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THE SPOTLIGHT

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

THE FIDUCIARY'S MANY HATS

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ROBINS KAPLAN LLP

WELCOME TO THE SPOTLIGHT

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

You read that right. Robins Kaplan LLP recently expanded its wealth planning, administration and disputes practice group to become the wealth planning, administration and fiduciary disputes practice group. The change reflects the broadening of the group's work in response to clients' everchanging needs. Like the law, we continue to evolve.

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 fiduciary 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.

– Denise S. Rahne and Steven K. Orloff

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 all_marketing@robinskaplan.com.

Chambers v. Gold Medal Bakery:

AN ILLUSTRATION OF PRIVILEGE IN SHAREHOLDER SUITS

BY TONY FROIO, PETER FOUNDAS, AND MICHAEL COLLIER

When working well, a closely held corporation can be the model of corporate governance—a shared vision, a united board, and intimate trust between officers and shareholders. However, over multiple generations the growth of the business can fray the bonds that originally allowed a closely held company to blossom. In the worst cases, shareholders may even sue the officers and directors of the business, which in a closely held company are frequently their own family members. One of our firm's recent cases in Massachusetts dealt with this very scenario and provided an important lesson in how family business disputes can escalate into shareholder claims, while also highlighting the boundaries of attorney-client privilege arising in a combined direct and derivative shareholder lawsuit. *See Chambers v. Gold Medal Bakery*, Inc., 983 N.E.2d 683 (Mass. 2013).

In *Gold Medal Bakery*, we represented the corporation and defendant officers and directors against a complex shareholder suit that alleged a wide array of fiduciary breaches. As is the case in many closely held companies, the shareholders and officers in Gold Medal Bakery were members of the same family, which after many generations had begun to disagree on the proper management of the family's highly successful bakery business. The dispute was a textbook example of a family business conflict—an older generation of founders passed the management of the company onto (some of) their children, but eventually the non-management children felt shut out. As a result, the non-management plaintiffs sought to force a sale of their shareholder interest in the company.

THE BASICS — DIRECT SHAREHOLDER SUITS VERSUS DERIVATIVE SHAREHOLDER SUITS

As family disputes emerged, it became apparent a shareholder suit was on the horizon for the Gold Medal Bakery. A shareholder lawsuit may take the form of: (1) a direct shareholder action against the company's officers and directors; and/or (2) a derivative suit, where the shareholders sue the officers and directors *on behalf of* the corporation itself. Despite these procedural differences, *Gold Medal Bakery* demonstrates how derivative claims frequently follow direct claims, because the information gathered via the direct claim is often used to make more serious allegations against company management.

Direct shareholder suits are the most straightforward of the two. As with traditional civil actions, in a direct shareholder suit the shareholder alleges the directors or officers have caused individual harm to the shareholder. However, it is usually difficult for such shareholders to demonstrate they have standing to individually sue a corporation's officers and directors, because they cannot demonstrate how the harm they suffered is "unique" to them and not suffered by other shareholders. *Quarterman v. City of Springfield*, 91 Mass. App. Ct. 254, 262, 74 N.E.3d 265, 273 (2017) ("As a general rule, a shareholder does not have standing to sue to redress an injury to the corporation in which he holds an interest."). In *Gold Medal Bakery*, the plaintiff-shareholders overcame this hurdle with Massachusetts General Law Ch. 156D, §§ 16.02 and 16.04, a common provision in state corporate law that gives individual shareholders a direct cause of action to inspect the corporation's business records and financial documents.

Derivative shareholders do not suffer from issues of standing like direct shareholder actions. In a derivative shareholder suit, shareholders can sue the corporation's directors and officers *on behalf of* the corporation itself. In this way, minority shareholders can derivatively protect a corporation from the directors' or officers' breach of fiduciary duty to the company. Derivative suits typically have much more gravitas than direct suits—they allege that directors and officers have committed some kind of malfeasance or misfeasance, such

[P]laintiffs' interests are adverse to Gold Medal. Of great significance is the nature and frequency of suit by the plaintiffs against Gold Medal. The plaintiffs have brought multiple suits directly against Gold Medal in a short span of several years and have been represented by their own counsel throughout this period....By the terms of their own pleadings, the plaintiffs have been pursuing a global buyout of their Gold Medal shares since approximately late 2006. They brought a direct suit solely against Gold Medal in 2007 for the inspection of corporate records to then use to value their Gold Medal shares.

Chambers v. Gold Medal Bakery, Inc., 464 Mass. 383, 396, 983 N.E.2d 683, 694 (2013)

as self-dealing, improper conflicts of interest, committing to overly risky business ventures, or even outright fraud against the company.

