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Minnesota Business Corporations Act: Greater Freedom for Corporations

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Notes

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I. INTRODUCTION

The new Minnesota Business Corporations Act[1] (new Act) modernizes Minnesota law to meet the needs of contemporary local businesses. The prior law,[2] the second oldest body of state business corporation law in the nation,[3] was inflexible, confusing, and unresponsive to the needs of modern businesses.[4] For example, although closely-held businesses comprise ninety percent of the business corporations in Minnesota,[5] prior law made no distinction between publicly-owned and closely-held businesses. The old law mandated procedures and requirements that reflected archaic notions of operating publicly-owned businesses, and ignored the special needs of closely-held corporations. These outmoded procedures and requirements prohibited shareholders and corporate managers from adopting contemporary business practices. In addition, because prior law often forced new business corporations to incur high legal costs during their formation,[6] many businesses either did not incorporate or feigned compliance with the statutory requirements.[7]

In response to these deficiencies, the Minnesota Advisory Task Force on Corporation Law[8] drafted Chapter 302A. The

1. Act of May 27, 1981, ch. 270, 1981 Minn. Laws 1141 (codified at MINN. STAT. §§ 302A.001-.917 (Supp. 1981)).

2. MINN. STAT. §§ 300.01-.84, 301.01-.98 (1980).

3. *See* REPORT TO THE SENATE BY THE ADVISORY TASK FORCE ON CORPORATION LAW (1980), *reprinted in* MINN. STAT. ANN. ch. 302A, at VII (West Supp. 1982) [hereinafter cited as ADVISORY COMM. REP.]. For example, prior law generally ignored the development of federal and state securities laws and rules. *Id.* at X.

4. *See* ADVISORY COMM. REP., *supra* note 3, at IX.

5. *See* ADVISORY COMM. REP., *supra* note 3, at VIII.

6. *See* ADVISORY COMM. REP., *supra* note 3, at IX-X.

7. For example, formalities such as annual shareholders' meetings, *see* MINN. STAT. § 301.25(2) (1980), forced small firms with only one or two shareholders to go to the expense and bother of holding meetings and keeping records or faking compliance with the statute.

8. *See* ADVISORY COMM. REP., *supra* note 3, at VII:

proposed Act was signed into law on May 27, 1981, and became effective on July 1, 1981.[9] By January 1, 1984, Chapter 302A will govern the activities of almost all businesses incorporated in Minnesota.[10]

Chapter 302A attempts to encourage the formation of new business corporations within the state by providing "the greatest degree of flexibility and the most clear cut recognition of contemporary business needs and practices."[11] In addition, Chapter 302A revises the rules governing corporate formation, governance, and dissolution to make them more consistent with contemporary business practices. For example, the new Act eliminates many needless and potentially expensive formalities. New corporations need no longer file long and intricate articles of incorporation. Chapter 302A only requires the articles to contain the name and address of the corporation, the name of its registered agent, the number of shares available for issuance, and the names and addresses of the incorporators.[12] The new Act also provides a checklist of provisions that the incorporators may desire to include in the articles of incorporation, thus saving many small businesses the unnecessary

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> The Advisory Task Force on Minnesota Corporation Law was formed because of a mounting concern that the corporation laws governing Minnesota business corporations are technically and substantively deficient, out of date, and a source of confusion and frustration in the modern business world for shareholders, directors, officers, creditors, governmental agencies, lawyers, and the courts.

Id. The Task Force was composed of thirteen attorneys, aided by one full-time staff member, several part-time research assistants, several members of the Minnesota Bar, and the comments and criticism of practitioners and professors across the nation. *See id.* at V-VII.

9. MINN. STAT. § 302A.021(2) (Supp. 1981).

10. Minnesota corporations prior to the enactment of Chapter 302A were governed by either Minnesota Statutes Chapter 301, which originated in 1933 Minn. Laws, ch. 300, or Chapter 300, which originated in 1858 Minn. Laws, ch. 55. The 1933 Act permitted businesses incorporated under Chapter 300 to elect to remain under Chapter 300. *Id.* § 301.60 (1980). The drafters of the 1981 Act doubted whether Chapter 300 corporations that never became governed by Chapter 301 could be forced to accept Chapter 302A, since Chapter 300 contained no reservation of power to subject corporations formed thereunder to future amendments. MINN. STAT. ANN. § 302A.021 reporter's notes (West Supp. 1982). The new Act thus exempts Chapter 300 corporations from its application. All other Minnesota corporations may elect to come under Chapter 302A until January 1, 1984, when non-electing corporations become subject to the new law. MINN. STAT. § 302A.021(7) (Supp. 1981).

11. ADVISORY COMM. REP., *supra* note 3, at X.

12. MINN. STAT. § 302A.111(1) (Supp. 1981). In contrast, prior law required a statement of business purpose or purposes, the duration of the business, a description of each class of stock, and the minimum amount of stated capital with which the corporation begins business. *Id.* § 301.04 (1980).

expense of hiring counsel.[13]

Chapter 302A facilitates the governance of both closely-held and publicly-held businesses by granting the board of directors broad discretion in corporate management.[14] The authority of the board of directors may now be vested in executive or other committees of the board.[15] The new Act modifies the directors' statutory duty of care by allowing them to rely upon the information and advice of officers or employees believed to be "reliable and competent"; directors can also rely on counsel, public accountants, and others who have pertinent "professional or expert competence."[16] In addition, Chapter 302A allows directors to conduct the business without holding meetings; if the articles so authorize, the board may act on the written authorization of its members.[17]

The new Act also allows shareholders to assume responsibilities for corporate management. Upon unanimous vote, the shareholders may undertake the function of the board of directors.[18] This provision allows a sole shareholder to directly manage the corporation.[19] Moreover, shareholder groups may

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13. *Id.* § 302A.111(2)-(4) (Supp. 1981). The checklist specifies the required provisions for the articles. *Id.* § 302A.111(1). In addition, the checklist enumerates all of the provisions of Chapter 302A that govern a corporation unless modified by the articles, *id.* § 302A.111(2), lists provisions of the law governing a corporation that the articles or bylaws may modify, *id.* § 302A.111(3), and lists those provisions of the law relating to the management and regulation of the corporation not otherwise applicable to the corporation that the articles or bylaws may include. *Id.* § 302A.111(4). The net effect of the checklist is to provide shareholders, subscribers, and incorporators a greater "opportunity to influence the future of the corporation." MINN. STAT. ANN. § 302A.111 reporter's notes (West Supp. 1982).

14. ADVISORY COMM. REP., *supra* note 3, at XII.

15. MINN. STAT. § 302A.241(1) (Supp. 1981). The former law only permitted the board to appoint an executive committee. *Id.* § 301.28 (1980). Under Chapter 302A, the board may delegate any part of its power of management to any committee of its choosing, while retaining the ultimate power over that committee. *Id.* § 302A.241(1) (Supp. 1981). The committee of disinterested persons under section 302A.243 represents the one exception to this provision. *Id.* §§ 302A.241(1), .243. *See also infra* notes 125-83 and accompanying text.

16. MINN. STAT. § 302A.251(2)(a) (Supp. 1981). This "safe harbor" provision recognizes that a director of a modern corporation may not be able to personally discover and collect all of the necessary facts to discharge his or her duties: MINN. STAT. ANN. § 302A.251 reporter's notes (West Supp. 1982). A director's actions are protected only if the director actually relied upon the information, and the information relied upon was within the field of the expert's competence. *Id.*

17. MINN. STAT. § 302A.239(1) (Supp. 1981).

18. *Id.* § 302A.201(2).

19. The new Act also allows a sole shareholder to be the only director of the corporation. *Id.* § 302A.203. A sole shareholder who is a natural person could also directly manage the corporation by becoming the sole director. *Id.*

enter into agreements relating to the voting of their shares[20] or the control of any phase of the corporation's business.[21]

Although Chapter 302A provides management with substantially more freedom, it also protects shareholders by increased disclosure requirements. For example, under the new Act, the corporation, upon written demand, must allow a shareholder access to records of board and shareholders' meetings, all articles and bylaws currently in effect, financial statements distributed to shareholders or governmental agencies as a matter of record, reports to shareholders within the last three years, voting trust and shareholder control agreements, and the share register.[22] The shareholder's particular intent or purpose in obtaining access to this information is irrelevant.[23] In addition, a shareholder can inspect any other records if he or she has a "proper purpose."[24]

The new Act incorporates four other provisions that significantly affect both newly-formed and existing businesses incorporated in Minnesota. These provisions allow courts to order a mandatory buy-out,[25] bar most claims not filed within one year of corporate dissolution,[26] authorize a special litigation commit-

§§ 302A.203 (board consists of "one or more directors"); 302A.205 (director must be natural person).

20. *Id.* § 302A.455.

21. *Id.* § 302A.457(1). Courts had traditionally regarded such agreements as impermissible infringements on the power of the board of directors. *See* McQuade v. Stoneham & McGraw, 263 N.Y. 323, 330, 189 N.E. 234, 237 (1934). *But see* Clark v. Dodge, 269 N.Y. 410, 415-17, 199 N.E. 641, 642-43 (1936) (criticizing use of *McQuade* rationale when all shareholders had entered into control agreement).

22. MINN. STAT. § 302A.461(4) (Supp. 1981).

23. Under the old law, a shareholder had to show a "proper purpose" prior to inspection of any documents. *Id.* § 301.34(5) (1980).

24. *Id.* § 302A.461(4)(b) (Supp. 1981). The new Act defines a "proper purpose" as "one reasonably related to the person's interest as a shareholder, beneficial owner, or holder of a voting trust certificate of the corporation." *Id.* The reporter's notes indicate that this section adopts the Delaware definition of "proper purpose" and corresponding case law while effecting no change in the definition of "proper purpose" set forth by the Minnesota Supreme Court. MINN. STAT. ANN. § 302A.461 reporter's notes (West Supp. 1982). *See* Founes v. Hubbard Broadcasting, 302 Minn. 471, 473, 225 N.W.2d 534, 536 (1975); Nationwide Corp. v. Northwestern Nat'l Life Ins. Co., 251 Minn. 255, 263, 87 N.W.2d 671, 679-80 (1958). The reporter's notes do indicate, however, that the "standard set forth in State ex rel. Pillsbury v. Honeywell, 291 Minn. 322, 327, 191 N.W.2d 406, 410 (1971) of 'investment return' ought to be interpreted broadly." MINN. STAT. ANN. § 302A.461 reporter's notes (West Supp. 1982).

