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Chapter 2: Corporations

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CHAPTER 2

Corporations

SURVEY Staff†

§ 2.1. Application of the business purpose and fairness test to public corporations where a director/controlling stockholder stands on both sides of a merger transaction.* While Massachusetts courts have long recognized the fiduciary obligations of corporate directors and controlling stockholders in close corporations,¹ they have not addressed the fiduciary duties of controlling shareholders involved in the merger of a publicly held corporation. During the *Survey* year, the Supreme Judicial Court considered in *Coggins v. New England Patriots Football Club, Inc.*² the fiduciary obligation of a controlling stockholder/director who executes a merger to eliminate public ownership in a publicly held corporation. In *Coggins*, the Court established a two part test for reviewing such cash freeze-out mergers.³

In other jurisdictions, courts analyzing the duties of directors and controlling shareholders in freeze-outs⁴ of publicly held corporations employ the “business purpose” test,⁵ the “fairness” test⁶ or a combination of the two tests.⁷ Under a business purpose test, the court determines whether the corporation, acting through its directors, had any legitimate business purpose in executing the merger other than attempting to force

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§ 2.1. ¹ *Leader v. Hycor, Inc.*, 1985 Mass. Adv. Sh. 215, 222, 479 N.E.2d 173, 177; *Wilkes v. Springside Nursing Home, Inc.*, 370 Mass. 842, 848–49, 353 N.E.2d 657, 661–62 (1976); *Horizon House-Microwave, Inc. v. Bazy*, 1985 Mass. App. Ct. Adv. Sh. 190, 198, 486 N.E.2d 70, 76.

² 1986 Mass. Adv. Sh. 525, 492 N.E.2d 1112 (1986).

³ *Coggins v. New England Patriots Football Club, Inc.*, 1986 Mass. Adv. Sh. at 534, 492 N.E.2d at 1118.

⁴ Freeze-outs are “transactions in which those in control of a corporation use their control to force non-controlling shareholders to lose their status . . . of that corporation.” R. CLARK, *CORPORATE LAW* 499 (1986). In a cash freeze-out merger such as in the *Coggins* case, the minority shareholders received cash for their shares. *See, e.g., Coggins*, 1986 Mass. Adv. Sh. at 528, 492 N.E.2d at 1115.

⁵ *See, e.g., Bryan v. Brock & Blevins Co.*, 490 F.2d 563, 568–71 (5th Cir. 1974); *Gabhardt v. Gabhardt*, 267 Ind. 370, 385, 370 N.E.2d 345, 356 (1977).

⁶ *See, e.g., Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

⁷ *See, e.g., Klurfeld v. Equity Enterprises*, 79 A.D.2d 124, 134–35, 436 N.Y.S.2d 303, 309 (1981).

out the minority shareholders.⁸ The entire fairness test, as established in Delaware in *Weinberger v. UOP, Inc.*,⁹ evaluates the entire transaction and considers whether the directors and controlling shareholders satisfied their fiduciary duty to the corporation by providing shareholders with both fair dealing and fair price. In *Coggins*, the Massachusetts Supreme Judicial Court concluded that a merger transaction in which a controlling shareholder eliminates a minority interest must satisfy both the business purpose and the entire fairness analysis.¹⁰

Under Massachusetts law, all shareholders in a close corporation owe to each other a duty of utmost good faith and loyalty in conducting the affairs of the corporation.¹¹ This stringent fiduciary duty is imposed on the shareholders because the special nature of close corporations poses an inherent danger to minority interests.¹² The applicable test when minority shareholders in a close corporation sue the majority shareholders for breach of this duty of utmost good faith and loyalty is whether the majority can demonstrate a legitimate business purpose for their actions.¹³ If the defendant does demonstrate a business purpose, and minority shareholders can demonstrate that there is an alternative course of action for achieving the objective that is less harmful to the minority interest,¹⁴ the court will weigh the business purpose against the alternative.¹⁵ This two prong test is applicable to alleged breaches of fiduciary duty by shareholders in a close corporation.

The dispute in *Coggins* centered around the activities of a director and controlling stockholder of the New England Patriots Football Club, Inc. ("Old Patriots"), William H. Sullivan.¹⁶ In 1960, Sullivan organized the Old Patriots, owners of an American Football League franchise, and by

⁸ *Gabhardt*, 267 Ind. at 388, 370 N.E.2d at 356 (1977).

⁹ 457 A.2d 701, 711 (fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed [Fair price] relates to the economic and financial considerations of the proposed merger")

¹⁰ *Coggins*, 1986 Mass. Adv. Sh. at 534, 492 N.E.2d at 1118.

