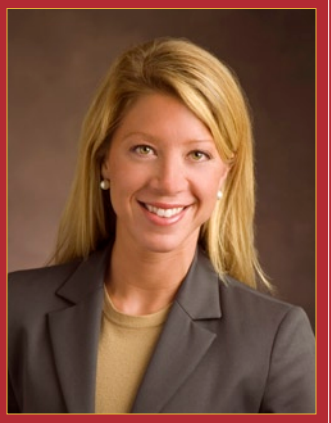
News from Moss & Barnett
A Professional Association

Fall 2009

Protecting The Minnesota Closely-Held Corporation: Avoiding Minority Shareholder Claims

By Kristin B. Heebner



Kristin Heebner is a business litigator who enjoys helping businesses resolve their disputes. She applies a solutions-based approach to advising her clients, recognizing that one size does not fit all. Kristin counsels corporations, limited liability companies, and individuals in a wide variety of business disputes, including minority shareholder disputes, contract disputes, environmental cleanup actions, and eviction proceedings. She may be reached at HeebnerK@moss-barnett.com or 612.877.5381.

"The best defense is a good offense." - *Vince Lombardi*

Disputes between shareholders of closely-held corporations present some of the most emotionally charged disputes in the law. This is likely because closely-held corporations — which are defined under Minnesota law as corporations with no more than 35 shareholders — are often formed by friends, family members, or business associates who have close relationships with one another but who do not always have similar business or leadership styles.

In these challenging economic times, the stress levels of the shareholders, officers, and directors of closely-held corporations may be soaring. The conflict associated with this stress can give rise to an increased number of shareholder disputes.

In Minnesota, closely-held corporations are governed by the Minnesota Business Corporations Act ("MBCA"). Since its original enactment in 1991, the MBCA has provided a fertile breeding ground for claims by, against, and between corporations and their shareholders. Much of the litigation in this area relates to claims brought against the corporation by one or more "minority shareholders," who are persons that own less than 50% of the corporation's stock. Minority shareholder claims may be direct claims, which are claims asserted against the corporation or its officers and directors by the minority shareholder, or derivative claims, which are claims asserted by the minority shareholder on behalf of the corporation.

Minority shareholder claims typically fall into three broad categories: breach of fiduciary duty claims, unfairly prejudicial conduct claims, and claims for corporate waste. Breach of fiduciary duty claims arise when shareholders or those in control of the corporation breach their duty "to act in an honest, fair, and reasonable manner in the operation of the corporation." Unfairly prejudicial conduct claims are asserted when a closely-held corporation or those in control of the corporation have acted "in a manner unfairly prejudicial toward one or more of the shareholders." Corporate waste means that the corporation has "misapplied or wasted" corporate assets.

The Minnesota legislature has given courts broad authority to resolve minority shareholder disputes. A court is allowed to grant the aggrieved shareholder "any equitable relief it deems just and reasonable in the circumstances." The aggrieved shareholder may seek monetary damages, a court-ordered buy-out of his or her shares, or, in extreme cases, dissolution of the corporation and liquidation of the corporate assets.

The Minnesota courts have decided a number of cases in recent years that have both bolstered and diminished minority shareholder rights. For example, in *Gunderson v. Alliance of Computer Professionals, Inc.* (Minn. Ct. App. 2001), the court held that the corporation did not engage in unfair prejudice towards the plaintiff shareholder by voting him out as officer and director and offering to repurchase his stock at a low price consistent with the terms of a buy-sell agreement. The thrust of the court's decision in *Gunderson* was that the corporation's actions were authorized by corporate agreements signed by the shareholder

In *Wiltse v. Boarder Financial Services, Inc.* (Minn. Ct. App. 2004), the court held that the corporation did not treat the minority shareholder in a manner unfairly prejudicial when all shareholders were provided with notice of meetings and the company engaged in practices to which the minority shareholder had raised no objections during the time he was actively involved in the business. Moreover, the fact that the shareholders had offered to sell their shares to the minority shareholder at the same price they offered to purchase his shares undermined any claim that the offer was unfairly prejudicial.

