the corporation's assets to another corporation controlled by the first corporation's directors.³⁰² This misconduct plainly raised a derivative claim, but the defendants had also violated the minority shareholders'

A Michigan court ordered dissolution under a statute similar to § 302A.751, finding that the majority shareholders had breached their fiduciary duties to the minority shareholders by breaching the parties' oral agreement and diverting corporate funds. *Salvadore v. Connor*, 276 N.W.2d 458, 463-64 (Mich. Ct. App. 1978). Not only did the breach of agreement cause direct injury, but the corporate waste claims had an unusual, direct aspect. *Id.* The disbursements were made without the consent of the minority shareholders, who were members of the board of directors. *Id.* at 463.

298. Even Justice Yetka's dissent obliquely acknowledged that the direct/derivative distinction makes sense in some close corporation cases. *PJ Acquisition Corp. v. Skoglund*, 453 N.W.2d 1, 14 (Minn. 1990) (Yetka, J., dissenting) (stating that "Courts and commentators have recognized that, *in certain cases involving closely held corporations*, the reasons for distinguishing between derivative and direct actions do not exist . . .") (emphasis added).

299. See, e.g., cases discussed *infra* at note 307.

300. This was the situation in *Pedro v. Pedro*, 489 N.W.2d 798 (Minn. Ct. App. 1992), *petition for review denied*, (Minn. Oct. 20, 1992). The excluded shareholder's trouble began when he questioned an apparent discrepancy in the company's books. *Id.* at 800.

301. 450 N.W.2d 145 (Minn. Ct. App. 1990).

302. *Id.* at 149.

rights directly—no vote had been taken on the asset sale,³⁰³ and the minority shareholders had been denied access to corporate books and records.³⁰⁴ Without commenting on the overlap or indeed on the direct/derivative issue, the court allowed a direct suit.

Similar circumstances produced a similar result in *Wheeler v. McGee*.³⁰⁵ The suit involved both conversion of corporate assets as well as an effective end to the plaintiff's employment with the corporation.³⁰⁶ The former claim should have been derivative, while the latter was direct. Again without reference to the direct/derivative issue, the court permitted a direct suit.³⁰⁷

These cases were decided correctly. "The general principle . . . is that a direct action is not precluded simply because the same facts could also give rise to a derivative action."³⁰⁸ That proposition does not, however, end the inquiry. There remains the question of how to handle the derivative claims. At least two possibilities exist: (i) keep the derivative claims separate and determine whether the direct plaintiff can be a fair and

303. *Id.* The *Warthan* court cited Minnesota Statutes § 302A.661, subdivision 2, which requires shareholder approval for the sale of "substantially all of [a corporation's] property and assets, including its goodwill, not in the usual and regular course of its business" *Id.*

304. *Id.* Section 302A.461 entitles shareholders to have access to certain books and records of the corporation. MINN. STAT. § 302A.461.

305. No. C5-92-680, 1992 WL 383460 (Minn. Ct. App. Dec. 29, 1992), *petition for review denied*, (Minn. Feb. 12, 1993).

306. *Id.* at *1.

307. *See also* Chabot v. Industrial Relations Council, Inc., No. 8720942 (St. Louis County Dist. Ct. Nov. 27, 1989) (involving conversion of corporate assets (derivative), but also denial of access to corporate files and reduction of work hours and salary (direct); allowing a direct suit), *aff'd*, No. C8-90-300, 1990 WL 119371 (Minn. Ct. App. Aug. 21, 1990); Frenzel v. Logistics, Inc., No. 457733 (Ramsey County Dist. Ct. Oct. 31, 1985) (involving usurpation of corporate opportunities and self-dealing (derivative), but also a denial of access to corporate books and records and elimination of cumulative voting (direct); allowing a direct suit). *Grogan v. Garner*, 806 F.2d 829, 833-34 (8th Cir. 1986), reflects the same phenomenon, involving a misappropriation of corporate assets and property (derivative), but also fraud and misrepresentation in inducing the plaintiff shareholders to agree to the sale of the corporation (direct). While the case applies Missouri law, it has been frequently cited by courts applying Minnesota law. *See, e.g.*, Arent v. Distribution Sciences, Inc., 975 F.2d 1370, 1372 (8th Cir. 1992) (applying Minnesota law); International Broadcasting Corp. v. Turner, 734 F. Supp. 383, 392 (D. Minn. 1990) (applying Minnesota law); Northwest Racquet Swim & Health Clubs, Inc. v. Deloitte & Touche, No. C9-94-301, 1994 WL 481345, at *3 (Minn. Ct. App. Sept. 6, 1994), *rev'd*, 535 N.W.2d 612 (Minn. 1995).

