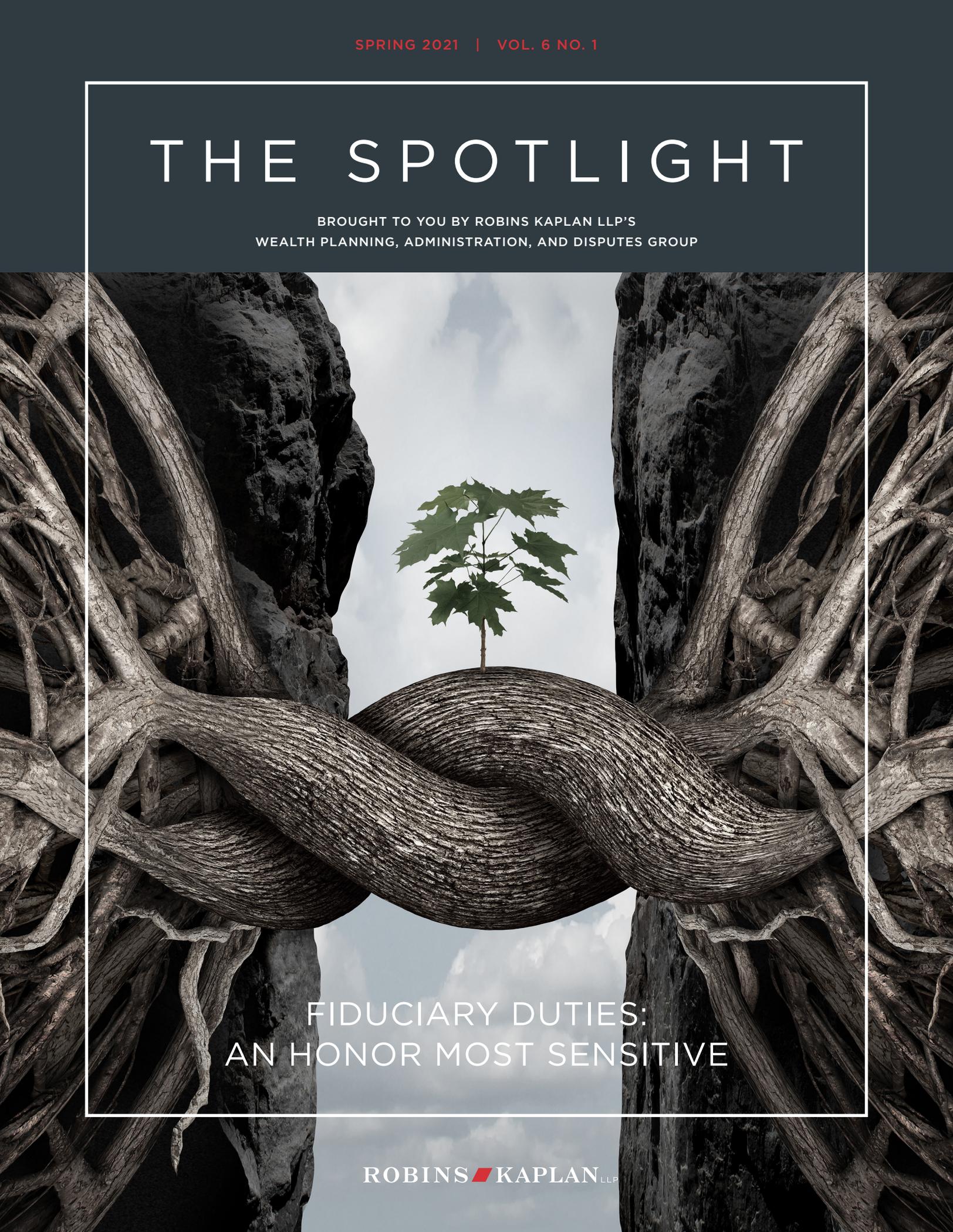


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# THE SPOTLIGHT

BROUGHT TO YOU BY ROBINS KAPLAN LLP'S  
WEALTH PLANNING, ADMINISTRATION, AND DISPUTES GROUP



FIDUCIARY DUTIES:  
AN HONOR MOST SENSITIVE

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# WELCOME TO THE SPOTLIGHT

## BROUGHT TO YOU BY ROBINS KAPLAN LLP'S WEALTH PLANNING, ADMINISTRATION, AND DISPUTES GROUP

The Spotlight is the result of ongoing collaboration between our national trial practice and estate planning groups, with the goal of providing a forum to discuss the latest news and other issues impacting the trusts and estates community. Whether you are a trustee, beneficiary, trust officer, attorney, financial advisor, or other professional in this area, we hope that you will find this newsletter interesting, informative, and perhaps at times even a bit entertaining.

