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No Longer Peas in a Pod: More Implications of the Divorce of Minnesota Corporate and LLC Law

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Abstract

Twenty-five years ago, when an MSBA task force drafted Minnesota's first limited liability company(LLC) statute, the drafters copied chapter 302A, the corporate statute, to the maximum extent possible. Labels were changed—e.g., member instead of shareholder; board of governors instead of board of directors—and substance was modified to the extent necessary to comply with the then-applicable tax classification regulations. But otherwise, the task was an exercise in replication.

The approach was far out of the mainstream. Almost everywhere else LLC statutes were being derived from partnership law. The task force's rationale for going rogue was straightforward. At the time, most business lawyers—even the most experienced ones—had no grasp of the law of general and limited partnerships. Using the corporate model eliminated a huge and widespread learning curve. As an added benefit, case law arising from the corporate statute would inform the law of Minnesota LLCs (and perhaps eventually, vice versa).

It seemed like a good idea at the time. It was a good idea at the time. But eventually the state bar committee on LLCs decided that it was time to return to the herd. Again, the rationale was straightforward. Minnesota's almost unique approach meant that any LLC deal involving participants outside Minnesota would likely have to use the very abstruse Delaware statute.

Accordingly, the new Minnesota LLC statute, Chapter 322C, follows the partnership paradigm and is derived from the Uniform Limited Liability Company Act (2006) (Last Amended 2013). This change in approach has many consequences. The rest of this brief article illustrates the consequences of Minnesota LLCs having left the pod that was 302A-322B.

Disciplines

Business Organizations Law

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By Daniel S. Kleinberger
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Twenty-five years ago, when an MSBA task force drafted Minnesota's first limited liability company(LLC) statute, the drafters copied chapter 302A, the corporate statute, to the maximum extent possible. Labels were changed—e.g., *member* instead of *shareholder*; *board of governors* instead of *board of directors*— and substance was modified to the extent necessary to comply with the then-applicable tax classification regulations. But otherwise, the task was an exercise in replication.

The approach was far out of the mainstream. Almost everywhere else LLC statutes were being derived from partnership law. The task force's rationale for going rogue was straightforward. At the time, most business lawyers—even the most experienced ones—had no grasp of the law of general and limited partnerships. Using the corporate model eliminated a huge and widespread learning curve. As an added benefit, case law arising from the corporate statute would inform the law of Minnesota LLCs (and perhaps eventually, vice versa).

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Accordingly, the new Minnesota LLC statute, Chapter 322C, follows the partnership paradigm and is derived from the Uniform Limited Liability Company Act (2006) (Last Amended 2013). This change in approach has many consequences. The rest of this brief article illustrates the consequences of Minnesota LLCs having left the pod that was 302A-322B.

Example: Action seeking buyout on account of oppression

In their recent, very cogent and useful *Bench & Bar* article, attorneys Pat Rooney and Pat Shriver noted that the new LLC statute does not provide for squeeze-out mergers.[2] The article discussed various ramifications, and the discussion extended to address oppression actions. Almost in passing, the article states: "Because oppressive conduct lawsuits are equitable in nature, they are tried to the court, not a jury."[3]

That proposition was certainly true under the old LLC statute, but has the new statute changed the rule? I think not, but the pathway to the answer is quite different. Under chapter 322B, we knew the

[1] See Daniel S. Kleinberger, "Don't Dabble in Delaware," Business Law Today (July 2017).
[2] Patrick J. Rooney and Ernest P. Shriver, "Freeze-Out Mergers and the New Minnesota LLC Act," Bench & Bar of Minnesota (December 2017).
[3] Id. at n. 13 (citing *Pedro v. Pedro,* 463 N.W.2d 285, 288 (Minn. App. 1990)).

proceeding was in equity because the very first sentence of Section 322B.833 told us so. "A court may grant any equitable relief it deems just and reasonable in the circumstances…."[4]

Chapter 322C continues no such language, although the statute does provide an oppression remedy. Section 322C.0701, Subdivision 1(5) authorizes judicial dissolution or a court-ordered buyout "on application by a member… on the grounds that the managers, governors, or those members in

control of the company… have acted or are acting in a manner that is oppressive and was, is, or will be directly harmful to the applicant."[5]

A plaintiff is to assert the claim in "an appropriate court,"[6] but the statute nowhere describes the proceeding as equitable.[7] Being without statutory guidance, we must consult case law. Moreover, because any Minnesota case law would have involved the statutory guidance no longer present in Minnesota LLC law, we must consult case law from other jurisdictions.

