

ALERT

Massachusetts Supreme Judicial Court Rejects Forced Buyout Remedy for Minority Shareholder Freeze-Out

In 2006, a two-judge majority of Massachusetts Appeals Court affirmed an unprecedented judgment directing the majority shareholders of a Massachusetts close corporation to purchase all of the shares held by a “frozen-out” minority shareholder. See *Brodie v. Jordan*, 53 Mass. App. Ct. 371, 847 N.E.2d 1125 (2006), discussed in Bingham McCutchen Client Alert dated July 5, 2006. In an opinion issued barely a month after oral argument on further appellate review, the Supreme Judicial Court has decided unanimously to reverse the judgment awarding relief to the shareholder and remand the case for further evidentiary proceedings to determine a more appropriate remedy. The SJC’s opinion is reported as *Brodie v. Jordan*, 447 Mass. 866, 857 N.E.2d 1076 (2006).

The *Brodie* decision does not hold that courts adjudicating freeze-out claims may never order a forced buyout of an aggrieved minority shareholder’s interest. The SJC did recognize, however, that the facts and circumstances warranting such a remedy must go well beyond the desirability of facilitating a clean break between acrimonious parties.

The Facts

Plaintiff-appellee Mary Brodie is executrix of her late husband Walter Brodie’s estate, which, at the time of his death in 1997, held a one-third interest in Malden Centerless Grinding, Inc., a corporation formed in 1973 under Mass. Gen. Laws ch. 156B and subsequently governed by Mass. Gen. Laws ch. 156D. The defendants, David Barbuto and Robert Jordan, were the only other shareholders; together they controlled a two-thirds majority of the company’s shares. After Walter Brodie, once Malden’s director and president, stepped away from active participation in the business, he and the other shareholders became estranged. In October 1992, Barbuto and Jordan voted to remove Brodie as a director. Brodie’s subsequent, repeated requests to the others to purchase his shares were refused.

After Brodie’s death in 1997, his widow attempted to join the board, although she had no contractual right to a board seat. The other two shareholders declined to vote for her, so they remained as the sole directors. They also denied her requests for an audit, a valuation of the shares now held by Brodie’s estate, and financial statements and information, including tax returns, beyond the annual, unaudited financial statements that the company had been regularly providing. In 1998, Mary Brodie filed suit alleging that the other shareholders’ conduct had frozen her out in breach of their fiduciary duties. She then gave notice, pursuant to a “right of first offer” provision in Malden’s articles of organization, that she wished to sell her shares for \$205,000. The defendants evidently had some interest in having Malden exercise its purchase right but considered that price too high, so the parties commenced a procedure specified by the articles to determine a price by arbitration or mediation. Before this procedure resulted in a price determination, however, the defendants decided instead to cause the

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corporation to waive its purchase right and accordingly informed the plaintiff that she was free from any restriction on selling her shares.

After a bench trial, the majority shareholders appealed from both the liability and remedy portions of the judgment. As noted above, the Appeals Court affirmed and upheld the order requiring the majority shareholders to purchase the plaintiff's shares. On further appellate review limited to the question of whether the trial court abused its discretion in ordering the buyout remedy, the SJC disagreed with the Appeals Court, reversed the judgment, and remanded the case for determination of more appropriate remedies.

The Opinion

The SJC's decision rests on two longstanding principles. The first principle derives from the historic analysis of freeze-out liability under which the court assesses whether and to what extent "the majority frustrates the minority's reasonable expectations of benefit from their ownership of shares." *Brodie*, 447 Mass. at 869-70. This mode of analysis, writes Justice Cowin, "is useful at both the liability and the remedy stages of freeze-out litigation." *Id.* at 870. The second relevant principle is that "[t]he proper remedy for a freeze-out is 'to restore the [minority shareholder] as nearly as possible to the position [s]he would have been in had there been no wrongdoing.'" *Id.* at 870.

According to the SJC, the fundamental problem with the remedy afforded to the shareholder in the *Brodie* case was that, based on the facts presented, "it placed the plaintiff in a significantly *better* position that she would have enjoyed absent the wrongdoing, and well exceeded her reasonable expectations of benefit from her shares." *Id.* at 871-72 (emphasis in original). The decision notes that nothing in the articles of organization or bylaws obligated the corporation or the majority shareholders to purchase the plaintiff's shares, nor were there any other circumstances that could have given her a reasonable expectation of having her shares bought out. It was therefore error for the trial judge to have "created an artificial market for the plaintiff's minority share of a close corporation—an asset that, by definition, has little or no market value." *Id.* at 872.

On remand, the SJC's opinion directs the trial court to determine the plaintiff's "reasonable expectations of ownership"; whether such expectations have been frustrated; and if so, the appropriate means by which to vindicate the plaintiff's interest without affording her a windfall. *Id.* at 873. The Court notes that money damages would be the appropriate remedy for "breaches resulting in deprivations that can be quantified," while prospective injunctive relief may be granted "to ensure that the plaintiff is allowed to participate in company governance, and to enjoy financial and other benefits from the business, to the extent that her ownership interest justifies." *Id.* at 873-74. In addition, the judge "may consider the fact that the plaintiff has received no economic benefit from her shares" and whether, if the defendants are shown to have denied her a return on her investment "while drain[ing] off the corporation's earnings for themselves," it is appropriate to compel the declaration of dividends. *Id.* at 874.

Comment

- Had the SJC upheld the buyout order in this case, there might have been a significant sea change in the risks and rewards associated with freeze-out litigation among shareholders

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of Massachusetts close corporations. As things now stand, however, the SJC has sent a clear signal that courts sitting in equity do not have unlimited discretion to fashion remedies in such cases but must carefully tailor relief that helps fulfill, but does not exceed, the shareholder's reasonable expectations of ownership.

- The liability findings in this case (which were left intact by the SJC's decision) bear notice. Among other things, majority shareholders may have a duty to ensure that minority shareholders who play no other role in corporate affairs, e.g., as an officer or employee, have a place on the board of directors or possibly even as an officer. At least, the majority may need to demonstrate affirmatively a legitimate business reason, going beyond inexperience, for denying the minority shareholder such a position.
- The SJC's decision makes clear that the remedies for shareholder breaches of fiduciary duty will necessarily vary according to the unique facts of each case as well as the articles of incorporation and bylaws of the corporation at issue. Shareholders of Massachusetts close corporations should assess the necessity of amending corporate bylaws to clarify whether any right of repurchase exists and, if so, under what circumstances.
- Clients considering where to incorporate should be aware that, in spite of the SJC's refusal to expand the court's authority to address shareholder freeze-out claims in the *Brodie* case, the law in Massachusetts still imposes broad fiduciary duties on shareholders of close corporations, in contrast to the laws in other potential states of incorporation, including Delaware, which recognize no such duty.

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