As leaders and teachers in the field of wealth planning and administration, our attorneys have built a reputation for excellence in meeting the needs of individuals and organizations from basic to complex testamentary planning. We counsel individuals and business owners in all aspects of estate planning and business succession, providing them with peace of mind and reassurance that their legacy is in the best of hands.

Furthermore, should a conflict arise, our wealth disputes attorneys are well positioned to resolve the matter with thoughtfulness, creativity, and compassion. Our national reputation for litigation excellence includes wins in the fiduciary arena for trustees and fiduciaries, personal representatives, beneficiaries, guardians, and conservators. Whether litigating fiduciary matters, inheritance issues, or contested charitable donations, we help clients cut through confusion to find a path to resolution.

Is there a topic affecting your practice that you would like us to discuss in an upcoming issue of the Spotlight? Let us know at [TPentelovitch@RobinsKaplan.com](mailto:TPentelovitch@RobinsKaplan.com).

- Denise S. Rahne and Steven K. Orloff

To learn more about our wealth planning, administration, and disputes attorneys and the services we provide, contact one of our experienced partners:



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## **FIDUCIARY OR FOE? REVISITING *MEINHARD V. SALMON***

**BY DENISE RAHNE AND SAMIA YOUNG**

Most lawyers have read—and likely briefed—the staple cases that helped to shape American fiduciary law. In the business law and partnership context, it is difficult to imagine a more well-known case than *Meinhard v. Salmon*.

The famous New York opinion, written by Justice Cardozo, helped define the fiduciary duties that partners owe to one another and to the partnership. Although it has been nearly a century since Cardozo issued what has now become one of the most widely cited business law opinions in the U.S., the opinion continues to be relevant in modern-day partnership disputes.

### **SALMON MEETS MEINHARD**

Walter J. Salmon was an up-and-coming real estate developer focused on commercial real estate in midtown Manhattan. His strategy was simple: Seek out property owners and acquire long-term net leases of the fee interests.

Salmon was well on his way to success when another developer, the Gerrys—looking for a partner to develop a

Manhattan property known as the Bristol Hotel—agreed to a 20-year lease at an annual rental of \$55,000. But Salmon had one significant problem: He had no money to improve the property. Lucky for Salmon, Morton H. Meinhard entered the picture at just the right time.

Meinhard, who worked in finance, had cash on hand. And he and Salmon eventually struck a deal in 1902. Meinhard would contribute half the funds necessary to renovate the property, and Salmon would pay Meinhard 40% of the net profits for five years and 50% thereafter. In addition to sharing losses equally, the agreement also gave Salmon full authority to manage the property.

### **HOW THINGS WENT DOWNHILL**

As we all know, good things often come to an end. At some point, Meinhard began questioning Salmon about charges that he was making for expenses and complained that Salmon was not informing him about management decisions. As these issues persisted, Salmon and Meinhard's

relationship continued to deteriorate. By 1917, the two had little or no contact.

The Bristol Hotel lease came up for renewal in 1922. At the time, it was one of the most valuable pieces of real estate in the world. The Gerrys awarded Salmon another 20-year lease in January 1922, three months before the old lease expired.

The new lease included adjoining lots owned by the Gerrys and was for annual rents beginning at \$350,000 and increasing to \$475,000 after 10 years. But as great as this new deal was for Salmon, it was not great for Meinhard, who was completely unaware of these negotiations. Upon learning of the new lease, Meinhard sued Salmon.

### WHO WON, AND WHY

Both the trial court and the appellate division agreed that Meinhard was entitled to a share of the lease, but the amount that Meinhard was entitled to remained in dispute.

In 1928, Cardozo upheld the appellate division's judgment in favor of Meinhard and awarded him half of the entire new lease. According to Cardozo, Salmon breached his fiduciary by not disclosing the new lease to Meinhard and by appropriating the benefit of the new lease to himself.

