Court Case No. A10-252

STATE OF MINNESOTA
IN SUPREME COURT

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,

Appellants,

v.

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

Respondents.

APPELLANTS' REPLY BRIEF

Date of Filing of Decision of Court of Appeals: September 14, 2010

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ARGUMENT

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

Respondents incorrectly argue that Appellants did not comply with their obligations under the Minnesota Rules of Civil Procedure. (Resp'ts' Br. 3-4.) Appellants' Statement of Facts is proper. Minnesota Rule of Civil Procedure 128.02, subdivision 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, Respondents do not, in any material respect, take issue with the facts set forth in Appellants' opening Brief as each fact is fully supported by the record.

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

While Respondents do not take issue, on its face, with the Court of Appeals' holding that Minnesota Statute sections 302A.402 and 302A.423 do not *per se* foreclose an action under Minnesota Statutes section 302A.751 and the protections afforded minority shareholders in non-publicly/closely-held corporations, Respondents appear to continue to argue that the Minnesota statute regarding cashing out fractional shares takes precedence over Minnesota Statutes section 302A.751. (Resp'ts' Br. 28-29.) Respondents are wrong in this respect.

First, Cold Spring Granite Company ("CSG") is properly analyzed as a closely-held corporation. At the time of the involuntary redemption, CSG satisfied the common law definition of a closely-held corporation. *See Berreman v. West Publ'g Co.*, 615 N.W.2d 362, 367-68 (Minn. Ct. App. 2000) (section 302A.011, subd. 6(a) does not abrogate common law definition of a closely-held corporation). *See also Westland Capital Corp. v. Lucht Eng'g, Inc.*, 308 N.W.2d 709, 712 (Minn. 1981); *Sundberg v. Lampert Lumber Co.*, 390 N.W.2d 352, 354, 357 (Minn. Ct. App. 1986). As pointed out in Appellants' opening brief (Appellants' Br. 25, n.5), at the time of the freeze-out, CSG had 11 common shareholders, 2 of which owned 93% of the company. (APP297.) There was no ready market for CSG's common stock. (Tr. 1333:2-20; 2606:4-10.) Alexander and other shareholders actively participated in the business. (Tr. 19:21-20:6.) Dividends for common shareholders were not distributed. (Tr. 293:18-294:4; 425:14-426:15.) Lastly, the largest shareholder, Alexander, received a salary and perquisites. (Tr. 19:21-20:6.) As such, it was proven that CSG constituted a closely-held corporation and the Court of Appeals properly analyzed the Company as such.

Second, the District Court, the Court of Appeals, and Respondents, all failed to address "the weight of authority addressed in Appellants' Brief that ". . . indicates that the use of a reverse split and elimination of fractional shares <u>for the purpose of eliminating stockholders</u> may raise fairness, business purpose, or reasonable expectation issues justifying judicial intervention." (Emphasis added.) 6A Fletcher Cyc. Corp. § 2857.10 (West 2008) (citations omitted) and the case law cited in Appellants' Brief pp. 32-33.

Respondents' reliance on non-case law authority to support their legal theory that appraisal proceedings are not allowed when a reverse stock split is followed by a forced redemption of fractional shares in order to freeze minority shareholders out of the corporation is unavailing. For example, the law review article, Philip S. Garon, et al., *Challenging Delaware's Desirability as a Haven for Incorporation*, 32 Wm. Mitchell L. Rev. 769 (2006), does not cite one case that supports the position. The article simply advocates for a change in the way the authors believe the Minnesota Business Corporation Act should be interpreted. Indeed, the authors note 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 comment that Minnesota's law regarding reverse stock split is "potentially more disadvantageous to the smaller shareholders in a freeze out merger because none of dissenters' rights are available." *Id.* The authors use 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 to which they refer.

The "practice pointer" Respondents cite is also not helpful. (Resp'ts' Br. 28, 31; (*citing* 20 *Olson Minnesota Practice—Business Law Deskbook* § 2.29, at 75 (2009 10th ed.)).) The practice pointer only indirectly addresses the issue at hand. Not only does it fail to cite a single case in support of Respondents' argument and the lower courts' holdings, it provides only that a reverse stock split and forced redemption of fractional shares "may allow" the elimination of minority shareholders.

