

Annual Survey of Massachusetts Law

Volume 1979

Article 5

1-1-1979

Chapter 2: Corporations

John D. Donovan Jr.

Clover M. Drinkwater-Lunn

Barbara Jane Levine

Daniel E. Wright

Follow this and additional works at: <http://lawdigitalcommons.bc.edu/asml>

 Part of the [Corporation and Enterprise Law Commons](#)

Recommended Citation

Donovan, John D. Jr.; Drinkwater-Lunn, Clover M.; Levine, Barbara Jane; and Wright, Daniel E. (1979) "Chapter 2: Corporations," *Annual Survey of Massachusetts Law*: Vol. 1979, Article 5.

C H A P T E R 2

Corporations

SURVEY STAFF†

§2.1. **Corporate Promoters—Personal Liability.*** In Massachusetts it is well established that promoters of intended but unformed corporations are personally liable on contracts entered into by them on behalf of the intended corporation.¹ Promoters may escape liability only if the contracting parties agree that only the corporation will be held liable on the contract,² if the corporation subsequently ratifies the pre-incorporation agreement,³ or if a novation is created.⁴ To hold promoters liable, courts have traditionally employed several theories. Most jurisdictions refer to agency principles and suggest that a promoter who acts for a non-existent principal is individually liable.⁵ Under this theory, courts reason that since the corporation remains unformed, no agency relationship with the promoter truly exists; the promoter's contract is thus personal, and he is individually responsible for his contract.⁶ Alternatively, some courts hold that promoters are liable on their pre-incorporation contracts as a breach of their implied warranty of authority to act on behalf of the intended corporation.⁷ Since the corporation remains unformed, it does not confer actual authority upon the promoter;

† JOHN D. DONOVAN, JR., CLOVER M. DRINKWATER-LUNN, BARBARA JANE LEVINE, and DANIEL E. WRIGHT.

§ 2.1. * By John D. Donovan, Jr., staff member, ANNUAL SURVEY OF MASSACHUSETTS LAW.

¹ See, e.g., *Hushion v. McBride*, 296 Mass. 4, 10, 4 N.E.2d 443, 447 (1936); *Mansfield v. Lang*, 293 Mass. 386, 390-91, 200 N.E. 110, 113 (1936); *Reuter v. Ballard*, 267 Mass. 557, 562, 166 N.E. 822, 824 (1929); *Storey v. Bickford*, 237 Mass. 284, 289, 129 N.E. 714, 716 (1921). See also 13 MASSACHUSETTS PRACTICE, PEAIRS, BUSINESS CORPORATIONS, §§ 221-23 (2d ed. 1971).

² *Mansfield v. Lang*, 293 Mass. 386, 391, 200 N.E. 110, 113 (1936).

³ See, e.g., *Storey v. Bickford*, 237 Mass. 284, 288-89, 129 N.E. 714, 716 (1921).

⁴ See 2 WILLISTON, CONTRACTS § 306 (3d ed. 1959).

⁵ 1 FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS [hereinafter cited as FLETCHER] § 215 (rev. ed. 1974).

⁶ See *Shell Oil Co. v. Hanchett*, 18 Cal. App. 2d 240, 243, 63 P.2d 338, 339 (1936); *Nichols v. Bodenwein*, 107 Fla. 25, 38-39, 146 So. 86, 91 (1932); *Wells v. Fay & Egan Co.*, 143 Ga. 732, 733, 85 S.E. 873, 874 (1915); *Strause v. Richmond Woodworking Co.*, 109 Va. 724, 731, 65 S.E. 659, 661 (1909); FLETCHER, *supra* note 5, at § 215; Isaacs, *The Promoter: A Legislative Problem*, 38 HARV. L. REV. 887 (1925).

⁷ See, e.g., *Weiss v. Baum*, 218 App. Div. 83, 86, 217 N.Y.S. 820, 822 (1926).

where no actual authority exists, personal liability is imposed.⁸ Finally, courts have relied on theories of deceit, misrepresentation, and the doctrine of estoppel to impose personal liability on corporate promoters.⁹ Thus, absent a ratification of a promoter's contract by the newly formed corporation or the inference of a novation, promoters remain personally liable on contracts entered into with third parties. In Massachusetts, as in most jurisdictions, personal liability of promoters is determined according to the general rules of agency.¹⁰

A problem arises in the promoter context when an intended corporation has several promoters, each of whom may contract with third persons. Determination of the liabilities *inter se* of the several promoters depends upon a definition of the legal relationship which the promoters bear to each other and upon the rights and duties which flow from that legal relationship.¹¹ During the *Survey* year, the Massachusetts Supreme Judicial Court had an opportunity to define the nature of the legal relationship between the several promoters of an unformed corporation and to determine the various liabilities which are a consequence of that legal relationship.¹²

In *Productora E Importadora de Papel, S.A. de C.V. (PIPSA) v. Fleming*,¹³ a Mexican corporation¹⁴ had ordered newsprint from one Dietrich, a promoter of Trans-Milpak, Inc. (TM),¹⁵ a corporation formed in Massachusetts after the contract was executed.¹⁶ The promoter signed the contract on behalf of TM representing herself as TM's president.¹⁷ A second contract was subsequently entered into between PIPSA and another unformed corporation, Trans-Milpak International, Inc. (TMI).¹⁸ This second agreement was negotiated and signed by the Mexican agent

⁸ See FLETCHER, *supra* note 5, at § 215.

⁹ See cases cited at 13 MASSACHUSETTS PRACTICE, PEAIRS, BUSINESS CORPORATIONS, § 222 (2d ed. 1971).

¹⁰ See *Mansfield v. Lang*, 293 Mass. 386, 391, 200 N.E. 110, 113 (1936); *Reuter v. Ballard*, 267 Mass. 557, 562, 166 N.E. 822, 824 (1929); *Storey v. Bickford*, 237 Mass. 284, 289, 129 N.E. 714, 716 (1921); 13 MASSACHUSETTS PRACTICE, PEAIRS, BUSINESS CORPORATION, § 222 (2d ed. 1971).

¹¹ FLETCHER, *supra* note 5, at § 191.

¹² *Productora E Importadora de Papel, S.A. de C.V. v. Fleming*, 1978 Mass. Adv. Sh. 3106, 383 N.E.2d 1129.

¹³ 1978 Mass. Adv. Sh. 3106, 383 N.E.2d 1129.

¹⁴ PIPSA is a "sociedad anomima" organized pursuant to the General Laws of Mercantile Companies of the United States of Mexico. Plaintiff's complaint, *reprinted* in Supplemental Appendix to Defendant's Appeal, Appeals Court No. 77-188, at 1 (1977).

¹⁵ 1978 Mass. Adv. Sh. at 3107, 383 N.E.2d at 1132.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 3109, 383 N.E.2d at 1132.

of TMI's promoter, the defendant Fleming,¹⁹ who later became president of both TM and TMI.²⁰ Upon the failure of either TM or TMI to fulfill completely orders placed by PIPSA under the contracts, PIPSA filed an action of contract against each corporation, its officers, and the several promoters of the two corporations.²¹

In its complaint, PIPSA alleged that defendant Fleming, the president of TM and TMI, was personally liable on the two contracts as "promoter and prospective incorporator" of the corporations.²² PIPSA further asserted that by virtue of Fleming's promoter status alone he was liable for damages incurred under the two contracts.²³ Upon defendant Fleming's failure to make discovery, the superior court entered a default judgment against him²⁴ and after a hearing to assess damages, entered final judgment.²⁵ Fleming appealed, and the Supreme Judicial Court ordered the case transferred from the Appeals Court on its own initiative.²⁶ Holding that the superior court had improperly failed to segregate damages among the various defendants and the promoters of the two corporations, the Supreme Judicial Court reversed.²⁷

In considering the nature of the relationship between co-promoters of an unformed corporation, courts and commentators have developed several views.²⁸ Most jurisdictions take the position that co-promoters of an intended but unformed corporation are partners.²⁹ Under this view

¹⁹ *Id.* See Defendant's response to interrogatories, reprinted in Supplemental Appendix to Defendant's Appeal, Appeals Court No. 77-188.

²⁰ *Id.* at 3110-11, 383 N.E.2d at 1133.