308. *See* CARY & EISENBERG, *supra* note 13, at 944; *see also* Moran Household Int'l, Inc., 490 A.2d 1059, 1070 (Del. Ch.) *aff'd*, 500 A.2d 1346 (Del. 1985).

adequate representative for those claims³⁰⁹ or (ii) fold the derivative harms into the direct suit. Before evaluating these possibilities, it is necessary to consider the third proposed rationale for having a special rule for close corporations.

C. No Reason, No Rule: When the Distinction Makes No Difference

Several jurisdictions have allowed close corporation plaintiffs to bring direct claims despite the traditional direct/derivative distinction. For example, in *Watson v. Button*,³¹⁰ the Ninth Circuit allowed a claim alleging that a former manager of a dissolved close corporation had misappropriated corporate assets to proceed as a direct suit.³¹¹ In *Thomas v. Dickson*,³¹² the Georgia Supreme Court allowed a direct claim where the plaintiff shareholder was the sole injured party.³¹³

The rationale for these decisions was straightforward. Certain circumstances justify the direct/derivative distinction in ordinary corporations. In close corporations those circumstances might not exist. If they do not, there is no reason to preserve the distinction they justify.³¹⁴

This rationale has been adopted by the American Law Institute in its Principles of Corporate Governance: Analysis and Recommendations. Section 7.01(d) states:

In the case of a closely held corporation, the court in its discretion may treat an action raising derivative claims as a

309. See *supra* notes 123-25 and accompanying text (discussing the fair and adequate representation requirement).

310. 235 F.2d 235 (9th Cir. 1956).

311. *Id.* at 236-37.

312. 301 S.E.2d 49 (Ga. 1983).

313. *Id.* at 51; see also *Kirk v. First Nat'l Bank*, 439 F. Supp. 1141, 1148-49 (M.D. Ga. 1977) (allowing former shareholders to bring direct action against former president who allegedly caused diminution in value of their previously owned shares by misappropriating corporate assets); *Caswell v. Jordan*, 362 S.E.2d 769, 773 (Ga. Ct. App. 1987) (permitting the minority shareholder to bring direct suit against corporation's president and president's wife for plundering and looting corporate assets), *cert. denied*, (Ga. Feb. 5, 1988).

314. *Watson*, 235 F.2d at 236-37; *Kirk*, 439 F. Supp. at 1149; *Thomas*, 301 S.E.2d at 51; *Caswell*, 362 S.E.2d at 773. Both *Thomas* and *Kirk* cite the rationale provided in *Watson*. The *Watson* court explained the general rule "that a stockholder of a corporation has no personal right of action against directors or officers who have defrauded or mismanaged it and thus affected the value of the stock." *Watson*, 235 F.2d at 236-37. However, the *Watson* court stated an exception to the general rule that permits a direct action "where the rights of creditors are not prejudiced and there are no other shareholders involved." *Id.*

direct action, exempt it from those restrictions and defenses applicable only to derivative actions, and order an individual recovery, if it finds that to do so will not (i) unfairly expose the corporation or the defendants to a multiplicity of actions, (ii) materially prejudice the interests of creditors of the corporation, or (iii) interfere with a fair distribution of the recovery among all interested persons.³¹⁵

Several courts have followed the ALI approach, including *W & W Equipment Co. v. Mink*³¹⁶ and *Richards v. Bryan*.³¹⁷ In the former, a shareholder in a close corporation brought a direct suit alleging that the directors had breached their fiduciary duties by terminating plaintiff's employment, failing to be honest about the value of retiring shareholder's stock, and threatening to bleed the corporation of its assets should the plaintiff refuse to pay the retiring shareholder's requested price.³¹⁸ The court rejected defendant's claim that plaintiff's suit had to be brought derivatively, concluding that "the reasons for requiring a derivative action are not present in this case."³¹⁹ More specifically, the court noted that there were only two shareholders, the plaintiff was the sole injured shareholder, and there was "thus no potential for multiplicity of shareholder suits"³²⁰ In addition, "there [was] no evidence of any creditor in need of protection," nor was there "prejudice to other shareholders not a party to the suit since [the plaintiff was] the only injured shareholder"³²¹ Moreover, the plaintiff "would not be adequately compensated by a corporate recovery because [the corporation was] a close corporation with no ready market for the sale of [the plaintiff's] shares."³²²

In the latter case, *Richards v. Bryan*, a minority shareholder in close corporation brought a direct suit against the majority shareholders alleging that the defendants had effectively frozen out the plaintiff, denied the plaintiff a reasonable return on

315. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.01(d). The ALI approach does not encompass all previous rationales. For example, *Thomas* addressed not only the issues considered by the ALI but also whether a derivative suit would suffice to adequately compensate the injured shareholder. *Thomas*, 301 S.E.2d at 51.

316. 568 N.E.2d 564, 571 (Ind. Ct. App. 1991).

317. 879 P.2d 638, 647-48 (Kan. Ct. App. 1994).

318. *W & W Equip. Co.*, 568 N.E.2d at 573.

319. *Id.* at 571.

