Don't Be The Next LUNDS & BYERLYS

Lessons learned from the *Lunds* shareholder litigation

By Janel Dressen

On March 27, 2019, the Minnesota Supreme Court denied review in the *Lunds* litigation that spanned more than four years and resulted in the largest reported fair value buyout award to a minority shareholder in Minnesota under Minn. Stat. §302A.751 (Section 751).[1] The history leading to the litigation, the litigation itself, and the courts' decisions in the case offer many important lessons for all private company business owners, business lawyers, and business litigators.[2]

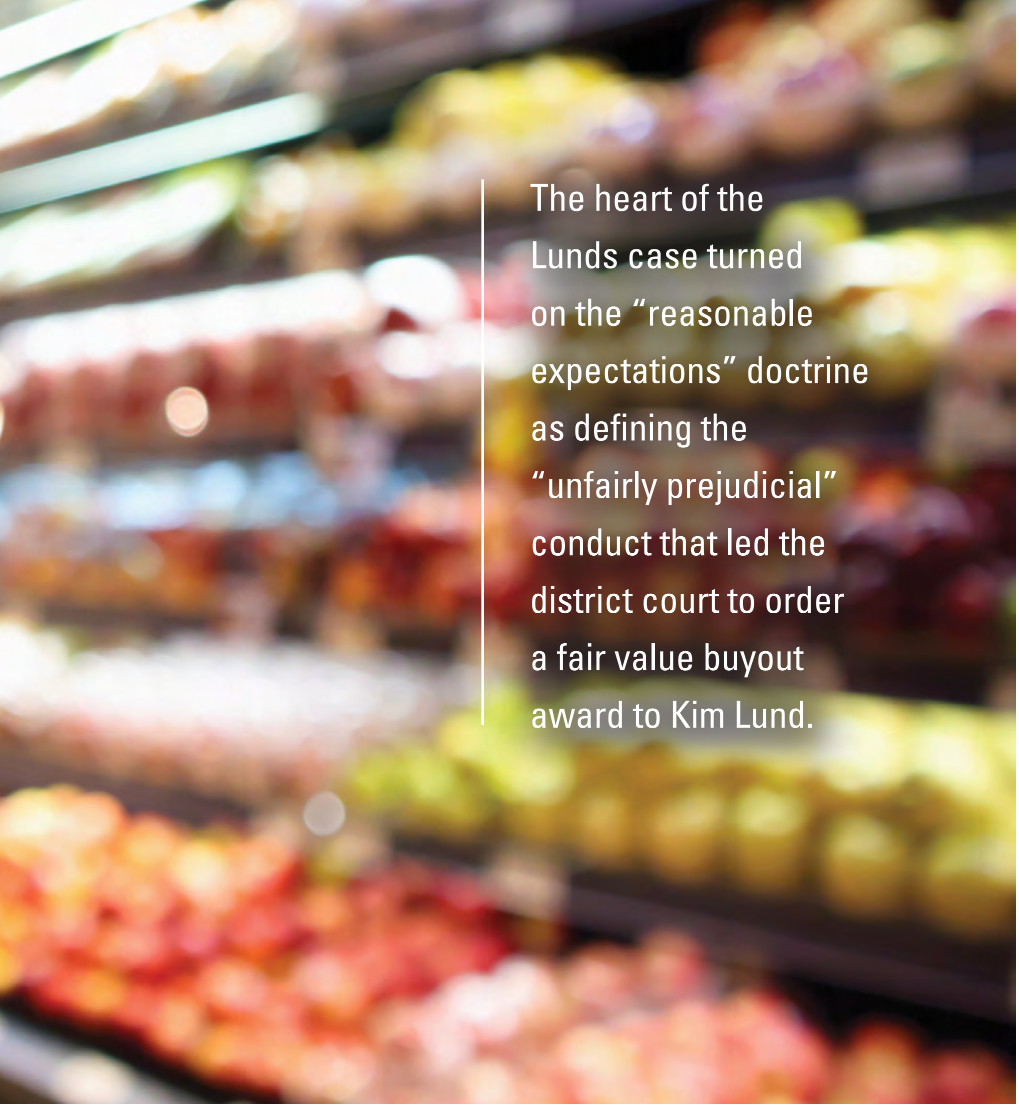
In December 2014, Kim Lund, as a 25 percent beneficial owner, commenced a Section 751 case based upon the frustration of her reasonable expectations of liquidity and financial independence from the Lunds and Byerlys grocery store businesses. She commenced a lawsuit against the companies and her brother, Tres Lund—who was in control of the businesses—after 20 years of clearly articulating her expectation of an exit plan (specifically, that her beneficial ownership interests in the companies be separated from the family business so she could engage in charitable and philanthropic pursuits). The Lund family worked on developing an exit plan without any indication that Kim could not get out as an owner or that the family wealth equally gifted to her by her grandparents and father would have to remain invested in the Lund's enterprise indefinitely. Kim's expectations, as well as her siblings' and the companies' support of those expectations, were confirmed in numerous documents, many of which included the words of her siblings and company management. Ultimately, after 18 months of discovery, the district court granted Kim Lund's buyout motion, ordering that she was entitled to a fair value buyout because her brother, Tres Lund, and the companies frustrated her reasonable expectations to financial independence and liquidity.[3]