²¹ *Id.* at 3111, 383 N.E.2d at 1133.

²² *Id.* See Count VI, Plaintiff's Complaint, reprinted in Supplemental Appendix to Defendant's Appeal, Appeals Court No. 77-188 at 10; Count X, *id.* at 20.

²³ 1978 Mass. Adv. Sh. at 3112, 383 N.E.2d at 1133. See MASS. R. Crv. P. 37(b)(2)(C), 365 Mass. 797 (1974).

²⁴ See MASS. R. Crv. P. 55(b)(2), 365 Mass. 822 (1974).

²⁵ 1978 Mass. Adv. Sh. at 3112, 383 N.E.2d at 1134. Transfer to the Supreme Judicial Court was accomplished pursuant to G.L. c. 211A, § 10(a).

²⁶ 1978 Mass. Adv. Sh. at 3128, 383 N.E.2d at 1140.

²⁷ In reversing the default judgment against defendant Fleming, the Court also relied on the fact that PIPSA had stated an erroneous theory of damages in its complaint. The Court held that a default judgment serves only to establish the truth of factual allegations in a complaint; it does not operate as an absolute imposition of liability. *Id.* at 3114-15, 282 N.E.2d at 1134-35. See MASS. R. Crv. P. 37(b)(2)(c); *Nishimatsu Construction Co. v. Houston Nat'l Bank*, 515 F.2d 1200, 1206 (5th Cir. 1975). While these procedural grounds for the Court's decision are significant, they are beyond the scope of this chapter of the *Survey*.

²⁸ FLETCHER, *supra* note 5, at § 191.

²⁹ *Id.* See, e.g., *King Features Syndicate v. Courier*, 241 Iowa 870, 877, 43 N.W.2d 718, 723 (1950); *Sterne v. Fletcher American Co.*, 204 Ind. 35, 49, 181 N.E. 37, 42 (1932); *Johnson v. Hulse*, 83 Cal. App. 111, 116, 256 P. 551, 554 (1927); *Graham Hotel Corp. v. Leader*, 241 S.W. 700, 701 (Tex. Civ. App. 1922); *McRee v. Quitman Oil Co.*, 16 Ga. App. 12 (1915); *Kennedy v. Fulton Mercantile Co.*, 33 Ky. L. R. 60, 62, 108 S.W. 948, 950 (1908).

co-promoters owe each other the fiduciary duties normally imposed by partnership relation³⁰ and may be held jointly and severally liable for each other's contracts.³¹ A partnership relation, however, does not flow automatically from the co-equal standing of various promoters of a corporation.³² Co-promoters may agree to transform their legal status to an agency relationship³³ or to a joint adventure;³⁴ rights and duties consequently may vary with circumstances. As partners, co-promoters are liable for each other's acts notwithstanding their lack of consent.³⁵ In an agency relationship, however, the liability of one promoter for the other's act turns upon authority.³⁶ Thus, under the majority view, the effect of status is significant. A minority of jurisdictions, on the other hand, hold that promoters are not partners, but that each operates individually.³⁷ Courts in these jurisdictions presumably take the position that although several promoters may undertake to develop a business for profit, the promoters' immediate objective is the creation of an organization rather than mutual gain.³⁸ Therefore, these courts reason, promoters do not fall within the general definition of partnership as co-ownership of a business for profit.³⁹ As a result, under this minority view, co-promoters are held to act as individuals, and they do not incur joint and several liability for acts of their fellow promoters.⁴⁰

In *PIPSA*, the Supreme Judicial Court adopted the minority view, holding that co-promoters are not partners and that they are liable only on pre-incorporation contracts entered into individually on the corporation's behalf.⁴¹ The Court thus found that since defendant Fleming had not been involved in the *PIPSA-TM* agreement,⁴² he could not be held liable by virtue of his status as a *TM* promoter alone.⁴³ The Court noted, however, that Fleming *could* have been held liable as a co-pro-

³⁰ See Uniform Partnership Act, G.L. c. 108A, §§ 1-44.

³¹ See FLETCHER, *supra* note 5, at § 191.

³² *Id.*

³³ *Id.* See, e.g., *Scuette v. Winternitz*, 498 P.2d 1183, 1185 (Colo. App. 1972).

³⁴ FLETCHER, *supra* note 5, at § 191. See, e.g., *Abrams v. Puziss*, 235 Ore. 60, 62, 383 P.2d 1012, 1013 (1963).

³⁵ See FLETCHER, *supra* note 5, at § 191; G.L. c. 108A, § 15.

³⁶ See FLETCHER, *supra* note 5, at § 191.

³⁷ See Mechem, *ELEMENTS OF PARTNERSHIP* § 29, at 31 (2d ed. 1920); *Mid-eastern Constr. Co. v. Hamlett*, 14 N.C. App. 57, 187 S.E.2d 438, *cert. denied*, 281 N.C. 621, 191 S.E.2d 758 (1972); *Refrigeration Engineering Co. v. McKay*, 4 Wash. App. 963, 486 P.2d 304 (1971); *Daniel A. Pouwels & Assocs. v. Fiumara*, 233 So. 2d 16, (La. App. 1970); *Carmody v. Powers*, 60 Mich. 26, 26 N.W. 801 (1886). Cf. *Hushion v. McBride*, 296 Mass. 4, 4 N.E.2d 443 (1936); *Storey v. Bickford*, 237 Mass. 284, 129 N.E. 714 (1921).

³⁸ See FLETCHER, *supra* note 5, at § 189.

³⁹ G.L. c. 198, § 6.

⁴⁰ See cases cited at FLETCHER, *supra* note 5, at § 191.

⁴¹ 1978 Mass. Adv. Sh. at 3117, 383 N.E.2d at 1136.

⁴² *Id.* at 3107, 383 N.E.2d at 1132.

⁴³ *Id.* at 3118, 383 N.E.2d at 1136.

moter had PIPSA demonstrated the existence of an alternative legal relationship between Fleming and his co-promoter.⁴⁴ Had the PIPSA complaint alleged, for example, that Dietrich was Fleming's agent, or that Fleming, as promoter, had ratified the Dietrich-PIPSA contract, liability could have been imposed. Because the superior court had held Fleming liable on both contracts, however, without such a showing and had failed to segregate damages among the various defendants pursuant to the two agreements,⁴⁵ the Supreme Judicial Court reversed.⁴⁶

To reach this result, the Court focused on the actual relationship which might exist between the several promoters of a corporation. The Court initially noted that the factual circumstances surrounding the co-promotion of a new corporation might establish a relationship with legal consequences. Under agency principles, for examples, co-promoters might be jointly and severally liable for the acts of each other.⁴⁷ Similarly, the Court observed, facts might demonstrate that co-promoters indeed were joint venturers,⁴⁸ or that one promoter had ratified the other's act.⁴⁹ The Court was thus unwilling to impose a single definition of the legal relationship which exists between co-promoters when factual circumstances might suggest a different legal status and yield a different legal result. Second, the Court observed that other states had adopted a similar approach.⁵⁰ The Court cited three cases in which state courts declined to impose liability on a co-promoter absent a showing of a direct relationship of agency, partnership, or joint venture, and defined the legal relationship of the several promoters according to the factual circumstances of the co-promotion.⁵¹ The Supreme Judicial Court agreed with these cases and refused to hold defendant Fleming liable merely because of his status as TM's promoter.⁵²

⁴⁴ *Id.* at 3117, 383 N.E.2d at 1136.

⁴⁵ *Id.* at 3118, 383 N.E.2d at 1136.

⁴⁶ *Id.* at 3128, 383 N.E.2d at 1140. The Court noted that Massachusetts law was applicable in this case notwithstanding the fact that the Trans-Milpak-PIPSA contract specified that Mexican law would apply in any dispute arising from the agreement. *Id.* at 3116 n.9, 383 N.E.2d at 1135 n.9. See G.L. c. 106 § 1-105. Since the parties had pleaded and tried the case under Massachusetts law, the Court declined to "disturb this tacit stipulation on the choice of law issues implicit in the case." See *Commercial Credit Corp. v. Stan Cross Buick, Inc.*, 343 Mass. 622, 625, 180 N.E.2d 88, 90-91 (1962); *Tsacoyeanes v. Canadian Pacific R.R.*, 339 Mass. 726, 728, 162 N.E.2d 23, 24 (1959). Cf. G.L. c. 33, § 70.