The case law is not abundant, but it does suggest that dissolution is an equitable remedy. As mentioned above, Minnesota's statute is based on the uniform act, which takes a partnership-like approach to almost all matters. Under partnership law, court-ordered dissolution was always an equitable remedy,[8] and the few LLC cases that mention the issue take the same position. For example, last year the Missouri court of appeals, discussing the standard of review in the case *sub judice*, stated: "The standard of review in *an equitable action, like one to dissolve a limited liability company*, is the same as that for any court-tried case…."[9]

For reasons of policy as well as precedent, Minnesota should (and most likely will) take the same view. There is no justifiable reason to treat Minnesota corporations and Minnesota limited liability companies

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[4] Minnesota Statutes, Section 322B.833, Subdivision 1. Plaintiffs asserting oppression invoked Minn. Laws 2014, Section 322B.833, Subdivision 1(ii)(authorizing dissolution or other equity remedies if "the governors or those in control of the limited liability company have acted fraudulently, illegally, or in a manner unfairly prejudicial toward one or more members in their capacities as members or governors of any limited liability company, or as managers or employees of a closely held limited liability company") ;

[5] Minnesota Statutes, Section 322C.0701, Subdivision 1(5)(ii). Subdivision 2 authorizes a buyout as an alternative remedy.

[6] Minnesota Statutes, Section 322C.0701, Subdivision 1(5).

[7] Section 322C.0701, Subdivision 1(4) does refer to "the entry by [an] appropriate court of an order," ("court order provision") but even with a civil trial by jury it is the court that enters orders. Although we will return to the court order provision presently in another context, note 9, the provision by itself cannot carry enough weight to determine this issue.

[8] LLC dissolution traces back to the dissolution of a general partnership, which until relatively recently required an action for accounting, which was considered an equitable remedy. See e.g. *Brewer v. Swartz*, 83 Mo. App. 451, 451 (1900).

[9] *Massood v. Fedynich*, 530 S.W.3d 49, 63–64 (Mo. Ct. App. 2017) (emphasis added). The relevant statute provided: "On application by or for a member, the circuit court for the county in which the registered office of the limited liability company is located may decree dissolution of a .imited liability company whenever it is not reasonably practicable to carry on the business in conformity with the operating agreement." Missouri Statutes, Section 347.143.2. Assuming that dissolution has been an equitable remedy, consider again the court order provision, this time in conjunction with Minnesota Statutes 322C.0107: "Unless displaced by particular provisions of this chapter, the principles of law and equity supplement this chapter." The court order provision may not suffice by itself to determine that the remedies are equitable, but even more so the provision does not suffice to particularly displace a pre-existing rule of equity. (Thank you to Messrs. Rooney and Shriver for helping the author see this point.)

differently on this issue. Moreover, oppression claims typically bring about a business divorce.[10] Just as with marital divorce, business divorces should not be heard by a jury.

Standing to bring a direct claim: The direct vs. derivative

When a corporate shareholder or LLC member brings suit against those who manage the company, the direct/derivative distinction typically has a huge impact. "The direct/derivative distinction… has… major practical ramifications [including]: the risk of dismissal for mistaking the distinction, the demand requirement, the special litigation committee [SLC], [and] the ownership of any amount recovered."[11] These ramifications are serious problems for any would-be plaintiff.

By far the leading (and correct) rule of distinction is the direct harm approach. A member or shareholder has standing to bring a direct claim only if she, he, or it can plead a direct harm—that is, an injury that is not merely derivative of the injury suffered by the entity.