25. MINN. STAT. § 302A.751(2) (Supp. 1981); *see infra* notes 29-90 and accompanying text.

26. MINN. STAT. § 302A.781 (Supp. 1981); *see infra* notes 91-124 and accompanying text.

tee,[27] and allow corporate merger without a business purpose.[28] The remainder of this Note discusses each of these provisions in greater detail.

II. COURT-ORDERED BUY-OUT

Chapter 302A significantly expands the equitable relief available to minority shareholders in closely-held corporations by authorizing a court-ordered sale of a party's interest.[29] The statute allows a court, at its discretion, to order a buy-out of shares in a closely-held corporation.[30] A buy-out order may issue upon the motion of the corporation, a shareholder, or a

27. MINN. STAT. § 302A.243 (Supp. 1981); *see infra* notes 125-83 and accompanying text.

28. MINN. STAT. § 302A.601-.661 (Supp. 1981); *see infra* notes 184-228 and accompanying text.

29. MINN. STAT. § 302A.751(2) (Supp. 1981). The mandatory buy-out provision reads as follows:

> In a case under subdivision 1, clause (b) [grounds for involuntary dissolution], involving a corporation having 25 or fewer shareholders, upon motion of a corporation, or of a shareholder or beneficial owner of shares of the corporation, a court of competent jurisdiction may order the sale by a plaintiff or a defendant of all shares of the corporation held by the plaintiff or defendant to either the corporation or the moving shareholders, whichever is specified in the motion, if the court determines in its discretion that an order would be fair and equitable to all parties under all of the circumstances of the case.
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> The purchase price of any shares so sold shall be the fair value of the shares as of the date of the commencement of the action or as of another date found equitable by the court.
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> The purchase price shall be paid in one or more installments as agreed on by the parties, or, if no agreement can be reached, as ordered by the court. Upon entry of an order for the sale of shares under this subdivision and provided that the corporation or the moving shareholders post a bond in adequate amount with sufficient sureties or otherwise satisfy the court that the full purchase price of the shares, plus such additional costs, expenses, and fees as may be awarded will be paid when due and payable, the selling shareholders shall no longer have any rights or status as shareholders, officers, or directors, except the right to receive the fair value of their shares plus such other amounts as might be awarded.

Id. If the parties are unable to agree on fair value within 40 days of the entry of the court order, section 302A.751(2) provides that "the court shall determine the fair value of the shares under the provisions of section 302A.473, subdivision 6," referring to the section providing for a dissenting shareholder's demand for payment according to his or her estimate of the shares' value. The accompanying reporter's note implies that the appraisal procedure in section 302A.473(7) will be used to determine value of the shares. MINN. STAT. ANN. § 302A.751(2) reporter's notes (West Supp. 1982).

30. MINN. STAT. § 302A.751(2) (Supp. 1981). Since the court may order either plaintiff or defendant to sell all their shares to the corporation or the moving shareholders, it is possible for the court to order the buy-out of a majority shareholder by a minority shareholder. MINN. STAT. ANN. § 302A.751(2) reporter's notes (West Supp. 1982).

beneficial owner, but only if the statutory grounds for involuntary dissolution are established.[31]

Oppressed minority shareholders in closely-held corporations may be forced to seek judicial relief because of the illiquidity of their investment in the corporation.[32] The stock in a close corporation is usually held by a few shareholders who often are family members.[33] Because transactions involving sales of stock in closely-held corporations are rare, these shares are relatively unmarketable; therefore, minority shareholders are typically locked into their investments.[34]

The marketability problem is especially harmful to minority shareholders in close corporations if the majority has lawfully excluded them from participation in the company.[35] If the minority shareholder is a member of a typical close corporation in which the shareholders are also the directors and the officers, the minority shareholder may be unable to prevent the majority from acting against the minority's interest. Outvoted, the minority is often forced to leave their investment under the majority's control.[36]

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31. MINN. STAT. § 302A.751(2) (Supp. 1981). *See infra* text accompanying notes 63-72. A shareholder must bring suit for an involuntary dissolution under section 302A.751(1) before the court may order a buy-out. The court then determines whether a buy-out order would be fair and equitable to all parties under all of the circumstances of the case. MINN. STAT. § 302A.751(2) (Supp. 1981). The decision to issue the buy-out order, however, falls under the court's discretion. *Id.*

32. *See generally* Hetherington & Dooley, *Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem*, 63 VA. L. REV. 1, 3-6 (1977).

33. *See, e.g.*, Galler v. Galler, 32 Ill..2d 16, 27, 203 N.E.2d 577, 583 (1965). Professor Israels describes a close corporation as "a corporation where management and ownership are substantially identical to the extent that the independent judgment of directors is, in fact, a fiction." Israels, *The Sacred Cow of Corporate Existence—The Problems of Deadlock and Dissolution*, 19 U. CHI. L. REV. 778, 778 (1952).

34. *See* Field, *Resolving Shareholder Disputes and Breaking Deadlocks in the Close Corporation*, 58 MINN. L. REV. 985, 986 (1974); Hetherington & Dooley, *supra* note 32, at 43.

35. *See* Hetherington & Dooley, *supra* note 32, at 43.

36. *Id. See also* Gidwitz v. Lanzit Corrugated Box Co., 20 Ill.2d 208, 170 N.E.2d 131 (1960). Often, as in the case of partnerships, the relations between owners of a close corporation are compared to those of marriage partners. *See, e.g.*, Howe, *Corporate Divorce: Deadlocks in the Close Corporation*, 22 BUS. LAW. 469, 469 (1967). Owners of closely-held corporations sometimes view themselves as partners, and are looking for a sort of hybrid entity, which combines the advantages of partnership, particularly that of easy dissolution, within the framework of a corporation. Partnership investments are more liquid than those in close corporations, however, because each partner has the right to dissolve the firm, while a majority of voting shares is necessary for the voluntary dissolution of a corporation. *See* Hetherington & Dooley, *supra* note

Minority shareholders in close corporations thus face many hazards. The majority may drain off earnings through payment of excessive salaries, bonuses, expense accounts, or other fringe benefits.[37] Loans may be made to officers without adequate security. The corporation may choose not to declare dividends, leaving minority shareholders without any return on their investment.[38] The majority may sell the assets of the corporation without the assent of the minority, or may sell stock to undesirable shareholders or competitors.[39]

Prior to the enactment of the mandatory buy-out provision, dissolution was the only statutory relief available in Minnesota to dissatisfied minority stockholders.[40] Involuntary dissolution is a drastic remedy, however, and traditionally courts have been hesitant to dissolve a corporation,[41] especially when its business was prospering.[42] Moreover, the assets employed in a business may have little value once it ceases to operate as a going concern.[43] Thus, involuntary dissolution may injure all the shareholders as well as deprive the community and the economy of a viable business venture.[44]

Although other jurisdictions provide alternatives to involuntary dissolution, these alternative remedies have proved in-

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32, at 3. Moreover, it is more difficult to exclude minority partners from participation in the management of a partnership than a close corporation, because if partners disagree, a majority of partners cannot legally prevent a minority partner from participating in the business, or from withdrawing a pro-rata share of the partnership's earnings. *Cf.* Elson, *Shareholders Agreements, A Shield for Minority Shareholders of Close Corporations*, 22 BUS. LAW. 449, 452 (1967) (majority rule applies as to most corporate decisions); Note, *Some Specific Needs of the Close Corporation Not Met Under the Minnesota Business Corporation Act: Some Suggestions for Statutory Relief*, 54 MINN. L. REV. 1008, 1009 (1970) (same).

37. *See, e.g.*, Kruger v. Gerth, 16 N.Y.2d 802, 210 N.E.2d 355, 263 N.Y.S.2d 1 (1965).

38. The majority may be in a better financial position to weather long periods without dividends, or may not need dividends because the majority shareholders receive salaries as officers of the corporation. *Cf. In re* Radom & Neidorff, 307 N.Y. 1, 119 N.E.2d 563 (1954) (president of a closely-held corporation ran the business, but the opposing faction refused to sign his salary checks, leaving him without any compensation for his services).

39. *See* Elson, *supra* note 36, at 450.

40. *See* MINN. STAT. § 301.49-.50 (1980).

41. *See, e.g.*, Lakeland Dev. Corp. v. Anderson, 227 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").

42. *See* W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 496 (5th ed. 1980); Howe, *supra* note 36, at 476.

43. *See infra* note 88. *See also* V. BRUDNEY & M. CHIRELSTEIN, CASES AND MATERIALS ON CORPORATE FINANCE 34, 125 (2d ed. 1979).

44. *See* Fales, *Judicial Attitudes Towards the Rights of Minority Stockholders*, 22 BUS. LAW. 459, 462-63 (1967).

adequate. Some jurisdictions authorize courts to appoint a custodian empowered to carry on the business of the corporation for a period of time.[45] A custodianship, however, imposes a high cost on the judicial system.[46] Moreover, this alternative is merely temporary, and represents an extreme invasion of the rights of shareholders opposing the custodian.[47] The custodian has no proprietary interest in the corporation, and thus has little to gain from aggressive or innovative policies. Instead, the custodian's concern is to forestall criticism and to maintain the status quo. The inherent uncertainty regarding the tenure of custodians hinders their dealings with customers, suppliers, and employees.[48] Perhaps in recognition of the difficulties involved, the appointment of a custodian is a remedy employed only rarely by the courts.[49]

Some jurisdictions authorize the court to appoint a provisional director empowered to break deadlocks.[50] This alternative does little to protect the interests of minority shareholders, however, since the appointed director acts only when the voting shares of the corporation are divided equally between two rival factions.[51] The appointment of a provisional director inevitably relegates some of the formerly equal shareholders to minority status.[52] The other faction, having gained a majority of one, may be able to make changes in the control structure of the corporation that have a persisting effect even after the provisional director is no longer sitting.[53]

It is also unreasonable to expect agreements entered into during the formation of the corporation to protect the minority shareholders adequately. The parties often assume upon incorporation that they will be in substantial agreement as to the operation of the firm.[54] If future disputes are unforeseen,

45. *See, e.g.*, DEL. CODE ANN. tit. 8, § 226(a) (1974).

46. *See* Hetherington & Dooley, *supra* note 32, at 25 ("Temporary custodial or judicially monitored management is costly to the judicial system and to the parties, both in continuing legal expenses and in lost opportunities.").

47. *Id.*

48. *Id.* at 25-26.

49. *Id.* at 23 n.64.

50. *See, e.g.*, CAL. CORP. CODE §§ 308, 1802 (West Supp. 1982); DEL. CODE ANN. tit. 8, § 353 (1974).

51. *See* Hetherington & Dooley, *supra* note 32, at 21.

52. *Id.* at 21-22.

