

JANSSEN V. BEST & FLANAGAN:
AT LONG LAST, THE BEGINNING OF THE END
FOR THE AUERBACH APPROACH IN MINNESOTA?

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The importance of holding corporate leadership responsible for their actions has, at least for the moment, assumed a place of prominence in American popular consciousness. However, despite the swarms of investigators buzzing around many cultural icons and multinational corporations in search of wrongdoing, an ugly truth remains: in Minnesota as in many other states, boards of directors are protected from shareholder litigation by a plethora of substantive and procedural obstacles. In the face of these barriers, shareholders are often powerless to rectify the negligent or even intentional wrongdoing of management. One of the most troublesome of these barriers is the “special litigation committee,” purportedly objective persons typically charged by a board of directors to decide whether shareholder

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grievances with the board are valid.

This May, the Minnesota Supreme Court weighed in on the issue of special litigation committees for the first time in Janssen v. Best & Flanagan.¹ The Janssen decision provides some confusing but tantalizing hints that the Minnesota courts may be ready to increase their scrutiny of internal corporate governance. This article describes the history, substance, and holding of Janssen and explores what it might mean for the business judgment rule in Minnesota. The article concludes by arguing that the Minnesota courts should abandon the deferential approach they have traditionally taken to special litigation committee decisions and that the Janssen decision empowers the lower courts to take the lead in doing so.

I. INTRODUCTION

Historically the only method for a shareholder to take action against a director for wrongs to a corporation was through a shareholder derivative action.² While derivative actions should, in theory, promote director accountability, commentators have questioned whether they offer any real benefit to shareholders or any real check on the power of directors.³ In an attempt to address these concerns, Minnesota has, like most other jurisdictions, imposed several procedural barriers to bringing a derivative claim. The first such obstacle is rule 23.06 of the Minnesota Rules of Civil Procedure (“Rule 23.06”), which requires any shareholder or member seeking to initiate derivative litigation to first demand that the corporation’s board of directors initiate the litigation.⁴ Failure to comply with this rule prior to filing a derivative claim is grounds for dismissal pursuant to Rule 12(b)(6).⁵ Such a demand is excused only if a plaintiff

1. 662 N.W.2d 876, 882 (Minn. 2003).

2. A derivative suit is a procedural mechanism by which a shareholder, in the case of a business corporation, or a member, in the case of a nonprofit corporation, may initiate litigation in the name of the corporation in order to enforce the corporation’s rights. *See id.* at 881 (citing *Brown v. Tenney*, 532 N.E.2d 230, 232 (Ill. 1988) (stating that “[t]he derivative suit is a device to protect shareholders against abuses by the corporation, its officers and directors, and is a vehicle to ensure corporate accountability”)).

3. *See, e.g.*, Roslyn Falk, *May a Shareholder Who Objects to a Proposed Settlement of a Derivative Action Appeal an Adverse Decision? A Report on California Public Employees’ Retirement System v. Felzen*, 25 DEL. J. CORP. L. 235, 240-41 (2000) (asserting that derivative suits do not substantially deter misconduct and serve only to generate excessive attorneys’ fees).

4. MINN. R. CIV. P. 23.06.

5. *Wessin v. Archives Corp.*, 592 N.W.2d 460, 464 (Minn. 1999) (holding that

properly alleges that the board is so biased as to render a demand futile.⁶

The second obstacle is more difficult to overcome. If a board of directors declines to join in a proposed derivative suit, Minnesota courts will defer to that decision and dismiss the derivative suit absent evidence or allegations that the board members acted in bad faith or were incapable of making the decision impartially.⁷ This deference is an application of the “business judgment rule,”⁸ which generally requires courts to accept the decisions of corporate management on matters of company business, including whether or not to pursue litigation.⁹ Even where a board is alleged to harbor bias with respect to a given decision,¹⁰ the business judgment rule allows the board to overcome that allegation of bias by delegating that decision to a “special litigation committee.”¹¹ Typically such committees consist of directors or other persons who were not involved in the subject matter of the litigation and have no personal interest in it.¹² This committee is given full authority by the board to investigate the claims articulated in the derivative suit and to decide whether the corporation should step in and assert those claims

compliance with MINN. R. CIV. P. 23.06 is an indispensable prerequisite to bringing a derivative action).

6. *Id.*

7. *St. James Capital Corp. v. Pallet Recycling Assoc. of N. Am., Inc.*, 589 N.W. 2d 511, 515 (Minn. Ct. App. 1999). An allegation of bias, which is pled prior to such board action, is sufficient to bar the board from making such a decision. *See, e.g., Black v. NuAire, Inc.*, 426 N.W.2d 203, 210 (Minn. Ct. App. 1988). However, once the board has considered the action, only actual evidence of bad faith will obviate the deference accorded under the business judgment rule. *St. James*, 589 N.W.2d at 515.

8. *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 882 (Minn. 2003) (“The business judgment rule means that as long as the disinterested director(s) made an informed business decision, in good faith, without an abuse of discretion, he or she will not be liable for corporate losses resulting from his or her decision.”) (citation omitted).

9. *See, e.g., Black*, 426 N.W.2d at 210 (explaining that business decisions should be left to company management, who are presumed to act in the corporation’s best interests).

10. A typical example of such a situation would be when a board must decide whether or not to join in proposed derivative litigation against one or more of its own members. *Id.*

11. *Drilling v. Berman*, 589 N.W.2d 503, 506-07 (Minn. Ct. App. 1999); *Skoglund v. Brady*, 541 N.W.2d 17, 21 (Minn. Ct. App. 1995).

12. *See Abbey v. Control Data Corp.*, 603 F.2d 724, 727 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980) (stating that the board decisions were made in “bad faith,” particularly where “the directors, themselves, are subject to personal liability” in the proposed action, which raises the most serious questions about whether the board is entitled to protection under the business judgment rule and that special litigation committees can address these potential concerns by appointing “disinterested” persons to make a decision for the board).

itself.¹³ Minnesota courts have traditionally reviewed the decision of such committees only to determine whether it was made independent of board influence and in good faith.¹⁴

The practical effect of the business judgment rule when combined with the demand requirement of Rule 23.06 is to prohibit shareholders or members of a corporation from bringing a derivative lawsuit against the wishes of the board unless: (1) the board is alleged to be incapable of making an impartial decision, and (2) the board lacks the good sense to appoint an independent committee to make the decision for it.¹⁵ Some commentators have claimed that the system prevents the derivative suit from functioning effectively.¹⁶ These criticisms appear to be borne out by empirical studies, which suggest that nearly all committees recommend that the corporation not join in the derivative action.¹⁷ Additionally, special litigation committees are typically composed of attorneys and corporate directors, who may be particularly subject to the

13. See *Janssen*, 662 N.W.2d at 888 (stating that it is the task of the special litigation committee to “dispassionately review the derivative lawsuit” and decide whether it should be pursued).