On the other hand, in *Blohm v. Kelly* (Minn. Ct. App. 2009), the court held that genuine issues of fact existed requiring a trial on the minority shareholder's claim that the corporation violated the MBCA by refusing to provide the minority shareholder access to certain

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In This Issue

Greetings from President Tom Shroyer

Dear Friends:

At Moss & Barnett, we recognize that giving back to the community is both a privilege and a responsibility, and many members of our Moss & Barnett team find ways to serve the larger community. One of the ways in which the firm chooses to serve is with our continuing support of the National Guard and Reserve. Toward that end, we recently signed a Statement of Support through the Employer Support of the Guard and Reserve ("ESGR"). The Statement of Support acknowledges our commitment to compliance with the Uniformed Services Employment and Re-Employment Rights Act, preparing our staff to manage the unique issues involved with employing Guard and Reserve members, and recognizing and supporting service members and their families To learn more about partnering with the ESGR and supporting Guard and Reserve members, I encourage you to visit its web site at esgr.org.

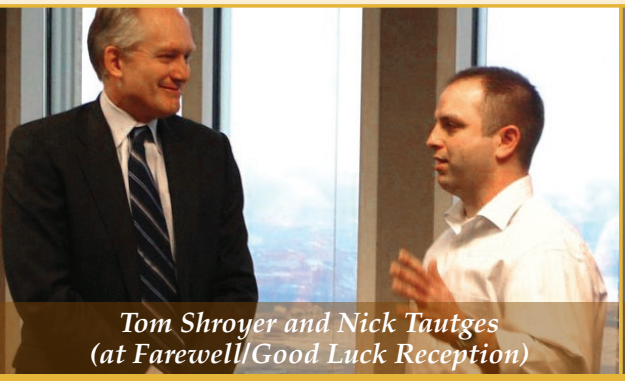
We are proud that **Nick Tautges**, an employee in Moss & Barnett's accounting department and a member of the Navy Reserve, is currently on active duty in Bahrain. He is part of the Operational Support Office, which is responsible for finding qualified reservists to fill critical staffing shortfalls and coordinating annual training. He is personally responsible for preparing a high visibility weekly report and is part of the Emergency Response Team.

Moss & Barnett has sent Nick and his colleagues a care package every month during his deployment. The packages are filled with gifts from Moss & Barnett employees and include items such as homemade cookies (a favorite!), popular movies on DVD, puzzle books, hunting and fishing magazines, local sports memorabilia, office supplies, candy, books, toiletries, a "freedom bracelet," and a battery operated fan.

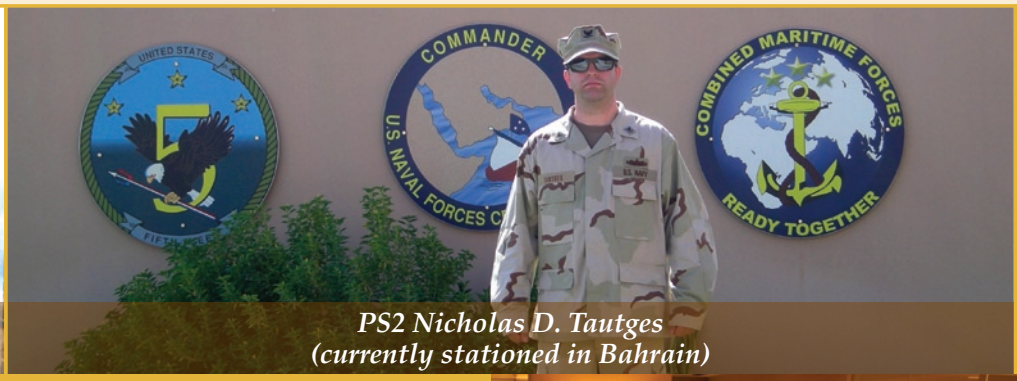
At Moss & Barnett, we believe that those who serve our country deserve our support. We continue to wish Nick the best during his service and look forward to his safe return.

With deep gratitude,

Tom Shroyer, President and Chief Executive Officer



Tom Shroyer and Nick Tautges (at Farewell/Good Luck Reception)



PS2 Nicholas D. Tautges (currently stationed in Bahrain)

Moss & Barnett Goes for the Gold!

