

No. A10-252  
STATE OF MINNESOTA  
IN COURT OF APPEALS

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U.S. Bank N.A. and Ann McCabe,  
Trustees of the LaVigne Family Trust,  
the McCabe Family Trust, the  
Agustsson Family Trust, the Elizabeth  
LaVigne Trust, the Ann Marie  
McCabe Trust, and the Kathleen  
Agustsson Trust, and Thomas J.  
Moore and Ann McCabe, Trustees of  
the Thomas J. Moore Family Trust and  
the Thomas J. Moore Trust,

Plaintiffs / Appellants,

vs.

Cold Spring Granite Company,  
Marble Falls Partners, LLC; and  
Patrick D. Alexander,

Defendants / Respondents.

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ON APPEAL FROM  
STATE OF MINNESOTA  
COUNTY OF STEARNS  
NO. CIV C6-06-003510

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**APPELLANTS' REPLY BRIEF**

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**I. APPELLANTS COMPLIED WITH THEIR OBLIGATIONS UNDER THE MINNESOTA RULES OF APPELLATE PROCEDURE.**

Respondents incorrectly suggest that Appellants did not comply with their obligations under the Minnesota Rules of Civil Appellate Procedure. (Respondents' Brief ("Res.' Br." 1, 3, 51.)

**A. Appellants Complied With Their Obligations Regarding A Request For A New Trial.**

After the Special Master issued the Recommended Findings Of Fact, Conclusions Of Law And Order For Judgment (the "Recommendation"), Appellants properly brought a motion under Minn. R. Civ. P. 53.07. Appellants' motion and supporting legal memorandum raised specific objections to the Recommendation. In addition, Appellants requested that the District Court modify the Recommendation. The District Court then decided whether it would receive additional evidence and/or "resubmit the matter to the master with instructions" which could have included instructions for a new trial. *See* Minn. R. Civ. P. 53.07(a). By making their Rule 53.07 motion, Appellants addressed Respondents' overly technical argument regarding a request for a new trial.

Respondents' argument regarding Appellants' request for a new trial is misguided for another reason. Where an action such as this one is tried by the Court without a jury, a party need not move for a new trial to secure full review of a judgment on appeal. *Twin City Motor Bus Co. v. Rechtzigel*, 38 N.W.2d 825, 831-32 (Minn. 1949). The rule requiring a motion for a new trial -- before matters such as trial procedure, evidentiary rulings and jury instructions are subject to appellate review -- does not apply to substantive questions of law that were properly raised. *Alpha Real Estate Co. of*

*Rochester v. Delta Dental Plan of Minn.*, 664 N.W.2d 303, on remand, 671 N.W.2d 213, review denied (Minn. 2003); see also *Tyroll v. Private Label Chems., Inc.*, 505 N.W.2d 54, 56 (Minn. 1993).

**B. Appellants' Statement Of Facts Appropriately Followed Rule 128.02.**

Respondents assert that Appellants' Statement of Facts is in some way improper. (Res.' Br. 3-4.) This assertion is misplaced. Minnesota Rule of Civil Appellate Procedure 128.02, subd. 1(c) provides that "the Statement of Facts shall set forth those facts relevant to the grounds urged for reversal, modification or other relief. The facts must be stated fairly and with complete candor. . . ." Appellants fairly set forth the facts relevant to the grounds that support the reversal sought by this appeal. Indeed, even Respondents do not, in any respect, take issue with the facts set forth in Appellants' opening brief as each fact is fully supported by the record. Appellants thus complied with Rule 128.02, subd. 1(c).

**C. Standard Of Review.**

As for the standard of review, this Court reviews the findings of fact for an abuse of discretion, but this Court does not give deference to the conclusions of law as those conclusions are reviewed *de novo*. *Alpha Real Estate v. Delta Dental*, 664 N.W.2d at 311 (citing *Cornberg v. Cornberg*, 542 N.W.2d 379, 384 (Minn. 1996)); *Boldt v. Roth*, 618 N.W.2d 393, 396 (Minn. 2000). The District Court's conclusions of law regarding the interplay between § 302A.423 and § 302A.471 and § 302A.751 should thus be reviewed *de novo*.

Furthermore, appraisal rights of a dissenting stockholder are legal rather than equitable actions “because of their historical limitation of the dissenting shareholder to the legal remedy of damages in the amount of the value of that shareholder’s stock.” *See* 12B Fletcher Cyc. Corp. § 5906.10 (West 2010) (citing *Atl. States Const., Inc. v. Beavers*, 301 S.E.2d 635, 636 (Ga. 1983) (noting that any equitable issue in a dissenter’s rights proceeding is ancillary to the legal issue of damages). Accordingly, the District Court’s legal conclusion that denied a dissenters’ rights legal proceeding under Minn. Stat. § 302A.471, subd. 1(a) should be reviewed *de novo*.

**II. THE DISTRICT COURT ERRED AS A MATTER OF LAW BY DENYING APPELLANTS A BUY-OUT PROCEEDING UNDER § 302A.751.**

The District Court erred as a matter of law when it failed to apply the protections afforded minority shareholders in a Minnesota non-publicly held corporation under Minn. Stat. § 302A.751. Minn. Stat. § 423 does not, as the District Court implicitly found and as Respondents argue, provide that a Board’s determination of value prevents a court from finding liability under Minn. Stat. § 302A.751 and from conducting a court-supervised valuation proceeding under the statute.