53. *See* W. CARY & M. EISENBERG, *supra* note 42, at 500. *See also In re* Jamison Steel Corp., 158 Cal. App. 2d 27, 322 P.2d 246 (1958), in which cumulative voting allowed both the minority and majority factions to elect two directors. The provisional director voted with the majority's two directors to increase the board to five directors, thereby permanently altering the balance of power.

54. *See* Hetherington & Dooley, *supra* note 32, at 2, 36-37.

shareholders' agreements may be ineffective or may never be executed.[55] The cost alone of retaining counsel to draft complex shareholders' agreements may preclude their use.

The mandatory buy-out provision responds to the shortcomings of involuntary dissolution and its alternatives.[56] Absent statutory authority, courts may be reluctant to order intermediate relief short of involuntary dissolution.[57] Because an order of involuntary dissolution was rare,[58] an oppressed minority shareholder in a close corporation could not be certain of obtaining judicial relief. Under the new Act, minority shareholders may move for a court ordered purchase of their shares,[59] or alternatively may move to have the corporation dissolved and its assets sold.[60] If the court decides a buy-out is equitable, the parties may either negotiate or litigate the value of the shares in the corporation.[61]

To obtain a court-ordered buy-out, a shareholder must initiate a suit and establish the grounds for involuntary dissolution.[62] The new Act broadens these grounds. Previously, involuntary dissolution was available only upon a showing that: corporate assets were insufficient to pay debts;[63] the object of the corporation had failed, been abandoned, or become impracticable;[64] the directors were guilty of fraud, mismanagement,

55. *See* Field, *supra* note 34, at 985.

56. *See* MINN. STAT. ANN. § 302A.751 reporter's notes (West Supp. 1982).

57. *Id. But see* Thwing v. McDonald, 134 Minn. 148, 153-54, 158 N.W. 820, 822 (1916), in which the court indicated that remedies short of dissolution should be considered.

58. *Cf.* Lakeland Dev. Corp. v. Anderson, 227 Minn. 432, 442, 152 N.W.2d 758, 765 (1967) (courts hesitant to grant dissolution).

59. MINN. STAT. § 302A.751(2) (Supp. 1981).

60. *Id.* § 302A.751(1)(b).

61. Initially, the parties to the sale have the right to agree upon the fair value of the shares. If they can agree upon the fair value within 40 days of the court order, the court will accept the agreed-upon value as "fair." If no agreement is reached, the court will determine the fair value using the same method it would use in an appraisal or dissenters' rights proceedings. *Id.* § 302A.751(2); MINN. STAT. ANN. § 302A.751 reporter's notes (West Supp. 1982). For a discussion of how courts value businesses in appraisal or dissenters' rights proceedings, see V. BRUDNEY & M. CHIRELSTEIN, *supra* note 43, at 1-78. *See also In re* Atlas Pipeline Corp., 9 S.E.C. 416, 435 (1941) ("The value derivable from [a company] as an operating entity is dependent in large part upon the amount of earnings to be obtained from the property as reorganized and the length of time for which such earnings will be available."); Francis I. DuPont & Co. v. Universal Studios, 312 A.2d 344 (Del. Ch. 1973) (court used two factors, earnings and assets, and assigned different weights to them in determining the value of the enterprise).

62. *See* MINN. STAT. § 302A.751(2) (Supp. 1981).

63. *Id.* § 301.49(1) (1980).

64. *Id.* § 301.49(2). This ground has been eliminated under Chapter 302A,

abuse of authority, or persistent unfairness towards minority shareholders;[65] the shareholders were so deadlocked that the business could not be conducted to the advantage of the shareholders;[66] or, the prescribed duration of the corporation had expired without extension.[67] Chapter 302A establishes several additional grounds for involuntary dissolution, including waste of corporate assets,[68] failure to elect directors,[69] and corporate admission of insolvency.[70] In addition, the new Act explicitly allows involuntary dissolution of profitable corporations[71] and eliminates the deadlock requirement.[72]

Although most of the grounds for involuntary dissolution and mandatory buy-outs are relatively straightforward,[73] the exact meaning of persistent unfairness or oppression[74] remains unsettled. One author used this definition:

> "[B]urdensome, harsh and wrongful conduct," "a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members," or "a visual departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely."[75]

This definition suggests that persistent unfairness is closely related to the fiduciary duty of good faith and fair dealing which

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id. § 302A.751(1)(b) (Supp. 1981), most likely because the requirement that a corporation state a specific business purpose in its articles has been eliminated. *Id.* §§ 302A.101, .751(1)(b).

65. *Id.* § 301.49(3) (1980).

66. *Id.* § 301.49(4).

67. *Id.* § 301.49(5).

68. *Id.* § 302A.751(1)(b)(4) (Supp. 1981).

69. *Id.* § 302A.751(1)(b)(3).

70. *Id.* § 302A.751(1)(c)(2).

71. *Id.* § 302A.751(3).

72. *Compare id.* § 301.49(4) (1980) (old law) *with id.* § 302A.751(1)(b)(3) (Supp. 1981) (new law).

73. Although any of the grounds for involuntary dissolution can support a motion for a mandatory buy-out order, the ground of "persistent unfairness" is probably both the most difficult to define and the most likely to be advanced by a disgruntled minority shareholder in a close corporation. While deadlock is a commonly advanced ground for dissolution, it is by its very terms inapplicable in regard to protecting a minority interest, unless the articles require a supermajority, in which case the minority has more leverage than is normal in a close corporation. The grounds of fraud, waste, and failure to elect directors are relatively easy to define, and may be elements of a claim of "persistent unfairness." The ground of expiration of the period of duration is self-explanatory.

74. Many statutes use the term "oppression" rather than "persistent unfairness" but the meaning of the terms are comparable. *See* W. CARY & M. EISENBERG, *supra* note 42, at 508.

75. Comment, *Oppression as a Statutory Ground for Corporate Dissolution*, 1965 DUKE L.J. 128, 134 (quoting Scottish Co-op. Wholesale Soc'y, Ltd. v. Meyer, [1958] 3 All E.R. 66, 71, 86 (HL); Elder v. Elder & Watson, Ltd., 1952 Sess. Cas. 49, 55 (Scot. 7th Div.)).

majority shareholders owe to the minority.[76] This definition seems to justify a buy-out order if shareholders abuse their corporate positions for private gain or attempt to plunder a close corporation by siphoning off profits through the payment of excessive salaries or bonuses.[77] Courts may also infer persistent unfairness if the majority shareholders have refused to allow the minority to participate in the affairs of the corporation.[78] Courts could look to, for example, majority refusals to consult with the minority, refusals to put meritorious minority proposals into effect, or hostility towards the minority.[79] In addition, a court trying to assess whether the majority's persistent unfairness warrants a buy-out order should examine the reasonableness of the shareholder's expectations. A reasonable minority shareholder's expectations will vary depending on the circumstances and the nature of the corporation. At the minimum, shareholders expect to be dealt with honestly and to share in the profits, but in some circumstances minority shareholders may expect to have a significant voice in the management of the corporation.[80] The term "persistent unfairness" affords courts the latitude necessary to determine whether grounds for dissolution or a buy-out exist in a variety of circumstances.[81]

Although a buy-out order is contingent upon a showing of the grounds for involuntary dissolution, courts should order buy-outs upon a lesser showing than they require in an involuntary dissolution proceeding. Because a buy-out is a less drastic remedy than an involuntary dissolution, courts should be willing to order a buy-out in situations in which an involuntary dissolution would be inappropriate.[82] A court-ordered buy-

76. Baker v. Commercial Body Builders, 264 Or. 614, 629, 507 P.2d 387, 394 (1973).

77. *See id.*

78. *Cf. In re* Hedberg-Freidheim & Co., 233 Minn. 534, 536-39, 47 N.W.2d 424, 426-27 (1951) (parties owned the same number of shares, but one used his position to take control of the business and exclude the other). Although the court found the plaintiff's allegations stated the grounds for persistent unfairness, the court ordered dissolution on the grounds of deadlock. *Id.* at 539-40, 47 N.W.2d at 428.

79. A single act of misdeed may be insufficient, however, since the term "persistent unfairness" seems to contemplate a continuing course of conduct. Persistent unfairness, however, is not synonymous with illegal or fraudulent conduct, and the absence of mismanagement, or misapplication of assets, does not prevent a finding of persistent unfairness or oppression. Baker v. Commercial Body Builders, 264 Or. 614, 628-30, 507 P.2d 387, 393-94 (1973).

80. *See* Comment, *supra* note 75, at 141.

81. *See id.*

82. *Cf.* MINN. STAT. ANN. § 302A.751 reporter's notes (West Supp. 1982) ("This section provides explicit statutory authority [to order buy-outs]; that authority is meant to be used."). The reporter also writes that "equitable relief

out is an especially attractive alternative to dissolution when a corporation is operating profitably. For example, in *Thwing v. McDonald*[83] the Minnesota Supreme Court was reluctant to order the involuntary dissolution of a solvent corporation, but showed a willingness to investigate remedies short of dissolution.[84] The specific authority to grant intermediate relief given the court by the new Act should encourage courts to grant relief in situations in which they were hesitant to do so in the past.

The addition of the buy-out provision to the arsenal of remedies available to the court provides minority shareholders in close corporations with much needed protection. Aside from the benefit of increasing the liquidity of minority investments, the buy-out provision diminishes the likelihood of majority exploitation, by providing the minority with a low cost, convenient remedy.[85] Since all parties know in advance that the minority may have a legal right to withdraw its pro-rata portion of the current value of the firm, a fair but nonjudicial settlement is more likely than under prior law. The possibility of a court ordered buy-out thus reduces the majority's ability to extort concessions from the minority with the threat of involuntary dissolution. By discouraging exploitative behavior, the new Act should save judicial resources and litigation costs, and reduce the need for complex and costly private agreements involving control or stock purchase options. Since the majority must pay a fair price for the minority's stock, it cannot appropriate the minority's interest at bargain rates. The majority, therefore, can increase its own wealth only by increasing the productivity of the firm. As exploitative behavior becomes less profitable for the majority, the incentive to manage fairly and efficiently increases.[86]

The buy-out provision neither overprotects minority shareholders, nor allows them to extort disproportionate gains from the majority. Because a buy-out order will issue only at the court's discretion,[87] the petitioner will most likely carry a sub-

[may be ordered] whenever the grounds for involuntary dissolution have been established." *Id.* Nevertheless, provided that the court determines that the buy-out order will be fair and equitable, *see* MINN. STAT. § 302A.751(2) (Supp. 1981), a prima facie case for involuntary dissolution should suffice to justify a buy-out order.

83. 134 Minn. 148, 158 N.W.820 (1916).

84. *Id.* at 153-54, 158 N.W. at 822.