320. *Id.*

321. *Id.*

322. *Id.*

investment, and fraudulently induced the plaintiff to enter a formation agreement.³²³ The court permitted the plaintiff to bring a direct suit for the derivative claims explaining that the suit "will not expose [the corporation] to a multiplicity of actions or interfere with a fair distribution of recovery because the [plaintiff is] the only minority shareholder in the corporation."³²⁴ Furthermore, said the court, "there is no indication that resolution of [plaintiff's] claims will prejudice any creditors' interests."³²⁵

Such cases and reasoning are by no means universal. Indeed, at present only a handful of decisions reflect the ALI approach. For example, in *Bagdon v. Bridgestone/Firestone, Inc.*,³²⁶ the Seventh Circuit examined Delaware's view of the matter.³²⁷ The case involved a minority shareholder, owning forty-nine percent of the corporate shares, who had brought a direct suit against the majority shareholder, who owned fifty-one percent of the corporate shares.³²⁸ The plaintiff claimed that the majority shareholder had wrongfully competed against the corporation,³²⁹ and the court rejected the direct suit.³³⁰ The decision explains that, although Delaware recognizes an exception to derivative actions when the shareholder suffers a "special injury," Delaware does not accept the ALI approach and has no special rules for differentiating direct and derivative

323. *Richards v. Bryan*, 879 P.2d 638, 641 (Kan. Ct. App. 1994).

324. *Id.* at 648.

325. *Id.*; see also *PJ Acquisition Corp. v. Skoglund*, 453 N.W.2d 1, 14 (Minn. 1990) (Yetka, J., dissenting and invoking the ALI approach); *Barth v. Barth*, 659 N.E.2d 559, 559-60 (Ind. 1995) (invoking the ALI approach and permitting minority shareholder to bring direct action alleging that majority shareholder had misused corporate assets by paying himself excessive salaries, using corporate employees without compensating the corporation, and appropriating corporate funds for personal investments); *Schumacher v. Schumacher*, 469 N.W.2d 793, 797-99 (N.D. 1991) (invoking the ALI approach and permitting minority shareholder to bring direct action on account of excessive lease payments and management fees paid to the majority shareholders). The ALI approach was probably unnecessary in both *W & W Equip.* and *Richards*. Each plaintiff had suffered a direct injury: in *W & W Equip.*, loss of employment, *W & W Equip. Co.*, 568 N.E.2d at 573; and in *Richards*, fraud, *Richards*, 879 P.2d at 646.

326. 916 F.2d 379 (7th Cir. 1990), *cert. denied*, 500 U.S. 952 (1991).

327. *Id.* at 383-84.

328. *Id.* at 380-81.

329. *Id.* at 381.

330. *Id.* at 384 (noting that the plaintiff alleged "direct injuries, which he was free to litigate, but he could not recover on account of the store-corporation's diminished profits without making the corporation a party").

claims within a close corporation.³³¹

As to blurring of the direct/derivative line, the decision states “[t]he premise of the [ALI] approach may be questioned. Corporations are *not* partnerships Commercial rules should be predictable; this objective is best served by treating corporations as what they are, allowing the investors and other participants to vary the rules by contract if they think deviations are warranted.”³³²

In any event, Minnesota would be unwise to adopt the ALI approach *in toto* or to use it automatically. The ALI approach can be easily overextended, because the ALI’s black letter underemphasizes a key characteristic of the relevant cases. In each case that foreshadowed or reflects the ALI approach, all of the corporation’s shareholders were inextricably involved in the dispute.³³³ They were either the alleged perpetrators or the

331. *Id.* at 383-84.

332. *Id.* at 384.

333. See *Watson v. Button*, 235 F.2d 235, 237 (9th Cir. 1956) (“[plaintiff] and [defendant] were the only stockholders at the time of the misappropriation”); *Thomas v. Dickson*, 301 S.E.2d 49, 50 (Ga. 1983) (plaintiff shareholder owned one-third of the corporate stock while defendant majority shareholders owned the remaining two-thirds); *Caswell v. Jordan*, 362 S.E.2d 769, 773 (Ga. Ct. App. 1967) (plaintiff “is the sole injured shareholder, the only other shareholders being the [defendants]”), *cert. denied*, (Ga. Feb. 5, 1988); *W & W Equip. Co.*, 568 N.E.2d 564, 568 (Ind. Ct. App. 1991) (50% owner of close corporation brought suit against the other 50% owner); *Richards v. Bryan*, 879 P.2d 638, 642 (Kan. Ct. App. 1984) (plaintiff shareholder owned 49% of the corporate stock while the defendant majority shareholders owned the remaining 51%). Neither the Principles of Corporate Governance § 7.01 nor its Comments mention this fact. The Comments, however, note that “[i]n general, when a direct action is brought on behalf of the entire class of injured shareholders . . . there is less reason to insist that the action be brought derivatively.” PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.01 cmt. e. *Kirk v. First Nat’l Bank*, 439 F. Supp. 1141 (M.D. Ga. 1977) is not to the contrary. The case allowed a direct suit for claims relating to misappropriation of corporate funds, even though some of the alleged victims were not parties. *Id.* at 1148-49. Indeed, the court specifically addressed that issue and discussed the possibility of “joinder of similarly situated injured parties.” *Id.* at 1149. However, *Kirk* has no need of an ALI-type rule, even though *Kirk* discusses *Watson v. Button*, one of the cases that presaged the ALI approach. *Id.* at 1147-48. The plaintiffs in *Kirk* had sold their stock in the corporation and alleged that the sale price had been substantially reduced by fraud. *Id.* at 1144. Thus, even under conventional doctrine plaintiffs asserted a substantial claim of direct injury. As the court explained:

