ANTHONY OSTLUND & BAER, P.A.
90 South Ninth Street
3600 Wells Fargo Building
Minneapolis, MN 55402
612-349-6969 fax 612-349-6996

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# Minority Shareholder Rights-Revisited

By Joseph W. Anthony and Karlyn Vegoe Boraas
Anthony Ostlund & Baer, P.A.

With the stroke of its pen, a three-judge panel of the Minnesota Court of Appeals may have done more damage to minority shareholder rights in Minnesota than 15 years of lobbying by corporate managers. In the recently announced decision of *Skoglund v. Brady*, 541 N.W.2d 17 (Minn. Ct. App. 1995), the court imposed procedural and substantive hurdles which may be difficult for minority shareholders to clear. The requirements that were recently imposed by the court of appeals are arguably unsupported by the language of the statute and inconsistent with the spirit of the legislation.[1]

This article will briefly discuss the conditions which led to the enactment of the Minnesota Business Corporation Act in 1981 and will touch on the important changes in that act over the past 15 years. Finally, it will end with a special emphasis on the impact of the recently announced *Skoglund* decision.

## Background

Minority shareholders have long been casualties in the struggle for control and wealth in the close corporations.[2] Close corporations are typically formed by friends, relatives, *or* other business associates who expect that they will each actively participate in directing and managing the corporation and receive a salary, bonus, and other benefits consistent with their roles.

While close corporations begin as friendly ventures, the balance of power in the close corporation often lends itself to oppression of those shareholders who do not control the corporation—the minority shareholders. Minority shareholders are sometimes subjected to a "freeze out" (sometimes known as a "squeeze out") by those in control. Typical "freeze-out" techniques include terminating the minority shareholder's employment with the corporation or terminating dividends. Left without a meaningful return on his or her investment, the minority shareholder may be left with little choice but to sell for less than a fair price, usually to the majority shareholders.

In part to remedy the perceived injustice to minority shareholders, in 1981 the Minnesota Legislature enacted the Minnesota Business Corporation Act (MBCA). Judicial interpretations and legislative amendments to the MBCA resulted in a significant expansion of minority shareholder rights. There are signs, however, that minority shareholder rights are now contracting. This article will chronicle some of the significant case law concerning minority shareholders' rights and the ensuing amendments to the MBCA.

## Causes of Action for the Minority Shareholder

The aggrieved minority shareholder most commonly sues for (1) dissolution, mandatory buyout, or other equitable relief under Minn. Stat. § 302A.751; (2) dissenters' rights under Minn. Stat. §§ 302A.471-.473; (3) equitable remedies under Minn. Stat. § 302A.467; or (4) a remedy for the corporation—that is, a shareholder derivative suit. Section 302A.751 is the minority shareholders' most powerful weapon and will consequently serve as the focus for this article.

## Section 302A.751: In General

Section 302A.751 offers the strongest protection for minority shareholders by providing for equitable relief or, in an extreme case, dissolution of the corporation under any of the following circumstances:

(1) the directors are deadlocked and the shareholders are unable to break the deadlock;

(2) the directors have acted fraudulently or illegally toward one or more shareholders in their capacities as shareholders or directors, or as officers or employees of a closely held corporation;

(3) the directors have acted in a manner unfairly prejudicial toward one or more shareholders in their capacities as shareholders or directors of a corporation that is not a publicly held corporation, or as officers or employees of a closely held corporation;

(4) the shareholders are so divided in voting power that they have failed to elect directors for two consecutive meetings;

(5) the corporate assets are being misapplied or wasted; or

(6) the period of the corporation's duration provided in its articles has expired and has not been extended.[3]

Section 302A.751 also provides for a mandatory buyout of shares upon the motion of a corporation or a shareholder if one of the six enumerated circumstances is established.[4] The court may order the sale by one shareholder of all shares held by that party either to the corporation or to the moving shareholders, whichever is specified in the motion.[5] A buyout motion may be granted based on the pleadings and submission of affidavits. Thus, buyout motions under section 302A.751 have been granted in various procedural stages short of trial.[6] The court must determine in its discretion that the buyout is "fair and equitable to all parties under all of the circumstances of the case."[7]

In a court-ordered buyout, the purchase price is the "fair value" of the shares either as of the date of commencement of the action or any other date deemed equitable by the court—unless there is an established or contracted price for the shares in the bylaws or a shareholder agreement.[8] The court will order the shares sold at the established price unless it determines that the price is unreasonable under all circumstances of the case.[9] The MBCA specifies the procedure for determining fair value, borrowing from the dissenters' rights section of the MBCA.[10] More importantly for the minority shareholder by using the term "fair value," the MBCA has created a term distinct from fair market value. "Fair value" carries with it the statutory goal that shareholders be fairly compensated—which may be more than a market's judgment about the stock's value.