Nor does Professor Matheson's testimony support Respondents' position that Appellants were not entitled to an appraisal proceeding under Minnesota Statutes section 302A.471. (Resp'ts' Br. 31.) First, Professor Matheson's testimony was limited only to the practice of reverse stock splits in Minnesota based on eight specific, publicly-held transactions identified in his report. (Tr. 2844:17-2847:11, 2862:1-19.) Professor Matheson was not allowed to testify about any legal interpretations or legal conclusions concerning the statutes at issue. (*Id.*)

More importantly, the testimony Professor Matheson offered, and on which Respondents rely, does not support their position. First, Professor Matheson purported to testify only on the alternatives a corporation might explore and the structure of those alternatives to force out minority shareholders. (Tr. 2845:13-2846:11.) Indeed, the so-called custom and practice on which Professor Matheson purports to base his testimony was his counsel and advice to publicly-held corporations. (Tr. 2846:15-21.) Professor Matheson could not recall a single case, such as this one, where one class of common shareholders were reduced from 71,322 to 10 because of a reverse stock split, while another shareholders' class of common votes remained the same 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. Professor Matheson did not, because he could not, testify that it was common or customary in Minnesota to use reverse stock splits to increase the voting power of one class of 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 a 1-for-7,132.23 shares that was designed to force out minority shareholders. (Tr. 2862:10-2866:13.) He could not recall whether the eight, publicly-held transactions that formed the factual basis for his opinion testimony involved reverse combinations of 1-for-2 shares, 1-for-5 shares, 1-for-8 shares or 1-for-10 shares, respectively. (*Id.*) In addition, Professor Matheson could not testify that any of the specific reverse stock splits on which his testimony was based was conducted for the purpose of forcing out minority shareholders in a non-publicly-held corporation. (*Id.*) Thus, Respondents' argument that Professor Matheson's testimony was unrebutted (Resp'ts' Br. 31) is wrong. Professor Matheson's testimony on cross examination amply demonstrated, contrary to Respondents' position, that a reverse stock split and redemption by a closely-held corporation undertaken for the purpose of eliminating minority shareholders does not constitute ordinary corporate custom and practice in Minnesota. (*See generally* Tr. 2862:20, 2866:1-13.) In fact, Professor Matheson testified that there are a number of reasons, other than to force minority shareholders out of a corporation, for reverse stock splits. (Tr. 2859:21-2861:25.)

III. THE DISTRICT COURT ERRED AS A MATTER OF LAW WHEN IT REFUSED TO AWARD ITS FINDING OF FAIR VALUE TO APPELLANTS.

It is undisputed that the District Court found that the fair value of Appellants' shares is at least approximately $800,000 higher than the value determined by CSG's

Board.[1] Respondents mischaracterize the admitted undervaluation as a 10.6% shortfall and then argue that the amount is not material because there is a recognizable margin of error in the fair valuations. (Resp'ts' Br. 33-34.)

As set forth in Appellants' Brief, the District Court found that the fair value of Appellants' shares was $1,142.92 per share and further found that the Board valued these shares at only $986.50 per share. (Appellants' Br. 20.) Accordingly, Appellants received $792,580 less than the fair value for their shares, or at least nearly 16% less than the judicially determined fair value. (*Id.*) Contrary to Respondents' argument, the failure to provide Appellants with a judicial valuation because the fair value of the corporation's shares is higher than that determined by the Board is not circular. It is substantively unfair and a frustration of the minority shareholders' reasonable expectations for a controlling shareholder or a group of shareholders to "appropriate over much of the enterprise's economic benefits." *Gunderson v. Alliance of Computer Prof'ls,*

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[1] Respondents' attempt to decrease the difference in fair value found by the District Court from that determined by the Board due to an alleged mistake concerning the company's Fresno property is wrong. The table in the Appendix on which the properties and the parties' valuations were listed used Respondents' designations for purposes of simplifying the District Court's consideration only. (*See* Pls.' Post-Trial Mem. of Law, Appendix at 2.) The "operations properties" were labeled as such in the corporate valuation and therefore carried over in the Appendix provided to the District Court to assist in its analysis. Appellants did not accept the company's designation of "operating properties" for all of the properties so designated by Appellants. Mr. Richert testified that the highest and best use of the Fresno property was not as a quarry. (Tr. 1729:7-15, 1731:1-1732:17.) The District Court agreed by including Mr. Richert's value opinion concerning the Fresno property in the Court's real estate valuation. Clearly, Respondents' mischaracterization of the District Court's valuation in this respect represents an unfair attempt to minimize the difference in the District Court's finding of fair value and that of the Board's.