14. *Id.* Courts in other jurisdictions have recognized the potential for abuse that exists in this system and have allowed for a more extensive review of special litigation committee decisions. See also *Zapata Corp. v. Maldonado*, 430 A.2d 779, 789 (Del. 1981) (holding that a court should defer to committee only if committee is independent and its decision comports with the court’s own business judgment); *Biondi v. Scrushy*, 820 A.2d 1148, 1164 n.40 (Del. Ch. 2003) (discussing the problem of structural bias in the context of special litigation committees); see also *Houle v. Low*, 556 N.E.2d 51, 59 (Mass. 1990) (holding that a court should decide whether committee is disinterested and whether it “reached a reasonable and principled decision”); *Alford v. Shaw*, 358 S.E.2d 323, 327-28 (N.C. 1987) (holding that reviewing court must determine whether action complained of was just and reasonable to the corporation).

15. See MINN. R. CIV. P. 23.06. See also *Winter v. Farmers Educ. & Co-op. Union of Am.*, 259 Minn. 257, 267, 107 N.W.2d 226, 233 (Minn. 1961) (stating that a “demand should be made on the board of directors unless the wrongdoers constitute a majority of the board” or it is “plain from the circumstances that [a demand] would be futile”).

16. See George W. Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U. L. REV. 96, 105-09 (1980) (arguing that the use of special litigation committees may effectively prevent derivative suits in most cases).

17. James D. Cox, *Searching for the Corporation’s Voice in Derivative Suit Litigation: A Critique of Zapata and the ALI Project*, DUKE L.J. 959, 963 (1982) (observing that nearly all special litigation committees reject proposed shareholder derivative litigation). Similarly, in all cases where the Minnesota Court of Appeals has had occasion to review the decision of a special litigation committee, the committee has found that pursuing the demanded litigation is not in the corporation’s best interests. See *Skoglund v. Brady*, 541 N.W.2d 17, 21 (Minn. Ct. App. 1995); *Black v. NuAire, Inc.*, 426 N.W.2d 203, 210 (Minn. Ct. App. 1988); *Drilling v. Berman*, 589 N.W.2d 503, 506-07 (Minn. Ct. App. 1999).

influence of the board that appointed them as well as biases originating in their elite socioeconomic status that could prevent them from being impartial.¹⁸

Until *Janssen v. Best & Flanagan*, the Minnesota Supreme Court had not addressed the use of special litigation committees and the Minnesota Court of Appeals had done so only in three cases.¹⁹ *Janssen* extended the rule to Minnesota nonprofit corporations and, most importantly, defined the role of such committees by balancing corporate autonomy and shareholder rights.²⁰ To further that balance, the court adopted a bright-line rule requiring trial courts to allow derivative actions to proceed if the decision of the special litigation committee is found wanting.²¹ This “one strike and you’re out” standard undermines the traditional business judgment rule in Minnesota and the broader concern of the court by “balancing” corporate self-governance and derivative claims.²² The rule may set the stage for further limitations on the use of special litigation committees by Minnesota corporations.²³

This article will first consider the origin and development of the business judgment rule in Minnesota.²⁴ Next, this article will offer an analysis of *Janssen*, discussing the reasoning of the decision and the implications that it has for Minnesota nonprofit corporations.²⁵ Finally, this article will describe how *Janssen* may signal a retrenching of the traditional deference Minnesota courts have shown to corporate boards and consider the possible future of the business judgment rule in Minnesota.²⁶

II. DEVELOPMENT OF THE LAWS GOVERNING SPECIAL LITIGATION COMMITTEES IN MINNESOTA

The business judgment rule was applied to corporate decisions regarding whether or not to participate in litigation as early as 1917.²⁷

18. See *Strougo v. Bassini*, 112 F.Supp.2d 355, 362-63 (S.D.N.Y. 2000) (discussing biases inherent in special litigation committee system).

19. See *infra* Part II.

20. See *infra* Part III.

21. See *infra* Part III.C.

22. See *infra* Part IV.

23. See *id.*

24. See *infra* Part II.

25. See *infra* Parts III&IV.

26. See *infra* Part IV.

27. *United Copper Sec. Co. v. Amalgamated Copper Co.*, 244 U.S. 261, 263-64

However, the use of special litigation committees as a tool to mute allegations of board bias first became common in the 1970s.²⁸ Special litigation committees did not make an appearance in Minnesota jurisprudence until Minnesota Statutes section 302A.243 was enacted in 1981.²⁹ At the time, there was substantial debate among both commentators and courts about whether such committees should be permitted and, if so, what level of deference their decisions should be accorded.³⁰ For example, many courts have questioned the allegedly

(1917).

28. Richard C. Brown, *Shareholder Derivative Litigation and the Special Litigation Committee*, 43 U. PITT. L. REV. 601, 616 (1982).

29. The statute provided:

Unless prohibited by the articles or bylaws, the board may establish a committee composed of two or more disinterested directors or other disinterested persons to determine whether it is in the best interests of the corporation to pursue a particular legal right or remedy of the corporation and whether to cause the dismissal or discontinuance of a particular proceeding that seeks to assert a right or remedy on behalf of the corporation. For purposes of this section, a director or other person is "disinterested" if the director or other person is not the owner of more than one percent of the outstanding shares of, or a present or former officer, employee, or agent of, the corporation or of a related corporation and has not been made or threatened to be made a party to the proceeding in question. The committee, once established, is not subject to the direction or control of, or termination by, the board. A vacancy on the committee may be filled by a majority vote of the remaining members. The good faith determinations of the committee are binding upon the corporation and its directors, officers, and shareholders. The committee terminates when it issues a written report of its determinations to the board.

MINN. STAT. § 302A.243 (1986), *repealed by* Minn. Laws, ch. 172, § 11 (1989).

30. The principal case criticizing *Auerbach v. Bennett*, 393 N.E.2d 994 (N.Y. 1979), was *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981). *Zapata* held that not only must a corporation prove the independence and good faith of its special litigation committee, there must also be a "reasonable basis" for the committee's decision. *Id.* at 789. Furthermore, even if such a reasonable basis exists, *Zapata* authorizes a court to exercise its own judgment regarding whether the suit should proceed. *Id.* The purpose of this broad power is "to provide a safeguard against the danger that the difficult-to-detect influence of fellow-feeling among directors (i.e., so-called 'structural bias') does not cause cessation of meritorious litigation valuable to the company." *Biondi v. Scrushy*, 820 A.2d 1148, 1164 n.40 (Del. Ch. 2003).

