

# Minority Shareholders in Massachusetts May Walk Softly, But They Carry a Big Stick - Legally Speaking That Is

By Andrew P. Botti

## 1. Business Background in the Foreground

Business disputes in the United States are legion, and always have been. For a myriad of reasons, competing companies in the same industry often wind up in court. Some of the typical scenarios: employee raiding; wrongful customer solicitation; theft of trade secrets; trade dress encroachment, copyright violations, and the like. Just as numerous – and often more emotional and acrimonious – are disputes between shareholders in the same privately held company. These disputes often arise in situations where the majority owners, for multiple reasons, decide to oust the minority, or minimize and compromise the value of shares held by the minority. My own father founded a privately held business in which he had 50% of the shares. His three partners held the remainder. After many years together they split up like a bad divorce. I never learned why, and he never talked about it. I knew, however, despite my tender age, that it was a very difficult (and costly) ending to what had been his life-long dream.

But why? A lot has to do with the limited “investment value realization” options available to shareholders in private corporations. Investors in public companies can dump the stock whenever they want. Partners in private partnership can often “cash out” their equity investment upon resignation from, or dissolution of, the partnership. But shareholders in closely held - that is “private” - companies do not have these readily available “liquidity” options. “A shareholder wishing to convert an investment in a close corporation to cash for personal financial reasons or because of unhappiness with the management of the enterprise will have only a limited number of opportunities for disposing of the asset.” *Goode v. Ryan*, 397 Mass. 85, 90 (1986). For this reason, Massachusetts common law – that is, court or judge-interpreted law – has long provided various legal safeguards for minority shareholders who may suddenly find themselves “oppressed” by the majority ownership of a privately held business. This article will discuss numerous remedies provided under the common law of the Commonwealth for minority shareholders experiencing such oppression. It will also cover the inverse scenario: minority shareholders oppression of the majority, which happens all too often. It is important to note that these type of cases are very fact sensitive. Given that the deciding courts are “sitting in equity” when fashioning remedies, the ultimate legal outcome is very difficult, if not impossible, to predict. This is why counsel should be retained from the outset to help alleviate – to the extent possible – the inherent uncertainty surrounding the ultimate resolution of a given matter.

## 2. Minority Disadvantage Somewhat Mollified By Applicable Law

The courts in Massachusetts have resorted to the concept of legal “equity” i.e., fairness, to resolve disputes between shareholders in privately held companies. This is a tremendously powerful area of law, as “[t]hose equitable remedies may be awarded without a showing of damage and causation.” *MAZ Partners LP v. Shear*, 265 F. Supp.3d 109 (D.Mass. 2017). Injury in this context may consist of loss of “undivided loyalty” rather than monetary loss. *Id.* at 117. Massachusetts law recognizes that “equitable remedies are flexible tools to be applied with the focus on fairness and justice.” *Id.* at 118. (Citation omitted.) “Under Massachusetts law, shareholders

in a closely held corporation have different obligations from those in an ordinary corporation. A closely held corporation is “typified by: (1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation.” *Butler v. Moore*, 2015 WL 1409676 (F.Supp.3d 2015) p. 49. Minority shareholders in private companies may have unrealistic expectations when it comes to fully realizing the fruits of their labors, or “cashing out” when they feel the time is right. Indeed, many minority shareholders – if not most – expect to realize the gains of their investment by full employment in the close corporation. The legal reasons for this are clear:

In the absence of an agreement among shareholders or between the corporation and the shareholder, or a provision in the corporation’s articles of organization or by-laws, neither the corporation nor a majority of shareholders is under any obligation to purchase the shares of minority shareholders when minority shareholders wish to dispose of their interest in the corporation. *Goode*, 397 Mass. at 90-91. (Emphasis added.)

Hence, the conundrum for the minority shareholder. To make matters more complicated, minority shareholders in closely held corporations are susceptible to “oppression” by the majority or controlling shareholders. Such cases are endless, both in scope and breath. This is somewhat ironic since the law is clear that there is, and always has been, a “distinctive nature” to a close corporation such that many legal remedies are available to those shareholders suffering oppression or unfairness at the hands of the majority. “[S]hareholders in a closely held corporation ... owe a ‘duty of utmost good faith and loyalty’ to the other shareholders.” *Butler* at p. 50, citing *Donahue*, 367 Mass. at 592-593. This duty of loyalty is more strict and comprehensive than that required of shareholders in corporations generally speaking. See e.g., *Demoulas v. Demoulas Super Markets, Inc.*, 424 Mass. 501, 529 (1997). “Just as in a partnership, the relationship among the stockholders [in a closely held corporation] must be one of trust, confidence, and absolute loyalty if the enterprise is to succeed.”