85. *See* Hetherington & Dooley, *supra* note 32, at 47.

86. *See id.* at 46-48.

87. *See* MINN. STAT. § 302A.751(2) (Supp. 1981).

stantial burden of showing the transaction to be fair to all parties. If the court finds that a buy-out order would be fair and the minority's interest in the corporation is small, it can be easily purchased by the majority. If the minority's interest is large, it is unlikely to request dissolution. Minority shareholders have an incentive to avoid dissolution and negotiate a selling price with the majority, because the minority's share of the corporation's going concern value is lost unless the business is sold intact to a third party or the majority purchases its interest.[88]

It is also unlikely that the buy-out provision will have the effect of depriving the community of viable businesses.[89] Minority shareholders have little incentive to invoke their buy-out right if the business is profitably, efficiently, and fairly managed. Since the majority can always liquidate voluntarily, it presumably views liquidation as contrary to its own interests. A shareholder who wishes to sell stock in a profitable business should find a willing buyer in the majority who will prefer raising the necessary capital for purchasing the minority's interest to liquidating the business. If the majority cannot purchase the minority interest out of its own funds, it can borrow or solicit new investors. Because the buy-out provision enhances the liquidity of investments in close corporations, outside investors will be easier to attract. Moreover, as more investment capital becomes available, the need to exercise the mandatory buy-out will decrease; the minority will be able to sell its interest more readily on the open market, obviating the need to resort to the courts. Finally, since the minority can purchase the majority's interest, it is even less likely that a mandatory buy-out will result in liquidation of the corporation. A business will be liquidated only if neither the majority nor anyone else finds the business sufficiently profitable to continue. There is little social cost in the demise of unprofitable businesses.[90]

The mandatory buy-out provision is an innovative solution to the problem of minority illiquidity and exploitation in closely-held corporations. It protects minority interests without unduly prejudicing the rights of the majority or subverting the nature of close corporations. In addition, the new provision

88. "Frequently, the assets employed in a business have little extrinsic value once the business is terminated and no longer operates as a going concern. Thus, dissolution tends in many instances to injure all stockholders, as well as to deprive the community and the economy of a going business venture." Fales, *supra* note 44, at 462-63.

89. Hetherington & Dooley, *supra* note 32, at 49-50.

90. *Id.* at 50.

should benefit the economy and the community by encouraging investment opportunities and reducing court and transaction costs.

III. ONE YEAR CLAIM BAR

Chapter 302A bars, with one exception, claims by or against a dissolved corporation that were not pending on the date of dissolution.[91] Nevertheless, claims may be filed for one year after the filing of the articles of dissolution or the entry of a decree of dissolution if the creditor or claimant "shows good cause for not having previously filed the claim."[92] In addition, the Act does not bar claims resulting from obligations or liabilities incurred during dissolution.[93] This new treatment sharply contrasts with former Minnesota law, which held the dissolved corporation open to suit for three years beyond the date of dissolution.[94]

The former Minnesota statutes were enacted to mitigate a harsh common law doctrine. At early common law, the dissolution of a corporation abated all future claims against the corpo-

91. MINN. STAT. § 302A.781(1) (Supp. 1981). The entire section reads as follows:

> Subdivision 1. Claims barred. A creditor or claimant who does not file a claim or pursue a remedy in a legal, administrative, or arbitration proceeding under sections 302A.729, 302A.741, 302A.751 or 302A.759, or in some other legal, administrative, or arbitration proceeding pending on the date of dissolution, and all those claiming through or under the creditor or claimant, are forever barred from suing on that claim or otherwise realizing upon or enforcing it, except as provided in this section.
>
> Subd. 2. Claims reopened. At any time within one year after articles of dissolution have been filed with the secretary of state, or a decree of dissolution has been entered, a creditor or claimant who shows good cause for not having previously filed the claim may apply to a court in this state to allow a claim:
>
> (a) Against the corporation to the extent of undistributed assets; or
>
> (b) If the undistributed assets are not sufficient to satisfy the claim, against a shareholder, whose liability shall be limited to a portion of the claim that is equal to the portion of the distributions to shareholders in liquidation or dissolution received by the shareholder.
>
> Subd. 3. Claims permitted. All debts, obligations, and liabilities incurred during dissolution proceedings shall be paid by the corporation before the distribution of assets to a shareholder. A person to whom this kind of debt, obligation, or liability is owed but not paid may pursue any remedy against the officers, directors, and shareholders of the corporation before the expiration of the applicable statute of limitations. This subdivision does not apply to dissolution under the supervision or order of a court.

Id. § 302A.781.

92. *Id.* § 302A.781(2).

93. *Id.* § 302A.781(3).

94. The former Minnesota law was the result of the interaction of two sections. *See* MINN. STAT. §§ 300.59, 301.54(4) (1980).

harsh common law doctrine. At early common law, the dissolution of a corporation abated all future claims against the corporation.[95] Those creditors or claimants who had not filed their claims prior to dissolution were forever barred. The common law rule was in accord with the major goal of dissolution—to provide a quick, certain, and final accounting of the business.[96]

Courts, rebelling against a lack of protection for legitimate claimants, eventually allowed personal actions against the shareholders and directors of a dissolved corporation on the basis of the "trust fund" theory.[97] The courts reasoned that when a corporation was dissolved, the assets became a " 'trust fund against which the corporate creditors have a . . . claim' prior to that of the shareholders or any transferee who is not a bona fide purchaser."[98] A party claiming an obligation of the corporation could thus sue shareholders for the amount they received when the corporation was dissolved.[99] In addition, distributing directors were potentially liable in their capacities as trustees for the creditors and shareholders for a breach of fiduciary duty involving the dissolution. This liability was personal, and attached even though the director had recieved no share of the assets of the dissolved corporation.[100] Thus, although the corporation was not itself open to suit, claimants could obtain some limited relief.

Legislatures, through laws such as the former Minnesota law[101] and the Model Business Corporation Act (MBCA),[102] ex-

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95. Friedlander & Lannie, *Post-Dissolution Liabilities of Shareholders and Directors for Claims Against Dissolved Corporations*, 31 VAND. L. REV. 1363, 1400 (1978); Wallach, *Products Liability: A Remedy in Search of a Defendant—The Effect of a Sale of Assets and Subsequent Dissolution on Product Dissatisfaction Claims*, 41 MO. L. REV. 321, 323 (1976).

96. *See* MINN. STAT. ANN. § 302A.781 reporter's notes (West Supp. 1982); 16A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 8157-58 (rev. perm. ed. 1979). *See also* Bishop v. Schield Bantam Co., 293 F. Supp. 94, 96 (N.D. Iowa 1968) (policy of a definite termination point "inherent" in dissolution).

97. *See* Friedlander & Lannie, *supra* note 95, at 1367; Norton, *Relationship of Shareholders to Corporate Creditors Upon Dissolution: Nature and Implications of the "Trust Fund" Doctrine of Corporate Assets*, 30 BUS. LAW. 1061, 1061 (1975); Note, *Shareholder Liability Upon Liquidation of a Corporation*, 46 UMKC L. REV. 454, 461 (1978).

98. Friedlander & Lannie, *supra* note 95, at 1367 (quoting 16A W. FLETCHER, supra note 96, § 8161 at 371; Norton, *supra* note 97, at 1061-72).

99. Note, *supra* note 97, at 466.

100. *See* Friedlander & Lannie, *supra* note 95, at 1368.

101. MINN. STAT. §§ 300.59, 301.54 (1980). The effects of this type of statutory section on the liability of shareholders and directors under the "trust fund" theory is not entirely clear, although one view holds that the time limit in the statute also bars "trust fund" actions. Friedlander & Lannie, *supra* note 95, at

panded claimant rights by allowing suit against the corporation if the action were commenced within a specified time period after dissolution. The former Minnesota law provided that to conclude its affairs the corporation would continue to exist for three years following dissolution.[103] The result of this law was a three year grace period in which to press claims against the dissolved corporation. The MBCA provides that claimant rights against the corporation would continue for two years.[104] In addition, several states have enacted statutes patterned after the MBCA which provide up to five years to press claims.[105]

New Jersey statutes, which are the model for Minnesota's new claim-bar provision,[106] codify claimant rights against both the shareholders and the corporation.[107] New Jersey law provides that a claimant, who shows good cause for not having filed before dissolution, may press a claim against a dissolved corporation or a shareholder who received a portion of the assets of the liquidated corporation.[108] As one commentator noted,[109] this provision seems to hold open perpetually shareholder liability for contingent claims, such as claims for product defects or breached warranties.[110] Because such claims may not mature until years after the original purchase of the product,[111] any claimant suing shortly after maturation, but many years after the dissolution, could easily show good cause for the lateness of the claim. The commentator therefore suggested that the statute be amended by affixing an absolute time limit beyond which claims would be barred.[112]

Chapter 302A embodies a response to that suggestion by including an absolute bar to all claims filed more than one year after dissolution. The expressed purpose of the new one year

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1381. The bar on "trust fund" actions seems to be in accord with the policy of finality underlying these statutes. *Id.* at 1401.

102. MODEL BUSINESS CORP. ACT § 105 (1979).

103. MINN. STAT. § 300.59 (1980).

104. MODEL BUSINESS CORP. ACT § 105 (1979).

105. *See, e.g.,* ALA. CODE § 10-2A-203 (1980); TENN. CODE ANN. § 48-1014 (1979). *See also* Wallach, *supra* note 95, at 325.

106. MINN. STAT. ANN. § 302A.781 reporter's notes (West Supp. 1982).

107. *See* N.J. STAT. ANN. § 14A:12-13 (West Supp. 1981-82).

108. *Id.*

109. Kessler, *The New Jersey Business Corporation Act: Some Effects of the 1974 Amendments on Close Corporations*, 28 RUT. L. REV. 96, 111 (1974).

110. Contingent liabilities may be defined as those which had not yet arisen at dissolution. The underlying obligation is not due and payable at the time of dissolution. The former Minnesota law provided that contingent claims were not subject to the three year time limit. MINN. STAT. § 301.54(4) (1980).

111. Kessler, *supra* note 109, at 111; Wallach, *supra* note 95, at 325-26.

112. Kessler, *supra* note 109, at 111.

time limit is to "provide some incentive for creditors and claimants to file their claims at the time that other claims are being processed."[113] The corporation thus receives notice prior to dissolution of virtually all claims against it, and may promptly pay legitimate claims and resist others.

