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# ENDURING EQUITY IN THE CLOSE CORPORATION

Lyman Johnson, Washington and Lee University School of Law

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## ENDURING EQUITY IN THE CLOSE CORPORATION

LYMAN JOHNSON\*

TOUT DOIT CHANGER POUR QUE RIEN NE CHANGE<sup>1</sup>

### INTRODUCTION

Much has changed since the summer of 1976—famously, the nation’s Bicentennial, but also the date of *Wilkes v. Springside Nursing Home, Inc.*,<sup>2</sup> the focus of this Symposium. In mid-2010, for example, South Africa was the site of a peaceful if exuberant World Cup Soccer tournament,<sup>3</sup> whereas in mid-1976, South African police opened fire on crowds protesting the government’s harrowing apartheid policies.<sup>4</sup> Unemployment stood at 7.7% in 1976<sup>5</sup>—higher than usual, but not the August 2010, stubborn rate of 9.7%.<sup>6</sup> The

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\* Robert O. Bentley Professor of Law, Washington and Lee University School of Law; LeJeune Distinguished Chair in Law, University of St. Thomas (Minneapolis) School of Law. The Frances Lewis Law Center at Washington and Lee University and the University of St. Thomas provided financial support. John Jacob, Archivist at Washington and Lee, provided extensive and invaluable archival assistance. Thomas Berg, Nathan Johnson, Jeffrey Kahn, and Ann Massie gave the author helpful information.

1. This French saying means “Everything must change so that nothing changes.” This ironic historical maxim likely came from the French translation of the 1958 novel *THE LEOPARD* by Giuseppe Di Lampedusa in which the character Tancredito declares, “[s]i nous voulons que tout resta tel que c’est, il faut que tout change.” GIUSEPPE DI LAMPEDUSA, *THE LEOPARD* (Feltrinelli 1958). It is less well-known than the phrase “Plus ça change, plus c’est la même chose” (“The more things change, the more they stay the same.”). ALPHONSE KARR, *LES GUÉPES* (1849). As argued in this Article, it is equity’s remarkable adaptability that makes it so durable and well-suited to preserve within the corporation—under constantly changing circumstances—the ongoing pursuit of a just ordering. See *infra* Part IV.

2. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 657 (Mass. 1976).

3. George Vecsey, *Celebrating South Africa and a Job Done Well*, N.Y. TIMES, July 10, 2010, <http://www.nytimes.com/2010/07/11/sports/soccer/11vecsey.html>.

4. Milton Nkosi, *Soweto 1976: A Schoolboy’s Memories*, BBC NEWS, <http://news.bbc.co.uk/2/hi/5060278.stm> (last updated June 13, 2006) (reciting the memories of Mr. Nkosi, who, as a young boy, witnessed the events).

5. David S. Broder, *Ford Asks \$440 Billion Outlay, \$47 Billion Deficit*, WASH. POST, Jan. 18, 1977, at A1.

6. Frank Ahrens, *March Unemployment Unchanged at 9.7 Percent*, WASH. POST, Apr. 2, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/04/02/AR2010040201040.html>.

two-year Treasury note yielded 6.67%,<sup>7</sup> not the August 2010 paltry 0.56%.<sup>8</sup> The Dow-Jones Industrial average hovered around 1,000 in 1976,<sup>9</sup> and in August of 2010 it flit around the 10,500 level.<sup>10</sup> Stalwart Eastman Kodak loomed large in the camera business, introducing instant film photography in 1976; at times that year its stock traded at over \$100 per share,<sup>11</sup> but as of August 2010 it played a minor role in a much-altered digital industry, the stock trading, on light volume, at around \$4 per share.<sup>12</sup> And, on the international trade front, in 1976 the United States faced its greatest trade competition from Japan and Germany,<sup>13</sup> whereas now China is a more formidable economic rival.<sup>14</sup>

In the cultural arena, *Rocky* was the top-grossing film in 1976,<sup>15</sup> with *Toy Story 3* leading so far in 2010.<sup>16</sup> *Silly Love Songs* by Wings was the biggest hit song in 1976,<sup>17</sup> but *California Gurls* by

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7. *Historical Data for the 2-Year Treasury Constant Maturities on an Annual Basis*, FED. RESERVE, [http://www.federalreserve.gov/releases/h15/data/Annual/H15\\_TCMNOM\\_Y2.txt](http://www.federalreserve.gov/releases/h15/data/Annual/H15_TCMNOM_Y2.txt) (last visited Nov. 19, 2010).

8. *Daily Treasury Yield Curve Rates*, U.S. DEP'T OF THE TREASURY, <http://www.treas.gov/offices/domestic-finance/debt-management/interest-rate/yield.shtml> (last visited Nov. 19, 2010). This rate was as of August 27, 2010, the rate continues to fluctuate slightly on a daily basis.

9. *See Performance of Good Money & Dow Jones Industrial Averages (Since the End of 1976)*, GOODMONEY.COM, [www.goodmoney.com/gmiaraw.htm](http://www.goodmoney.com/gmiaraw.htm) (last updated Jan. 10, 2001) (showing the Dow Jones Industrial in 1976 at 1,004.65).

10. *Dow Jones Industrial Average*, YAHOO! FINANCE, <http://finance.yahoo.com/q/hp?s=DJI&a=08&b=17&c=2010&d=08&e=17&f=2010&g=d> (last visited Nov. 20, 2010) (showing the historical price as of September 17, 2010).

11. Vartanig G. Vartan, *Eastman and Polaroid: The Profit Outlook*, N.Y. TIMES, Aug. 20, 1976, at 68; *see also Eastman Kodak Historical Prices*, YAHOO! FINANCE, <http://finance.yahoo.com/q/hp?s=EK&a=00&b=1&c=1976&d=11&e=31&f=1976&g=d&z=66&y=198> (last visited Nov. 20, 2010).

12. Dana Mattioli, *Fresh Kodak Concerns Surface*, WALL ST. J., July 29, 2010, at B5, available at <http://online.wsj.com/article/SB10001424052748703940904575394892494087732.html>.

13. *See* Edwin L. Dale, Jr., *\$906 Million Deficit in November Trade Sets Record for U.S.*, N.Y. TIMES, Dec. 29, 1976.

14. WAYNE M. MORRISON, CONG. RESEARCH SERV., RL 33536, CHINA-U.S. TRADE ISSUES, at 1-3 (2009), available at <http://fpc.state.gov/documents/organization/127016.pdf>.

15. Tim Dirks, *All-Time Top Box Office Hits (domestic) By Decade and Year*, FILMSITE, <http://www.filmsite.org/boxoffice2.html> (last visited Nov. 20, 2010).

16. *See id.* (noting that *Toy Story 3* has made the top ten list for the 2000's); *see also 2010 Yearly Box Office Results*, BOX OFFICE MOJO, <http://boxofficemojo.com/yearly/chart/?yr=2010&p=.htm> (last updated Nov. 13, 2010).

17. *The Billboard Hot 100 Songs of the Year (1970-1979)*, BILLBOARD.COM, <http://www.billboard.com/specials/hot100/charts/top50-no1s-70s.shtml> (last visited Nov. 21, 2010).

Katy Perry featuring Snoop Dogg, leads the pack so far in 2010.<sup>18</sup> The top mid-70's television show, *All in the Family*, is long gone,<sup>19</sup> and today the *CSI* franchise holds sway.<sup>20</sup> Disco dancing has disappeared,<sup>21</sup> and people now are "Dancing with the Stars."<sup>22</sup> Much else in the realms of politics, economics, medicine, law, and social-cultural affairs also has changed over the years.

But much has not changed since 1976. The death penalty—held by the U.S. Supreme Court not to violate the Eighth Amendment in 1976<sup>23</sup>—remains in force in a majority of states.<sup>24</sup> Tom Watson was playing remarkable golf in 1976,<sup>25</sup> and in 2010, at age 60, he still is.<sup>26</sup> Bobby Knight, who coached Indiana to an NCAA basketball championship in 1976,<sup>27</sup> still offers acerbic if insightful commentary on the game.<sup>28</sup> Movie actors Sylvester Stallone (*Rocky*—1976),<sup>29</sup> Robert Redford (*All the President's Men*—1976),<sup>30</sup> Clint Eastwood (*The Enforcer*—1976),<sup>31</sup> and Jack Nichol-

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18. *Hot 100*, BILLBOARD.COM, <http://www.billboard.com/charts/hot-100#/charts/hot-100> (last visited Sept. 19, 2010).

19. *Top Ten 1970-1976*, TVPARTY.COM, <http://www.tvparty.com/70topten.html> (last visited Nov. 21, 2010).

20. *CSI (franchise)*, WIKIPEDIA.ORG, [http://en.wikipedia.org/wiki/CSI\\_\(franchise\)](http://en.wikipedia.org/wiki/CSI_(franchise)) (last modified Sept. 17, 2010).

21. Gaynor Borade, *History of Disco Dance*, BUZZLE.COM, <http://www.buzzle.com/articles/history-of-disco-dance.html> (last visited Sept. 17, 2010).