**A. The More General § 302A.423 Does Not Take Precedence Over The More Specific § 302A.751.**

Respondents’ argument that § 302A.423 predominates over § 302A.751 is incorrect as a matter of law. (Res.’ Br. 25-29.) Section 423 does not specifically reference or prohibit a § 751 valuation proceeding. The two provisions are not in conflict, and may be harmonized and reconciled to give effect to both. *See* Minn. Stat. § 645.172 (Legislature intends entire statute to be effective.) *See also Berreman v. West*

*Publ'g Co.*, 615 N.W.2d 362, 373 (Minn. Ct. App. 2000) (citing Minn. Stat. § 645.17 (1994) (statute must be considered as a whole to harmonize and give effect to all provisions)); *Kirkwold Constr. Co. v. M.G.A. Constr., Inc.*, 513 N.W.2d 241 (Minn. 1994) (whenever possible, the court must interpret statute so as to give effect to all of its provisions). *See also State by Beaulieu v. Indep. Sch. Dist. No. 624*, 533 N.W.2d 393 (Minn. 1995) (apparently conflicting laws are to be construed together, if possible, to give effect to both provisions); *Aslakson v. State Dep't of Highways*, 15 N.W.2d 22, 24 (Minn. 1944) (provisions shall be construed together, and, if possible, harmonized and reconciled in effect given to both); Minn. Stat. § 645.26 (West Supp. 2008).

In addition, a provision in one part of the statute addressing the specific protections due a minority shareholder in a non-publicly held corporation must be given effect over a section more generally addressing the power of a corporation, both public and non-public, to engage in a reverse stock split. *See, e.g., Custom AG Serv. of Montevideo, Inc. v. Comm'r of Revenue*, 728 N.W.2d 910, 917 (Minn. 2007) (“As we have often noted when construing a statute that contains both general and specific provisions, canons of statutory construction dictate that the specific provisions prevail.”)

Here, the District Court focused only on the more general reverse stock split, § 302A.423. The District Court omitted any meaningful analysis of the specific protections afforded by § 302A.751 that are available only to shareholders in a non-publicly held corporation. The analysis of a reverse stock split and involuntary redemption that followed the orchestration of a stock combination by Alexander and the Alexander Family Trust and which resulted in the 1-for-7,132.23 reverse stock split and

involuntary redemption of all non-Alexander minority common shareholders in CSG cannot stand when viewed in light of the provisions of section 302A.751 and its specific safeguards that address breaches of fiduciary duties and unfairly prejudicial conduct in a non-publicly held corporation. To allow Respondents to proceed with the corporate actions at issue without liability would render the provisions in § 302A.751 a nullity. This Court should rule as a matter of law that Minn. Stat. § 302A.423 does not *per se* take precedence and control over Minn. Stat. § 302A.751 and the protections afforded minority shareholders of non-publicly held companies.

**B. Appellants Are Legally Entitled To A Court Supervised Valuation Proceeding.**

Respondents cite only one case in support of their argument that Appellants are not entitled to a buy-out proceeding under § 302A.751. (Res.' Br. at 27 (citing *Small v. Sussman*, 713 N.E.2d 1216 (Ill. Ct. App. 1999)). However, even in *Small v. Sussman*, after the reverse stock split, the minority shareholder was allowed to obtain fair value through a valuation proceeding that proceeded in the trial court. 713 N.E.2d at 1223. The outcome in *Small v. Sussman* case thus supports Appellants' position, not Respondents' position.

Respondents' argument is also counter to case law in other jurisdictions. "The weight of authority indicates that the use of a reverse split and elimination of fractional shares for the purpose of eliminating minority stockholders may raise fairness, business purpose, or reasonable expectation issues justifying judicial intervention." *See* 6A Fletcher Cyc. Corp. § 2857.10 (West 2008) (citations omitted.) *See also Clark v. Pattern*

*Analysis & Recognition Corp.*, 384 N.Y.S.2d 660, 664-665 (Sup. Ct. 1976) (providing relief based on fiduciary duty, even where appraisal was available); *Leader v. Hycor, Inc.*, 479 N.E.2d 173 (Mass. 1985) (upholding a challenge to a reverse stock split after applying the two party enhanced duty test for shareholder disputes in a close corporation); *Lerner v. Lerner*, 511 A.2d 501 (Md. 1986) (enjoining reverse stock split based on the irreparable harm to the minority shareholder); *Edick v. Contran Corp.*, 12 Del. J. Corp. L. 244, 1986 WL 3418 (Del. Ch. 1986); *Kirtz v. Grossman*, 463 S.W.2d 541, 544-45 (Mo. Ct. App. 1971); *Flarsheim v. Twenty Five Thirty Two Broadway Corp.*, 432 S.W.2d 245 (Mo. 1968); *Sullivan v. First Mass. Fin. Corp.*, 569 N.E.2d 814, 817 (Mass. 1991); *Lebold v. Inland Steel Co.*, 125 F.2d 369, 374-75 (7th Cir. 1941); Elliot M. Kaplan, *Corporate "Eminent Domain": Stock Redemption and Reverse Stock Splits*, 57 U.M.K.C. L. Rev. 67 (1988).

Respondents cite a single law review article in support of their novel legal theory that appraisal proceedings are not allowed when a contrived reverse stock split is followed by a forced redemption of fractional shares. (Res.' Br. 26 (citing Garon, *Challenging Delaware's Desirability As A Haven For Incorporation*, 32 Wm. Mitchell L. Rev. 769 (2006)). This article, however, does not cite a single case that supports Respondents' position. Instead, the article advocates for changes in the way the authors believe the Minnesota Business Corporation Act should be interpreted.