If you are still having difficulty remembering this case from law school, perhaps the way that Cardozo famously described the fiduciary duty owed by one "co-venturer" to another will jog your memory: The fiduciary duty is "something stricter than morals of the market place. Not honesty alone, but the punctilio of an honor most sensitive, is then the standard of

behavior." Indeed, "[j]oint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty." Legal historians note that this opinion was of the most eloquent and memorable of Cardozo's efforts to "implant a sense of honorable conduct into law."<sup>1</sup>

### THE AFTERMATH

Despite its reception, it turns out that Cardozo rarely ever mentioned the famous opinion that drew attention from scholars and commentators alike. In fact, Cardozo's one and only recorded comment about the opinion was found in a letter to Felix Frankfurter, to whom he wrote, "*Meinhard v. Salmon* is one of the cases in which some of my colleagues think that my poetry is better than my law. I think its law is better than its poetry (which, indeed I cannot discover)." Despite Cardozo's modesty, the opinion has been cited over a thousand times, according to Westlaw.

Still, Cardozo's opinion had its critics. Some people believe that Salmon should have won the case. These commentators provide multiple reasons to support this conclusion, including that the contract between Meinhard and Salmon clearly contemplated an arrangement limited to the term of the original lease and that Meinhard had no experience in managing real estate. Others have noted that the opinion is remembered more for its rhetoric than for its facts.

Regardless of the side you take, we can all likely agree that Cardozo's description of the fiduciary duties that partners owe to each other set the standard and continues to influence American business-partnership law.

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<sup>1</sup>Andrew L. Kaufman, *Cardozo* 241 (1998).



# SHAREHOLDER RISKS IN MERGERS AND ACQUISITIONS

BY DAVID MARTINEZ AND JASON FAIR

Corporate mergers and acquisitions can disproportionately affect minority shareholders and members of closed corporations. Those effects may include the dilution of the value of shares, the loss of the holder's voting rights, or, in the context of family legacy shares, the total loss of the originating family's interest in the corporation. This is why owners of these shares should scrutinize their shareholder rights while confronting any proposed merger or reorganization of the corporation. This article identifies some of the tools and procedures available to the minority shareholder to protect its interest during a corporate merger or other reorganization.

## THE FIDUCIARY DUTY OF OFFICERS, DIRECTORS, AND CONTROLLING SHAREHOLDERS

Established fiduciary duty law offers a common place of assurances to minority shareholders facing merger or other reorganization. States generally recognize two key duties: Officers and directors owe a fiduciary duty to all shareholders; and controlling shareholders owe a fiduciary duty to minority shareholders. The rule of thumb is that officers, directors, and majority shareholders should act with the utmost good faith in the interest of the corporation and its shareholders. For example, California has adopted a comprehensive rule of "inherent fairness from the viewpoint of the corporation and those interested therein." The rule applies alike to officers, directors, and controlling shareholders in the exercise of powers that are theirs by virtue of their position and to transactions wherein controlling shareholders seek to gain an advantage in the sale or transfer or use of their controlling block of shares."<sup>2</sup>

In the context of a merger or reorganization, the fiduciary duty laws require officers, directors, and majority shareholders to:

- Act in the utmost good faith;
- Refrain from unqualified self-dealing;
- Follow all corporate bylaws to approve a proposed transaction; and,
- Follow all statutory procedures for dissenting shareholder rights.

A violation of any one of these standards may cause a minority shareholder to go along with a merger or reorganization to which it otherwise would have dissented or about which it would have made further inquiries. An action for damages may be available for such breaches of an officer's, director's or majority shareholder's fiduciary duty.

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<sup>2</sup>*Singhania v. Uttarwar* (2006) 136 Cal.App.4th 416, 426 (citing *Jones*, 1 Cal.3d at 110) (internal citations omitted).



## DISSENTING RIGHTS

In most states, shareholders with statutory dissenters' rights may opt for a buyout at either the fair market value<sup>3</sup> or fair value<sup>4</sup> of the shares determined prior to the announcement of the merger or other reorganization. These statutory rights typically apply to minority shareholders with some voting right in the corporation. Reasons for forcing a buyout include the lack of appetite for the economic risks of the proposed transaction, an unwillingness to invest in an enterprise that will be fundamentally different post-transaction, or a distrust in a takeover entity.

State statutes protect dissenting rights by forcing the corporation to make fair offers to purchase these shares at a price established pre-transaction. In California, for example, a corporation must provide written notice to the shareholders that includes:

- a copy of designated sections of California statutory provisions governing dissenters' rights,
- a statement of the price determined by the corporation to represent the fair market value of the dissenting shares, and
- a brief description of the procedure to be followed if the shareholder desires to exercise the shareholder's rights to have the corporation purchase the shares under those provisions.