Minnesota court decisions on how to value shares of a minority shareholder have given minority shareholders significant negotiating leverage in buyout situations. In determining fair value, the corporation is to be valued as a whole instead of valuing individual shares.[11] Minnesota courts have expressly rejected discounts for the minority shareholder's lack of control over corporate decision making and for lack of marketability—even though the discount is almost universally applied in market value calculations.[12]

The court has discretion to award reasonable expenses, including attorneys' fees and disbursements to any of the parties if the court finds that a party to a section 302A.751 action has acted arbitrarily, vexatiously, or otherwise not in good faith.[13] Both the Minnesota Court of Appeals and the 8th Circuit Court of Appeals have upheld such awards.[14]

## Provisions of Section 302A.751

### I. "UNFAIRLY PREJUDICIAL"

When section 302A.751 was enacted in 1981, it provided relief when the directors or those in control of the corporation acted fraudulently, illegally, or in a manner "persistently unfair" toward one or more shareholders.[15] In 1983 the words "persistently unfair" were replaced by the words "unfairly prejudicial."[16] The change was intended to eliminate the need to establish a continuing course of abuse.[17] A claim under Minn. Stat. § 302A.751 may now succeed upon establishing a single instance of unfairly prejudicial conduct.[18]

### II. REASONABLE EXPECTATIONS

In 1983, the Legislature added subdivision 3a to section 302A.751. As originally enacted, subdivision 3a provided that the court should take into consideration the reasonable expectations of the shareholders as they existed at the inception and developed during the course of the shareholders' relationship with the corporation and with each other.[19]

Since the addition of the provision in 1983, Minnesota courts have applied the provision on several occasions. In *Pedro v. Pedro*, one shareholder brought a claim seeking dissolution of the corporation and damages for wrongful termination after he was terminated from his position with the family business owned equally by the shareholder and his two brothers.[20] The shareholder had been employed by the business for 45 years when he discovered financial discrepancies and started an investigation. After warning him to drop his investigation, his brothers fired him. The court of appeals found an implied agreement to provide lifetime employment. The court stated that "[t]he reasonable expectations of such a shareholder are a job, a salary, a significant place in management, and economic security for his family."[21] The court of appeals affirmed the trial court's award of damages for wrongful termination, plaintiff's ownership interest, and breach of fiduciary duty plus attorneys' fees, expenses, and prejudgment interest.

Similarly, in *Sawyer v. Curt & Co.*, the Minnesota Court of Appeals found that the plaintiff, a shareholder-employee of the corporation, had reasonable expectations that included "a job, salary, and a significant place in management."[22] As a result, the court held that the plaintiff's termination without a good-faith effort to buy her shares or without any attempt to compensate her for the loss of status within the corporation warranted a court-ordered buyout under section 302A.751.

When subdivision 3a of section 302A.751 was enacted in 1983, it provided that the reasonable expectations of **"the"** shareholders should be considered. In the *Pedro* and *Sawyer* decisions, the courtS appeared to consider only the reasonable expectations of the complaining shareholder.[23] In 1994, the Legislature amended subdivision 3a to require consideration of "the reasonable expectations of **all** shareholders."[24] The reasonable expectations of both the majority and minority shareholders should now be examined by courts when deciding whether to order equitable relief under section 302A.751.

In 1994, the Minnesota Court of Appeals determined that the "misconduct" of a minority shareholder did not affect that shareholder's reasonable expectations and rights to a buyout.[25] *Pooley v. Mankato Iron & Metal, Inc.*, involved a close corporation owned equally by Terry, Gregory, and Ronald Pooley. The majority shareholders proved that Terry Pooley had engaged in several instances of misconduct relating to the corporation. For example, he pled guilty to assault of a customer in the early 1980s. In 1989, Terry Pooley was convicted of assaulting Gregory Pooley and damaging a customer's truck. After his conviction, the corporation terminated Terry Pooley's employment and the shareholders voted him out as an officer and a director.