⁴⁷ 1978 Mass. Adv. Sh. at 3117, 383 N.E.2d at 1136.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Mideastern Constr. Co. v. Hamlett*, 14 N.C. App. 57, 59, 187 S.E.2d 438, 440, cert. denied, 281 N.C. 621, 191 S.E.2d 758 (1972); *Refrigeration Engineering Co. v. McKay*, 4 Wash. App. 963, 975, 486 P.2d 304, 312 (1971); *Daniel A. Pouwels & Assocs. v. Fiumara*, 233 So. 2d 16, 18 (La. App. 1970).

⁵² 1978 Mass. Adv. Sh. at 3117-18, 383 N.E.2d at 1136.

The result reached in *PIPSA* is appropriate for two reasons. First, courts should be reluctant to presume a legal relationship between individuals absent evidence of such a relation. The sound view expressed by the Supreme Judicial Court in *PIPSA* permits plaintiffs to recover against co-promoters merely by establishing the existence of a relationship between the co-promoters. Plaintiffs may demonstrate agency, joint venture, partnership, or ratification to establish joint and several liability. In *PIPSA*, for example, the Mexican firm might have introduced evidence that TM's promoter Dietrich acted on defendant Fleming's instructions or that Fleming had ratified Dietrich's act. Moreover, even without such a showing, third parties retain their right to sue the actual contracting promoter or the newly formed corporation under traditional theories of promoter liability.⁵³ Thus, *PIPSA* could still recover against Dietrich. Second, the result arrived at in *PIPSA* is correctly based on the facts of the case. Even had the Court adopted the majority view that co-promoters are partners, no evidence of Fleming and Dietrich's co-promoter status was ever presented. *PIPSA*'s complaint alleged that Fleming was liable to the Mexican corporation solely by virtue of his status as a TM promoter.⁵⁴ No allegation of co-promotion—with whatever legal relationship and consequence that might entail—was pleaded. Thus, Fleming could not be held liable on the default judgment in favor of *PIPSA* on that count in any event. The Supreme Judicial Court has therefore established an easily followed rule which appropriately balances the rights of third parties against the nature of the relationship between the several promoters of an unformed corporation.

§2.2. **Fiduciary Duty—Commercial Bank as a Trustee and Creditor.*** During the *Survey* year, the Supreme Judicial Court considered the extent to which a commercial bank owes a duty to beneficiaries of a corporate voting trust when the bank functions in the dual roles of trustee of the corporate voting trust and creditor of the corporation. The defendant in *The First National Bank of Boston v. Slade*¹ had executed a guaranty for the obligations of a Massachusetts corporation, P.S. Thorsen Co., to the plaintiff bank.² When the corporation, acting through Slade as president and treasurer, executed an assignment for the benefit of creditors, the bank brought an action to collect the remaining unpaid obligations of the corporation from Slade as guarantor.³ Slade defended the action upon the ground that the bank, as trustee of the voting trust

⁵³ See text accompanying notes 1-9 *supra*.

⁵⁴ See Plaintiff's complaint, reprinted in Supplemental Appendix to Defendant's Appeal, Appeals Court No. 77-188, at 10 (1977).

§ 2.2. * By Daniel E. Wright, staff member, ANNUAL SURVEY OF MASSACHUSETTS LAW.

¹ 1979 Mass. Adv. Sh. 2509, 399 N.E.2d 1047.

² *Id.* at 2509, 399 N.E.2d at 1049.

³ *Id.*

which held all the corporation's common stock, had violated its fiduciary duty owed to him as a trust beneficiary by collecting a portion of the corporation's obligations in its role as creditor.⁴ Slade claimed, therefore, that he was not liable under the guaranty and counterclaimed that the bank was liable to him for its breach of trust.⁵ The Supreme Judicial Court upheld the superior court's entry of summary judgment in favor of the bank.⁶

The complicated factual situation is best discussed in terms of the two roles assumed by the bank. One role was that of trustee of the voting trust. The corporation was formed in 1956, and its principal stockholder during these early years was William B. Wilkes.⁷ In order to secure a smooth transition of corporate management from Wilkes to Slade, Wilkes and all other stockholders created a voting trust in September 1966, with the bank as trustee.⁸ When Wilkes died in 1971, the bank, as trustee of the voting trust, assumed full voting control of the corporation.⁹ As trustee, the bank was to remain in voting control of the corporation until the trust was terminated and Slade became principal stockholder.¹⁰

The other role assumed by the bank was that of creditor. The corporation had been a loan customer of the bank for many years prior to the establishment of the voting trust in 1966.¹¹ The corporation had outstanding unsecured loans of approximately \$200,000 from the bank, when, in May 1976, the company experienced a cash shortage.¹² The bank

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at 2510, 399 N.E.2d at 1049.

⁷ *Id.* at 2512, 399 N.E.2d at 1050.

⁸ *Id.* It appears that the trust was essentially an estate planning mechanism to enable a transfer of ownership of the corporation from the Wilkes family to Slade after Mr. Wilkes's death. *Id.* at 2512-13, 399 N.E.2d at 1050. The trust included a requirement that the corporation purchase the interests of a deceased stockholder at a specified price. *Id.* at 2512, 399 N.E.2d at 1050. The trust agreement further provided that the trust could be terminated only after the beneficial interests of Wilkes and his wife had been sold, and any indebtedness of the corporation created by such a sale was discharged. *Id.* In compliance with the trust agreement, the corporation undertook to purchase Wilkes's beneficial interest in the trust upon his death. *Id.* Additionally, in 1975 the corporation agreed to purchase Mrs. Wilkes's shares and beneficial interest in the trust. *Id.* The bank participated in the corporation's purchase of the stock both as coexecutor of Mr. Wilkes's estate and as an agent for Mrs. Wilkes. *Id.* at 2512-13, 399 N.E.2d at 1050. Although the issue was not presented, the bank's role as both agent for the corporation in the stock purchase and coexecutor/agent for the Wilkes family in the sale of the stock may also raise questions regarding conflicts of interest resulting from the bank's multiple roles in these transactions. See note 30 *infra* for a discussion of conflicts of interest.

⁹ *Id.* at 2512, 399 N.E.2d at 1050.

¹⁰ *Id.* at 2513, 399 N.E.2d at 1050.

¹¹ *Id.* at 2512, 399 N.E.2d at 1050.

¹² *Id.* at 2513, 399 N.E.2d at 1051.

agreed to loan the corporation an additional \$150,000 if all of the corporate debt to the bank was secured by its receivables and if Slade, as president and chief executive officer, signed as guarantor of the corporation's obligations.¹³ Both Slade and the bank were aware at the time Slade signed the guaranty that unless the corporation could obtain the additional financing, it would be unable to meet its next payroll.¹⁴ In light of these circumstances, Slade agreed to sign the guaranty.¹⁵ In the summer and fall of 1977, the bank collected \$90,000 from funds of the corporation on deposit with the bank.¹⁶ By October 1977 the corporation's cash flow had become critical, and the corporation executed an assignment for the benefit of creditors.¹⁷ At the commencement of the action, the corporation's outstanding debt to the bank was approximately \$96,500.¹⁸

The First National Bank brought a civil action in superior court against Slade to collect the unpaid obligations of P.S. Thorsen Co.¹⁹ The superior court entered summary judgment in favor of the bank.²⁰ The Supreme Judicial Court granted Slade's application for direct appellate review of his appeal and upheld judgment in favor of First National.²¹ On appeal, Slade contended that he felt indirect pressure from the bank's voting control over the corporation in his execution of the guaranty.²² Acknowledging that the bank had considerable influence upon the financial affairs of the corporation,²³ the Court nevertheless ruled that there was no evidence that the bank had improperly used its control to obtain Slade's guaranty.²⁴ The Court observed instead that the insistence by the bank of a guaranty was conduct as a creditor rather than as a trustee.²⁵ Noting Slade's knowledge and background as a businessman,²⁶

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* Presumably these funds were collected by the bank pursuant to a right of set-off. Prior to the collections noted in the text, the bank also collected \$30,000 in payment for the shares purchased from the Wilkes estate and from Mrs. Wilkes. *Id.* The bank instructed the corporation to cease making payments for the shares in June 1977—just before the bank began its collections of the \$90,000. *Id.*

¹⁷ *Id.* at 2513-14, 399 N.E.2d at 1051.