628 N.W.2d 173, 185 (Minn. Ct. App. 2001). Where, as here, the controlling shareholders appropriated, with the approval of the Board, at least approximately $800,000 of the value of Appellants' shares, said shareholders and the Company have breached their fiduciary duty to Appellants. *Id.*

Respondents' attempt to rationalize and make permissible this approximate $800,000 investment theft by arguing that valuations are accurate if they are within a margin of error of 15-30% is wrong. Rather than condoning undervaluations in these ranges, at least two courts have sanctioned corporations with costs and attorneys' fees when they undervalued minority shareholders' interest by such margins. *See Hernando Bank v. Huff*, 609 F. Supp. 1124 (N.D. Miss. 1985) (awarding expert fees to a 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 Bank* 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 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 minus $80.50 divided by $80.50 equals 24.22%).[2] *See Am. Sharecom, Inc. v. LDB Int'l Corp.*, No. C9-94-2419, 1995 WL 321540, at *1, 3 (Minn. Ct. App. May 30, 1995)

[2] Using the manner in which Respondents calculate the percent difference in this case would have resulted in a 19.5% difference in *Hernando Bank* because the difference between the Court's value ($100) and the corporation's value ($80.50) is $19.50, or 19.5% of $100. (*See* Resp'ts' Br. 21, n.1.)

(finding violation of section 302A.473, subd. 8(b) and awarding costs and fees to minority shareholder because corporation claimed fair value was $7,500,000 and the court found it was $25,600,000).[3]

As a matter of law, Respondents' underpayment and the fraudulent nature thereof, cannot be sustained by a legally unrecognized "margin of error." The District Court found that Appellants were deprived of at least approximately $800,000 of the fair value for their shares. Respondents' underpayment constitutes a substantial failure to comply with the MBCA, and thus entitled Appellants to a judicial valuation of their shares because it constituted a breach of Respondents' fiduciary duty to Appellants. *See Sifferle v. Micom Corp.*, 384 N.W.2d 503, 507 (Minn. Ct. App. 1986), *review denied* (Minn. June 13, 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 fiduciary duty. . . .")

IV. THE LOWER COURTS ERRED AS A MATTER OF LAW IN FINDING THAT THE MOORES FAILED TO PROVE GROUNDS FOR A JUDICIAL BUY-OUT UNDER SECTION 302A.471.

Respondents persist in their reliance on the Model Act to support the argument that Appellants are not entitled to a judicial buy-out under section 302A.471. As more fully addressed in Appellants' Brief, reliance on the Model Act is unavailing given the

[3] Had the manner in which Respondents calculate the percent difference here been used in *American Sharecom,* the value offered in *American Sharecom* was off by 31.6% because the difference between the Court's value ($25,600,000) and the corporation's value ($17,500,000) is $8,100,000, or 31.6% of $25,600,000. (Resp'ts' Br. 21, n.1.)

restrictive nature of the Model Act when compared to the liberal nature of the MBCA. (Appellants' Br. 39-40.)

Respondents reliance on *Wigart v. Cervenka* for the proposition that if an action is not specifically listed in section 471, subdivision 1, that dissenters' rights are not available to a minority shareholder is also misplaced. *Wigart*, No. C7-98-1505, 1999 WL 243231, at *5 (Minn. Ct. App. Apr. 27, 1999), *review denied* (July 28, 1999). *Wigart* 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 a material difference, as section 471, subdivision 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 shareholders' right to vote or their right to obtain payment under section 471, subdivision 1(a)(5). *Id.* Here, Respondents eliminated Appellants' right to vote and their right to obtain payment under the statute. It is undisputed that 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.)[4]

Moreover, unlike the broad and liberal dissenters' rights provisions in the MBCA, the Model Business Corporation Act has a history of moving in the opposite direction in

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[4] Contrary to Respondents' argument (Resp'ts' Br. 42 n.10), Appellants did argue that Respondents violated section 302A.471, subdivision 1(a)(5). (*See* Appellants' Ct. of Appeals Reply Br. 18-20.)