The new Act allows plaintiffs to pursue claims filed within one year of the dissolution only for "good cause."[114] According to the reporter's notes, good cause includes circumstances in which the claimant never received notice of dissolution or the claim did not arise until the dissolution was complete;[115] in these circumstances, the trial court retains discretion to hear the claim.[116] The absolute one year time limit thus promotes certainty and timely filing of claims.[117] In addition, if an action against the corporation would be allowed but would not yield enough to satisfy the claim,[118] the claimant may also sue the shareholders.[119] The dissolution process is thereby in accord with the main goal of dissolution "to end the corporate existence as quickly and neatly as possible."[120]

The statute's treatment of matured obligations arising prior to dissolution strikes a fair balance between the corporation's interest in the expeditious termination of its affairs and litigants' interests in pursuing claims against the corporation. Claimants whose claims mature prior to dissolution should receive sufficient notice to enable them to file before dissolution; claimants who do not receive notice may file claims for one

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113. MINN. STAT. ANN. § 302A.781 reporter's notes (West Supp. 1982).

114. MINN. STAT. § 302A.781(2) (Supp. 1981).

115. MINN. STAT. ANN. § 302A.781 reporter's notes (West Supp. 1982).

116. *Id.*

117. *Id.*

118. MINN. STAT. § 302A.781(2)(b) (Supp. 1981). The statute specifies the order in which defendants can be sued. A shareholder is not open to suit unless the remaining assets of the corporation are inadequate to satisfy the claim. *Id.*

119. The maximum liability of shareholders in any suit is "limited to a portion of the claim that is equal to the portion of the distributions to shareholders in liquidation or dissolution received by the shareholder." MINN. STAT. § 302A.781(2)(b) (Supp. 1981). The Task Force clarified this language with an example showing that a shareholder receiving 15% of the distribution is liable for the lesser of either the amount received in distribution or 15% of the judgment recovered by the claimant. MINN. STAT. ANN. § 302A.781 reporter's notes (West Supp. 1981).

The statute places no liability on directors. The policies underlying statutes which bar claims indicate that director liability under the "trust fund" theory has no continuing vitality. *See generally* Friedlander & Lannie, *supra* note 95.

120. MINN. STAT. ANN. § 302A.781 reporter's notes (West Supp. 1982); *cf.* Friedlander & Lannie, *supra* note 95, at 1401 (survival statute intended to protect certainty and definiteness, as well as to protect certain claims).

year after dissolution, because the failure to receive notice should constitute good cause for filing late.[121]

The failure of the new Act to preserve litigants' contingent claims beyond the one year time limit presents a larger problem. Because the claim would not arise until after the expiration of the absolute time limit, the claimant has no recourse against the dissolved corporation or its shareholders.[122] In some instances, the effect of this rule may be unjust—valid claimants will be denied a remedy. Nevertheless, there is some justification for barring contingent claims after some essentially arbitrary time limit has elapsed. The purpose underlying corporate dissolution is analogous to the settlement of the estate of a decedent.[123] The overall goal in both types of proceedings is finality. The heirs of a deceased person are usually not responsible for the liabilities of the deceased once the estate is settled.[124] The uncertainty involved in allowing such claims is simply not acceptable. By analogy, the possibility that a claim against a dissolved corporation could arise decades later involves too much uncertainty for the shareholders. The uncertainty simply outweighs the gain provided by such a remedy.

The analogy between the dissolution of a corporation and the closing of a decedent's estate is, however, not perfect. Although heirs taking from an estate probably committed no conscious acts to become heirs, shareholders usually make a conscious decision to become involved with the corporation. The shareholders may well have received increased dividends due to the business activity giving rise to the contingent claim. In addition, shareholders normally enjoy a continuous economic interest in the corporation and benefit from their limited liability as shareholders. Although a policy allowing contingent claims at any time after the dissolution involves too much uncertainty, the one year time bar is too restrictive; a longer period is necessary to protect contingent claimants. The legislature should therefore consider amending the statute to

121. Claims that mature just before the end of the statutory time period may be barred if not filed immediately. While the result may seem unjust, it is an unavoidable consequence of any absolute time bar.

122. Chapter 302A also protects the purchasers of the assets of a dissolved corporation from liability. MINN. STAT. § 302A.661(4) (Supp. 1981). Under section 302A.661(4), the purchaser would be liable for such claims only if the purchase agreement provided for that liability. *See generally* Wallach, *supra* note 95, at 335-45.

123. *See* Oklahoma Gas Co. v. Oklahoma, 273 U.S. 257, 259 (1927); Wallach, *supra* note 95, at 324.

124. *See* 273 U.S. at 259.

reach a more equitable balance between the shareholders' interests in the finality of dissolution and contingent claimants' interests in recovery.

IV. SPECIAL LITIGATION COMMITTEE

Chapter 302A specifically authorizes the creation of a special litigation committee,[125] composed of "disinterested" persons, who may or may not be directors of the corporation.[126] The committee is empowered to dismiss suits—including shareholder's derivative suits—brought on behalf of a corporation,[127] if the committee finds that pursuing the suit is not "in the best interest of the corporation."[128] When a litigation committee dismisses a suit, it is expected to set forth specific, business-related reasons supporting the conclusion that the suit is not in the best interests of the corporation.[129] If the committee makes its decision in good faith, the decision is final and binds the corporation and shareholders unless a court finds that the

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125. MINN. STAT. § 302A.243 (Supp. 1981). The provision authorizing the creation of a special litigation committee reads as follows:

> 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 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 determinations.

Id.

The new Act significantly expands the ability of corporations to create committees governing all aspects of corporate activity. Although former law permitted the appointment of an executive committee, it required unanimous board approval before the committee could act. MINN. STAT. § 301.28(4)(7) (1980). The new Act requires only a majority vote. Any number of committees may be created for any purpose. Committee members need not be directors of the corporation. With the exception of the litigation committee, however, all committees are subject to the control of the board of directors. *See id.* §§ 302A.241, 302A.243 (Supp. 1981).

126. *See supra* note 125.

127. Shareholder's derivative suits are the primary example of suits brought on behalf of the corporation.

128. MINN. STAT. § 302A.243 (Supp. 1981).

129. MINN. STAT. ANN. § 302A.243 reporter's note (West Supp. 1982).

committee was not independent and objective.[130] Upon such a finding, a court presumably will order the reinstatement of the suit.[131]

The shareholder's derivative suit developed as an equitable remedy to check abuses of power by corporate management.[132] Corporate directors owe a fiduciary duty to the corporation's shareholders, which requires them to discharge their management duties in good faith.[133] The directors appoint officers, who have some discretion but are expected to effectuate the policies of the board.[134] Shareholders usually bring derivative suits against corporate officers or directors for alleged misconduct in the performance of their corporate duties.[135] The shareholder, however, is only a nominal plaintiff; the cause of action and any recovery belong to the corporation.[136]

Although a shareholder may bring a derivative suit to remedy directors' or officers' misconduct, derivative suits are often abused. Although the rationale behind derivative suits is to check abuses of corporate management, derivative suits are

130. *Id. See also* Note, *The Business Judgment Rule and the Litigation Committee: The End of a Clear Trend in Corporate Law*, 14 IND. L. REV. 617, 635-36 (1981).

131. *See* MINN. STAT. § 302A.243 reporter's notes (West Supp. 1982).

132. *See* Prunty, *The Shareholder's Derivative Suit: Notes on its Derivations*, 32 N.Y.U. L. REV. 980 (1957).

133. *See* Note, *supra* note 130, at 618. *See also* MINN. STAT. § 302A.251(1) (Supp. 1981), which defines the good faith standard of conduct for directors as follows:

> 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 an ordinarily prudent person in a like position would exercise under similar circumstances. A person who so performs those duties is not liable by reason of being or having been a director of the corporation.

134. *See, e.g.*, MINN. STAT. § 302A.311 (Supp. 1981); Elson, *supra* note 36, at 452.

135. *See* Nornstein, *The Counsel Fee in Shareholder's Derivative Suits*, 39 COLUM. L. REV. 784, 797 (1939) (finding that in nearly all successful derivative suits defendants included one or more directors or officers of corporation).

136. Warner v. E.C. Warner Co., 226 Minn. 565, 569, 33 N.W.2d 721, 724 (1948). Shareholder's derivative suits may be initiated for various purposes. A shareholder may seek to enjoin the corporation from engaging in certain conduct, *see, e.g.*, Horwitz v. Balaban, 112 F. Supp. 99 (S.D.N.Y. 1949); or to challenge a certain transaction, *see, e.g.*, Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch.), *rev'd on other grounds*, 417 A.2d 378 (Del. Ch. 1980); or to pursue an unasserted corporate claim against third parties, *see, e.g.*, Dodge v. Woolsey, 59 U.S. (18 How.) 331 (1855). Although any monetary recovery belongs to the corporation, a large recovery could significantly increase the value of a shareholder's interests in the corporation. In addition, shareholders are usually indemnified for the costs of bringing suit. Shareholders may thus bring suits merely to harass a corporation, or to recover attorney's fees.

sometimes used as a vehicle for corporate extortion.[137] These so-called strike suits often are brought by plaintiffs who are pursuing something other than the corporation's best interests.[138] A single dissident shareholder, owning only one share of stock, may file a derivative suit for its nuisance value alone. Because plaintiffs in derivative suits usually recover costs and attorney's fees, unscrupulous attorneys may initiate suits for the sole purpose of realizing large fees.[139] A shareholder of a rival corporation may acquire a single share of stock and initiate a suit to harass or embarrass a competitor.[140]

Even if a suit is brought by a well-meaning shareholder, there is no reason to believe that a minority shareholder is more likely to act in the best interest of the corporation than are the directors who are elected by a majority of stockholders.[141] Shareholders often lack corporate information, and may not have a realistic conception of the corporation's best interests.[142] A shareholder may, through the medium of a derivative

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137. *See generally* Note, *Extortionate Corporate Litigation: The Strike Suit*, 34 COLUM. L. REV. 1308 (1934).

138. *See* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 548 (1949). *See generally* Block & Barton, *The Business Judgment Rule as Applied to Stockholder Proxy Derivative Suits under the Securities and Exchange Act*, 8 SEC. REG. L. J. 99, 100 (1980).

139. *See* W. CARY & M. EISENBERG, *supra* note 42, at 979:

> As a practical matter, the engine that normally drives a derivative action involving a public held corporation is not the plaintiff, but the plaintiff's attorney. The plaintiff typically makes little or no investment in the action and stands to gain very little benefit. His attorney, on the other hand, makes a very substantial investment (in the form of his time and disbursements) and stands to reap a very substantial benefit (in the form of a fee). This raises the unwholesome possibility that defendants may be able to make an improper settlement by giving their acquiescence to an inflated fee in exchange for acquiescence by plaintiff's counsel to an inadequate corporate recovery.