¹⁸ *Id.* at 2514, 399 N.E.2d at 1051.

¹⁹ *Id.* at 2509, 399 N.E.2d at 1049.

²⁰ *Id.* at 2509-10, 399 N.E.2d at 1049.

²¹ *Id.* at 2510, 2511, 399 N.E.2d at 1049, 1050.

²² *Id.* at 2514, 399 N.E.2d at 1051.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.* at 2514-15 n.4, 399 N.E.2d at 1051-52 n.4. The Court concluded: "As an experienced businessman, Slade understood or should have understood the obligation that he was assuming." *Id.* at 2515 n.4, 399 N.E.2d at 1052 n.4.

the Court concluded that Slade had “knowingly and freely executed the guaranty.”²⁷

The Court, however, did consider the bank’s status both as a creditor and as a trustee of the voting trust to be a potential conflict of interest requiring close scrutiny.²⁸ Rejecting the bank’s contention that the actions of its commercial loan department and its trust department should be viewed separately, the Court stated: “The bank is one entity and must take responsibility for the effect of its collective action.”²⁹ Nevertheless, the Court found that the bank’s dual role³⁰ “does not alone make [it] liable for all consequences adverse to Slade resulting from its conduct as a creditor.”³¹ Rather, the Court concluded that the appropriate standard is whether the bank, in its capacity as a creditor, breached any fiduciary duty owed to the beneficiaries of the voting trust.³²

The Court enumerated three actions by the bank which could have violated its fiduciary duty to Slade as one of the voting trust beneficiaries: (1) requiring Slade to guarantee the corporation’s obligations, (2) obtaining a preferential status on its loan to the corporation, or (3) collecting the corporation’s obligations.³³ Regarding the first two actions, the Court held that Slade had failed to demonstrate that these actions harmed the interests of the trust beneficiaries.³⁴ Lastly, the Court observed that the question was whether the bank’s *lawful actions* as a creditor had violated a duty to Slade as a trust beneficiary.³⁵ The Court resolved the issue in practical terms:

²⁷ *Id.* at 2514, 399 N.E.2d at 1051.

²⁸ *Id.* at 2514, 2516, 399 N.E.2d at 1051, 1052.

²⁹ *Id.* at 2515-16, 399 N.E.2d at 1052. See generally 2 A. SCOTT, TRUSTS § 170.23A (3d ed. Supp. 1978).

³⁰ An interesting comparison can be made between the dual role of the bank in *Slade* and cases involving exchanges of confidential information between bank departments. Compare *Slade* with *Washington Steel Corp. v. TW Corp.*, 465 F. Supp. 1100, 1101-1102, 1105 (W.D. Pa. 1979) (finding a breach of fiduciary obligation) and *Am. Medicorp, Inc. v. Continental Ill. Nat’l Bank & Trust Co.*, 475 F. Supp. 5, 7, 9, 10 (N.D. Ill. 1977) (finding no breach of fiduciary obligation). *Slade* might have been more successful had he produced evidence that information known to the bank through its trust department was conveyed to and used by its commercial loan department in its decision to collect the corporation’s outstanding debt. See 465 F. Supp. at 1105.

³¹ 1979 Mass. Adv. Sh. at 2516, 399 N.E.2d at 1052.

³² *Id.* at 2517, 399 N.E.2d at 1053. The Court noted that in asserting that he could avoid liability to the bank, Slade could not rely upon the rights of others. *Id.* at 2516, 399 N.E.2d at 1052. It was thus irrelevant that other creditors’ rights may have been violated by the bank’s alleged preferential claim to the corporation’s assets. In fact, Slade stood to gain as guarantor from the bank having a superior claim over the corporation’s general creditors. *Id.* at 2516 & n.5, 399 N.E.2d at 1052 & n.5.

³³ *Id.* at 2517, 399 N.E.2d at 1053.

³⁴ *Id.* The Court noted that the loan did not destroy the corporation but rather “gave it life-prolonging, if not lifesaving, assistance.” *Id.*

³⁵ *Id.*

A rule of law would be too harsh and impractical which failed to recognize that a commercial bank and a business client may wish to maintain a relationship which involves the bank, in its various aspects, in the operations of the business and in the estate planning of one or more owners of that business. If the parties *voluntarily* enter into such an arrangement, the law should be hesitant to deny them the right to develop and enforce the terms of their own agreements. At times, indeed, the multiple role of the bank may prompt it to refrain from acting purely as a creditor, all to the advantage of the bank's customer and interested parties.³⁶

Since Slade, both as a corporate officer and as a trust beneficiary, voluntarily accepted the bank's dual role as trustee of the voting trust and as creditor of the corporation, the Court rejected Slade's claim that the bank's actions as creditor were unlawful as to him.³⁷

In *Slade*, the Supreme Judicial Court attempted to balance the interest in preventing trustees from assuming dual roles which pose conflict of interest problems with the interest in allowing commercial banks and their clients flexibility in their business relationships. As a result of the decision, it appears that the Massachusetts courts will be hesitant to impose liability upon a bank which functions in a dual role with a client or trust beneficiary when the parties knowingly and voluntarily consent to the bank's multiple role. To establish such a breach of fiduciary duty, the plaintiff must prove specific facts which demonstrate actual misconduct by a bank in its dual capacities.³⁸

The rule laid down by the Supreme Judicial Court places a greater burden upon the plaintiff trust beneficiary than the rule in New York. In order to establish a breach of fiduciary duty in New York, the plaintiff need only show that a dual role with a potential conflict of interest exists.³⁹ Under the *Slade* rule, in Massachusetts the plaintiff must estab-

³⁶ *Id.* at 2518, 399 N.E.2d at 1053 (emphasis added).

³⁷ *Id.* at 2518-19, 399 N.E.2d 1053-54. See generally 3 A. SCOTT, TRUSTS § 216 (3d ed. 1967) (no breach of trust if beneficiary has full knowledge of relevant facts of act or omission by trustee). The Court additionally justified its decision on the ground that Slade made no showing that the bank's collection of the corporation obligations caused the corporation to fail. "The bank's action of withdrawing financial support may have affected the date of the corporation's demise, but there is no representation of facts to show that the corporation would have survived but for the bank's collection practices." 1979 Mass. Adv. Sh. at 2519, 399 N.E.2d at 1054.

³⁸ 1979 Mass. Adv. Sh. at 2511, 2516, 399 N.E.2d at 1050, 1052.

³⁹ The New York fiduciary standard is that a trustee cannot occupy any position which has interests that may conflict with those of the trust. See, e.g., *In the Matter of the Estate of William R. Grace*, 42 Misc. 2d 214, 216, 247 N.Y.S.2d 695, 697-98 (1964); *City Bank Farmers Trust Co. v. Cannon*, 291 N.Y. 125, 131-32, 51 N.E.2d 674, 675-76 (1943).

lish not only that a dual role exists but also that the defendant abused its position to the detriment of the plaintiff trust beneficiary. Since the *Slade* Court partially based its decision upon Slade's consent and participation in establishing the bank's trustee/creditor role, the Court left unanswered the question whether a fiduciary holding corporate stock may also become a creditor of that corporation and exercise such creditor rights without becoming liable for breach of trust to a non-consenting, non-participating trust beneficiary.⁴⁰

§2.3. Fiduciary Duty—Closely held Corporations.* During the *Survey* year, the Appeals Court was faced in *Hallahan v. Haltom Corp.*¹ with a question of the appropriateness of injunctive relief to prevent a freeze-out of the minority shareholders in a close corporation. Until the 1975 decision of *Donahue v. Rodd Electrotype Corp. of New England, Inc.*,² the law afforded little protection to minority stockholders in a close corporation against majority shareholders who voted their shares to deprive the minority of the benefits of corporate ownership.³ In *Donahue* the Supreme Judicial Court abandoned this traditional approach, holding that stockholders in a close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.⁴ The Court in *Donahue* noted that a close corporation bears a striking resemblance to a partnership.⁵ The Court observed that, just as in a partnership, the relationship among the stockholders must be of trust, confidence, and absolute loyalty.⁶ Accordingly, the Court required that the stockholders in close corporations discharge their management and stockholder responsibilities in conformity with this strict good faith standard.⁷ The Court concluded that denying a minority stockholder the opportunity to sell her shares to the corporation when the corporation had made such a purchase from a member of the controlling group was a violation of this good faith standard.⁸ To remedy this situation, the Court proposed either that the majority shareholder

⁴⁰ 1979 Mass. Adv. Sh. at 2520, 399 N.E.2d at 1054.