Lesson 1: Business owners need to understand the reasonable expectations doctrine.

In order to fully appreciate the lessons to be learned from the *Lunds* litigation as a business owner or an attorney advising Minnesota private businesses and business owners, the legal genesis of this family business dispute is important. The heart of the *Lunds* case turned on the "reasonable expectations" doctrine as defining the "unfairly prejudicial" conduct that led the district court to order a fair value buyout award to Kim Lund under Section 751, subd. 1(b)(3).

Minnesota does not stand alone in the adoption of the reasonable expectations doctrine. More and more jurisdictions are adopting a reasonable expectations standard in business separation and dissension cases. In fact, about one-half of U.S. jurisdictions apply a "reasonable expectations" approach to oppression, unfair prejudice, and/or breach of fiduciary duty claims.[4]

While the Minnesota Legislature has not defined what constitutes "unfairly prejudicial" conduct, judicial authorities and the Reporter's Notes to Section 751 dictate that the phrase "unfairly prejudicial" as used in Section 751 is to be interpreted liberally.[5] The *Lunds* courts emphasized this tenet of Section 751 law in their decisions.[6]



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The Minnesota Supreme Court first applied the reasonable expectations doctrine—previously adopted by the Minnesota Court of Appeals in several decisions—in 2011.[7] The Court affirmed that acting in an unfairly prejudicial manner "*includes* conduct that violates the reasonable expectations of the minority shareholder."[8] While the "reasonable expectations" doctrine was not new law applied in the *Lunds* case, the doctrine was applied to a set of facts not previously presented in any published or unpublished Minnesota decision.[9]

One mistake many lawyers make in Section 751 cases is to assume that the section applies only to a "freeze-out" of a minority shareholder. That assumption is not correct. Neither Section 751 nor Minnesota jurisprudence have held that any particular expectations are *per se* unreasonable. Businesses, therefore, need to understand the development of shareholder expectations and manage those expectations. Indeed, the district court held that Tres Lund and the companies "have an ongoing obligation toward the other Lund siblings/shareholders to meet their reasonable expectations."[10]

Defendants argued that Kim's expectations of liquidity and financial independence were not reasonable because the companies did not "freeze" her out of the companies, and her "personal desires" were counter to the reasonable expectations Minnesota law recognizes. But the district court rejected defendants' arguments and aptly noted that varying fact patterns were "anticipated when section 751 was amended so as to include broader remedial flexibility than the previous versions" and the only prerequisite to application of Section 751 is the existence of a closely held corporation.[11] Minnesota law does not establish the reasonable expectations; the conduct, words, and actions of the parties do.

So how do reasonable expectations develop? Importantly, reasonable expectations are not the "mere subjective hopes of a shareholder, but must be determined *objectively*, based on review of written and oral agreements among shareholders, as well as the conduct of the parties. The

reasonable expectations of a particular shareholder will vary depending on the circumstances and the nature of the corporation… Those expectations are not limited to traditional shareholder rights such as notice, information, voting, and dividends."[12]

In this regard, the district court and the court of appeals rejected defendants' arguments that Kim could not have a reasonable expectation to liquidity because: (1) the dominant characteristic of a closely held business is the lack of a public market for its shares; and (2) a buy-out remedy to Kim would discourage close corporations from accommodating or even discussing a shareholder's request for liquidity because any consideration could later be found to establish the shareholder's reasonable expectations. Both of these arguments reflect a misunderstanding of Section 751 and in particular the reasonable expectations doctrine.