In *Gold Medal Bakery*, the fundamental difference between these types of shareholder suits would prove critical to the defense of this case.

PRIVILEGE ISSUES WHEN DIRECT AND DERIVATIVE SUITS ARE BROUGHT SIMULTANEOUSLY

In *Gold Medal Bakery*, the plaintiff-shareholders asserted both direct and derivative claims simultaneously. According to the plaintiffs, the defendant officers were not only responsible for direct harms under the Massachusetts record-inspection statutes but were also allegedly liable to the corporation itself for serious purported breaches of their fiduciary duty and self-dealing. Plaintiffs' claims were multifaceted but essentially alleged that the defendant officers (relatives of the plaintiffs) had intentionally concealed financial information to hide severe mismanagement of the company.

Our firm took a unique approach to defending this claim, one which eventually made its way to the Massachusetts Supreme Judicial Court (SJC). Put simply, we argued that many of the corporate documents plaintiffs sought included attorney-client privileged or attorney work product in the defense of the claims asserted by the plaintiffs. Our rationale was that—contrary to the goal of correcting "mismanagement" as stated in the derivative claims—the plaintiffs were actually adverse to the corporation, and thus privilege applied.

The Massachusetts SJC ultimately agreed, citing not only the shareholder-plaintiffs' adversarial posture toward the company but also that plaintiffs had simultaneously asserted *direct claims*. The SJC correctly deduced that these direct claims were not motivated to assist the company but to secure the highest sale price for plaintiffs' shares, proving that plaintiffs were ultimately "adverse":

> [P]laintiffs' interests are adverse to Gold Medal. Of great significance is the nature and frequency of suit by the plaintiffs against Gold Medal. The plaintiffs have brought multiple suits directly against Gold Medal in a short span of several years and have been represented by their own counsel throughout this period....By the terms of their own pleadings, the plaintiffs have been pursuing a global buyout of their Gold Medal shares since approximately late 2006. They brought a direct suit solely against Gold Medal in 2007 for the inspection of corporate records to then use to value their Gold Medal shares.
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KEY TAKEAWAYS

Gold Medal Bakery illustrated the predictable escalation from informal family dispute, to direct claims, to serious derivative allegations of mismanagement. However, as we successfully proved in this case, the decision to simultaneously bring direct and derivative claims caused serious privilege issues for the shareholder-plaintiffs, because they could no longer be said to be acting solely in the company's interests.

Gold Medal Bakery also demonstrates that, even when successful, shareholder suits are time-consuming and expensive to defend. A frequent lesson from the case law is that transparency to all shareholders through regular, well-noticed board meetings with the assistance of capable corporate counsel can assuage many concerns about potential self-dealing or conflicts of interest among directors and officers, which may prevent shareholder discontent. This is especially significant in closely held family businesses, where family members hold different long-term goals for the company. Despite the varying perspectives, the overriding concern for the company's best interests is paramount and should be considered before making any corporate governance decisions.

WEARING THE RIGHT HAT

BY DENISE RAHNE AND HEATHER CHANG

BECAUSE LITIGANTS IN PROBATE AND TRUST MATTERS CAN PLAY MANY DIFFERENT ROLES—DETERMINING WHETHER SOMEONE WILL HAVE THEIR FEES PAID BY AN ESTATE OR TRUST CAN GET COMPLICATED.

As demonstrated in our *Gold Medal Bakery* case, with corporate fiduciary claims, there can be thought-provoking challenges and issues presented by the question of whether a claim is direct or derivative. Probate and trust matters sometimes present analogous fiduciary issues with significant consequences—namely whether a litigant can get his or her fees paid. In these cases, however, the potential complexity has less to do with the nature of the claims and more to do with the capacity in which and for whose benefit the litigant or litigants act. Because litigants in probate and trust matters can play many different roles—including beneficiary, personal representative, trustee, and/or a shareholder or officer of an entity held in an estate—determining whether someone will have their fees paid by an estate or trust can get complicated.