§ 2.3.* By Clover M. Drinkwater-Lunn, staff member, ANNUAL SURVEY OF MASSACHUSETTS LAW.

¹ 1979 Mass. App. Ct. Adv. Sh. 207, 385 N.E.2d 1033.

² 367 Mass. 578, 328 N.E.2d 505 (1975).

³ F. O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS § 3.06 (1975).

⁴ 367 Mass. at 593, 328 N.E.2d at 515 (1975). For a detailed analysis of the case, see Elephante, *Corporations*, 1975 ANN. SURV. MASS. LAW § 17.1, at 455-76.

⁵ 367 Mass. at 586, 328 N.E.2d at 512. In arriving at this conclusion the Court for the first time defined a close corporation. It found a close corporation to have three characteristics: (1) few stockholders; (2) no ready market for corporate stock; (3) substantial majority stockholder participation in the management and operations of the corporation. *Id.* at 586, 328 N.E.2d at 511.

⁶ *Id.* at 587, 328 N.E.2d at 512.

⁷ *Id.* at 593, 328 N.E.2d at 515.

⁸ *Id.* at 603, 328 N.E.2d at 520.

be required to repurchase his shares or alternatively, that the corporation offer to the minority shareholder the opportunity to sell her shares to the corporation at the same price offered to the majority shareholder.⁹

In *Wilkes v. Springside Nursing Home, Inc.*,¹⁰ decided soon after *Donahue*, the Court held that when a close corporation provides income to its stockholders solely in the form of salaries, the dismissal of a stockholder by the controlling group for no legitimate business purpose violates the fiduciary duty stockholders owe to one another. In reaching this decision the Court noted that the shareholders' sole benefit from the corporation was derived in the form of salary.¹¹ The Court, emphasizing the devastating effect that employment termination would have on the interests of a minority stockholder whose sole benefit from the corporation is thus derived,¹² concluded that the majority shareholders had failed to demonstrate a business purpose for firing the minority stockholder-employee who had consistently performed his duties.¹³ The Court, therefore, held that the minority stockholder was entitled to damages from the majority stockholders.¹⁴

Donahue and *Wilkes* made clear that a strict fiduciary duty is imposed on the shareholders in a close corporation. These cases also made it apparent that damages¹⁵ and some forms of injunctive relief¹⁶ will be available to a besieged minority shareholder. Yet the extent of the injunctive relief that a Massachusetts court would be willing to apply remained undetermined until this *Survey* year. In *Hallahan v. Haltom Corp.*, the Appeals Court confirmed the availability of injunctive relief and compelled a minority shareholder who had not benefited from the breach of fiduciary duty to sell his shares back to the corporation.¹⁷

⁹ *Id.* at 603, 328 N.E.2d at 520-21.

¹⁰ 370 Mass. 842, 851-52, 353 N.E.2d 657, 663 (1976). For a detailed analysis of the case, see Elephante, *Corporations*, 1976 ANN. SURV. MASS. LAW § 9.1, at 265-71.

¹¹ 370 Mass. at 853, 353 N.E.2d at 664.

¹² *Id.* See F. O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS § 3.06, at 78-80.

¹³ 370 Mass. at 852, 353 N.E.2d at 664. The Court stated that it would apply a two-part analysis to the actions of controlling shareholders. It would first ask whether the controlling group could demonstrate a legitimate business purpose for the action in question. If such a purpose were advanced, the minority would be permitted to show that the same objectives could have been achieved through an alternative course of action less harmful to the minority's interest. The court would then be required to weigh the legitimate business purpose against the practicability of a less harmful alternative. *Id.* at 851-52, 353 N.E.2d at 663.

¹⁴ *Id.* at 854, 353 N.E.2d at 664-65.

¹⁵ *Id.*

¹⁶ *Donahue v. Rodd Electrotpe Co. of New England, Inc.*, 367 Mass. at 603, 328 N.E.2d at 520-21.

¹⁷ 1979 Mass. App. Ct. Adv. Sh. at 211, 385 N.E.2d at 1035.

The corporation involved in *Hallahan* was formed from a previously established joint venture, a bar and restaurant launched by two sets of brothers, the Hallahans and the Thompsons.¹⁸ One hundred shares of stock were issued, each brother receiving 23¾ shares.¹⁹ The remaining five shares went to David Thompson, a cousin of the Thompson brothers, as partial payment for carpentry work he had performed in renovating the premises.²⁰ The four venturers agreed that the cousin would not actively participate in the business.²¹ It was Paul Hallahan's understanding that the power among the stockholders should remain equally divided between the two sets of brothers.²² David Thompson, however, signed an undated proxy, which contained no time limitation, in favor of one of the Thompson brothers.²³ This proxy gave the Thompson brothers majority control of the corporation.

A few months after incorporation, disagreement arose between the two sets of brothers. The Thompson brothers called a stockholders meeting at one of the Hallahan homes without notice of the business to be transacted.²⁴ At this meeting the Thompsons said they had received complaints about the Hallahans' performance as bartenders.²⁵ Because of these complaints, the Thompson brothers voted their shares and those of David Thompson to fire the Hallahans as employees of the corporation.²⁶ The Hallahans insisted, however, that they had not received any complaints from either customers or the Thompsons prior to the meeting.²⁷

The Hallahan brothers filed an action in the Superior Court of Barnstable County.²⁸ In order to restore the balance of control originally envisioned by the brothers, the trial judge ordered David Thompson to return his five shares of stock to the corporation in exchange for \$500.²⁹ From this judgment David Thompson appealed.³⁰

The Appeals Court upheld the trial judge's order.³¹ At the outset the court found that the corporation formed by the Hallahans and Thomp-

¹⁸ *Id.* at 207, 385 N.E.2d at 1033.

¹⁹ *Id.* at 208, 385 N.E.2d at 1034.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.* at 209, 385 N.E.2d at 1034.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at 207, 385 N.E.2d at 1033. The opinion is silent as to the type of relief sought.

²⁹ *Id.* at 209, 385 N.E.2d at 1034.

³⁰ *Id.*

³¹ *Id.* at 211, 385 N.E.2d at 1035.

sons was a close corporation as defined in *Donahue*.³² As such, the court reasoned that the principal stockholders owed to each other and minority stockholders the rigorous fiduciary duty of partners and participants in a joint venture.³³ The court held that the peremptory discharge of the Hallahans without warning, when salary as employees was their principal benefit from the corporation, fell short of the *Donahue* standard.³⁴ Applying the *Wilkes* test, the court inquired whether the controlling group had demonstrated a legitimate business purpose for its action.³⁵ The court found no such validating purpose in the unchallenged findings of the trial judge, which instead recited a seizure of control without prior warning.³⁶

After finding that the majority stockholders' actions had breached the fiduciary duty owed the majority, the Appeals Court considered the remedy ordered by the trial judge. The court noted that a stockholder in a corporation, in order to file a petition for dissolution under chapter 156B, section 99(a), must own at least fifty per cent of the voting shares of that corporation.³⁷ It found that the trial judge ordered David Thompson's five shares returned to the corporation in order to place the Hallahan brothers in just such a position.³⁸ The \$500 to be paid in exchange for the stock reflected the \$100 per share repurchase value established in Haltom Corporation's articles of incorporation.³⁹ The court agreed that the sale ordered by the trial judge would restore the balance of control between the brothers that the parties had originally envisioned and which

³² *Id.* at 209, 385 N.E.2d at 1034. For the *Donahue* definition of close corporation, see note 5 *supra*.

³³ 1979 Mass. App. Ct. Adv. Sh. at 209, 385 N.E.2d at 1034.

³⁴ *Id.* at 209-10, 385 N.E.2d at 1034. The trial judge found that the Haltom Corporation's net income at the end of its first full year was \$7.00. *Id.* at 210 n.3, 385 N.E.2d at 1034 n.3.