As to the first argument, there is nothing in the Minnesota Business Corporations Act or in the law providing that a private company cannot purchase shares from a shareholder.[13] The second argument ignores that Section 751 gives the district court the authority and discretion to evaluate and balance the equities before it, and determine, based upon all of the facts and circumstances, whether an expectation to liquidity was reasonable. *Lunds* did not turn on a simple discussion among the shareholders about purchasing Kim's shares; rather, the district court's determination was based on the decades-long conduct of the parties and the defendants' decades-long assurances to Kim that an exit plan would be provided. The conduct of the parties is key and should be considered in the determination of reasonable expectations.

Lesson 2: Written agreements are not dispositive of expectations in all circumstances.

Section 751 subd. 3a provides that in determining whether to order equitable relief to a shareholder, including a fair value buy-out, "any written agreements, including employment agreements and buy-sell agreements, between or among shareholders or between or among one or more shareholders and the corporation are presumed to reflect the parties' reasonable expectations concerning matters dealt with in the agreements."

The Lunds shareholders entered into Transfer Restriction Agreements (TRAs) providing that all shareholders had to consent to the transfer of shares by a shareholder. Defendants argued that the TRAs made Kim's liquidity expectation unreasonable as a matter of law because all shareholders did not agree that her shares should be purchased by the companies. The district court and the court of appeals rejected defendants' argument. The reasonable expectations of a minority shareholder "frequently include understandings which are not articulated in the corporate documents."[14] The district court considered the TRAs, as well as the companies' bylaws and the shareholder trust agreements, and held that "the words, conduct, and history of the parties shed more light on Kim's reasonable expectations than do the trust and corporate governance documents. Tres, in particular, as well as [the chief administrative officer, secretary and treasurer of the Lund Entities], have continuously contributed to Kim's belief that an exit strategy was in the works, wherein she would gain liquidity and financial independence from the Lund Entities."[15]

In analyzing the TRAs and other corporate documents, the court of appeals highlighted the fact that the documents did not prohibit transfers and, in the case of the TRAs, actually authorized a sale of interests by a shareholder. Thus, the district court had to assess the communications and conduct of the parties to determine if Kim's liquidity expectations were reasonable.[16]

In order to dictate "reasonable expectations," any agreements between the shareholders need to expressly eliminate the expectation at issue in order to govern the analysis. And it is not enough to have an agreement in place if the shareholders do not follow it and their conduct demonstrates a course of conduct and dealing inconsistent with the agreements entered into. In such circumstances, the statutory presumption of the written agreements may be overcome.

Lesson 3: Minority shareholders have rights and may need protection by the courts if the company and its shareholders have not implemented planning to address the rights of the minority.

Throughout the litigation, the Lunds companies and Tres Lund continuously emphasized Kim's role as a minority shareholder as though that meant she had limited expectations and virtually no rights. Businesses and controlling owners should not make the same mistake. "Minority shareholders are in a vulnerable position."[17] The district court stressed that the defendants' emphasis on Kim's "limited role as a minority shareholder" was wrong: "Defendants are wrong to rely on Kim's vulnerabilities in making their argument that, essentially all is well at Lunds. Emphasizing the limitations of Kim's voting rights, Defendants highlight the necessity of an equitable remedy in this situation. Minority shareholders in a closely-held company are the exact persons section 751 was created to protect…"[18]

The district court further observed from the evidence that: (1) "the relationship among the Lund siblings had steadily and sadly deteriorated;" (2) "Family discussions, which once appeared candid and collegial, have devolved into an entrenched legal battle;" and (3) "for at least 15 years, Tres and Kim have been unable to effectively address their divergent expectations as beneficial owners, shareholders, and co-trustees, and the relationships and dealings among the siblings have become increasingly acrimonious as the years have passed."[19]