When a corporation undervalues the dissenting shares, the minority shareholder can file a civil action to appraise the fair market value of the shares. The appraisal right is fundamental to a minority shareholder's ability to receive fair compensation in place of going along with the proposed merger or other reorganization.

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<sup>3</sup> See generally Cal. Corp. Code § 1300, et seq.

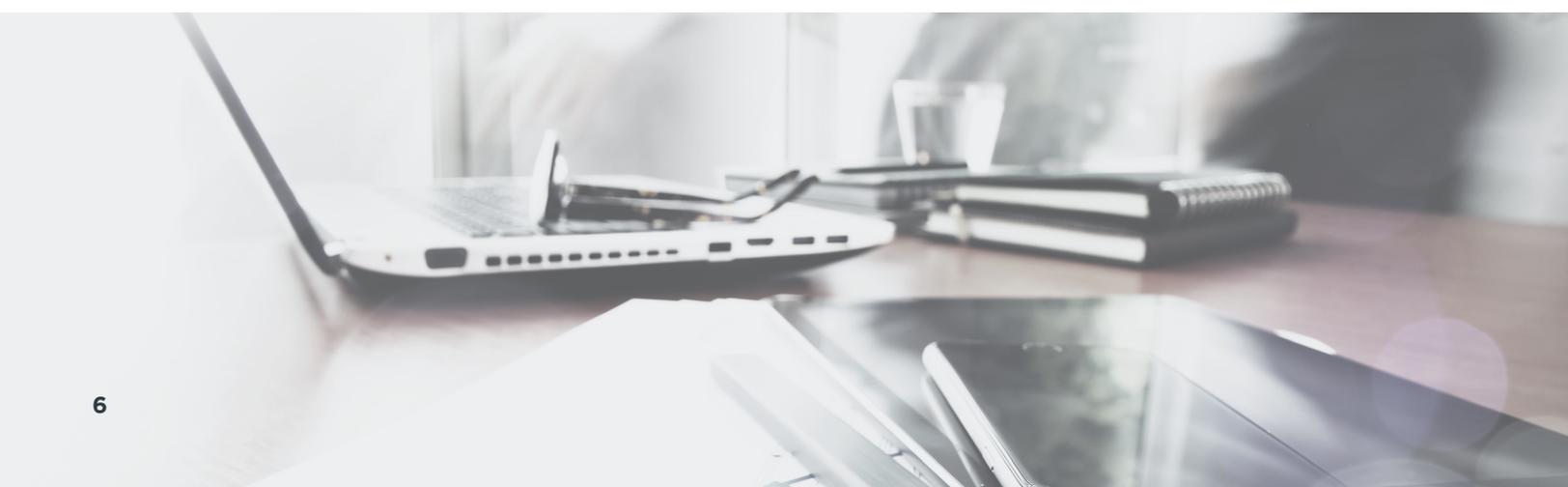
<sup>4</sup> Del. Code Ann. tit. 8, § 262 (2020); *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, 177 A.3d 1, 5 (Del. 2017); Minn. Stat. § 302A.473, Subd. 7. *Advanced Commc'ns Design Inc. v. Follett*, 615 N.W.2d 285, 292 (Minn. 2000).

## ATTACKING RIGHTS FOR COMMON-CONTROL MERGERS

Generally, appraisal rights are a minority shareholder's exclusive remedy to obtain a fair buyout—that is, minority shareholders cannot ordinarily challenge or attack the corporation's proposed merger. An exception to this rule applies when one party to the merger is directly or indirectly controlled by, or under common control with, another party to the merger. This type of “common-control merger” may occur when a majority shareholder attempts to dilute a minority shareholder's interest by having a corporation under its common control acquire the corporation. Such a transaction often leaves the majority shareholder in full control of the primary assets through the common-control corporation but leaves the minority shareholder greatly undervalued or completely diluted of its interest.

In such a common-control merger, a shareholder that does not demand a cash buyout may institute an action to attack the validity of the merger or to have the proposed transaction set aside or rescinded. To further protect against self-dealing, the law requires that the commonly controlled party carries the burden to prove that the transaction is just and reasonable as to the shareholders of any party so controlled.