³⁵ *Id.* at 210, 385 N.E.2d at 1034.

³⁶ *Id.*

³⁷ *Id.*, 385 N.E.2d at 1035. The statute provides in relevant part that a petition for dissolution of a corporation may be filed as follows:

(a) A corporation which desires to close its affairs may authorize the filing of such a petition by a vote of a majority of each class of its stock outstanding and entitled to vote thereon:

(b) Such a petition may be filed by the holder or holders of not less than forty per cent of all the shares of its stock outstanding and entitled to vote thereon, . . . if:

(1) the directors are deadlocked in the management of corporate affairs, and the shareholders are unable to break the deadlock, or

(2) the shareholders are deadlocked in voting power and have failed to elect successors to directors whose terms have expired or would have expired upon the election of their successors.

G.L. c. 156B, § 99(a)-(b).

³⁸ 1979 Mass. App. Ct. Adv. Sh. at 211, 385 N.E.2d at 1035.

³⁹ *Id.*

they had a fiduciary duty to one another to maintain.⁴⁰ The Appeals Court found the judge's action to be consistent with the generic similarities of the duties of the stockholders in a close corporation and partners in a partnership as defined by *Donahue* and *Wilkes*.⁴¹ It concluded that his order comported with a court's traditional equity power to remedy the wrong complained of and to make the decree effective.⁴²

The Appeals Court's decision in *Hallahan* is clearly consistent with the recent rulings of the Supreme Judicial Court in *Donahue* and *Wilkes*. As in *Donahue*, the Appeals Court in *Hallahan* required that the majority stockholders discharge their responsibilities with utmost good faith.⁴³ Following *Wilkes*, the *Hallahan* court held that the freeze-out attempted by the Thompson brothers clearly violated this rigorous standard.⁴⁴ In reaching its holding the Appeals Court emphasized⁴⁵ many of the factors that were significant to the *Wilkes* court: the lack of business purpose behind the freeze-out, the absence of any benefit beyond salary that could be derived from corporate ownership, and the prior understandings and intentions of all the parties as to control of the corporation.⁴⁶ Thus, in these respects, the Appeals Court's decision in *Hallahan* simply follows precedent.

The injunctive remedy granted by the *Hallahan* court, however, differs significantly from the injunctive remedy awarded in *Donahue*. In *Donahue*, the Court proposed that on remand the majority shareholder who had benefited from the breach of fiduciary duty be required to repay the purchase price of his shares to the corporation.⁴⁷ In contrast, the court in *Hallahan* required a five per cent shareholder who had not benefited from the breach of fiduciary duty to sell his shares back to the corporation.⁴⁸ In so doing, the superior court apparently proceeded on the assumption that the plaintiff's ultimate goal was the dissolution of the corporation.⁴⁹ The only way to return the Thompson and Hallahan brothers to equal voting strength was to return David Thompson's shares to the corporate treasury. Apart from his executing a proxy to the Thompson brothers, however, it is not clear from the record that David Thompson was actively involved in or even aware of the Thompson brothers' attempt to unseat the Hallahans. Thus, it is possible that in

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.* at 209, 385 N.E.2d at 1034.

⁴⁴ *Id.* at 209-10, 385 N.E.2d at 1034.

⁴⁵ *Id.* at 210-11, 385 N.E.2d at 1034.

⁴⁶ 370 Mass. at 852-53, 353 N.E.2d at 664.

⁴⁷ 367 Mass. at 603, 328 N.E.2d at 521.

⁴⁸ 1979 Mass. App. Ct. Adv. Sh. at 211, 385 N.E.2d at 1035.

⁴⁹ *Id.*

its attempt to restore the rights of two minority stockholders, the trial court completely eliminated the rights of a third party who was innocent of any wrongdoing. The Appeals Court nevertheless concluded that the trial court's order did not exceed the appropriate exercise of traditional equity powers.⁵⁰

The Appeals Court's ruling in *Hallahan* may be an indication of the types of remedies that Massachusetts courts will entertain in the future with respect to close corporations. Traditionally, courts have been reluctant to order the performance of discretionary acts.⁵¹ As a result, prior to *Hallahan* many minority stockholders found themselves without remedy when monetary damages were inadequate to redress the wrong complained of.⁵² With this innovative injunctive relief, however, the trial court in *Hallahan* boldly injected itself into the area that most courts have sought to avoid. The Appeals Court's affirmance of the trial court's order may indicate that Massachusetts courts are interpreting the *Dona-hue* and *Wilkes* courts' imposition of a rigorous standard of fiduciary duty of stockholders of close corporations as a mandate to trial courts to cast aside their traditional reluctance to order injunctive relief. It is arguable that implicit in the concept of a duty of utmost care and loyalty among stockholders is the notion that when breaches of this duty arise, the injured party should be returned to the position he was in before the breach occurred. The mere ordering of monetary damages or of an injunction against a majority stockholder who has breached his fiduciary duty may be insufficient to do so, particularly where future employment is at stake. Thus, *Hallahan v. Haltom Corp.* may foreshadow a bolder approach to remedies in the area of close corporate litigation.

§2.4. Appraisal of Stock Value.* Sections 86 through 98 of the Massachusetts Business Corporation Law¹ provide for a single proceeding for determining the value of stock held by a dissenting minority shareholder who demands payment for his shares.² During the *Survey* year, the Supreme Judicial Court first interpreted these sections in *Piemonte v. New Boston Garden Corp.*,³ an appeal from a judgment determining

⁵⁰ *Id.*

⁵¹ Elephante, *Corporations*, 1976 ANN. SURV. MASS. LAW § 9.1, at 271; see also F. O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS, § 3.06, at 78-80 (1975).

⁵² F. O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS, § 3.06, at 80 (1975).

§ 2.4. ° By Barbara Jane Levine, staff member, ANNUAL SURVEY OF MASSACHUSETTS LAW.

¹ G.L. c. 156B. This chapter was enacted in 1964 primarily to simplify the appraisal process of prior law under G.L. c. 156, §§ 46, 46E. No legislative intent to overrule the few appellate cases decided under c. 156 with the enactment of c. 156B has been found to exist. *Piemonte v. New Boston Garden Corp.*, 1979 Mass. Adv. Sh. 922, 926, 387 N.E.2d 1148-49.

² See Notes by Boston Bar Committee—1964, G.L. c. 156B, §§ 86-98.

³ 1979 Mass. Adv. Sh. 922, 387 N.E.2d 1145.

the fair value of the minority dissenters' stock in the Boston Garden Arena Corporation. The Court reviewed the procedures employed by the trial judge in valuing the plaintiffs' stock and held that the judge properly applied his discretion in the method he employed to value the stock.⁴

Although provisions for stock appraisal vary from state to state,⁵ most courts consider three principal elements: market value, earnings (or investment) value, and net asset value.⁶ The trial judge in *Piemonte* considered these three elements, following the "Delaware block approach."⁷ This approach to stock appraisal calls first for a determination of the three values and then an assignment of a percentage weight to each based on the relative importance of each element to the particular corporation and to the industry in which the corporation operates.⁸ The Supreme Judicial Court approved this method, reasoning that since sections 86 through 98 were based in part on Delaware law,⁹ case law from that state is an appropriate guide¹⁰ in the interpretation of the Massachusetts provisions.¹¹ The specific challenges raised in *Piemonte*, however, did not concern the method of appraisal employed by the judge but rather the result of his appraisal. The plaintiff stockholders and the defendant corporation challenged both the values and the weight the

⁴ *Id.* at 924, 939, 387 N.E.2d at 1148, 1154.

⁵ The provisions differ in large part on the circumstances creating the right of appraisal. In the last decade a trend has begun, although not followed in Massachusetts, toward restricting the situations in which appraisal may be employed. When an appraisal right is not granted by statute, a minority dissenter must either accede to the corporate action or sell his shares on the market. See generally Note, *A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal*, 74 MICH. L. REV. 1023 (1975-76).