And a director’s duty of loyalty to the corporation means he cannot place his own interests above that of the corporations in a manner which would harm the business. See e.g., *Orsi v. Sunshine Art Studios, Inc.*, 874 F.Supp. 471, 475-476 (D. Mass. 1994). The *Donahue* Court went on to observe an often recognized reality:

Close corporations with substantial assets and with more numerous stockholders are no different from smaller close corporations in this regard. All participants rely on the fidelity and abilities of those stockholders who hold office. Disloyalty and self-seeking conduct on the part of any stockholder will engender bickering, corporate stalemates, and, perhaps efforts to achieve dissolution. *Donahue* at 587. (Emphasis added.)

Despite these well-recognized legal precepts, minority shareholders remain vulnerable to unscrupulous conduct by the majority.

### 3. The Traditional Majority Cudgel is Well-Recognized

The *Donahue* court went on to list a variety of long-recognized often utilized oppressive business measures the majority may, and often do, implement against minority shareholders:

- Refusal to declare dividends;
- Draining of corporation earnings via excess salaries/bonuses;
- Exorbitant rent paid to majority shareholder building owners;
- Depriving minority shareholders of appropriate employment;

- Sell-off of corporate assets to the majority at inadequate prices.

Donahue at 589. In these ways – and others – the majority may effectively compelled the minority to sell their shares at an extremely discounted value, having left them “trapped in a disadvantageous situation.” These so-called “freeze-out” schemes are designed to do precisely that, and essentially render useless and valueless the often substantial investments made by minority shareholders in the subject venture. These inequities fortunately are addressed by the common law.

#### 4. What’s Fair is Fair, Particularly in Business

To avoid such calamities, the common law treats shareholders in close corporations as partners with the same fiduciary obligations to one another. Thus, stockholders of close corporations “must discharge their management and stockholder responsibilities in conformity with” the standard of “utmost good faith and loyalty” to the corporation itself and all other shareholders. This is recognized as a higher legal standard than the “fiduciary duty” which directors and shareholders of all corporations are held to vis-à-vis the corporation per se and the other stockholders. “The controlling group [majority owners] may not, consistent with its strict duty to the minority, utilize its control of the corporation to obtain special advantages and disproportionate benefit from its share ownership.” Donahue at 598. Due to this high good faith standard, equitable remedies tailor-made to fit and resolve these wrongdoings are available.

Ultimately, in the Donahue case, the majority controlled corporation was ordered to purchase the minority shareholder’s shares at the same price as that used to purchase a majority owner’s shares. Under the close corporation fiduciary duty standard, the minority shareholder had to be given the same opportunity to sell shares at the same price as the majority owner.

#### 5. What Goes Around May Come Around

The minority, however, does not have carte blanche to behave in a completely self-serving manor simply because it may be somewhat disadvantaged due to lack of shares. In *Smith v. Atlantic Properties, Inc.*, 12 Mass. App. Ct. 201 (1981), both the company by-laws and articles of organization required an affirmative vote of 80% of all outstanding shares for approval of corporate action. There were four shareholders, each of which held a 25% interest in the company. This distribution effectively meant that unanimous consent was necessary to effectuate any significant action by the corporation or an officer thereof. The founder of the business – a real estate management company – steadfastly refused to declare dividends. The other three shareholders constituting a majority wanted dividends paid in order to avoid certain substantial IRS tax penalties for “unreasonable accumulation of corporate earnings.” The minority shareholder claimed that he wanted to retain corporate funds in order to implement various real estate improvements recommended by a consultant. The minority owner, however, did not have any specific plans for making real estate improvements. The minority shareholder nevertheless continuously refused year after year to vote for the dividend distributions desired by the other three shareholders. This resulted in major tax penalties being assessed against the corporation.