In Terry Pooley's suit for a buyout under section 302A.751, the court found that, despite the misconduct, the corporation's directors had "unfairly prejudiced" Terry Pooley within the meaning of section 302A.751 by freezing him out of a business in which he reasonably expected to participate. The court ordered a buyout of his shares at fair value.[26] The court further determined that the corporation could not discount the value paid for Terry Pooley's shares based on his history of bad acts relating to the corporation.[27]

## III. WRITTEN SHAREHOLDER OR EMPLOYMENT AGREEMENTS

When determining "reasonable expectations," Minnesota courts have not always given significant weight to written agreements among the parties.[28] In 1994, the Legislature added to subdivision 3a of section 302A.751 a presumption that written agreements, including employment agreements and buy-sell agreements, reflect the parties' reasonable expectations concerning matters addressed in the agreements. The amendment increases the need for parties to accurately recite their expectations and intentions in written agreements.

## IV. FIDUCIARY DUTY

Minnesota courts have long imposed a duty of fair dealing between shareholders in a close corporation.[29] This duty is akin to a fiduciary duty, the breach of which gives rise to a direct claim.[30] When subdivision 3a was added to section 302A.751 in 1983, the Legislature directed courts to consider the duty that shareholders in a closely held corporation owe one another "to act in an honest, fair and reasonable manner in the operation of the corporation."[31]

The Minnesota Court of Appeals recently held that equitable owners of stock are owed a fiduciary duty by officers and directors of a closely held corporation.[32] Equitable owners include pledgees, trust beneficiaries, and parties who have executed but not yet closed on a contract to purchase shares.[33]

### Shareholder Derivative Suits: Special Litigation Committees

When the MBCA was enacted in 1981, there was a separate section addressing the board of director's authority to appoint committees.[34] Section 302A.243 provided that the board could establish a committee of two or more "disinterested" directors or other persons to determine whether pursuing a legal right or remedy was in the best interest of the corporation. The statute defined "disinterested" and further stated that the good-faith determination of the committee were binding on the corporation.

In *Black v. NuAire, Inc.*, the Minnesota Court of Appeals interpreted Minn. Stat. § 302A.243 as limiting the review that a court could make of a committee's decision to dismiss a shareholder's derivative action. The court's review was limited to a determination of whether the recommendation was made by a disinterested committee conducting its investigation in good faith.[35] If this threshold standard was satisfied, then the committee's recommendation was protected by the business judgment rule. *Black* struck a blow to minority shareholders' ability to bring derivative actions. If majority shareholders were accused of wrongdoing by minority shareholders, the majority-controlled board could appoint a committee to investigate. The shareholders would have no recourse unless they could establish that the committee was not independent or did not make its recommendation in good faith.

In 1989, the year following the decision in *Black*, the Legislature repealed Minn. Stat. § 302A.243 and amended Minn. Stat. § 302A.241 to take its place. The Legislature repealed section 302A.243 but noted that its action "does not imply that the legislature has accepted or rejected the substance of the repealed section but must be interpreted in the same manner as if section 302A.243 had not be [sic] enacted."[36]

Since 1989, a corporation's power to appoint a special litigation committee is governed by Minn. Stat. § 302A.241, subd. 1. That section provides that corporations may appoint special litigation committees consisting of one or more independent directors or other independent persons to consider the legal rights or remedies of the corporation and whether those rights and remedies should be pursued. Until recently, no court had interpreted the new section or considered its curious legislative history.

## *Skoglund v. Brady:* A New Chapter in Shareholder Rights?

The Minnesota Court of Appeals recently affirmed a decision which appears at odds with precedent under Minn. Stat. § 302A.751. *Skoglund v. Brady* held that to bring a claim under Minn. Stat. § 302A.751, a shareholder must suffer an injury that is separate and distinct from any injury to the corporation.[37] The court also held that judicial review of a special litigation committee's recommendation to not pursue a shareholders' derivative claim is limited to any inquiry of whether the committee is independent and performed its review in good faith.

In *Skoglund*, Donald Skoglund, one of the shareholders of a closely held corporation called Instrumentation Services, Inc., (ISI) objected to certain leases with board members, promissory notes and bonuses issued to board members, the issuance of additional shares of ISI stock, and the sale of some of the newly issued stock to a board member at a price lower than the stock's book value. Skoglund brought derivative and direct claims under Minn. Stat. § 302A.751 against ISI and the members of its board. He alleged that the directors breached fiduciary duties, usurped corporate opportunities, and committed waste and fraud.