Id. (footnote omitted). *See also* Fistel v. Christman, 133 F. Supp. 300 (S.D.N.Y. 1955) (plaintiff's attorney agreed to dismiss Securities Exchange Act § 16(b) action on condition that defendant pay him $2,500 for legal services); Jamison v. Butcher & Sherrerd, 68 F.R.D. 479 (E.D. Pa. 1975) (proposed settlement of class action involved no benefit to the class but called for payment by defendants of $50,000 attorneys' fee).

140. Private settlements, even though prohibited by statute, *see, e.g.*, MINN. R. CIV. PRO. 23.06 (requiring prior court approval of settlements), may still make it possible for a plaintiff to profit from a nuisance suit if a secret settlement goes undiscovered. Moreover, the rules requiring court approval of settlements do not apply to derivative suits threatened but not filed. *See* Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96, 137-40 (1980).

141. Lewis v. Anderson, 615 F.2d 778, 783 (9th Cir. 1980).

142. *See* F. WOOD, SURVEY AND REPORT REGARDING SHAREHOLDER'S DERIVATIVE SUITS 45-47 (1944). The problem is exacerbated, since shareholders deciding whether to pursue corporate claims are not burdened by fiduciary duties like those of a director.

suit, attempt to force a corporation to effectuate personally held beliefs, or broad public policy goals, which are not necessarily in the corporation's or the other shareholders' best interests.[143]

The traditional justification for allowing director or litigation committee dismissal of derivative suits has been the business judgment rule.[144] Under the business judgment rule, courts will not intervene in corporate decision making, if the directors exercise good faith judgments in an honest, unbiased, and reasonable manner.[145] The business judgment rule is based on the courts' belief that shareholders' interests in a business corporation are limited to preserving the value of their investment.[146] Because directors are uniquely situated to make business decisions, the rule presumes that business judgments are best left to their expertise, or to committees appointed by them, rather than to shareholders. Absent fraud or illegality, shareholders should have no more right to challenge the directors' decision to dismiss a derivative suit than to chal-

143. *Cf.* State *ex rel.* Pillsbury v. Honeywell, Inc., 291 Minn. 322, 191 N.W.2d 406 (1971) (in suit for inspection of corporate books, shareholder's sole motivation for buying stock in a company was to attempt to change the course of the company's business, because the company's course of business was incompatible with his political views).

144. Abbey v. Control Data Corp., 460 F. Supp. 1242, 1243 (D. Minn. 1978), *aff'd*, 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980).

145. *See, e.g.*, Auerbach v. Bennett, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979). Directors are insulated from personal liability for acts within the scope of their management duties so long as they act in good faith. *See, e.g.*, MINN. STAT. § 302A.251(1) (Supp. 1981). In Minnesota, directors act in good faith when they perform their duties in a manner which they reasonably believe "to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances." *Id.* Thus, a court will not hold a director liable for honest errors or mistakes of judgment, and directors are not held to be guarantors of their companies' success. Otherwise, few, if any, individuals would be willing to become directors. *See* Chaplin, *Outside Directors and Their Responsibilities: A Program for the Exercise of Due Care*, 1 J. CORP. L. 57, 59 (1975); *see also* Note, *supra* note 130, at 621.

146. *See* Rosengarten v. International Tel. & Tel. Corp., 466 F. Supp. 817, 824 (S.D.N.Y. 1979):

> A derivative action is designed to redress wrongs to the corporation and not wrongs to the public. If the directors legitimately determine that such an action will not benefit the corporation, then, regardless of the illegality of the underlying transaction, the business judgment rule permits termination of the suit.

Id. Courts thus acknowledge that the fundamental purpose of a business corporation is to make money for its shareholders; neither the corporation nor its shareholders are guardians of the public. *See id.* Moreover, if a shareholder disagrees with a decision of the directors or a committee appointed by the board, the shareholder can vote against the directors at the next election, or sell his or her interest in the corporation.

lenge any other business decision of the board of directors.[147] The business judgment rule therefore recognizes that courts should not substitute their judgment for that of the directors.[148]

There are several reasons why courts traditionally defer to directors' business decisions. State law places the responsibility of management on the board of directors;[149] it would therefore be unfair to allow a court, which is totally unaccountable to the shareholders, to second-guess decisions of the directors.[150] Moreover, because derivative claims, even against corporate directors, belong to the corporation itself,[151] the decision whether and to what extent to explore and to prosecute such claims lies within the business judgment of the board of directors.[152] Like other questions of corporate policy and management, the decision to dismiss a claim involves weighing and balancing a variety of factors to determine what course of action or inaction best advances the interests of the corporation and its shareholders.[153] These decisions are the very kind of decisions that directors are required to make, and courts, therefore, should not "intrude to interfere."[154] In addition, courts may lack the training or expertise necessary to pass judgments on complex business decisions.[155]

The authorization of a special litigation committee to review derivative suits reflects a clear trend in the federal courts.[156] In *Abbey v. Control Data Corp.*,[157] for example, the

147. *See* Swanson v. Traer, 249 F.2d 854, 859 (7th Cir. 1957). Moreover, courts generally assume that directors act honestly. *See* Note, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CHI. L. REV. 168, 192 (1976).

148. *See* Auerbach v. Bennett, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979).

149. *See* MINN. STAT. § 302A.201 (Supp. 1981).

150. *See* Note, *supra* note 130, at 621. *See also* Holmes v. St. Joseph Lead Co., 84 Misc. 278, 283, 147 N.Y.S. 104, 107 (1914) (quoting Gamble v. Queens County Water Co., 123 N.Y. 91, 99, 25 N.E. 201, 208 (1890)).

151. *See* Warner v. E.C. Warner Co., 226 Minn. 565, 569, 33 N.W.2d 721, 724 (1948).

152. *See* Auerbach v. Bennett, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 1000-01, 419 N.Y.S.2d 920, 926 (1979).

153. *Id.*

154. *Id.*

155. *See* Note, *supra* note 130, at 621.

156. *See, e.g.*, Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Lewis v. Anderson, 615 F.2d 778, 781 (8th Cir. 1979); Note, *supra* note 130, at 630. *See also* Burks v. Lasker, 441 U.S. 471 (1979); Genzer v. Cunningham, 498 F. Supp. 682 (E.D. Mich. 1980); Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

157. 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980).

Court of Appeals for the Eighth Circuit affirmed the dismissal of a shareholder's derivative suit pursuant to a litigation committee's finding that the suit did not serve the best interests of the corporation.[158] The suit alleged violations of the securities laws stemming from illegal foreign payments made by several directors and officers of Control Data. The corporation established a special litigation committee to investigate the charges. After determining that the suit was not in the best interest of the corporation, the committee directed counsel to move for summary judgment. On appeal, the district court refused to substitute its opinion for that of the special litigation committee and affirmed the grant of Control Data's motion.[159] Similarly, in *Lewis v. Anderson*[160] the Ninth Circuit held that "the good-faith exercise of business judgment by a special litigation committee of disinterested directors is immune to attack by shareholders or the courts."[161]

Some courts and commentators, however, question the propriety of allowing a committee appointed by the board of directors to terminate shareholder's derivative suits brought against members of the board of directors.[162] These authorities suggest that directors will hesitate to recommend a suit against fellow directors with whom they work and socialize, and question whether a corporate litigation committee, appointed by the directors of a corporation, can ever be objective and unbiased in reviewing the alleged wrongdoing of directors.[163] In the recent

158. *Id.* at 727.

159. Abbey v. Control Data Corp., 460 F. Supp. 1242, 1246 (D. Minn. 1978). The court found that the business judgment rule applied to committee dismissal of shareholder derivative suits. *Id.* at 1245. The court went on to quote with approval Justice Brandeis's concurrence in Ashwander v. Tennessee Valley Auth., 297 U.S. 288, 343 (1936). "Mere belief that corporate action, taken or contemplated, is illegal gives the [shareholder] no greater right to interfere than is possessed by any other citizen. Stockholders are not guardians of the public. The function of guarding the public against acts deemed illegal rests with public officials." 460 F. Supp. at 1246.

160. 615 F.2d 778 (9th Cir. 1979).

161. *Id.* at 783. The court characterized the application of the "business judgment doctrine" as essentially an issue of standing. If the doctrine is applicable, then the plaintiffs have no standing to sue. *Id.*

162. *See infra* notes 163-64 and accompanying text.

163. *See* Dent, *supra* note 140, at 109-13 ("[T]he pressures on even nonimplicated directors are so great as to justify a conclusive presumption that they cannot independently investigate and weigh the facts and reach a conclusion that is in the best interest of the corporation."); Note, *supra* note 130, at 636-37 ("An inside director's decision not to sue a fellow director may be influenced by salary, promotion, fringe benefits, employee morale, and career consideration."). *See also* Lasker v. Burkes, 567 F.2d 1208, 1212 (2d Cir. 1978), *rev'd*, 441 U.S. 471 (1979).

case of *Maldonado v. Flynn*,[164] for example, the court declined to defer to the recommendations of a litigation committee. Instead, the court held that the power to dismiss a shareholder's derivative action, based on an alleged breach of fiduciary duty, was not included in the powers of the board of directors to manage the corporation.[165] The court expressly limited its holding, however, to cases involving a breach of fiduciary duty on the part of directors.[166] Although *Maldonado* was reversed,[167] the appellate court still reasoned that courts should apply their own independent business judgment when determining whether to grant a litigation committee's motion to dismiss a derivative suit based on a director's breach of duty.[168]

The Minnesota legislature, by enacting a statutory provision for the review of shareholder derivative suits by a litigation committee, apparently has determined that the advantages of the business judgment rule outweigh its potential for abuse. The legislature's determination is justified. Through the use of a special litigation committee, corporations can effectively deal with the potential abuses of strike suits.[169] In addition, the new statute should benefit corporations faced with suits which, although not malicious, are not in the best interests of the corporation.

Many situations may arise in which director or litigation committee dismissal of a derivative suit brought in good faith is legitimately in the best interest of the corporation or its shareholders. The prospects of a suit's success may be slim. Litigation costs may exceed any potential recovery.[170] Unfavorable or unwanted publicity may injure the corporation's reputation

164. 413 A.2d 1251 (Del. Ch.), *appeal dismissed*, 417 A.2d 278 (Del. Ch. 1980), *rev'd sub nom.* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

165. 413 A.2d at 1257.

166. *Id.* at 1263.

167. Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

168. *Id.* at 789. The court held that while an independent committee may cause its corporation to file a pretrial motion to dismiss, the court should apply a two-step test to the motion. First, the court should inquire into the independence and good faith of the committee and the reasons supporting its conclusion. If the court finds the committee was not independent or did not show reasonable bases for its conclusions, the motion will be denied. Otherwise, the court will take the second step and determine, applying its own independent business judgment, whether the motion should be granted. *Id.* at 788-89.