Moss & Barnett was named a Gold Level Award Winner in the 2009 Hennepin County Wellness by Design Awards. This award is given out annually by the Hennepin County Human Services and Public Health Department in recognition of outstanding achievements in employee health promotion for worksites in Hennepin County. It acknowledges efforts by employers to ensure healthy work environments and to encourage healthy employee lifestyles.

Moss & Barnett was named a Gold Level Award Winner for its variety of programs and the broad spectrum of participation within the firm. The programs Moss & Barnett's administrative team put into place in 2009 include weekly onsite "Weight Watchers at Work" meetings, a health fair and health assessments (with a savings on medical premiums for those participating), weekly walking groups, and prizes for top achievers.

From left to right: Julie Donaldson, Human Resources Administrator, and Maria Peichel, Human Resources Generalist

Powers of Appointment

By Cindy J. Ackerman and Richard J. Kelber

In the last Moss & Barnett newsletter, we wrote about disclaimers. Some of the questions we received in response to that article led to discussions of a different estate planning technique known as a "power of appointment."

A person writing a will or trust can give his or her beneficiaries a power of appointment, which enables them to direct where their share of the estate or trust goes at their death. A power of appointment provides flexibility for transferring property to children and grandchildren.

What Is A Power of Appointment?

A power of appointment grants authority to designate the recipients of property held in an estate or trust. A power of appointment may be given to a beneficiary to permit that beneficiary to direct the ultimate distribution of his or her share.

There are two types of powers of appointment: a limited power of appointment and a general power of appointment. A limited power of appointment permits the beneficiary to allocate his or her share of the estate or trust among certain classes of potential recipients, such as the testator's descendants or charitable organizations, but not to the beneficiary, the beneficiary's estate, or creditors of the beneficiary or the estate thereof. A general power of appointment is a broad power that enables the beneficiary to allocate all or part of his or her share of the estate or trust among any individuals or organizations selected by the beneficiary.

How Can A Power of Appointment Be Used to Create Flexibility?

A client creating a will or trust today cannot predict his or her family's economic or personal situation 30 years from now. A power of appointment provides flexibility by permitting the holder of the power to alter the distribution plan in a will or trust to accommodate changed family situations. The person holding the power of appointment has the opportunity to reevaluate the family situation to determine the best possible outcome for the assets. The following examples illustrate powers of appointment.

Example 1. A's will creates a trust for the benefit of his spouse after A's death. A grants his spouse a limited power of appointment to appoint the assets remaining in the trust at her death among A's issue (*i.e.*, children, grandchildren, great-grandchildren, etc.) or trusts for their benefit as she determines. If A's surviving spouse does not exercise this power, the assets remaining in the trust will be distributed outright in equal shares to A's children. A's son has developed a substance abuse problem. A's spouse exercises her limited power of appointment to appoint the share for A's son to a trust for his benefit rather than leaving the funds to him outright.

Example 2. B's will creates a trust for the benefit of her daughter after her death. B grants her daughter a general power of appointment to appoint the assets remaining in the daughter's trust in any manner. Over the years, daughter accumulates substantial wealth and in various ways she provides adequately for her children. Daughter then exercises the general power of appointment to appoint the assets in the trust to charities of the daughter's choice.

Note that giving a person a power of appointment implies a great degree of trust in that person's judgment. As a general power of appointment places no limits on the power holder, limited powers of appointment are often used instead. In addition, limited powers of appointment in most circumstances lead to more favorable tax treatment.

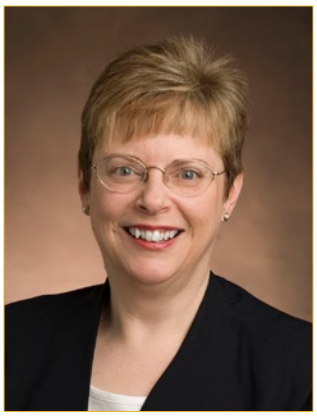
Tax Consequences

General powers of appointment and limited powers of appointment have very different tax consequences. The mere possession of a general power of appointment over trust property will cause the power holder to be subject to gift tax or estate tax on that property whether or not the general power of appointment is exercised. In most cases, the possession of a limited power of appointment does not subject the power holder to gift or estate tax. To be sure that a power is a limited power rather than a general power, specific wording must be used to comply with Internal Revenue Code requirements.

