



Kevin Koepke
763.201.1201
kkoepke@koepkelaw.com

Jacqueline J. Williams
763.201.1202
jwilliams@koepkelaw.com

Jack Atnip, III
763.201.1205
jatnip@koepkelaw.com

Scott R. Manthei
763.201.1207
smanthei@koepkelaw.com

Christine Eid
763.201.1218
ceid@koepkelaw.com

Koepke Law
3161 Fernbrook Lane North
Plymouth, MN 55447

Overview

- ❑ There is a backlog of shareholders wishing to retire or to sell for other reasons.
- ❑ The law affords legal protections for shareholders in closely held businesses, because shareholders, in particular, non-majority shareholders, lack control and they lack liquidity.
- ❑ As minority owners, these shareholders generally cannot control the management or operations of the company.
- ❑ But unlike shareholders in public corporations, their stock is illiquid- there is usually a very limited market, if any, for their stock.
- ❑ Often the financial interests of a departing shareholder are at odds with the operational and financial interests of their fellow shareholders who remain to continue the business.
- ❑ As the relationship among the partners is strained, disputes and sometimes litigation results.

The Departing Shareholder

- ❑ First Question: Is there a buy-sell agreement?

- ❑ The “buy-sell agreement” is King. Regardless of the entity (e.g. LLP, Corporation, LLC, etc.) the law provides that but for a few exceptions, this agreement controls the relations:
 - among the partners; and
 - between the partnership.

- ❑ Unfortunately, without a buy-sell agreement, buy out disputes are common.

- ❑ **Tip:** Don’t let an “outsider” (legislature or the courts) decide how the company and the shares are valued –
 - Use a comprehensive buy-sell agreement and operating agreement that outlines reasonable expectations.
 - When a shareholder is departing, hire an expert to conduct the necessary valuation to determine the fair market value of a company and its shares.

What Kinds of Claims Arise?

1. **Duty of Loyalty:** The duty of loyalty, a component of fiduciary duty, prevents shareholders from acting in a manner that is unfairly prejudicial to other shareholders.

Shareholders may run afoul of the duty of loyalty by:

- Taking company assets or opportunities for personal use (i.e., “Misappropriation”).
 - Excluding co-owners from having a voice in management.
 - Refusing to make required financial and business disclosures to shareholders.
 - Otherwise “freezing out” shareholders, by siphoning off company profits through excessive salaries, refusing to declare dividends, selling or transferring business assets to certain shareholders or companies owned by those shareholders.
2. **Fraud:** More egregious breaches of loyalty (e.g., stealing of assets from the company, deceptions, misrepresentations, lies) also constitute fraud, which are also violations of fiduciary duty.

What Kinds of Claims Arise?

3. **Violations of Reasonable Expectations:** Shareholders in closely-held entities have reasonable expectations that develop at the inception of the relationship and also arise during the course of the shareholders' relationship with each other and with the entity.

Some reasonable expectations include:

- the ability to transfer shares
- the ability to manage the company (e.g. removal from the board of directors)
- ongoing employment
- the value of ownership interests
- the amount and frequency of distributions

A shareholder's reasonable expectations will vary on a case-by-case basis. Where a shareholder's reasonable expectations are circumvented, shareholder litigation will ensue.

What Kinds of Claims Arise?

4. **Employment Claims:** Most closely-held entities employ shareholders to run the company or perform other important roles in the company. Shareholders who are employees expect:
- to have a job; and
 - to have a salary.

Violation of Reasonable Expectations: If a shareholder-employee has a reasonable expectation of continued employment, the termination or salary reduction of such shareholder-employee often sparks disputes that are ripe for litigation. Use an employment agreement or include a provision in the shareholder agreement to prevent reasonable expectation of employment and salary claims of the shareholder-employee.

Wrongful Termination: Remember that a shareholder-employee who is terminated may also have a claim for wrongful termination. An employment agreement also prevents erroneous claims for wrongful termination.

What Can the Courts Do For You (Or to You)?

1. **Fair Value Buy-Out:** A fair value buy-out is a statutory remedy that offers a “fair value” buy-out of the complaining shareholder’s stock in the corporation.

“Fair Value” vs. Fair Market Value: Minnesota courts use the “Fair Value” standard. Fair Value is defined generally as a shareholder’s pro rata share of the value of the business as a going concern without a discount for the lack of marketability. As opposed to “Fair Market Value”, where obviously, the lack of liquidity of the shares in the open marketplace would lead to a severely depressed valuation result.

Valuation Date: The usual valuation date under Minnesota law is the date of the commencement of the lawsuit. However, a court may use another valuation date, if the court decides it is more equitable for the situation.

Limitation: If the buy-out is subject to a shareholder control agreement, courts must adhere to the valuation formula, unless the terms or price are unreasonable under the circumstances, or the agreement is found invalid.

What Can the Courts Do For You (Or to You)?

2. Other Relief

- *Temporary Injunction* – A court may prohibit existing shareholders from creating and/or transferring any company assets or operations to any other entity without certain conditions being met. Courts may also prohibit individual shareholders from transferring *personal* assets until the dispute is resolved.
- Access to Corporate Records
- Rescinding Corporate Actions (such as fraudulent transfers of property)
- Defining as constructive dividends amounts paid to controlling shareholder as salary or otherwise (e.g., personal expenses charged to a business credit card). The shareholder may face a tax issue with the IRS, who may seek criminal prosecution in certain circumstances.
- Requiring declaration of dividends
- Accounting
- Appointment of Receiver
- Sale of the Business