The 80% majority rule in effect had made the minority shareholder “an ad hoc controlling interest.” *Id.* at 207. The minority shareholder actually testified that he insisted on the 80% provision “in case the people [the other shareholders] whom I knew, but not very well, ganged up on me.” *Id.* at 207. The majority shareholders eventually challenged legally the minority shareholder’s continuous refusal to vote for dividend distributions,

and thereby avoid tax penalties. The court found that in refusing to declare dividends, “we think that [the minority shareholder] recklessly ran serious and unjustified risks of precisely the penalty taxes eventually assessed, risks which were inconsistent with any reasonable interpretation of a duty of ‘utmost good faith and loyalty.’” *Id.* at 209. (Emphasis added.) Thus, refusal to make distributions was the legal equivalent of breach of that legal standard by the minority. “The protections of Donahue are not limited to those with less than 50% share ownership.” See *Zimmerman v. Bogoff*, 402 Mass. 650, 657 (1988). The Donahue court recognized explicitly that in close corporations, the minority shareholders “may do equal damage through unscrupulous and improper ‘sharp dealings.’” *Donahue*, at 593 n. 17.

#### 6. **There is a Risk Regarding the Traditional Fix**

Fast-forward several decades after the Donahue decision. The law pertaining to minority shareholder remedies for freeze-outs was somewhat refined by a few salient cases. In *Brodie v. Jordan*, 447 Mass. 866 (2006), the court was charged with determining the appropriate remedy for a minority shareholder “freeze out.” The minority shareholder claimed that the two majority owners had purposefully kept her from any participation in company activities, prevented her from access to company information, and effectively denied her the “economic benefit of her shares.” *Brodie* at 867. The minority shareholder won her freeze-out case before the trial court, and the majority shareholders were ordered to buy her out. On appeal, the “buy-out” remedy was reversed, having found to be inappropriate under the circumstances.

The minority shareholder had inherited her minority share interest from her husband who had founded the subject close corporation. The other two shareholders subsequently prevented her from becoming a company director, refused to have her shares valued, and refused to provide her with the “financial and operational information” she had requested. The appellate court found that in doing so, the majority shareholders had stymied the minority shareholder’s “reasonable expectations of benefit” by virtue of holding shares. The majority shareholders had given the minority shareholder permission to sell her shares to a third party. By refusing to conduct a professional appraisal of stock value, however, the majority had effectively prevented her from doing so. Nevertheless, the appellate court refused to find that a forced buy out was the appropriate remedy in this particular instance, where neither of the other majority shares were being bought. The Court opined:

The remedy of a forced buyout may be an appealing one for a court of equity in that it results in a “clean break” between acrimonious parties. Yet this rationale would require a forced share purchase in virtually every freeze-out case, given that resort to litigation is itself an indication of the inability of shareholders to work together. In any event, no matter how expedient a forced buyout may be as a solution, the remedy for a breach of fiduciary duty must be proportional to the breach. Other remedies are available to compensate and protect minority shareholders without radically transforming the nature of their asset or arbitrarily increasing its value. *Brodie* at 872-873. (Emphasis added.)

The court held that other remedies such as allowing the minority owner dividends or participation in the company business, were more appropriate.

#### 7. **Balance Right or Fall Hard**

A “balancing test” of sorts was established in *Wilkes v. Springside Nursing Home, Inc.*, 370 Mass. 842 (1976) – an instance where a minority shareholder was terminated from employment in the close corporation he had

founded many years earlier. The Court in *Wilkes* recognized that majority shareholders “must have a large measure of discretion... in declaring or withholding dividends, deciding to merge or consolidate, establishing the salaries of corporate officers, dismissing directors with or without cause, and hiring and firing corporate employees.” *Wilkes* at 851. The *Wilkes* Court said of the *Donahue* opinion:

The *Donahue* decision acknowledged, as a ‘natural outgrowth’ of the case law of this Commonwealth, a strict obligation on the part of majority stockholders in a close corporation to deal with the minority with the utmost good faith and loyalty. On its face, this strict standard is applicable in the instant case. The distinction between the majority action in this case is more one of form than of substance. Nevertheless, we are concerned that untampered application of the strict good faith standard enunciated in *Donahue* to cases such as the one before us will result in the imposition of limitations on legitimate action by the controlling group in a close corporation which will unduly hamper its effectiveness in managing the corporation in the best interests of all concerned. The majority, concededly, have certain rights to what has been termed ‘selfish ownership’ in the corporation which should be balanced against the concept of their fiduciary obligation. *Wilkes* at 851.