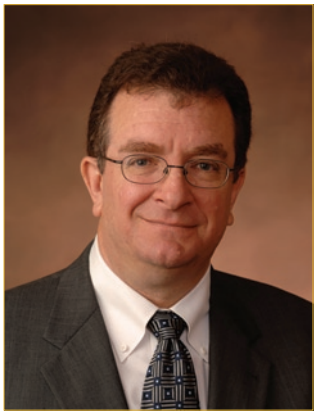
Thus, in Example 2 above, the existence of a general power of appointment will cause the assets in the trust for daughter's benefit to be subject to estate tax at daughter's death. By exercising the general power of appointment in favor of one or more charitable organizations, daughter's estate receives a charitable deduction for the assets passing to charity.

Conclusion

Powers of appointment can be an effective and cost-efficient tool to add flexibility to long-term trusts. If you would like to learn more about powers of appointment and whether they could be an appropriate addition to your estate plan, please contact your attorney at Moss & Barnett.



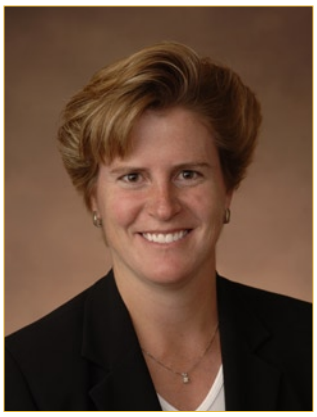
Cindy Ackerman represents individuals and business clients in the areas of estate planning, probate and trust administration, taxation, and non-profit organizations. She may be reached at AckermanC@moss-barnett.com or 612.877.5330.



Rick Kelber represents individuals and business clients in the areas of business transactions and estate planning. He may be reached at KelberR@moss-barnett.com or 612.877.5433.

The Return of Seller Financing: Contracts for Deed as an Option in Today's Struggling Real Estate Market

By Elizabeth (Betsy) H. Kiernat



Elizabeth ("Betsy") Kiernat is a real estate attorney who enjoys representing lenders, businesses, individuals, landlords, tenants, and other parties in real estate finance, acquisition and sales, leases, and development transactions. She has significant nationwide experience including the negotiation of sophisticated documentation necessary to meet the needs and requirements of clients and lenders. She may be reached at KiernatE@moss-barnett.com or 612.877.5260.

A contract for deed may be a helpful tool for both sellers and purchasers in a tough real estate market. A contract for deed is also known as a "land contract" or "installment land contract." In a contract for deed, the seller, rather than a lending institution, finances the purchase of the property. The purchaser takes immediate possession of the property and agrees to pay the purchase price of the property over time, generally in monthly installments. The seller retains legal title to the property throughout the term of the contract until the last payment is made and the contract is fulfilled. When the total purchase price has been paid to the seller, the purchaser is entitled to the type of conveyance identified in the contract. Generally, this will require the conveyance of a warranty deed to the purchaser.

Contracts for Deed - From A Purchaser's Perspective

A contract for deed is attractive to purchasers who may not otherwise qualify for a loan or be in a financial position to purchase the property. A contract for deed is beneficial to a purchaser, because (i) it generally requires a smaller down payment than institutional mortgage financing; (ii) in the event of a default in payments, the purchaser must only bring payments current (within the time period provided by state law) to preserve rights in the property (assuming there is no acceleration clause in the contract, as discussed below); (iii) it is faster and easier to qualify for financing since the seller decides whether the purchaser is approved; and (iv) it is less costly than traditional mortgages since many closing costs, origination fees, application costs, and mortgage registration taxes are not applicable.