169. According to the reporter's notes, the intent of the statute is to grant corporations the ability to respond effectively to such suits. MINN. STAT. ANN. § 302A.243 reporter's notes (West Supp. 1982).

170. *See* Note, *Corporations—The Stockholder's Independent Right to Sue Derivatively*—Maldonado v. Flynn *and Its Progeny*, 29 U. KAN. L. REV. 135, 136 (1980).

and cause a drop in the market price of its stock. Similarly, derivative suits may demoralize management or distract it from its duties, perhaps resulting in inefficiency and lower profits. Finally, a corporation may simply prefer to apply its own internal sanctions to employee or director misconduct.[171]

Moreover, the fear that litigation committees simply will dismiss all shareholder's derivative suits brought against members of the board of directors is unfounded. The statute imposes significant limitations on the composition and deliberations of a litigation committee. Under the new Act, members of a litigation committee must be "disinterested."[172] To be disinterested an individual cannot be a defendant to the derivative suit, and cannot have been threatened to be made a defendant to the suit.[173] Directors may serve on a litigation committee, but only if they own less than one percent of the outstanding shares in the corporation.[174] The committee must be independent, and cannot be subject to the control of the board of directors.[175] Finally, litigation committee decisions not to sue must be made in "good faith," and the committee must set forth specific business related reasons supporting its conclusion that the suit should be dismissed as being not in the corporation's best interests.[176]

Given these limitations, it is unlikely that a committee will dismiss derivative suits involving legitimate shareholder grievances. Moreover, the decision to dismiss a derivative suit is not immune from judicial review. The new Act shields the deliberations and conclusions of the committee only if its members possess a disinterested independence and do not stand in a relation that prevents an unprejudiced exercise of judgment.[177] Thus, a court may review and overturn a committee's determination if it is shown that the committee was not composed of independent disinterested individuals.[178] The statute only precludes reviewing courts from inquiring into the substantive de-

171. *See, e.g.*, Maher v. Zapata, 490 F. Supp. 348, 350 (S.D. Tex. 1980).

172. MINN. STAT. § 302A.243 (Supp. 1981).

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id. See also* MINN. STAT. ANN. § 302A.243 reporter's notes (West Supp. 1982). "Committees dismissing suits should be expected to set forth specific, business-related reasons why the suit is not in the best interests of the corporation." *Id.*

177. *See* Auerbach v. Bennett, 47 N.Y.2d 619, 631, 393 N.E.2d 994, 1001, 419 N.Y.S.2d 920, 927 (1979).

178. *Id.*

cision whether to pursue a claim, because this necessarily involves weighing commercial, promotional, ethical, and fiscal factors that are common to the resolution of most corporate problems.[179] Such decisions are best left to the business judgment of a director-appointed committee. But courts may properly inquire into the adequacy and appropriateness of the committee's investigative procedures and methodologies, since these do not involve business decisions.[180] Cursory investigations that are shallow in scope or execution raise obvious questions of good faith[181] and are not shielded by Chapter 302A.

While according deference to the business judgment of director-appointed committee members, the limitation of judicial review to an examination of the procedures, methodologies, and potential interests of the committee also prevents judicial review of committee decisions from becoming a vehicle for strike suits. Although shareholders can litigate the procedural aspects of a committee's decision to dismiss, the substantive basis for the decision is immune from attack. The burden is on the party opposing the committee's decision to make a prima facie showing that the committee was not disinterested or independent, or that the decision was reached in bad faith.[182] Thus, it will be difficult for strike suit plaintiffs to pursue frivolous claims in court. In addition, the number of suits initiated by attorneys motivated by the hope of recovering fees should decline as the prospects for prevailing on the merits diminish. Finally, because judicial review will not reach the substantive basis of the claim, the cost of defending such an action is significantly decreased, thereby reducing the nuisance value of the suit.[183]

The authorization of a committee, empowered to dismiss shareholder's derivative suits, is justified on both legal and public policy grounds. The new Act enables corporations to deal effectively with strike suits, by properly recognizing that the decision to dismiss a derivative suit is within the managerial prerogatives of the business's directors. In addition, by requiring that the litigation committee's decision be made by

179. *Id.* at 663, 393 N.E.2d at 1002, 419 N.Y.S.2d at 928.

180. *Id.* at 634, 393 N.E.2d at 1002-03, 419 N.Y.S.2d at 929.

181. *See id.*

182. *See id.*

183. *See, e.g.*, Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Lewis v. Anderson, 615 F.2d 778 (8th Cir. 1979); Note, *supra* note 130, at 630.

disinterested directors in good faith, the new Act adequately protects the legitimate interests of shareholders.

V. FREEZE OUT MERGERS

The new Act allows corporations to engage in three types of fundamental change: merger with another corporation, exchange of shares with another corporation, and transfer of assets.[184] The most important modification of any fundamental change is the rejection of the "business purpose" doctrine developed in Delaware[185] and apparently adopted in Minnesota.[186] The language of the new Act expressly authorizes a merger without an underlying business purpose: "Any two or more corporations may merge, resulting in a single corporation, *with or without a business purpose* . . . ."[187]

The business purpose doctrine developed in response to the recent phenomenon of mergers designed to eliminate the publicly-held equity interests of minority investors, namely, "going private" mergers.[188] The rising stock prices of the bull market of the 1960's induced many previously privately-held corporations to seek public equity financing, or to "go public."[189] The falling stock prices of the bear market of the 1970's provided the majority shareholders of many publicly-held corporations with an opportunity to regain sole ownership of the corporation at a low cost.[190] The majority shareholders' voting power enabled them to force the publicly-held corporation to merge into a corporation owned solely by the majority, with the

184. MINN. STAT. § 302A.601 (Supp. 1981).

185. Prior to any significant Delaware decisions, the federal courts attempted to use section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1980), and Rule 10b-5 of the Securities and Exchange Commission Regulations, 17 C.F.R. § 240.10b-5 (1981), to graft a "business purpose" doctrine on the federal securities laws. *See* Green v. Santa Fe Indus., 533 F.2d 1283 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977); Marshel v. AFW Fabric Corp., 553 F.2d 1277 (2d Cir.), *vacated as moot*, 429 U.S. 881 (1976); Bryan v. Block & Blevins Co., 343 F. Supp. 1062 (N.D. Ga. 1972), *aff'd on other grounds*, 490 F.2d 563 (5th Cir. 1974); Note, *Seeking a Legal Basis for the Valid Corporate Purpose in Going Private Mergers*, 12 CREIGHTON L. REV. 629, 629, 634-636 (1979). This movement was stopped when the United States Supreme Court, in Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1977), eliminated federal securities laws as a basis for the "business purpose" doctrine.

186. Minnesota arguably adopted the doctrine in the unreported district court opinion in Bird v. Wirtz, *aff'd on other grounds*, 266 N.W.2d 166 (Minn. 1978). MINN. STAT. ANN. § 302A.601 reporter's notes (West Supp. 1982).

187. MINN. STAT. § 302A.601(1) (Supp. 1981) (emphasis added).

188. Brudney, *A Note on "Going Private,"* 61 VA. L. REV. 1019, 1019-21 (1975); Note, *supra* note 185, at 629.

189. Brudney, *supra* note 188, at 1019.

190. *Id.*

minority "frozen out" of equity participation in the new corporation and paid off in cash or debt securities.[191] Under the business purpose doctrine, a merger undertaken solely to eliminate the interest of the minority shareholders is invalid for lack of an underlying business purpose.[192]

Delaware, in *Singer v. Magnavox Co.*,[193] was the first state court to apply the doctrine. In *Singer*, North American Philips Corporation had acquired, through a tender offer, approximately eighty-four percent of the outstanding common stock of Magnavox. North American Philips then formed T.M.C. Development Corporation and merged Magnavox into T.M.C., paying all minority shareholders in cash and retaining sole equity ownership of T.M.C. The plaintiffs, minority shareholders of Magnavox, filed suit to nullify the merger on numerous grounds, including an allegation of fraud based on the majority's lack of a business purpose.[194] The Delaware Supreme Court held that a merger must be based on a business purpose, explaining that a desire to eliminate minority equity interests does not meet that standard.[195] The business purpose doctrine, according to the court, is a logical consequence of the duty of the majority shareholders to the minority.[196]

Elaborating on *Singer*, one commentator suggested that because the majority shareholders are subject to a fiduciary standard when dealing with the property of the minority, they may not freeze out the minority without a legitimate business purpose.[197] Such a freeze-out inevitably will damage the minority's interest.[198] The notion that minority shareholders are harmed in every freeze-out merger stems from a recognition that minority shareholders have an interest in both the form and the value of their investment.[199] In *Singer*, for example, the court rejected the majority's argument that it had satisfied its fiduci-

191. Such a merger may be accomplished by the use of a "shell" corporation or by a parent-subsidiary transaction. Brudney, *supra* note 188, at 1020.

192. Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977).

193. 380 A.2d 969 (Del. 1977); *see supra* note 185.

194. 380 A.2d at 972.

195. *Id.* at 980. *Singer* involved a long form merger. In Roland Int'l Corp. v. Najjar, 407 A.2d 1032 (Del. 1979), the Delaware court extended the business purpose doctrine to encompass short form mergers.

196. 380 A.2d at 976.

197. McBride, *Delaware Corporate Law: Judicial Scrutiny of Mergers—The Aftermath of* Singer v. The Magnavox Company, 33 BUS. LAW. 2231, 2233 (1978).

198. *Id.*

199. Singer v. Magnavox Co., 380 A.2d at 977-78; Note, *Fairness in Freeze Out Transactions*, 69 KY. L.J. 77, 99 (1980); *see* Note, *Elimination of Minority Share Interest by Merger: A Dissent*, 54 NW. U.L. REV. 629 (1960).

ary duty by offering a fair price for the minority shareholders' interest.[200] The court also stressed that the terms of the merger were inadequate because no equity ownership in the corporation was offered as a part of the minority's compensation.[201] Thus, the *Singer* court rejected the common law rule that the minority shareholders were harmed only if the value of their investments was confiscated.[202]

Subsequent Delaware decisions[203] have affirmed the use of the business purpose test, as have courts in Indiana,[204] New York,[205] and other jurisdictions.[206] Although none of these opinions have adequately defined the term "business purpose,"[207] the requirement suggests that the purpose must be legitimate or bona fide.[208] Significantly, courts assessing the legitimacy of a purported business purpose do not treat the business judgment of the directors with as much deference as they accord it in other areas of corporate law.[209] Moreover, the courts are not clear on exactly whose business purpose satisfies the test. In one instance, the Delaware court upheld a merger in furtherance of the business purpose of the majority shareholder.[210]

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200. Singer v. Magnavox Co., 380 A.2d at 977.

