



So . . . When Is A Shareholder A Shareholder . . . And When Does It Matter?

By Rich Ostlund

Rich Ostlund, a principal at the exclusively business litigation firm Anthony Ostlund Baer & Louwagie in Minneapolis, has frequently litigated issues of Minnesota business governance and shareholder relationships over the past 30 years. Mr. Ostlund has been trial counsel on numerous leading Minnesota trial and appellate decisions in this area of the law, was counsel for the company in *Miller Waste Mills v. Mackay* and served as co-trial counsel to the company in the May 2011 trial in *Drewitz* and upon the 2012 appeal in *Drewitz V*. Mr. Ostlund was not involved as company counsel in *Drewitz I, II, III or IV*.

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Trying to define the beginning of life, and later, its end has spawned intense philosophical and legal debates across the landscape of American law for decades. So too have our courts been called upon to define the moment of termination of a shareholder's rights in privately held Minnesota businesses.

Recently, our Minnesota appellate courts have once again examined the question of when a shareholder's financial rights end in one of Minnesota's most common business forms, the privately held corporation as governed by Chapter 302A, The Minnesota Business Corporation Act.

A set of common facts are found repeatedly in these typical Minnesota businesses. The essential story goes as follows: the company has owners (often shareholders in a private corporation or members in a limited liability company setting) who are also employees of the company. These owner-employees enter into one or more written contracts with the company and/or each other concerning how key aspects of their business relationship will be governed. These agreements commonly address a variety of core business governance issues, including the company's right to purchase an owner-employee's shares upon either the end of his/her employment or when that shareholder dies. These agreements also establish a timeframe for the corporation to give notice of its exercise of an option to purchase the departing owner-employee's shares and also set a time period for the company and the shareholder to close on the share redemption (e.g., exchange the shares for payment).

So, when do such a departing owner-employee's shareholder rights end? At the moment of employment termination? Upon exercise of the purchase option? When payment is tendered to the shareholder? When the shareholder accepts payment? What happens if the required closing (payment) for the share redemption/purchase is delayed beyond the period specified for closing in the shareholder agreement?

The case of *Drewitz v. Motorwerks* provides important guidance to when a departing owner-employee's financial rights as a shareholder terminate. Drewitz was employed as the general manager of a car dealership, he owned 30% of its stock and had an employment contract with a term through March 31, 1999. His employment contract was not renewed when it expired and, by contract, the company was obligated to purchase his shares at a set formula value, the closing on the redemption to be within 90 days of employment termination. Drewitz sued to challenge his employment termination and, because his suit was pending, he refused to attend the stock redemption closing set by the company for July 1999. When Drewitz refused to attend the closing the company did not initiate a declaratory judgment or other legal proceeding to force a closing to occur. While the company later tendered a business check which Drewitz refused to accept, it was determined by the court that this tender did not conform to the terms of the governing redemption agreement.

Drewitz' original lawsuit (contesting his termination of employment and seeking a fair value award on his shares) ended in 2001 via summary judgment in favor of the company, that being affirmed by the Court of Appeals. [(*Drewitz v. Motorwerks*, No. C3-00-1759, 2001 WL 436223 (Minn. App. 1 May 2001). "*Drewitz I*.")] Between 2001 and early 2004, lawyers and accountants for the company and Drewitz negotiated over how to compute the value of his shares under the valuation formula in the stock redemption agreement.