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 Corporations 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 (emphasis added).

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

As addressed in Appellants' Brief (pp. 38-39), the elimination of the right to obtain payment under section 302A.471, subdivision 1(a)(5) can be accomplished in a number of different ways. A reverse stock split followed by a forced redemption of fractional shares constitutes but one such way to accomplish the elimination of the rights. Respondents and the lower courts fail to appreciate this fact. The Minnesota Legislature's action in leaving section 302A.471, subdivision 1(a)(5) broader than the one specific act set forth in section 13.02(v) of the Model Act makes it clear that the Minnesota Legislature elected not to more narrowly encompass restrictions on dissenters' rights but rather, in keeping with liberal treatment of dissenters' rights, chose to address the rights using the more expansive term found in subdivision 1(a)(5); a term that entitled Appellants to a judicial valuation under section 471, subdivision 1(a). Respondents' argument that section 302A.471, subdivision 1(a)(5) does not apply to the amendment in this case, the avowed purpose of which was that "under the provisions of 302A.423 and 302A.471 . . . *the shareholders would not be entitled to assert dissenters' rights*" (APP144) (emphasis added) is mistaken. Subdivision 1(a)(5) is not so restrictive. The clause is general in nature and addresses the elimination of dissenters' rights " . . . in response to articles amendments." Minn. Stat. § 302A.471, subd. 1(a)(5). It is not limited only to an amendment of articles to opt-out of the dissenters' rights section, as argued by Respondents. (*See* Resp'ts' Br. 43.)

The Minnesota Practice cite relied upon by Respondents, *Minnesota Practice—Corporation Law And Practice,* section 2.22, 48 n.4, plainly acknowledges that an amendment to a company's articles to opt-out of dissenters' rights is but only <u>one</u> amendment that triggers dissenters' rights, not the sole and exclusive amendment that would trigger dissenters' rights under subdivision 1(a)(5). *Id.*

In addition, the result Respondents advocate under subdivision 1(a)(5) cannot be reconciled with this Court's decision in *Whetstone.* Respondents' argument assumes that subdivision 1(a)(5) is very explicit and should be interpreted as such. *See Whetstone v. Hossfeld Mfg. Co.*, 448 N.W.2d 536, 538 n.1 (Minn. Ct. App. 1989), *rev'd in part,* 471 N.W.2d 380 (Minn. 1990). As this Court earlier found, and in light of the closely held corporation context of this case, this position misconstrues the broad "investment rights" afforded to minority shareholders under section 471, subdivision 1. *See Whetstone v. Hossfeld Mfg. Co.*, 457 N.W.2d 380, 382-384 (Minn. 1990). Simply stated, an amendment, the avowed purpose of which was to assure that the shareholders were not entitled to dissenters' rights, particularly in a case such as this, unquestionably "eliminates the right to obtain payment under this subdivision." As such, contrary to the observation of the Court of Appeals and as argued by Respondents, this case is not distinguishable from *Whetstone* because the Moores were eliminated as shareholders. (ADD160.) It is the elimination of Appellants as shareholders <u>and</u> the rights of ownership such as the right to vote and the right to obtain payment under section 471, subdivision 1 that give rise to dissenters' rights under this Court's decision in *Whetstone* and Minnesota Statutes section 302A.471, subdivision 1. *See also Brown v. Arp & Hammond Hardware*, 141 P.3d 673, 678 (Wyo. 2006); *Sec. State Bank, Hartley, Iowa v. Ziegeldorf*, 554 N.W.2d 884, 887 (Iowa 1996).

Finally, in *Whetstone*, the Minnesota Court of Appeals issued an important ruling concerning section 471, subdivision 1 that was not altered by this Court on appeal. The Court of Appeals referenced the comment to section 471 which provides 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." Minn. Stat. § 302A.471 gen. cmt. *See Whetstone*, 448 N.W.2d at 538 n.1. The Court of Appeals then ruled that one of these "investment rights" is the right 'to maintain a percentage of ownership,' and the termination of a minority shareholder's ownership percentage would give rise to a dissenters' rights proceeding under Minn. Stat. § 302A.471, subd. 1." This part of the Court of Appeals' decision was not reversed by this Court and should remain binding precedent. *Whetstone*, 471 N.W.2d 380.