Plaintiffs allege . . . that a substantial factor in determining the selling price of their shares was book value of those shares; that the book value figure actually used did not reflect sums owed [the corporation by one of the defendants] because of misappropriation of company assets; that the time of the sale [defendants] knew of the improper valuation or of facts indicating the likelihood of improper valuation; and that both [defendants], in either misinforming or

alleged victims. A direct suit could not “unfairly expose the corporation or the defendants to a multiplicity of actions” because all of the participants were parties.³³⁴

In some such situations, it does make sense to apply the notion of an “incorporated partnership” into a new context and to treat a close corporation as an aggregate of owners rather than as a separate entity.³³⁵ From that perspective, breach of loyalty claims, whatever their gravamen, appear direct rather than derivative—just as in a general partnership.³³⁶

It would be very unwise, however, to allow a direct claim just because all participants are parties. As the ALI itself notes, the direct/derivative distinction in part reflects a concern for corporate creditors, and that concern argues against any casual overriding of the distinction. The ALI approach is significant *only when the malefactors have injured a minority shareholder by injuring the corporation*. If the injury has been direct, conventional doctrine suffices to allow a direct suit.³³⁷ Therefore, whenever

failing to inform plaintiffs of this material information, are liable for fraud

Id. at 1144. Thus, *Kirk* is an overlap case. See *supra* part VI.B. Furthermore, the court states an additional reason for permitting a direct suit: “all shares of [the corporation] had changed hands” in the complained-of transaction, and no derivative suit was possible. *Kirk*, 439 F. Supp. at 1149.

334. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 212, § 7.01(d)(i).

335. As explained *supra* notes 28-29 and accompanying text, the term “incorporated partnership” influenced courts as they developed the notion that shareholders in a close corporation owe each other fiduciary duties. Here, as there, the notion of an aggregate is used as a metaphor. The point is not to deny the legal existence of the entity but rather to look through the entity to its owners. As a metaphor, the notion of an “incorporated partnership” continues to make sense, even though the Revised Uniform Partnership Act (RUPA) deems a RUPA general partnership to be an entity. R.U.P.A. § 201 (1994). The metaphor owes its power to the historical concept of a partnership as an aggregate of owners.

336. See *supra* note 1 (discussing the partnership action for an accounting). *Cf.* *McLaughlin v. Wedum Found., Inc.*, No. C3-91-1784, 1992 WL 31359, at *2 (Minn. Ct. App. Feb. 25, 1992) (holding that Minnesota law does not allow a general partner of a general partnership to bring a derivative action on behalf of the partnership against a third party).

337. *Grogan v. Garner*, 806 F.2d 829 (8th Cir. 1986) is instructive in this respect. The case arose following the sale of a corporation and involved both misuse of corporate assets and misrepresentations connected with shareholder approval of the sale. *Id.* at 833-34. As to the direct/derivative issue the court stated:

Had the plaintiffs challenged only the propriety of the pre-closing sale of STI-Kansas shares to certain employees of the corporation, then possibly *Dawson* [a case requiring a derivative suit] would have been controlling because the plaintiffs would be challenging the sufficiency of consideration paid for STI-Kansas stock However,

er the ALI approach is significant, there will likely be allegations of self-dealing, usurpation of corporate opportunity or similar tactics that have bled the corporation of its assets. It is precisely this sort of situation in which a derivative suit, with its corporate rather than individual recovery, is important for the protection of creditors.

Moreover, allowing a direct suit for indirect injuries is only appropriate when plaintiffs allege some sort of disloyalty or bad faith and not for claims of mere mismanagement. Even in a close corporation, corporate law entitles the majority shareholder to manage the enterprise,³³⁸ and the law should not provide an *ersatz* direct claim for every disagreement over business decisions made by the majority shareholder in good faith.