The authors noted that "[i]n most states, including Delaware, the extent to which such a reverse stock split may be used to eliminate shareholders is uncertain." *Id.* at 816. The authors also ambiguously commented that Minnesota's law regarding reverse stock

splits is “potentially more disadvantageous to the smaller shareholders than a freeze-out merger because no dissenters’ rights are available.” *Id.* The authors specifically used the word “potentially” without a cite to a single case to support their speculation. The facts of this case do not fall within the potential, speculative situation they reference.

The “practice pointer” Respondents cite is also off point. (Res.’ Br. 26, 29 (citing 20 Olson, Minnesota Practice -- Business Law Deskbook § 2.29, at 75 (2009-10 ed.)).) The practice pointer only indirectly addresses the issue. It too fails to cite a single case that supports Respondents’ argument. *Id.*

Respondents cite nothing that overcomes the “weight of authority” from other jurisdictions that supports a court supervised valuation proceeding after a corporation uses a contrived reverse split and forced redemption of fractional shares to eliminate minority stockholders. *See* 6A Fletcher Cyc. Corp. § 2857.10.

**C. The District Court Erred When It Refused To Award Its Finding Of Fair Value To Appellants.**

Respondents admit that the District Court found the fair value of Appellants’ shares was nearly \$800,000 higher than the value determined by CSG’s Board. (Res.’ Br. 36-38.) Respondents then mischaracterize the undervaluation as a 10.6% shortfall and incorrectly argue that this amount is not material. (Res.’ Br. 37-38.)

The District Court found that the fair value for Appellants’ shares was \$1,142.92 per share and further found that the Board valued these shares at only \$986.50 per share. (Apps’ Br. at 22-23.) Thus, Appellants received \$792,580 less than fair value for their shares, or nearly 16% less than fair value. (*Id.*)

When the granite rights are properly accounted for, the fair value increases to \$1,310.90 per share. (Apps' Br. at 24-25.) Accordingly, the Board undervalued Appellants' shares by \$324.40 per share, or by \$1,640,000. (*Id.*) The fair value of Appellants' shares is thus 33% higher than the Board's valuation. (*Id.*)

The MBCA defines "fair value" as an absolute term (*e.g.*, "the value"), not a relative term (*i.e.*, "a value"). See Minn. Stat. § 302A.473, subd. 1(c) ("'Fair' value means *the value* of the shares of a corporation before the effective date of the corporate action.") (Emphasis added.).

Likewise, the definition of *Sifferle* fraud within the MBCA is absolute, not relative. *Sifferle* fraud includes a single act of deception as well as a single breach of fiduciary duty. See *Sifferle v. Micom Corp.*, 384 N.W.2d 503, 507 (Minn. Ct. App. 1986) ("the legislature intended the term 'fraudulent' [under the MBCA] to be construed more broadly than strict common-law fraud. . . and to include deception, misrepresentation, actual fraud, or in violation of applicable statutes or articles of incorporation, or in violation of a fiduciary duty. . .". *Id.*

The Board's undervaluation of Appellant's shares by \$1,640,000 and the forced redemption of Appellants' ownership interests at a price that should have been 33% higher constitutes *Sifferle* fraud. At a minimum, it involves an act of deception and/or a breach of fiduciary duty. Both qualify as *Sifferle* fraud. *Id.* To hold otherwise would render the definition of "fair value" superfluous and ignore the holding of *Sifferle*. It would condone a form of investment theft under § 302A.423 and eviscerate the MBCA's protections for minority shareholders.

Respondents' argument that "valuations are purportedly accurate if they are within a margin of error of 15 to 30 percent" is wrong. (Res.' Br. 37.) Rather than condoning undervaluations in these ranges, at least two courts have sanctioned corporations with costs and attorneys' fees when they undervalued minority shareholders' interests by such margins. See *Hernando v. Huff*, 609 F. Supp. 1124 (D. Miss. 1985) (awarding expert fees to minority shareholder because actual value was 24% greater than corporation's offer and it "materially exceeded" value offered) *aff'd*, 796 F.2d 803, 806 (5th Cir. 1986).

The corporation in *Hernando* offered the shareholders \$80.50 per share for their stock. 609 F. Supp. at 1125. The court found the fair value of the stock was \$100.00 per share. *Id.* at 1128. The court then awarded the shareholders their costs, attorneys' fees, and expert witness fees because the fair value "materially exceeded the amount offered by the corporation." *Id.* at 1129. The difference in values was 24.22% (\$100.00 minus \$80.50 divided by \$80.50 = 24.22%).<sup>1</sup> Cf. *American Sharecom, Inc. v. LDB Int'l Corp.*, No. C9-94-2419, 1995 WL 321540, at \*\*1, 3 (Minn. Ct. App. May 30, 1995) (finding violation of § 302A.473, subd. 8(b) and awarding costs and fees to minority shareholder because corporation claimed fair value was \$17.5 million and court found it was \$25.6 million).<sup>2</sup>

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<sup>1</sup> The way Respondents calculate percentage differences, it was only 19.5% because the difference between the court's value (\$100.00) and the corporation's value (\$80.50) is \$19.50, or 19.5% of \$100.00. (Res.' Br. 22, fn.3.)

<sup>2</sup> The way Respondents calculate percentage differences, the value offered in *American Sharecom* was off by 31.6% because the difference between the court's value (\$25.6 million) and the corporation's value (\$17.5 million) is \$8.1 million, or 31.6% of \$25.6 million. (Res.' Br. 22, fn.3.)