V. THE COURT OF APPEALS ERRED IN UPHOLDING THE DISTRICT COURT'S FINDING THAT THE BOARD'S VALUATION WAS NOT FRAUDULENT.

Appellants argued before the Court of Appeals that Cobb's valuation was flawed as a matter of law. (Appellants' Ct. of Appeals Br. 51-54 and Appellants' Ct. of Appeals Reply Br. 10-14.)

The basis on which the District Court found, and the Court of Appeals affirmed, that the Board's valuation was not fraudulent was based on a misperception. The Court of Appeals, in upholding the District Court, found there was evidence to support the finding that the failure to disclose management projections was immaterial based on Cobb's self-serving testimony that he would not have relied on the projections, and testimony by corporate representatives that the projections were dated and based on an aborted plan to significantly enlarge the business. (*See* ADD158.) Appellants have addressed in their brief the Court of Appeals' error in focusing on what Cobb testified he used in his valuation opinion rather than focusing on what was and was not provided to the Board. (Appellants' Br. 42-44.) Respondents do not take issue with this aspect of Appellants' argument. However, in an effort to gloss over the District Court's finding that appears to be based on only one set of "outdated" projections, Respondents argue that the projections prepared by corporate management that were outdated and based on an aborted business plan were speculative and thus implicitly, should not have been provided to the Board.[5] The projections that were not provided to the Board and that Respondents now attempt to argue were speculative, were anything but speculative.

For example, the June 2005 sets of financial projections prepared by CSG's Chief Financial Officer Greg Flint were prepared at a time fairly contemporaneous with that during which the reverse stock split was being considered by the Board. (Tr. 528:18-529:11, 559:10-560:15; APP189.) Flint knew the projections would be used for litigation purposes to value the company and redeem the shareholders' interests. The first set of projections known as Version A and a related valuation "Version A-1" were prepared to reflect the company's liquidation value. (Tr. 569:23-570:4, 636:8-12; APP197.) Flint was told by Alexander, among others, that the projections were "too pessimistic" and was instructed to prepare another set of projections. (Tr. 636:8-15, 637:7-640:1, 667:18-668:4.) As a result, Flint prepared three additional sets of financial projections, Versions B, C and D, and a fair market valuation based on Version D projections designated as "D-1." (APP193; APP194; APP196; APP198; Tr. 563:23-564:1, 564:20-565:4, 561:12-562:5, 568:12-25.) Critically, Flint testified that all four versions should have been disclosed. (Tr. 570:23-24, 572:2-6.) Yet, the Board only received Version A and was never informed that Version A constituted a set of liquidation projections. (Tr. 668:20-671:22; APP119-133; APP147-156.)

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[5] The "dated" projections that were based on the aborted business plan were used by the Kahlerts' appraiser, Schmidt. (ADD047-49, ¶¶ 49-52.) They were not Mr. Flint's 2005 projections or the 2006 operating budget provided to U.S. Bank.

The 2006 budget provided by the company to U.S. Bank was also critically withheld from the Board. Respondents' analysis of this budget as solely and exclusively bearing on the $10,000,000 valuation contained therein is also misplaced. The 2006 operating budget prepared by management at a point in time contemporaneous with the reverse stock split was not provided to the Board. It is undisputed that the 2006 budget provided to U.S. Bank constituted an operating budget prepared by management in the ordinary course of business. (*See* Tr. 2430:5-25; 2436:4-21.) In fact, management provided to U.S. Bank in its 2006 operating budget two scenarios, scenarios A and B, only one of which budgeted for a buy out of the minority shareholders. (Tr. 2440:2-2441:17.)