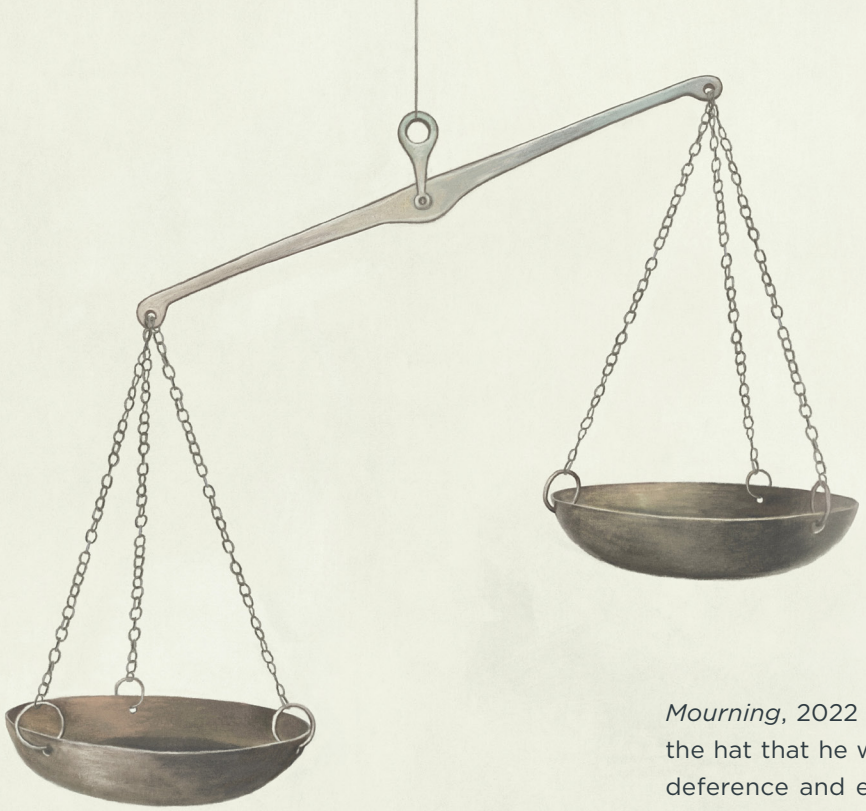
Two cases illustrate this potential complexity. In *In Re: the Trust of the Arnold B.A. Schauer and Yvonne B. Schauer Family Irrevocable Trust*, No. A18-0969, 2019 WL 1510698 (Minn. Ct. App. Apr. 8, 2019), the Minnesota Court of Appeals examined an award of attorney fees to David Schauer, who was a beneficiary of the family trust and a shareholder of the principal asset of the trust—a family business. Schauer initiated litigation regarding the valuation of corporate stock for the business held in the family trust and mediated the dispute with an independent trustee. Schauer's sister, who was a beneficiary but not a shareholder of the company held in trust, objected to the mediated purchase price and objected to the payment of fees for Schauer.

The district court in Minnesota approved fees for Schauer in the amount of $188,566.46. The Minnesota Court of Appeals reversed, and its reasoning is telling. It held that:

"[t]he district court awarded the majority of Schauer's attorney fees. In doing so, it reasoned that justice and equity entitled Schauer to the award of attorney fees as a beneficiary of the trust in working to settle trust disputes. But Schauer was not acting in the role of beneficiary in contesting the value of the stock held by the trust; he was acting in his role as a shareholder of the family's farming company. And as the shareholder purchasing the stock, Schauer's interests were precisely contrary to the interests of the trust. Schauer's attorney fees incurred in contesting the value of the stock, therefore, cannot be based solely upon his role as a beneficiary of the trust. The award of these attorney fees to Schauer solely on the basis of his status as a beneficiary of trust was error as a matter of law."

Id. at *5. In this case, what mattered most was whether the individual in question was acting in a role for the benefit of the estate as opposed to other capacities such as shareholder and beneficiary. The role was less than magnanimous, and instead benefited Schauer himself as a shareholder and beneficiary, and therefore attorney fees were inappropriate.

In another recent case, *In Re: the Estate of Sylvia Ann Mourning*, No. A21-1241, 2022 WL 1132230 (Minn. Ct. App. Apr. 18, 2022), two siblings disputed the disposition of their deceased mother's home. The daughter Elizabeth had lived with the mother for many years and had owned the home until she defaulted on the mortgage and the mother stepped in and bought the home from the bank. After her mother repurchased the home, Elizabeth continued to live there until her mother passed away. Elizabeth's brother Michael was appointed personal representative of their mother's estate. The protracted negotiations (and ultimately, litigation) between the two siblings continued for some time, at times implicating a third sibling and at least one friend of Elizabeth who offered to purchase the house on Elizabeth's behalf on discounted terms. After nearly two-and-one-half years of litigation between the two, Michael sought a final accounting, including fees by the firm that



assisted with the estate administration. Elizabeth objected based on the argument that the fees were not incurred in good faith and instead out of Michael's self-interest in his dispute with his sister. The district court found that Michael acted for his own personal benefit regarding the dispute over the home and made decisions that did not benefit the estate, particularly by not compromising with Elizabeth.