The Court found that it was obligated to “carefully analyze” the actions taken by controlling shareholders in a given case: “It must be asked whether the controlling group can demonstrate a legitimate business purpose for its action.” Any such purpose must then be weighed “against the practicability of a less harmful alternation.” *Id* at 852. (Emphasis added.) The majority action in *Wilkes* consisted of denying the minority shareholder and founder of the corporation any further involvement as an officer, director and employee of the company. Any further payments to the minority holders were cut off entirely. These actions stemmed from increasing animosity between the minority holder and one other shareholder in particular. Despite increasing problems with the other shareholder, the minority shareholder had continued to perform his duties for the corporation. The *Wilkes* court, under the circumstances, concluded that “the action of the majority stockholders here was a designed ‘freeze out’ for which no legitimate business purpose has been suggested.” Here, under the circumstances, the Court found:

At a minimum, the duty of utmost good faith and loyalty would demand that the majority consider that their action was in disregard of a long-standing policy of the stockholders that each would be a director of the corporation and that employment with the corporation would go hand in hand with stock ownership; that *Wilkes* was one of the four originators of the nursing home venture; and that *Wilkes*, like the others, had invested his capital and time for more than fifteen years with the expectation that he would continue to participate in corporation decisions. Most important is the plain fact that the cutting off of *Wilkes*’s salary, together with the fact that the corporation never declared a dividend ..., assured that *Wilkes* would receive no return at all from the corporation.

*Id.* at 853. Although *Wilkes* was awarded money damages, he didn’t ask to be reinstated as an officer or director of the corporation, which at times does happen.

When it comes to self-dealing interactions with the corporation, an officer or director is required by their fiduciary duties and the applicable “balancing test” to “first disclose material details of the venture to the corporation, and then either receive the assent of disinterested directors or shareholders, or otherwise prove that the decision is fair to the corporation.” *Demoulas* at 533. “[U]nanimous and fully informed shareholder approval” is generally considered “sufficient to satisfy the duty of loyalty.” *Butler* at p. 52. Thus, “the duty of

loyalty generally prohibits, among other things, a director or shareholder in a closely held corporation from taking, for his or her own personal benefit, a business or investment opportunity that "would be of interest to the corporation" without first presenting that opportunity to the corporation." Butler at p. 61.

#### 8. Holding a Share is Not Always Fair

Being a minority shareholder in Massachusetts does not guarantee employment in the company you may own. In *Merola v. Exergen Corp.*, 423 Mass. 461 (1996), a former minority shareholder of the close corporation wound up suing the company and the majority shareholders because of his termination as an officer and employee. The termination by the majority shareholder was without cause. *Merola* at 461. The court pointed out that in *Donahue, supra*, a claim based upon the duty of utmost good faith and loyalty owed towards shareholders of a close corporation "is an equitable claim against individual stockholders." *Id.* at 464. Breach of this duty owed is a question of law for the court to decide on the facts presented. The *Merola* Court pointed out that even in close corporations with the extant fiduciary duties, the majority shareholders are allowed legally broad discretion to:

- Declare or withhold dividends;
- To merge or consolidate the company;
- Set the salaries of corporate officers;
- Dismiss directors with or without cause; and
- Hire and fire corporate employees.

*Id.* at 464. The Court also noted, however, that minority shareholders typically depend upon their salary as the principle means of realizing a return on their investment. The Court in *Merola* concluded that: "[t]he investment in the stock was an investment in the equity of the corporation which was not tied to employment in any formal way." *Merola* also noted that the stock investment increased in value "independent of the employment expectation." In fact, the minority shareholder sold his stock back to the corporation after his termination for a hefty price – much higher per share than he had purchased it for. In finding that the termination of the minority shareholder was not a breach of fiduciary duty by the majority shareholders, the Court concluded:

Although there was no legitimate business purpose for the termination of the plaintiff, neither was the termination for the financial gain of [defendant] or contrary to established public policy. Not every discharge of an at-ill employee of a close corporation who happens to own stock in the corporation gives rise to a successful breach of fiduciary duty claim. The plaintiff was terminated in accordance with his employment contract and fairly compensated for his stock. He failed to establish a sufficient basis for a breach of fiduciary duty claim under the principals of *Donahue v. Rodd Electrotrope Co.*