22. Gia Kourlas, *Cheek to Cheek (and Tongue-In-Cheek)*, N.Y. TIMES, Apr. 19, 2010, at C1, available at <http://www.nytimes.com/2010/04/20/arts/dance/20stars.html>.

23. *Gregg v. Georgia*, 428 U.S. 153, 187 (1976); see also *Jurek v. Texas*, 428 U.S. 262, 276 (1976); *Proffitt v. Florida*, 428 U.S. 242, 247 (1976).

24. See *Facts About the Death Penalty*, DEATHPENALTYINFO.ORG 1, [www.deathpenaltyinfo.org/documents/FactSheet.pdf](http://www.deathpenaltyinfo.org/documents/FactSheet.pdf) (last updated Nov. 10, 2010).

25. Mr. Watson won the British Open in 1975 and 1977. Brent Kelley, *Tom Watson*, ABOUT.COM, [http://golf.about.com/od/golfersmen/p/tom\\_watson.htm](http://golf.about.com/od/golfersmen/p/tom_watson.htm) (last visited Sept. 19, 2010). The Open is one of the four "major" tournaments in men's golf. See *id.* He also later won the U. S. Open and the Masters, each of which is a "major" tournament. See *id.*

26. For example, Mr. Watson lost in a playoff at the 2009 British Open Championship held in Turnberry Scotland. *Id.* It would have been his sixth Open victory. See *id.*

27. *Bob Knight: Former Indiana University Basketball Coach*, INDYSTAR.COM, [http://www2.indystar.com/library/factfiles/people/k/knight\\_bob/knight.html](http://www2.indystar.com/library/factfiles/people/k/knight_bob/knight.html) (last updated Feb. 4, 2008).

28. *In Praise of Bobby Knight*, STORMINGTHEFLOOR.NET, <http://www.stormingthefloor.net/2009/12/in-praise-of-bobby-knight.php> (last visited Mar. 31, 2011).

29. *Sylvester Stallone*, THE INTERNET MOVIE DATABASE, <http://www.imdb.com/name/nm0000230> (last visited Nov. 13, 2010).

30. *Robert Redford*, THE INTERNET MOVIE DATABASE, <http://imdb.com/name/nm/0000602/> (last visited Nov. 13, 2010).

31. *Clint Eastwood*, THE INTERNET MOVIE DATABASE, <http://imdb.com/name/nm/0000142/> (last visited Nov. 13, 2010).

son (*One Flew Over the Cuckoo's Nest*—1976, Best Picture)<sup>32</sup> all remain active in the movie industry. Musically, Elton John (*Don't Go Breaking My Heart*—1976)<sup>33</sup> and Paul Simon (*50 Ways to Leave Your Lover* and *Still Crazy After All These Years*—1976)<sup>34</sup> remain on tour. Steve Jobs co-founded Apple Computer in 1976 (on April Fools' Day),<sup>35</sup> and still regularly produces innovative products,<sup>36</sup> while Microsoft (trademarked in 1976 and led for decades by Bill Gates, who left Harvard in 1976 to go full time at the company he co-founded) remains a formidable force in the software world.<sup>37</sup> Many other high-profile features and people from 1976 also are still part of the social landscape today.

This commemorative reflection on *Wilkes* will develop this theme of change/sameness in connection with equity—the source of the fiduciary duties which stood, as they often do in close corporations, as the centerpiece in *Wilkes*. Equity's role in the Western legal tradition began, of course, long before *Wilkes*, and it endures today in the law of close corporations precisely because, ironically, it is so adaptable. Parts I, II, and III will sketch the larger milieu of the *Wilkes* case, where details about place, industry, and company are rich in their historic particulars but where too endless change is at work in the perennial quest for survival. Part I describes the city, Pittsfield, Massachusetts where the focal point of litigation—Springside Nursing Home, Inc. (Springside)—was located. Part II tells a bit about the key industry in the case, nursing homes, from the early 1950s to the mid-1970s—the period spanning the company's origins to the Supreme Court decision in *Wilkes*. Part III highlights a few noteworthy, but little noted, facts about Springside itself. Part IV hones in on the dispute between Stanley Wilkes and his fellow shareholders in *Wilkes v. Springside Nursing Home, Inc.*, and on how the Massachusetts Supreme Judicial Court, in resolving that dispute, re-fashioned the equitable concerns animating the

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32. *Jack Nicholson*, WIKIPEDIA.ORG, [http://en.wikipedia.org/wiki/Jack\\_nicholson](http://en.wikipedia.org/wiki/Jack_nicholson) (last modified Aug. 20, 2010).

33. *Elton John: Don't Go Breaking My Heart*, LAST.FM, [http://www.last.fm/music/Elton+John/\\_/Don't+Go+Breaking+My+Heart](http://www.last.fm/music/Elton+John/_/Don't+Go+Breaking+My+Heart) (last visited Sept. 20, 2010).

34. *Paul Simon*, PBS.ORG (Feb. 26, 2001), [http://www.pbs.org/wnet/american\\_masters/episodes/paul-simon/about-paul-simon/705/](http://www.pbs.org/wnet/american_masters/episodes/paul-simon/about-paul-simon/705/).

35. *Steve Wozniack*, WIKIPEDIA.ORG, [http://en.wikipedia.org/wiki/Steve\\_Wozniack](http://en.wikipedia.org/wiki/Steve_Wozniack) (last modified Sept. 13, 2010).

36. *Apple, Inc.*, WIKIPEDIA.ORG, [http://en.wikipedia.org/wiki/Apple\\_Inc](http://en.wikipedia.org/wiki/Apple_Inc) (last modified Sept. 19, 2010).

37. *Bill Gates*, WIKIPEDIA.ORG, [http://en.wikipedia.org/wiki/Bill\\_Gates](http://en.wikipedia.org/wiki/Bill_Gates) (last modified Sept. 19, 2010).

landmark *Donahue v. Rodd Electrotype Company*<sup>38</sup> decision. Part IV also places the *Wilkes* decision in a broader legal context—where it is seen as no aberration—and elaborates on how and why, in 2011, equity endures, by taking account of the inevitable flux in business relations in a way which static law does not. Equity endures even as it continually eludes law’s attempted subduing by rules, with the result that equity itself must still be endured by those involved in close corporations.

## I. THE PLACE

Springside, a corporation formed under Massachusetts law, was located in Pittsfield, Massachusetts, the county seat of Berkshire County.<sup>39</sup> Named after William Pitt, today the city’s population of 42, 642 is down from the 51,974 of the 1980 census, and it is about back to where it stood in 1920.<sup>40</sup> Due to the many streams flowing into the nearby Housatonic River, numerous lumber, paper, and textile mills dotted the landscape around Pittsfield, and for a significant part of the 19th century, that “area [was] the center of woolen manufacturing in the United States.”<sup>41</sup> Today, those industries are gone, and although Pittsfield’s economy still has some manufacturing enterprises,<sup>42</sup> far more people are employed in education and health services, leisure and hospitality, and in the public sector.<sup>43</sup> The city also has been a place of residence for several famous writers, including Herman Melville, who wrote *Moby Dick* while living in Pittsfield;<sup>44</sup> Henry Wadsworth Longfellow, Edith Wharton, and Oliver Wendell Holmes, whose family had vast land-

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38. *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505 (Mass. 1975).

39. *Things to Do & Places to Stay in the Berkshires: Pittsfield, Mass.* BERKSHIRE-LINKS.COM, <http://www.berkshirelinks.com/pittsfield-ma/> (last visited Mar. 21, 2011).

40. U.S. DEP’T OF COMMERCE BUREAU OF THE CENSUS, CHARACTERISTICS OF THE POPULATION: NUMBER OF INHABITANTS OF MASSACHUSETTS 23-10 (1980), available at [http://www2.census.gov/prod2/decennial/documents/1980a\\_maABC-01.pdf](http://www2.census.gov/prod2/decennial/documents/1980a_maABC-01.pdf); *Pittsfield, MA Profile*, IDCIDE.COM, <http://www.idcide.com/citydata/ma/pittsfield.htm> (last visited Mar. 31, 2011); *Pittsfield, Massachusetts*, WIKIPEDIA.ORG, [http://en.wikipedia.org/wiki/Pittsfield,\\_Massachusetts#NotableResidents](http://en.wikipedia.org/wiki/Pittsfield,_Massachusetts#NotableResidents) (last visited Sept. 30, 2010).

41. *Id.*

42. See *Pittsfield, Massachusetts (MA): Accommodation, Waste Management, Arts, Entertainment & Recreation, etc.—Economy and Business Data & Market Research*, CITY-DATA.COM, <http://www.city-data.com/business/econ-Pittsfield-Massachusetts.html> (last visited Sept. 18, 2010).

43. See *Economy at a Glance: Pittsfield, MA*, BUREAU OF LABOR STATISTICS, [http://www.bls.gov/eag/eag.ma\\_pittsfield\\_mn.htm](http://www.bls.gov/eag/eag.ma_pittsfield_mn.htm) (last visited Sept. 18, 2010).

