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THE SPOTLIGHT

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WEALTH PLANNING, ADMINISTRATION, AND DISPUTES GROUP

AN OUNCE OF PREVENTION

WELCOME TO THE SPOTLIGHT

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

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

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

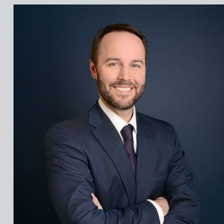
Is there a topic affecting your practice that you would like us to discuss in an upcoming issue of The Spotlight? Let us know at TPentelovitch@RobinsKaplan.com.

– Denise S. Rahne and Steven K. Orloff

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

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

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



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

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

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

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THINKING AHEAD: KEY PROVISIONS TO CONSIDER WHEN DRAFTING ENTITY GOVERNING DOCUMENTS

BY MARK S. LACONTE AND NARGESS N. HADJIAN

A company's governing documents, whether they be corporate bylaws and shareholder agreements, limited liability company ("LLC") operating agreements, or partnership agreements, typically include the rules and regulations for its operation and management. These agreements act as a critical framework for the entity's governance and identify the duties and responsibilities of its directors, managers, officers, and owners. Companies often rely on boilerplate templates that lack important provisions that mitigate risk and uncertainty. If drafted carefully, however, these agreements can prevent misunderstandings, minimize the risk of lawsuits, and enhance company value.

Consider including these key provisions when drafting company governing documents.

EXIT STRATEGY

A business's exit strategy is arguably as important as its inception. Yet, like the happy couple that foregoes a prenup, no one wants to kill the excitement of a new venture by bringing up how it might end. Therefore, exit strategies are often overlooked.

An exit strategy, however, should be planned at the time a company is formed. Many boilerplate bylaws or operating agreements do not include any restrictions on transferability of shares or ownership, resulting in myriad complications when an owner wants out or dies.

One clause to consider, especially in a 50-50 relationship, is a shotgun provision. Under this type of exit strategy, an owner is forced to either sell its shares or buy out the offering partner at the offering price. This provision, however, works only where partners share equal stake in the agreement.

Another consideration is to include a right-of-first-refusal provision. A right of first refusal gives the company and other owners the opportunity to buy the ownership interests before they are sold or transferred to a third party. This provision protects shareholders and owners from ending up with a new owner with whom they do not wish to be in business. The drafter may also want to consider whether the right of first refusal will apply to the transfer of ownership in the event of a death or by gift.

WAIVER OF FIDUCIARY DUTIES

Directors, managers, and officers are bound by fiduciary duties when acting in their official capacities. The fiduciary duties of loyalty and care require directors, managers, and officers to act with inherent fairness to the entity and its other owners. And while California and Delaware statutory and common law expressly prohibit the waiver of fiduciary duties in corporations, LLCs and partnerships are frequently characterized as "creatures of contract" and treated differently: Members of an LLC or partnership are free to contract among themselves concerning a multitude of management issues, including those regarding corporate-style fiduciary duties. Thus, an often forgotten yet important provision to consider when drafting operating or partnership agreements is whether to include an express waiver or modification of fiduciary duties.

Eliminating or modifying default fiduciary obligations can benefit the parties involved by more clearly defining the parameters of their relationship. It can also help eliminate the uncertainty stemming from potential challenges based on fiduciary-duty violations by promoting efficiency in management and establishing clear expectations. Owners often require such a waiver as a condition to agreeing to assume management duties.

In eliminating or modifying fiduciary duties, drafting attorneys must clearly articulate the contours of the contractual obligations. Absent clear and unambiguous limiting language, the parties may find themselves subject to default fiduciary duties borrowed from corporate law.

Of course, modifications of fiduciary duties are motivated by different reasons and may only make sense in certain situations, depending upon the context of the roles and relationships. For example, where an owner is qualified to run the business, it may make sense to waive fiduciary duties. But if a non-owner is to assume a management role, waiving fiduciary duties may not be the right option. Nonetheless, it is important to consider this issue when drafting operating or partnership agreements.

INDEMNIFICATION AND INSURANCE

These two provisions go hand in hand.

It is vital to ensure that the indemnification provision is adequately drafted to protect the company's officers, managers, and directors from personal exposure to liability claims for the business decisions and actions undertaken in their official capacities.

To take this a step further, a drafter may want to consider including a provision that obligates the company to maintain Directors and Officers Liability Insurance ("D&O"). Directors and officers are at risk of being sued for a variety of reasons relating to their company roles typically involving corporate governance matters, among other things. The main function of the D&O policy is to insure against personal losses and to allow the leadership to make decisions confidently, without fear of personal financial liability. It may also provide coverage for claims against the company itself and help reimburse a business for the legal fees or costs associated with defending its management against such claims. Note that D&O policies typically exclude coverage for intentionally dishonest conduct such as fraud.

Additionally, all organizations—small or large, private or public—can be vulnerable to D&O liability. Thus, any business with a board or advisory committee could benefit by including an insurance provision in its governing documents.