While a contract for deed has many benefits for a purchaser, it does not come without risk. The seller keeps legal title to the property until the contract price is paid in full, which means the purchaser does not become the owner of the property until he or she completes his obligations and receives title from the seller. If the purchaser defaults on the contract and fails to cure such default, the purchaser in almost all cases loses all of the money that has been paid on the contract and never obtains the property. It is extremely important for a purchaser to understand each and every obligation under the contract for deed prior to executing the document.

Contracts for Deed - From A Seller's Perspective

A contract for deed is attractive to a seller because it is relatively simple to understand and allows the seller to control payment and interest terms. A seller facing large taxable capital gains on the sale of a property may wish to create an installment sale scenario where they can spread any taxable gains over many years.

A contract for deed also gives the seller more flexibility than a mortgage because the contract for deed affords the seller a quick method of canceling the transaction in the event of a default. In general, if the purchaser defaults on an installment, the seller can cancel the contract, retake the land, and, almost always, retain all the payments made and benefit from any improvements that the purchaser has made to the property. The seller may take this action without a foreclosure by advertisement or judicial foreclosure, which are required if the property is secured by a mortgage. A seller alternatively may elect to sue the purchaser for breach of contract, if the amount owing on the contract for deed exceeds the value of the property.

While a contract for deed has many benefits for a seller, it also involves some risk. The seller continues to own the property during the term of the contract for deed and retains exposure to some forms of liability that may attach to the property. If the seller chooses to retake the property after a default, he or she may have to take legal action to evict the purchaser. If the seller instead chooses to sue the purchaser for the unpaid

The Return of Seller Financing continues on page 5

installments, separate lawsuits will be required for each installment unless the contract for deed included an acceleration clause that provides for all principal payments to become due upon a single default. The standard form contract often used by non-lawyers in Minnesota does not include such a clause.

Contractual Rights and Remedies

The standard form contract for deed provides that the time of performance by the purchaser is an essential part of the contract. Thus, in most cases, the failure of the purchaser to comply with the terms of a contract for deed on the date specified in the contract constitutes a default. Once a monetary or non-monetary default has occurred, the seller has the right to terminate the contract for deed.

Minnesota Statute § 559.21 clearly sets forth the steps that must be taken to terminate a contract for deed. Once a default exists and the seller has decided to terminate the contract for deed, a notice of termination must be served upon the purchaser. The notice must set forth the following information:

1. The conditions under which default exists.
2. The period of time within which the purchaser may reinstate.
3. A statement that the purchaser must either (i) make payments in the amount owed, plus costs of service, attorneys' fees incurred, and other amounts due under the cancellation statute; or (ii) secure a court order suspending termination of the contract for deed.
4. The name, address, and telephone number of the seller or an attorney authorized by the seller to accept payments.
5. Certain specific language required by Minn. Stat. § 559.21 that notifies the purchaser of the consequences of a failure to comply with the notice.

For contracts for deed executed on or after August 1, 1985, the notice must state that the purchaser is further required to pay two percent (2%) of the amount in default at the time of service of the notice, not including balloon payment, taxes, assessments, mortgages, or prior contracts assumed by the purchaser. For the seller to recover attorneys' fees under a contract for deed executed on or after August 1, 1985, some default must have occurred for at least 30 days prior to the date of service of the notice upon the purchaser.

The right of the purchaser to reinstate a contract for deed is absolute, if the purchaser pays all sums required by the notice. If the purchaser fails to comply with the notice, the contract will automatically terminate. Upon termination, the Seller is almost always able to retain all sums that have been paid on the contract. The purchaser will lose the possession and use of the property, forfeit the right to assert any claims or defenses against the seller, and be subject to eviction from the property. Once the termination has been completed, however, the seller can no longer maintain any action for a monetary deficiency judgment against the purchaser.

A real estate attorney can help either a seller or purchaser understand the benefits, the risks, and the process of entering into a contract for deed.

