January 1992

Montana's New Business Corporation Act: Duties, Dissension, Derivative Actions and Dissolution

Steven C. Bahls
MONTANA'S NEW BUSINESS CORPORATION ACT: DUTIES, DISSENSION, DERIVATIVE ACTIONS AND DISSOLUTION

Steven C. Bahls*

I. Introduction ........................................ 4

II. Duties of Directors, Officers and Controlling Shareholders ........................................ 6
   A. Statutory Changes to the Duty of Care ......... 9
      1. Definition of the Duty of Care and the Business Judgment Rule ......................... 9
      2. Applicability of Duty of Care to Officers ...................................................... 13
   B. Statutory Changes to the Duty of Loyalty ......................................................... 14
   C. Controlling Shareholders' and Directors' Duty to Avoid Illegal, Oppressive and Fraudulent Conduct ................................................................. 16
      1. The Plight of Minority Shareholders .............................................................. 17
      3. Impact of New Legislation ............................................................ 27
         a. Threshold Standard for Judicial Intervention .................................................. 27
         b. Discretion to Grant Other Forms of Equitable Relief ....................................... 29

III. Legislative Changes Governing Derivative Actions .... 33
   A. Statutory Modifications to the Demand Requirement on Directors ....................... 34
   B. Statutory Clarification of the Board's Power to Dismiss an Action .................... 36

* Associate Dean and Professor, University of Montana, School of Law. B.B.A. 1976, University of Iowa; J.D. 1979, Northwestern University. The author served as the Chair of Corporate Law Revision Committee of the State Bar of Montana, which drafted the new Montana Business Corporation Act adopted by the legislature in 1991. The author wishes to thank Dean J. Martin Burke for his support of law revision projects.
The new Montana Business Corporation Act (MBCA), enacted by the Fifty-Second Montana Legislature, is the first complete revision of Montana’s law controlling corporate governance in almost twenty-five years. After an extensive study of the state’s corporate governance laws, the State Bar of Montana’s Corporate Law Revision Committee (the “Committee”) proposed revisions largely based on the American Bar Association’s Model Business Corporation Act. The Committee included a broad spectrum of attorneys representing private practice, government, a nonprofit organization, private industry and academia. With Representative Brent Cromley of Billings as principal sponsor, the legislature enacted the Committee’s proposals, which are effective January 1, 1992.

The Committee set as its objectives clarification, simplification and modernization of the law relating to corporate governance. The majority of the changes serve the objective of clarifying Mont-
tana law. Because of the relatively small number of court cases decided under the prior Montana Business Corporation Act, several ambiguities in previous enactments had yet to be resolved. The Committee believed that clarifying these ambiguities adds certainty to the law and allows corporate stakeholders and attorneys to engage in more precise planning.

The legislation also simplifies corporate governance in two respects. It eliminates needless formality and it allows the corporation additional flexibility with which to operate. The new flexibil-

4. Among the more significant clarifications are:
   a. Preemptive Rights. Many corporations elect to provide for preemptive rights (rights of existing shareholders to purchase a pro-rata amount of any new stock issue) in their articles of incorporation. When a corporation elects preemptive rights, the previous law was not always clear when these rights apply. The new legislation provides a detailed definition of when preemptive rights accrue, if the articles of incorporation provide for preemption rights. The articles of incorporation may alter the statutory provision concerning when preemptive rights accrue. MONT. CODE ANN. § 35-1-535(2) (1991).
   e. Duties of Officers, Directors and Controlling Shareholders. The previous legislation (and previous court cases) had several ambiguities concerning the duties of directors, officers and controlling shareholders and the consequences of violations of these duties. The new legislation clarifies many of the ambiguities. See infra text accompanying notes 12-146.
   f. Dissolved Corporations. The rights of creditors against dissolved corporations were not clear in many respects. The new legislation clarifies (and expands) these rights. See infra text accompanying notes 195-247.
5. Stakeholders are those with a "stake" in the corporation. Stakeholders include officers, directors, shareholders, creditors and state government.
6. For example, the two-step filing procedure for dissolution (i.e., filing both a Statement of Intent to Dissolve and Articles of Dissolution) has been reduced to one step. MONT. CODE ANN. § 35-1-933 (1991). Similarly, the requirement that two persons serve as corporate officers has been eliminated. MONT. CODE ANN. § 35-1-441 (1991). Likewise, the board of directors is now able to make certain housekeeping amendments (e.g., changing a registered agent or office) without having to seek the approval of shareholders. MONT. CODE ANN. § 35-1-226 (1991).
7. The old laws require cumulative voting, affirmative vote of two-thirds of the shareholders to take certain major corporate actions and other provisions that, while appropriate for many corporations, are unnecessarily cumbersome for others. The new legislation allows shareholders to opt out of these requirements if they so desire. See, e.g., MONT. CODE ANN.
ity in the law allows the shareholders in the corporation to structure the corporation to meet their needs and expectations. The Committee members agreed that the State of Montana should afford informed shareholders the flexibility to structure their relationship as they please, so long as the rights of creditors and other stakeholders are not unduly burdened.

The most significant changes are those that modernize Montana's law controlling corporate governance. Although many of these changes follow statutory trends in other states, others stem from the Committee's belief that Montana law should codify certain judicial trends. This article describes statutory changes that fall primarily in the category of codifying judicial trends. It examines three specific dimensions of the new legislation: The duties of directors, officers and controlling shareholders, derivative actions and dissolution. The article will discuss existing case law in each of these areas, because an understanding of existing case law is critical to an understanding of the statutory modifications. Finally, the article will describe the impact of legislation on the case law.

II. DUTIES OF DIRECTORS, OFFICERS AND CONTROLLING SHAREHOLDERS

With the increasing frequency of litigation by minority share-
holders against officers, directors and controlling shareholders, the members of the Committee decided to examine the statutory duties of directors, officers and controlling shareholders. The first step in analyzing those duties is to determine to whom the duties are owed. Historically, courts view the duties of those managing the corporation as requiring maximization of profits for the benefit of shareholders. Recently, however, at least twenty-eight states have enacted statutes allowing those managing the corporation to take into account the interest of other stakeholders, including employees, customers, suppliers and the community. The statutes, often referred to as “other constituency” statutes, are usually enacted to help management of corporations fend off takeover bids by out-of-state corporations. Because of a disagreement among Committee members on the advisability of enacting anti-takeover measures, the Committee decided not to propose an “other constituency” statute. Instead, the Committee agreed that the common law rules governing the objective of a corporation ought to apply. Common law clearly provides that a business corporation has as its objective conducting the business to profit shareholders. This

12. One commentator describes the increase in shareholder oppression cases as “phenomenal.” Haynsworth, The Effectiveness of Involuntary Dissolution Suits As a Remedy for Close Corporation Dissension, 35 CLEV. ST. L. REV. 25, 87 (1987) (citing F. O'NEAL & R. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS at iii (2d ed. 1985)).

13. The best known of these cases is the historic case of Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919). In Dodge, the court found:
A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.
Id. at 507, 170 N.W. at 684.


15. Id. at 1356. Other constituency statutes allow corporate directors to more easily recommend rejection of a hostile takeover attempt, notwithstanding the fact that the takeover would benefit shareholders by allowing them to sell their interest at a premium price. In such case, directors may recommend rejection of the offer because of the negative impact on employees and the community. The author agrees with the observation of Professor Jonathan Macey that “it seems patently clear that the true purpose of these statutes is to benefit a single nonshareholder constituency, namely top managers of publicly held corporations who want still another weapon in their arsenal of anti-takeover protective devices.” Macey, An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties, 21 STETSON L. REV. 23, 26 (1991).

16. The best statement of the common law principles is found in the American Law Institute Draft Principles of Corporate Governance.
§ 2.01. The Objective and Conduct of the Business Corporation.
A business corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain, except
common law principle does not mean that corporations must blindly pursue profits at the expense of the greater social well being. It has long been recognized that corporations may devote reasonable amounts of resources to the public welfare. Similarly, corporations may also take into account ethical considerations "reasonably regarded as appropriate to the responsible conduct of business," even if such ethical considerations diminish profits. All corporations benefit from a responsible and stable social and business climate. Reasonable contributions to that climate serve to benefit shareholders in the long run.

Although the new legislation did not modify the common law rule that those in control owe a primary duty to shareholders, the legislation better defined the specific types of duties owed to shareholders. When scrutinizing the conduct of directors, officers and controlling shareholders, the courts should examine three separate duties. First, courts should examine whether the directors and of-

that, whether or not corporate profit and shareholder gain are thereby enhanced, the corporation, in the conduct of its business
(a) is obliged, to the same extent as a natural person, to act within the boundaries set by law,
(b) may take into account ethical considerations that are reasonably regarded as appropriate to the responsible conduct of business, and
(c) may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes.

A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 at 25 (Tent. Draft No. 2, April 13, 1982).


18. A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(b), at 25 (Tent. Draft No. 2, April 13, 1982).

19. Courts typically apply two of these duties primarily to directors. There is, however, some confusion as to the classification of the two primary duties of directors. This article describes the two primary duties as the duty of care and the duty of loyalty. Some commentators find different classifications of duties. Dennis J. Block, Nancy F. Barton and Stephen A. Radin identify the duties as the duties of care, loyalty and candor. D. BLOCK, ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 27 (3d ed. 1990). Others find separate duties of obedience, diligence and loyalty. W. KNEEPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.05, at 10-12 (3d ed. 1978). This author prefers to recognize only two duties for directors of all corporations: the duty of care and the duty of loyalty. These two duties are those recognized by the Committee on Corporate Laws of the American Bar Association's Section of Business Law. Committee on Corporate Laws, Corporate Directors Guidebook, 33 BUS. LAW. 1595, 1599-1603 (1978). It was the ABA Committee on Corporate Laws that promulgated the Revised Model Business Corporations Act, upon which the Montana corporate governance law is based. Further, the influential American Law Institute, in its Principles of Corporate Governance has also recognized these two duties. A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, PARTS IV AND V, at 171-497 (Tent. Draft. No. 11, April 25, 1991) [hereinafter A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE] (referring to the duty of loyalty as the duty of fair dealing).

As I will define duties broadly, duties such as obedience and candor are subsumed within the duties of care and loyalty.
ficers violated their duty of care to the corporation and whether their conduct is protected by the business judgment rule. Second, courts should scrutinize whether directors, officers and controlling shareholders violated their duty of loyalty by personally profiting from their relationship with the corporation, at the expense of the corporation. Finally, for close corporations, courts must analyze whether directors and others in control of the corporation oppressed minority shareholders by violating the reasonable expectations of minority shareholders. The new legislation provides guidance to courts in defining and applying each of these duties.

A. Statutory Changes to the Duty of Care

The new legislation continued the prior law's tradition of statutorily defining the directors' duty of care. The drafters of the law specifically resisted the temptation to codify the elusive and related business judgment rule because courts need the flexibility provided by the business judgment rule in applying the duty of care to directors. The legislation did, however, clarify the duty of care by expressly charging officers with the same duties as directors.

1. Definition of the Duty of Care and the Business Judgment Rule

The duty of care requires a director to act carefully in discharging his or her task of monitoring and managing the affairs of the corporation. The new law's definition of the duty of care is similar to that of the previous legislation. The new legislation provides:

General standards for directors. (1) A director shall discharge his duties as a director, including the director's duties as a member of a committee:

(a) in good faith;
(b) with the care an ordinarily prudent person in a similar position would exercise under similar circumstances; and
(c) in a manner the director reasonably believes to be in the best interests of the corporation.20

As a general rule, courts have recognized that while directors ought to exercise due care in making decisions, they must also have some latitude to innovate and to take risks.21 If directors are sub-

21. Ski Roundtop, Inc. v. Hall, 202 Mont. 260, 273, 658 P.2d 1071, 1078 (1983) ("directors of a commercial corporation may take chances"). See also, Daniels v. Thomas, Dean &
jected to the scrutiny of 20/20 hindsight, directors may hesitate to take the risks that entrepreneurs must take. To minimize this risk, courts have developed a judicial gloss to the duty of care referred to as the business judgment rule. Those drafting the legislation neither attempted to define the business judgment rule nor to impinge on the court's latitude to define the rule.