In *Black v. NuAire, Inc.*, 426 N.W.2d 203 (Minn. Ct. App. 1988), the Minnesota Court of Appeals echoes these very concerns, stating that "the possible risk of hesitancy on the part of the members of any committee . . . to investigate the activities of fellow members of the board where personal liability is at stake is an inherent, inescapable, given aspect of the corporation's predicament." *Id.* at 210-11 (quoting *Auerbach*, 393 N.E.2d at 1002). But the court failed to address the concerns directly and instead adopted the *Auerbach* approach, finding that even if courts could provide a more objective analysis of disputed corporate decisions than a conflicted special litigation committee,

impartial committees, noting that it is “unrealistic to assume that members of [special litigation] committees” are not likely influenced by those who appoint them.³¹ Furthermore, the business professionals who typically serve on such committees may have a “there but for the grace of God go I” attitude toward derivative claims that prevents them from making impartial decisions as to whether a suit should proceed against their fellow corporate leaders.³² For reasons such as these, Delaware and courts in other states began, in the early 1980s, to allow courts to inquire into not only the good faith and independence of special litigation committees, but also the substance of their decisions.³³

It was in this legal landscape that Minnesota Statutes section 302A.243 was first applied in *Black v. NuAire*.³⁴ The *Black* decision held that the express language of section 302A.243 required the court to review the decisions of a special litigation committee only to determine if they were made in good faith, defined as “honesty in fact in the conduct of the act or transaction concerned.”³⁵ The court in *Black* also stated that this standard of review was consistent with the approach followed by other jurisdictions with similar statutes, and cited the reasoning of those decisions as supporting its decision.³⁶

In particular, the court in *Black* noted two policy rationales discussed in *Auerbach v. Bennett*³⁷ that supported its decision. First,

such oversight would “work an ouster of the board’s fundamental responsibility and authority for corporate management” and must therefore be rejected. *Id.* For further discussion of the academic and judicial debate on this subject in the early 1980s, see generally Cox, *supra* note 17 (summarizing development of the business judgment rule in the early 1980s), and Dent, *supra* note 16, at 105-09 (arguing that the use of special litigation committees may effectively prevent derivative suits in most cases).

31. Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709, 716 (Iowa 1983).

32. Douglas M. Branson, *The Rule that Isn’t a Rule—the Business Judgment Rule*, 36 VAL. U. L. REV. 631, 641-42 (2002) (characterizing “structural bias” as “the predilection of directors to favor those of the same social or economic class, such as fellow directors or senior managers” and to sympathize with the directors of a corporation to such an extent that their neutrality is compromised).

33. See, e.g., Zapata Corp. v. Maldonado, 430 A.2d 779, 789 (Del. 1981).

34. 426 N.W.2d 203, 210 (Minn. Ct. App. 1988). The reason for the absence of decisions and law on the subject is likely that, as the Minnesota Supreme Court noted, “shareholder-derivative litigation is not an everyday occurrence in Minnesota’s courts.” *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 882 (Minn. 2003).

35. *Black*, 426 N.W.2d at 211 (quoting MINN. STAT. § 302A.011 subd. 13 (1986)).

36. *Id.* at 210 (citing *Abbey v. Control Data Corp.*, 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980) (construing Delaware law); *Lewis v. Anderson*, 615 F.2d 778, 784 (9th Cir. 1979), *cert. denied*, 449 U.S. 869 (1980) (applying California law); and *Auerbach v. Bennett*, 393 N.E.2d 994 (N.Y. 1979) (applying New York law)).

37. 393 N.E.2d 994 (N.Y. 1979).

decisions regarding the interests of a corporation should be delegated to those best positioned to make them, namely the directors of the corporation.³⁸ Second, it noted that the business judgment rule promotes efficiency in the resolution of corporate affairs by “[precluding] stockholders from disrupting the board’s decision through derivative actions where the board has determined a particular action is not in the corporation’s best interest.”³⁹ Both of these rationales boil down to a single principle: the decisions of a corporate board are presumed to be exempt from challenge unless and until it is proven that the board is incapable of acting in the best interests of the corporation.⁴⁰ When *Black* was decided, this reasoning (known as the “*Auerbach* approach”) was a subject of vigorous debate.⁴¹ The *Black* decision considered, but declined to adopt, alternatives to the *Auerbach* approach because of its “interpretation of section 302A.242 to preclude judicial interference beyond inquiry into the interest and good faith conduct of an appointed committee.”⁴²

In 1989, Minnesota Statutes section 302A.243 was repealed.⁴³ It was replaced with Minnesota Statutes section 302A.241 subdivision 1, which specifically empowered Minnesota business corporations to appoint “special litigation committees,” but was silent as to the level of deference that must be accorded to such committees.⁴⁴ The legislative record contains some evidence that the repeal of section 302A.243 was not intended as a comment on the substance of the section or the decision

38. *Black*, 426 N.W.2d at 211 (citing *Auerbach*, 393 N.E.2d at 1000).

39. *Id.*

40. *Id.* See also *Janssen*, 662 N.W.2d at 882 (“The business judgment rule is a presumption protecting conduct by directors that can be attributed to any rational business purpose.”) (citing DENNIS J. BLOCK, ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* § 18 (5th ed. 1998)).

41. See *supra* note 17.

42. *Black*, 426 N.W.2d at 210 n.3.

43. Minn. Laws, ch. 172, § 11 (1989).

44. In relevant part, Minnesota Statutes section 302A.241 subdivision 1 states:

A resolution approved by the affirmative vote of a majority of the board may establish committees having the authority of the board in the management of the business of the corporation only to the extent provided in the resolution. Committees may include a special litigation committee consisting of one or more independent directors or other independent persons to consider the legal rights or remedies of the corporation and whether those rights and remedies should be pursued. Committees other than special litigation committees . . . are subject at all times to the direction and control of the board.

MINN. STAT. § 302A.241 subd. 1 (2001)

in *Black*,⁴⁵ but was instead an attempt to give the courts “flexibility” to “develop” the business judgment rule.⁴⁶ These statements at least imply that the legislature envisioned that Minnesota courts would someday deviate from the rule in *Auerbach*. There could be no other logical reason to offer courts “flexibility” with the intent to “allow the case law to develop,”⁴⁷ particularly when the *Black* court believed its application of the *Auerbach* approach was mandated by section 302A.243.⁴⁸ At the very least, it appears evident that the legislature intended the courts to substantively consider alternatives to *Auerbach* in light of the ongoing scholarly and judicial discussion of special litigation committees.⁴⁹

The Minnesota Court of Appeals, however, interpreted the comments of Senator Luther otherwise.⁵⁰ When the court of appeals next considered the application of the business judgment rule to special litigation committees in *Skoglund v. Brady*,⁵¹ it specifically held that the decision in *Black* “was not affected by the repeal” of Minnesota Statutes section 302A.243 and that *Black* therefore continued to control how the decisions of special litigation committees should be evaluated.⁵² *Skoglund* cited the comments of Senator Luther⁵³ as if they expressly endorsed the holding of *Black*.⁵⁴ As noted above, this holding is at least somewhat inconsistent with the express language of the *Black* decision itself and the comments of the senator.⁵⁵ *Skoglund* also explained the

45. See *Drilling v. Berman*, 589 N.W.2d 503, 506 (Minn. Ct. App. 1999) (citing Senator Luther’s statement at the hearing before the Senate Commission on the Judiciary on April 11, 1989). In repealing MINN. STAT. § 302.243, the legislature also stated:

Notwithstanding any contrary provision of Minnesota Statutes, chapter 645, the repeal of Minnesota Statutes, section 302A.243, does not imply that the legislature has accepted or rejected the substance of the repealed section but must be interpreted in the same manner as if section 302A.243 had not be [sic] enacted.

Minn. Laws, ch. 172, § 12 (1989).

46. See *Drilling*, 589 N.W.2d at 506 (citing Senator Luther’s statements at the senate hearings that the repeal of section 302A.243 was intended to give the courts “flexibility” to allow the case law of the business judgment rule to develop).

47. *Id.*

48. *Black*, 426 N.W.2d at 210.