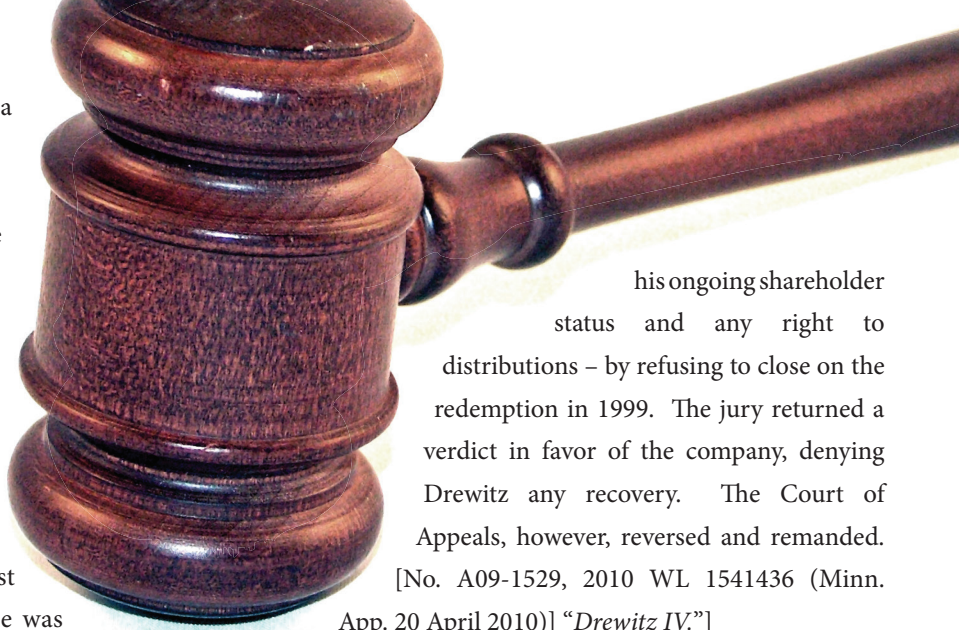
Among the agreements entered into in 1995 between the company and Drewitz in addition to his employment agreement was a shareholder agreement that governed the process for making shareholder financial distributions on company shares. After the company gave notice of its intent to redeem and set a July 1999 redemption date, the company did not consider Drewitz to

be a shareholder any longer. He was issued a “final” K-1 for tax purposes by the company for part of 1999, consistent with his shareholder interest ending on March 31, 1999 (the date his employment ended). Drewitz was paid no further share distributions, nor did he ask for any distributions or assert any additional shareholder rights while his initial lawsuit was pending nor for approximately 2 years while negotiations proceeded over how to value his shares under the redemption formula.

In 2004, Drewitz brought a new lawsuit against the company claiming, in relevant part, that he was still a company shareholder and as such was still entitled to ratable distributions on his shares from 1999 onward under the parties’ shareholder agreement because his stock redemption had not been completed. In response, the company moved for summary judgment seeking dismissal of the claims based on principles of *res judicata*, which the trial court granted. On appeal, the Minnesota Court of Appeals, in relevant part, reversed the trial court’s determination that *res judicata* and lack of shareholder status barred Drewitz’ claim for breach of the shareholder agreement and for distributions thereunder. (706 N.W.2d 773 (Minn. App. 2005) (*Drewitz II*). The Minnesota Supreme Court thereupon took review in *Drewitz III* [728 N.W.2d 231 (Minn. 2007)]. The Supreme Court, concluding that the company had not made a “conforming tender” for Drewitz’ shares under the shareholder agreement to perfect the redemption, remanded for three (3) determinations: (1) whether (when) the company made a conforming tender; (2) whether the company breached the shareholder agreement by not making distributions to Drewitz; and (3) whether Drewitz’ shareholder rights had been breached post-termination of employment so as to trigger a fair value claim.

The company had eventually tendered funds into court in December 2005, which the trial court found was a “conforming tender,” under the shareholder agreement, thereby extinguishing Drewitz’ shareholder status as of December 23, 2005.

Following remand from the Supreme Court decision in *Drewitz III*, two additional trials and two appeals in the Drewitz case ensued, most recently concluding in January 2013. In 2008, a jury trial was conducted on the issue of whether Drewitz had repudiated his shareholder agreement obligations – and thereby



his ongoing shareholder status and any right to distributions – by refusing to close on the redemption in 1999. The jury returned a verdict in favor of the company, denying Drewitz any recovery. The Court of Appeals, however, reversed and remanded. [No. A09-1529, 2010 WL 1541436 (Minn. App. 20 April 2010)] “*Drewitz IV*.”]