The business judgment rule has been discussed in two recent Montana cases, *Ski Roundtop, Inc. v. Hall* and *Daniels v. Thomas, Dean and Hoskins, Inc.* In the first of these cases, *Ski Roundtop*, the Montana Supreme Court adopted the following as a statement of the business judgment rule: "'[T]he 'business judgment rule' immunizes management from liability in a corporate transaction undertaken within both the power of the corporation and the authority of management where there is a reasonable basis to indicate that the transaction was made in good faith.'" The business judgment rule described in this case appears to use a subjective good faith standard to evaluate directors' conduct. The subjective standard is satisfied when a court decides that the actual motivation of the director is to serve the corporation. An objective standard, on the other hand, does not focus on the actual motivation of the director; instead it asks whether a director acted as an ordinarily prudent person in the management of his or her own business affairs. The subjective standard focuses on actual intent; the objective standard measures the directors' conduct against the conduct of others. In *Ski Roundtop*, the Montana Supreme Court emphasized the subjective standard when it stated:

> Because [directors] are given this wide latitude, the law will not hold directors liable for honest errors, for mistakes of judgment, when they act without corrupt motive and in good faith, that is, for mistakes which may properly be classified under the heading of honest mistakes. And that is true even though the errors may be so gross that they may demonstrate the unfitness of the directors to manage the corporate affairs.

More recently, in *Daniels v. Thomas, Dean & Hoskins, Inc.*, the court seemed to shift its focus to an objective standard:

Hoskins, Inc., 246 Mont. 125, 139, 804 P.2d 359, 367 (1990) ("Judges are not business experts and therefore should not substitute their judgment for the judgment of the directors").

This Court recognized that when a reasonable basis exists to indicate that directors of a corporation acted in good faith, the directors are immunized from liability for honest errors [citation omitted]. Daniels failed to offer proof that Thomas' actions were unreasonable in that they would not have been taken by 'an ordinarily prudent man . . . in the management of his own affairs of like magnitude and importance.'

The Corporate Law Revision Committee did not attempt to codify either a subjective or objective business judgment rule. No states have codified this complex rule, and judicial interpretations of the rule vary. Some latitude for the courts is desirable. For example, in some cases there is ample evidence of the subjective good faith, or lack thereof. In other cases, there is little or no evidence bearing on subjective good faith, but ample evidence is available against which courts may evaluate objective good faith. Courts need the flexibility to apply a standard which is most judicious. As a result, the legislation permits the statutory duty of care to continue to coexist with the judicially created business judgment rule.

Perhaps the best statement of the business judgment rule is a blending of the objective standard of Daniels and the subjective standard of Ski Roundtop. The drafters of the A.L.I. PRINCIPLES OF CORPORATE GOVERNANCE have stated the rule as follows:

. . . (c) A director or officer who makes a business judgment in good faith fulfills his duty under this section if:

(1) he is not interested . . . in the subject of his business judgment;

(2) he is informed with respect to the subject of his business judgment to the extent he reasonably believes to be appropriate under the circumstances; and

(3) he rationally believes that his business judgment is in the best interests of the corporation.

The words "rationally believe" direct courts to examine a direc-

26. 246 Mont. at 139, 804 P.2d at 367 (quoting Nanfito v. Tekseed Hybrid Co, 341 F. Supp. 240, 244 (D. Neb. 1972)).

27. The drafters of the RMBCA, in an early draft, attempted to codify the business judgment rule. Rev. Model Business Corp. Act § 8.30 at 933 (1984-91) [hereinafter ABA Official Comments]. The drafters recognized that "the scope of the 'business judgment rule' [is] among the most difficult and controversial issues in corporation law today." Id. After receiving numerous objections to the proposal, it was decided that definition of the business judgment rule was "too complex to be handled as part of the broad revision process and . . . should be left to continuing judicial interpretation and development." Id. at 933-34.

28. A.L.I., Principles of Corporate Governance, supra note 19, § 4.01(c) comment, at 223.

29. Id., at § 4.01(c) comment, at 223-24.
tor's subjective beliefs. Not all subjective beliefs, however, are protected from judicial scrutiny. The word “rationally” establishes a limit on the range of acceptable subjective beliefs. Those limits are to be determined by an objective standard of what the reasonable person in a like position might do under similar circumstances.

The business judgment rule serves to create a presumption that the directors acted in good faith and on an informed basis. The Delaware Superior Court accurately describes the business judgment rule as “a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company.”

According to the Delaware Superior Court, “the party attacking a board decision as an uninformed one must rebut the ‘presumption’ that its business judgment was an informed one.” Judgments by the directors, though mistaken, are protected if the directors were informed and not grossly negligent. A director's judgment is grossly negligent if the director's conduct is either without reason, in deliberate disregard of the interest of shareholders or recklessly indifferent to their interests.

The new legislation continues to allow corporations to limit the liability of directors for a violation of the duty of care. Basically, the new law allows shareholders, through a statement in the articles of incorporation, to waive their right to make a claim for most breaches of the duty of care. Permitting this type of waiver allows shareholders to opt out of the statutory and judicial schemes governing the duty of care. However, under the new law,

31. Id. See also Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984). See also A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE, supra note 19 § 4.01 comment, at 184: “Courts, when applying the business judgment rule, have often stated that a ‘presumption’ exists in favor of the propriety or regularity of the actions of the directors and officers. This correctly signifies that no inference of dereliction of duty can or should be drawn from the fact, for example, that a corporation has suffered a business reversal.”
32. Smith, 488 A.2d at 872-73.
34. MONT. CODE ANN. § 35-1-216 (1991) provides in part:
   (2) The articles of incorporation may set forth:
      * * *
   (d) a provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any actions taken or any failure to take any action, as a director, except liability for:
      (i) the amount of a financial benefit received by a director to which the director is not entitled;
      (ii) an intentional infliction of harm on the corporation or the shareholders;
      (iii) a violation of 35-1-713; or
      (iv) an intentional violation of criminal law.
shareholders may not waive their right to recover if the directors' actions amount to an "intentional infliction of harm." The previous law prohibits limitations on director liabilities if the actions amount to "willful misconduct, recklessness, or a knowing violation of law." The Committee wanted to afford the directors reasonable predictability. The new statute is more precise in that terms from the previous statute such as "recklessness" are less capable of determination than the "intentional infliction of harm" standard found in the new statute.

2. Applicability of Duty of Care to Officers

Unlike the previous statute, the new legislation expressly extends the duty of care obligation to officers. The duties of care of directors and of officers, as defined by this statute, are now identical. The new statute, however, probably does not change the law. The Montana Supreme Court has quoted approvingly from legal treatises that state that officers also have a duty of care. Officers, as agents of the corporation, are also in a relationship of trust with the corporation. As such, the officers likewise ought to be subject to a duty of care.

The new legislation does not permit officers of a corporation to benefit from provisions in the articles of incorporation limiting

37. Ski Roundtop, Inc., 202 Mont. at 273, 658 P.2d at 1078, quoting what is now 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1039, at 45 (rev. perm. ed. 1986 & Supp. 1991). ("It is too well settled to admit of controversy that ordinarily neither the directors nor the officers of a corporation are liable for mere mistakes or errors of judgment, either of law or fact.") Not all courts agree, however, that the business judgment rule and the duty of care apply to officers. Platt v. Richardson, 1989 W.L. 159584 (M.D. Pa. June 9, 1989.) ("The business judgment rule applies only to directors of a corporation and not to officers.") But see Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971) ("the decision of executive officers may also come within the [Business Judgment] Rule").

The Comments to the American Law Institute Principles of Corporate Governance also make the observation that the officers' and directors' duties of care are virtually identical: Although most precedents and statutory provisions deal solely with directors, it is relatively well settled that officers will be held to the same duty of care and business judgment standards as directors. Sound public policy points in this direction, as does the little case authority that exists, statutory precedents in at least eighteen states, and the views of most commentators.

A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE, supra note 19, § 4.01 comment, at 179.
38. RESTATEMENT (SECOND) OF AGENCY, supra note 19, § 14C comment b, at 66 (1958) ("In these cases, . . . [an officer is] necessarily an agent, and normally a general agent, of the corporation, since he acts on its behalf and subject to its control exercised through the board of directors").
their own liability. Some states do extend this benefit to officers.\textsuperscript{39} The Committee decided not to permit limitations on the liability of officers because their function is not as discretionary as directors.\textsuperscript{40} Officers are subject to more specific direction from directors than directors are from shareholders. As such, their duties and obligations are clearer than those of directors. Furthermore, officers are more likely to serve as employees, receiving a salary. Because they receive salaries, they are more likely to serve without the benefit of limitations of liability. Officers, the Committee decided, are best protected from liabilities by the indemnification provisions of the statute.\textsuperscript{41}

B. \textit{Statutory Changes to the Duty of Loyalty}

The second major duty of directors and officers is the duty of loyalty. Broadly stated, a duty of loyalty is a duty to act solely for the benefit of the corporation in all matters that come before them. The duty prohibits undue personal profit at the expense of the corporation. The classic statement of the directors' duty of loyalty is found in the Delaware case of \textit{Guth v. Loft, Inc.}\textsuperscript{42}

The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.

The duty of loyalty encompasses at least five subduties:

1. The duty not to "unduly profit individually" or through a related party from a transaction with the corporation.\textsuperscript{43}

2. The duty to avoid causing the corporation to pay oneself excess compensation.\textsuperscript{44}

3. The duty to use corporate property, material, nonpublic corporate information and corporate position only for the benefit of the corporation.\textsuperscript{45}

4. The duty to avoid profiting from corporate opportunities.\textsuperscript{46}


\textsuperscript{40} In the event a person serves as both an officer and director, courts must determine in which capacity the person made the alleged misjudgment to determine whether the person's liability is limited by the corporation's articles.


\textsuperscript{42} 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (1939).

\textsuperscript{43} A.L.I., \textit{Principles of Corporate Governance}, supra note 19, at § 5.02 and § 5.07.

\textsuperscript{44} Id. at § 5.03.

\textsuperscript{45} Id. at § 5.04.

\textsuperscript{46} Id. at § 5.05, ABA \textit{Official Comments}, supra note 27, at § 8.58, at 1142.6-1142.7.
5. The duty to refrain from competing with the corporation.\textsuperscript{47}

Montana statutes have been largely silent as to the specific duties of loyalty of officers and directors. An exception are those statutes relating to “conflict of interest” transactions between the corporation and the directors or parties related to directors. The previous law included a general statement that certain conflict of interest transactions are “void or voidable.”\textsuperscript{48} The statute was unclear as to the exact meaning of “void or voidable” and what action, if any, was required to effectively void a contract. Under the previous law, contracts existed which, unbeknownst to parties relying on them, may be void or voidable. The realities of the business world and the need for certainty in business contracts and transactions dictated a change in the “void or voidable” standard.

The new legislation increases certainty about conflict of interest transactions by adopting a bright line approach. The legislation clearly defines “conflict-of-interest transactions” by identifying which contracts between parties are considered to be between related parties.\textsuperscript{49} The legislation also eliminates any references to “void or voidable” contracts. Instead the legislation provides specific rules governing when contracts may be set aside or enjoined.\textsuperscript{50} Contracts or transactions which are otherwise considered conflict-of-interest transactions, may not be subject to judicial intervention if approved by disinterested shareholders or disinterested directors or are judged to have been fair to the corporation.\textsuperscript{51}

The conflict-of-interest provisions in the new legislation have two notable limitations. First, the legislation does not provide a “laundry list” of all possible types of director violations of the duty of care (e.g., misappropriation of a corporate opportunity). Instead, the statute relies on the courts and case law to continue to identify

\textsuperscript{47} A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE, supra note 19, at § 5.06.
\textsuperscript{48} MONT. CODE ANN. § 35-1-413 (1989).
\textsuperscript{49} MONT. CODE ANN. § 35-1-461(1) & (2) (1991). The new statute defines a related party as:

(a) the spouse or a parent or sibling of a spouse of the director;
(b) a child, grandchild, sibling, parent or spouse of any child, grandchild, sibling, or parent of the director;
(c) an individual having the same residence as the director;
(d) a trust or estate of which an individual . . . [that] is a substantial beneficiary; or
(e) a trust, estate, incompetent person, conservatee, or minor for whom the director is a fiduciary.