Thus, minority shareholder status does not guarantee employment with the subject close corporation. A similar conclusion was reached in *Vakil v. Anesthesiology Associates of Taunton, Inc.*, 51 Mass. App. Ct. 114 (2001). In *Vakil*, unlike in *Merola*, the minority shareholder signed a written employment agreement with the close corporation which provided that he could, in fact, be terminated upon proper written notice. The minority shareholder also signed a stock redemption agreement with the company. This agreement required the minority shareholder to sell his shares back to the company when terminated from employment. The two majority shareholders eventually voted to terminate the minority holder's employment. The termination was not a breach of fiduciary duty owed to a minority shareholder:

Where there was no evidence that the plaintiff's compensation or employment was conditioned on his ownership of stock in the corporation or that the majority stockholders acted out of a desire to increase their financial gain in the corporation, the majority stockholders' termination of the plaintiff's employment and repurchase of his stock in accordance with the agreements into which the plaintiff had freely entered did not constitute a breach of fiduciary duty. *Id.* at 118-119.

The Vakil court emphasized that the termination of the minority shareholder's employment with the close corporation did not result in a financial gain or windfall for those employees who held the majority of shares in the company.

#### 9. Employment Requires a Duty of Loyalty, But Doesn't Always Get it

In *O'Connor v. Kadrmas*, 96 Mass. App. Ct. 273 (2019), the Court found that one of the shareholders had violated his fiduciary duties to a minority shareholder by surreptitiously helping to start up a competing business within a mile of the existing close corporation. The miscreant shareholder secretly planned to solicit patients, referral sources and key personnel from the existing close corporation, all while he was president of the close corporation. In so doing, the Court pointed out that: "the relationship among the stockholders [of a close corporation] must be one of trust, confidence and absolute loyalty if the enterprise is to succeed." *Id.* at 234. *Chelsea Indus., Inc. v. Gaffney*, 389 Mass. 1, 11-12, 449 N.E.2d 320 (1983). While president and shareholder, the defendant:

had a duty not to frustrate the reasonable expectations of Kadrmas, whether by soliciting POK doctors or employees, refusing to hire replacement doctors which he remained president of POK, or otherwise taking steps designed to gut POK's and Kadrmas's ability to compete with OCB or to recover from O'Connor's departure. See *Pointer v. Castellani*, 455 Mass. 537, 550, 918 N.E.2d 805 (2009) ("A breach of fiduciary duty through a freeze-out also occurs when the reasonable expectations of a shareholder are frustrated"). O'Connor was free to do all of these things after he left POK; the problem for him here is that the record permits the inference that he did not wait until his departure. (Emphasis added.)

All this was so although the close corporation's president – O'Connor – had not signed a non-compete or non-solicitation agreement with the company. His fiduciary obligations did not permit him to essentially compete with his own company before he left said company.

#### 10. What's Good for the "Inc." is Good for the "LLC" Legally

Taking these principles a step further, the courts have reasoned that, "[a]s a matter of logic and fairness, there is no reason why the fiduciary duties of members of a closely held LLC should be materially different from those of shareholders of a closely held corporation....an LLC is, practically speaking, something of a hybrid of a corporation and a partnership[.]" *Butler* at p. 51. By ignoring purposefully the express terms of an operating agreement governing the operations of an limited liability company or LLC, majority shareholders may breach their fiduciary duty to minority owners of the LLC.

In *Penebre v. Kurland*, 33 Mass. L. Rptr. 621 (2016), the minority shareholder was the principle salesperson of the corporation. His total compensation – and that of his subordinate sales persons – consisted of 100%

commissions. Following unsuccessful attempts to resolve disputes between the majority owners and the head of sales, the majority voted to close the Boston based sales office and terminate all salespeople, including the minority owner, the head of sales. Right after the vote, the majority owners began to dismantle the Boston sales office. The minority owner sought a court order preventing any further such actions by the majority, citing breach of fiduciary duty by the majority owners. The Court sided with the minority owners:

What the majority members did by their unauthorized, self-help conduct was to deny [the minority] the fruits of their employment and member status.

The Operating Agreement expressly provided that any such drastic action such as terminating an agreement with another shareholder required a super-majority vote of 85% of the shares held. The majority owners did not collectively hold this percentage of shares. Thus, when they took the vote, declared victory, and began dismantling the company's Boston office – they were dead wrong: “Because the vote to terminate the Boston office and fire employees failed to obtain an 85% vote of the members the vote was a nullity.” The Court went on to find that the majority action was a “classic example of a corporate “freeze out” of a minority shareholder.”