Respondents' underpayment cannot be sheltered within a legally unrecognized "margin of error." The underpayment constitutes a substantial failure to comply with the MBCA and warrants an award to Appellants of their costs and fees in this action. Minn. Stat. § 302A.473, subd. 8(b); *American Sharecom, Inc.*, 1995 WL 321540 (Minn. Ct. App. May 30, 1995).

**D. Cobb's Valuation Methodology Is Flawed As A Matter Of Law.**

Respondents argue that "Cobb's valuation was 'within the range of historical valuations . . . made for purposes other than litigation,' and that it is 'not so unreasonably low as to indicate fraud.'" (Res.' Br. 37.) Respondents then incorrectly attempt to use Cobb's report to justify the District Court's valuation finding, claiming "the difference between the court's and Cobb's estimates of value. . . is well within a reasonable margin of accuracy." (*Id.*) Cobb's estimate of value, however, is not only lower than that found by the District Court, it is also flawed as a matter of law. The District Court erred in placing any reliance on it.

Under the Minnesota buy-out statute, fair value "means the pro rata share of the value of the corporation *as a going concern.*" *Advanced Commc'n Design v. Follett*, 615 N.W.2d 285, 290 (Minn. 2000) (italics added) (citing *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144 (Del. 1989) & 2 American Law Institute, *Principles of Corp. Governance: Analysis and Recommendations* § 7.22(a)(1994) (recommending that fair value should equal the shareholder's proportionate interest in the corporation)).

The District Court found that Cobb “ultimately decided that the net asset approach was the best indicator of CSG’s value.” (ADD051 ¶ 57, ADD053 ¶ 64.) The District Court should have rejected Cobb’s net asset valuation methodology because it failed to value CSG as a going concern, and instead established CSG’s minimum liquidation value. (APP368.) See *Helfman v. Johnson*, No. A08-0396, 2009 WL 437818, at \*2 (Minn. Ct. App. Feb. 24, 2009) (rejecting expert’s asset valuation method because it did not value company as a going concern and set an unrealistically low value).

In addition, as part of his valuation methodology, Cobb erroneously used book value to establish the value of CSG’s equipment and machinery. (Tr. 1203:1-1206:24.) See *Rainforest Café, Inc. v. State of Wisconsin Inv. Bd.*, 677 N.W.2d 443 (Minn. Ct. App. 2004) (rejecting book value and noting, “case law from Minnesota and other jurisdictions overwhelmingly recognizes that book value is not a reliable indicator of fair value.”) (citing *Thomas v. Thomas*, 407 N.W.2d 124, 126 (Minn. Ct. App. 1987) (stating book value is often an erroneous figure and easily subject to manipulation) and also citing *Beerly v. Dep’t of Treasury*, 768 F.2d 942, 946 (7th Cir. 1985) (stating book value is “virtually meaningless” index of share value)). See also Shannon Pratt et al., *Valuing A Business* 308 (4th ed. 2000) (“It is important to distinguish between the application of any asset-based approach valuation method and simple reliance on an accounting ‘book value’ to conclude a value estimate. . . accounting book value is not a business valuation method. In fact, accounting book value is not a business valuation method at all.”) The District Court erred as a matter of law when it relied upon Cobb’s book valuation methodology.

Finally, the District Court should have completely rejected Cobb's use of the discounted cash valuation methodology. Like Cobb, the defendant's expert in *In re Radiology Associates Inc. Litigation* used a discounted cash flow/earnings valuation methodology to value the company. 611 A.2d 485, 490-91 (Del. Ch. 1991). The court rejected the defendant's expert's discounted cash flow/earnings opinion because his earnings projections were based on historical earnings and because they were *not* based on projections of future earnings that were prepared with management's direct input. *Id.* at 490-91, 497-98.

As in *In re Radiology*, the District Court expressly found that Cobb "prepared his own projections, based upon CSG's historical financial data in undertaking his discounted cash flow analysis" and that "Cobb did not rely upon projections that were prepared by management." (ADD051 ¶ 60-61.) The District Court, however, then erred as a matter of law when it failed to exclude Cobb's discounted cash flow analysis.

The *In re Radiology* court also noted "the conduct of persons who supply the information upon which one bases a valuation analysis is relevant to . . . the credibility of that analysis." *Id.* (citing *Alabama ByProducts v. Neal*, Del.Supr., 588 A.2d 255, 258 (1991)). The *In re Radiology* court then rejected the expert's projections based on doubts as to the credibility of the information supplied to him. *Id.* at 498.

The facts in this case are nearly identical to *In re Radiology*. CSG's counsel sent Cobb only the Version A projections, even though CSG internally admitted the Version A projections were "too pessimistic" and "wouldn't fly." (Tr. 636:8-15, 637:7-640:1, 667:18-668:4.) The more realistic projections in Versions B, C, and D were concealed

from Cobb. (Tr. 1127:2-1128:3, 1135:13-1136:14). Cobb then incredibly concluded that the Version A projections were “overly optimistic” and he prepared an even lower set of net income projections that he purportedly based on the Company’s historical financial performance. (Tr. 1132:10-19, 1285:10-15, 1299:25-1302:11.)