\textit{Id.} at (3).
\textsuperscript{50} MONT. CODE ANN. § 35-1-462 (1991).
the full extent of the duty of loyalty. The Committee believed that any attempt to develop a "laundry list" of the subduties to the duty of loyalty would risk excluding some actions which courts should have the flexibility to deem unacceptable. Courts can often apply the principles of the new statute governing conflict-of-interest transactions to other breaches of the duty of loyalty. Usually if a director makes full disclosure and disinterested directors or shareholders approve of the transaction, the transaction does not violate the duty of loyalty.52

The second limitation is that the provisions of the statute deal only with director conflict-of-interest.53 Conflicts-of-interest involving officers of the corporation are not specifically addressed. Because officers are agents, the rules of agency (as well as employer policy) should serve to define the acceptable limits of conduct. Although the duty of directors does not, by statute,54 necessarily apply to officers, the general rules concerning the directors' duty of fair dealing are helpful in analyzing the officers' duties. The American Law Institute, in its Principles of Corporate Governance, has adopted this approach by recognizing that the duty of loyalty is equally applicable to officers (senior executives) and directors.55

C. Controlling Shareholders' and Directors' Duty to Avoid Illegal, Oppressive and Fraudulent Conduct

The duty most significantly changed by the new legislation is the duty of controlling shareholders' and directors' to avoid oppressive conduct. The new legislation provides additional weapons for minority shareholders seeking to realize their reasonable expectations.

The controlling shareholder's and director's duty to avoid conduct that is illegal, oppressive or fraudulent is addressed by both the previous statute56 and the new statute.57 In one sense, the reference to "oppression" buried in the statute is a state legislative acorn grown into a judicial oak,58 because it is the primary remedy available to minority shareholders to combat oppression.

52. ABA Official Comments, supra note 27, at § 8.58 at 1142.7.
55. A.L.I., Principles of Corporate Governance, supra note 19, at § 5.01, at 267.
58. Perhaps the best known reference to a legislative acorn growing into a judicial oak is the reference to Securities Exchange Commission Rule 10b-5 found in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).
1. The Plight of Minority Shareholders

The growth in the number of shareholder dissension cases in the last several decades has been called "phenomenal." In Montana alone, the state supreme court has decided five major cases within the last dozen years. The number of oppression cases is not surprising. As close corporations are handed from the founders to their successors, the cohesiveness that the founders bring to the business is often lost. The successors often have divergent goals for the business. Given the preponderance of close corporations in Montana, developing a procedure to resolve shareholder oppression sensibly was a critical task of the drafting committee.

In order to fashion an appropriate statutory provision addressing corporate dissension, it is necessary to understand its cause. The primary cause of corporate dissension is illiquidity of the interest of minority shareholders. Shareholders in publicly held corporations have the option of selling their stock on an organized stock market if they become dissatisfied, but shareholders in close corporations do not have that luxury.

The plight of a minority shareholder in a close corporation was of particular concern in drafting the new legislation. Typically, the close corporation is a family-owned corporation. Often one or more of the parents founding the corporation have died. One or


63. A close corporation is any business corporation without a ready market for the corporation's stock. See F. O'NEAL & R. THOMPSON, OPPRESSION OF MINORITY SHAREHOLDERS, § 2.15, at 2-38 (2d ed. 1985 & Supp. 1991). The Montana Supreme Court focuses on the relationship between management and ownership in its definition: "a close corporation is one in which management and ownership are 'substantially identical to the extent that it is unrealistic to believe that the judgment of directors will be independent of that of the stockholders.'" Thisted v. Tower Mgmt. Corp., 147 Mont. 1, 14, 409 P.2d 813, 820 (1966) (quoting Symposium, The Close Corporation, 52 Nw. U. L. REV. 345, 345 (1957)).

more of the children frequently operate the business, assuming the position of the formerly dominant parent in the business. Other children have subservient roles in the business or choose employment outside the business. As the sense of obligation to the founders to avoid dissension among the successors fades, the divergent goals of the successors create conflict. Those successors most active in the business often perceive that those less active are unduly benefiting from the more active shareholders’ efforts.

Minority shareholders find that several of their expectations are often violated. Among the expectations most often violated are:

1) that the majority shareholders will negotiate fairly with the minority shareholders;65

2) that the minority may participate in management,66

3) that the majority shareholders will cause the corporation to consent to a reasonable valuation of stock for a shareholder wishing to retire;67

4) payment of dividends or other distributions, if sufficient earnings exist;68

5) the expectation that those in control of the corporation will not use the corporate assets as if they were their own or receive a profit from the corporation in violation of the controlling shareholders’ duty of care.69

Shareholders whose reasonable expectations are ignored by those in control have relatively few alternatives. Unlike shareholders in a publicly held corporation, they are unable to sell their stock on an organized market. In addition, even if the minority shareholder could find someone interested in investing in a close corporation, those investors are not usually interested in buying

into a corporation where minority shareholders' reasonable expectations are disregarded. Usually, the only buyer available is the corporation itself or the oppressive shareholders controlling the corporation. Because they are already in control and the costs associated with dealing with minority shareholders are minimal, the controlling shareholders have little incentive to purchase the shares of the minority.\footnote{See Bahls, supra note 61, at 291-92.}


Under the business judgment rule directors could justify a freeze-out by arguing that it is best for business to keep the profits in the corporation and reward those who stay on the farm. The decision might also satisfy the duty of loyalty because there was no demonstrable transaction in which the directors personally profited. However, the conduct is unlikely to satisfy the duty to meet the reasonable expectations of shareholders, who reasonably expect some opportunity to participate in the management and profits of a successful family farm.
Montana law should recognize a duty not to oppress shareholders in a closely held corporation that is separate from the duties of care and loyalty. Close corporations, by their very nature, do not provide shareholders with a market for their shares. Remedies for oppressed shareholders in a close corporation are easily frustrated by two doctrines: the majority rules doctrine and the business judgment rule. If those in control of the corporation are able to use the majority rules doctrine to justify all decisions, minority shareholders will have virtually no rights. If the majority decides that the original shared expectations no longer suit them, they may use the majority rules doctrine as a sword to cut off the rights of the minority. Similarly, courts should not apply the business judgment rule as a defense in oppression cases. The business judgment rule is a valid defense only if the decisionmaker-defendant is “not interested” in the transaction. Usually, efforts to force out a minority shareholder are a result of the majority’s self interest. Likewise, the business judgment rule creates thorny problems of proof for disempowered minority shareholders. As such, in close corporations, the conduct of the majority should not only withstand the business judgment rule, but satisfy the reasonable expectations of shareholders.

Protection of reasonable expectations is not a new concept; it is well founded in the law:

Although court intervention to protect the reasonable expectations of shareholders is still evolving, the doctrine of protecting reasonable expectations has been termed ‘near the center of the legal universe.’ Contract law protects the reasonable expectations of parties to contracts, property law defines and protects expectations of those who own property, tort law allocates risks partially based on reasonable expectations, and the law of fiduciary obligations also requires the person owing the obligation to fulfill the reasonable expectations of the other.

Not all minority shareholder expectations are reasonable. Subjective hopes and desires that are not reasonable are not protected. Courts, for example, have held that it is not reasonable for a part-time employee-shareholder who “apparently contributed little, if anything,” to the business to expect continued employ-

74. A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE supra note 19, § 4.01(c)(1), at 178.
75. Bahls, supra note 61, at 322.
ment and associated benefits.\textsuperscript{77} Reasonable expectations are usually those recognized by all shareholders at the time they formed the business or those they mutually consented to from the start. Expectations are reasonable when they are known and become part of the basis of operation or continued operation of the business.\textsuperscript{78}

Recent Montana Supreme Court cases which limit bad faith actions should not diminish the statutory protection given to minority shareholders. These recent Montana cases reduced the protection courts give to other types of expectations by significantly reducing the ability of plaintiffs to recover tort damages for a breach of an implied covenant of good faith and fair dealing. In \textit{Story v. City of Bozeman},\textsuperscript{79} the Montana Supreme Court recognized the continued importance of protecting expectations,\textsuperscript{80} but limited the plaintiff's ability to obtain tort damages for a violation of reasonable expectations arising from contract. The \textit{Story} case, then, should not serve to diminish the protection of the reasonable expectations of minority shareholders.\textsuperscript{81} Courts are authorized not by tort law, but by legislation,\textsuperscript{82} to use their equitable powers to

\begin{itemize}
  \item \textsuperscript{78} For a discussion of how to determine which expectations are reasonable, whether expectations change over time and how to determine the reasonable expectations of shareholders admitted after the business is formed, see Bahls, supra note 53, at 325-27.
  \item \textsuperscript{79} 242 Mont. 436, 791 P.2d 767 (1990).
  \item \textsuperscript{80} Id. at 450, 791 P.2d at 775. “Each party to a contract has a justified expectation that the other will act in a reasonable manner.” \textit{Id}.
  \item \textsuperscript{81} Id. at 447-50, 791 P.2d at 774-75. “This Court affixed tort damages against the defendant noting that each party to a contract has a justifiable expectation that the other will act in a reasonable manner in performance or efficient breach of the contract. When one party used its discretion to arbitrarily, capriciously or unreasonably deprive the other party of the benefit of the contract, those expectations were violated. . . . In the typical contract case the \textit{Nicholson} reasoning is still sound, but the \textit{Nicholson} tort remedy is excessive.” \textit{Id}.
  \item \textsuperscript{82} The Montana legislature, for example, enacted \textit{Mont. Code Ann. \S\S 35-1-938 (1991)}, permitting courts to dissolve a corporation if those in control oppressed those not in control. In 1987, the legislature also adopted the Montana Close Corporation Act (the “MCCA”). \textit{See Mont. Code Ann. \S\S 35-9-101 to -504 (1991). See generally Bahls and Quist, The ABA Model Statutory Close Corporation Act: A New Opportunity for 'Made in Montana' Corporations, 49 Mont. L. Rev. 66 (1988). The benefits of the MCCA apply only to those corporations electing its coverage. Mont. Code Ann. \S\S 35-9-103 (1991). The MCCA provides that a court may use its full range of equitable powers to intervene when "directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, fraudulent, or unfairly prejudicial . . . .” Mont. Code Ann. \S 35-9-501(1)(a) (1991). The court may remedy these problems by taking one of a number of actions: setting aside a wrongful action, removing a director, appointing a custodian, ordering the payment of dividends, ordering a share purchase or dissolving the corporation. Mont. Code Ann. \S\S 35-9-502 through 504 (1991). Unfortunately, a small minority of corporations have elected the benefits of the MCCA.
\end{itemize}

Telephone conversation with Garth Jacobson, attorney for the Secretary of State (Dec. 10, 1991). The author speculates that the primary reason for the failure to elect is lack of famil...
resolve shareholder oppression. The Story court recognized that it is important to "discourage oppression" when the parties are in unequal positions and when one places trust in the other. Minor-ity shareholders are in a fiduciary relationship with majority shareholders. If courts do not intervene to protect reasonable expecta-
tions, minority shareholders are likely to suffer recurring oppression at the hands of those in control.

2. Montana Case Law Addressing Oppression in Close Corporations

Over the years Montana courts have attempted to level the playing field by allowing minority shareholders in close corpora-
tions to petition courts for relief when majority shareholders act oppressively. In Thisted v. Tower Management Corp., the Montana Supreme Court recognized that "intracorporate problems arising in a close corporation demand the unusual and extraor-dinary remedies available only in a court of equity." Courts of equity will grant relief "when, in view of all of the circumstances, to deny it would permit one of the parties to suffer a gross wrong at the hands of the other party who brought about the condition."