44. *Herman Melville and Arrowhead*, BERKSHIRE HISTORICAL SOCIETY, <http://berkshirehistory.org/herman-melville/herman-melville-and-arrowhead/> (last visited Nov. 13, 2010).

holdings in Pittsfield and whose son, Oliver Wendell Holmes, Jr., served on the Supreme Judicial Court of Massachusetts for two decades before becoming a Justice on the U.S. Supreme Court in 1902.<sup>45</sup>

Like the path-breaking legal duo of *Donahue* and *Wilkes*, Pittsfield itself is associated with several “firsts.” William Craig was the first Secret Service agent killed on a presidential protection detail as he accompanied President Theodore Roosevelt on a trip to Pittsfield.<sup>46</sup> Mr. Craig was thrown to the street when the barouche carrying President Roosevelt collided head-on with a trolley.<sup>47</sup> Roosevelt’s face was badly bruised, and ever the pugilist, he nearly came to blows with the trolley’s motorman, who later pled guilty to manslaughter.<sup>48</sup> The first electric transformer was produced in Pittsfield by William Stanley, whose Electric Manufacturing Company was a forerunner to General Electric.<sup>49</sup> In the first ever inter-collegiate baseball game—held in Pittsfield in 1859 and played under the more wide-open, but soon-abandoned, “Massachusetts rules”—Amherst defeated Williams in twenty-five innings and by the astounding score of 73-32.<sup>50</sup> In addition, Colonel John Brown of Pittsfield, was, during the Revolutionary War, the first to accuse Benedict Arnold of treachery;<sup>51</sup> Pittsfield resident William Allen wrote *An American Biographical and Historical Dictionary* and was President of Dartmouth at the time of the famous Supreme Court

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45. *Pittsfield, Massachusetts*, WIKIPEDIA.ORG, [http://en.wikipedia.org/wiki/Pittsfield,\\_Massachusetts#NotableResidents](http://en.wikipedia.org/wiki/Pittsfield,_Massachusetts#NotableResidents) (last visited Sept. 30, 2010). Holmes, Jr. served as both an Associate Justice and, later, as the Chief Justice of the Massachusetts Supreme Judicial Court. Michael A. Carrier, Note, 93 MICH. L. REV. 1894, 1902-03 (1995) (reviewing G. EDWARD WHITE, *JUSTICE OLIVER WENDELL HOLMES: LAW AND THE INNER SELF* (1993)).

46. Press Release, United States Secret Serv., United States Secret Serv. Honors First Operative Killed in The Line of Duty (Aug. 27, 2002), available at <http://www.secretservice.gov/press/pub2002.pdf>.

47. *Id.*

48. Clarence Fanto, *Pittsfield: The City is on a Major Upswing Despite Recent Setbacks*, THE BERKSHIRE EAGLE, June 5, 2007, [http://www.berkshireeagle.com/search/ci\\_6063023?IADID=search-www.berkshireeagle.com-www.be](http://www.berkshireeagle.com/search/ci_6063023?IADID=search-www.berkshireeagle.com-www.be).

49. *History of Pittsfield*, CITY OF PITTSFIELD, [http://www.pittsfield-ma.org/about\\_pittsfield/history\\_of\\_pittsfield.htm](http://www.pittsfield-ma.org/about_pittsfield/history_of_pittsfield.htm) (last visited Nov. 13, 2010).

50. *One hundred fiftieth anniversary of first college baseball game—Williams vs. Amherst to air LIVE on ESPN360 from Pittsfield’s Wahconah Park and on tape delay on ESPN U May 4, 6 and 13*, WILLIAMS ATHLETICS (Apr. 7, 2009), [http://athletics.williams.edu/sports/bsb/2008-09/news/0407\\_150th\\_anniversary\\_of\\_1st\\_college\\_baseball\\_game\\_-\\_Williams\\_vs.\\_Amherst\\_to\\_air\\_on\\_ESPNU\\_from\\_Pittsfield-s\\_Wahconah\\_Park](http://athletics.williams.edu/sports/bsb/2008-09/news/0407_150th_anniversary_of_1st_college_baseball_game_-_Williams_vs._Amherst_to_air_on_ESPNU_from_Pittsfield-s_Wahconah_Park).

51. Robert L. French, *Colonel John Brown 1744-1780*, THREE RIVERS (2003), <http://www.fortklock.com/coloneljbrown.htm>.

case;<sup>52</sup> and department store magnate Marshall Field took his first paying job as an “errand boy” in Pittsfield.<sup>53</sup>

With its stolid but interesting history, Pittsfield was an apt setting for what surely started out as just another prosaic lawsuit, involving a typical business dispute, which went on, nonetheless, to generate considerable, if niched, notoriety. Unlike Pittsfield’s other encounters with famous firsts,<sup>54</sup> the *Wilkes* ruling in 1976<sup>55</sup> may have gone unnoticed by, and may be still largely unknown to, the local populace—the case drew no comment in the *Berkshire Eagle* newspaper, much less the August *Boston Globe*<sup>56</sup>—even though its enduring influence may be far greater than those “firsts” elsewhere touted by Pittsfield’s boosters.

## II. THE INDUSTRY

The four original partner-shareholders in Springside showed remarkable entrepreneurial vision, or enjoyed extremely good fortune, in entering the nursing home business in the early 1950s. The Massachusetts Supreme Judicial Court opinion spends little time on this, observing only that, with respect to a certain real estate parcel, “the parties later determined that the property would have its greatest potential for profit if it were operated by them as a nursing home.”<sup>57</sup> We see change in the parties’ thinking, it is obvious, from the very outset.

The post-World War II period was a time of considerable growth in the nursing home business.<sup>58</sup> This resulted from, among other factors, shifting cultural attitudes about proper care for the elderly and increased availability of federal payments for construction of nursing homes “in conjunction with existing facilities,” which were approved in the 1954 Medical Facilities Survey and Construction Act in an effort to improve the overall quality of elder

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52. *Guide to the Papers of William Allen, 1800-1856*, DARTMOUTH C. LIBR., [http://ead.dartmouth.edu/html/ms916\\_fullguide.html](http://ead.dartmouth.edu/html/ms916_fullguide.html) (last visited Mar. 31, 2011); see *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. 5184 (1819).

53. *Marshall Field*, ENCYCLOPEDIA BRITANNICA, <http://www.britannica.com/EBchecked/topic/206204/Marshall-Field> (last visited Sept. 18, 2010).

54. See *supra* notes 46-53 and accompanying text.

55. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 (Mass. 1976).

56. Electronic searches of the digitized *Berkshire Eagle* (through Ancestry.com) and the *Boston Globe* (via Factiva.com) produced no results.

57. *Wilkes*, 353 N.E.2d at 659.

58. BRADFORD H. GRAY, *FOR-PROFIT ENTERPRISE IN HEALTH CARE* 496-98 (1986).



care.<sup>59</sup> Passage of the Kerr-Mills Provisions in 1960, moreover, authorized medical assistance payments to poorer residents of nursing homes,<sup>60</sup> though many states did not participate in that voluntary program.<sup>61</sup> Still, the real growth lay ahead, given that of all money appropriated by Congress for construction of various facilities in 1954, only \$4 million was allotted for nursing homes.<sup>62</sup>

The real growth in the nursing home industry occurred in the 1960s.<sup>63</sup> Due to the availability of Medicare and Medicaid payments to nursing homes beginning in the mid-1960s, by the mid-1970s the nursing home industry had experienced a dramatic upsurge, with overall nursing home expenditures increasing 1,400% between 1960 and 1974.<sup>64</sup> President Gerald Ford, in May 1976, even called for the observance of National Nursing Home Week.<sup>65</sup> Sixteen thousand homes were generating \$4.7 billion in annual revenue by the mid-70s.<sup>66</sup> Three-quarters of the private nursing homes in the mid-1970s were operated on a for-profit basis, with approximately two-thirds of total industry revenue coming from government sources.<sup>67</sup> Moreover, by the mid-1970s, much of the industry was organized with the same separation between ownership and management as seen in other businesses,<sup>68</sup> as larger care-providers increasingly were drawn to the attractive profit opportunities the industry offered.<sup>69</sup> It was also during this high-growth period, however, and notwithstanding extensive regulation, that the nursing home industry was famously associated with chilling tales of patient neglect and abuse, corruption, and rampant Medicaid fraud.<sup>70</sup> It

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59. Medical Facilities Survey and Construction Act of 1954, Pub. L. No. 83-482, 68 Stat. 461 (codified as amended at 42 U.S.C. §§ 291 to 291b, 291c, 291g, to 291j, 291m, 291o to 291 o-1 (2006)).

60. Act of Sept. 13, 1960, Pub. L. No. 86-778, 74 Stat. 987 (codified as amended at 42 U.S.C. §§ 301, 302 (2006)).

61. JAMES MIDGLEY & MICHELLE LIVERMORE, *THE HANDBOOK OF SOCIAL POLICY* 384-85 (2d ed. Sage Publications, Inc. 2009).

62. *Tabulation Made of Nursing Homes*, N. Y. TIMES, Jan. 2, 1955, at 78.