⁶ Note, *Valuation of Dissenter Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1457 (1966). Commentators have given two reasons for using these three principal elements. First, they are all said to reflect upon the proportional value of a share. Second, and possibly more importantly, they are mathematically ascertainable. There are other elements of value which can be considered—trend of operation and place in the industry, for example—but they are all intangibles and cannot be mathematically ascertained. They are nonetheless taken into account in the second stage of the appraisal when the three principal elements are weighted. 23 MO. L. REV. 223, 228 (1958). See Note, *Valuation of Dissenter Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1468 (1966).

⁷ 1979 Mass. Adv. Sh. at 925, 387 N.E.2d at 1148.

⁸ *Id.*; Note, *Valuation of Dissenter Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1457 (1966).

⁹ See DEL. CODE ANN. tit. 8, § 262.

¹⁰ The Court noted two major reasons why Delaware case law should not bind the Commonwealth in the interpretation of §§ 86-98. First, the Massachusetts provisions are similar, but not identical, to the Delaware provision. Second, the Court found that there was a lack of a legislative intent to adopt Delaware case law developed either prior to, or after, the enactment of G.L. c. 156B. 1979 Mass. Adv. Sh. at 924, 925 n.4, 387 N.E.2d at 1148, 1148 n.4.

¹¹ *Id.* at 924, 387 N.E.2d at 1148.

judge assigned to the three elements.¹² On appeal the Court considered the facts employed by the trial judge to determine a numerical value for each element to see if the judge abused his discretion in making his numerical determinations.

The stock of the Boston Garden Arena Corporation had been traded on the Boston Exchange only to a very limited extent.¹³ Ninety percent of the stock was held by the company's controlling interests.¹⁴ In 1972, before the proposed merger with the New Boston Garden Corporation was announced to the public, the price of the stock ranged from \$20.50 to \$29 per share. At the last trade, the price was \$26.50.¹⁵ The trial judge found that this last figure represented the stock's market value, and both parties objected.¹⁶ The minority shareholders contended that since the stock was traded only on a limited basis, the stock's market value was not ascertainable and should have been disregarded.¹⁷ The defendant corporation agreed that the market value used was erroneous but argued that the judge was obliged to reconstruct the market value based on the price of stock of comparable companies.¹⁸

To these claims the Supreme Judicial Court stated that if no actual market price exists, the trial judge may, but is not required, to reconstruct the market value.¹⁹ The Court further noted that under Delaware

¹² *Id.* at 926, 387 N.E.2d at 1149. A challenge was also made to the judge's consideration of certain evidence which the defendant thought should have been excluded and to the judge's decision on the rate of interest to be allowed to the plaintiffs. *Id.* In discussing the propriety of the award of interest at eight per cent a year, the Court states that the interest rate chosen should reflect the fact that the corporation had use of the minority dissenter's money during the appraisal proceeding. From a conservative viewpoint, the Court stated that the interest rate should reflect the rate of interest of a prudent investment. *Id.* at 938-39, 387 N.E.2d at 1154. For a detailed discussion on interest awards pursuant to stock appraisals, see Grant, *Appraisal Rights: Allowance for Prejudgment Interest*, 17 B.C. IND. & COM. L. REV. 1 (1975).

¹³ 1979 Mass. Adv. Sh. at 927-28, 387 N.E.2d at 1149.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* at 926, 928, 387 N.E.2d at 1149.

¹⁷ *Id.* at 926, 387 N.E.2d at 1149.

¹⁸ *Id.* at 927, 387 N.E.2d at 1149.

¹⁹ *Id.* There are a number of approaches to reaching a hypothetical market value. One approach compares the close corporation to "similar" public corporations—similar in the sense that they are in the same industry, with a similar position in that industry, equivalent assets, earnings, and sales. Another, perhaps more realistic, approach takes into account net assets and capitalized earnings. Indeed, the Court in *Piemonte* noted that "the process of the reconstruction of market value may actually be no more than a variation on the valuation of corporate assets and corporate earnings." *Id.* Note, *Valuation of Dissenter Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1463 (1966). See *Application of Delaware Racing Ass'n*, 213 A.2d 203 (Del. 1965) (although stock appraiser concluded market price to be \$1,530 a share, market price reconstructed to be \$1,305 a share to reflect subsequent decline in earnings).

law, market value is only reconstructed when actual market value cannot be determined and when a hypothetical market value can be mathematically constructed.²⁰ The Court did not elaborate on this point, however, since it found that the trial judge had not abused his discretion by employing the actual market price instead of reconstructing it. The Court considered it within the trial judge's discretion to conclude both that a sufficient volume of trading existed to indicate accurately a market value and that an actual value is preferable to a reconstructed sales price.²¹ In addition, the Court found the ten percent weight given to this value appropriate to reflect the thin trading in the stock.²²

The second measure of the stock's value under the Delaware block approach applied in *Piemonte* is the corporation's earning capacity, or investment value. This measure is intended to reflect that price which a willing buyer would pay for the company.²³ Two steps are involved in determining this second element. The first step requires the averaging of the corporation's earnings for the past five years.²⁴ If earnings reflect the proceeds of a transaction which was extraordinary and outside of normally transacted business,²⁵ the gains or losses attributable to such a transaction are excluded from the computation.²⁶ In the case at bar, the judge included in his calculation of earning capacity payments which had been received by the corporation from teams newly admitted to the National Hockey League during two of the five years.²⁷ The defendant corporation argued that these figures inflated the earnings value of the corporation. The Court, however, found no abuse of the trial judge's discretion to include or exclude transactions according to whether they

²⁰ 1979 Mass. Adv. Sh. at 927 n.7, 387 N.E.2d at 1149 n.7. See *Sporberg v. City Specialty Stores, Inc.*, 35 Del. Ch. 560, 123 A.2d 121 (1956) (no market value ascertainable).

²¹ 1979 Mass. Adv. Sh. at 928, 387 N.E.2d at 1149.

²² *Id.* at 937, 387 N.E.2d at 1153. See *Swanton v. State Guaranty Corp.*, 42 Del. Ch. 477, 215 A.2d 242 (1965) (where company's dividend record bore a ten per cent weight to market value appropriate).

²³ Note, *Valuation of Dissenter Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1464 (1966).

²⁴ 1979 Mass. Adv. Sh. at 928, 387 N.E.2d at 1150. Delaware law requires this value be measured in terms of historical earnings rather than prospective earnings, and the period of five years is the standard period used. Application of Delaware Racing Ass'n, 213 A.2d 203, 212 (Del. 1965). The purpose behind the averaging of five years is to minimize the impact of extraordinarily good or bad years. *Adams v. R.C. Williams & Company*, 39 Del. Ch. 61, 158 A.2d 797, 800 (1960) (two-year time period too short). Cf. *Woodward v. Quigley*, 133 N.W.2d 38, 47, *modified on rehearing*, 136 N.W.2d 280 (Iowa 1965) (ten-year period too long).

²⁵ The sale of a major branch of the corporation's business is an example of such a transaction. *Gibbons v. Schenley Indus., Inc.*, 339 A.2d 460, 468-70 (Del. Ch. 1975).

²⁶ 1979 Mass. Adv. Sh. at 929, 387 N.E.2d at 1150.

²⁷ *Id.* at 931, 387 N.E.2d at 1151. See note 6 *supra*.

properly reflect the corporation's earning capacity.²⁸ The defendant corporation also contended that the investment value of the corporation should include its dividend record. Stating that dividends tend to reflect the same factors as earnings, the Court found no need to give the dividend value independent weight.²⁹ Moreover, since dividend policies clearly play a role in the market price of stock, the corporation's low and sporadic dividend rate already was accounted for in the appraised value of the stock.³⁰

Once the corporation's average earnings have been computed, the second step in determining investment value of a corporation is to apply a capitalization factor, or a multiplier, to the earnings figure.³¹ Reflecting the certainty and stability of the corporation's prospective financial condition, the capitalization factor will be low if future earnings are not promising and high if they are.³² The Supreme Judicial Court left the assignment of the capitalization factor within the trial judge's discretion.³³ The trial judge in *Piemonte* had weighed the favorable financial prospects of the Boston Bruins against the negative financial prospects and had concluded that a capitalization factor of ten was appropriate.³⁴ The Court affirmed this conclusion.³⁵

The net asset value is the third principal element considered under the approach to stock appraisal applied by the *Piemonte* Court. Net asset value represents the corporation's current worth or "going concern" value.³⁶ The Boston Garden Arena Corporation owned all the stock in the subsidiary corporations that owned, respectively, the Boston Bruins, a franchise in the National Hockey League, and the Boston Braves, a franchise in the American Hockey League. The corporation also owned

²⁸ 1979 Mass. Adv. Sh. at 931, 387 N.E.2d at 1151. The trial judge noted that since expansion of the National Hockey League was projected in the immediate future, the defendant corporation would be receiving additional payments in subsequent years. *Id.*

²⁹ *Id.* at 930, 387 N.E.2d at 1150.