For the same reasons the *In re Radiology* court disregarded the defendant’s expert’s discounted cash flow/earnings approach, the District Court should have rejected Cobb’s discounted cash flow approach and the rest of his valuation methodology. *Id.* at 498. *See also Doft & Co. v. Travelocity.com, Inc.*, 2004 WL 1152338, at \*\*5-6 (Del. Ch. May 20, 2004) (discounted cash flow analysis “depends on the validity and reasonableness of the data relied upon,” so courts prefer “valuations based on contemporaneously prepared management projections because management ordinarily has the best first-hand knowledge of a company’s operations.”); *Gilbert v. MPM Enters., Inc.*, 709 A.2d 663, 668-669 (Del. Ch. 1997) (stating that “management was in the best possible position” to provide accurate business forecasts of the company’s future prior to the merger); *Gray v. Cytokine Pharmasciences, Inc.*, 2002 WL 853549, at \*8 (Del. Ch. Apr. 25, 2002) (refusing to accept opinion of expert who disregarded management projections as “what if scenarios” and, instead, formulated his own “litigation-driven projections”); *Bomarko, Inc. v. Int’l Telecharge, Inc.*, 794 A.2d 1161, 1185 (Del. Ch. 1999) (expert’s methodology deemed too unreliable to be considered where his forecasts were “not supported by the contemporaneous expectations of management”); *Agranoff v. Miller*, 791 A.2d 880, 892 (Del. Ch. 2001) (courts are inherently suspicious of post-merger, litigation-driven forecasts because the possibility of hindsight bias and other

cognitive distortions seems untenably high); *Hull Junction Holding Corp. v. Princeton Borough*, 16 N.J. Tax 68 (N.J. Tax. Ct. 1996) (“The DCF method. . . is an amalgam of interdependent, attenuated assumptions of limited probative value; . . . its use in this case can only be described as an exercise in financial haruspication.”)

**E. CSG’s Granite Rights In The Marble Falls Real Estate Are Worth \$13 Million.**

Respondents admit the value of a fee simple ownership of the Marble Falls land is \$15 million. (Res.’ Br. 38.) They further admit that the District Court accounted for less than \$2 million of this amount as the value of the Marble Falls land without the granite rights retained by CSG. (*Id.*) Respondents’ argument regarding the missing \$13 million value of the granite rights retained by CSG is a *non sequitur*. According to Respondents: \$2 million + \$0 = \$15 million. (*Id.*)

The District Court found that Alexander and Wilensky met with Appellants and informed them that “the granite rights withheld by CSG represented the greater value in the transaction.” (ADD038 ¶ 21; ADD044 ¶ 37.) This finding is irreconcilable with Respondents argument that the granite rights “had a *de minimis* value.” (Res.’ Br. 38.) The District Court erred when it failed to award Appellants their share of the \$13 million granite rights, which “represented the greater value in the transaction.” (ADD038 ¶ 21; ADD044 ¶ 37.)

Respondents also argue that Appellants remain as owners of Marble Falls. (Res.’ Br. 38-39.) This argument is irrelevant. CSG owned the granite rights at the time of the forced redemption. Marble Falls did not. The issue is the fair value of the granite rights

that were owned by CSG at the time Appellants were forced out of CSG. As shareholders of CSG, Appellants are entitled to their share of the value of the granite rights CSG owned at the time of the redemption. The value of CSG's granite rights at that time was \$13 million. The District Court erred when it failed to award Appellants their share of the \$13 million value.

**F. CSG Violated Its Bylaws.**

Respondents state that § 7.3 of CSG's Bylaws permits reverse stock splits. (Res.' Br. 41.) This argument misses the mark. The issue is not whether CSG was permitted to perform a reverse stock split. The issue is whether CSG could effectuate an involuntary redemption and force Appellants to surrender their ownership interests. Section 7.3 of CSG's Bylaws does not speak to that issue. Section 7.4 does, and it mandates that a shareholder must consent to such a forced redemption. Section 7.4 expressly provides that the shareholder must "authorize" the "surrender" and "transfer" the shareholder's shares. (ADD003; APP012.) Appellants never authorized the surrender and transfer of their shares, so CSG's forced redemption violated § 7.4 of its Bylaws.

**G. The Marble Falls Claims Are Not Derivative.**

Respondents argue that Appellant's objections to the Marble Falls transaction were investigated by the Special Litigation Committee and addressed by the District Court in *Kahlert I* as a derivative claim. (Res.' Br. 43-44.) Respondents are mistaken.

The District Court previously rejected this same argument when it ruled against Respondents' motion to dismiss. In its previous order, the District Court ruled that Alexander's misrepresentations to Appellants concerning Marble Falls gave rise to a

direct claim, not a derivative claim. (See Jan. 25, 2007 Order and Mem., pp. 10-11) (“Plaintiffs have made allegations that they were harmed by misrepresentations by Alexander and the reverse stock split, but there has been no indication that the corporation was harmed by either of these actions.”) (See also Oct. 1, 2007 Order and Mem., pp. 7-8) (“In the present case there is no evidence that anybody but Plaintiffs were harmed by the low value placed upon CSG. As such, the proposed amended claims are not derivative.”)

Nothing changed after the District Court issued these rulings. Nevertheless, Respondents called as a witness Lew Remele of the Special Litigation Committee (the “SLC”) that investigated the claims in the *Kahlert I* litigation. (Tr. 2300:17-2301:7.) He testified that the SLC did not address any issues concerning the reverse stock split and forced redemption of the minority shareholders’ shares because those actions occurred after the SLC issued its report. (Tr. 2299:18-2300:16.) The SLC did not address Appellants’ complaints regarding the Marble Falls transaction. The SLC did not even bother to interview the Appellants, and it never investigated their fraud claims or MUFTA claims. (Tr. 2300:17-2301:7; 2306:10-16, 2303:18-2304:5.) Consequently, the District Court was correct in its initial rulings that Appellants’ claims regarding Marble Falls are direct, not derivative.