63. GRAY, *supra* note 58, at 497.

64. David Shulman & Ruth Galanter, *Reorganizing the Nursing Home Industry: A Proposal*, 54 MILBANK MEMORIAL FUND. Q. 129, 130 (1976).

65. Gerald Ford, *Message on the Observance of National Nursing Home Week*, THE AM. PRESIDENCY PROJECT, <http://www.presidency.ucsb.edu/ws/index.php?pid=5993> (last visited Sept. 18, 2010).

66. Shulman & Galanter, *supra* note 64, at 130.

67. *Id.* at 130-31.

68. *Id.* at 130.

69. *Id.*

70. *Nursing Home Report: Things Are Still Bad*, N. Y. TIMES, May 23, 1976, at E5; *Nursing-Home Head Is Indicted In Fraud*, N. Y. TIMES, Nov. 10, 1976, at 98.

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should be emphasized, however, that nothing in the *Wilkes* opinion suggests that the Springside Nursing Home was afflicted with these problems.

The industry was quite capital intensive, not because of large expenditures for capital equipment, but due to extensive investment in improved real estate.<sup>71</sup> This investment was encouraged by government reimbursement formulas, which included a percentage return on invested capital.<sup>72</sup> For example, a 1976 study of the nursing home industry drawing on data obtained from public company reports filed with the Securities and Exchange Commission, reveals that due to large depreciation charges affording tax shelters, a typical nursing home bed yielded an enviable 29% rate of cash flow return on investment.<sup>73</sup>

Mr. Wilkes, with a judicially-noticed reputation for profitable dealings in real estate,<sup>74</sup> would have clearly understood depreciation charges, tax shelters, and cash flow. Financially, the nursing home business generated a steady, government-provided revenue stream; government-sanctioned depreciation charges; and high, dependable cash flow returns, all in a stable growth industry.<sup>75</sup> For any shareholder to abruptly lose a longstanding stream of income from any corporation is a financial setback. For a real estate and cash-flow-savvy investor like Wilkes, it altered fundamentally the very *raison d'être* for investing in a nursing home company like Springside in the first place.

### III. THE CORPORATION

In 1951, Mr. Wilkes acquired an option to purchase a lot and building on the corner of Springside Avenue and North Street in Pittsfield.<sup>76</sup> The property had previously housed the Hillcrest Hos-

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71. Shulman & Galanter, *supra* note 64, at 134.

72. *Id.* at 137.

73. *Id.*

74. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 659 (Mass. 1976). Mr. Wilkes apparently continued to invest in Pittsfield real estate even after he became involved in Springside. See *Wilkes Buys Berkshire City Land at Auction*, THE BERKSHIRE EAGLE, Aug. 13, 1965, at 15.

75. See 4 ALAN M. GARBER, FRONTIERS IN HEALTH POLICY RESEARCH 78 (The MIT Press 2001) (“In 1960, public expenditure on long-term care in the United States accounted for only 2 percent of health care spending, but in 1996 it accounted for 10 percent.”).

76. *Wilkes*, 353 N.E.2d at 659.

pital.<sup>77</sup> Mr. Wilkes was said to be “principally engaged in the roofing and siding business” but he also had a local reputation for “profitable dealings in real estate.”<sup>78</sup> To be accurate, Mr. Wilkes had started his roofing business in 1939, when he was thirty-three years old, and in 1972, when he was sixty-six, he sold it and went into the siding business.<sup>79</sup> He was forty-five when he bought the Springside Avenue option in 1951.<sup>80</sup> Wilkes brought in three other investors—Riche, Quinn, and Pipkin—and the four of them initially purchased the building and lot “as a real estate investment which, they believed, had good profit potential on resale or rental.”<sup>81</sup> Initially, Wilkes may have seen this as yet another opportunity for his “profitable dealings in real estate.”<sup>82</sup>

Later the four men decided “the property would have its greatest potential for profit . . . as a nursing home.”<sup>83</sup> Whether visionary or simply fortunate, in retrospect this was a wise move, given how rapidly the nursing home industry grew in the 1950s and, especially, in the 1960s.<sup>84</sup> The decision to operate a nursing home on the lot the four gentlemen acquired must have happened fairly quickly because a *Berkshire Eagle* newspaper article reports that Springside opened its first nursing home in October 1951,<sup>85</sup> the same year the property was purchased.<sup>86</sup> Springside opened a second home in late 1952 and a third home in February of 1957, when it bought and renovated property previously owned by the Pittsfield Anti-Tuberculosis Association.<sup>87</sup> The third home had especially impressive and up-to-date fire-alarm, sprinkler, and back-up power systems.<sup>88</sup> Once the third home had opened, the company reportedly was the largest privately-owned nursing home operator in Massachusetts.<sup>89</sup>

The *Wilkes* opinion reports that Wilkes consulted his attorney about the new business, and that his attorney suggested they form a

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77. *Open House Tomorrow at Nursing Home*, THE BERKSHIRE EAGLE, Feb. 9, 1957, at 6.

78. *Wilkes*, 353 N.E.2d at 659.

79. Obituary, *Stanley J. Wilkes, Ex-President of Berkshire Roofing*, BERKSHIRE EAGLE, Apr. 30, 1981, at 17.

80. *Id.*

81. *Wilkes*, 353 N.E.2d at 659.

82. *Id.*

83. *Id.*

84. *See supra* Part II.

85. *Open House Tomorrow at Nursing Home*, *supra* note 77, at 6.

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

corporation rather than a partnership, largely to avoid personal liability for business debts.<sup>90</sup> The other three investors concurred.<sup>91</sup> It appears, however, that the business was operated for at least some period as a partnership prior to being incorporated, a fact that would shape Wilkes's initial legal strategy.<sup>92</sup> This background fact in *Wilkes* certainly confirms the observation made a year earlier in *Donahue* that many close corporations are, essentially, "little more than incorporated . . . partnerships."<sup>93</sup>

The newly formed Massachusetts corporation, Springside Nursing Home, Inc., owned and operated all aspects of the nursing home business, and each of the four men became a twenty-five percent shareholder.<sup>94</sup> The Massachusetts Supreme Judicial Court opinion emphasized that certain original "understandings" existed among the parties,<sup>95</sup> but, apparently, Wilkes's attorney did not advocate a written shareholders' agreement to protect his client or any of the other shareholders.<sup>96</sup> Consequently, the parties evidently relied on these spoken but unmemorialized understandings. This may reveal poor legal counsel, or client naïveté, but it also indicates a certain level of trust; this trust was understandable on Wilkes's part given that all three co-investors already were known to him at the time of the investment and were described by the court as his acquaintances.<sup>97</sup> This background fact likewise confirms the insightful observation in *Donahue* that, in close corporations, the participants necessarily "rely on the fidelity and abilities of those stockholders who hold office."<sup>98</sup>

The mutual understandings of the participants in *Wilkes* were straightforward and quite typical of those arising from a close corporation. Each shareholder would be a director, would actively participate in management and decision-making concerning company operations, and "each would [, in turn,] receive money from the corporation in equal amounts."<sup>99</sup> No federal income tax "S" election, permitting avoidance of tax at the corporate level, was in effect. Thus, salaries reduced corporate income subject to taxation.

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90. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 659 (Mass. 1976).

91. *Id.*

92. *See id.*

93. *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 512 (Mass. 1975).

94. *Wilkes*, 353 N.E.2d at 659-60.

95. *Id.*

96. *Id.* at 659.

97. *Id.*

98. *Donahue*, 328 N.E.2d at 512.

99. *Wilkes*, 353 N.E.2d at 660.

Wilkes, also by understanding, served as treasurer of the business from 1951 until 1967.<sup>100</sup> And so it went, as planned and understood, for many years. By 1955, only the fourth full year of operation, each shareholder was receiving \$100 per week, amounting to \$5,200 per year.<sup>101</sup> The median income for men in the United States in 1955 was only \$3,400 per year.<sup>102</sup> And only 23.7% of all men earned over \$5,000 per year.<sup>103</sup> Consequently, payments received from the corporation alone—excluding all other sources of income—placed each Springside shareholder in the top quartile of all male wage earners in 1955.

Moreover, it should be recalled that Wilkes was “principally engaged” in the roofing business.<sup>104</sup> Thus, his non-primary business activity—the nursing home business—was providing him at age forty-nine with annual income more than 50% above the median level of income for all men in 1955. For some unexplained reason, the weekly payouts did not increase over the next twelve years but remained at \$100 per week in 1967, the year trouble broke out.<sup>105</sup> Even in 1967, however, the mean income for all men was only about \$8,100.<sup>106</sup> Moreover, for people between the ages of 55 and 64—Wilkes was 61 in 1967—the median income was only around \$7,000.<sup>107</sup> Thus, Wilkes’s non-primary business activity—the nursing home business—still was providing a very handsome financial return, on a relative basis, even though roofing was his chief occupation, and even though corporate payouts had not increased for many years. Furthermore, assuming the business was flourishing—and certainly the period from the mid-1950s through the 1960s was a profitable time for the nursing home industry generally—given the flat annual payout ratio and bright industry prospects with new Medicare and Medicaid payments, the value of the stock itself must have been appreciating considerably.