Kim R. Bonuomo

Attorney Kim Bonuomo Joins Moss & Barnett

Kim R. Bonuomo has joined our family law practice area. Kim received her law degree from the University of Virginia School of Law in 1988, where she was the recipient of the Ritter Award for Character, Honor, and Integrity. From law school, Kim went into active duty with the U.S. Army Judge Advocate General's Corps, twice earning a Meritorious Service Medal for outstanding service. In 1993, Kim began her private practice in North Carolina, including ten years of practice as a founding partner of Morgenstern and Bonuomo, PLLC. She served as the Vice Chair and the Chair for the Family Law Sections of both the Greensboro Bar Association and the North Carolina Bar Association, as well as chairing the North Carolina Bar Association's Family Law Section Continuing Legal Education Committee and Domestic Violence Committee. Kim is a fellow of the American Academy of Matrimonial Lawyers and is a Certified Family Law Specialist and mediator in the state of North Carolina. Kim relocated to Minnesota in 2009.

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corporate records. The court concluded that the corporation's refusal to provide the records raised enough questions about the corporation's conduct to allow the claim to go to the jury.

Minority shareholder disputes can be expensive and exhausting to litigate. They quickly can drain corporate assets that are better left invested in the corporation. Even as stress levels skyrocket and tensions among business partners run high, there are important steps that closely-held corporations can take in an effort to avoid minority shareholder claims. Consider the following:

1. **Enter into a shareholder control agreement.** Shareholder control agreements are agreements that govern the relationships between the shareholders and the corporation. These agreements govern "any phase of the business and affairs of the corporation, its liquidation and dissolution, or the relations among shareholders of or subscribers to shares of the corporation…." How to determine the purchase price for a buy-out of a shareholder's shares and how to deal with a shareholder's shares in the event of the death of a shareholder are just two examples of topics included in shareholder control agreements. Agreeing to such terms in writing can help minimize future disputes.

   Shareholder control agreements also are important because, according to the MBCA, they "are presumed to reflect the parties' reasonable expectations concerning matters dealt with in the agreements." This means that when a shareholder asserts a claim against the corporation alleging that his or her "reasonable expectations" have been frustrated, the court must look to the shareholder control agreement to determine the reasonable expectations of the shareholder.

2. **Communicate with all shareholders equally and in writing.** The concept is simple. Do not include certain shareholders to the exclusion of other shareholders. Communicate with all shareholders equally and in writing, and keep a record of the correspondence. Invite all shareholders to important corporate meetings and allow them to participate. Send written meeting notices to all shareholders, and require them to R.S.V.P. Inform shareholders of major corporate decisions. Although the officers and directors may ultimately be the arbiters of major corporate decisions, it is important that the corporation notify minority shareholders of important corporate business.

3. **Keep records of significant communications and a corporate minute book.** Keep copies of all letters, facsimiles, and email communications to, from, and between the corporation and its shareholders. Write down the details of significant corporate events. Prepare minutes of corporate meetings and written actions of significant corporate events and decisions. Save all such documents in the corporate minute book. The corporate minute book should contain important corporate records such as the articles of organization, bylaws, minutes, shareholder control agreements, buy-sell agreements, written actions of the shareholders, and other key documents and agreements. Request that the shareholders ratify certain corporate decisions and retain copies of the ratifications.

4. **Respond promptly to shareholder requests for company records.** The MBCA provides that within ten (10) days of making a written demand of the corporation, shareholders have "an absolute right" to examine and copy the following corporate records: the corporate share register, records of all proceedings of shareholders for the last three (3) years, records of all proceedings of the board for the last three (3) years, the corporation's articles and all amendments currently in effect, the corporation's bylaws and all amendments currently in effect, annual financial statements and the financial statement for the most recent interim period prepared in the course of the operation of the corporation for distribution to the shareholders or to a governmental agency as a matter of public record, reports made to shareholders generally within the last three (3) years, a statement of the names and usual business addresses of the corporation's directors and principal officers, voting trust agreements, shareholder control agreements, and a copy of certain corporate agreements and contracts. It is important to respond to a minority shareholder's request for corporate records promptly, as the corporation's refusal to provide the minority shareholder with corporate records may give rise to a claim under the MBCA.

5. **Consult with legal counsel.** If one or more shareholders of your closely-held corporation threatens a minority shareholder claim against the corporation, immediately seek legal counsel. Strategy decisions can be tricky. The sooner you get your counsel up to speed on the issues, the sooner your counsel can assist you in responding to the minority shareholder claim.