**H. Vavra Did Not Know Respondents Concealed The Actual Projections.**

Respondents claim that Vavra knew the “wacky” projections he received were not the projections used in the Schmidt Report. (Res.’ Br. 33.) This claim is false. Vavra’s final report expressly states that he “received and reviewed certain documents from

management [the “wacky” projections] which are believed by management to reflect the information referenced within the Schmidt Report and which appear to be the foundation for the discounted cash flow analysis presented within the Schmidt Report.” (APP307; Tr. 1975:2-1976:9.) Vavra’s final opinion was based on the information provided to him, including the deceptive and “wacky” projections. (Tr. 1975:2-1977:10.)

**III. THE DISTRICT COURT ERRED AS A MATTER OF LAW WHEN IT DENIED A COURT SUPERVISED VALUATION UNDER § 302A.471.**

Respondents argue that Appellants had no grounds for a Court supervised dissenters’ rights proceeding pursuant to Minn. Stat. § 302A.471. (Res.’ Br. 47-50.) Respondents are mistaken.

**A. Appellants Are Entitled To A Court Supervised Valuation Proceeding Under § 302A.471, subd. 1(a)(2).**

Section 302A.471, subd. 1(a)(2) of the Minnesota Statutes reads, in relevant part, as follows:

Subdivision 1. Actions creating rights. A shareholder of a corporation may dissent from, and obtain payment for the fair value of the shareholder’s shares in the event of, any of the following corporate actions:

(a) . . . , an amendment of the articles that materially and adversely affects the rights or preferences of the shares of the dissenting shareholder in that it:

(2) *creates, alters, or abolishes a right in respect of the redemption* of the shares . . . ;

Minn. Stat. § 302A.471, subd. 1(a)(2) (italics added).

The amendment to CSG’s articles of incorporation which enabled the 1-for-7,132.23 reverse stock split unquestionably “created a right in respect of the redemption” of Appellants’ shares as that phrase is used in § 302A.471, subd. 1(a)(2). Without the

reverse stock split amendment, Appellants would not hold any fractional shares. Rather, they would continue to hold their 5,067 shares and Respondents would have no right to redeem those shares. With the amendment, Respondents fractionalized Appellants shares and “created a right in respect of the redemption” of the fractional shares. The District Court erred, as a matter of law, when it failed to find that Respondents violated Minn. Stat. § 302A.471, subd. 1(a)(2) when they created a right to redeem Appellants shares and denied Appellants a dissenters’ rights proceeding to determine the fair value of their shares.

**B. Appellants Are Entitled To A Court Supervised Valuation Proceeding Under § 302A.471, subd. 1(a)(5).**

Section 302A.471, subd. 1(a)(5) of the Minnesota Statutes reads, in relevant part, as follows:

Subdivision 1. Actions creating rights. A shareholder of a corporation may dissent from, and obtain payment for the fair value of the shareholder’s shares in the event of, any of the following corporate actions:

(a) . . . , an amendment of the articles that materially and adversely affects the rights or preferences of the shares of the dissenting shareholder in that it:

(5) *eliminates the right to obtain payment under this subdivision.*

Minn. Stat. § 302A.471, subd. 1(a)(5) (italics added).

CSG’s January 12, 2006 Board minutes highlight the fact that the reverse stock split and involuntary redemption falls within the broad statutory language found in § 471, subd. 1(a)(5). (APP143-144.) According to the Board minutes, CSG amended its articles

so that “under the provisions of 302A.423 and 302A.471. . . the shareholders would not be entitled to assert dissenters’ rights.” (APP144.) (Italics added.)

The Board’s amendment to CSG’s articles was specifically intended to eliminate the Appellants’ right to assert their dissenters’ rights and eliminate their right to receive payment under § 302A.471. CSG’s amendment thus violated the express language of § 471, subd. 1(a)(5). See *Brown v. Arp & Hammond Hardware*, 141 P.3d 673, 678 (Wyo. 2006) (minority shareholder entitled to dissenters’ rights proceeding if articles of incorporation are amended to allow a reverse stock followed by a redemption of fractional shares because action materially and adversely affected shareholder’s rights). See also *Sec. State Bank, Hartley, Iowa v. Ziegeldorf*, 554 N.W.2d 884, 887 (Iowa 1996) (allowing dissenters’ rights proceeding following reverse stock split/redemption of minority shareholders’ ownership interests).

Respondents argue that Appellants are not entitled to proceed with a dissenters’ rights fair valuation proceeding because other states’ statutes and the Model Business Corporation Act specifically mention the availability of dissenters’ rights whereas Minn. Stat. § 302A.471 does not. (Res.’ Br. 49-50.) This overly-narrow interpretation of § 302A.471, subd. 1(a)(5) is without merit.

There are many different ways that majority shareholders can “eliminate the right to obtain payment under this subdivision [§ 302A.471, subd. 1(a)(5)].” A reverse-stock split followed by a forced redemption of fractional shares is just one of those ways. The Minnesota legislature could have, but chose not to, follow other states’ statutes to more narrowly encompass only reverse-stock splits followed by forced redemptions. The

Minnesota legislature instead left § 302A.471, subd. 1(a)(5) broader to cover reverse-stock splits followed by redemption of fractional shares, in addition to many other situations that adversely affect a minority shareholders' rights with respect to their shares. The District Court erred by disallowing a dissenters' rights proceeding under the broad language of § 302A.471, subd. 1(a)(5).