The Montana Supreme Court applied the rationale of Thisted to a dispute involving a family-owned corporation in Skierka v. Skierka Bros., Inc. In Skierka, a widow and her daughter filed suit against her brother-in-law who was in control of the corporation. The plaintiffs alleged, and the district court agreed, that the following actions amounted to oppression:

1) fixing an unfair stock valuation at which minority share-
holders may sell.
2) carrying on the business without consulting the other shareholders.
3) failing to create an executive vice presidency for a minor-
ity shareholder with power equal to that of a majority shareholder.

83. 242 Mont. at 451, 791 P.2d at 776.
84. 147 Mont. 1, 409 P.2d 813 (1966).
85. Id. at 14, 409 P.2d at 820.
86. Id. at 15, 409 P.2d at 821.
4) excluding the minority shareholders from "any part or voice in the operation . . . except for participation in the annual meeting." 88

The Montana Supreme Court upheld the district court decision even though the district court did not find any violation of contractual rights. Additionally, the court refused to permit the controlling shareholder's conduct on the theory that the controlling shareholders owned more stock than the plaintiff. The court implicitly recognized that the "majority rules" doctrine must not permit majority shareholders to oppress minority shareholders.

In Fox v. 7L Bar Ranch Co., 89 the Montana Supreme Court more clearly defined the obligations of majority shareholders to minority shareholders. The court, relying on the work of the late Professor F. Hodge O'Neal, defined oppression as the violation of the reasonable expectations of the shareholders. 90 The reasonable expectation standard adopted by the Montana Supreme Court is consistent with the standard adopted in other states. 91 In Fox, the court held that the majority shareholder violated the reasonable expectations of minority shareholders. The court specifically found the majority shareholder's failure to cause the corporation to pay dividends, when combined with depriving the minority shareholders "of any voice in management," 92 amounted to a plan to squeeze out minority shareholders.

The court found that the "most persuasive consideration" justifying application of its equitable power was that the relationship between close corporation shareholders is akin to that of partners. 93 In essence, the court found a fiduciary duty that extended beyond the typical duties of a corporation to a shareholder. The

88. Id. at 517, 629 P.2d at 220.
89. 198 Mont. 201, 645 P.2d 929 (1982).
92. Fox v. 7L Bar Ranch Co., 198 Mont. 201, 205, 645 P.2d 929, 931 (1982). The court also found that the majority shareholder violated his duties by causing the corporation to lease properties to a related corporation he controlled for less than fair market value. Id. at 211, 645 P.2d at 934.
93. Id. at 212, 645 P.2d at 935.
court did not rely on a breach of contract analysis or a "majority rules" analysis, but relied upon a breach of fiduciary duties.

The court in Fox also addressed the failure to pay dividends. Courts have traditionally been hesitant to order the payment of dividends. The traditional standard to test whether dividends should be paid is the "abuse of discretion" standard. Typically, abuse of discretion requires a finding of fraud or bad faith. The court rejected these traditional standards in favor of the more progressive "reasonable expectation standard."

Just one year later, in Maddox v. Norman, the Montana Supreme Court seemed to place less emphasis on the reasonable expectation standard. In this case, minority shareholders alleged that the dominant shareholder in a ranching corporation misapplied and wasted funds. Specifically, the minority shareholder alleged that the majority shareholder did not inform her that her father had given her stock until nine years after the gift. During this time period she was not given the opportunity to participate in management and did not receive information about the corporation. The corporation failed to keep separate records and the proceeds of a corporate loan were used to repay a loan on property titled in the majority shareholder's name. The record was replete with financial irregularities, including loans between the corporation and majority shareholder that were not documented. Likewise, proceeds of the sale of calves and crops and rental income from corporate property were deposited in the bank accounts of the majority shareholders.

The Montana Supreme Court refused to overrule the district court's denial of the plaintiff's request to liquidate. The district court held that, "although defendants' conduct was not per forma as to corporate law or the corporation's by-laws, 'its informality was not oppressive toward the plaintiff, nor was she defrauded.'" The district court did not explicitly test the control-
ling shareholders' conduct against the reasonable expectations standard. Instead, it simply stated that the plaintiff had not "demonstrated underlying equities which demand the harsh liquidation remedy."\textsuperscript{104}

The Maddox court, however, did require the corporation to purchase the interest of the minority shareholder against her will. Relying on its general equitable power (as distinguished from its statutory authorization to liquidate),\textsuperscript{105} the court found that it had the power to order sales of stock, when shareholders were "unable to cooperate" in management.\textsuperscript{106}

Recently, the Montana Supreme Court seemed to retreat further from the fiduciary duty and reasonable expectations analysis. In \textit{Daniels v. Thomas, Dean & Hoskins, Inc.},\textsuperscript{107} a minority shareholder sued on both a breach of fiduciary duty theory and a corporate oppression theory. The shareholders alleged that:

1) the majority shareholder induced the minority shareholder to leave his employment on representations he would receive 100% of the "fair value" for his stock;\textsuperscript{108}

2) the majority shareholder used "hardball" negotiation tactics in negotiating for the purchase of stock, including failing to disclose important information and threatening to "bleed the assets" from the corporation if there was not a settlement favorable to the corporation.\textsuperscript{109}

In analyzing the plaintiff's fiduciary duty claim the court reiterated that shareholders in a close corporation are akin to partners.\textsuperscript{110} The court correctly noted that the controlling shareholders have a duty of "utmost good faith and loyalty."\textsuperscript{111} The court further held that the fiduciary duty was owed to "all of the shareholders," not only to the minority shareholder.\textsuperscript{112} The court reasoned that courts are not business experts and should not ordinarily substitute their judgment for that of the directors. Justice Barz, writing for the majority, concluded that "when a reasonable basis exists to indicate that the directors of a corporation acted in good faith, the directors are immunized from liability for honest

\begin{footnotes}
\item[104] Maddox, 206 Mont. at 13, 669 P.2d at 236.
\item[105] MONT. CODE ANN. § 35-1-921 (1989).
\item[106] Maddox, 206 Mont. at 16, 669 P.2d at 238.
\item[107] 246 Mont. 125, 804 P.2d 359 (1990).
\item[108] Id. at 135, 804 P.2d at 365.
\item[109] Id. at 139-40, 804 P.2d at 367-68.
\item[110] Id. at 136, 804 P.2d at 366.
\item[111] Id. at 137, 804 P.2d at 366 (quoting Donahue v. Rodd Electrotype Co., 367 Mass. 578, 593, 328 N.E.2d 505, 515 (1975)).
\item[112] Daniels, at 137, 804 P.2d at 366.
\end{footnotes}
errors."113

The court also analyzed minority shareholders' claims that the acts of the majority shareholder constituted oppression. The minority shareholders' strongest argument was that the corporation's agents, when negotiating a buyout on favorable terms, threatened to "bleed the assets from the corporation" if the minority did not succumb to their demands. The court rejected this claim stating categorically: "Possible future oppressive actions are not sufficient to invoke" the court's power to liquidate the corporation under theories of oppression.114

The court's analysis in Daniels, although citing Skierka and Fox, seems to be a retreat from the reasonable expectations standard. The court focuses not on the reasonable expectations of the minority, but whether the majority has acted with a legitimate business purpose. The change in focus from the expectations of the shareholders to whether there is a legitimate business reason is troublesome because it seems to confuse the controlling shareholders' duty to avoid oppression with the directors' duties of care.

In the Daniels decision, the court may have succumbed to the temptation to decide cases involving dissension in close corporations by applying the majority rule doctrine and the business judgment rule. In the Daniels decision, those in control of the corporation threatened to "bleed the assets" from the corporation if the minority did not accept the majority's offer for his stock.115 The court allowed this conduct, in part because of the protections afforded by the business judgment rule116 and in part because of the majority rules doctrine.117 As previously discussed, the proper standard is whether the reasonable expectations of the shareholders have been violated.118

In the Daniels case, the court also confused the standard necessary to satisfy the duty of loyalty with the standard necessary to satisfy the duty of care. When analyzing whether the duty of loy-

113. Id. at 139, 804 P.2d at 367.
114. Id. at 141, 804 P.2d at 368.
115. Id.
116. Id. at 137-38, 804 P.2d at 366. "However, the controlling group should not be stymied by a minority stockholder's grievances if the controlling group can demonstrate a legitimate business purpose and the minority stockholder cannot demonstrate a less harmful alternative." Id.
117. Id. at 138, 804 P.2d at 367 (controlling shareholders' duties to "all of the shareholders") (emphasis in original).
alty of those in control of the corporation had been satisfied, the court correctly cited such cases as *Donahue v. Rodd Electrotype Co.* The duty of loyalty provides that those in control must not "act out of avarice, expediency or self interest" in degradation of their duty to the corporation or its shareholders. The Montana Supreme Court then stated that "the controlling group should not be stymied by a minority stockholder's grievance if the controlling group can demonstrate a legitimate business purpose and the minority stockholder cannot demonstrate a less harmful alternative." The defense of "legitimate business purpose" is also known as the business judgment rule defense. Satisfying the business judgment rule is a defense against the duty of care, not a defense against the duty of loyalty. Additionally, the business judgment rule does not apply to those transactions where the director has a personal interest.

3. Impact of New Legislation

The new legislation makes significant changes in the law concerning the duty of majority shareholders to avoid oppression of minority shareholders. It changes the threshold standards defining when courts may use their equitable powers and it defines a broader range of equitable powers available to courts.

a. Threshold Standard for Judicial Intervention

The MBCA broadens the threshold standard for a finding of oppression. The new legislation allows the court to dissolve a corporation if, "in a proceeding by a shareholder . . . it is established that . . . the directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent." The previous statute allowed dissolution only

119. 367 Mass. 578, 328 N.E.2d 505 (1975). In *Donahue* the board caused the corporation to purchase the stock of a retiring shareholder who was the father of the majority shareholders at a premium price. The court held that "[s]tockholders in close corporations must discharge their management and stockholder responsibilities in conformity with [a] strict good faith standard." *Id.* at 593, 328 N.E.2d at 515.

120. *Id.* at 593, 328 N.E.2d at 515, cited with approval in *Daniels*, 246 Mont. at 137, 804 P.2d at 366.

121. *Daniels*, 246 Mont. at 137-38, 804 P.2d at 366.


124. Id. at 228-29.

when the directors' actions actually were "illegal, oppressive, or fraudulent." 126 By adding the provisions that a demonstration that directors "will act" in a manner that is illegal, fraudulent, or oppressive, the legislature has established that threats of future oppressive actions are sufficient for the courts to invoke their equitable powers.

The change in the law is a needed one. Threats of future oppressive action certainly violate the reasonable expectations of shareholders. Frequently, majority shareholders and directors exact concessions from minority shareholders by threatening to take certain illegal actions (e.g., withholding dividends or eliminating minority shareholders' participation) if the minority shareholders will not sell their stock at a bargain price or if the minority will not take some other action favorable to the majority. Such threats, if successful in coercing shareholders to "agree" to surrender their rights, are as inimical as other more direct techniques calculated to derive minority shareholders of their rights.

The changes in the statute serve to call into question (and probably overrule) part of the Daniels case. In Daniels, the majority shareholders allegedly attempted to force the minority shareholders to accept a low valuation of the property by threatening illegal actions. The court found that the threats did not amount to oppression:

The court's finding that Thomas made a statement in which he threatened to bleed the assets from T & D Properties also does not rise to the level of oppressive conduct that would warrant the ordering of T & D Properties to buy Daniels' shares. Possible future oppressive actions are not sufficient to invoke § 35-1-921, MCA. On the other hand, if Thomas were to carry through with his threats, Daniels may then have had a legitimate cause of action in which he could allege that Thomas was engaging in oppressive actions against him as a minority shareholder. However, the mere possibility of oppression is not sufficient to warrant the remedy the District Court ordered here. 127

The facts of the Daniels case demonstrate the importance of the changes in the law. If the court is unable to utilize its equitable powers until the damage is done, it is forced to attempt to remedy a wrong which may have caused irreparable harm. If the court may intervene prior to the damage done, it may use its equitable powers to prevent unnecessary losses.