On appeal, the Minnesota Court of Appeals reversed and noted that:

"The district court misapplied section 524.3-720 by requiring Michael to show that his actions actually benefitted the estate. Michael, in his capacity as personal representative, sought reimbursement for attorney fees under the first sentence of section 524.3-720. Under the first sentence of section 524.3-720, 'Any personal representative ... who defends or prosecutes any proceeding in good faith, whether successful or not ... is entitled to receive from the estate necessary expenses and disbursements including reasonable attorneys' fees incurred.' A personal representative is not required to show that his actions actually benefitted the estate to recover attorney fees under the first sentence of section 524.3-720." *In re Est. of Evenson*, 505 N.W.2d 90, 92 (Minn. App. 1993).

Mourning, 2022 WL 1132230, at *3. In this case, the hat that he was wearing gave Michael some deference and effectively shifted a burden to Elizabeth even if Michael may arguably have personally benefited from the work that he did as personal representative.

Beyond the always intriguing human drama, these two cases are instructive for several reasons, including:

- Minnesota has adopted versions of the Uniform Codes for Probate and Trust, and so the general standards articulated in these cases, while not necessarily precedential, may provide good guidance to individuals serving in these capacities and their counsel.
- Where people inhabit multiple roles, particularly a fiduciary role and an additional role such as a beneficiary or a shareholder, blurred lines can have monetary implications.
- As these cases illustrate by example, real or perceived conflict as to an individual's role and motivation can increase litigation costs and extend litigation.

Overall and most importantly, maintaining objectivity can prove difficult when you are navigating a situation where you are wearing multiple hats. Find objective counsel to help you navigate these roles and do the right thing while wearing the *right* hat, and particularly for fiduciaries with the best of intentions, avoid unexpected financial consequences in the form of unapproved attorney fees.

THE NOTE FROM THE DELIBERATING JURY

BY GABRIEL BERG AND ELLEN JALKUT

With a jury deliberating, there is nothing more exactingly scrutinized by trial lawyers than a written question emanating from the jury deliberation room to the trial judge. As the judge reads the question, the lawyers, exhausted from having just tried the case and having nothing left to do but await a verdict, spend hours deciphering whether even the most innocuous question will lead to victory or defeat.

In 2018, every eye on our trial team was focused on a folded piece of paper that originated with the deliberating jury and was being held by our judge as he retook the bench. An hour earlier, we had delivered our closing argument to a New York jury in a dispute involving shareholders and executives in a startup vodka distillery. Our client, the plaintiff, was one of three key co-equal majority shareholders and principals who had been forced out of the distillery by the other two majority shareholders. When our client was ousted, he lost his salary, his right to future shares accrued by continued service to the distillery, and his position as the public face of the business.

The theory of our case was that the two defendant-shareholders had executed a quintessential power grab. Defendants elevated their own interests ahead of their fellow shareholders by unjustifiably eliminating our client from the business and precluding our client from receiving any further vested shares. By defendants' continued service to the distillery, they would become the two co-equal majority shareholders in short order.

Our trial team braced for the judge to read the one question that concerned us most: Is the harm to our client or to the vodka distillery? The answer to this question is one of the most difficult to determine under the law in virtually every state. Everything hangs in the balance by this determination because fundamentally disparate rules apply to derivative and individual fiduciary duty claims.

To oversimplify the legal issue, a stakeholder suing for harm to a corporation, limited liability company, partnership, trust, estate, or similar entity, is a derivative claim owned by the entity. Direct harm to an individual, e.g., a stakeholder who is deprived of some individual right, is a claim for breach of fiduciary duty owned by that individual. Judges, lawyers, arbitrators, and juries often struggle distinguishing between a derivative and individual fiduciary duty claim, because the case law and the applicable legal tests are hardly the model of clarity.

In New York, for example, one of the leading courts in the state, the Appellate Division, First Department, has held, "New York does not have a clearly articulated test, but approaches the issue on a case-by-case

JUDGES, LAWYERS, ARBITRATORS, AND JURIES OFTEN STRUGGLE DISTINGUISHING BETWEEN A DERIVATIVE AND INDIVIDUAL FIDUCIARY DUTY CLAIM, BECAUSE THE CASE LAW AND THE APPLICABLE LEGAL TESTS ARE HARDLY THE MODEL OF CLARITY.