49. See *Drilling*, 589 N.W.2d at 506.

50. See *supra* note 45.

51. 541 N.W.2d 17 (Minn. Ct. App. 1995).

52. *Id.* at 21.

53. See *supra* note 45.

54. *Skoglund*, 541 N.W.2d at 21.

55. *Black*, 426 N.W.2d at 209-10 (“We interpret section 302A.243 to preclude our courts from reviewing the merits of a recommendation to dismiss a shareholder’s derivative action when that recommendation is made by a disinterested committee

policy arguments made in *Black* when describing the general function of the business judgment rule, but failed to evaluate them in light of possible alternatives or state that they were the basis for its decision.⁵⁶ The Minnesota Supreme Court declined to review the *Skoglund* decision.⁵⁷ After *Skoglund*, Minnesota courts applied the business judgment rule as a general principle of law outside the context of special litigation committees.⁵⁸

The next case to consider the use of special litigation committees to terminate derivative litigation was *Drilling v. Berman*.⁵⁹ In *Drilling*, the court considered *Zapata Corp. v. Maldonado*⁶⁰ and similar cases from North Carolina and Massachusetts that adopted and applied alternatives to the *Auerbach* approach.⁶¹ However, *Drilling* rejected all of these alternatives without any substantive analysis.⁶² Instead, the court stated that the level of deference to be accorded to special litigation committees “is not a question of first impression.”⁶³ While technically true, the reality is that in the decade before *Drilling*, no Minnesota court had ever taken up the nearly express direction of the Minnesota legislature to “develop” the law of special litigation committees. The court in *Skoglund* had wrongly claimed, mistakenly or for rhetorical purposes, that it was bound by *Black*.⁶⁴ The *Drilling* court followed along by holding that *Skoglund* and *Black* were controlling precedent.⁶⁵

The inquiry into the “good faith” and “independence” of a special litigation committee, as authorized by these cases, is a very limited and deferential process. It can be described by the *Drilling* court as follows:

[T]he corporation may be expected to show that the areas and

conducting its investigation in good faith.”).

56. See *Skoglund*, 541 N.W.2d at 20-21.

57. See *Skoglund v. Brady*, 541 N.W.2d 17, 21 (Minn. Ct. App. 1995), review denied (Minn. Feb. 27, 1996).

58. Minnesota also applied the business judgment rule as a general principle of common law in *St. James Capital Corp. v. Pallet Recycling Assoc. of N. Am., Inc.*, 589 N.W.2d 511, 515 (Minn. Ct. App. 1999) and *Wigart v. Cervenka*, 1999 WL 243231 *3 n.1 (Minn. Ct. App. 1999) (unpublished). However, neither of these cases involved the appointment of a special litigation committee.

59. 589 N.W.2d 503 (Minn. Ct. App. 1999).

60. 430 A.2d 779 (Del. 1981).

61. *Drilling v. Berman*, 589 N.W.2d 503, 507 (Minn. Ct. App. 1999) (citing *Zapata Corp. v. Maldonado*, 430 A.2d 779, 789 (Del. 1981), *Houle v. Low*, 556 N.E.2d 51, 59 (Mass. 1990) and *Alford v. Shaw*, 358 S.E.2d 323, 328 (N.C. 1987)).

62. *Id.*

63. *Id.*

64. *Skoglund v. Brady*, 541 N.W.2d 17, 20-21 (Minn. Ct. App. 1995).

65. See *Drilling*, 589 N.W.2d 509.

subjects to be examined are reasonably complete and that there has been a good-faith pursuit of inquiry into such areas and subjects. *What has been uncovered and the relative weight accorded in evaluating and balancing the several factors and considerations are beyond the scope of judicial concern.*⁶⁶

Under this deferential review, the only proper inquiry is “[w]hether a committee’s investigative *methods* demonstrate good faith.”⁶⁷ Furthermore, “[r]ather than focusing on one element of the committee’s investigation, the proper inquiry is into the adequacy of the committee’s procedures and methodologies as a whole.”⁶⁸ Factors recognized as relevant to this inquiry include:

(1) the length and scope of the investigation, (2) the committee’s use of independent counsel or experts, (3) the corporation’s or the defendants’ involvement, if any, in the investigation, and (4) the adequacy and reliability of the information supplied to the committee.⁶⁹

Under this approach, even a short report that fails to address pertinent issues is deserving of judicial deference, provided that it describes a methodology that is “reasonably complete,”⁷⁰ regardless of how outlandish or seemingly unreasonable the conclusions reached by the committee might be.⁷¹

III. JANSSEN: FACTS AND PROCEDURAL HISTORY

A. Facts

In *Janssen v. Best & Flanagan*, certain members of the Minneapolis Police Relief Association⁷² (the “MPRA”), including lead plaintiff

66. *Drilling*, 589 N.W.2d at 508 (citing *Auerbach v. Bennett*, 393 N.E.2d 994, 1003 (N.Y. 1979)) (emphasis in original).

67. *Id.* at 509 (citing *Auerbach*, 393 N.E.2d at 1003) (emphasis added).

68. *Id.*

69. *Id.* at 509 (citing *Lewis v. Boyd*, 838 S.W.2d 215, 224 (Tenn. Ct. App. 1992)).

70. *Drilling*, 589 N.W.2d at 507-08 (stating but not agreeing with appellants’ contention that the “brevity of the committee’s report indicates a lack of good faith because it does not . . . address all of the claims raised in appellants’ complaint”).

71. *Id.*

72. The MPRA is a Minnesota nonprofit corporation charged with administering a pension fund maintained for approximately 1000 Minneapolis police officers hired before June 15, 1980, and their spouses and beneficiaries. MINN. STAT. § 423B.04 (2003). The MPRA is incorporated and operates under MINN. STAT. 317A, the Minnesota Nonprofit Corporation Act, and is governed by a nine member Board of Directors, which is elected by its members. MINN. STAT. § 423B.05 subd. 1 (2003).

George Janssen, brought a derivative suit on behalf of the MPRA against two of its partners, Brian Rice and Charles Berquist (collectively “Best”), alleging attorney malpractice.⁷³ Plaintiffs alleged that Best had committed malpractice in its alleged review of certain ill-fated investments the MPRA made through an investment adviser named David Welliver (“Welliver”).⁷⁴ In 1996 and 1997, the MPRA lost approximately \$15 million in one such investment, a company known as “Technimar.”⁷⁵ The MPRA Board engaged two separate law firms to conduct investigations into this loss and to prosecute several related lawsuits.⁷⁶ However, the MPRA Board of Directors (the “Board”) specifically declined to initiate legal action against Best, who remained its general counsel.⁷⁷ Plaintiffs brought this action and several others⁷⁸ only after failed attempts to assume control of the Board and to convince the Board to support their claims against Best. Plaintiffs alleged that Best served as general counsel for the MPRA and failed to conduct a “due diligence” inquiry into the Technimar investment.⁷⁹ The lawsuit alleged that the Board was biased and could not make an impartial decision as to whether Best should be sued.⁸⁰

In response to the lawsuit, the Board appointed attorney Robert A. Murnane (“Murnane”) to investigate Plaintiff’s claims and determine whether it was in the best interests of the MPRA to join in Plaintiff’s claim.⁸¹ The Board instructed Murnane to conduct an independent review of this issue but not to “reinvestigate” facts discovered by the two law firms previously hired by the Board in connection with the Welliver investments.⁸² Murnane, however, was free to deviate from the conclusions of those reports.⁸³

After several months of reviewing voluminous documentary evidence and records from other legal proceedings, Murnane concluded that pursuing legal action against Best would “not be a prudent use of the MPRA funds.”⁸⁴ Murnane did not interview Plaintiffs or their counsel.⁸⁵

73. Janssen v. Best & Flanagan, 662 N.W.2d 876, 879 (Minn. 2003).

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. See, e.g., Stocke v. Berryman, 632 N.W.2d 242, 246 (Minn. Ct. App. 2001).