The failure to disclose the 2006 operating budget from Cobb and the Board denied each the opportunity to fairly assess the Company's forward projection and arrive at a fair value of CSG. For 2006, management projected significant cost savings that were projected to increase the Company's profitability and thus its value. Ms. Wirta, a U.S. Bank representative that testified at trial, testified that the budget submitted by management budgeted for over $6,000,000 in cost savings compared to 2005. (Tr. 2432:4-2435:19). The failure to even consider management's projections that were created at a time fairly contemporaneous to the reverse stock split and redemption in a valuation of the Company is so fundamentally wrong that it constitutes error as a matter of law. *In Re Radiology Assocs., Inc. Litig.*, 611 A.2d 485, 490-91 (Del. Ch. 1991); *see also Gray v. Cytokine Pharmasciences, Inc.*, No. Civ. A. 1745, 2002 WL 085359, at *8

(Del. Ch. Apr. 25, 2002); *Bomarko, Inc. v. Int'l Telecharge,* 794 A.2d 1161, 1195 (Del. Ch. 1999).

Additionally, Respondents mischaracterize the testimony of Ms. Wirta concerning the $10,000,000 budgeted by management in one of its 2006 scenarios to buy out the minority shareholders. Ms. Wirta only testified that there was a "best guesstimate or educated guess" concerning whether or not there would be a shareholder repurchase, not as to the value of the repurchase:

> Q. Did anyone from Cold Spring ever tell you how much they actually expected to pay the minority shareholders?
>
> A. Actually expected?
>
> Q. Yes.
>
> A. No, it was all budgeted information.
>
> Q. What was the difference between budgeting and expecting, from your point of view?
>
> A. Best guesstimate or educated guess. I mean, they knew there was a possibility of a shareholder repurchase.
>
> I don't recall when that was actually determined that they were for sure going to do that, but they budgeted an amount for it.

(Tr. 2444:16-2445:5.) It is clear that Ms. Wirta was not indicating that the $10,000,000 budgeted by the company for the minority shareholder purchase was a guesstimate with respect to the amount but rather, it was a "best guesstimate or educated guess" as to whether or not there would, in fact, be a shareholder repurchase in 2006.

Respondents' reliance on *Advanced Communication Design v. Follet*, 615 N.W.2d 285 (Minn. 2000) is misplaced. This Court in *Advanced Communication Design* did not hold that a bright line rule in respect of valuation is inappropriate, although Appellants do not advocate as such. Rather, the Court in *Advanced Communication Design* indicated that a remedy for a violation of Minnesota Statutes section 302A.751, subdivision 2 is not subject to a bright line rule. *Advanced Commc'n Design*, 615 N.W.2d at 292. In fact, the Court in *Advanced Communication Design*, recognized that a result, such as here, that allows a majority shareholder to reap a windfall is contrary to the statutory purpose providing remedies to minority shareholders under Minnesota Statutes section 302A.751, subdivision 2.

> Our statutory scheme in court ordered buy-outs is clearly directed toward providing the court maximum flexibility to fashion a remedy 'fair and equitable to all parties,' Minn. Stat. § 302A.751, subd. 2, and thus a bright line rule is not appropriate. A result that allows majority shareholders to reap a windfall by buying out dissenting or pressed shareholders at a discount or that encourages corporate squeeze outs is contrary to the statutory purpose to provide a remedy to minority shareholders. *See, e.g., In Re McLoon Oil Co.*, 565 A.2d 997, 1005 (Me. 1989); *Cavalier Oil Corp. v. Hartnet*, 564 A.2d 1137, 1155 (Del. 1989).

Id.

As previously addressed, Cobb's testimony that the projections were unreliable and unduly optimistic begs the question. It was for the Board to determine the reliability of management's projections; a point which the District Court and the Court of Appeals critically failed to address. The failure to disclose the projections and operating budget prepared at a time fairly contemporaneous with the consideration of the reverse stock split and fair value determination, and Cobb's flawed valuation, resulted in a windfall to the majority shareholders and entitled Appellants to a judicial valuation under Minnesota Statutes section 302A.751. (*See* Appellants' Br. 41-44.)

VI. THE COURT OF APPEALS ERRED AS A MATTER OF LAW IN CONCLUDING THAT THE PREFERENTIAL TREATMENT AFFORDED ALEXANDER AND THE ALEXANDER FAMILY TRUST THAT INSULATED THEIR SHARES FROM BEING FRACTIONALIZED DID NOT CONSTITUTE A BREACH OF FIDUCIARY DUTY AND/OR UNFAIRLY PREJUDICIAL CONDUCT ENTITLING APPELLANTS TO A JUDICIAL VALUATION UNDER MINNESOTA STATUTES SECTION 302A.751.