> The foreman of the jury wants to know if the jury can use a calculator.

basis depending on the nature of the allegations." *Yudell v. Gilbert*, 99 A.D.3d 108, 114 (1st Dept. 2012). Given this freedom to maneuver, New York often looks to Delaware and analyzes "the nature of the wrong and to whom the relief should go" to determine whether the fiduciary claim is derivative or individual.[1]

In our case, we took great pains, with extensive but imperfect case law, to establish in the jury instructions that the harm had been to our client, individually. Despite all our efforts, if we heard the Court read aloud: "Is Plaintiff's claim for breach of fiduciary duty a derivative or individual claim?" I would be both encouraged by the likelihood of winning our case and distraught by the possibility that our hard-fought win would belong to the corporation, possibly to be shared with the very wrongdoers who caused the harm. A win that would feel like a gut punch.

From the inception of the case, we had successfully navigated the proverbial minefield of fiduciary duty issues, many of which are illustrated in *Gold Medal Bakery, In Re: the Trust of the Arnold B.A. Schauer and Yvonne B. Schauer Family Irrevocable Trust and In Re: the Estate of Sylvia Ann Mourning*. An additional obstacle is whether minority shareholders lie in wait to intervene in the matter to try to convert a direct claim into a derivative one if the defendants themselves do not raise the question. We had managed to keep the attorney-client privilege intact with our client, and we worked cooperatively with the remaining minority shareholders, who were upset at our client's ouster but did not join our lawsuit.

Still, our precise concern revolved around our client's identity as the public face of the company. An argument could be made that his expulsion caused harm to both our client and the distillery, because the distillery's marketing efforts had suffered after our client was removed. Under these circumstances, how can the distillery not have been harmed?

Looking directly at our trial team, the judge unfolded the note and announced: "The foreman of the jury wants to know if the jury can use a calculator."

After years of battling, including numerous trips to the appellate court (in New York state court, just about every order is immediately appealable), the three shareholders stepped out into the hallway. Shepherded by a mutual friend with an interest in the distillery who had remained neutral, the parties promptly settled the case. The essential terms of the settlement were read into the record. The fiduciary duty treachery that lurks in so many of these cases had been avoided.

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[1] "The stockholder's claimed direct injury must be independent of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation." *Yudell*, 99 A.D.3d 108, 114, citing, *Tooley v Donaldson, Lufkin & Jenrette, Inc.*, 845 A2d 1031, 1039 (Del 2004).

MEET OUR ISSUE EDITOR:

GABRIEL BERG

Gabriel Berg is a partner in Robins Kaplan's New York office. A true trial lawyer, he has tried numerous complex commercial jury trials, bench trials and arbitrations, as plaintiffs and defendants across a broad range of business sectors. Over the course of his 24-year career, Gabriel has tried cases involving high-stakes claims for breach of contract, breach of fiduciary duty, fraud, misappropriation of trade secrets, patent infringement and others. He can be reached at **GBerg@RobinsKaplan.com**.

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

DENISE S. RAHNE
Partner; Co-Chair, Wealth Planning, Administration, and Fiduciary Disputes
Minneapolis, MN
DRahne@RobinsKaplan.com
612 349 8500

STEVEN K. ORLOFF
Partner; Co-Chair, Wealth Planning, Administration, and Fiduciary Disputes
Minneapolis, MN
SOrloff@RobinsKaplan.com
612 349 8500

MATTHEW J. FRERICHS
Partner
Minneapolis, MN
MFrerichs@RobinsKaplan.com
612 349 8500

ANTHONY A. FROIO
Managing Partner, Boston, MA
Member of the Executive Board
AFroio@RobinsKaplan.com
617 267 2300

BRENDAN V. JOHNSON
Partner
Sioux Falls, SD
BJohnson@RobinsKaplan.com
605 335 1300

ROBINS KAPLAN LLP

800 LASALLE AVENUE
SUITE 2800
MINNEAPOLIS MN 55402

BISMARCK
1207 West Divide Avenue
Suite 200
Bismarck, ND 58501
701 255 3000 TEL

BOSTON
800 Boylston Street
Suite 2500
Boston, MA 02199
617 267 2300 TEL

LOS ANGELES
2049 Century Park East
Suite 3400
Los Angeles, CA 90067
310 552 0130 TEL

MINNEAPOLIS
800 LaSalle Avenue
Suite 2800
Minneapolis, MN 55402
612 349 8500 TEL

NEW YORK
1325 Avenue of the Americas
Suite 2601
New York, NY 10019
212 980 7400 TEL

SILICON VALLEY
555 Twin Dolphin Drive
Suite 310
Redwood City, CA 94065
650 784 4040 TEL

SIOUX FALLS
140 North Phillips Avenue
Suite 307
Sioux Falls, SD 57104
605 335 1300 TEL