If the mismanagement is egregious, the minority shareholder can bring a derivative suit. The corporation will likely respond with a special litigation committee, but that committee's determination will be a barrier to the plaintiff only if the committee is independent and conducts its investigation in good faith.³³⁹ If this is not good enough for the minority shareholder—if the minority shareholder wishes some greater power to second guess management decisions made in good faith—then the minority shareholder should make those wishes known before the fact and should obtain the majority shareholder's written agreement.³⁴⁰

the plaintiffs . . . are claiming that they were defrauded by [the defendant's] representation [relating to the sale of the corporation]

Id. at 835 n.7. The court, therefore, allowed a direct claim. *Id.* at 835. As mentioned *supra* note 307, *Grogan* applies Missouri law but has been frequently cited by courts applying Minnesota law.

338. As *Wilkes v. Springside Nursing Home, Inc.*, explains:

[T]he controlling group in a close corporation must have some room to maneuver in establishing the business policy of the corporation. It must have a large measure of discretion, for example, in declaring or withholding dividends, deciding whether to merge or consolidate, establishing salaries of corporate officers, dismissing directors with or without cause, and hiring and firing corporate employees.

Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 663 (Mass. 1976).

339. See *supra* part III.B.

340. See MINN. STAT. § 302A.457 (1994). The statute authorizes a written shareholder control agreement

that relates to the control of or the liquidation and dissolution of the corporation, the relations among them, or any phase of the business and affairs of the corporation, including, without limitation, the management of its business, the declaration and payment of distributions, the election of directors or officers, the employment of shareholders

Even as to claims of disloyalty or bad faith, some further guidelines are necessary. Not every claim of bad faith should transmute a derivative claim into a direct one. That transmutation is appropriate only when the majority shareholder has used a corporate harm to target the minority shareholder for oppression.

With that targeting concept in mind, it might seem sufficient to require the plaintiff to allege that the derivative-type harms were "aimed at minority shareholder." That standard, however, is too subjective and would allow direct claims even when the minority shareholder could not show any likelihood of injury.³⁴¹

Switching to an "effect" rule—i.e., allowing the transmutation when misconduct "has the effect, albeit indirectly, of specially injuring the minority shareholder"—would not solve the problem. An effect rule would also sweep too broadly, allowing a direct claim even when the majority is merely exercising "the legitimate rights of selfish ownership."³⁴² Suppose, for example, that the controlling shareholders wish the business to grow and therefore reject a lucrative offer to buy a company asset.³⁴³ The minority shareholder wants a quick return and claims that, given the conflict of goals, rejecting the offer caused a special injury. Assuming the rejection was not part of an effort to freeze-out the minority shareholder, a direct claim would be completely inappropriate.³⁴⁴

by the corporation, or the arbitration of disputes

Id. at subd. 2(a). Although the statute does not limit the times at which an agreement may be made, ordinarily the minority shareholder's bargaining power is greatest just prior to becoming a shareholder.

341. *Cf. Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458-59 (1993) (criticizing lower court decisions which had held, for the purposes of attempted monopolization claims, that evidence of specific intent to monopolize suffices as evidence of a dangerous probability of success), *remanded sub nom. McQuillan v. Sorobothane, Inc.*, 23 F.3d 1531 (9th Cir. 1994) (remanding with directions to dismiss). See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY - THE LAW OF COMPETITION AND ITS PRACTICE* § 6.5(b), at 254 (1994).

342. *Wilkes*, 353 N.E.2d at 663.

343. This example assumes that the corporation is not "up for sale." If the corporation were up for sale, those in control would have a duty to try to maximize the sale price. See *supra* note 266.

344. If the rejection of the offer were part of a pattern intended to expropriate the minority shareholder's value, the minority shareholder would have a direct claim under traditional doctrine. See *supra* notes 26, 29 and accompanying text (describing "classic" freeze-outs).

The better rule is to allow transmutation only when the derivative harm has occurred *with the purpose and effect of causing an injury targeted at the minority shareholder*. The effect requirement precludes claims based on mere allegation of evil intent. The purpose requirement precludes claims that reflect mere differences in business judgment and is moreover consistent with the “good faith” approach of Minnesota Statutes section 302A.751, subdivision 3a.³⁴⁵

In sum, a shareholder in a close corporation should be able to bring a direct claim under any of the following circumstances:

- (1) when the shareholder has suffered a direct injury, rather than a injury merely in consequence of an injury to the corporation;³⁴⁶
- (2) when the shareholder has suffered both direct and indirect injuries, the direct injury is substantial rather than *de minimus* and a single action can efficiently remedy both injuries;³⁴⁷ and
- (3) when the shareholder has suffered only indirect injury, the shareholder can show that the misconduct had the purpose and effect of causing an injury targeted at the plaintiff, and all shareholders are involved in the suit either as alleged victims or alleged perpetrators.

VII. THE PROCEDURAL WRAP-UP: PLEADING AND REMEDIES

The special rule just suggested leaves open two issues: (i) what must the plaintiff allege or establish in order to proceed with direct claims; and (ii) when a direct plaintiff makes use of derivative harms, how do those harms factor into the direct remedy.