¹¹ *Donahue v. Rodd Electrotype Co. of New England*, 367 Mass. 578, 593, 328 N.E.2d 505, 515 (1975). See *Cardullo v. Landau*, 329 Mass. 5, 8, 105 N.E.2d 843 (1952) for a discussion of the fiduciary duties of partners.

¹² See *Donahue*, 367 Mass. at 591-93, 328 N.E.2d at 514-15. Court notes that dissident stockholders in public corporations can sell their stock to regain some of their capital, an opportunity not available for shareholders in a close corporation. *Id.* at 591, 328 N.E.2d at 514. Court also comments on the trust and confidence which are essential in a close corporation. *Id.* at 592-93, 328 N.E.2d at 515.

¹³ *Wilkes*, 370 Mass. at 851, 353 N.E.2d at 663.

¹⁴ *Id.* at 851-52, 353 N.E.2d at 663.

¹⁵ *Id.* at 852, 353 N.E.2d at 663.

¹⁶ *Coggins*, 1986 Mass. Adv. Sh. at 527, 492 N.E.2d at 1114-15. The corporation was originally named the American League Professional Football Team of Boston, Inc. *Id.* at 526, 492 N.E.2d at 1114.

April 1974, accumulated 23,718 of the 100,000 shares of privately owned voting common stock.¹⁷ He also owned 5,499 of the 120,000 shares of publicly owned non-voting common stock.¹⁸ After his ouster from the presidency of the corporation in 1974, Sullivan sought to regain control.¹⁹ By late 1975, Sullivan owned or controlled all of the 100,000 shares of voting common stock.²⁰ To finance the purchase of the shares, Sullivan borrowed over five million dollars from two lenders.²¹ Both loans required Sullivan to reorganize the corporation to allow for the use of the corporation's income to repay Sullivan's personal obligations under these loans.²² To meet this condition, Sullivan had to eliminate the publicly owned shares.²³

Sullivan formed a new corporation, New Patriots Football Club, Inc. ("New Patriots") with exactly the same board of directors as the Old Patriots board of directors and planned a merger of the two corporations.²⁴ Under the merger agreement, shareholders of the publicly-held non-voting stock of the Old Patriots would exchange this stock for \$15 per share, and Sullivan would exchange his 100,000 shares of Old Patriots stock for 100% of the New Patriots stock.²⁵ This exchange would cause a freeze-out of public ownership in the corporation.²⁶ Sullivan obtained the requisite majority approval of the agreement by each class of affected stock,²⁷ and on January 31, 1977, the merger was consummated.²⁸ Coggins, however, the owner of ten shares of non-voting common stock, believed that the merger was illegal, voted against the transaction, and

¹⁷ *Id.* at 527, 492 N.E.2d at 1114. Ten shareholders formed the original corporation. In return for their contributions, each received 10,000 shares of voting common stock. *Id.*

¹⁸ *Id.* Four months after the corporation was formed, it sold 120,000 shares of non-voting common stock to the public.

¹⁹ *Id.*

²⁰ *Id.* Sullivan purchased, or agreed to purchase at some future date, all of the shares he did not own at a price of \$102 per share. *Id.*

²¹ *Id.*

²² *Id.* at 527–28, 492 N.E.2d at 1114–15. Sullivan borrowed a total of over five million dollars from the LaSalle National Bank of Chicago and the Rhode Island Hospital National Bank. *Id.* at 527, 492 N.E.2d at 1114.

²³ *Id.* at 527–28, 492 N.E.2d at 1115. This was a finding of fact made in an earlier Patriots case, which the trial judge in *Coggins* adopted as his own. *Id.* at 528 n.4, 492 N.E.2d at 1115 n.4.

²⁴ *Id.* at 528, 492 N.E.2d at 1115.

²⁵ *Id.*

²⁶ *Id.* at 532–33, 492 N.E.2d at 1117.

²⁷ *Id.* at 528–29, 492 N.E.2d at 1115. Prior to its amendment in 1976 and after 1981, the merger statute required two thirds approval of each class of stock. G.L. c. 156B § 78(c)(1)(iii) (as amended by St. 1976, c. 327) (cited in *Coggins*, 1986 Mass. Adv. Sh. at 528–29 and n.7, 492 N.E.2d at 1115 and n.7).