**C. The Model Act Does Not Apply Because The MBCA Is Among The Most Liberal In The Nation In Its Protection Of Dissenters' Rights.**

Respondents' analysis of the Model Act and other states' dissenters' rights statutes is unavailing for additional reasons. The MBCA cannot be analogized to the Model Act or any other state's act because Minnesota's dissenters' rights provisions are "among the most liberal" in the nation. John H. Matheson, *Corporation Law and Practice*, 18 Minnesota Practice § 7.22 (West 2004). Minnesota never adopted a restrictive form of the Model Business Corporation Act. When the Minnesota legislature enacted § 302A.471, it noted that "[t]his section greatly expands the occasions upon which a shareholder may dissent from a corporate action." Minn. Stat. § 302A.471 Reporter's Notes – 1981. The legislature also noted that "[t]he grant of these rights increases the security of investors by allowing them to escape when the nature of their investment rights is fundamentally altered." *Id.*, General Comment.

The explicit language Respondents cite to in the Model Act is not found in the MBCA because it would actually limit, not expand, a minority shareholder's entitlement to a dissenters' rights proceeding under Minnesota law. This would run counter to the

Reporter's Notes and case law that make Minnesota's dissenters' rights provisions among the most liberal in the nation.

Like the Respondents, the Minnesota Court of Appeals once characterized Minn. Stat. § 302A.471 as a "very explicit statute." *Whetstone v. Hossfeld Mfg. Co.*, 448 N.W.2d 536, 538 fn.1. To support this characterization, the Court cited to the Model Business Corporations Act Annotated and related case law. *Id.* The Minnesota Supreme Court reversed. *Whetstone v. Hossfeld Mfg. Co.*, 457 N.W.2d 380, 383 (Minn. 1990). The Minnesota Supreme Court specifically referenced the Court's rationale, and ruled that the *Whetstone* court misconstrued the broad "investment rights" afforded to minority shareholders under § 471, subd. 1. *Id.* Simply put, the Minnesota Supreme Court previously rejected Respondents' argument.

Respondents did not distinguish this aspect of *Whetstone*. Instead, Respondents cite *Wigart v. Cervenka* for the proposition that if an action is not specifically listed in § 471, subd. 1, then dissenters' rights are not available to a minority shareholder. No. C7-98-1505, 1999 WL 243231 (Minn. Ct. App. April 27, 1999). *Wigart*, however, is completely off point, as it turned on two seminal facts that are not present in this case. First, unlike CSG, the corporation in *Wigart* did not amend its articles of incorporation. 1999 WL 243231, at \*5. This is an extremely important difference, as § 471, subd. 1(a) is not triggered unless the articles are amended.

Second, unlike the evidentiary record in this case, the record in *Wigart* contained no evidence that the corporation excluded or limited the minority shareholder's right to vote or their right to obtain payment under § 471, subd. 1(a)(5). *Id.* Here, Respondents

eliminated Appellants' right to vote and their right to obtain payment under the statute. Consequently, unlike the corporation in *Wigart*, Respondents violated the Minnesota Supreme Court's *Whetstone* decision. In light of these major differences, *Wigart* is inapposite.<sup>3</sup>

Finally, unlike the broad and liberal dissenters' rights provisions in the MBCA, the Model Business Corporation Act has a history of trending in the opposite direction and curtailing dissenters' rights. For instance, in 1999, the Model Act was amended to "radically reduce the triggering actions and bring the Model Act closer in line with the Delaware provision." See Bryn Vaaler, *Scrap The Minnesota Business Corporation Act!*, 28 Wm. Mitchell L. Rev. 1365, 1384 (2002). In Minnesota, however, "no initiatives [were] undertaken to bring the *expansive rights provisions of the MBCA* into line with the 1999 revisions to the Model Act." *Id.* at 1385 (italics added).

Even after the 1999 amendments, the more restrictive amended Model Act still provides for a dissenters' rights proceeding after a reverse stock split/redemption occurs. *Id.* at 1384. Respondents' argument that such a right does not exist within the MBCA constitutes an invitation for this Court to rule that the "broad and liberal" MBCA is even more restrictive than the "radically restricted" Model Act. This Court should decline the

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<sup>3</sup> Respondents also cite *Rotation Eng'g & Mfg. Co v. Secura Ins. Co.*, 497 N.W.2d 292 (Minn. Ct. App. 1993). This authority is particularly misplaced because it concerns the Minnesota No-Fault Automotive Insurance Act, not the Minnesota Business Corporations Act. Moreover, the holding in *Rotation Eng'g* rested on a prior Minnesota Court of Appeals decision. 497 N.W.2d at 295 (citing *Erickson v. Great Am. Ins. Cos.*, 466 N.W.2d 430, 433 (Minn. Ct. App. 1991) (interpreting the Minnesota No-Fault Act without referring to any Model Act)). *Rotation Eng'g* thus stands for the unremarkable legal proposition that an appellate court should follow a prior appellate decision.

unprecedented invitation to rule that the MBCA is even more restrictive than the Model Act.

**D. Respondents' Analogies Are Inapposite Because § 302A.471 Is Completely Different Than The Model Act And The California Code.**

Respondents' analogies to Model Bus. Corp. Act § 13.02 and Cal. Corp. Code §§ 407, 1300 are misplaced for additional reasons. (Res.' Br. 49-50). Neither the Model Act nor the California Code contain a provision equivalent to Minn. Stat. § 471, subd. 3 and its four express exceptions. (See Apps' Br. 39-40.) While § 13.02 of the Model Act contains some of the provisions found in § 471, it completely omits the four express exceptions found in § 471, subd. 3. The California Code omits all of the provisions found in § 471.

