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DISPUTES AMONG THE OWNERS OF CLOSELY-HELD SERVICE BUSINESSES

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Marc C. Laredo
Payal Salsburg
Laredo & Smith, LLP
101 Federal Street, Suite 650
Boston, MA 02110
617.443-1100
laredo@laredosmith.com
salsburg@laredosmith.com

1. Basic Rules

As is the case with many closely-held corporations, small businesses have a tendency to pay little attention to corporate formalities in terms of meetings and record-keeping. In reiterating the SJC's holding in *Samia v. Central Oil Co. of Worcester*, 339 Mass. 101 (1959), the Appeals Court, in an unpublished order issued under Rule 1:28, recently ruled that when suit is brought against a director, officer or shareholder of such a corporation for breach of fiduciary duty, the director cannot reasonably rely upon the absence of a formal meeting to shield himself from liability for his misdeeds. *Houser Buick, Inc. v. Houser*, 89 Mass. App. Ct. 1113 (2016). Without condoning the absence of formalities in operating closely-held businesses, the court refused to permit the director who had been complicit in years of informality, including years without any formal directors meetings, to shield him from requiring to respond to allegations of misappropriations. "Where rights of creditors or other outsiders are not involved, actions taken without compliance with corporate formalities have frequently been held to bind shareholders." *Id.* at *1 (citing *Pitts v. Halifax Country Club, Inc.*, 19 Mass. App. Ct. 525 (1985)).

In *Rubin v. Murray,* 79 Mass. App. Ct. 64 (2011), the Appeals Court found no abuse of discretion in the trial judge ordering the return of an alleged overpayment of extra compensation and compelling the declaration of dividends.

2. Derivative Actions

The importance of standing in the context of actions brought against shareholders was highlighted yet again in *DeCroteau v. DeCroteau*, 90 Mass. App. Ct. 903, 65 N.E.3d 1217 (2016). In that case, the DeCroteau Corporation was owned 51% by Joseph and 49% by his brothers Mark and Michael. The corporation owned and operated a funeral home on property rented property from DBR Realty LLC, which in turn was owned solely by Mark and Michael. When the lease to the property expired, brothers Mark and Michael listed the property for sale, thus risking the existence and operation of the DeCroteau Corporation and jeopardizing Joseph's livelihood. When Joseph brought suit against his brothers in his individual capacity, and moved *inter alia* for a preliminary injunction, the trial court denied the motion following a nonevidentiary hearing. On appeal, the denial was affirmed on grounds that Joseph had not demonstrated that he had standing to bring most of the claims in the lawsuit. "DeCroteau Corporation, not the plaintiff, is the tenant of DBR. DeCroteau Corporation, not the plaintiff, owns and operates the funeral home business ... consequently, the plaintiff's claims [] belong to DeCroteau Corporation, an entity separate and distinct from the plaintiff." 65 N.E.3d at 1219. Moreover, even if Joseph personally may have paid the monthly rent and taxes on the property over the course of many years, that fact in itself was insufficient to establish either a constructive or resulting trust. Where Joseph did not furnish consideration of any kind for the purchase of the real estate owned by DBR Realty, he could not prevail on the merits of his claim for injunctive relief.

3. Shareholder Agreements

Where shareholders of a closely-held corporation do not in advance establish the terms and conditions of permissible outside work performed by directors, officers or shareholders, a court will not read into their agreement a provision that curtails such activity where such outside engagement does not pose a conflict of interest to the corporation (such as taking for personal gain work that might otherwise inure to the benefit of the corporation) and does not diminish the shareholder's capacity to generate revenues for the corporation. *McGrath v. Braney*, 2014 WL 1588714 (Sup. Ct. 2014). In *McGrath*, three shareholders of an accounting firm brought suit against the fourth for breach of fiduciary duty alleging that (1) defendant deceived his partners concerning his status as a compensated board director of a local bank, (2) defendant diverted his time, attention and/or best efforts away from the accounting firm, and (3) defendant failed to turn over his earnings from the local bank to the closely-held corporation. The trial court found in favor of the defending shareholder, stating that neither the articles nor the bylaws contained any restrictions on what a shareholder could or could not do with respect to outside activity. Indeed, the evidence demonstrated that the defending shareholder's position as a board director was conspicuously posted on the corporation's website, disclosed annually on various regulatory filings, and listed on the accounting firm's malpractice insurance application. Moreover, the defending shareholder carried out his duties to the corporation with diligence and consistently exceeded two of the three partners in his economic productivity for the firm. Finally, despite their complaints to the contrary, each of the three complaining shareholders engaged in substantial amounts of outside activity unrelated to the business of the corporation, albeit only the defending partner's activity generated any actual compensation. Thus, without any agreement specifically restricting outside business activities or obligating individual shareholders to turn over all income derived therefore to the corporation, the defending shareholder was free to engage in such activity.

In yet another case arising out of the many disagreements between shareholders of the Demoulas Super Markets chain, in *Merriam v. Demoulas Super Markets, Inc.*, 464 Mass. 721 (2013), the Supreme Judicial Court held that the minority shareholders of a Subchapter S corporation were not bound by fiduciary duty and could sell their shares consistent with the articles and bylaws, regardless whether the buyer's ownership would terminate the corporation's status as a Subchapter S corporation. Because the articles of organization did not contain any restrictions on stock transfers requiring the corporation's Subchapter S status to be maintained, and the shareholders had not elected to do so in a separate stock restriction agreement or amendment to the articles, the SJC found it entirely proper for a trial court to decline the invitation to impose such restrictions after the fact. Moreover, where the articles did not contain a pre-emptive right of first offer to the company, neither principles governing fiduciary duty nor the implied covenant of good faith and fair dealing would insert such a term where the parties chose not to do so themselves.