### I. SEPARATE AND DISTINCT INJURY UNDER SECTION 302A.751

On a motion to dismiss the direct claims, the trial court held that a shareholder must have a separate and distinct injury to bring an action under section 302A.751. The court cited the general principle that an individual shareholder cannot assert a cause of action that belongs to the corporation.[38] While this general principle involving the direct claim/derivative claim distinction undoubtedly applies to causes of action belonging to corporations that are not closely held, it is questionable whether it applies to claims for equitable relief under section 302A.751 involving closely held corporations.

Relying solely on *PJ Acquisition Corp v. Skoglund*, 453 N.W.2d 1 (Minn. 1990) (involving another individual with the surname "Skoglund"), the court of appeals held that a separate and distinct injury is required for a shareholder to bring an action under section 302A.751.[39] This portion of *Skoglund* is problematic. The language of section 302A.751 does not suggest that a shareholder must have a distinct injury to assert a direct claim. To the contrary, the statute specifically provides for equitable relief when "corporate assets are being misapplied or wasted."[40] Claims for corporate waste almost always affect all shareholders equally, and historically were brought as derivative actions.[41] The enactment of section 302A.751 presumably provided for direct claims in these cases. This issue in *Skoglund* is currently on petition for review by the Minnesota Supreme Court.

## II. SPECIAL LITIGATION COMMITTEE

*Skoglund* also interpreted the revised special litigation committee provision of the MBCA. To investigate Skoglund's shareholder derivative claims, ISI's board appointed a special litigation committee comprised of one attorney. The committee retained an accounting firm to assist with the investigation. Although the committee found that the directors had committed corporate waste by issuing additional stock at approximately one-half the stock's book value, the committee recommended that the claim not be pursued by the corporation due to economic feasibility—the expenses incurred in pursuing the lawsuit would exceed the value of the claim. In other words, the directors conferred a significant and apparently improper benefit to themselves but—because the directors indicated they would fight the claim—it would be economically unfeasible to pursue it.

On appeal, Skoglund argued that in light of the repeal of section 302A.243, courts should apply stricter scrutiny to the independence of a special committee and should conduct a substantive review of the special committee's decisions.

The court of appeals relied on *Black v. NuAire*[42] to hold that judicial review of a special litigation committee recommendation was limited to whether the committee was independent and conducted the investigation in good faith. Although *Black* had been decided under repealed section 302A.243, the court determined that the rule of *Black* should be unaffected by the section's repeal. The court noted the Legislature's express statement that repealing the section was not intended to convey any legislative intent with regard to the substance of the repealed section.[43]

The court failed to acknowledge the Legislature's intention that the repealed section be treated as if it had never been enacted.[44] The court of appeals essentially reinstated the *Black v. NuAire* standard as if section 302A.243 still existed. This issue is also currently on petition for review by the Minnesota Supreme Court in *Skoglund*. If the Court accepts the case and announces a more lenient standard for courts to review decisions by special litigation committees, it will likely make derivative actions more available to Minnesota shareholders. If the Court denies review or affirms the court of appeals, however, the standard of review created in *Black*, and now *Skoglund*, will appear to be the law in Minnesota. It may be necessary for the Legislature to clear up the confusion created by the *Skoglund* decision by acting to eliminate the special litigation committee concept entirely or by subjecting its recommendations to judicial scrutiny.

## III. SIGNIFICANCE OF SKOGLUND

*Skoglund* is significant for several reasons. First, it limits a powerful remedy to the minority shareholder by adding a judicially created requirement that is not found in the express language of the statute or arguably within a fair reading of it. Second, where the shareholder cannot allege a separate and distinct injury, the action must be brought derivatively. In a derivative action, the shareholder must make demand on the board of directors before commencing the suit (or plead good cause why demand would be futile).[45] A derivative action also may be subject to review by a special litigation committee if the corporation chooses to appoint one. As also determined by *Skoglund*, if the special litigation committee determines that it is not in the best interests of the corporation to pursue the claim, the shareholder has little recourse unless he or she can establish that the committee was not independent or did not conduct its investigation in good faith.

As a practical matter, in closely held corporations there is virtually no mechanism in place, other than the goodwill of the malfeasant directors, to protect minority shareholders' rights against a biased special committee. What is the likelihood that directors, if they have been engaged in wasting corporate assets for personal gain, for example, are going to appoint a committee that will recommend their prosecution? For that reason, judicial scrutiny of a special committee's decision is virtually a prerequisite to the reasonable protection of minority shareholder rights.

Regardless of whether the Minnesota Supreme Court accepts review, *Skoglund* may be another case that prompts the Minnesota Legislature to consider amending the MBCA to clarify its intentions.