127. Daniels, 246 Mont. at 141, 804 P.2d at 368-69 (emphasis added).

https://scholarship.law.umt.edu/mlr/vol53/iss1/1
b. Discretion to Grant Other Forms of Equitable Relief

The new legislation expressly allows the courts to exercise their broad equitable powers to fashion remedies other than dissolution.\(^{128}\) The statute gives the court broad authority to make "any order to grant relief . . . as, in its discretion, it considers appropriate."\(^{129}\) That relief may include altering the bylaws, altering a corporate resolution, directing or prohibiting certain actions of directors and officers, or requiring a compelled purchase of shares. In addition, the statute establishes a procedure by which courts may remove directors "engaged in fraudulent or dishonest conduct or in gross abuse of authority or discretion . . . [if] removal is in the best interest of the corporation."\(^{130}\)

These new statutory provisions codify part of the holding of

\(^{128}\) MONT. CODE ANN. § 35-1-939 (1991) states:
Discretion of court to grant relief other than dissolution. (1) In any action filed by a shareholder or director to dissolve the corporation on the grounds enumerated in 35-1-938, the court may make any order to grant the relief other than dissolution as, in its discretion, it considers appropriate, including, without limitation, an order.
(a) canceling or altering any provision contained in the articles of incorporation, in any amendment of the articles of incorporation, or in the bylaws of the corporation;
(b) canceling, altering, or enjoining any resolution or other act of the corporation;
(c) directing or prohibiting any act of the corporation or of shareholders, directors, officers, or other persons party to the action; or
(d) providing for the purchase at fair value of shares of any shareholder, either by the corporation or by other shareholders.
(2) Relief under subsection (1) may be granted as an alternative to a decree of dissolution or may be granted whenever, under the circumstances of the case, relief but not dissolution would be appropriate.

This statute is similar to a former Maine statute. See, e.g., ME. REV. STAT. ANN. tit. 13A, § 1123 (West 1981).

The new statute expressly authorizing repurchase of shares should avoid the problem caused by cases such as the Minnesota case of Sundberg v. Lampert Lumber Co., 390 N.W.2d 352 (Minn. Ct. App. 1986). Like the Montana statutes prior to the legislative changes, the Minnesota statutes expressly permitted courts to order share repurchases for statutory close corporations but were silent as to court authority to order share repurchases for all other corporations. MINN. STAT. ANN. § 302A.741 (West 1985). In Sundberg, the court found that because share repurchase was not specifically authorized, except for statutory close corporations, the courts could not so order for a business corporation. 390 N.W.2d at 357.


\(^{130}\) MONT. CODE ANN. § 35-1-425(1)(a), (b) (1991). Courts may well have the power to remove directors even absent statutory authorization. See Brown v. North Ventura Road Dev. Co., 216 Cal. App. 2d 227, 232, 30 Cal. Rptr. 568, 571 (1963) ("since directors hold a position of trust, judicial power to remove them exists independently of statute.") Cf. Harkey v. Mobley, 552 S.W.2d 79, 81 (Mo. Ct. App. 1977) (taking the position that, because the statute allowing removal was repealed, the court could not remove the director).
Maddox v. Norman. Quoting the Alaska Supreme Court case of Alaska Plastics, Inc. v. Coppock, the Montana Supreme Court in Maddox held:

Liquidation is an extreme remedy. In a sense, forced dissolution allows minority shareholders to exercise retaliatory oppression against the majority. Absent compelling circumstances, courts often are reluctant to order involuntary dissolution. [citations omitted] As a result, courts have recognized alternative remedies based upon their inherent equitable powers. Thus, in Baker, . . . the court authorized numerous alternative remedies for oppressive or fraudulent conduct by the majority. Among those would be:

'An order requiring the corporation or a majority of its stockholders to purchase the stock of the minority shareholders at a price to be determined according to a specified formula or at a price determined by the court to be a fair and reasonable price.' (footnote omitted).

The Montana Supreme Court in Maddox followed the modern trend of courts using their equitable powers broadly and creatively to resolve shareholder oppression and protect the reasonable expectations of the shareholder. In addition to ordering dissolution of a corporation, courts have, with increasing frequency, ordered:

1) The corporation or a shareholder to purchase the shares of another (usually the minority) shareholder.
2) Partition of the property of the corporation.
3) Payment of dividends.
4) Appointment of special fiscal agents, receivers, or provisional directors to assist under the operation of the corporation.
5) Removal of directors.
6) Forfeiture of controlling shareholders’ salaries.
7) Setting aside corporate actions.
8) An accounting.

The new statute provides little guidance as to which of its eq-

133. 206 Mont. at 15, 669 P.2d at 237-38 (emphasis in original).
134. Bahls, supra note 61, at 294-312.
135. Id. at 298-305.
136. Id. at 305-06.
137. Id. at 307-06.
138. Id. at 308-11.
139. Id. at 311.
140. Id.
141. Id.
142. Id.
suitable powers a court should use when resolving shareholder oppression. A method of determining the most appropriate equitable remedy cannot be reduced to a mathematical formula. Instead, courts should develop general standards for evaluating the facts and circumstances of each case. The following standards allow courts to arrive at solutions that are both equitable and efficient:

1) The remedy should maximize the ability of minority shareholders to realize their reasonable expectations.
2) The remedy should minimize the administrative costs associated with resolving the dissension.
3) The remedy should maximize the value of the economic unit while allowing shareholders to realize value in accordance with their reasonable expectations.¹⁴³

Courts should fashion equitable remedies to meet shareholders’ reasonable expectations, so that minority shareholders will realize the benefit of their bargained for participation in the corporation. As such, if the shareholders reasonably expect the payment of dividends in a profitable close corporation, the court could order payment of dividends. If one director is frequently using his or her corporate position for self-dealing, the court could order removal of the director or appointment of a custodian to review expenses.

Courts must also minimize administrative costs associated with resolving shareholder disputes. Administrative costs include not only the costs of the court’s time, but also the costs of attorneys’ fees, filing fees and the added costs of management complying with a court order. If recurring litigation is likely, it may not be efficient for the court, in effect, to manage the corporation by setting aside or ordering various corporate actions. If courts find continuing irreconcilable deadlock or oppression, the costs of using its equitable power to manage the corporation in such a way as to meet the reasonable expectations of the shareholders may be too high. In those cases, partitioning the business, ordering a dissolution or ordering a buyout of a shareholder may be the only viable solutions.

Court-ordered remedies should maximize the value of the business and allow shareholders to realize value in accordance with their proportional interests. Typically, then, courts should not order a dissolution and liquidation of the corporation. A liquidation of a business is a draconian solution resulting in considerable economic waste. Businesses that are liquidated often lose the going concern value, thereby penalizing both the majority and minor-

¹⁴³. Id. at 320.
ity. Instead, in cases of irreconcilable deadlock or oppression, if the court is unable to order surgically precise remedies (e.g., ordering payment of dividends, voiding a corporate action), it should consider other remedies that do not involve a loss of the going concern value of the firm. One of those remedies is partitioning the business. While partitioning of a business such as a large family ranch into two viable economic units may be successful, partitioning other businesses into viable economic units may not be possible.

Sadly, the most efficient and equitable solution may be the forced buyout of a shareholder. While a forced buyout of a shareholder may not allow that shareholder to realize his or her expectation to participate in a business, it may allow the shareholder to realize his or her expected pro-rata value of the firm. To fulfill that expectation, courts should value the shareholders' interest in the firm in such a way as to allow the shareholder to realize his or her full fair market value of the firm. Shareholders whose shares are purchased should not be forced to sacrifice any element of value representing the going concern value of the firm. Shareholders usually expect that they will all be treated equally. Minority shareholders usually expect they will receive their full pro-rata value of the firm, without a discount for minority shares. The new legislation allows courts to use their broad equitable powers to provide both equitable and efficient solutions.

144. Id. at 330-32.
145. Id. at 330-36.
146. Id. at 301-03.
147. One commentator has suggested that to allow courts to select from one of a broad range of equitable solutions is an "ad hoc approach" that "diminishes the certainty of future judicial outcomes that, in turn, causes both courts and litigants to increase expenditures in the litigation process." Schermerhorn, Efficiency vs. Equity in Close Corporations, 52 Mont. L. Rev. 73, 87 (1991). To reduce these costs, a statute could rely on self-policing mechanisms. Schermerhorn suggests that the most "effective self-policing mechanism that is absent from [the Montana statute] is dissolution-at-will rights." Id. at 86. According to Schermerhorn "depriving the minority shareholders of dissolution-at-will rights greatly decreases the value of their interests." Id. at 87.

Schermerhorn's suggestion that minority shareholders should have dissolution-at-will rights is troublesome. Granting dissolution-at-will rights reduces the value of the corporation. Dissolution-at-will rights mean that at any time, for any reason, any shareholder is able to force the firm into dissolution and liquidation. Untimely liquidations risk loss of the going concern value of the firm for all shareholders. With such a weapon in hand, the opportunistic minority shareholder holds a sword over the heads of all majority shareholders, even those who satisfy the reasonable expectations of minority shareholders.

The new legislation does not give shareholders the ability to force dissolution-at-will. Instead, the shareholder must demonstrate illegality, fraud or oppression before courts may dissolve the corporation. Mont. Code Ann. § 35-1-938 (1991). Even then, the new statute recognizes that dissolution may not be efficient and provides for a broad range of other remedies. While Schermerhorn properly recognizes that efficient solutions minimize court...
III. Legislative Changes Governing Derivative Actions

A second significant area of change under the new statute involves derivative actions. During the 1980s, state courts in other jurisdictions provoked a meaningful shift in the rules concerning derivative actions. This shift in the rules has largely bypassed Montana, because there have been no major derivative action cases decided by the Montana Supreme Court since 1978. The Corporate Law Revision Committee was impressed with the direction of many of these cases from other jurisdictions, particularly those decided by the Delaware courts. The Committee successfully recommended adoption of the ABA Revised Model Act provisions codifying many of these concepts.

A derivative action is an action brought by one or more shareholders to enforce a right belonging to a corporation. It is “an invention of equity to supply the want of an adequate remedy at law to redress breaches of fiduciary duty” by those in control of a corporation. Most derivative actions are brought against directors and/or officers alleging a breach of their duties of care and loyalty. A derivative action is appropriate when the damage done by the defendant officers and directors is primarily suffered by the corporation. Derivative actions are to be distinguished from direct actions. Direct actions are actions shareholders bring against officers for damages to the shareholders that are separate and distinct from those suffered by the corporation or other shareholders generally. In a derivative action, shareholders as a group suffer damages (usually diminution of the value of their stock). In a derivative action, the corporation itself is entitled to recover; in a direct action, recovery goes to the shareholder directly.

The Corporate Law Revision Committee balanced several policy considerations when deciding to opt for the ABA’s Revised...
Model Act. Procedural limitations should not frustrate shareholders with valid claims for a breach of the duty of care or the duty of loyalty. Management of a corporation, however, should not have to spend valuable resources defending a derivative action when the action is nothing more than a strike or nuisance suit. Defense of frivolous actions saps time and energy from corporate management. The Committee also recognized that, because management of the corporation is left to the directors, as a general rule, management of lawsuits ought to be left to directors. When, however, directors cannot act without self interest, courts should permit derivative lawsuits to proceed to a resolution on the merits of the cases.

A. Statutory Modifications to the Demand Requirement on Directors

Montana corporate law has long required that before a shareholder may bring a derivative action, the shareholder must make a demand on the corporation that the board of directors provide relief from the grievance. This rule assumes that after a demand is made, the corporation might provide the relief requested, obtain reimbursement from the offending director or officer, or commence action against the offender. The Montana Rules of Civil Procedure state that in derivative actions, the complaint must "allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors . . . ." A demand on the


155. Mont. R. Civ. P. 23.1. The Montana Rules of Civil Procedure also require the shareholders to "allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires . . . , if necessary, from the shareholders." Id. (emphasis added). The provisions of the Montana Business Corporation Act do not require that a demand be made on shareholders. The "if necessary" language of the Montana Rules of Civil Procedure means that whether a demand on shareholders is necessary is left to the relevant business corporation law. See D. Block, supra note 19, at 488-89.