A. Pleading Requirements

As explained in Part IV, it is essential that the direct/derivative issue be decided as early as possible.³⁴⁸ It

345. That subdivision refers to “the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner.” MINN. STAT. § 302A.751, subd. 3a.

346. See *supra* notes 269-70 (describing close corporation cases involving genuinely direct injuries).

347. See *supra* part VI.B. (describing overlap cases).

348. See *supra* part IV (explaining the importance of making an early threshold determination).

follows therefore that to proceed with a direct claim a plaintiff should have to plead facts, which if true, would satisfy one of the tests stated in Part V. Plaintiff should plead these facts with particularity. In this context, the pleadings function not merely to give the defendants general notice of the claims, but also to allow the court to make a fundamentally important determination.³⁴⁹ The requirement of particularity is not onerous. If the plaintiff has suffered a genuinely direct injury, the plaintiff has the necessary facts at hand. If the plaintiff is seeking to transmute a derivative claim, some information about corporate operations will be necessary. However, given the intimate nature of a close corporation, the plaintiff should have access to the necessary information unless those in control of the corporation are purposefully denying access. That denial would give the plaintiff a direct cause of action in any event.³⁵⁰

B. Factoring Derivative Harms into Direct Remedies

When a close corporation shareholder dispute goes into litigation, a buy-out becomes the remedy of choice.³⁵¹ If the business is successful, dissolution is not only draconian but often economically wasteful.³⁵² At the same time, it makes little sense to keep warring parties locked into co-ownership of a

349. Cf. MINN. R. CIV. P. 23.06 (requiring that "[t]he complaint [in a derivative action] shall . . . allege with particularity the efforts, if any, made by the plaintiff to obtain the desired action from the directors . . . and the reason for the plaintiff's failure to obtain the action or for not making the effort"); *Grobow v. Perot*, 539 A.2d 180, 186 (Del. 1988); *Aronson v. Lewis*, 473 A.2d 805, 808 (Del. 1984) (requiring that derivative plaintiffs who assert demand futility to plead certain facts with particularity).

350. See *Warthan v. Midwest Consol. Ins. Agencies*, 450 N.W.2d 145 (Minn. Ct. App. 1990); *Chabot v. Industrial Relations Council, Inc.*, No. 8720942 (St. Louis County Dist. Ct. Nov. 27, 1989), *aff'd*, No. C8-90-300, 1990 WL 119371 (Minn. Ct. App. Aug. 21, 1990); *Frenzel v. Logistics, Inc.*, No. 457733 (Ramsey County Dist. Ct. Oct. 31, 1985) (each holding that denying shareholders access to information engenders a direct claim).

351. Harry J. Haynsworth, *The Effectiveness of Involuntary Dissolution Suits As A Remedy for Close Corporations Dissentions*, CLEV. ST. L. REV. 25, 43 (1986-87).

352. Steven C. Bahls, *Resolving Shareholder Dissension: Selection of the Appropriate Equitable Remedy*, 15 J. CORP. L. 285, 296-97 (1989-90) (explaining that liquidating a corporation does not yield the maximum value for the shareholders); *BJUR & SOLHEIM*, *supra* note 44, § 8015, at 95 (explaining that courts view judicial dissolution as an extreme remedy). See also MINN. STAT. § 302A.751, subd. 3b (instructing courts to consider "lesser relief" in lieu of dissolution). *But see id.* at subd. 3 (instructing, *inter alia*, that a corporation's financial success is not a per se bar to dissolution).

closely held business.³⁵³

In the context of a buy-out, it is a conceptually simple matter to determine how to factor derivative harms into the direct remedy.³⁵⁴ The buy-out price is based on the fair value of the corporation,³⁵⁵ and that fair value includes whatever funds, property, or other assets have been diverted or depleted from the corporation.

Although there is no reported Minnesota case precisely on point, one unreported decision does illustrate this approach. *Henricksen v. Big League Game Co.* was a direct suit alleging that the defendant shareholder had breached fiduciary duties by improperly issuing stock and making unauthorized corporate distributions.³⁵⁶ In determining the value of the complaining shareholder's fifty percent interest, the court considered not only the value of the corporate assets at the time of trial, but also the value of the assets improperly withdrawn from the corporation.³⁵⁷

353. Cf. MINN. STAT. § 302A.751, subd. 1(b)(1) (permitting a court to dissolve a corporation when "the directors or the persons having the authority otherwise vested in the board are deadlocked in the management of the corporate affairs and the shareholders are unable to break the deadlock"); MINN. STAT. § 323.31(4) (1994) (permitting a court to dissolve a partnership when a partner "acts in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with that partner"); BJUR & SOLHEIM, *supra* note 44, § 8066, at 141 (explaining that inability to conduct business must be shown before courts will order a dissolution).