PREVAILING PARTIES

A prevailing-party provision gives the company, and its owners, additional leverage, because it acts as a powerful deterrent against baseless lawsuits. In the context of a company's governing documents, a prevailing-party provision provides that, if legal action is taken against the company or its owners, then the party that loses the lawsuit will be required to pay the prevailing party's reasonable attorneys' fees and costs, creating a significant consequence for frivolous claims.

Attorneys often overlook fee-shifting provisions when preparing agreements, but they're a key tool in protecting the company and its owners from meritless claims.

Governing documents are essential in articulating the rules and regulations for an entity's structure and management. Although not an exhaustive list, the provisions above can help avoid fiduciary disputes down the road.

EARLY MEDIATION IN FIDUCIARY DISPUTES:

IF AND WHEN YOU CAN PREVENT ESCALATED LITIGATION AND COSTS

Frequent Spotlight contributor Denise Rahne sat down with former Minnesota Supreme Court Chief Justice Eric Magnuson, whose experience as a practitioner, judge, and mediator provides him with a unique perspective on early mediation efforts in fiduciary disputes.

Q: We appreciate your taking some time to share your expertise on this topic. Let's start out at a high level: What are some key differences between fiduciary disputes and more traditional business disputes as it relates to dispute resolution?

A: If the dispute is between parties that have no fiduciary relationship, there are no special rules. The dispute is guided by traditional contract terms or, perhaps, tort or statutory laws. But if the dispute is between the fiduciary and the beneficiaries whose interests the fiduciary is charged with protecting, then a whole different set of considerations come into play. The fiduciary has an obligation to the beneficiaries that it must balance against its decision to dispute the beneficiaries' claims.

Q: What about shareholders in closely held businesses — can that situation present unique dynamics?

A: Certainly. Often the parties don't fully understand the extent to which fiduciary duties exist until after a problem has arisen. Unlike a trust, with clearly defined responsibilities, the law imposes fiduciary obligations on shareholders in a closely held corporation. Frequently resolving disputes of this kind is the equivalent of trying to un-ring the bell. Disputes between the stakeholders of closely held corporations also often involve close friends or family members, which can add another level of complexity to an already complicated dynamic. Mediators can play a key role in bridging the treacherous divide that often exists in these scenarios.

Q: In your experience, are there key categories of information that a mediator and the parties should have—maybe through early informal discovery—that can position a dispute for early mediation?

A: When I'm a mediator, I try to get an honest assessment from each side about the issues and the prospects for resolution. I ask them to tell me not only the strengths of their position, but the weaknesses, and the strengths of the position of the other side. Getting that information in advance of the mediation session helps me guide the discussion. It's sometimes difficult to get an honest and realistic assessment from each side, but if I start them thinking about it before the mediation, we make more progress once the mediation actually starts.

Understanding each party's business objective can also help me assess whether there is the potential for a business resolution.

Q: Besides the obvious cost savings, are there other compelling reasons that parties in fiduciary disputes should explore early mediation?

A: A fiduciary relationship is often ongoing, even after a specific dispute is resolved. The longer the dispute goes on, the more entrenched the parties are in their position, and the more the assets that are the subject of the fiduciary structure are dissipated due to paying the litigation expense of both sides. That is a unique aspect of fiduciary litigation.

In addition, as mentioned above, fiduciary disputes often involve family members or relationships that are far from arms-length. An early mediation can sometimes (but by no means always) prevent a dispute from becoming so contentious that there is no hope of repairing the relationship.

Q: What are the most typical obstacles to the success of early mediation of fiduciary disputes?

A: Getting the parties to understand the unique obligations of a fiduciary is sometimes a challenge. Fiduciaries need to look out for the best interests of the beneficiaries. But sometimes that means not agreeing with them on a particular issue. Setting expectations and the rules of play are key. The emotions that can come with the close nature of the relationships can also hinder successful mediations.

Q: What are some missteps or missed opportunities you have seen with early mediations that could have been successful but were not?

A: In order for a mediation to be successful, the parties have to be willing to compromise. If the mediation takes place too early, the parties will have not had an opportunity for their positions to be tested either through discovery or preliminary adjudicative procedures. Untested ideas are some of the hardest to deal with.

Q: Any parting wisdom?

A: Strong advocates for the competing interests are critical to the process. And that strength must include more than the ability to represent the client's position to the mediator and the adversary. The advocate needs to be able to identify the weaknesses in their own case, and the strengths in the opposing case, and speak directly and realistically with the client. The mediator is a facilitator, and seldom acts as an advocate. The lawyers for the parties need to be part of the mediation team.

RECALL MESSAGE! DO YOURSELF (AND YOUR EMPLOYER) A FAVOR AND SHARPEN YOUR EMAIL GAME

BY THOMAS F. BERNDT

This isn't the 1990s: Email isn't a new technology. By now, we all know that our work emails aren't private, and most of us exercise some discretion in deciding what to "put in writing" in our business communications. We've heard horror stories of incriminating emails turning up in business lawsuits. Those alive in the early '90s may remember the U.S. government's antitrust suit accusing Microsoft of using monopolistic practices to kill rival web browser Netscape. The ruthless tone of Microsoft's internal emails, using phrases like "knife the baby," "take away their oxygen supply," and "crush them" not only made headlines but changed the tide of that case.