The legislation does not state whether the shareholder bringing the derivative action must first make a demand on other shareholders. At least one older Montana Supreme Court case required a demand on shareholders. Allen v. Montana Refining Co., 71 Mont. 105, 227 P. 582 (1924). In Allen, the court stated:

If the subject matter of the stockholder's complaint is for any reason within the immediate control, direction, or power of confirmation of the body of stockholders it should be brought to the attention of such stockholder for action, before an action is commenced by a stockholder, unless it clearly appears by the complaint that such application is useless.
board gives the corporation an opportunity to decide whether or not to pursue the issue itself. The board must decide whether the potential recovery justifies the time and expense associated with recovery.

Although courts have provided that a shareholder must normally make a demand on directors, courts have developed several exceptions to the general rule for times when the circumstances would make the demand futile. In its most recent case involving derivative actions, the Montana Supreme Court described four situations when demand is excused because it would be futile:

1) [A] majority of the present board participated in, approved of, or benefitted from the alleged wrongful acts;
2) [T]he board, although aware of wrongful acts failed to take action itself, instead conspiring to conceal these acts from the shareholders;
3) [T]he individual defendants dominate and control the corporation; and
4) [D]emand would have required the board to institute action

_id._ at 123, 227 P. at 587.

The holding of the _Allen_ case, if still valid, would necessitate a demand on shareholders when shareholders are capable of ratifying the complained about actions. In cases involving conflicts of interest, for example, state law expressly permits shareholder ratification of contracts that might otherwise violate the duty of loyalty. _Mont. Code Ann._ § 35-1-464 (1991).

The holding of the _Allen_ case has been long criticized. In a 1942 law review note, Grover C. Schmidt, Jr. argued that "[t]he course of Montana decisions up to the _Allen_ case [did not] require application to the shareholders where there was a recognized corporate cause of action . . . ." Note, _Corporations: Limitation Upon the Right of a Stockholder to Bring a Representative Suit in Montana_, 3 _Mont. L. Rev._ 105, 109-10 (1942). Schmidt concluded: "Consequently, the natural result of adherence to the rule of the _Allen_ case is to hog-tie individual stockholders and facilitate management without corresponding ownership, thus making it easier for the directors and managers to avoid being held accountable for their acts even including positive frauds." _Id._ at 110.

The _Allen_ case should not serve to require a demand on shareholders under the current law. The current statutory provisions governing derivative actions are more detailed than previous statutes and occupy the field. The statutes only require a demand on directors, but do not require a demand on shareholders. See D. Block, _supra_ note 19, at 489.

The rule that a demand on shareholders is not a prerequisite for a derivative suit is consistent with the Montana Business Corporation Act. The Act leaves management decisions to the directors, not the shareholders. _Mont. Code Ann._ § 35-1-416(2) (1991). As a general rule, the Act does not contemplate or provide a procedure by which shareholders may ratify most management decisions. In those cases in which shareholders do have the power to ratify corporate actions (e.g., _Mont. Code Ann._ § 35-1-464 (1991), the directors, once demand is made upon them, may still ask shareholders to ratify the transaction in question. Ratification by shareholders, if in compliance with state law, would presumably preclude the derivative action. In cases where shareholders do not have the power to ratify board action, demand on shareholders would most always be futile because shareholders cannot, short of removing and replacing directors, force directors to take any specific action. _See_ Mayer v. Adams, 39 Del. Ch. 298, 141 A.2d 458, 462-65 (1958). Similarly, if a demand on shareholders were necessary, the intent of the provisions of the Montana Business Corporation Act to eliminate unnecessary litigation over procedural barriers would be frustrated.
against itself.\textsuperscript{156}

In each of these instances, the Montana Supreme Court assumed that the directors could not apply independent judgment to ascertain whether the plaintiff's claim necessitated action.

The exceptions created by the Montana Supreme Court to the rule that shareholders must make a demand are so broad as to nearly swallow the rule. In most cases involving breach of duty, the directors have either approved of the decision, or were aware of it and did not take corrective action. In many cases, those controlling the corporation are the same as the potential defendants. In most cases, then, under the previous law demand would be excused.

The previous rules that purport to require demand, but easily excuse it, create a number of problems. A good deal of judicial time is potentially wasted determining whether or not demand should be excused. This issue serves only to lengthen the amount of time it takes the court to get at the heart of the controversy. Similarly, the easy waiver of demand is misguided. Even if directors are interested in the transaction, a formal demand may still have utility. A demand on the board gives the board the opportunity "to reexamine the act complained of in light of the potential lawsuit and take corrective action."\textsuperscript{157}

The new statute includes a universal demand rule requiring a demand at least 90 days prior to the commencement of the lawsuit in all cases, except those in which "irreparable injury to the corporation would result" by waiting for 90 days.\textsuperscript{158} This provision overrules the judicially created exceptions to demand found in \textit{S-W Company}. The new statute should eliminate needless litigation over demand requirements and allow courts to move quickly to the issue of whether the suit is in the best interest of the corporation.

\textbf{B. Statutory Clarification of the Board's Power to Dismiss an Action}

Once a demand has been made and either rejected or ninety days has elapsed, the shareholder may file a derivative action.\textsuperscript{160} At this point, however, an independent board may seek to dismiss the lawsuit.\textsuperscript{160} The Committee believes that the statute should permit the board, applying independent business judgment, to terminate

\begin{itemize}
\item \textsuperscript{156} S-W Co. v. John Wight, Inc., 179 Mont. at 403, 587 P.2d at 354.
\item \textsuperscript{157} ABA \textit{OFFICIAL COMMENTS}, \textit{supra} note 27, § 7.42, at 778.2.
\item \textsuperscript{158} \textit{MONT. CODE ANN.} § 35-1-543 (1991).
\item \textsuperscript{159} \textit{MONT. CODE ANN.} § 35-1-543 (1991).
\item \textsuperscript{160} \textit{MONT. CODE ANN.} § 35-1-545 (1991).
\end{itemize}
litigation. Management of the corporation is with the board. If the board cannot control lawsuits brought on behalf of the corporation, its management rights are limited. Even when the board determines that an officer or one of its members breached a duty, it may make a legitimate business judgment not to pursue the litigation. As Judge Easterbrook aptly states:

> If the directors run the show, then they must control litigation (versus other remedies) to the same extent as they make the initial business decision. They may conclude that internal remedies such as discharge or a reduction in compensation are more cost-effective for the firm. A lawsuit that seems to have good prospects and a positive value (net of attorneys’ fees) still may be an unwise business decision because of the value of managerial time that would have to be invested, time unavailable to pursue the principal business of the corporation. Similarly, a lawsuit that appears to have a negative net value may be useful to the firm if it deters future misconduct.\(^{161}\)

Following Judge Easterbrook’s rationale, judicial decisions in numerous jurisdictions permit directors to dismiss lawsuits in certain circumstances. In Montana, for example, even prior to the new legislation, if a demand was made and refused by the board, courts did not always permit a derivative action to proceed. In *Brooks v. Brooks Pontiac, Inc.*, the Montana Supreme Court recognized that as a general rule it is in the directors’ discretion whether to sue.\(^{162}\) If directors “act in good faith, their refusal to sue violates no right of dissenting stockholders, so as to entitle them to maintain a suit in their own behalf.”\(^{163}\)

Perhaps the best analysis of the power of a corporate board to dismiss a suit is found in the Delaware case of *Zapata Corp. v. Maldonado*.\(^{164}\) In this case, the Delaware Supreme Court observed that derivative suits have the effect of allowing the shareholders to “invade the discretionary field committed to the judgment of the directors . . . .”\(^{165}\) Unless a board decision to seek dismissal of a suit is “wrongful,” its decision should be respected. According to the Delaware court, “[a]bsent a wrongful refusal, the stockholder in such a situation [his or her demand being refused] simply lacks

---

163. 143 Mont. at 260, 389 P.2d at 187 (quoting Goodwin v. Castleton, 19 Wash. 2d 748, 762, 144 P.2d 725, 732 (1944)).
165. *Id.* at 783 (quoting McKee v. Rogers, 156 A. 191, 193 (Del. Ch. 1931)).
legal managerial power."\textsuperscript{166} The Delaware court then found that the board, or a committee of the board, could effectively dismiss a derivative action if it was independent and acted in good faith, after a reasonable investigation.\textsuperscript{167} It is these concepts of independence (of the board or a committee), good faith and reasonable investigation found in Zapata,\textsuperscript{168} that have been codified by the Montana statute.\textsuperscript{169}

The new legislation provides that the decision to dismiss a suit may be made either by a vote of the independent directors, if they constitute a quorum, or the vote of a committee of independent directors.\textsuperscript{170} In addition, "upon motion by the corporation, the court may appoint a panel of one or more independent persons to make a determination of whether the maintenance of the derivative proceeding is in the best interests of the corporation."\textsuperscript{171} The statute provides guidance as to which directors are considered independent. According to the statute, none of the following will cause a director to lose his or her independent status:

(a) the nomination or election of the director by persons who are defendants in the derivative proceeding or against whom action is demanded;
(b) the naming of the director as a defendant in the derivative proceeding or as a person against whom action is demanded; or
(c) the approval by the director of the act being challenged in the derivative proceeding or demand if the act resulted in no personal benefit to the director.\textsuperscript{172}

These definitions are consistent with those described by Delaware courts.\textsuperscript{173} Thus, the definition of independent directors is broader than that implicit in S-W Company. In S-W Company, the court implied that directors were not independent if they were named as defendants or if they approved of the transaction.\textsuperscript{174} The new statute supplants the definition of independence implicit in S-W Company. The rationale for rejecting the S-W Company view of independence is twofold. First, if the S-W Company position that

\textsuperscript{166} Id. at 784.
\textsuperscript{167} Id. at 788-89.
\textsuperscript{168} Id. at 784-89.
\textsuperscript{173} See Aronson v. Lewis, 473 A.2d 805, 812-16 (Del. 1984).
\textsuperscript{174} See S-W Co. v. John Wight, Inc., 179 Mont. 392, 403, 587 P.2d 348, 354 (1978) (dealing with the issue of independence for purposes of determining whether a demand is futile).
a director is not independent if he is a defendant in a derivative action is followed, directors will seldom be considered independent. As such, directors would seldom be allowed to exercise their business judgment to dismiss a suit. Second, creating artificial presumption of lack of independence is not necessary because court approval is necessary to dismiss the suit. The court, before granting a motion to dismiss a derivative suit, should look for actual loss of independence or bias. As the ABA Official Comments state: "court[s] will be able to assess any actual bias in deciding whether the director is independent without any presumptions arising out of the method of the director's appointment, the mere naming of the directors as a defendant or the directors' approval of the act . . . ."175

In determining whether the directors or a committee of directors are independent, courts should make two inquiries. First, courts should examine whether the directors in question appear on both sides of the transaction or whether the directors expect to derive a pecuniary benefit which is not available to the corporation and other shareholders generally.176 Second, courts should determine whether the directors are otherwise beholden to the alleged wrongdoer in a way likely to affect their judgment. In making this determination, courts should look to familial relationships, other personal relationships and whether the director has a close financial or business interest with the wrongdoer.177

The new Montana Business Corporation Act also clarifies that board committees composed of independent directors may dismiss lawsuits.178 An independent board committee may be appointed by independent directors, whether or not those independent directors constitute a quorum.179 Permitting independent directors to make a determination dismissing a lawsuit is consistent with Montana law permitting board committees to make decisions otherwise required to be made by directors.180 The modification is also consistent with modern trends in the case law. For example, in Zapata Corp. v. Maldonado,181 the Delaware Supreme Court addressed the issue of whether board committees could dismiss a derivative action, and, if so, whether the same is true if the board itself is not

175. ABA Official Comments, supra note 27, § 7.44, at 778.10.
177. See A.L.I., Principles of Corporate Governance, supra note 19, § 1.18(a)(2), at 29.
independent. The court decided that board committees were empowered to dismiss derivative lawsuits. In Zapata, however, the court acknowledged the risk that the director members of the committee might be hesitant to pass judgment on fellow directors. In the words of the court, "[T]he question naturally arises whether a 'there but for the grace of God go I' empathy might not play a role." To mitigate this problem, the court stated it would examine two issues when a committee requests dismissal of a lawsuit. First, it would examine the independence and good faith of the committee and the reasonableness of an investigation done by the committee. The corporation would have the burden of proving independence, good faith and reasonableness of the decision. Second, the court would "determine, applying its own independent business judgment" whether the suit ought to be dismissed.