354. The concept may be straightforward, but valuation disputes are anything but. To the contrary, they are quite fact intensive, and typically involve a battle of experts. See, e.g., *Rapid-American Corp. v. Harris*, 603 A.2d 796, 802 (Del. 1992) ("It is frequently the case in appraisal proceedings that valuation disputes become a battle of experts."); *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 175 (Del. 1991) ("As is often the case in disputed appraisal proceedings, the dispute over the value of [corporation's] shares at the time of the merger became a battle of the experts . . .").

355. MINN. STAT. § 302A.751, subd. 2. This subdivision does give some role to the price set in "the bylaws of the corporation, a shareholder control agreement, the terms of the shares, or otherwise." *Id.* However, if oppression has prompted the buy-out, the court will disregard as "manifestly unreasonable" any agreed-upon price that is lower than the actual fair value. Otherwise, the agreed-upon value will serve to effectuate the oppression. *Pedro v. Pedro*, 489 N.W.2d 798, 802 (Minn. Ct. App. 1992), *petition for review denied*, (Minn. Oct. 20, 1992).

356. *Henricksen v. Big League Game Co.*, No. Co-95-388, 1995 WL 550935 (Minn. Ct. App. Sept. 19, 1995).

357. *Id.* at *2. The decision states this point obliquely:

It appears from the record that the trial court attempted to compare the corporate assets at the time that [the plaintiff] withdrew from active participation in the company to those that remained at the time of the trial. The court determined what assets had been sold or

An Eighth Circuit case, *Foy v. Klapmeier*,³⁵⁸ supports the approach by analogy. In *Foy* a minority shareholder brought a combined derivative/appraisal action, alleging usurpation of corporate opportunity. The court took into consideration the worth of the usurped opportunity in determining the value of the minority shareholder's five percent interest.³⁵⁹

VIII. CONCLUSION

Understanding how to differentiate between direct and derivative claims within a close corporation requires first understanding the general rule for making that distinction. Minnesota's general rule requires correction; its reference to "same character" of injury should be replaced by the concept of direct injury. With that correction in place, Minnesota should then adopt a special rule for close corporations, allowing direct claims (i) when the plaintiff has suffered purely direct harm, (ii) when the plaintiff has suffered both direct and indirect harm, and (iii) when the parties to the dispute comprise all the

valued and deducted the distributions already paid to [the plaintiff]. The court then calculated the remaining amount due to him for his 50 percent share of the corporate ownership.

Id.

358. 992 F.2d 774 (8th Cir. 1993).

359. *Id.* at 779. See also *Pooley v. Mankato Iron & Metal, Inc.*, 513 N.W.2d 834, 838 (Minn. Ct. App. 1994) (rejecting a minority discount in oppression-triggered buy-out), *petition for review denied*, (Minn. May 17, 1994); *MT Properties v. CMC Real Estate Corp.*, 481 N.W.2d 383, 386-87 (Minn. Ct. App. 1992) (rejecting a minority discount in appraisal proceeding). A line of Delaware appraisal cases provides support as well. These cases hold that the fair value of the corporation, as determined in the appraisal proceedings, includes the value of derivative claims. See, e.g., *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1142-43 (Del. 1989) (holding that, in light of parties' stipulation, the trial court did not err in considering minority shareholder's loss of corporate opportunity claim in an appraisal proceeding); *Bomarko, Inc. v. International Telecharge, Inc.*, No. C.A.13052, 1994 WL 198726, at *3 (Del. Ch. May 16, 1994) (rejecting argument that derivative claims may only be asserted in an appraisal proceeding under exceptional circumstances and holding that "breach of fiduciary duty claims that do not arise from the merger are corporate assets that may be included in the determination of fair value"); *In re Radiology Associates, Inc.*, No. CIV.A.9001, 1990 WL 67839, at *13 (Del. Ch. May 16, 1990) (holding that derivative claims which are precluded for lack of standing and do not relate to the validity of the merger may be considered in an appraisal proceeding); *Porter v. Texas Commerce Bancshares, Inc.*, No. CIV.A.9114, 1989 WL 120358, at *6 (Del. Ch. Oct. 12, 1989) (responding to shareholders' suit seeking rescission of a merger on the grounds that the directors had breached fiduciary duties and holding that "[i]f there is any value to the corporation of the claims of mismanagement alluded to . . . in the complaint, that value would be reflected in an appraisal award").

corporation's shareholders and those in control of the corporation have engineered corporate harms with the purpose and effect of targeting the plaintiff.

When a plaintiff successfully adjudicates a direct claim, a buy-out is typically the appropriate result. To the extent a direct plaintiff has standing to invoke indirect harms, the buy-out price should take into account the value of those harms.

APPENDIX A
ANALYSIS AND RESTATEMENT OF MINNESOTA STATUTES SECTION
302A.751, SUBDIVISION 1(b)(2) AND (3).

FIGURE 1. THE ELEMENTS

	malefactors	misconduct	injured party	injury status
subd. 1(b)(2)	directors/those in control	fraudulent or illegal action	(toward) shareholders	in their capacity as . . .
subd. 1(b)(3)	directors/those in control	in a manner unfairly prejudicial	(toward) shareholders	in their capacity as . . .