It was Wilkes’s announcement in early 1967 of his intention to sell his stock that brought to the surface some simmering bad

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100. *Id.* at 660 n.9.

101. *Id.* at 660.

102. BUREAU OF THE CENSUS, U.S. DEP’T OF COMMERCE, CURRENT POPULATION REPORT—CONSUMER INCOME, SERIES P-60, No. 21 (May, 1956).

103. *Id.*

104. *See supra* note 78 and accompanying text.

105. *Wilkes*, 353 N.E.2d at 661.

106. BUREAU OF THE CENSUS, U.S. DEP’T OF COMMERCE, CURRENT POPULATION REPORTS—CONSUMER INCOME, SERIES P-60, No. 57 (Dec. 17, 1968).

107. *Id.*

blood,<sup>108</sup> and afforded the other investors an opportune way to put the “squeeze” on Wilkes.<sup>109</sup>

The falling out among shareholders is well if tersely described in the *Wilkes* opinion.<sup>110</sup> The upshot was that, just as Wilkes in early 1967 sought to exit and “cash out” of Springside after sixteen years, he was cut off by the other three director-investors from all salary payments and was removed as an employee, officer, and director.<sup>111</sup> The discord had its origins in Wilkes’s insistence in 1965 that co-shareholder Quinn pay a higher price for certain Springside property Quinn wished to purchase for himself.<sup>112</sup> Wilkes’s fidelity to the corporation apparently annoyed Quinn and led to a deterioration in their relationship.<sup>113</sup> Eventually, two intra-corporate factions formed: Wilkes versus the other three investors.<sup>114</sup> There were no allegations or findings of misconduct, neglect, or unwillingness to work on Wilkes’s part.<sup>115</sup> Wilkes, a minority shareholder, was being “frozen out” of the venture he initiated, a venture designed—like his early real estate dealings and like all investments in the nursing home industry—to generate high, dependable cash flow.<sup>116</sup> In fact, the manner of freezing out Wilkes was far more in line with the typical corporate freeze-out than the unequal purchase and sale of stock technique deployed in *Donahue*,<sup>117</sup> oppressive as that technique was. This was important in situating the *Wilkes* facts well within the ambit of customary concern in close corporations, a concern that was so expansively—perhaps too expansively—identified in *Donahue*.<sup>118</sup>

#### IV. THE DECISION

Although cut off from all corporate payments in early 1967, Wilkes did not start a lawsuit until August 1971, more than four

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108. *Wilkes*, 353 N.E.2d at 660.

109. *Id.* at 664 n.14 (the court drew the sensible inference of a plan to squeeze Wilkes based on Mr. Connor’s “offer to purchase Wilkes’s [stock] for a price Connor . . . would not have accepted for his own shares”).

110. *Id.* at 660-61.

111. *Id.* at 661.

112. *Id.* at 660.

113. *Id.*

114. *Id.* at 660-61.

115. *Id.* at 661.

116. *Id.* For an apt definition of a “freeze out,” see *Donahue v. Rodd Electrotape Co.*, 328 N.E.2d 505, 513-515 (Mass. 1975).

117. *Wilkes*, 353 N.E.2d at 661; *Donahue*, 328 N.E.2d at 513-14.

118. *Donahue*, 328 N.E.2d at 513-15.

years later.<sup>119</sup> In the author's experience, this delay is not uncommon, as a disgruntled shareholder often tries and expects (or hopes) to reach an acceptable resolution before suing. Moreover, it is only when the shareholder has been "cut off" for two or more years that one can truly conclude he has experienced a "pattern" of being shut out of corporate distributions.

Wilkes engaged an out-of-town lawyer, James F. Egan, from Springfield, who later engaged another Springfield lawyer David J. Martel (Wilkes's nephew), to assist in the appeal to the Supreme Judicial Court.<sup>120</sup> He filed a "bill in equity" in Probate Court for Berkshire County and named as defendants the corporation itself, two of his fellow shareholders, and the executors of the deceased third shareholder.<sup>121</sup> His initial theory for relief was breach of a 1951 oral partnership agreement.<sup>122</sup> Relying on a master's report—which essentially found what Wilkes had alleged—the probate judge nonetheless dismissed the case in 1974,<sup>123</sup> the year before the seminal *Donahue* decision.<sup>124</sup> Interestingly, the Supreme Judicial Court granted direct appellate review of the *Wilkes* dismissal in late 1974,<sup>125</sup> just before the *Donahue* decision itself, which was issued on May 2, 1975.<sup>126</sup> Thus, as it deliberated over the *Wilkes* case, the court had *Donahue* fresh in its mind. It seems unlikely that a direct appeal would be granted if the court saw the case as involving only a breach of partnership agreement, the theory below. Justice Wilkins's very terse concurrence in *Donahue* was remarkably prescient in light of the *Wilkes* appeal because he refrained from joining in any implication in the majority opinion that the court's reasoning "applies to all operations of the corporation as they affect minority stockholders. That broader issue, which is apt to arise in connec-

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119. *Wilkes*, 353 N.E.2d at 658-59.

120. *Id.* at 658. The author thanks Mr. Martel for describing when he got involved in the litigation and his relationship to Mr. Wilkes. David J. Martel, Esq., Speech at the Western New England College School of Law Business Symposium: Fiduciary Duties in Closely Held Business 35 Years after *Wilkes v. Springside Nursing Home, Inc.* (Oct. 15, 2010).

121. *Wilkes*, 353 N.E.2d at 658-59.

122. *Id.*

123. *Id.* at 659.

124. *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 505 (Mass. 1975).

125. *Wilkes*, 353 N.E.2d at 659. Under Rule 11 of the Massachusetts Rules of Appellate Procedure, direct appeal to the Supreme Judicial Court may be granted on the vote of two justices where, among other grounds, a question of first impression or a novel question of law is presented. MASS. R. APP. P. 11; *see also* MASS. GEN. LAWS ch. 211A, § 10 (2008).

126. *Donahue*, 328 N.E.2d at 505.

tion with salaries and dividend policy, is not involved in this case. The analogy to partnerships may not be a complete one.”<sup>127</sup> It was more than “apt” to arise; it had already arisen, and would soon be before the court, in the *Wilkes* appeal. Sense can be made of this concurrence when one sees that, for some reason, Justice Wilkins did not subsequently participate in the *Wilkes* opinion—although he was still on the court—and thus his concurrence in *Donahue* apparently was his only opportunity to express at least some misgivings about how to resolve the upcoming *Wilkes* appeal in light of *Donahue*.

Having taken the *Wilkes* appeal in October 1974, the court did not rule until August 1976,<sup>128</sup> suggesting the court was struggling to craft its ruling. *Donahue* was also slow to be decided, taking fourteen months after the ruling in the appeals court.<sup>129</sup> Moreover, on appeal, and in light of the fact that *Donahue* had been decided since *Wilkes* had taken his appeal, *Wilkes* added a claim for breach of fiduciary duty owed him by the majority shareholders.<sup>130</sup> The court permitted the additional theory, a deviation from standard appellate practice, but understandable in light of the intervening and momentous decision in *Donahue*.<sup>131</sup> The court—now led by a new Chief Justice (Hennessey), former Chief Justice Tauro having retired after *Donahue*<sup>132</sup>—made short shrift of Justice Wilkins’s hesitancy in his *Donahue* concurrence to automatically apply partnership law analogies in all close corporation settings.<sup>133</sup> The court concluded that it was not vital to its decision whether *Wilkes*’s claim was governed by partnership law or corporate law because *Donahue* had held that shareholders in close corporations owe one another substantially the same duties partners owe each other.<sup>134</sup> The *Wilkes* court, in other words, was not carving back the *Donahue* partnership analogy—the court described the factual differences

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127. *Id.* at 521 (Wilkins, J. concurring).

128. *Wilkes*, 353 N.E.2d at 657.

129. *Donahue v. Rodd Electrotpe Co.*, 307 N.E.2d 8, 8-9 (Mass. App. Ct. 1974), *rev’d*, 328 N.E.2d 505 (Mass. 1975). The appeals court affirmed the trial court’s dismissal of *Donahue*’s claim on February 20, 1974. *Id.* The Supreme Judicial Court decision came down on May 2, 1975. *Donahue*, 328 N.E.2d at 505.

130. *Wilkes*, 353 N.E.2d at 659.

131. *Id.*

132. *Justices of the Supreme Judicial Court*, SUPREME JUDICIAL COURT OF MASSACHUSETTS, <http://www.massreports.com/justices/alljustices.aspx> (last visited Apr. 23, 2011).

133. *Wilkes*, 353 N.E.2d at 662-63.

134. *Id.* at 662.



between the two cases as “more of form than of substance”<sup>135</sup>—though it did, as is well-known, reconfigure *Donahue* in another key fashion described below.