Respondents do not, for the most part, address Appellants' argument that the Court of Appeals erred as a matter of law in concluding that the preferential treatment afforded Alexander and the Alexander Family Trust that insulated their shares from being fractionalized constituted a breach of fiduciary duty and/or unfairly prejudicial conduct that entitled Appellants to a judicial buy-out and judicially determined fair value determination pursuant to Minnesota Statutes section 302A.751. (*See* Appellants' Br. 31-34.) Rather, Respondents wrongly argue that *Berreman* did not hold that it is a breach of fiduciary duty for a shareholder or a group of shareholders to be afforded preferential treatment as compared to other shareholders. (Resp'ts' Br. 36.) Respondents too narrowly interpret the decision in *Berreman* that "'Freeze-out' situations are the classic situations in which Courts have found and enforced fiduciary duties." *Berreman v. West Publ'g Co.,* 615 N.W.2d 362, 370 (Minn. Ct. App. 2000).

A review of the cases relied upon by the Court in *Berreman* proves that Respondents' interpretation of *Berreman* as limited to preferential use of corporate assets is a distinction without merit. For example, in *Crosby v. Beam,* 548 N.E.2d 217, 221 (Ohio 1989), the Court held it to be a breach of fiduciary duty when the majority shareholders used their control to give themselves benefits not enjoyed by the minority.

In *Tillis v. United Parts, Inc.*, 395 So. 2d 618, 619 (Fla. Dist. Ct. App. 1981), the Court recognized that allowing only a majority shareholder to sell shares to the corporation constitutes preferential distribution of corporate assets and is inconsistent with fiduciary duty. In fact, in *Wenzel v. Mathies,* 542 N.W.2d 634 (Minn. Ct. App. 1996), the Court found that a Board's fiduciary duty to the company's shareholders requires that the Board treat the shareholders fairly and evenly. 542 N.W.2d at 641 (citations omitted).

Here, the fiduciary duty to treat the common shareholders of Cold Spring Granite fairly and evenly was clearly breached. The Class A Shareholders were not relatively or evenly affected in proportion to their percentage of ownership. Alexander and the Alexander Family Trust minority interests were afforded preferential treatment to the detriment of Appellants and other minority shareholders by their receipt of the advice and counsel of corporate counsel to set up the reverse stock split and redemption so that not even one of their shares was fractionalized and that left them as the sole common shareholders of CSG. This preferential treatment, orchestrated by corporate counsel, constituted, as a matter of law, a breach of fiduciary duty. Unquestionably, corporate assets were preferentially used to the detriment of Appellants. Use of corporate counsel and corporate assets to pay corporate counsel for the preferential treatment constitute the preferential use of corporate assets. Similarly, the shortfall in the payment of fair value to the Appellants while the Alexander and Alexander Family Trust received a windfall in the form of the retention of that shortfall, constitutes preferential use of corporate assets in that the equity of the Company represents a corporate asset. Lastly, the Class A Common Shares, all of which passed to Alexander and the Alexander Family Trust through the reverse stock split and freeze-out, constitute a corporate asset to which Alexander and Alexander Family Trust were unfairly preferentially treated.

VII. THE COURT OF APPEALS ERRED AS A MATTER OF LAW IN FINDING THAT THE MINERAL RIGHTS WERE OF DE MINIMIS VALUE.

The Court of Appeals incorrectly rejected Appellants' argument that the Board's valuation fraudulently undervalued the mineral rights the Company retained in the land transferred to Marble Falls. Contrary to Appellants' argument, the only evidence of the value in 2005 of the mineral rights is not the testimony of Mr. Cobb.

First, the District Court found that Alexander and corporate counsel Wilensky represented to Appellants that the real estate the Company was transferring to Marble Falls would be valued very low, at $1,950,000, and the granite rights withheld by the company represented the greater value in the transaction. (ADD044, ¶ 37.) In addition, the District Court found that the value of a fee simple interest in the Marble Falls property was worth $15,000,000. (ADD072, ¶ 107.)