In conclusion, a minority shareholder possesses rights and remedies pre-merger or preceding other reorganization. Any minority shareholder in such a situation should exercise its statutory rights of inspection to investigate its options to challenge the transaction or proceed with a fair buyout. Each of the procedures available to the minority shareholder must be exercised timely, making early action by the minority shareholder very important.



# WHEN THE BUSINESS IS ALL IN THE FAMILY

ANNE M. LOCKNER AND JEAN MORRISON<sup>5</sup>

Workplace dynamics can be fraught with peril. Family dynamics can be even more treacherous. Add them together into a family business and the result can create a recipe for complex fiduciary relationships and potential litigation. Indeed, family tensions magnify when moved into the business context, where recognition of legal duties become blurred and disputes can, without intervention, result in litigation that jeopardizes family relationships, the business, and everyone's investment in it. So, what causes these disputes, and how can they be mitigated?

## WHAT ARE THE SOURCES OF CONFLICT?

Family business owners can find infinite issues to fight about, but the common points of contention typically result from unresolved questions of ownership and authority.

First, is there a clear and rational succession plan? Is there an assumption that the oldest child or a favored son will take over the business? Disputes can arise when the presumed successor does not want that role or is not the most qualified for it.

Second, undefined roles create problems. If the founder of the family business hands over the reins to a member of the next generation—at least in name—but still steps in to exert influence, it will undermine the successor's authority and credibility, and create confusion over who really calls the shots.

Third, unspoken, unclear, and conflicting expectations can pose significant problems. Does the second generation presume permanent employment by the company? Or would some prefer to be bought out to pursue something other than what the family business would require them to do?

Like many disputes, most family business conflicts are based in either a failure to

communicate or a failure to see things from someone else's perspective—or both.

## WHAT STRATEGIES MINIMIZE AND MITIGATE CONFLICT?

The best way to avoid conflict is to start with adequate planning and open communication. The sooner planning can begin, the less likely the chances disputes can arise. For example, family stakeholders should define why they believe the business exists and address what each member wants, needs, and expects from it. What does the business expect of the family members? Establishing clear guidelines and expectations early on—and then enforcing them—avoids many pitfalls. For instance, rather than just assuming that the next generation will want to be or should be involved in the business, establish clear guidelines for who can be: what qualifications are required, and how a succession plan will be determined. Revisit these rules and guidelines regularly to spot potential areas of dispute on the horizon and address those scenarios objectively before people get too emotionally invested in the decision.

## HOW CAN THESE STRATEGIES BE IMPLEMENTED?

Planning ahead sounds easier than it actually is. After all, the early years of a company—and sometimes the later years as well—often means living and breathing the immediate needs of the company. And long-term planning simply falls by the wayside. Plus, even with early planning, many of the challenges family businesses face exist from the outset. Therefore, it is the rare family business that can manage these issues without some external expertise.

Hiring legal counsel to draft certain legal agreements (buy-sell, shareholder and voting trust, operating, and

employment) makes an obvious first and necessary step in establishing expectations. But legal documents only do so much to address family dynamics.

Hiring a consultant—on behalf of the company—to deal head on with the more intangible areas of friction may sound like a luxury the business cannot afford. But the cost of unresolved conflicts and inadequate planning could cost much more in the long run.

Enlisting the help of an objective outside consultant skilled in navigating corporate conflicts will ultimately benefit the company as a whole, which, in turn, will benefit all shareholders. Discussions that might otherwise escalate into conflict when occurring directly between stakeholders can be constructively addressed by a knowledgeable facilitator trained to avoid or minimize tension. The consultant can identify unspoken assumptions causing conflicts, expose dysfunctions and seek to repair them, improve communications that might be stifled by family dynamics, and mediate necessary conversations that have, up to that point, been prone to breakdown and further damage. The consultant should be someone every key stakeholder signs on to—not the attorney, accountant, or trusted advisor of just one member.

At the end of the day, while hiring a business lawyer or a consultant is not a guaranteed way to avoid litigation, doing so can lessen the chances that a family-business dispute will escalate to the degree that one party sues another. But if that happens, finding counsel who can aggressively and strategically advocate for your objectives is paramount. Ideally, however, litigation counsel understands that the legal strategy must also take into account the very human and emotional elements that often drive these types of disputes.

<sup>5</sup>Jean Morrison founded Morrison and Associates, Inc., a human resources management consulting firm specializing in conflict resolution, conflict management, and organizational transitions. She has extensive experience coaching and counseling businesses and organizations of all sizes, including closely held and family businesses.

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