Wilkes, because he had never been “principally” employed by Springside,<sup>136</sup> was not the typical shareholder-employee who, in being terminated as an employee, loses his chief source of wage income. Thus, the court could not, with respect to Wilkes, over-emphasize the “job guarantee” or employment aspect of a minority shareholder’s investment in a close corporation.<sup>137</sup> Instead, the court, besides mentioning Wilkes’s loss of “participation in the management of the enterprise,”<sup>138</sup> shrewdly and neutrally phrased a longstanding salary payment to Wilkes as being “the principal return on his investment” and its curtailment as denying Wilkes “an equal return on his investment.”<sup>139</sup> That perceptively hit the financial nail on the head for Wilkes himself, specifically, as an inveterate real estate investor and for investors generally in the nursing home industry, where, as noted earlier, regular cash flow is a chief investment goal.<sup>140</sup>

The larger human narrative in the *Wilkes* opinion was one of betrayal and dashed expectations among longtime colleagues. This theme played out in the usual way in a close corporation after “bad blood” between Wilkes and Quinn grew into majority and minority factionalism.<sup>141</sup> Although none of the parties is fully sketched in the opinion, Wilkes is fleshed out in somewhat fuller humanity than are the defendants.<sup>142</sup> As to the defendants, relatively little is said, with more attention given to their role as—controlling shareholders—in the morality play of corporate dissension and the specific actions they took in that role.<sup>143</sup> Even in that archetypal capacity, neither the defendants nor the court had much to say in their defense.

In keeping with the tenor of the times, the *Wilkes* opinion was doctrinal, though it drew heavily on scholarship detailing the plight

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135. *Id.* at 663.

136. *See supra* notes 79-81 and accompanying text.

137. *See Wilkes*, 353 N.E.2d at 663.

138. *Id.* at 662.

139. *Id.* at 662-63. These were Wilkes’s “reasonable expectations.” *Brodie v. Jordan*, 857 N.E.2d 1076, 1079 (Mass. 2006); *Wilkes*, 353 N.E.2d at 662-63.

140. *See supra* notes 73-75, 115-118 and accompanying text.

141. *See Wilkes*, 353 N.E.2d at 660-61.

142. *See id.*

143. *See id.* at 663-64.

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of a minority shareholder.<sup>144</sup> There was no evident “law and economics” influence on the opinion—landmark works in that vein by Guido Calabresi and Richard Posner were very recent<sup>145</sup>—and corporate law itself was several years away from being systematically examined from an economics perspective.<sup>146</sup> The opinion also was not empirical or multidisciplinary in orientation.

The enduring and memorable heart of *Wilkes*, of course, is the way in which it sought to rein in a potentially over-broad reading of *Donahue*’s imposition of partnership-like fiduciary duties on controlling shareholders. The court stressed the need for a “balanced” approach to the legitimate control rights of the majority, on the one hand, with the rightful concerns of the minority, on the other hand.<sup>147</sup> Balancing, of course, is a longstanding mainstay of constitutional law analysis, where competing interests are weighed against each other and the relative strengths of each are assessed.<sup>148</sup> Its use can be seen, for example, in dormant commerce clause analysis,<sup>149</sup> due process review,<sup>150</sup> outlining abortion rights,<sup>151</sup> and in evaluating (and upholding) a law criminalizing the distribution of child pornography.<sup>152</sup> All of these knotty issues—and others like them—require courts to measure the rival interests and determine which, on balance, carries the greater weight. The Massachusetts Supreme Judicial Court itself had used a balancing approach in con-

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144. *Id.* at 663. This theme is developed more fully in the articles for this symposium by Professors Loewenstein and Thompson. See Mark J. Loewenstein, *Wilkes v. Springside Nursing Home, Inc.: A Historical Perspective*, 33 W. NEW ENG. L. REV. 339 (2011); Robert B. Thompson, *Allocating the Roles for Contracts and Judges in the Closely Held Firm*, 33 W. NEW ENG. L. REV. 369 (2011).

145. See, RICHARD POSNER, *THE ECONOMIC ANALYSIS OF LAW* (1973); GUIDO CALABRESI, *THE COST OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970). Michael Jensen’s and William Meckling’s pathbreaking work on a theory of the firm appeared in 1976. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

146. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L. J. 698 (1982) (analysis of the economic benefits of freezing out a shareholder in a closely held corporation); Daniel R. Fischel, *The Law and Economics of Dividend Policy*, 67 VA. L. REV. 699 (1981) (critique of an analysis of the effect of dividends on share prices).

147. *Wilkes*, 353 N.E.2d at 663.

148. See T. Alexander Aleinikoff, *Constitutional Law in an Age of Balancing*, 96 YALE L. J. 943, 943-44 (1987).

149. See, e.g., *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 143 (1970).

150. See, e.g., *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976).

151. See, e.g., *Roe v. Wade*, 410 U.S. 113, 154-57 (1973).

152. See, e.g., *New York v. Ferber*, 458 U.S. 747, 756 (1982).

stitutional law cases before *Wilkes*.<sup>153</sup> Thus, as a decision-making methodology, the *Wilkes* approach was drawing on deep and established precedent.

*Wilkes*'s balancing approach was fitting, but paradoxical. In constitutional law the pivotal issue in balancing is how to reconcile individual rights with governmental interests, the latter typically being embodied in legislatively-enacted, majority-supported statutes.<sup>154</sup> Indeed, the first ten amendments to the U.S. Constitution—the Bill of Rights—and their subsequent incorporation via the Due Process Clause of the Fourteenth Amendment, are designed to protect individual interests against the lawfully-exercised power of a political majority.<sup>155</sup> The *Donahue* opinion, by analogy, struck a protective “bill of rights” blow for minority interests in close corporations gave little heed to the rightful claims of the majority interests acting in accordance with the corporate statute’s “constitutional” power structure.<sup>156</sup> *Wilkes* sought to restore the potential imbalance of *Donahue* by acknowledging the “selfish ownership” rights of the controlling group.<sup>157</sup> Rather than the usual constitutional law concern for the individual in relation to the potentially tyrannical majority, therefore, *Wilkes* set forth a “reverse bill of rights” to recognize the legitimate concerns and prerogatives of the duly-constituted majority.

Such a case-by-case balancing approach inevitably is messy, context specific, and often lacking in *ex ante* predictability.<sup>158</sup> In the constitutional law area, balancing has been severely criticized for just these reasons, as well as for the broad discretion it accords judges.<sup>159</sup> Consequently, in the governance of a close corporation, as in a constitutionally-democratic government, frequently there

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153. See, e.g., *Commonwealth v. Horne*, 291 N.E.2d 629 (Mass. 1973); *Commonwealth v. Thomas*, 233 N.E.2d 25 (Mass. 1967).

154. See, e.g., *Delaware v. Prouse*, 440 U.S. 648, 654 (1979); *United States v. Rodriguez-Morales*, 929 F.2d 780, 787 (1st Cir. 1991); *Commonwealth v. Knapp*, 804 N.E.2d 885 (Mass. 2004).

155. See, e.g., *McDonald v. City of Chicago*, 130 S.Ct. 3020, 3021 (2010) (holding that the Second Amendment right to keep and bear arms is fully applicable to the states by virtue of the Fourteenth Amendment).

156. See *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 512-14 (Mass. 1975).

157. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976).

158. Some balancing tests are not case-by-case but are more systemic in thrust. See *Legal Theory Lexicon 024: Balancing Tests*, LEGAL THEORY LEXICON, [http://lsolum.typepad.com/legal\\_theory\\_lexicon/2004/02/legal\\_theory\\_le\\_1.html](http://lsolum.typepad.com/legal_theory_lexicon/2004/02/legal_theory_le_1.html) (last visited Feb. 22, 2011).

159. See, e.g., *Bendix Autolite Corp. v. Midwesco Enters.*, 486 U.S. 888, 897 (1988) (Scalia, J., concurring).

arises an unavoidable and recurrent clash. This clash is not just between minority expectations and majority prerogatives, but also over views as to how best, jurisprudentially, to address that clash. Some favor the case-by-case approach, notwithstanding its messy, time-consuming, and somewhat indeterminate nature, on the grounds that it promotes more finely-tailored overall fairness.<sup>160</sup> Others prefer a more categorical approach in which, in corporations at least, minority shareholders must self-help *ex ante* by private bargaining or are left out in the cold when trouble erupts, because such an approach promotes greater certainty of outcome and somewhat disempowers the judiciary.<sup>161</sup> This clash of positions presents a stark antinomy in which a true harmonization of views is, ultimately, impossible to attain.

Of course the jurisprudential vessel for “unsettling” corporate law and its statutorily-enacted majoritarian regime is equity. Equity—and its offspring, fiduciary duties<sup>162</sup>—by their very nature subvert and destabilize law.<sup>163</sup> The problem with legal precepts, identified so clearly by Aristotle, is their universality.<sup>164</sup> Although generally the categorical nature of law is desirable, so that evenhandedness is attained, in some settings to apply a legal rule blindly will itself create a manifest injustice and it is equity’s essential function to prevent that.<sup>165</sup> Delaware’s corporate jurisprudence long has recognized this role in numerous settings.<sup>166</sup> For example, with respect to the improper use of statutory power to amend bylaws to

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160. See, e.g., Lyman Johnson, *After Enron: Remembering Loyalty Discourse In Corporate Law*, 28 DEL. J. CORP. L. 27, 41 (2002).