Although no closely-held corporation is impervious to minority shareholder claims, incorporating these steps into your business practices may significantly minimize your corporation's exposure to such claims. If you have questions about minority shareholder disputes, please contact your attorney at Moss & Barnett.

Correction to Summer 2009 Newsletter

The legislative amendment to the voting leave statute referenced in the "Employment Law Alert" of our Summer 2009 Newsletter was ultimately vetoed by Governor Pawlenty. Although the amendment is likely to be included in future election reform bills, the prior statutory language, which provides for time off work during the morning to vote, is currently still in effect.

Various Accolades

Moss & Barnett is pleased to congratulate **Kevin Busch, Mitch Cox, Ben Henschel, Tom Keller, Jim O'Brien, Chuck Parsons, Susan Rhode, Jim Rubenstein, Dave Senger, Tom Shroyer, Curt Smith, Cass Weil,** and **Ed Winer**, who have all been listed in *2009 Super Lawyers*. Special congratulations to **Chuck Parsons** and **Susan Rhode** who were listed in the *Top 100*. *Super Lawyers* was established in 1981 and is an annual listing of outstanding lawyers (five percent of the licensed active lawyers in Minnesota) who have attained a high degree of peer recognition and professional achievement.

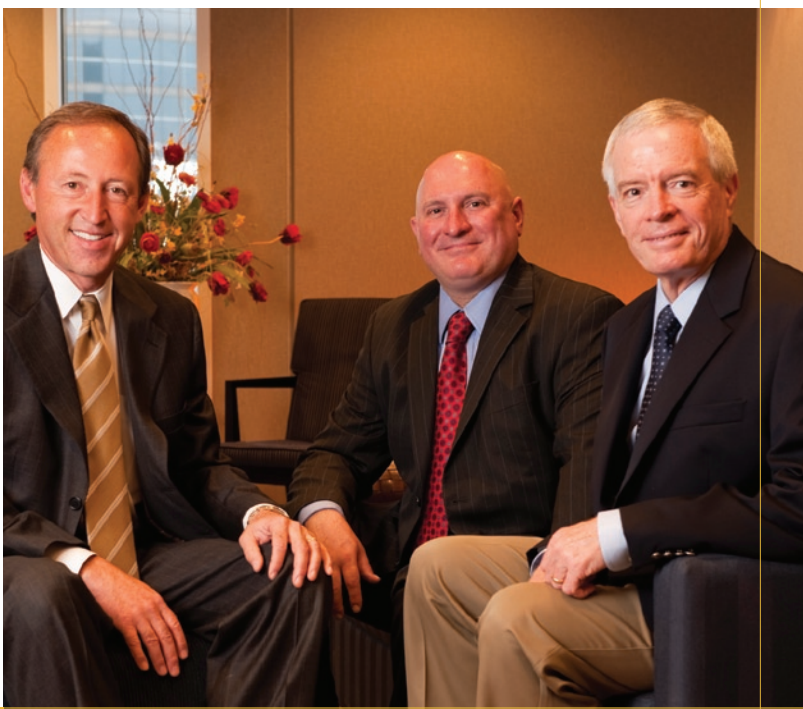
Moss & Barnett is also pleased to recognize the following attorneys:

Mathew Meyer, a member of our litigation practice area, was recently awarded "The Seven Seals Award" by the Employer Support of the Guard and Reserve ("ESGR"). "The Seven Seals Award" refers to the seven Guard and Reserve branches and is the only ESGR award that bridges both the employer and ESGR volunteer recognition programs. It is presented at the discretion of the Field Chair in recognition of significant individual or organizational achievement, initiative, or support that promotes and supports the ESGR mission. Mathew is an Ombudsman with the ESGR, and his volunteer work includes mediating disputes under the Uniformed Services Employment and Reemployment Rights Act ("USERRA"); conducting employer outreach to encourage support for service-member employees; presenting Patriot Awards to employers who have demonstrated outstanding support for their service member employees; and conducting pre-mobilization and post-mobilization briefings to service members to explain their rights under USERRA. Mathew is also the ESGR military liaison to the United States Marine Corps Reserve units in Minnesota. To learn more about the ESGR, visit its web site at esgr.org.