For example, a claim that directors have mismanaged the corporation and thereby decreased its value is derivative. Each shareholder suffers injury, but only because the value of stock reflects the value of the corporation. Any decrease in share value is therefore indirect. In contrast, if a member claims that the manager of a limited liability company has wrongfully withheld distributions due the member under the operating agreement, the member is complaining about a direct harm and therefore has standing to sue directly.

Following the uniform LLC act, Chapter 322C leaves no doubt as to the applicable rule: "A member maintaining a direct action… must plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited liability company."[12] An official comment to the uniform act notes that: "This [subdivision] codifies the rule of standing that predominates in entity law."[13]

In the corporate context, the rule was cloudy until quite recently, and the issue under chapter 322B was beclouded as well. Fortunately, in January 2016, the court of appeals dispelled the cloud and adopted the direct harm approach.

Noting the "logical fallacy" inherent in allowing direct claims only upon a showing of unique injury,[14] the court of appeals stated: "[W]e conclude that all shareholders may bring a direct claim (1) [even if] all

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[10] In fact, the leading blog on closely held New York corporations and limited liability companies, written by Peter Mahler, is called "New York Business Divorce." *https://www.nybusinessdivorce.com/*, last visited 1/2/18.

[11] Daniel S. Kleinberger, "Direct Versus Derivative and the Law of Limited Liability Companies," 58 Baylor L. Rev. 63, 70–71 (2006) (footnotes omitted). See also See also Daniel S. Kleinberger & Imanta Bergmanis, "Direct vs. Derivative, or What's a Lawsuit Between Friends in an 'Incorporated Partnership?,"' 22 Wm. Mitchell L. Rev. 1203, 1226-29 (1996).

[12] Minn. Stat. Ann. §322C.0901, Subdivision 2.

[13] Uniform Limited Liability Company Act (2006) (Last Amended 2013) §901(b), cmt.

[14] *In re Medtronic, Inc.*, No. A15-0858, 2016 WL 281237, at *5, n.5 (Minn. Ct. App. 1/25/2016), review granted (4/19/2016), aff'd in part, rev'd in part sub nom. *In re Medtronic, Inc. S'holder Litig.*, 900 N.W.2d 401 (Minn. 2017) ("Respondents' argument falls prey to the logical fallacy identified by Daniel Kleinberger…. [A]s a matter of consequence when a shareholder's injury is indirect, all shareholders have in common the same (indirect) injury. It does not logically follow, however, that whenever shareholders have a common injury they necessarily suffered their injury indirectly.") (quoting Daniel S. Kleinberger, "Direct versus Derivative and the Law of Limited Liability Companies," 58 Baylor L.Rev. 63, 103 n. 5 (Winter 2006)).

shareholders share the same injury; (2) [if] the shareholders would receive the benefit of the recovery or remedy; and (3) [if] the injury is not suffered by the corporation."[15] The Supreme Court rejected some embellishments added by the court of appeals but agreed on the fundamental principle: "[T]he test …which distinguishes direct from derivative claims [involves] identifying who [first] suffered the injury and therefore who is entitled to the recovery for that injury."[16]

Thus, chapters 302A and 322C have essentially the same rule of standing. However, the harmony was not automatic— not like peas in a pod. Rather, the courts "found" the rule for corporations, and the Legislature proclaimed the rule for LLCs.

Conclusion

Chapter 322C brings with it all the advantages that come from being a uniform act. However, the new statute has ended the intra-state uniformity that had existed between the corporate statute and Chapter 322B.

[15] *In re Medtronic, Inc.*, No. A15-0858, 2016 WL 281237, at *3 (Minn. Ct. App. 1/25/2016), review granted (4/19/2016), aff'd in part, rev'd in part sub nom. *In re Medtronic, Inc. S'holder Litig*., 900 N.W.2d 401 (Minn. 2017).
[16] *In re Medtronic, Inc. S'holder Litig.*, 900 N.W.2d 401, 409 (Minn. 2017).