161. Easterbrook & Daniel R. Fischel, *supra* note 146, at 700-703.

162. *McMahon v. New Castle Assoc.*, 532 A.2d 601, 604 (Del. Ch. 1987) (“Chancery takes jurisdiction over ‘fiduciary’ relationships because equity, not law, is the source of the right asserted.”).

163. MARGARET HALLIWELL, *EQUITY & GOOD CONSCIENCE IN A CONTEMPORARY CONTEXT* 6 (1997) (“Fundamental misconceptions of equity abound, . . . because of a persistent refusal to acknowledge that equity is, by its very nature, subversive of the law.”).

164. ARISTOTLE, *NICOMACHEAN ETHICS* 142 (Martin Ostwald trans., Bobbs-Merrill Co., Inc., 1962). “[E]very law is necessarily universal while there are some things which it is not possible to speak of rightly in any universal or general statement . . . [t]he law takes the generality of cases, being fully aware of the error thus involved.” *Id.*

165. See HALLIWELL, *supra* note 163, at 6 (explaining that equity occasionally “subverts” law to correct a potential injustice caused by law’s inherent universality).

166. *Davenport Servs., Inc. v. Five North Corp.*, No. 01L-04-101, 2003 WL 21739066, at \*4 (Del. Super. Ct., May 19, 2003) (“The Court of Chancery is a court of ‘limited jurisdiction’ that decides matters in equity; its jurisdiction was first defined by the jurisdiction of the English High Court of Chancery in 1776.”); see also *Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 801 (Del. Ch. 2009); *Carney v. Preston*, 683 A.2d 47, n.4 (Del. Super. Ct. 2006).

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thwart a minority shareholder in the landmark case of *Schnell v. Chris Craft Industries, Inc.*, the Delaware Supreme Court stated that “inequitable action does not become permissible simply because it is legally possible.”<sup>167</sup> And Delaware courts also have held that otherwise lawful corporate contracts are invalid if entering them constitutes a breach of fiduciary duty.<sup>168</sup> In other words, equity, in certain circumstances, routinely intervenes into law-complying arrangements to correct injustice by imposing fiduciary duties on a control person or group and by constraining an inequitable exercise of power. Although equity usefully meliorates the potential unfairness of law’s categorical rules in this way, it can, nonetheless, seem disturbingly amorphous with no clearly-delineated limits. This was one of the post-*Donahue* concerns that required attention in *Wilkes*.

The perennial temptation, of course, is for law, initially hobbled by equity, to counteract equity’s foray by turning its very interventions back into more orderly “rules of law.” Aristotle cautioned against this understandable but faulty desire for an illusory certainty by stating: “The rule of the undefined must itself remain undefined also.”<sup>169</sup> Along this line, *Wilkes* valiantly tried to corral somewhat the equitable forces unleashed in *Donahue* through *Donahue*’s broad holding that shareholders in a close corporation owe one another a strict fiduciary duty of utmost good faith and loyalty.<sup>170</sup> At the same time that *Donahue* articulated this broad duty, it went on in utter tension therewith to mandate a “rule of equal opportunity,”<sup>171</sup> apparently not appreciating the inherent differences and functions between “standards” and “rules.”<sup>172</sup>

*Wilkes* sought to cabin the broad duty laid out in *Donahue*—without also reverting to the trap of “rule talk”—through a structured four-step framework.<sup>173</sup> First, the plaintiff minority-share-

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167. *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971).

168. *In re Paramount Commc’ns Inc. S’holders’ Litigation*, 637 A.2d 34, 51 (Del. 1993).

169. See ARISTOTLE, *supra* note 164.

170. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 661-62 (Mass. 1976); *Donahue v. Rodd Electrotyping Co.*, 328 N.E.2d 505, 517-18 (Mass. 1975).

171. *Donahue*, 328 N.E.2d at 519 (emphasis added). An early comment on *Donahue* noted what the author called “a rule of equality in the stock purchase area.” Michael B. Elefante, *Corporations*, 23 ANN. SURV. MASS. L. 264, 269 (1976).

172. For a contrasting of standards and rules in corporate law, see Lyman P. Q. Johnson & Mark A. Sides, *The Sarbanes-Oxley Act and Fiduciary Duties*, 30 WM. MITCHELL L. REV. 1149, 1194-95 (2004). See generally, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

173. See *Wilkes*, 353 N.E.2d at 663 (describing the four-step framework).

holder has an initial burden to plead a breach of fiduciary duty.<sup>174</sup> Second, the defendant control group then must demonstrate a legitimate business purpose.<sup>175</sup> Third, the plaintiff must prove that the same objective could have been achieved by an alternative course less harmful to the minority.<sup>176</sup> Finally, taking a balancing approach, the court weighs the strengths of the two sides and settles the dispute.<sup>177</sup> This methodology seeks to bring order to the analytical and adjudicative process, but in the age-old law vs. equity tug of war it cannot—nor does it seek to—ultimately subdue the ever-unruly equity by crafting universal “rules” of law. In keeping with that approach, at the end of its opinion, the *Wilkes* court summed up that Mr. Wilkes—who, recall, had brought his suit as a bill in equity—was to be awarded such damages as a result of the “inequitable enrichment” of the majority.<sup>178</sup>

The ongoing, but futile, Sisyphus-like effort in corporate law to counter the disruptive effects of equity by turning equity into the very rule-oriented approach it is designed to resist can be seen not just in *Donahue* but in other areas of corporate law. For example, self-dealing transactions by directors or controlling shareholders long have been closely scrutinized by courts.<sup>179</sup> In an effort to bring a measure of legal predictability to these transactions, many states—including Massachusetts and Delaware—have enacted statutes addressing director conflict of interest transactions.<sup>180</sup> Yet, these statutes, in Delaware at least,<sup>181</sup> and seemingly in Massachusetts as well,<sup>182</sup> have been interpreted as permitting avoidance of a transaction’s voidability but not as preventing a court from reviewing the matter *ex post* for compliance with fiduciary duties. Equity will not altogether quit the field here.

Even the seemingly awkward multi-step framework laid out in *Wilkes* has considerable company in corporate law.<sup>183</sup> The aim, re-

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174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.* at 665.

179. *See, e.g., Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 596-603 (1921).

180. MASS. GEN. LAWS ch. 156 D, § 8.31 (2008); DEL. CODE ANN. tit. 8, § 144 (2001).

181. *See In re Cox Commc’ns, Inc. S’holders’ Litigation*, 879 A.2d 604, 614-15 (Del. Ch. 2005).

182. MASS. GEN. LAWS ch. 156 D, § 8.31 preliminary note 1.

183. *See FRANK H. EASTERBROOK & DANIEL R. FISCHER, THE ECONOMIC STRUCTURE OF CORPORATE LAW*, 246-51 (Harvard University Press 1991).

call, is to guide the equitable inquiry without vainly trying to reduce it to rule-like status.<sup>184</sup> Such a methodology is not too dissimilar, for example, to Delaware's approach in demand-excused derivative litigation.<sup>185</sup> There, after a plaintiff-shareholder begins an action for breach of fiduciary duty, defendants may establish an independent committee to investigate, and, if the committee members conclude the action is not in the company's best interests, they may move to dismiss.<sup>186</sup> However, the defendants must carry the burden on certain issues, such as the committee's independence and good faith.<sup>187</sup> If they carry that burden, the court itself may weigh various factors and exercise its own judgment whether to dismiss the case or proceed to trial.<sup>188</sup>

Also, in *Cede & Co. v. Technicolor, Inc.*, the Delaware Supreme Court likewise devised a framework of shifting burdens in fiduciary duty litigation.<sup>189</sup> Beginning with a presumption of propriety in director actions, the plaintiff-shareholder assumes the initial burden of providing evidence of a breach of duty, which, if proven, shifts to the director-defendants the burden of proving, to the court's satisfaction, the entire fairness of director conduct.<sup>190</sup> And in the shareholder voting context, if the board acts in a way that thwarts a shareholder vote, neither the deferential business judgment rule nor a rule of *per se* invalidity is appropriate, but rather the defendants have the burden to provide a "compelling" corporate justification for the actions taken.<sup>191</sup>

The *Wilkes* court mandated as one step in its framework that the controlling shareholders must "demonstrate a legitimate business purpose" for its action—a burden they failed to carry in that case.<sup>192</sup> This step likewise situates the case in a larger stream of decisional law designed to guide and constrain judicial review. "Business purpose," for example, has long been required in the corporate tax area,<sup>193</sup> in the hostile takeover defensive measures

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184. See *supra* notes 162-163 and accompanying text.

185. See *Zapata Corp. v. Maldonado*, 430 A.2d 779, 784 (Del. 1981).

186. *Id.* at 778.