79. Janssen, 662 N.W.2d at 879-80.

80. *Id.* at 880.

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

The Board then moved to dismiss Plaintiffs' derivative suit on the grounds that the court should defer to the judgment of the MPRA, as exercised by its special litigation committee.⁸⁶ The district court held that the business judgment rule, as applied through special litigation committees, applies to Minnesota nonprofit corporations.⁸⁷ However, the court found that Murnane's first investigation was impermissibly limited insofar as the Board had instructed him not to reinvestigate facts described by prior investigations.⁸⁸ Additionally, the court could not determine whether Murnane had offered a business judgment or legal opinion, and was concerned that Murnane did not interview Plaintiffs and their counsel.⁸⁹

Instead of ruling on the Board's motion to dismiss, the district court deferred its decision and gave the Board an opportunity to remedy the deficiencies in Murnane's original report by instructing Murnane to conduct an additional investigation and to submit "adequate evidence of independence and good faith."⁹⁰ The Board subsequently instructed Murnane to conduct such additional investigation as he deemed was appropriate and clearly indicated that Murnane was not limited in any way with respect to the information he could consider or the investigation he could conduct.⁹¹ Murnane then duly conducted such an expanded investigation, which included additional review of various documents as well as interviews with several plaintiffs and their counsel.⁹² At the end of the investigation, Murnane again provided the Board with a report that concluded that pursuing the plaintiffs' claims against Best was not in the business interests of the MPRA.⁹³

Based on Murnane's second report, the Board renewed its motion to dismiss, which was converted into a motion for summary judgment by the district court and granted.⁹⁴ The district court specifically found that Murnane's investigation was conducted independently and in good faith.⁹⁵

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* at 881 (internal quotations omitted).

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.*

B. Janssen in the Minnesota Court of Appeals

The Minnesota Court of Appeals reversed the district court's decision, finding that Minnesota nonprofit corporations lack the statutory authority necessary to appoint a special litigation committee.⁹⁶ Specifically, the court held that under the Minnesota Nonprofit Corporations Act, the Board could only establish committees "subject at all times to the direction and control of the board."⁹⁷ The Business Corporation Act, on the other hand, also contains such language but specifically exempts special litigation committees from board control.⁹⁸ The court reasoned that the differences between these two sections indicated that the legislature did not intend to allow nonprofit corporations to appoint any independent committees and that the inability to appoint such an independent committee was an absolute barrier to the appointment of any special litigation committee by such a corporation.⁹⁹

More importantly, the court of appeals also found that Murnane's investigation failed to satisfy the demands of the business judgment rule.¹⁰⁰ Specifically, the court found that the district court, having ruled that Murnane's first investigation was not conducted with independence and good faith, could not later defer to a decision by that same committee.¹⁰¹

C. Janssen in the Minnesota Supreme Court

The Minnesota Supreme Court partially reversed the court of appeals, holding that the general authority granted by the Minnesota Nonprofit Corporations Act permits nonprofit corporations to appoint a special litigation committee whose decisions are entitled to deference under the business judgment rule.¹⁰² Specifically, the court held that the modern Nonprofit Act and the Business Act were revised many years apart and that a review of the pertinent legislative history relating to each act "produced no discernible indication of why" special litigation

96. *Janssen v. Best & Flanagan*, 645 N.W.2d 495, 498 (Minn. Ct. App. 2002), *aff'd*, 662 N.W.2d 876, 881 (Minn. 2003).

97. *Id.* (citing MINN. STAT. § 317A.241 subd. 1 (2000)).

98. *Id.* (citing MINN. STAT. § 302A.241 subd. 1 (2000)).

99. *Id.* at 498-99.

100. *Id.* at 499-500.

101. *Id.* at 500.

102. *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 884-85 (Minn. 2003).

committee language was omitted from the Nonprofit Act.¹⁰³ In the absence of legislative history, the court considered the consequences of adopting the court of appeals' interpretation of section 317A.241.¹⁰⁴ The two consequences discussed by the court were reminiscent, but significantly different from, the policy rationales of *Auerbach*: the ouster of nonprofit directors from corporate governance and the desirability, from a corporate board's point of view, of being able to "weed out nuisance suits."¹⁰⁵ The court concluded, after applying these *Auerbach*-like policy rationales, nonprofit and for-profit corporations were identically positioned and that, accordingly, both should be afforded the ability to appoint special litigation committees.¹⁰⁶

The Minnesota Supreme Court argued that the court of appeals' statutory argument was misguided because, while "statutes govern certain aspects of corporate life . . . corporate litigation has largely been a creature of common law" that courts can properly address even in the absence of express statutory authority.¹⁰⁷ Alternatively, the court argued that the power to appoint a special litigation committee was one aspect of the broad "incidental" powers of a corporation to govern its affairs.¹⁰⁸ The court concluded that the business judgment rule, as applied through special litigation committees, applies to Minnesota nonprofit corporations.¹⁰⁹ However, the court went on to note that it was not adopting "a particular version of the business judgment rule for use with Minnesota nonprofit organizations."¹¹⁰

After this lengthy analysis, the Minnesota Supreme Court affirmed the court of appeals' decision that the district court could not defer to Murnane's second report, holding that whenever a district court

103. *Id.* at 886.

104. *Id.* at 886-87.

105. *Id.* at 887.

106. *Id.* at 887-88.

107. *Id.* at 887.

108. *Id.* ("The old concept of a corporation as a bundle of only a few, specifically granted powers, has been replaced by the concept of a corporation as an artificial person, lacking only those powers which the law specifically denies to it.") (citing HOWARD L. OLECK, *NONPROFIT CORPORATIONS, ORGANIZATIONS, AND ASSOCIATIONS* § 168 (6th ed. 1994)).

109. *Id.* at 888.