On remand from *Drewitz IV*, the two remaining issues specified by the Supreme Court in *Drewitz III* were tried consensually to the court without a jury in May 2011. Thereafter, in late 2011 the trial court found as follows: (1) there had been no intent by the company to harm Drewitz’ shareholder rights post-termination of employment; (2) the delay in closing on the redemption of his shares from July 1999 into 2005 was equally the responsibility of Drewitz and the company; (3) that upon exercise of the company’s contractual right to purchase Drewitz’ shares in 1999, it became the equitable owner of the shares under *Miller Waste Mills, Inc. v. Mackay*, 520 N.W.2d 490 (Minn. Ct. App. 1994) and, as such, he was not entitled to distributions; and (4) that there was no breach of the shareholder agreement in not paying distributions to Drewitz between March 1999 and December 23, 2005, it being the court’s view of the parties’ intent (looking at all facts, including the employment agreement) that Drewitz was not to receive distributions after termination of his employment and upon exercise by the company of its right to redeem his shares. Accordingly, the trial court: (1) denied Drewitz’ claim for distributions as a shareholder between 1999 and the “conforming tender” in 2005; and (2) denied Drewitz’ alleged \$7 million plus fair value buy-out claim.

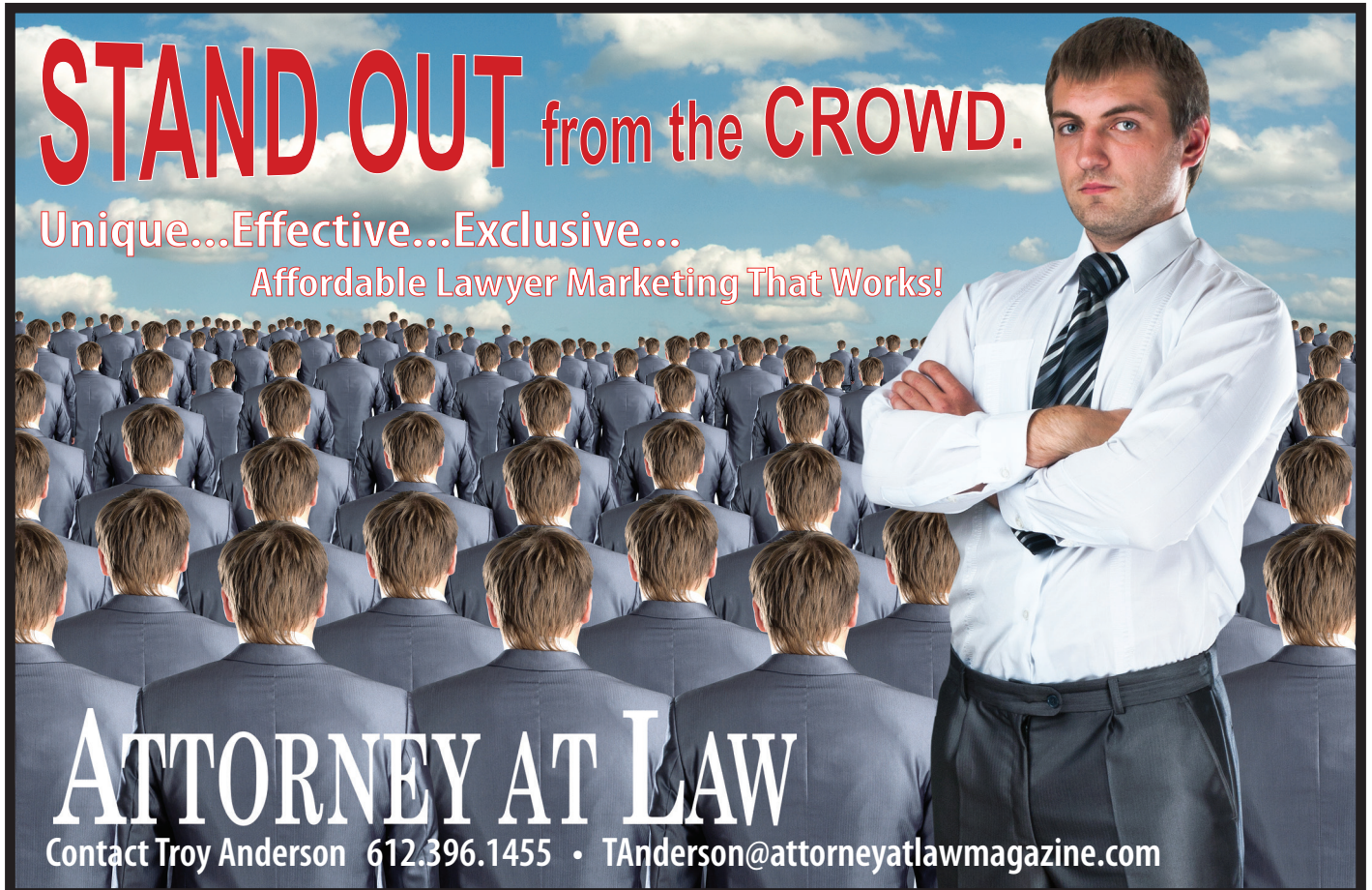
In *Miller Waste Mills vs. Mackay*, the Minnesota Court of Appeals held in 1994 that the voting rights attached to privately held shares during the period between a company’s exercise of a redemption contract/option and payment for the shares, were transferred to the company as the “equitable owner” of the shares, thereby prohibiting the selling shareholder from voting the shares during the post-exercise/pre-closing time period. *Id.*