FIGURE 2. WHAT INJURIES ARE ACTIONABLE, ACCORDING TO
TYPE OF CORPORATION

type of corporation	type of offense	injury status giving rise to a claim
closely held	fraudulent or illegal conduct	injured <i>qua</i> shareholder ^a
		injured <i>qua</i> director ^b
		injured <i>qua</i> officer or employee ^c
	unfairly prejudicial conduct	injured <i>qua</i> shareholder ^d
		injured <i>qua</i> director ^e
		injured <i>qua</i> officer or employee ^f

a. MINN. STAT. § 302A.751, subd. 1(b)(3) (referring to “shareholders [injured] in their capacities as shareholders”).

b. *Id.* at subd. 1(b)(2) (referring to “shareholders [injured] in their capacities as . . . directors”).

c. *Id.* (referring to “shareholders [injured] in their capacities . . . as officers or employees of a closely held corporation”).

d. *Id.* at subd. 1(b)(3) (referring to “shareholders [injured] in their capacities as shareholders . . . of a corporation that is not publicly held”).

e. *Id.* (referring to “shareholders [injured] in their capacities as . . . directors of a corporation that is not publicly held”).

type of corporation	type of offense	injury status giving rise to a claim
not public (but not CHC)	fraudulent or illegal conduct	injured <i>qua</i> shareholder ^a
		injured <i>qua</i> director ^b
		NOT <i>qua</i> officer or employee ^c
	unfairly prejudicial conduct	injured <i>qua</i> shareholder ^a
		injured <i>qua</i> director ^b
		NOT <i>qua</i> officer or employee ^c
publicly held ^g	fraudulent or illegal conduct	injured <i>qua</i> shareholder ^a
		injured <i>qua</i> director ^b
		NOT <i>qua</i> officer or employee ^c
	unfairly prejudicial conduct	UNAVAILABLE, REGARDLESS OF INJURY CAPACITY ^h

f. *Id.* (referring to “shareholders [injured] in their capacities . . . as officers or employees of a closely held corporation”).

g. MINN. STAT. § 302A.011, subd. 40. Section 302A.011, subd. 40 defines a publicly held corporation as “a corporation that has a class of equity securities registered pursuant to section 12, or is subject to section 15(d), of the Securities Exchange Act of 1934.” *Id.*

h. Section 302A.751, subd. 1(b)(3) omits any reference to shareholders of a corporation that is publicly held. MINN. STAT. § 302A.751, subd. 1(b)(3). Indeed, the clause specifically refers to corporations that are not publicly held. *Id.*

FIGURE 3. WHO CAN BRING CLAIMS, ACCORDING TO
TYPE OF MISCONDUCT

Type of Misconduct	Shareholder Capacity/Corporation Type
fraudulent or illegal	regardless of corporation type, <i>qua</i> shareholder or director
	in a closely held corporation, also <i>qua</i> officer/employee
unfairly prejudicial	in a publicly held corporation—no one
	in a corporation not publicly held (but not close) <i>qua</i> shareholder or director only
	in a closely held corporation, in any of the four capacities, i.e., <i>qua</i> shareholder, director, officer or employee

APPENDIX B. COMPARISON OF DIRECT AND DERIVATIVE CLAIMS

	Direct	Derivative
Plaintiff's status	shareholder	shareholder
Claim asserted on behalf of	self	corporation
nature of injury to shareholder	direct	indirect
source of claims	common law and statutes; as to statutes, primarily 302A.751	common law and statutes; as to statutes, primarily 302A.251 and 302A.255
typical defendants	the corporation (as a real party in interest) and individual malefactors	the corporation (as a nominal defendant) and individual malefactors
contemporaneous ownership requirement	probably ¹	yes
"fair and adequate representative" requirement	no	yes
demand requirement	no	yes
role of special litigation committee	none	substantial; possibly dispositive
applicability of business judgment rule	no; <i>Wilkes</i> standard instead ²	yes
availability of exculpatory provisions	arguably not ³	yes
availability of indemnification for individual defendants	probably ⁴	yes
typical remedies	buy-out of complainant's interest	corporate recovery, including damages, disgorgement (constructive trust) and rescission; direct recovery to shareholders only in extraordinary circumstances
attorney's fees for plaintiff	302A.751 requires finding "that a party . . . has acted arbitrarily, vexatiously, or otherwise not in good faith" ⁵	under "common fund" theory, plaintiff's attorney is compensation from whatever money is recovered

¹ See *supra* note 121.

² See *supra* text accompanying notes 176-78.

³ See *supra* text accompanying notes 195-200.

⁴ See *supra* text accompanying notes 85-87.

⁵ There is, however, some authority suggesting that § 302A.467 allows an award of attorney's fees without such a finding. See *supra* note 48.