The district court also addressed the need for family business planning. "In a family setting such as this, it is also prudent corporate planning, as has been recognized over the years by [professionals], to ensure the wellbeing of the Lund Entities in the face of aging grandchildren/shareholders and to properly prepare for any life changes that could trigger additional liquidity needs. A court-ordered buyout—which will provide necessary closure to the parties and will galvanize the development of a clear plan to address the long-term needs of the company and its remaining beneficial owners/shareholders—is an appropriate equitable remedy under the circumstances."[20]

Rather than implementing planning that incorporated Kim's reasonable expectations as defendants assured Kim they would do, the defendants instead focused on the "divide" between Kim and her siblings, repeatedly arguing to the district court that on every issue, "Kim stands alone." The district court found this to be another basis upon which equitable relief was appropriate:

> "[S]eeking to bolster their claim that Kim's expectations are unreasonable, Defendants overstate the divide between Kim and her siblings, implying an unequivocal "us" versus "her" situation. *** The reasonableness of Kim's expectations does not hinge on whether her siblings have the exact same objectives for themselves as shareholders and beneficial owners of the Lund Entities. The conduct and words of the parties define what of Kim's expectations are "reasonable" in this case, and the evidence indicates that all individuals involved were well versed in and, to varying degrees at various times, supportive of Kim's desire for independence and liquidity. The fact that Kim is the only sibling pursuing complete independence from the family business does not make her expectations unreasonable."[21]

If there is dysfunction and disharmony among shareholders in a closely held business, it is prudent to consider, plan for, and address those matters proactively, rather than ignore such matters by employing internal reasoning that a minority shareholder has limited rights. That kind of thinking is a mistake under Minnesota law. It would be equally prudent for closely held companies to understand, plan for, and address the varying differences in shareholder expectations rather than treating a shareholder who holds differing views as "standing alone."

Lesson 4: Transparency, not appeasement, should be the objective.

The Lund defendants made a number of poor decisions before Kim commenced litigation. Had they avoided such decisions and actions, the parties may have been able to resolve their differences by a negotiated resolution, rather than a forced resolution dictated by Hennepin County District Court Chief Judge Ivy Bernhardson. For example, before the litigation was commenced, defendants implemented a partial redemption plan providing that the Lund siblings could elect to sell a limited portion of their shares in the entities for a total of up to $8,000,000 for all four owners. Such a partial, limited redemption offering, together with the manner in which it was implemented, had many flaws—resulting in Kim's concluding that she had no other viable option but to commence litigation.

The district court addressed the shortcomings of the offering: "[t]he partial redemption offer was inconsistent with what Kim had reasonably desired since at least the early 1990s—full divestiture of her trust assets from the Lund Entities, at a fairly valued price."[22] The court of appeals also weighed in on the partial, limited redemption offering and held that it did not create a disputed fact requiring a trial: "[o]ffering a single, partial redemption over a 20-year period when all parties understood that Kim would achieve complete liquidity established frustration of her reasonable expectations as a matter of law."[23]

Second, to make matters worse, when implementing the single, partial redemption offering, the companies refused to allow Kim to attend a board meeting during a discussion about the offering and refused to give her communications containing the valuation of professionals employed by the companies to value the company stock for the redemption offering. This lack of transparency by the companies served to heighten the lack of trust by Kim in the companies' treatment of her as a shareholder, and to undermine any confidence that the redemption would be fair to her.

Had the Lund Entities and Tres Lund acted with transparency, rather than insincere appeasement, the parties may have been able to resolve the matter without litigation and without suffering the negative consequences of damage to the family relationships and to the reputation of the business in the public eye.

Lesson 5: Family business disputes get resolved by making a compromise business deal and setting aside egos and emotions.

One of the most fascinating, yet tragic, facts about the *Lunds* case is that the parties did not engage in a single settlement discussion after Kim commenced litigation. In business litigation, that is virtually unheard of. However, because Kim Lund was requesting liquidity and defendants were solely focused on keeping Kim Lund captive as a shareholder, the parties were at a standstill. Very rarely is it beneficial to the company and its other shareholders to insist that a shareholder wanting separation remain a shareholder, particularly when the company and/or its shareholders are in a financial position to fund, on terms and conditions, a separation. In that respect, it is not much different from spouses seeking a divorce.

Avoiding litigation when a shareholder dispute arises, or resolving a shareholder dispute after litigation has commenced, undoubtedly requires compromise by everyone, and most importantly, a recognition that the parties are making a business deal. With family businesses in particular, that means the parties must set aside their emotions and their desire for control to reach a deal that results in a permanent separation.