These findings constitute evidence of the value of the leased rights in 2005. The representation found by the District Court made by Alexander & Wilensky that the transferred land was worth $1,950,000 and that the leased rights represented the greater value in the transaction amply proves that the leased rights should have been valued in an amount at least greater than $1,950,000. In addition, the finding by the District Court that the mineral rights together with the Marble Falls real estate were collectively worth $15,000,000 as of December 31, 2006 (ADD072, ¶ 107), coupled with the admission found by the District Court that "the granite rights withheld by CSG represented the greater value in the transaction" (ADD038, ¶ 21; ADD044, ¶ 37), can lead to only one conclusion as a matter of law, namely, that the granite rights were valuable and at least worth more than the $1,950,000. In other words, Cobb's undervaluation of the granite rights was proven by the admission on the part of Alexander & Wilensky that the granite rights represented the greater value in the transaction.

Mr. Wilensky also offered compelling evidence concerning the value of the property rights. At trial he testified that he was not aware of any restriction in the agreement between CSG and Marble Falls that would prevent the same entity from obtaining both the property rights and mineral rights before expiration of the lease. (Tr. 2336:11-2337:23.) Thus, CSG and Marble Falls—both controlled by Alexander—may recombine the rights and realize the fair market value of the property, a fair value found by the District Court to be $13,000,000 in 2005. (ADD072 ¶ 207.) It defies logic to accept the argument that the mineral rights were worth $41,919 in 2005 when the property was found to be worth $15,000,000 and the land value subject to the lease was $1,950,000 per Respondents' admission. Stated differently, it defies common sense to conclude that approximately $13,000,000 of value disappeared with the lease.

Respondents' argument that the granite rights were not undervalued because Appellants remain owners of Marble Falls is irrelevant. (Resp'ts' Br. 50.) That Marble Falls will own the entire fee simple interest in the land when the mineral rights lease expires does not mean that the Appellants will enjoy the value at the end of the lease. As demonstrated in Appellants' brief, the right to force Appellants from Marble Falls at a capped appreciation of the undervalued land is unconditional. (Appellants' Br. 9.) This encumbrance on Appellants' interest in Marble Falls constitutes a cloud on their interest in Marble Falls, regardless of whether Alexander sought to execute upon the provision to date or not. Additionally, the issue is what fair value the mineral rights added to the Company value for purposes of the fair value determination, not what the owners of Marble Falls may speculatively receive in the future or who may or may not be owners of Marble Falls in the future.

In conclusion, the District Court erred, and the Court of Appeals failed to address, Alexander's misrepresentation to the Company's appraiser that the granite rights had a minimal value (Tr. 1212:25-1213:19) when he had earlier admitted to Appellants that the granite rights represented the greater value in the Marble Falls transaction (ADD038, ¶ 21; ADD044, ¶ 37.) It was the "minimal value" misrepresentation that lead Cobb and in turn, CSG's Board to undervalue CSG's granite rights by over $13,000,000. At an absolute minimum, the misrepresentation constituted *Sifferle* fraud entitling Appellants to a judicially determined fair value determination of the mineral rights. *See Sifferle,* 384 N.W.2d at 507; *Newell v. Randall,* 19 N.W. 972, 973 (Minn. 1884).

CONCLUSION

Appellants respectfully request that this Court reverse the Court of Appeals, and remand for a new trial with guidance to the District Court that Appellants are entitled to a judicial determination of fair value of their shares in accordance with an appropriate valuation based on management's financial projections and information plus interest, costs and fees. Alternatively, Appellants request that the Court reverse the Court of Appeals, modify the District Court's judgment, and order that Appellants are entitled to an additional $792,500 as the fair value amount found by the District Court and which Appellants have been deprived, and an additional $740,350 for their share of the value of the mineral rights lease, plus interest, costs and fees.

Dated: February 3, 2011

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CERTIFICATE OF COMPLIANCE

Pursuant to Minnesota Rule of Civil Appellate Procedure 132.01, subd. 3, the undersigned hereby certifies, as counsel for Appellants, that this brief complies with the type-volume limitation as there are 6066 words of proportional space type in this brief. This brief was prepared using Microsoft Word 2003.

Dated: February 3, 2011

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