²⁸ *Coggins*, 1986 Mass. Adv. Sh. at 529, 492 N.E.2d at 1115.

initiated suit.²⁹ He was certified the representative of a class of shareholders who, like himself, sought to void the merger.³⁰

The superior court held for the plaintiffs and found that the merger failed to serve any legitimate business purpose separate from the personal interests of Sullivan.³¹ The court rejected the defendants' stated business justifications, noting that the sole reason for the merger was to restructure the Patriots so that Sullivan could satisfy his five million dollar debt to the lenders.³² In addition to considering the business purpose, the court considered the adequacy of disclosure and the fairness of the price and found the merger illegal.³³ Instead of granting the usual remedy of rescission upon a finding of an illegal merger, the court granted the plaintiffs rescissory damages and ordered further hearings on the specific amount.³⁴

On direct appellate review, the Supreme Judicial Court initially considered whether shareholders can invoke judicial review of a merger that technically complied with the merger statute.³⁵ The Court began by noting

²⁹ *Id.* at 529, 492 N.E.2d at 1115-16.

³⁰ *Id.* at 529, 492 N.E.2d at 1115-16. Two related cases based on the Patriots merger are *Pavlidis v. New England Patriots Football Club, Inc.*, 737 F.2d 1227 (1st Cir. 1984) and *Sarrouf v. New England Patriots Football Club, Inc.*, 1986 Mass. Adv. Sh. 542, 492 N.E.2d 1122 (1986). The *Pavlidis* plaintiff class were stockholders who voted to accept the cash offer for their stock, claiming that they were induced into acceptance by a misleading proxy statement. *Pavlidis*, 737 F.2d at 1229. The *Sarrouf* plaintiff class consisted of stockholders who, rather than accepting the offering price of \$15 per share, sought the statutory remedy of appraisal. *Sarrouf*, 1986 Mass. Adv. Sh. at 543, 492 N.E.2d at 1124.

³¹ *Coggins*, 1986 Mass. Adv. Sh. at 535, 492 N.E.2d at 1115.

³² *Id.* The defendant contended that a NFL policy requiring majority ownership in a single family or individual required elimination of public ownership. *Id.* The superior court rejected this argument, noting that the rationale behind the NFL policy was to eliminate internal management disputes in NFL franchises. Although Sullivan did not own a majority of the non-voting stock, he owned all of the voting stock and this satisfied the goal of the NFL policy. *Id.*

³³ *Id.* at 534, 492 N.E.2d at 1118.

³⁴ *Id.* at 529, 492 N.E.2d at 1116. Following the decision, the plaintiffs of two related cases, *Pavlidis*, 737 F.2d 1227 and *Sarrouf*, 1986 Mass. Adv. Sh. 542, 492 N.E.2d 1112, moved to intervene. *Coggins*, 1986 Mass. Adv. Sh. at 529-30, 492 N.E.2d at 1116. The *Pavlidis* plaintiffs were allowed to permissively intervene as were the *Sarrouf* plaintiffs who had not been granted relief in their own case. *Id.* The Supreme Judicial Court ruled that the trial judge erred as a matter of law in permitting the *Pavlidis* and *Sarrouf* plaintiffs to intervene. *Id.* at 539-40, 492 N.E.2d at 1121. An additional issue considered by the Supreme Judicial Court on appeal was the decision to certify the case as a class action. *Id.* at 537-38, 492 N.E.2d at 1120-21. The Court ruled that class certification was proper. *Id.* at 538, 492 N.E.2d at 1121.

³⁵ *Coggins*, 1986 Mass. Adv. Sh. at 532, 492 N.E.2d at 1117. G.L. c. 156B, § 98 provides

The enforcement by a stockholder of his right to receive payment for his shares in the manner provided in this chapter shall be an exclusive remedy except that this chapter shall not exclude the right of such stockholder to bring or maintain an appropriate proceeding to obtain relief on the ground that such corporate action will be or is illegal or fraudulent as to him.

that in the context of close corporations, the statute does not deprive judicial review of the independent fiduciary principle governing the behavior of majority stockholders.³⁶ The Court recognized that similar dangers of self-dealing and breach of fiduciary duties exist where a director/controlling stockholder seeks to eliminate public ownership in a corporation.³⁷ Thus, the Court concluded that in such a situation, the motives of the controlling stockholder are a proper subject of judicial inquiry despite technical compliance with the merger statute.³⁸ Finally, the Court stated that a controlling shareholder, who is also a director standing on both sides of the merger transaction, maintains the burden of showing that his or her actions did not violate his or her duty of loyalty to the corporation.³⁹

After determining that judicial scrutiny was appropriate, the Supreme Judicial Court affirmed the superior court's decision that the merger was illegal.⁴⁰ The Court noted, however, that although the superior court reached the proper result, it failed to structure its analysis properly.⁴¹ While the trial court examined the business purpose, the adequacy of disclosure and the fairness of price, the Supreme Judicial Court applied a more structured analysis.⁴²

In its consideration of the appropriate analysis, the Court looked to the approach of the Delaware courts, experienced in the law of corporations. Although the Court acknowledged that Delaware courts adhere only to the fairness test,⁴³ the Court stated that the business purpose test was an additional useful device for reviewing cash freeze-out mergers.⁴⁴ Consequently, the Court stated that in a cash freeze-out merger situation, the director/controlling shareholder must show first that the merger ad-

³⁶ *Coggins*, 1986 Mass. Adv. Sh. at 532–33, 492 N.E.2d at 1117.