Courts may fashion equitable remedies in freeze-out actions which may consist of actually rewriting portions of an LLC Operating Agreement after a merger. This may be done to ensure that LLC members holding a minority interest in a pre-merger LLC are not treated unfairly by the terms of the new LLC's Operating Agreement. In *Allison v. Erickson*, 479 Mass. 626 (2018), the Court affirmed the trial Court's rewriting of an Operating Agreement to protect the interests of a minority shareholder. The minority shareholder in the original LLC was not aware of and did not approve the merger of the original LLC into a new LLC created by the majority. The Court rejected the exclusive statutory remedy provided by the LLC law, finding that the surreptitious merger amounted to a freeze out. This was so because the terms of the new Operating Agreement governing the new Delaware LLC were markedly different than the terms of the original LLC Operating Agreement:

The operating agreement for ATT-DE is significantly different from the operating agreement for ATT-MA. The ATT-DE operating agreement creates a class of preferred shares with liquidation preference over common shares, and establishes a board of directors (board) to manage the company. Members have no rights other than to select the directors of the board. Directors of the board are elected by members holding a majority of the company's outstanding shares. Erickson could select the directors. As a minority member, Allison would not have the ability to successfully elect directors by himself. The operating agreement also provides that members owe no fiduciary duty to ATT-DE or one another, and attempts to limit all other duties to the extent permitted by Delaware law. Members do not have the right to access ATT-DE's books or records, or to receive any information about ATT-DE's business or affairs, without the board's authorization. No membership interest may be transferred without board approval, even to family members. *Id.* at 631.

The Court found that the terms of the original operating agreement “expressly prohibited many of the consequences of the merger, such as the ability to dilute a member's interest without that member's consent, the ability to amend the operating agreement without the original member's consent, and the ability to cut members out of the management of the company.” *Id.* at 635. The majority holder's “secret merger” clearly “subverted each of these explicit protections.” The original operating agreement “structured the LLC as a closely held company designed to prevent the very freeze-out accomplished by the merger” via the new operating agreement. *Id.* at 637. The appellate court found that the trial judge “carefully crafted an equitable remedy, amending specific



provisions in ATT-DE's operating agreement." The new operating agreement had essentially diminished the minority owner's rights.

#### 11. **Leading Bad Actors May Hurt Company More Than Minority Thespian**

The wrongdoing by Directors and controlling shareholders demonstrated by paying themselves and their relatives excessive compensation, refusing to declare dividends, and attempting to purchase minority shares for meager amounts, may constitute harm to the corporation per se, as well as the minority. In *Crowley v. Communications for Hospitals, Inc.*, 30 Mass. App. Ct. 251 (1991) the Court found that the controlling shareholders withdrew, "as compensation for themselves and members of" one of the controlling shareholder's family, "virtually the entire net income of the company" for a five year period. *Id.* at 757. And this during a time when gross revenues of the company declined substantially. The Court found that these distributions were a "function of available net income, not performance" of the majority and their family members. Moreover, the majority claimed falsely that they were full time employees in an attempt to conceal the excessive compensation they took. The Court concluded:

There is manifest unfairness to the excluded, nonconsenting minority interests for the majority, year after year, to appropriate to themselves substantially all of the net income of the enterprise, and such an operational policy, which deprives the company, and therefore its stockholders, of all opportunities for growth in net worth, serves no legitimate business purpose. *Id.* at 759. (Emphasis added.)

As for paying their relatives, the Court pointed out that there was no "jurisprudence of this commonwealth establishing hereditary entitlements to compensate without the consent of independent directors and a majority of the disinterested stockholders." *Id.* In so holding, the Court emphasized that "there were no authorizing or ratifying votes of disinterested directors or of the minority stockholders in respect of compensation paid to the defendants." *Id.* The trial judge had found a "freeze-out" of the minority shareholder via the nefarious and continuous cash draining by the majority:

This "freeze-out," he found, consisted of (i) seizure of majority control of the company, (ii) payment of excessive compensation to themselves and their relatives, (iii) refusal to declare dividends, (iv) failure to make available the opportunity to redeem the Crowley shares on the same basis as was made available to the majority, and (v) attempting to purchase the Crowley shares at a bargain price. *Id.* at 762.