110. *Id.* at 888 n.5 (noting that a more "exacting" level of judicial scrutiny might be called for in the case of nonprofit corporations because the risk of losses cannot be spread to other investments and because investments may be less mobile than in the case of a business corporation). The potential ramifications of these remarks, which arguably draw an untenable distinction between business and nonprofit corporations, for special litigation committees in Minnesota are discussed below.

concludes that a special litigation committee report does not satisfy the business judgment rule, any pending derivative suit must proceed immediately.¹¹¹ According to the court, a board of directors that is faced with derivative litigation has “one opportunity to exercise its business judgment” through a special litigation committee.¹¹² The majority argued this absolute rule “strike[s] a balance” between corporate autonomy and the “nullification” of shareholder rights that would occur if the courts allow corporate boards to “continually improve” their investigations to meet the demands of the business judgment rule.¹¹³ Implicit in this argument is the assumption that a more lenient rule would allow corrupt corporate boards to collude with their special litigation committees to obtain judicial sanction for their decision to bar a derivative action.¹¹⁴

Justice Hanson, joined by Chief Justice Blatz, concurred with the majority’s decision regarding the application of the business judgment rule to nonprofit corporations, but dissented as to its holding that Murnane’s second investigation could not be considered by the district court.¹¹⁵ Justice Hanson argued that there was “no authority” supporting the majority’s “one strike you’re out” rule and that the need for supplemental court-ordered investigations by a special litigation committee should simply be viewed as additional facts that may be relevant to evaluating the committee’s good faith and independence.¹¹⁶

IV. THE *JANSSEN* BALANCING ACT AND ONE-STRIKE RULE— STUMBLING TOWARD A NEW PARADIGM OF CORPORATE RESPONSIBILITY IN MINNESOTA?

The Minnesota Supreme Court decision in *Janssen* purports to be based on an attempt to “balance” allowing corporations to “control their own destiny” and the desirability of “permitting meritorious suits by shareholders and members” to proceed.¹¹⁷ Interpreted broadly, *Janssen* points toward an abandonment of the *Auerbach* approach in Minnesota and may, in the end, accomplish what the legislature’s repeal of Minnesota Statutes section 302A.243 did not—give the Minnesota Court

111. *Id.* at 888-89.

112. *Id.* at 890.

113. *Id.*

114. *Id.* at 888.

115. *Id.* at 890 (Hanson, J., dissenting).

116. *Id.* at 890-91 (Hanson, J., dissenting).

117. *Id.* at 890.

of Appeals an opportunity to develop a new paradigm for evaluating the decisions of special litigation committees.

The *Janssen* decision cites two principal rationales for allowing nonprofit corporations to appoint special litigation committees. First, a “properly functioning board of directors” is better equipped than the courts to make judgments concerning the “merits of a lawsuit” brought by a shareholder or member.¹¹⁸ Second, nonprofit corporations “would benefit from the ability to weed out *nuisance* suits.”¹¹⁹ These principles are reminiscent of the reasoning articulated in *Auerbach*, but seem to place a greater emphasis on the desirability of allowing corporations to eliminate meritless derivative litigation as opposed to absolute board control over corporate affairs.¹²⁰ Prior to *Janssen*, Minnesota decisions expressly regarded the protection of corporate autonomy as a principal goal of special litigation committees.¹²¹ For example, the *Black* court described one of the purposes of the business judgment rule as “preclud[ing] stockholders from disrupting the board’s decision through derivative actions where the board has determined a particular action is not in the corporation’s best interests.”¹²² Despite the arguably different emphasis of the *Janssen* decision, it is clear that *Janssen* did not wholly abandon *Auerbach*’s autonomy rationale. The *Janssen* decision opposes allowing the judiciary to review “the merits of every lawsuit brought by a member of a nonprofit corporation” on the grounds of limited judicial resources,¹²³ corporate autonomy, and a lack of judicial expertise in business affairs.¹²⁴ However, these concerns are tempered by a substantial criticism of the special litigation committee that is implicit in the *Janssen* decision’s bright line rule giving corporate boards “one opportunity” to appoint such a committee.¹²⁵

This aspect of the decision imposes a limit on the otherwise broad

118. *Id.* at 886 (emphasis added).

119. *Id.* at 887 (emphasis added).

120. *See* *Auerbach v. Bennett*, 393 N.E.2d 994, 1002 (N.Y. 1979).

121. *See* *Skoglund v. Brady*, 541 N.W.2d 17, 21 (Minn. Ct. App. 1995); *Drilling v. Berman*, 589 N.W.2d 503, 506-07 (Minn. Ct. App. 1999).

122. *Black v. NuAire, Inc.*, 426 N.W.2d 203, 210 (Minn. Ct. App. 1988) (citing *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979)); *see also* *Skoglund*, 541 N.W.2d at 20 (citing *Black*, 426 N.W.2d at 209-10).

123. *Janssen*, 662 N.W.2d at 886. It is odd that the *Janssen* court would cite this rationale after itself noting that “shareholder-derivative litigation is not an everyday occurrence in Minnesota’s courts.” *Id.* at 882. Presumably, any administrative burden associated with judicial involvement in such suits would be minimal, at least in Minnesota.

124. *Janssen*, 662 N.W.2d at 882.

125. *See id.* at 890 (citing *Kaplan v. Wyatt*, 484 A.2d 501, 508 (Del. Ch. 1984)).

power of trial courts to manage litigation.¹²⁶ Specifically, it prevents a trial court that has found a lack of independence from permitting a corporate board to cure this deficiency through a second investigation.¹²⁷ This bright-line rule is inconsistent with the purposes of the business judgment rule as it has been traditionally articulated by both the Eighth Circuit and Minnesota state courts, and is not directly supported by any decisions in other jurisdictions.¹²⁸ Until *Janssen*, Minnesota courts viewed board autonomy as an essential aspect of corporate existence that must be protected against shareholder or member interference except where the members of a board or their appointees are afflicted by partiality or self-interest.¹²⁹ Carrying this reasoning through to its logical conclusion supports the argument that courts should have the discretion to permit additional investigations by a special litigation committee for purposes of curing errors in its original mandate provided that the committee proceeded independently and in good faith.¹³⁰

The majority rejected this approach, because “[i]f the courts allow corporate boards to continually improve their investigation to bolster

126. For example, a trial court is normally permitted to accept a renewed motion for summary judgment at any time. *See id.* at 891 (Hanson, J., dissenting) (citations omitted).

127. *Id.* The court did suggest that a district court could defer its decision to dismiss a derivative claim pending the submission of additional evidence concerning a committee’s methodology. *Id.* at 889 n.6.

128. The majority does cite several cases in support of this proposition. *Id.* at 889-90. However, all of these cases stand only for the proposition that a derivative suit should proceed when summary judgment has been denied and do not reach the issue decided by the majority in *Janssen*—that a trial court lacks the discretionary authority to allow a board to order its special litigation committee to supplement a deficient report. *See, e.g.,* *Hasan v. CleveTrust Realty Investors*, 729 F.2d 372, 380 (6th Cir. 1984); *Auerbach v. Bennett*, 393 N.E.2d 994, 1003 (N.Y. 1979); *Houle v. Low*, 556 N.E.2d 51, 53 (Mass. 1990); *Will v. Engebretson & Co., Inc.*, 261 Cal. Rptr. 868, 873-74 (Ct. App. 1989); *Lewis v. Fuqua*, 502 A.2d 962, 972 (Del. Ch. 1985); *Davidowitz v. Edelman*, 153 Misc.2d 853, 858 (N.Y. Sup. Ct. 1992).

129. *See Black v. NuAire, Inc.*, 426 N.W.2d 203, 210-11 (Minn. Ct. App. 1988).