187. *Id.* at 788.

188. *Id.* at 789.

189. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 371 (Del. 1993).

190. *Id.* at 361.

191. *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988).

192. *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 663 (Mass. 1976).

193. See *Gregory v. Helvering*, 293 U.S. 465, 469 (1935).

area,<sup>194</sup> and in other cases where the court seeks to prohibit the majority from unilaterally “freezing out” minority shareholders.<sup>195</sup>

These examples of multi-step frameworks and of requiring the business purpose element demonstrate the efforts of Delaware and other courts to do in a parallel way what the *Wilkes* court did: affirm the centrality of strict fiduciary duties among shareholders in a close corporation while bringing a principled sense of order and guidance to the law and equity tension so as to prevent one from vanquishing the other, while also avoiding the corresponding *Donahue* misbelief that the two forces had somehow been harmonized into an easy-to-apply “rule.” Concerns about *Donahue* led the Supreme Court of Delaware to reject it by reading it as just such a “rule-based” decision—without noting the subsequent tempering of *Wilkes*—which Delaware eschewed in favor of its customary “entire fairness” test in a self-dealing context like that in *Donahue*.<sup>196</sup> Yet, in *Wilkes* itself, the Delaware approach would not have worked because the controlling shareholders did not themselves enter a self-dealing transaction with the company for which the “entire fairness” test was designed.<sup>197</sup> Rather, the controlling shareholders caused the company to terminate the minority shareholder’s prior arrangement with the business. Delaware’s more traditional doctrinal approach seems not to capture such behavior. And the Supreme Judicial Court itself, in subsequent cases, has struggled to reconcile the broad fiduciary duty of *Donahue* with the employment-at-will doctrine in an effort to curb a corporate law incursion into the labor law area.<sup>198</sup> No rule exists to make this accommodation easy.

Law and equity will continue to subsist in an uneasy tension in our corporate legal system because each plays a vital role in the production of a healthy balance in that system.<sup>199</sup> Indeed, there is a great irony thirty-five years after the *Wilkes* decision and its *Dona-*

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194. *Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 954 (Del. 1985).

195. *Schwartz v. Marien*, 335 N.E.2d 334, 339 (N.Y. 1975).

196. *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993).

197. *See Wilkes*, 353 N.E.2d at 660-61 (showing no mention of the controlling shareholders entering into a self-dealing transaction); *Nixon*, 625 A.2d at 1376 (explaining the purpose of the “entire fairness” test).

198. *See Merola v. Exergen Corp.*, 668 N.E.2d 351, 354-55 (Mass. 1996); *Blank v. Chelmsford Ob/Gyn, P.C.*, 649 N.E.2d 1102, 1105-06 (Mass. 1995). Professor Deborah DeMott develops this theme more fully. Deborah A. Demott, *Investing In Work: Wilkes as an Employment Law Case*, 33 W. NEW ENG. L. REV. 497 (2011).

199. On the roles of law and equity in co-producing a healthy balance in corporate jurisprudence, see Lyman Johnson, *Counter-Narrative in Corporate Law: Saints and Sinners, Apostles and Epistles*, 2009 MICH. ST. L. REV. 847.



*hue*-like drawing on partnership law to bolster fiduciary duties in the close corporation. Today, in partnerships—and also in LLCs, entities unknown in 1976—fiduciary duties supposedly may be contractually eliminated altogether,<sup>200</sup> while in corporations that is forbidden.<sup>201</sup> Thus, while in 1975-76 *Donahue* and *Wilkes* creatively drew on partnership law to amplify the equitable voice in close corporations, thirty-five years later that voice, although still remaining in the corporation, may, by contract, now be silenced altogether in Delaware partnerships and LLCs.<sup>202</sup> In the initially more robust and protective non-corporate fiduciary duty area, law today in the leading business law state seeks to subdue equity, whereas in the close corporation arena law and equity remain, as always, at wary play. In Massachusetts, by contrast, thirty-five years after *Wilkes* a greater harmony between corporate and non-corporate business enterprises still endures.<sup>203</sup>

#### CONCLUSION

Much has changed since 1976. The city of Pittsfield, Massachusetts has changed as it continues to adapt economically to a far different industrial-commercial environment than that in which it flourished for many years. The nursing home industry continues to change as well, with the use of physical and chemical restraints—permitted in the mid-70s—now outlawed and the development of new procedures to ensure greater regulatory compliance.<sup>204</sup> Spring-side Nursing Home, Inc. also has changed—apparently it was dissolved long ago. Yet, one of its former properties endures as a 39-unit housing complex for homeless veterans,<sup>205</sup> just as Springside Nursing Home itself had earlier converted a former tuberculosis

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200. See DEL. CODE ANN. tit. 6, § 18-1101(c) (2008) (statute permitting elimination of fiduciary duties in Delaware limited liability companies); DEL. CODE ANN. tit. 6, § 15-103(f) (statute permitting elimination of fiduciary duties in Delaware general partnership). Massachusetts appears not to permit elimination of fiduciary duties in partnerships or LLCs. For a critique of Delaware's waiver statutes on constitutional grounds, see Lyman Johnson, *Delaware's Non-Waivable Duties* 91 B.U. L. REV. (forthcoming 2011).

201. *Sutherland v. Sutherland*, No. 2399-VCL, 2009 WL 857468, at \*4 (Del. Ch. 2009).

202. See Johnson, *supra* note 200.

203. The *Wilkes* approach was applied by the Massachusetts Supreme Judicial Court to LLCs in 2009. *Pointer v. Castellani*, 918 N.E.2d 805 (Mass. 2009).

204. CHARLES W. LIDZ, LYNN FISCHER, & ROBERT M. ARNOLD, *THE EROSION IN LONG-TERM CARE* 34 (1992).

205. *Veterans Group Gets \$2.6 M Boost*, THE BERKSHIRE EAGLE, Aug. 18, 2008 (on file with author).

treatment center into a nursing home.<sup>206</sup> Adaptation has occurred, for survival sake, in many venues associated with the *Wilkes* case.

Fiduciary duties in the close corporation are an example of enduring equity. Shareholders in close corporations must “endure” equity in the sense that they must put up with it and, generally, cannot expel it *a priori* by means of statutes and private contracts. Equity in the close corporation also “endures” in the sense that it persists. It persists because in many instances—*Donahue* and *Wilkes* being examples—it is needed to prevent lawfully-exercised power from unjustly harming a minority shareholder. One key feature in its staying power, besides its usefulness, is its remarkable adaptability to the flux and “gray” of—and range of emotions affecting—human relations within a business. It opportunely takes account of time—and its passage—in a way timeless legal rules do not. Law assumes both a highly rational world and one in which, while everything around it may change, a rule itself—once adopted—will be the same tomorrow as it was yesterday, no matter what else—even if much else—may have changed.<sup>207</sup> In *Donahue*, hoary partnership law was equitably re-fashioned to the close corporation setting and history was made. In *Wilkes*, the very force unleashed in *Donahue* was itself molded yet again to give greater weight to the law-conferred privilege of control. *Wilkes* tethered equity and law together in a multi-step framework without purporting to elegantly and forever solve the intractable law-equity quandary. The decision itself has endured. It has been cited countless times,<sup>208</sup> appears in leading corporate law casebooks<sup>209</sup> usually as a coda to *Donahue*—and probably is taught (or at least touched on) in most American law school corporations courses.<sup>210</sup>

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206. See *supra* note 87 and accompanying text.

207. As noted by Professor Robert Thompson, modern corporate statutes frequently provide remedies—for example, corporate dissolution—in cases of “oppression.” Thompson, *supra* note 144. But those “law” provisions require that a shareholder show oppression, which is conduct engaged in over time and is, essentially, an equitable concept.

208. As of February 4, 2011, *Wilkes* had been cited 797 times. KEYCITE CITING REFERENCES: *Wilkes v. Springside Nursing Home, Inc.*, Westlaw, [www.westlaw.com](http://www.westlaw.com) (search for *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657 and follow the “Citing References” link) (last visited Feb. 4, 2011).

209. See, e.g., ALAN PALMITER & FRANK PARTNOY, CORPORATIONS A CONTEMPORARY APPROACH 1044 (2010); ROBERT W. HAMILTON, ET AL, CORPORATIONS 363 (2010).

210. See Stephen M. Bainbridge, *Brodie v. Jordan and Wilkes v. Springside Nursing Home*, PROFESSORBAINBRIDGE.COM, <http://www.professorbainbridge.com/professorbainbridge.com/2009/11/brodie-v-jordan-and-wilkes-v-springside-nursing-home.html> (last visited Oct. 3, 2010).

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Equity's unruly power to upend can be irksome to those who crave predictability and determinacy. It remains essential, however, in a rules-based system where humility demands we admit that few rules are so sagely written that they will always avoid injustice if categorically applied. Equity usefully permits the taking of a second look, and, therefore, by nature it is more pliant and fluid than rigid precepts of law. Equity's very capacity to bring change means that nothing need change in our legal system's ongoing pursuit of a just ordering within the close corporation.