Chuck Parsons, a member of our real estate practice area, was recently elected as a Regent of the American College of Mortgage Attorneys. The American College of Mortgage Attorneys was formed in 1974 by a group of lawyers seeking to establish and maintain an integrated group of lawyers from each state who are highly skilled and experienced in the preparation of real estate mortgages, lending transactions secured by real estate, and related practice. The College seeks to improve and reform laws and procedures affecting real estate secured transactions and to raise the level of professional responsibility of lawyers practicing in this area. The College is governed by a Board of Regents. To learn more about the College, visit its web site at acmaatty.org.

Dave Senger, chair of our wealth preservation and estate planning practice area, was named as a *FIVE STAR Wealth Manager* for the second consecutive year. The *FIVE STAR Best in Client Satisfaction Wealth Manager* award is limited to less than seven percent of all wealth managers within the Twin Cities area. Professionals are rated by their clients and other professionals on service, integrity, knowledge, communications, value for fees charged, meeting financial objectives, and overall client satisfaction. To learn more about the *FIVE STAR Best in Client Satisfaction* program, visit its web site at fivestarprofessional.com.

To learn more about Moss & Barnett, our attorneys, and our various practice areas, please visit our web site at moss-barnett.com.

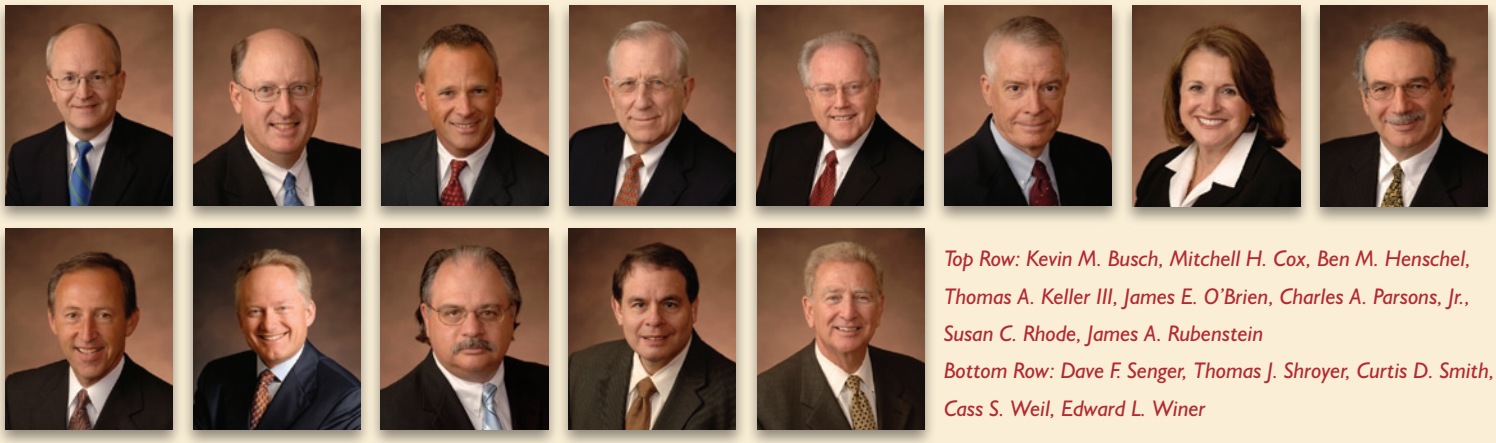


From left to right: Dave Senger, Mathew Meyer, and Chuck Parsons

PROFESSIONAL

Excellence + Teamwork

MOSS & BARNETT CONGRATULATES ITS ATTORNEYS LISTED IN *2009 SUPER LAWYERS®*



Top Row: Kevin M. Busch, Mitchell H. Cox, Ben M. Henschel, Thomas A. Keller III, James E. O'Brien, Charles A. Parsons, Jr., Susan C. Rhode, James A. Rubenstein

Bottom Row: Dave F. Senger, Thomas J. Shroyer, Curtis D. Smith, Cass S. Weil, Edward L. Winer

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