130. Such a process would not be appropriate in every case and could even raise additional questions about the integrity of the committee. As Justice Hanson stated:

There may be situations where an initial investigation by a special litigation committee is so tainted that an expanded investigation, at least by the same committee, could not cure the deficiencies in the required independence and good faith. For example, if there was evidence that [a special litigation committee] had developed some bias or was committed to reach the same recommendation no matter what facts or arguments were brought to [its] attention, the [revised] second report would stand no better than the first.

Janssen, 662 N.W.2d at 891 (Hanson, J., dissenting).

These concerns, however, could appropriately be addressed by the district court in the course of evaluating the good faith and independence of the committee.

their business decision, the rights of shareholders and members will be effectively nullified.”¹³¹ While this argument is susceptible to several interpretations, the most reasonable are: (1) any additional investigations ordered by a district court will be guided by the will of the board toward the inevitable conclusion that proposed litigation should be denied,¹³² and (2) a board that has once failed to appoint a special litigation committee to act independently and in good faith should not be trusted to utilize the special litigation committee mechanism.¹³³ However, in either event, the *Janssen* decision expresses a fundamental distrust of the special litigation committee mechanism and assumes that courts are incapable of exercising their discretion to prevent manipulation of that system.¹³⁴

In a final attack on the *Auerbach* approach, the *Janssen* decision specifically noted in dicta that concerns particular to nonprofit corporations may justify application of “a more exacting standard of judicial review” to nonprofit corporations than is applied to business

131. *Id.* at 890.

132. This remark is reminiscent of a broader criticism of the special litigation committee mechanism: that such committees are appointed only because the directors know they will provide a desirable decision. *Joy v. North*, 692 F.2d 880, 888 (2d Cir. 1982), *cert. denied*, *Baldwin v. Joy*, 460 U.S. 1051 (1983) (“If . . . the directors expected any result other than a recommendation of termination . . . they would probably never establish the committee.”)

133. This interpretation, if correct, does not account for the categorical prohibition on supplemental investigations, which the *Janssen* decision adopted. It is entirely possible that a board may be mistaken as to the scope of the investigation that should be conducted or otherwise make some entirely innocent mistake that, under *Janssen*, would doom their corporation to derivative litigation. Presumably, a “continually improving” series of investigations implicitly or expressly guided by the courts would better serve the legitimate interests of shareholders or members than a derivative suit that is permitted to proceed only because of a technical error by the corporation’s board. It is more likely, therefore, that the *Janssen* decision was concerned about a structural problem in the way special litigation committees operate rather than the effect of a failure to correctly appoint a special litigation committee.

134. The mere expression of these concerns may not determine what approach the Minnesota Supreme Court adopts. Nearly all courts have recognized that the decisions of special litigation committees may be infected by structural bias but many have nevertheless found that “independent directors are capable of rendering an unbiased opinion despite being appointed by directors and sharing a common experience with the defendants.” *Strougo v. Bassini*, 112 F.Supp.2d 355, 362 (S.D.N.Y. 2000) (citing *Peller v. The Southern Co.*, 707 F.Supp. 525, 527 (N.D.Ga. 1988), *aff’d*, 911 F.2d 1532 (11th Cir. 1990)). However, at the same time, these are the same kind of criticisms that have led other courts to abandon the *Auerbach* approach. *See, e.g., Zapata Corp. v. Maldonado*, 430 A.2d 779, 789 (Del. 1981); *Houle v. Low*, 556 N.E.2d 51, 56 (Mass. 1990); and *Alford v. Shaw*, 358 S.E.2d 323, 328 (N.C. 1987).

corporations.¹³⁵ Courts that have applied the business judgment rule to nonprofit corporations have not entertained such an approach,¹³⁶ though some commentators have endorsed it.¹³⁷ More importantly, the Minnesota Supreme Court's concern for shareholders who cannot freely move their money out of a nonprofit corporation might equally well be applied to many business corporations, potentially including in some cases closely held corporations¹³⁸ or even publicly traded corporations with alienation restrictions on employee-owned stock. These

135. *Janssen v. Best & Flanagan*, 662 N.W.2d 876, 888 (Minn. 2003). This statement is arguably at odds with Janssen's earlier discussion of the business judgment rule and its application to nonprofit corporations. *Id.* at 883 (concluding that the same needs which drive application of the business judgment rule to business corporations including corporate autonomy, limits on judicial ability to review business decisions, and the need to discourage overly risky adverse behavior apply in the case of nonprofit corporations as well and concluding "that the boards of nonprofit corporations may receive the protection of the business judgment rule"). *Id.*

136. *See* *Finley v. Super. Ct.*, 96 Cal.Rptr.2d 128, 132 (Cal. Ct. App. 4 Dist. 2000) (applying business judgment rule to decision of special committee appointed by homeowners association); *Miller v. Bargaheiser*, 591 N.E.2d 1339, 1343 (Ohio 1990) (applying business judgment rule to decision of special committee appointed by hospital); *see also* *Fairhope Single Tax Assoc. v. Rezner*, 527 So. 2d 1232, 1235-36 (Fla. 1987) (equating members in a nonprofit association with stockholders in a corporation, the court applied the business judgment rule to the nonprofit organization and declined to substantively review the decisions of its governing body); *Tiffany Plaza Condo. Assoc. Inc., v. Spencer*, 416 So. 2d 823, 826-27 (Fla. Ct. App. 1982) (while not specifically mentioning the business judgment rule, the court effectively applied it by deferring to the judgment of the corporation in determining whether a particular real estate improvement was necessary or beneficial to the association); *Chun v. Bd. of Trs. of the Employees' Ret. Sys.*, 952 P.2d 1215 (Haw. 1998) (applying business judgment rule in context of public pension plan); *Papalexio v. Tower West Condo.*, 401 A.2d 280, 286 (N.J. Sup. Ct. 1979) (applying the business judgment rule to preclude legal action on the merits of a decision made by the board of directors of a nonprofit corporation); *Dockside Ass'n, Inc., v. Detyens*, 352 S.E.2d 714, 716 (S.C. Ct. App. 1987) (noting that the business judgment rule applies especially well to nonprofit corporations); *Burke v. The Tennessee Walking Horse Breeders & Exhibitors Assoc.*, 1997 WL 277999, *8 (Tenn. Ct. App. 1997) (court applied the business judgment rule in deferring to the decisions of the board of a nonprofit corporation).

137. *See* Mary Francis Budig et al., *Pledges to Nonprofit Organizations: Are They Enforceable and Must They Be Enforced?* 27 U.S.F. L. REV. 47, 100 (1992) (arguing that nonprofit corporations are exempt from many market and internal forces that promote responsibility to shareholders); *see also* Denise Ping Lee, Note, *The Business Judgment Rule: Should It Protect Nonprofit Directors?* 103 COLUM. L. REV. 925, 956 (2003) (arguing that the threat of litigation is essential to ensure nonprofit directors since other methods of controlling directors are not available in the nonprofit context and endorsing an ordinary negligence standard of conduct for nonprofit directors).