³⁰ *Id.*

³¹ 1979 Mass. Adv. Sh. at 929, 387 N.E.2d at 1150.

³² *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 218 (Del. 1975).

³³ 1979 Mass. Adv. Sh. at 929, 929 n.9, 387 N.E.2d at 1150, 1150 n.9. The Court did state, however, that the capitalization chart upon which the Delaware courts have relied in the past, *see* 1 A.S. DeWing, *THE FINANCIAL POLICY OF CORPORATIONS* 390-91 (5th ed. 1953), *but see* *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 219, 219 n.3 (Del. 1975), was outdated. 1979 Mass. Adv. Sh. at 929 n.9, 387 N.E.2d at 1150 n.9.

³⁴ 1979 Mass. Adv. Sh. at 930, 387 N.E.2d at 1150.

³⁵ *Id.* The Court added that the judge could have compared the price-earnings ratio of other corporations but need not do so in reaching his conclusion of the correct multiplier. *Id.*, 387 N.E.2d at 1150.

³⁶ *See Note, Valuation of Dissenter Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1457 (1966).

and operated concessions at the Boston Garden.³⁷ In determining the net asset value for the corporation, the trial judge valued the net assets of the parent corporation separately from the assets of the Bruins' franchise and the concession operation³⁸ and then added the three values.³⁹ Challenging this sum, the defendant corporation contended that by separating the net assets value into three sources the judge included some items twice—particularly the goodwill of the Bruins, net player investment, and the value of the American Hockey League franchise.⁴⁰ The Court found, however, that the trial judge had not included these values in his determination of the Bruins' franchise and therefore had properly included them in the figure representing the net asset value of the parent corporation.⁴¹ The defendant further argued that no separate value should have been given to the concession operation.⁴² The Court acknowledged that the value had been included in the earning capacity figure. Nevertheless, it concluded that the value of the concession operation also had an asset component.⁴³ The defendant had purchased the concession rights as an asset before it purchased the real property on which the concessions were operated. This purchase demonstrated that the concession operation had a value independent of the value of the defendant's real estate.⁴⁴

After considering the evidence presented at trial and applying the above-described techniques, the judge found a market value of \$26.50, an earnings value of \$52.60 and a net asset value of \$103.16.⁴⁵ These raw figures represent different elements inherent in the value of the cor-

³⁷ 1979 Mass. Adv. Sh. at 923, 387 N.E.2d at 1147.

³⁸ See note 6 *supra*.

³⁹ 1979 Mass. Adv. Sh. at 931-32, 387 N.E.2d at 1151.

⁴⁰ *Id.* at 932, 387 N.E.2d at 1151.

⁴¹ *Id.* Since the judge on remand might choose to include these values in his redetermination of the value of the Bruins' franchise, an adjustment to the figure representing the parent corporation's net asset value may be necessary. *Id.* at 933 n.12, 387 N.E.2d at 1151 n.12.

⁴² *Id.* at 932, 387 N.E.2d at 1151.

⁴³ *Id.* at 935, 387 N.E.2d at 1152.

⁴⁴ *Id.* at 935-36, 387 N.E.2d at 1152-53. The Court, however, was unsure of the reason why the judge accepted the plaintiff's evidence of the operation's value and remanded the issue for further consideration. The Court noted that even though the defendant failed to offer evidence on this issue, the judge is not bound to accept the plaintiff's evidence at face value but should exercise his own judgment concerning the expert witness's testimony. The Court added, however, that the judge may well reaffirm his previous determination of the concession operation's net asset value. *Id.* at 936, 387 N.E.2d at 1153. The Court also remanded the determinations made of the value of the Boston Garden and the Bruins franchise, in response to the plaintiff's argument that these assets were undervalued. *Id.* at 932-35, 387 N.E.2d at 1151-52. Thus, although several issues were remanded for reconsideration, the Court accepted the judge's overall method of determining the net assets component.

⁴⁵ *Id.* at 924 n.3, 387 N.E.2d at 1148 n.3.

poration's stock. The figures must be balanced, however, by applying a percentage weighting process which, according to the *Piemonte* Court, it is within the judge's discretion to compose.⁴⁶ In *Piemonte*, because of the thin trading of the stock, the judge attributed a ten percent weight to the market value.⁴⁷ The judge also concluded that the corporation's value depended more on its assets than its earnings and assigned weights of fifty percent and forty percent, respectively.⁴⁸

Under most circumstances in Massachusetts where a minority stockholder dissents from a proposed corporate activity, the stockholder's sole remedy is to demand payment from the corporation for his stock's value as set out in *Piemonte* and thereby terminate his interest in the corporation.⁴⁹ Where, however, the proposed corporate activity will be or is illegal as to the dissenting stockholder, the last section of the Massachusetts appraisal provisions, section 98, entitles the stockholder to other relief.⁵⁰ In *Pupecki v. James Madison Corp.*,⁵¹ a case decided during the 1978 Survey year, the stockholder alleged that payments to the controlling stockholder following the sale of the corporation were actually in consideration of the corporation's assets and not for the employment and noncompetition agreements made between the controlling stockholder and the new corporate owners.⁵² The Supreme Judicial Court held that if the allegations were proved, the payments would constitute a diversion of corporate property—an illegal and fraudulent action by the controlling stockholder as to the minority dissenter. If such were the case, the dissenting stockholder's action to rescind all the agreements that transferred the corporation's assets to the new owners would be allowed.⁵³ Alternatively, if the allegations were not proved, the dissenting stockholder's remedy would be limited under section 98 to appraisal of his shares.⁵⁴ Whether the allegations were true remained a factual issue, and the case was remanded for trial.⁵⁵

⁴⁶ *Id.* at 937-38, 387 N.E.2d at 1153.

⁴⁷ *Id.* at 937, 387 N.E.2d at 1153.

⁴⁸ *Id.*

⁴⁹ *Cf.* Note, *A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal*, 74 MICH. L. REV. 1023 (1975-76) (in other states where stock is listed on a stock exchange or is otherwise actively traded remedy may be limited to sale of stock on the market).

⁵⁰ G.L. c. 156B, § 98 (1964).

⁵¹ 1978 Mass. Adv. Sh. 2340, 382 N.E.2d 1030.

⁵² *Id.* at 2345, 382 N.E.2d at 1033.

⁵³ *Id.* at 2342, 2345, 382 N.E.2d at 1032-33.

⁵⁴ *Id.* at 2344-45, 382 N.E.2d at 1033.

⁵⁵ *Id.* at 2346-47, 382 N.E.2d at 1033-34. The case dealt with some additional issues not pertaining to the appraisal provision, including whether the necessary requirements for a derivative suit on a corporation's behalf were satisfied by the minority stockholder and whether the suit was champertous. *Id.* at 2347-49, 382 N.E.2d at 1034.

Both *Piemonte v. New Boston Garden Corporation* and *Pupecki v. James Madison Corporation* shed some light on the appraisal provisions of chapter 156B, sections 86 through 98. Of foremost importance is the Supreme Judicial Court's sanction of Delaware law as persuasive.⁵⁶ Use of the Delaware block approach for appraisal allows the dissenting stockholder to receive the full, equitable value of his stock and not just the market price which, as illustrated in *Piemonte*, may not be reflective of the true worth of an interest in an on-going corporation. In addition, although appraisal provisions were originally intended to keep minority stockholders from seeking to enjoin certain corporate activities by allowing them to disengage themselves from the corporation in an equitable manner,⁵⁷ proof of corporate illegality or fraud as to the minority stockholder will leave open the door to injunctive relief.

⁵⁶ For examples of other issues which have arisen under Delaware law, see generally Kerr and Letts, *Appraisal Procedures for Delaware Stockholders*, 20 BUS. LAW. 1083 (1965).

⁵⁷ See generally Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223 (1962).