The excessive compensation made the payment of dividends to the minority impossible. In fashioning a remedy for the excessive compensation structure, the Court found that "a "freeze-out" scheme may well be an element of a case for direct relief [for the minority], but it is not necessarily sufficient to preclude the need for derivative relief," i.e., relief to the corporation per se. *Id.* at 765. In so finding, the Court fashioned a remedy calling for the return of misappropriated funds to the corporation to be distributed "as a dividend to all of the stockholders." The Court reasoned:

The Crowley and Lakewitz interests have been frozen out of the benefits of this business for more than a decade; they are now entitled to participate in the favorable results of operations to the extent that those results have been wrongly appropriated by the majority. The failure to pay dividends has not been in good faith, there has

been a "plain violation of the rights of stockholders," and an order requiring a dividend distribution of the amount wrongfully withheld by those in control is required to right the wrong that has been done. *Id.* at 768.

Varying facts will determine whether claims brought by minority shareholders belong to the shareholders *per se*, or to the corporation. As the Court stated in *O'Donnell v. Davidson*, 34 Mass L. Rptr 493 (2017):

The Supreme Judicial Court in *Bessette v. Bessette*, 385 Mass. 806 (1982), provided guidance as to when a breach of fiduciary duty by a director or majority shareholder gives rise to a personal action by a minority shareholder. Acknowledging that shareholders in a close corporation owe one another fiduciaries duties ... the Court noted that "our holding in *Donahue* applies if '[i]t would be difficult for the plaintiff ... to establish breach of fiduciary duty owed to the corporation ...'" *Bessette*, 385 Mass. at 809, citing *Donahue* at 589, n.14. In other words, if the minority shareholder suffers a harm unique to himself, as in *Donahue*, he may sue directly. But if the harm perpetrated by the majority is suffered by the corporation, the remedy is a derivative action on behalf of the corporation. The Court concluded that "[i]t is a basic principal of corporate law that if a majority stockholder receives corporate cash distributions and a salary in excess of the reasonable value of services rendered, the right to recover the overpayments belongs to the corporation." *Bessette*, 385 Mass. at 809. The direct action by the minority shareholder in *Bessette* was dismissed. *Id.* at 810.

The *O'Donnell* Court found that if "there has been an unlawful diversion of money or opportunity away from [the corporation], the harm is to the corporation," not the individual minority shareholder. *Butler v. Moore*, F. Supp. 3d (2015) also found:

Thus, if a majority shareholder improperly removes assets from a corporation, or diverts assets away from it, the wrong is normally inflicted on the corporation itself, and recover should be made on behalf of the corporation. See, e.g., *Bessette*, 385 Mass. at 809-10 and n. 5...(distribution of excess salaries and dividends to majority shareholder is a claim of the corporation; "plaintiffs do not allege that the defendant's conduct was an attempted 'freeze-out' of the minority stockholders by draining off 'the corporation's earnings in the form of exorbitant salaries and bonuses.' ... Thus, the vulnerability of minority stockholders, which we found controlling in *Donahue*, is missing."); *Schaeffer v. Cohen Rosenthal, Price, Mirkin, Jennings & Berg, P.C.*, 405 Mass. 506, 513 [] (1989). However, if the majority shareholder inflicts harm directly on the minority shareholder (such as freezing him or her out of the business or terminating his or her employment) the claim may be asserted directly.

## 12. What You Should Do Now That You Know How It Is

The above cases demonstrate unequivocally that the Court of this Commonwealth have tremendous power when it comes to resolving disputes between shareholders in a close corporation. The courts can even re-write operating agreements if they appear to be one-sided and "unfair." The challenge for shareholders in a battle with one another is attempting to figure out what precisely will the remedy be? In equity jurisdiction, the court will fashion a remedy based upon what it thinks is fair and just under the circumstances. Courts usually follow general precedent governing liability, but when sitting in equity, so to speak, may fashion remedies they feel are consistent with the specific facts found in each individual case. I actually worked on the *Crowley* case cited above in its later stages, after the decision of the appeals court. There was no expectation that the final ruling would require that money paid back into the corporation be paid back out again to all shareholders – even the wrongdoers who were found to have created the business maelstrom to begin with! Its makes sense then when starting a close corporation to consult with counsel to determine what the best form