The Delaware court in Zapata was rightfully concerned that a committee of directors may, consciously or subconsciously, give their nonindependent colleagues the benefit of the doubt. The Corporate Law Revision Committee, however, did not agree with the Delaware court's suggested resolution of the problem, that a court apply its own independent business judgment. Montana courts have been hesitant to apply their own independent business judgment to disputes. For courts to apply their own independent judgment entangles courts unduly in management of the corporation. This entanglement requires courts to make judgments that judges are often not in a position to make. Instead, the Montana legislation places the burdens of proof on the corporation when the majority of the board members are not independent. The party with the burden must demonstrate that the directors or a committee has (a) in good faith, (b) after conducting a reasonable inquiry upon which its conclusions are based (c) determined that the pro-

182. Id. at 785.
183. Id. at 787. See also Hasan v. Clevertrust Realty Investors, 729 F.2d 372, 376-77 (6th Cir. 1984).
184. Zapata at 788.
185. Id.
186. Id. at 789.
187. Noble v. Farmers Union Trading Co., 123 Mont. 518, 541, 216 P.2d 925, 936-37 (1950) (quoting Goodwin v. Castleton, 19 Wash. 2d 748, 762-63, 144 P.2d 725, 732 (1944) "[t]he exercise of such discretion by the directors will not be lightly set aside by the court, and where a stockholder complains of such action of the directors the court will consider the circumstances, and, if no bad faith is shown, will decline to substitute the judgment of the stockholder for that of the managing directors").
188. MONT. CODE ANN. § 35-1-545(5) (1991). The general rule is if the majority of the board members is independent, the plaintiff has the burden. Id.
ceeding is not in the best interest of the corporation. The statute does not anticipate that courts will apply their own independent business judgment. Instead, courts should limit their review to deciding whether the determination made by the board or a committee "has some support in the findings of the inquiry."160

C. Statutory Provisions Governing Payment of Expenses

The new legislation191 clarifies the obligations of the losing party to pay the winning party's expenses. The legislation continues the provisions of the previous law192 allowing the court to require the plaintiff to pay the defendant's reasonable fees and expenses if the action was brought without reasonable cause or for an improper purpose. The previous statutory law was silent as to any corresponding duty of the corporation to pay the successful plaintiff's fees. The new statute provides that a court may order the corporation to pay the plaintiff's fees and expenses if the court finds the derivative suit resulted in substantial benefit to the corporation. This provision serves to codify existing state193 and federal194 case law.

IV. LEGISLATIVE CHANGES GOVERNING CLAIMS AGAINST DISSOLVED CORPORATIONS

Members of the Corporate Law Revision Committee perceived of too many instances of corporations dissolving (often by way of administrative dissolution) but not fully providing for their debts. Committee members were particularly concerned when corporations dissolve and distribute assets to shareholders but do not adequately provide for their debts. At the same time, Committee members recognized that legislation should allow those corporations making provisions for their debts to distribute any excess assets to shareholders. Because courts historically encounter diffi-

189. MONT. CODE ANN. § 35-1-545(1) (1991). This general rule is consistent with previous Montana cases. See, e.g., Noble v. Farmers Union Trading Co., 123 Mont. at 542, 216 P.2d at 937 ("stockholders bringing such action not only have the burden of proving the material charges entitling the corporation itself to recover, but they must also establish the grounds entitling them to sue in place of the corporation").
190. ABA OFFICIAL COMMENTS, supra note 20, § 7.44, at 778.15. ("Finally, section 7.44 does not authorize the court to review the reasonableness of the determination. As discussed above, the phrase in Section 744(a) 'upon which its conclusions are based' limits judicial review to whether the determination has some support in the findings of the inquiry.")
culty balancing the rights of creditors against the expectations of shareholders, it is appropriate that the legislature strike that balance.\textsuperscript{195} The Committee addressed the issue of payment of debts of dissolved corporations by adopting four changes in the law. First, the new law provides, in certain cases, that known claims against dissolved corporations must be made within a relatively short period of time.\textsuperscript{196} Second, the legislation removes the old five-year limitation on corporate survival period in which unknown claims must be made.\textsuperscript{197} Third, the statute codifies the common law trust fund doctrine.\textsuperscript{198} Finally, the statute provides that the rules governing dissolution for domestic corporations apply to foreign corporations transacting business in Montana for unknown claims otherwise arising or accruing under Montana law.\textsuperscript{199}

\textbf{A. Known Claims Against Dissolved Corporations}

Previous law required that dissolving corporations file a statement of intent to dissolve prior to filing articles of dissolution.\textsuperscript{200} Upon the filing of the statement of intent to dissolve, the corporation ceased doing business, except that business necessary to wind up its affairs.\textsuperscript{201} After filing the statement of intent to dissolve, the law provided that the corporation would notify its known creditors.\textsuperscript{202} The corporation then collected its assets, liquidated its properties and paid its liabilities.\textsuperscript{203} When the corporation paid its debts (or made adequate provisions for paying its debts), the corporation would file articles of dissolution.\textsuperscript{204} The statute required that the articles of dissolution state that "all debts, obligations, and liabilities of the corporation have been paid and

\begin{flushleft}
\textsuperscript{195} See, e.g., Gonzales v. Progressive Tool & Die Co., 463 F. Supp. 117, 120 (E.D.N.Y. 1979). In Gonzales, the court noted:

The inquiry thus must be as to what the legislature would have done had it considered the issue against the background of the common law. This inevitably entails the weighing of conflicting policies, that of corporate repose and certainty and that of compensating the injured . . . .

A legislature, far more than a court, has the capability of determining the extent of the problem and of assessing accurately the overall effect of the choice of one policy over another.

\textit{Id.} at 120.

\textsuperscript{196} See infra text accompanying notes 201-10.

\textsuperscript{197} See infra text accompanying notes 211-27.

\textsuperscript{198} See infra text accompanying notes 228-31.

\textsuperscript{199} See infra text accompanying notes 232-47.

\textsuperscript{200} MONT. CODE ANN. \S 35-1-904 (1989).

\textsuperscript{201} MONT. CODE ANN. \S 35-1-905 (1989).

\textsuperscript{202} MONT. CODE ANN. \S 35-1-906(1) (1989).

\textsuperscript{203} MONT. CODE ANN. \S 35-1-906(2) (1989).

\textsuperscript{204} MONT. CODE ANN. \S 35-1-911 (1989).
\end{flushleft}
The Committee successfully recommended abolition of the two-step filing process for a number of reasons. The two-step filing process was cumbersome and entailed needless paperwork. The objectives of the two-step process, notification of creditors and satisfaction of creditors' claims, could be achieved through a simpler scheme. The apparent assumption of the two-step filing statute, that the statement of intent to dissolve would provide creditors notice of the upcoming dissolution, proved unrealistic. Known creditors were to get direct notice from the corporation anyway; unknown creditors are unlikely to monitor the filings with the secretary of state. The Committee determined that known creditors would be better protected with a statute specifying how claims were to be made. Unknown creditors would be better protected by indefinitely extending the corporate survival period, so as not to bar creditors' claims.

The new legislation provides that corporations may dispose of known claims by following a special procedure. If the procedure is followed, the statute bars the claims of known creditors who fail to act in a timely manner. If the corporation does not avail itself of the statute, the known claims are not barred but subject to the statute of limitations (i.e., contract statute of limitations) otherwise applicable to the claim.

A dissolved corporation is required to notify its known creditors of their right to file their claim with the corporation. A claim is a known claim even if it is not liquidated, but a contingent claim (a claim that has not matured to the point that the claimant has the right to bring suit) is not considered a known claim.

The claims of known claimants are barred in two primary circumstances. The notice to claimants must state a time for filing the claim. If the claim is not received within that time (not less than 120 days after the notice) the claim is barred. Likewise, if a claim has been rejected by a corporation and the claimant does not bring suit within 90 days, the claim is barred.

The new statutory scheme provides a quick and certain way to provide for known claims and deters spurious claims made against the corporation, by requiring claimants whose claims are rejected

209. ABA OFFICIAL COMMENTS, supra note 27, at § 14.06, at 1492.
210. Id.
to file suit within 90 days. The legislation balances the need to allow creditors fair notice of dissolution with the need to wind up corporate affairs.

B. Unknown Claims Against Dissolved Corporations

The previous version of the Montana Business Corporation Act did not adequately address the rights of creditors unknown by the dissolved corporation at the date of dissolution. The statute simply stated that dissolution "shall not take away or impair any remedy available . . . against such corporation, its directors, officers, or shareholders for any . . . claim existing or any liability incurred prior to such dissolution if action . . . thereon is commenced within 5 years after the date of such dissolution." The previous statute created two problems for unknown creditors. First, the rights, if any, of creditors owning claims arising after dissolution were unclear. Second, if the injury giving rise to the right was suffered after the five-year survival period elapsed, the creditor had no apparent rights against the corporation. The dearth of case law in Montana concerning the rights of creditors in corporate dissolution compounded the confusion.

The first problem is most frequently manifested by a products liability claim. What rights does a plaintiff who suffered an injury after the date of dissolution have against the dissolved corporation that had manufactured the product causing injury before the date of dissolution? The previous statute only allows claims "incurred prior to dissolution." A products liability claim typically is incurred not when the product was manufactured but as of the date of injury. Arguably, the claim is barred. The ABA's Official Comments to the Revised Model Business Corporation Act correctly conclude: "Earlier versions of the Model Act did not recognize the serious problem created by possible claims that might arise long after the dissolution process was completed . . . .

215. ABA OFFICIAL COMMENTS, supra note 27, § 14.07, at 1500.
A review of the history of corporate survival statutes does not clearly answer the problem. At common law, dissolution of a corporation terminates its existence. As a result, the corporation could neither sue nor be sued. Dissolution abated all claims.\textsuperscript{216} To mitigate the harshness of this rule all jurisdictions provide for a corporate survival period extending the time in which a dissolved corporation may be sued.\textsuperscript{217} Given the general rule that the common law still governs those claims outside the exception in the old statute, those product liabilities claims not "incurred prior to dissolution" may well be barred.\textsuperscript{218} Several courts, interpreting statutes similar to Montana’s, have denied the claims of those creditors whose claims first arose after the date of dissolution.\textsuperscript{219} Still other courts, recognizing the harshness of common law and states providing short survival periods, have held that post-dissolution claims are not subject to short-survival statutes.\textsuperscript{220}

The Corporate Law Revision Committee determined the legislature should adopt legislation to resolve these ambiguities. It first looked at the ABA’s Revised Model Business Corporation Act for


\textsuperscript{217} ABA OFFICIAL COMMENTS, supra note 27, § 14.07, at 1505.

\textsuperscript{218} Courts are unclear as to whether continuation statutes should be narrowly or broadly construed. Some courts reason that because these statutes are in derogation of common law, courts should narrowly construe the statutes. Gary Furniture \& Appliance Co. v. Skinner, 288 Ala. 617, 623-24, 264 So. 2d 174, 180-81 (1972); MBC, Inc. v. Engel, 119 N.H. 8, 11, 397 A.2d 636, 638 (1979). Other courts find these statutes remedial in nature and give them broad construction. Lesnow Bros., Inc. v. United States, 78 F. Supp. 829, 831 (Ct. Cl. 1948).