138. A similar argument was made and rejected in *Black v. NuAire, Inc.*, 426 N.W.2d 203 (Minn. Ct. App. 1988), based upon the express language of former MINN. STAT. § 302A.243. *Id.* at 211.

possibilities are all the more real given the absence of viable precedent on this point and *Janssen*'s silence on the issue of what standard of review should be applied to those special litigation committees appointed by business corporations.¹³⁹

While *Janssen* may represent a realization that special litigation committees are a potentially flawed mechanism, the court's reaction to this epiphany leaves much to be desired. The *Janssen* "one strike" rule inflexibly gives plaintiffs' attorneys an opportunity to benefit from good-faith mistakes by a board while failing to prevent directors from appointing committees that formally follow an appropriate methodology but whose conclusions are nevertheless substantively biased.¹⁴⁰ In other words, this rule combines the worst elements of the *Auerbach* approach with an increased probability that meritless derivative suits will be permitted to proceed against corporations. However, *Janssen* is not entirely without merit. The one-strike rule may allow courts to catch an unethical board in the act of controlling its special litigation committee or encourage boards to exercise greater caution to ensure that special litigation committees are independent and act in good faith.

It would have been more consistent with the concerns expressed by the court, as well as with the policy rationales of *Auerbach*, to adopt a more flexible approach to special litigation committees—such as giving corporate boards accused of partiality the option of appealing to the trial courts to select, appoint, and monitor a special litigation committee for them.¹⁴¹ In order to defer any burden this approach might have on the

139. The *Janssen* decision specifically refrained from addressing these issues in the context of either nonprofit or corporate in general. See *Janssen*, 662 N.W.2d at 888 n.5 ("We do not adopt a particular version of the business judgment rule for use with Minnesota nonprofit corporations today."); see also *id.* at 886-88 (discussing numerous "principles" that guide the decision but refraining from any explicit endorsement of a particular approach to special litigation committees). Furthermore, as argued *supra* Part II, controlling precedent on this point (*Skoglund*, *Drilling*, and *Black*) is arguably no longer relevant (in the case of *Black*) or is based on a misinterpretation of precedent and legislative history (*Skoglund* and *Drilling*). In short, the way is open for the Minnesota courts to adopt a less-deferential version of the business judgment rule.

140. See discussion of the deferential approach Minnesota courts have taken when reviewing the decisions of special litigation committees, *supra* Part II. Since courts have limited their analysis to whether a committee's methodology was proper, a committee could shelter improper motives and substantively biased conclusions through a formally neutral and complete methodology.

141. *Miller v. Register & Tribune Syndicate, Inc.*, 336 N.W.2d 709, 709 (Iowa 1983) (holding that directors charged with misconduct may not participate in the selection of special litigation committee members and that, where the majority of a board is accused of bias, the corporation may apply to the court for judicial appointment of a special litigation committee).

judicial system, corporations could be required to pay a modest administrative fee for this service. This solution would have the advantage of reducing the numerous problems occasioned by allowing directors accused of misconduct to select those who will determine their fate and could, if the courts exercise good judgment, also reduce the impact of the structural bias that concerned *Zapata* and its progeny.

Another difficulty with *Janssen* is that the decision fails to fully address the concerns the Minnesota Supreme Court has expressed about the potential for abuse of the special litigation committee. *Janssen's* decreased emphasis on corporate autonomy and concern that special litigation committees may become vehicles to prohibit legitimate shareholder claims suggest that the Minnesota Supreme Court has implicitly endorsed a more substantive paradigm for evaluating the decisions of such committees.¹⁴² This “balancing” of the need to permit legitimate shareholder suits while respecting corporate autonomy is more reminiscent of *Zapata* than *Auerbach*.

The essence of *Zapata* is a two-step standard of review requiring courts to first consider the independence and good faith of a committee,¹⁴³ and second to “determine, applying its own business judgment” whether the derivative suit should be dismissed.¹⁴⁴ The second step does not necessarily involve a detailed factual inquiry.¹⁴⁵ Furthermore, the second step is discretionary and is employed only where a court senses that the procedural requirements of the business judgment rule have concealed substantive bias or that the shareholder’s action is deserving of further review prior to termination in order to ensure that the corporation’s interests are protected.¹⁴⁶ This review has been compared to an “imprecise smell test allowing the court to search between the lines of the SLC’s report of [sic] the scent of a meritorious claim enclosed within a record that has not been opened by truly adversarial proceedings.”¹⁴⁷

142. See *Janssen*, 662 N.W.2d at 890 (expressing the concern that shareholder’s rights would be nullified if a corporate board is allowed to use investigation to bolster their business decision).

143. See *Strougo v. Bassini*, 112 F.Supp.2d 355, 361 (S.D.N.Y. 2000) (summarizing *Zapata* approach).

144. *Id.*

145. See *Zapata Corp. v. Maldonado*, 430 A.2d 779, 788-89 (Del. 1981) (stating that the court’s review requires only a “balancing of probabilities as to the likely future benefit” of the suit to the corporation, not a detailed analysis of the proposed suit’s merits).

146. *Id.* at 789.

147. *Strougo*, 112 F.Supp.2d at 368 (quoting *Johnson v. Hui*, 811 F.Supp. 479, 490

In some sense, *Janssen* has implicitly endorsed a limited and inflexible version of this approach by finding that the failure to appoint an independent committee is suspicious enough to taint all further efforts by a board to redeploy the committee, even if subsequent investigations are procedurally flawless. The *Janssen* court appears to have “looked between the lines” and found that such a situation likely indicates misconduct. It would be wholly consistent with *Janssen* for a court to apply this same methodology and “balancing test” in other circumstances where the facts suggest a meritorious suit is being suppressed.

There are several good reasons for the Minnesota courts to do so. First, as discussed in this article, *Skoglund*, *Drilling*, and *Black* are not based on firm authority, and the reasoning of *Janssen* seems to authorize a rejection of the *Auerbach* approach. Furthermore, a majority of jurisdictions have recognized the fundamental problems inherent in the special litigation committee system, as explained above, and found that these problems necessitate substantive judicial intervention.¹⁴⁸ Adopting the approach of one of these jurisdictions, such as the *Zapata* approach, would give the Minnesota courts an extensive amount of experience and precedent to draw upon. *Janssen* has opened the door for the Minnesota courts to take up the task given to it by the legislature when Minnesota Statutes section 302A.243 was repealed. All that remains is for an enterprising trial court or appellate court to walk through it.

V. CONCLUSION

Until *Janssen*, the Minnesota Court of Appeals had mistakenly held that it was bound to follow the *Auerbach* approach for over a decade. *Janssen* did not directly address the propriety of these decisions, but it did present a framework that, if followed in subsequent decisions, would seem to suggest that a less-deferential approach to special litigation committee decisions is now the law of Minnesota. The precise contours of this new approach have yet to be defined by the courts, but the fundamental logic of *Janssen* and strong public policy concerns suggest that a version of the *Zapata* or *Miller* approaches may be appropriate.

(N.D. Cal. 1991)).

148. See *id.* at 362 (stating “[s]tructural bias in special litigation committees has been widely discussed and analyzed” and noting that the standards of review developed by courts are “designed to overcome the effects, if any, of structural bias”) (citing *Weiland v. Illinois Power Co.*, 1990 WL 267364, at *15 (C.D. Ill. Sept. 17, 1990)).