Yet, despite our awareness of these risks, the problem persists. Time and again, bet-the-company lawsuits turn on the content of internal work emails. And it's not just so-called "smoking gun" emails where an employee admits wrongdoing. More often, the key emails are seemingly innocuous co-worker communications that, due to their poor wording, are taken out of context and made to look malicious, heavy-handed, or insensitive.

Let's examine how emails are used in litigation, with hopes that, through awareness, employees can better protect themselves and their employers.

LITIGATION IS MORE INTRUSIVE THAN YOU THINK

Everyone knows that employers can monitor employees' emails and that emails can be forwarded beyond their original recipients. But some may be less aware that competitors or customers can obtain internal company emails

through litigation, for instance. And owners of closely held corporations often feel a false sense of security that they have more control over their work emails than they actually do.

But anyone familiar with business lawsuits knows that email is the predominant form of evidence. In civil lawsuits, each side is entitled to "discover" the evidence the other side plans to use at trial to prove its case. This is typically done by each side sending the other "requests" for documents relating to certain relevant topics. Search terms are often applied to email inboxes to isolate and identify relevant emails. After the company's attorneys review the captured documents, the company must produce nonprivileged, relevant emails to the other side, even if they contain proprietary business information. Even trade secrets are "discoverable." While courts may restrict the parties themselves from seeing each other's proprietary information or trade secrets, the lawyers, judge, and jury will have access to this information.

If your company is sued, plan on the other side's lawyers perusing your emails, looking for ways to make you look bad. Don't give them the opportunity. Here are a few ground rules that may help you avoid sending regrettable emails:

- Remember that email has replaced formal letters and inner-office memos. Treat them that way.
- In deciding whether an email may be problematic, assume others will read it without context and, in a lawsuit, with the aim of twisting it to look worse than it is.
- Email is not the place to vent or blow off steam. We all feel the need to commiserate or brighten long workdays with moments of levity, but do it in person or over the phone.
- Resist the urge to attribute fault, especially where you don't have all the facts. It's often not necessary, can be divisive, and can come back to bite you.
- Be kind. In addition to being a search for truth, every lawsuit is a morality play. Juries punish those they perceive as bad actors. Be wary of groupthink or an us-versus-them mentality. Businesses are social groups, after all. And our need to belong can lead us to dehumanize outsiders, whether they be competing businesses, difficult customers, industry regulators, or the like. In short, social forces can cause good people to say (or write) ugly things.
- No matter what you've heard, merely copying a lawyer on an email does not make it attorney-client privileged. For the privilege to apply, you must have an attorney-client relationship and be seeking legal advice—as opposed to mere business advice. And any privilege that may otherwise apply can be waived by sharing the communication with third parties who are not necessary to the rendering of legal advice.
- Be especially careful with sarcasm or exaggeration for comedic effect. Even if the recipient knows you're not serious, the humor may not translate to the courtroom.
- Text messages are not a sanctuary. Lawyers in civil lawsuits are increasingly requesting to search not just the other side's emails, but their text messages, too. And if there's reason to believe someone discussed company business via text, judges will often allow it, even if the messages were deleted, forcing the plaintiff to subpoena the text records from a mobile provider. This exposure applies equally to other messaging services like Slack or WhatsApp.

A WORD ABOUT DELETING: [SPOILER ALERT: IT IS NOT REALLY DELETED]

Once sent, emails leave your control. Our email inboxes give us the illusion of control by allowing us to delete or even "double delete" emails. Don't be fooled. Deleted emails often still exist on the company's servers and can be recovered and produced in litigation. The act of deleting leaves its own fingerprints, even if you use special software that purports to permanently delete data. It's not uncommon for a litigant to retain an expert to forensically search the other side's computers for signs of document destruction.

Courts refer to the destruction of evidence as "spoliation." To deter spoliation, courts can impose extreme sanctions, including dismissal of a lawsuit, entry of a judgment, or imposition of fines. Considering these penalties, it simply doesn't pay to try to delete bad emails. The "cover-up" will almost certainly lead to worse consequences than the "crime."

Times are changing, and sloppy emails at the workplace are about as popular as other 1990s memories like dial-up internet, brick phones, or Dawson's Creek references (present reference excepted).

MEET OUR ISSUE EDITOR:

ANNE M. LOCKNER

Anne M. Lockner is a partner in the firm's National Business Litigation Group and a member of the firm's Executive Board. With over 20 years of experience litigating and trying cases in state and federal courts throughout the country, she has extensive experience in representing companies of all sizes in a wide array of complex business disputes involving breaches of fiduciary duties among shareholders, breaches of contract, fraud, trade secret misappropriation, and non-compete cases. She can be reached at **ALockner@RobinsKaplan.com**.

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

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

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

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

NEW YORK
900 Third Avenue
Suite 1900
New York, NY 10022
212 980 7400 TEL

SILICON VALLEY
2006 Kala Bagai Way
Suite 22
Berkeley, CA 94704
650 784 4040 TEL

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

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