of governance would be, i.e., what should be contained in the articles of organization and the by-laws respecting voting rights and percentages necessary to effectuate company policy and procedure. Also, shareholder rights to employment and termination thereof, and stock buy-back consequences, should be in writing ab initio – that is, from the beginning. As should stock “buy-back” provisions upon termination. “[Q]uestions of good faith and loyalty with respect to rights on termination or stock purchase do not arise when all the stockholders in advance enter into agreements concerning termination of employment and for the purchase of stock of a withdrawing or a deceased stockholder.” *Blank v. Chelmsford Ob/Gyn, P.C.*, 420 Mass. 404, 408 (1995). “When rights of stockholders arise under a contract, however, the obligations of the parties are determined by reference to contract law, and not by the fiduciary principles that would otherwise govern. When a director’s contested action falls entirely within the scope of a contract between the director and the shareholders, it is not subject to question under fiduciary duty principles.” *Chokel v. Genzyme Corporation*, 449 Mass. 272, 278 (2007). There is no question that “[a]greements in a corporation’s articles of organization or bylaws are treated as contracts between the shareholders and the corporation.” *Merriam v. Demoulas Super Markets, Inc.*, 464 Mass. 721 (2013). As Merriam went on to say:

Although a shareholder in a close corporation always owes a fiduciary duty to fellow shareholders, good faith compliance with the terms of an agreement entered into by the shareholders satisfies that fiduciary duty. A claim for breach of fiduciary duty may arise only where the agreement does not entirely govern the shareholder’s actions.

Merriam at 727. It is worth noting, however, that “there is an implied covenant of good faith and fair dealing between parties to a contract.... Such a covenant requires ‘that neither party shall do anything that will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.’” *Blank* at 407. (Citation omitted.)

When controversies become unresolvable, again counsel should be consulted before any material actions or decisions are implemented. Such consultation is the best way to try and avoid what may be a very long and costly court action. The good news is that court’s sitting in equity can fashion preliminary injunctive relief to maintain the status quo ante until controversies are resolved by the parties. This can happen very quickly relative to the traditional “Bleak House,” years-long type of lawsuit. And failure to follow a court’s preliminary order can lead to contempt proceedings, not to mention a complete loss of credibility with the court.

Equitable r mstances, a wronged shareholder need not even prove actual damages to recover money under certain equitable remedies for breach of fiduciary duty. See e.g., *Fidelity Management & Research Co., v. Ostrander*, 1993 WL 818684 (Mass. Super. 1993) (where the defendant breached her fiduciary duty she owed plaintiff, “the appropriate remedy is disgorgement of her improper profits... It is of no import whether or not the plaintiffs in this case suffered any measureable monetary damages.)

The cases cited herein and their outcomes illustrate abundantly that these matters are very fact intensive and “fact sensitive,” and thus the ultimate rulings in such cases are difficult to call from a legal perspective.

### About Andrew P. Botti

Andrew represents corporations, smaller businesses, and family owned and operated enterprises in complex business and employment-related issues. He advises management and business owners/operators on business disputes, shareholder issues, employee discrimination claims, and commercial litigation matters. He has tried numerous cases to verdict in both state and federal court, and has appeared before various administrative and legislative agencies such as the Massachusetts Commission Against Discrimination. Andrew has testified before the Joint Committee on Labor and Workforce Development of the Massachusetts legislature regarding the efficacy of "An Act Relative to Non-competition Agreements," and has been actively involved in the debate over recent efforts to eliminate non-competes in their entirety.



Andrew was appointed to the Massachusetts Economic Development Planning Council by Governor Charlie Baker. The Council's mission was to develop a written comprehensive economic development policy for Massachusetts, and construct a strategic plan for its implementation. The plan was eventually signed into law by the Governor.

In December 2014, Andrew was appointed by Governor-Elect Charlie Baker to the Baker-Polito Transition Team Subcommittee on Jobs and the Economy. In this capacity, Andrew helped prepare findings and recommendations for the new administration.

Andrew is currently a member of the Board of Directors of AIM, the Associated Industries of Massachusetts. Founded in 1915, AIM is the oldest and largest statewide association working to serve and foster the business interests of Massachusetts employers. He formerly served as Chairman of the Board of SBANE, the Smaller Business Association of New England, from 2009 - 2011. SBANE (now known as the New England Business Association) was founded in 1938 to promote and foster the interests of smaller businesses throughout the 6 state region.

Andrew received his J.D. from Northeastern University (1991) and B.A. from Columbia University (1983). He was previously a litigation partner at Donovan Hatem LLP, and a Senior Associate at Burns & Levinson, LLP.