201. *Id.*

202. *See* Coyne v. Park & Tilford Distillers Corp., 73 Del. Ch. 558, 146 A.2d 785, 789 (1958), *aff'd*, 38 Del. 514, 154 A.2d 893 (1959) (example of common law position); McBride, *supra* note 197, at 2235.

203. Roland Int'l Corp. v. Najjar, 407 A.2d 1032, 1034 (Del. 1979); Tanzer v. International Gen. Indus., 402 A.2d 382, 395 (Del. Ch. 1978); Young v. Valhi, Inc., 382 A.2d 1372, 1376 (Del. Ch. 1978).

204. Gabhart v. Gabhart, 267 Ind. 370, 388, 370 N.E.2d 345, 356 (1977) (court refused to specifically accept *Singer* but held that a merger must have a valid business purpose).

205. The decisions of the New York courts indicate a movement toward a business purpose standard. Note, *An Apology for the Unwanted Public Shareholder: The Business Purpose Test and the Freeze-Out Merger*, 4 J. CORP. L. 97, 116-17 (1978); *see* Clark v. Pattern Analysis Recognition Corp., 87 Misc.2d 385, 384 N.Y.S.2d 660 (Sup. Ct. 1976); Schulwolf v. Cerro Corp., 86 Misc.2d 292, 380 N.Y.S.2d 957 (Sup. Ct. 1976); People v. Concord Fabrics, Inc., 83 Misc. 2d 120, 371 N.Y.S.2d 550 (Sup. Ct. 1975).

206. *See* Note, *supra* note 199, at 102-03.

207. Note, *supra* note 205, at 117; Note, *Short-Form Merger in Missouri: Potential Problems For Minority Shareholders*, 46 MO. L. REV. 195, 222 (1981).

208. *See* Tanzer v. International Gen. Indus., 402 A.2d 382, 395 (Del. Ch. 1978).

209. *See* Singer v. Magnavox Co., 380 A.2d 969, 979 (Del. 1977); *see also supra* text accompanying notes 177-82 for a discussion of the business judgment rule as applied to review of shareholder's derivative suits by special litigation committees.

210. In Tanzer v. International Gen. Indus., 402 A.2d 382 (Del. Ch. 1978), the parent merged a wholly owned subsidiary into a subsidiary of which it owned 81%, eliminating minority shareholder's interests. Using *Singer* as its basis,

The new Act rejects the business purpose doctrine. The business purpose doctrine seems to require a court to examine the facts and circumstances of each case,[211] since "it is clear that [a] business purpose which is sufficient to justify some mergers may not be sufficient in different circumstances."[212] The uncertainty associated with the judicial review of mergers has increased their cost and has possibly chilled some going-private transactions.[213] Chapter 302A avoids these undesirable effects by eliminating the business purpose requirement.[214] Moreover, the rejection of the business purpose doctrine and the underlying fiduciary duty of majority shareholders is in accord with the new Act's overall goal of decreased interference in corporate management.[215] The new Act recognizes that the majority shareholders fulfill their duty to the minority if the majority offers the minority a fair price for their shares. Because the scope of the majority's fiduciary duty is thus limited to the price offer for the minority's shares, appraisal is the only available remedy under the new Act for an unfair price.[216]

Commentators have argued that the real danger to minority shareholders in a merger is that they may receive an inadequate price for their interest.[217] Nevertheless, although they argue that an inadequate price is the major danger, they reject

the court upheld the freeze out merger because the elimination of the minority interests facilitated long term debt financing for the parent corporation. *Id.* at 387.

211. McBride, *supra* note 197, at 2246-50.

212. *Id.* at 2249.

213. Note, *supra* note 185, at 652-53 n.179 (citing Brudney, *supra* note 188, *Singer*, and other authorities).

214. MINN. STAT. § 302A.601(1) (Supp. 1981).

215. *See supra* notes 11-12 and accompanying text.

216. "The remedy for lack of 'entire fairness' in the transaction in this act is the appraisal section; by obtaining the fair value of the shares, the dissenting minority shareholder recoups the investment." MINN. STAT. ANN. § 302A.601 reporter's notes (West Supp. 1982). Appraisal proceedings are available to shareholders who dissent from a "plan of merger to which the corporation is a party." MINN. STAT. § 302A.471(1)(c) (Supp. 1981). Upon proper notice from the dissenting shareholder or after the merger takes effect, the corporation must remit the fair value of the dissenting shareholder's interest. *Id.* § 302A.473(5). The dissenter must then demand any supplemental payment due to an improper determination of fair value by the corporation. *Id.* § 302A.473(6). If the corporation and dissenting shareholder do not agree on the fair value, the dissenter may petition the court for a valuation. In that valuation, the court is free to "determine the fair value of the shares, taking into account any and all factors the court finds relevant, computed by any method or combination of methods that the court, in its discretion, sees fit to use." *Id.* § 302A.473(7).

217. *See* Brudney & Chirelstein, *A Restatement of Corporate Freeze Outs*, 87 YALE L.J. 1354, 1361, 1364, 1368 (1978); Note, *supra* note 205, at 101.

the utility of appraisal as the sole remedy.[218] Moreover, they reject the use of the business purpose test as a measure of the fairness or validity of the merger.[219] In a merger involving a large, publicly-held corporation with numerous small minority interests, this assessment is probably correct—the possibility of an inadequate price is the primary danger.[220] Such investors generally are indifferent regarding the form of the compensation they receive if the value of their investment is conserved. These investors would remain indifferent to the results of a freeze-out merger, provided that the majority paid a fair price for the investment and another investment with an equal or greater return was available.

Some considerations, however, may make the form of the compensation important to investors.[221] Federal and state income taxes may affect the net value that the minority shareholders receive. Although the exchange of shares completing the merger is tax free to the majority, the payment of cash and debt securities to the minority may well be a realization of income and thus a taxable event.[222] Even if the majority pays the full value of the minority interest, the minority may be at a short-run disadvantage due to these tax consequences. In addition, minority investors in a closely held corporation may lose the less tangible values of an interest in the investment.[223] Under the new Act, the minority investor in a closely-held corporation may be frozen out and left in the same position as a minority investor in a publicly-held corporation, with appraisal

218. Brudney & Chirelstein, *supra* note 217, at 1368.

219. *Id.* at 1368, 1376.

220. *But see* Singer v. Magnavox Co., 380 A.2d 969, 977 n.8 (Del. 1977) (citing Jutkowitz v. Bourns, Cal. Super. Ct. C.A. 000268 (Nov. 19, 1975), in which the court listed some of the stakes involved in an investor beyond the simple investment value).

221. Note, *Corporate Freezeouts: A New Limitation Imposed by the "Entire Fairness" Standard*, 1978 U. ILL. L.F. 686, 698-9. One possible loss to the minority shareholders is the expense and risk of finding alternate investments. Brudney, *supra* note 188, at 1023. Another loss to the minority is the "synergistic gain" accruing to the majority by virtue of the economies of only having one corporation (as in a parent-subsidiary merger) or no longer having to file reports as a publicly-held corporation. Brudney & Chirelstein, *supra* note 217, at 1371-1375 (citing Mills v. Electric Auto-Lite Co., 552 F.2d 1239 (7th Cir.), *cert. denied*, 434 U.S. 922 (1977)).

222. *See* I.R.C. § 354(a)(1) (1976); Note, *supra* note 221, at 698 n.85.

223. *See* Note, *supra* note 199, at 99 (supporting an analytical distinction between publicly and closely held corporations); Note, *Corporate Freeze-Outs Effected by Merger, The Search for a Rule*, 37 U. PITT. L. REV. 115, 130 (1975) (same).

as the sole remedy.[224] The conversion of the minority interest to cash may deprive shareholders of a proprietary interest in the corporation or force them to part with an investment with other sentimental value.[225]

The business purpose doctrine afforded minority shareholders some protection from these otherwise uncompensated losses. Although the rejection of the doctrine will result in less interference in the internal affairs of the corporation,[226] a portion of the protection afforded to minority shareholders is no longer available.[227] The net value of the rejection of the business purpose doctrine depends on the magnitude of interference in corporate affairs compared with the magnitude of the harm caused by the decreased protection for minority shareholders.

The rejection of the business purpose doctrine should entail significant gains for the business community. To that extent, the statute is a desirable development. The application of the doctrine was too uncertain to be a useful guide to business activity. The decreased protection afforded minority shareholders by the new Act, however, mandates that the courts pay careful attention to the value paid to holders of minority interests.[228] In the absence of judicial attitudes encouraging liberal valuations for the shareholders opting for appraisal, the overall effect of the rejection of the business purpose doctrine will be to unduly increase the power of majority shareholders in dealings with the minority.

VI. CONCLUSION

Chapter 302A represents a reasonable accommodation of

224. The new Act applies identically to both closely and publicly held corporations. ADVISORY COMM. REP., *supra* note 3, at VIII.

225. *See* Jutkowitz v. Bourns, Cal. Super. Ct. C.A. 000268 (Nov. 19, 1975), *cited in* Singer v. Magnavox Co., 380 A.2d 969, 977 n.8 (Del. 1977).

226. *See supra* notes 214-16 and accompanying text.

227. The business purpose doctrine does not provide direct protection against an inadequate offer price for the shares of the minority. In *Tanzer*, the court spoke of an "entire fairness" approach in which the price was only a factor in the court's determination of fairness. 402 A.2d 382, 387-89 (Del. Ch. 1978).

228. A liberal valuation in appraisal proceedings is one possible solution to the problem of uncompensated losses. The problems associated with uncompensated tax consequences or intangible losses make a more specific guide impracticable. Although different shareholders have different problems, policies of equity demand that those minority shareholders in the same merger with holdings of similar size receive the same amount. In the final analysis, the only proper admonition is that courts make liberal valuations cognizant of the disadvantages inherent in the minority shareholder's position.

the state's interest in regulating corporate activity and the requirements of corporate self-governance. The new Act has reformed corporate law by eliminating many of the unnecessary formalities associated with corporate formation, governance, merger, and dissolution. Moreover, the new Act provides corporate management with much needed flexibility while protecting shareholders from the most blatant abuses of corporate power. In its sections on merger and special litigation committees, the new Act correctly recognizes that the directors, rather than the shareholders or the courts, are best able to make decisions concerning the management of the corporations. Nevertheless, the new claim bar and buy-out provisions should help to protect shareholder's legitimate interests in receiving a fair and certain return on their investments. By incorporating these and other revisions, the new Act makes Minnesota law more responsive to the realities of contemporary business practices.