³⁷ *Id.* at 532–33, 492 N.E.2d at 1117.

³⁸ *Id.* at 532, 492 N.E.2d at 1117–18. *See also Leader*, 395 Mass. at 221, 479 N.E.2d at 177.

³⁹ *Coggins*, 1986 Mass. Adv. Sh. at 533, 492 N.E.2d at 1118 (citing *Geddes v. Annaconda Copper Mining Co.*, 254 U.S. 590, 599 (1921)) (because directors have a fiduciary duty to the corporation, when the fairness of a transaction between corporations having common directors is challenged, fairness and adequacy of consideration must be shown).

⁴⁰ *Coggins*, 1986 Mass. Adv. Sh. at 530, 492 N.E.2d at 1116.

⁴¹ *Id.* at 534, 492 N.E.2d at 1118.

⁴² *Id.*

⁴³ *Id.* at 531, 492 N.E.2d at 1116–17. *See Weinberger*, 457 A.2d at 715. In *Weinberger*, the Supreme Court of Delaware eliminated the business purpose prong which it had previously adhered to in cases, such as *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977), stating that “we do not believe that any additional meaningful protection is afforded minority shareholders by the business purpose requirement . . .” 457 A.2d at 715.

⁴⁴ *Coggins*, 1986 Mass. Adv. Sh. at 531, 492 N.E.2d at 1117. The Court never stated specifically what the business purpose test adds to the entire fairness test.

vanced a legitimate business purpose.⁴⁵ If the defendant satisfies this showing, he or she next must prove that the transaction was fair to the minority shareholders.⁴⁶

In applying the test, the Court held that the defendant did not satisfy the first inquiry because the merger failed to serve any valid corporate objective unrelated to the personal interest of the majority shareholder.⁴⁷ The Court stated that the sole purpose of the merger was to facilitate repayment of Sullivan's personal indebtedness to the banks.⁴⁸ Moreover, the Court noted that the superior court rejected the defendant's claim that a National Football League rule requiring majority ownership by an individual or family necessitated the elimination of public ownership. The superior court had concluded that because Sullivan possessed unquestionable authority to act for the corporation, this satisfied the rule's underlying policy of avoiding internal management conflicts.⁴⁹ Because the Court found that the merger of the Old Patriots and New Patriots served no legitimate business purpose, it did not go on to consider whether the transaction was fair to minority interests.⁵⁰

After determining that the plaintiffs were entitled to relief, the Court considered the appropriate remedy for the shareholders.⁵¹ Reasoning that the normal equitable remedy for an illegal freeze-out, rescission of the merger, would be inappropriate due to the passage of time and reliance by third parties on the transaction, the Court decided to award the plaintiffs rescissory damages based on the present value of the corporation.⁵² The Court specifically rejected appraisal damages based on the 1976 value, noting that this would make the suit a nullity by giving the plaintiffs exactly the amount of money they would have received had they never initiated suit.⁵³ Accordingly, the case was remanded for determination of the present value of the Old Patriots merger as if the merger has never taken place.⁵⁴

⁴⁵ *Id.* at 534, 492 N.E.2d at 1118.

⁴⁶ *Id.* at 535, 492 N.E.2d at 1118.

⁴⁷ *Id.* at 534, 535, 492 N.E.2d at 1118, 1119. The Court cited *Widett & Widett v. Snyder*, for the proposition that the director of a corporation violated his or her fiduciary duty to the corporation when he or she failed to disclose to the corporation that a mortgage assignment transaction personally benefited the director and was of no benefit to the corporation. *Id.* (citing *Widett*, 392 Mass. at 778, 786, 467 N.E.2d at 1312, 1317 (1984)).

⁴⁸ *Coggins*, 1986 Mass. Adv. Sh. at 535, 492 N.E.2d at 1119.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Coggins*, 1986 Mass. Adv. Sh. at 535-36, 492 N.E.2d at 1119-20.

⁵³ *Id.* at 536, 492 N.E.2d at 1119-20.