Following the trial court’s late 2011 decision rejecting both

Drewitz' fair value and distributions claims, Drewitz' again appealed (*Drewitz V*). In *Drewitz V*, the Court of Appeals addressed whether to extend the *Miller Waste Mills* equitable ownership principle beyond voting rights to a shareholder's financial rights during the period between option exercise and closing, as well as the scope of the trial court's interpretative authority relative to the shareholder agreement on the distributions claim. On November 13, 2012 the Minnesota Court of Appeals affirmed the trial court's denial of Drewitz' alleged \$7 million fair value claim, deferring to a trial court's broad discretion in evaluating equitable claims under Chapter 302A. The Court of Appeals, however, reversed on the issue of the shareholder distributions claim. [(A12-0604 Minn. App. 13 November 2012 (*Drewitz V*).] The appellate court: (1) declined to extend the *Miller Waste Mills* decision on "equitable ownership" from the sphere of shareholder voting rights to the interpretation of financial rights in the time period between a redemption option exercise and the closing on that stock redemption by the company; and (2) held as a matter of contractual interpretation

that Drewitz was entitled to receive distributions on his shares between March 1999 and the eventual "conforming tender" by the company in 2005. In January 2013, the Minnesota Supreme Court denied the parties' cross-petitions for further review.

The principles to be distilled from this series of decisions are important to all Minnesota private companies. Failing either the completion of a redemption pursuant to the governing contract's terms; or an unquestionably "conforming tender" to the shareholder under the subject redemption agreement; and/or timely and diligently pursued litigation by a company to enforce the agreement against a shareholder who refuses to close upon a redemption, a Minnesota company should assume a shareholder retains all financial rights until the redemption of the shares in question is completed. Given the frequency with which owner/employees in private companies come and go over the lifespan of virtually every private Minnesota business, this set of issues arises frequently – whether under Chapter 302.A (corporations) or Chapter 322.B (limited liability companies).

An advertisement for 'Attorney at Law' featuring a man in a white shirt and tie standing with his arms crossed, looking directly at the camera. He is positioned on the right side of the frame, standing out from a large crowd of men in dark suits who are seen from behind, filling the rest of the frame. The background is a bright blue sky with white clouds. The text 'STAND OUT from the CROWD.' is written in large, bold, red letters at the top left. Below it, in smaller red text, is 'Unique...Effective...Exclusive...' and 'Affordable Lawyer Marketing That Works!'. At the bottom, the words 'ATTORNEY AT LAW' are written in large, white, serif capital letters. Below that, in smaller white text, is 'Contact Troy Anderson 612.396.1455 • TAnderson@attorneyatlawmagazine.com'.