\textsuperscript{220} See Levy v. Liebling, 238 F.2d 505, 507 (7th Cir. 1956), cert. denied 353 U.S. 986 (1957). If a district court were to interpret the previous Montana statute as prohibiting any claim arising after dissolution, arguably their decision would be inconsistent with the Montana Constitution. At art. II, § 16, the Constitution provides "[c]ourts of justice shall be open to every person, and speedy remedy afforded for every injury of person, property, or character." Professor Henry F. Johnson argues that the Texas corporate survival statute, similar to the old Montana survival statute, is unconstitutional pursuant to similar "open court" provisions of the Texas Constitution. Johnson, \textit{The Texas Corporate Survival Statute: An Endangered Species?}, 17 TEX. TECH L. REV. 747, 760-64 (1986). Such an argument, however, was recently rejected by a Texas Court of Appeals. Weibel v. Martin Indus., Inc., 806 S.W.2d 345 (Tex. App. 1991). The court stated: "We hold there is no violation of [the open courts provisions] because Weibel's claim against a dissolved corporation did not involve an established right to redress of any injury. The right to hold a dissolved corporation liable for a post-dissolution claim has never been recognized in Texas . . . ." \textit{Id.} at 346.
guidance. The ABA Model provided that if a dissolved corporation published notice of its dissolution, unknown claims would be barred unless claims were made within five years.\textsuperscript{221} The Committee rejected the ABA Model for two reasons. First, it is unreasonable to expect an unknown claimant to actually read the newspaper notice when it is published. Tort claimants rarely expect to be tort claimants and rarely peruse the legal sections of newspapers of general circulation prior to suffering their injury. Second, the Committee determined that a five-year extension period was simply too short. The Committee was concerned about the many claims that arise after five years. Many losses are not known for a decade or more.\textsuperscript{222} Most tort statute of limitation periods address this problem by requiring a claim to be made within a specified period after the loss is discovered or the accident occurs.\textsuperscript{223}

The Committee vigorously debated the appropriate length of the corporate survival period. On one hand, shareholders of dissolved corporations have an interest in protection from extended litigation after dissolution. Opting for an unlimited survival period impairs the ability of the corporation to wind up its affairs and forces shareholders who receive assets from the corporation to hold them subject to the claims of creditors.\textsuperscript{224} Uncertainty may preclude the shareholders from redeploying the assets received into other productive ventures. Even with a short survival period, corporations have difficulty fully winding up their affairs because of

\begin{itemize}
\item \textsuperscript{221} Revised Model Business Corp. Act \S 14.07 (1984).
\item \textsuperscript{222} Mark Sarlitto observes the problems with a five-year limitation period:

Insurance industry statistics, however, suggest that only thirty percent of expected general liability claims (which include products liability) are reported three years after the initial policy year and only sixty percent are reported after the eighth year. Not until thirteen years after the initial policy year are seventy-five percent of the losses known to the insurer. The balance of these losses develop over the next two decades. These statistics suggest that a substantial proportion of products liability claimants are precluded from recovery by a five-year abatement period.


\item \textsuperscript{223} See, e.g., MONT. CODE ANN. \S 27-2-102 (1991).
\item \textsuperscript{224} According to the court in Bishop v. Schield Bantam Co., 293 F. Supp. 94 (N.D. Iowa 1968):

There should be a definite point in time at which the existence of a corporation and the transaction of its business are terminated. To allow ... the continued prosecution of lawsuits perverts the definiteness and orderly process of dissolution so as to produce a continuous dribble of business activity contrary to the intent of the ... statute.

\textit{Id. at 96.}
\end{itemize}
the exceptions that exist to lengthen survival periods,\textsuperscript{225} and because other states permit suits against dissolved foreign corporations after the expiration of the survival period.\textsuperscript{226}

A short survival period, however, impairs the rights of those injured by the company's products. As most claims arise many years after the date of manufacture of a product, a short limitation period will cause substantial losses. The price of products should bear the full costs of injuries caused by the products. Allowing corporations to escape responsibility by dissolving allows corporations and shareholders to walk away from this responsibility. Requiring dissolved corporations to bear these costs will encourage shareholders to reserve adequate funds for future claims. If shareholders are content that reserves established for unknown debts are adequate, they should be comfortable redeploying excess assets to other productive endeavors.

In the final analysis, the majority of the Committee members were convinced that abolishing the limited survival period would encourage corporations to reserve sufficient funds for claims. If shareholders believed that reserves were sufficient they could confidently redeploy assets; if not they should not redeploy assets. Likewise, just as otherwise applicable statutes of limitations are sufficient to balance the rights of the injured with the need for certainty for ongoing businesses, they were sufficient for dissolved corporations. Finally, the Committee was convinced that injured parties should not have different rights to pursue the assets of a dissolved business causing injury, depending on whether that business happened to be a sole proprietorship, partnership or corporation.

Montana is not alone in abolishing a limited corporate survival period. In eliminating the limited survival period from the corporate code, Montana joins the ranks of ten other jurisdictions.\textsuperscript{227}

C. Codification of the Trust Fund Doctrine

The common law has long provided that when assets of a corporation have been distributed to shareholders in dissolution, the

\textsuperscript{225} These exceptions include claims arising from injuries to minors, failure to notify creditors or fraudulent inducement to delay claims. \textit{See}, \textit{e.g.}, Moore v. Nick's Finer Foods, Inc., 121 Ill. App. 3d 923, 460 N.E.2d 420 (1984); People v. Parker, 30 Ill. 2d 486, 197 N.E.2d 30 (1964); Edwards v. Chicago & N.W. Ry., 79 Ill. App. 2d 48, 223 N.E.2d 163 (1967).


\textsuperscript{227} ABA OFFICIAL COMMENTS, supra note 27, § 14.07, at 1505 (1989). Those jurisdictions are Arizona, California, Florida, Louisiana, Maryland, New Jersey, New Mexico, New York, Ohio and Virginia, \textit{Id.}
shareholders hold those assets as trustees for creditors. Each shareholder is liable to creditors to the extent of assets he or she receives. Courts, although generally agreeing on most of the parameters of the trust fund doctrine, disagree whether the doctrine allows creditors to recover from shareholders after the survival period expires. At least one court went so far as to hold that the common law trust fund theory is not effective when not expressly included in a state statute governing dissolution. The new legislation adds certainty to the law by codifying this common law doctrine. The abolition of the limited survival period renders academic the question of whether the trust fund doctrine applies after the period’s expiration. Under the new law, only the otherwise-applicable statute of limitation will extinguish a claim.

D. Application of Dissolution Provisions to Foreign Corporations

As a general rule, the law of the state of incorporation governs the ability of creditors to sue the dissolved corporation. A significant number (although still a minority) of states have departed from this rule. Courts adopting the majority position view the limited survival periods not as statutes of limitation, but as a substantive rule defining the existence of the corporation. If the majority rule were followed in Montana, several undesirable results would follow. Only plaintiffs injured by the products of a dissolved Montana corporation would benefit from the new Montana unlimited survival period. If the same plaintiffs had been injured by a dissolved Idaho corporation, they would be required to file their

BUSINESS CORPORATIONS ACT

claim within two years of the date of dissolution.234 Montana plaintiffs would suffer from the vagaries of the laws of a manufacturers' state of incorporation. Manufacturing corporations otherwise desiring to incorporate in Montana may prefer to incorporate elsewhere to avoid the disadvantages of Montana's pro-creditor dissolution provisions. Finally, in a products liability claim against two dissolved corporate codefendants, the Montana codefendant may be the only one subjected to liability. For example, assume a plaintiff injured in Montana brings a products liability claim against a dissolved Idaho corporation (with a two-year dissolved corporation survival period) and a Montana corporation (with no separate dissolved corporation survival period) three years after the date both corporations dissolved. If Montana courts honored the short Idaho survival period, the dissolved Idaho corporation would be free from liability. The Montana corporation may be the sole defendant legally responsible.

The status of Montana law concerning claims against dissolved foreign corporations is uncertain. The leading case, Mieyr v. Federal Surety Co., dates back to 1933.235 In Mieyr, the Montana Supreme Court held that a claim by a Montana plaintiff against a dissolved Iowa corporation was not abated upon the entry of a decree of dissolution in Iowa.236 The court rejected the position that the laws of the state of incorporation (in this case Iowa) controlled the rights of a Montana claimant for the purposes of a foreign corporation. It did so based on the Montana Constitution then in effect and a Montana statute. At the time, the Montana Constitution provided that "no . . . corporation formed under the laws of any other country, state or territory, shall have, or be allowed to exercise, or enjoy within this state any greater rights or privileges than those possessed or enjoyed by corporations of the same or similar character created under the laws of [Montana]."237 This provision has been subsequently removed from the Montana Constitution.

The court in Mieyr, however, also relied on a provision of the Montana statute that provided that "all foreign corporations . . . shall be subject to all the same liabilities, restrictions, and duties which are or may be imposed upon corporations of like character organized under the laws of [Montana]."238 This statute, although

235. 94 Mont. 508, 23 P.2d 959 (1933).
236. Id. at 522, 23 P.2d at 963.
237. Mont. Const. of 1889, art. 15, § 11.
238. Montana Revised Codes § 6659 (1921).
modified, survives intact today. In addition, however, the current statute states that the Montana Business Corporation Act "does not authorize [Montana] to regulate the organization or internal affairs of a foreign corporation." This provision is necessary to avoid subjecting corporations to inconsistent and duplicative regulation of matters of organization and internal affairs. It also is consistent with common law and avoids unduly burdening interstate commerce.

The Corporate Law Revision Committee wanted to clarify whether the unlimited survival limitation period applied to foreign dissolved corporations for claims arising in Montana. Arguably, the Mieyr case was no longer valid law because of the changes in Montana's Constitution. Likewise, issues concerning dissolution might be issues of "organization or internal affairs," thereby exempting foreign corporations from the Montana abolition of the limited survival period for dissolved corporations. In order to clarify this issue, the new legislation adopts the rationale of Mieyr by stating that the dissolution rules concerning claims "apply to foreign corporations and their shareholders transacting business in [Montana] for any claims otherwise arising or accruing under Montana law."

The members of the Corporate Law Revision Committee were cognizant of the problems the legislation might cause for foreign corporations. A dissolved Idaho corporation, for example, would have a two-year survival period for claims arising in Idaho and an unlimited survival period for claims arising in Montana. The Idaho policy of quick and dirty dissolution might be frustrated. In balancing the Idaho policy with the policy of Montana to compensate injury to plaintiffs, the Committee relied upon the analysis in North American Asbestos Corp. v. Superior Court. In North American Asbestos Corp., the court dealt with the conflict between California law (no limitation period) and Illinois law (at that time, a two-year limitation period). The court found that the burden

241. For a discussion of the obligations of states not to impose regulations unduly burdening interstate commerce, see Fletcher, supra note 240, §§ 8402-08 at 335-56.
on California plaintiffs exceeded the burden on Illinois dissolving corporations.\textsuperscript{245} The court concluded that when the corporate code of the state of incorporation for claims against dissolved corporations differs from the corporate code in the jurisdiction in which the claim arises, the law of the jurisdiction in which the claim arises controls.\textsuperscript{246} The Committee believes that corporations doing business in several states should (with minimal burden) be able to reserve funds for claims asserted after the limited survival period in their home jurisdiction expires. The legislative determination to subject dissolving foreign corporations doing business in Montana to the same rules as domestic corporations is particularly appropriate in view of the mandate of Article XIII(2) of the Montana Constitution: "The legislature shall provide protection . . . for the people against harmful and unfair practices by either foreign or domestic corporations . . . ."\textsuperscript{247}

V. Conclusion

The corporate governance statutes of a state must balance the need to protect the \textit{individual} rights and obligations of stakeholders of a corporation (including shareholders and creditors) with the \textit{group} rights of stakeholders of the corporation generally. The balance is a delicate one. Courts and legislatures grapple (in Montana and other states) with innovative methods of striking a proper balance. From time to time it is useful for the organized bar to review existing Montana legislation and court decisions, compare that law and those decisions with those of other states, and ask whether Montana law might be improved. I hope that the new Montana Business Corporation Act is a useful improvement, the benefits of which will be enjoyed until the turn of the century and beyond.

\begin{thebibliography}{99}
\item 245. \textit{Id.} at 906-07, 225 Cal. Rptr. at 880-81.
\item 246. \textit{Id.} at 907, 225 Cal. Rptr. at 881.
\end{thebibliography}