### An Enlightened Decision

In a case decided on Jan. 18, 1996, the New Jersey Supreme Court, interpreting a statute that is remarkably similar to Minn. Stat. § 302A.751, upheld a trial court ruling ordering majority shareholders to sell their controlling interest in a closely held corporation to the minority shareholder. In *Muellenberg v. Bikon Corporation*, 669 A.2d, 1382 (N.J. 1996), the court concluded that the majority shareholders exercised their majority power in a manner which conflicted with the expectations of the minority. The minority shareholder had been primarily responsible for the company's day-to-day operations. The majority shareholders had provided capital and the inventive genius for the company's products. When conflict developed among the shareholders, the majority shareholders voted to declare substantial dividends to all shareholders and to assert themselves in the daily operations of the company, thereby usurping the minority shareholder's role. Claiming that the corporation was deadlocked, the majority voted to dissolve the corporation and instituted proceedings to that end.

The Supreme Court concluded that it was a close question whether the actions of the majority amounted to oppression. After carefully analyzing the New Jersey statute, which prohibited majority shareholders from abusing their authority as directors or acting oppressively or unfairly toward one or more minority shareholders in their capacities as shareholders, directors, officers, or employees, the court concluded that the majority's actions constituted oppressive conduct which frustrated the reasonable expectations of the minority shareholder. Most importantly, the court concluded that the appropriate remedy was to order the sale of the majority's shares to the minority since the minority had the expectation of long-term employment and had, in fact, been running the company on a daily basis.

## Conclusion

Section 302A.751 has been a refreshing and distinguishing feature of the MBCA. Minnesota is one of the few states that has legislated a buyout provision for minority shareholders.[46] Section 751 has contributed tremendously to protecting minority shareholders' rights by penalizing corporate malfeasance by an abusive majority. *Skoglund* simply may be another case that prompts the Minnesota Legislature to pass a clarifying amendment. More importantly, it may be a vehicle for a long overdue look at a specialty business court.

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1. Decisions such as *Skoglund* will inevitably inspire additional legislation to undo the damage and will rekindle the long-simmering debate over the need for a specialized business court to deal with corporate law questions.
2. A closely held corporation is defined as "a corporation which does not have more than 35 shareholders." Minn. Stat. § 302A.011, subd. 6a.
3. Minn. Stat. § 302A.751, subd. 1(b)(1-6).
4. Minn. Stat. § 302A.751, subd. 2.
5. *Id*.
6. *See*, *e.g*., Sawyer v. Curt & Co., Nos. C7-90-2040, C9-90-2041, 1991 WL 65320 (Minn. Ct. App. Feb. 12, 1991).
7. *See* Minn. Stat. § 302A.751, subd. 2.
8. *Id*.
9. *Id*.
10. *Id.*
11. *See* MT Properties, Inc. v. CMC Real Estate Corp., 481 N.W.2d 383, 387 and n. 3 (Minn. Ct. App. 1992); Spinnaker Software Corp. v. Nicholson, 495 N.W.2d 441, 444 (Minn. Ct. App. 1993).
12. *See* Pooley v. Mankato Iron & Metal, Inc., 513 N.W.2d 834, 838 (Minn. Ct. App. 1994) (no minority discount); MT Properties, Inc., 481 N.W.2d at 386 (dissenter's rights case, Minn. Stat. § 302A.473) (no minority discount); Foy v. Klapmeier, unpublished slip op., Civ. No. 3-90-292 (D. Minn. 1992) (no marketability discount),

*aff'd* 992 F.2d 774 (8th Cir. 1993); American Sharecom, Inc. v. LDB Int'l Corp., slip op., Ct. File No. 92-16922 (Hennepin County District Court, Nov. 15, 1994) at 11, (no marketability discount).

13. Minn. Stat. § 302A.751, subd. 4 (1994).

14. *See* Pedro v. Pedro, 489 N.W.2d 798 (Minn. Ct. App. 1992); Foy v. Klapmeier, 992 F.2d 774 (8th Cir. 1993).

15. Minn. Stat. § 302A.751, subd. 1(b)(2) (1982).

16. Minn. Stat. § 302A.751 subd. 1(b)(3).

17. *See* Joseph E. Olson, *A Statutory Elixir for the Oppression Malady*, 36 Mercer L. Rev. 627, 638 (1985).