In Minnesota, a minority shareholder that otherwise qualifies under § 471, subd. 1 is presumed to have an absolute right to a Court-supervised dissenters' rights proceeding unless this right is taken away by one of the four express exceptions set forth in § 471, subd. 3. The Model Act and the California Code do not have Minnesota's presumption-exception statutory framework. Consequently, they offer no guidance for interpreting §§ 471, subd. 1, subd. 3, and § 423.

**E. Professor Matheson's Testimony Is Unavailing Because The District Court Excluded Him From Testifying About Minnesota Law And From Interpreting The Statutes At Issue.**

Respondents suggest that Professor Matheson's testimony in some way supports their arguments concerning whether Appellants' were entitled to an appraisal proceeding under Minn. Stat. § 302A.471. (Res.' Br. 12, 47.) This suggestion is misleading.

Professor Matheson's testimony was limited to only custom and practice of reverse stock splits in Minnesota based on eight, specific, publicly held transactions identified in his report. (Tr. 2844:17-2845:16, 2862:1-19.) He was not allowed to testify about any legal interpretations or legal conclusions concerning the statutes at issue. (*Id.*)

Furthermore, the testimony Professor Matheson offered does not support Respondents' position. He could not recall a single case, such as this one, where the class A shareholders' votes were reduced from 71,322 to 10 because of the reverse stock split while the Class B shareholders' votes remained the same at 7,000 both before and after the reverse stock split. (Tr. 2866:6-2867:11.) This fact is crucial. Respondent Alexander's 7,000 Class B votes controlled only 9.1% of the CSG voting power before the reverse stock split, but controlled 99.8% of the CSG voting power immediately after the reverse stock split. (Apps' Br. 17-18.) Professor Matheson did not, because he could not, testify that it is common or customary in Minnesota to use reverse stock splits to increase the voting power of Class B shareholders from less than 10% to almost 100%.

Professor Matheson also failed to identify a single transaction that used a reverse stock split in the nature of 1-for-7,132.23 shares that was designed to force out minority shareholders. (Tr. 2862:10-2866:19.) He could not recall whether the eight, publicly held transactions referenced in his report involved the following reverse combinations: 1-for-2 shares; 1-for-5 shares; 1-for-8 shares; and 1-for-10 shares. (*Id.*) In addition, he could not recall if any of these reverse stock splits were conducted for the purpose of forcing out minority shareholders in a non-publicly held corporation. (*Id.*) For these

reasons, Professor Matheson's testimony is not helpful in resolving the legal issues in this case.

#### **IV. THE DISTRICT COURT ERRED AS A MATTER OF LAW WHEN IT REFUSED TO AWARD INTEREST TO APPELLANTS.**

Respondents argue that Appellants are not entitled to interest, even though Respondents failed to pay anything to Appellants for over three years after the forced redemption. (Res.' Br. 51-52.) Respondents are wrong.

Respondents do not dispute that they waited for over three years before making a payment to Appellants. (*Id.*) Nor do they dispute that they controlled the decision of where to place the money during this timeframe. (*Id.*) The law is clear and straightforward. Respondents must pay interest on this money because Respondents controlled this money and because Appellants did not use it. See *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 222 (Del. 1975) ("the purpose of interest is to fairly compensate [dissenting shareholder] plaintiffs for their inability to use the money during the period in question"); *Hernando v. Huff*, 609 F. Supp. 1124, 1129 (D. Miss. 1985) ("the rate is determined with a view towards compensating the dissenting stockholders for their inability to use the money owed them for their shares during the time fair value is calculated") *aff'd*, 796 F.2d 803 (5th Cir. 1986); *In re Glosser Bros.*, 382 Pa. Super. 177, 555 A.2d 129, 146 (1989) (interest awarded is to be "fair compensation to the dissenters for deprivation of the fair value of their stock from the effective date of the merger."); *In Re Valuation Of Common Stock Of McLoon Oil Co.*, 565 A.2d 997, 1007 (Me. 1989).

Moreover, a CSG board member threatened Tom Moore that if Appellants did not accept the amount established by CSG's Board and nothing more, then Appellants would receive nothing until the year 2010 because CSG would litigate this dispute all the way to the Minnesota Supreme Court. (Tr. 286:21-287:25.)<sup>4</sup> This improper motivation provides further grounds for an interest award to Appellants. Minn. Stat. §§ 302A.473, subd. 1(d), subd. 5, subd. 6; § 302A.751, subd. 2; § 549.09.

### CONCLUSION

Appellants request that this Court reverse the District Court's entry of judgment for Respondents, and remand for a new trial with directions to ensure that Appellants receive fair value for their shares plus interest, costs and fees. Alternatively, Appellants request that this Court modify the District Court's decision.

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<sup>4</sup> Appellants cite this testimony under Minn. R. Evid. 408 for the purpose of negating Respondents' incorrect claim that Appellants were responsible for the delay in payment. (Apps' Br. 49 and n.4.) Appellants preserved this issue under Minn. R. Civ. P. 53.07, by objecting to the special master's ruling and asking the District Court to modify the ruling and potentially exercise its discretion by remanding the issue with instructions for a new trial. (See Pls.' Legal Mem. In Supp. Of Mot. To Modify Recommendation And Objections Pursuant To Minn. R. Civ. P. 53.07(b) at 16-19 and n.11.)

Dated: April 19, 2010

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**CERTIFICATE OF COMPLIANCE**

Pursuant to Rule 132.01 subd. 3, the undersigned hereby certifies, as counsel for Appellants, that this Brief complies with the type-volume limitation as there are 6,994 words of proportional space type in this brief. This Brief was prepared using Microsoft Word 2003.

Dated: April 19, 2010

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