The benefits of a negotiated resolution in these cases are significant, as are the risks of a failure to compromise. A compromise resolution avoids the parties fighting over and wasting their own assets as well as the collateral damage to family relationships and the distraction and reputational harm to the business and business owners. To state the obvious, one side of the equation cannot make a business deal. It takes all hands on deck to compromise—and in these cases, compromise can mean the difference between saving and permanently losing important relationships and between protecting and causing undue harm to a successful business. The stakes are high. Employing counsel and advisors who understand this area of the law, and the risks involved, is therefore imperative. ▲

Notes

1 *Lund v. Lund*, 924 N.W.2d 274, 2019 WL 178461 (Minn. Ct. App. 1/14/2019), *review denied* (3/27/2019).

2 There are many legal and business lessons that can be learned from the *Lunds* litigation, not all of which can be covered in the space limitations of this article. For example, this article does not address any of the lessons learned on valuation and trustee matters, which were the subject of a trial, or the award of attorneys' fees, which is currently on remand before the district court.

3 *Lund v. Lund*, 10/4/16 Buy-Out Order (Dist. Ct.) at 23.

4 *See* 2 Close Corp and LLCs: Law and Practice §9:18 (Rev. 3d. ed.) (Nov. 2018 Update), *O'Neal and Thompson's Close Corporations and LLCs, Statutory and judicial alternatives for closely held entities wracked by dissension*.

5 *U.S. Bank N.A. v. Cold Spring Granite Co.*, 802 N.W.2d 363, 378 (Minn. 2011); Minn. Stat. §302A.751, Reporter's Notes (1982-1984) ("This change altered the grounds for involuntary dissolution or buy-out on motion to include circumstances when the directors *or* those in control of the corporation (a deliberately vague term not necessarily referring only to majority shareholders) act in an 'unfairly prejudicial' manner towards any shareholder in that person's capacity as a shareholder, director, officer, or employee. This is a more liberal rule than 'persistently unfair,' which required repeated adverse results before a shareholder could sue. Now only one instance is required.")

6 *Lund*, 924 N.W.2d at 280; *Lund v. Lund*, 10/4/16 Buy-Out Order (Dist. Ct.) at 5.

7 *Id.; Berreman v. W. Publ'g Co.*, 615 N.W.2d 362, 374 (Minn. Ct. App. 2000); *Gunderson v. Alliance of Computer Prof'ls, Inc.*, 628 N.W.2d 173, 184 (Minn. Ct. App. 2001); *see also* Minn. Stat. §302A.751, subd. 3a, which states that the Court "*shall* take into consideration the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair, and reasonable manner in the operation of the corporation and the reasonable expectations of all shareholders as they exist at the inception and develop during the course of the shareholders' relationship with the corporation and with each other."

8 *Cold Spring Granite Co.*, 802 N.W.2d at 378-79.

9 It is important to note that violation of a shareholder's "reasonable expectations" is not the sole source of determining "unfairly prejudicial conduct." The *Cold Spring Granite* court left open the possibility that "conduct other than conduct violating the reasonable expectations of the shareholder may also be unfairly prejudicial." *Cold Spring Granite*, 802 N.W.2d at 379, n.10.

10 *Lund v. Lund*, 10/4/16 Buy-Out Order (Dist. Ct.) at 22.

11 *Id.* at 6-7.

12 *Id.* at 11.

13 *Lund*, 924 N.W.2d at 281.

14 *Lund v. Lund*, 10/4/16 Buy-Out Order (Dist. Ct.) at 11.

15 *Lund v. Lund*, 10/4/16 Buy-Out Order (Dist. Ct.) at 12.

16 *Lund*, 924 N.W.2d at 280-81.

17 *Id.* at 282.

18 *Lund v. Lund*, 10/4/16 Buy-Out Order (Dist. Ct.) at 24.

19 *Lund v. Lund*, 10/4/16 Buy-Out Order (Dist. Ct.) at 25.

20 *Id.* at 24, 26.

21 *Id.* at 20.

22 *Lund v. Lund*, 10/4/16 Buy-Out Order (Dist. Ct.) at 23.

23 *Lund*, 924 N.W.2d at 281.

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