18. Minn. Stat. § 302A.751, Reporter's Notes 1982-1984.

19. Minn. Stat. § 302A.751, subd. 3a (1984).

20. Pedro, 489 N.W.2d at 799-800.

21. *Id.* at 802.

22. Sawyer, 1991 WL at *2.

23. Pedro, 489 N.W.2d at 802; Sawyer, 1991 WL at *2.

24. Minn. Stat. § 302A.751, subd. 3a (1994).

25. *See* Pooley, 513 N.W.2d at 838.

26. *Id.* at 836.

27. *Id.* at 838.

28. *See* Pedro v. Pedro, 463 N.W.2d 285, 288 (Minn. Ct. App. 1990); *reconfirmed,* 489 N.W.2d 798, 802 (Minn. Ct. App. 1992); *but see also* Kelley v. Rudd, No. C7-91-1142, 1992 WL 3651, at *3 (Minn. Ct. App. Jan. 14, 1992).

29. *See* Fewell v. Tappan, 27 N.W.2d 648, 654 (Minn. 1947); Westland Capital Corp. v. Lucht Engineering, Inc., 308 N.W.2d 709, 712 (Minn. 1981).

30. *See* Evans v. Blesi, 345 N.W.2d 775, 779 (Minn. Ct. App. 1984); Pedro, 489 N.W.2d at 801.

31. Minn. Stat. § 302A.751, subd. 3a.

32. *See* Wenzel v. Mathies, 542 N.W.2d 634 (Minn. Ct. App. 1996).

33. *See* Miller Waste Mills, Inc. v. Mackay, 520 N.W.2d 490, 495 (Minn. Ct. App. 1994).

34. Minn. Stat. § 302A.243 (1982).

35. Black v. NuAire, Inc., 426 N.W.2d 203, 209-10 (Minn. Ct. App. 1988).

36. 1989 Minn. Laws ch. 172 § 12.

37. Skoglund v. Brady, 541 N.W.2d 17 (Minn. Ct. App. 1995).

38. *See* Arent v. Distrib. Sciences, Inc., 975 F.2d 1370, 1372 (8th Cir. 1992) (applying Minnesota law); PJ Acquisition Corp. v. Skoglund, 453 N.W.2d 1, 6 (Minn. 1990).

39. *PJ Acquisition* involved a claim under section 302A.751 brought by a shareholder that did not own its shares at the time of the alleged wrongdoing. The Minnesota Supreme Court held that the claim was derivative; that the rules for derivative actions applied; and that, therefore, the shareholder could not assert the claims based on alleged wrongdoing prior to its purchase of the shares. The *PJ Acquisition* Court noted: "While Minn. Stat. § 302A.751, subd. 1 (1988), does expand the option of shareholders to bring actions seeking personal damages, as distinguished from derivative damages, the equitable remedy expanded does not replace the traditional derivative action."

40. Minn. Stat. § 302A.751, subd. 1(b)(5).

41. *See* J. Matheson & P. Garon, *Minnesota Corporation Law & Practice* § 10.1 at 10-5 (1992).

42. Black, 426 N.W.2d 203.

43. Skoglund, 541 N.W.2d at 21.

44. *See* 1989 Minn. Laws ch. 172, § 12.

45. *See* Minn. R. Civ. P. 23.06.

46. In addition to Minnesota, four other states—New Jersey, Illinois, North Dakota, and Florida—have such statutory provisions. *See* N.J. Stat. Ann. § 14A:12-1 *et seq.* (West 1995); Ill. Ann. Stat. Ch. 32 § 12.50, 12.55 (Smith-Hurd 1995); N.D. Cert. Code § 10-19.1-115 (1995); Fla. Stat. Ann. §§ 607.1434, 607.1436 (West 1995). Other state courts have granted the same equitable relief without the express statutory language.


About the authors:

Joseph W. Anthony is a shareholder of the Minneapolis law firm of Anthony Ostlund & Baer, P.A., which practices exclusively in business litigation. He is admitted to practice before the U.S. Supreme Court, U.S. Circuit Court of Appeals for the 3rd and 8th Circuits, U.S. district courts for the state of Minnesota, and the Minnesota Supreme Court. Mr. Anthony has written extensively and lectured at many seminars in such areas as financial fraud, RICO, and other business-litigation related matters.

Karlyn Vegoe Boraas is a shareholder of the Minneapolis law firm of Anthony Ostlund & Baer, P.A., practicing in the areas of business and commercial litigation. She is a 1993 *cum laude* graduate of the University of Minnesota Law School.



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