⁵⁴ *Id.* at 536-37, 492 N.E.2d at 1120. The Supreme Judicial Court ordered the trial court to award the plaintiffs what they would receive if the merger was undone and the old corporation put together again. *Id.* at 537, 492 N.E.2d at 1120. The court was also ordered

Although the *Coggins* decision establishes a two prong test for examining cash freeze-out mergers of publicly held corporations, it fails to address several important issues. For example, while the Court relied upon the fiduciary standard for transactions involving close corporations, it did not elaborate on the nature of this duty in public corporations.⁵⁵ Also, because the entire fairness test considers business justifications, it is not clear what the business purpose prong adds to the fairness approach. Thus, the Supreme Judicial Court's analysis in *Coggins* raises as many questions as it resolves.

The *Coggins* decision focused on the special dangers involved when a controlling stockholder and director stands on both sides of a merger transaction which eliminates the public. The likelihood of personal motivation, with little concern for the corporation or its minority shareholders, seems great in such situations.⁵⁶ Similar dangers of self-dealing and disregard for minority interests exist in close corporations.⁵⁷ Perhaps for this reason, the Court frequently analogized the fiduciary obligations of the majority interest in cash freeze-out mergers of public corporations to those of the majority in closely held corporations.⁵⁸ However, the court did not specifically address the differences between fiduciary obligations of directors/controllers stockholders in public corporations as compared to close corporations.⁵⁹

The *Coggins* court concluded that merger transactions involving corporations with common boards of directors must show a legitimate business justification, apart from any personal purposes, for the transaction. Even if a valid corporate purpose is found, the defendant must further prove that the entire transaction was fair to the minority shareholders. Although the *Coggins* Court specifically stated that the business purpose test was an *additional* useful analysis to the entire fairness test,⁶⁰ the Court failed to state specifically what the tests add to each other. The

to include in the present value the amount wrongfully diverted from the corporation's assets by the defendants. *Id.*

⁵⁵ See *Id.* at 532–33, 532 n.13, 492 N.E.2d at 1117–18, 1117 n.13 (citing *Leader*, 395 Mass. at 221, 479 N.E.2d at 177, *Pupecki v. James Madison Corp.*, 376 Mass. 212, 216–17, 382 N.E.2d 1030, 1033 (1978), and *American Discount v. Kaitz*, 348 Mass. 706, 711, 206 N.E.2d 156, 160 (1965)).

⁵⁶ See *Elephante, Corporations*, 1975 ANN. SURV. MASS. LAWS § 17.1, at 457–58.

⁵⁷ See *supra* notes 11–15 and accompanying text for a discussion of close corporations.

⁵⁸ See *Coggins*, 1986 Mass. Adv. Sh. at 532–33, 492 N.E.2d at 1117.

⁵⁹ *Coggins*, 1986 Mass. Adv. Sh. at 532 n.13, 492 N.E.2d at 1117 n.13 (quoting *Donahue*, 367 Mass. at 593–94, 328 N.E.2d at 515–16). The Court's only treatment of this issue was in a footnote, in which the Court distinguished the stricter standard imposed on close corporations from the "less stringent standard of fiduciary duty to which directors and stockholders of all corporations must adhere". *Id.*

⁶⁰ *Coggins*, 1986 Mass. Adv. Sh. at 531, 492 N.E.2d at 1117.

fairness test considers if the transaction included fair dealing and fair price.⁶¹ Under the fair dealing question, the court investigates the initiation, the structure, and the negotiation of the transaction.⁶² Fair dealing also encompasses a duty of candor about the transaction.⁶³ Fair price includes economic considerations, including any element which affects the value of the transaction.⁶⁴ Given the fair dealing requirement, it is difficult to see what the business purpose test adds to the fairness test. Applying an entire fairness test to the *Coggins* case, for example, Sullivan would have had to disclose his personal interest in the merger transaction to satisfy his duty of candor.

One notable difference between the *Coggins* approach and a test which looks solely at the fairness of the transaction is the effect of shareholder approval of a merger. Utilizing the fairness analysis, had the informed shareholders approved the merger after Sullivan's disclosure of his personal interest, the transaction would have satisfied judicial scrutiny, provided that the shareholders were given a fair price for their shares.⁶⁵ Under the holding in *Coggins*, however, even if the fully informed shareholders approved the transaction, it would be illegal due to lack of a business purpose. Thus, when focusing on motives in the context of the fair dealing prong of the entire fairness approach, fully informed shareholders retain the option to approve the merger.

The Supreme Judicial Court left open a number of important questions posed by the *Coggins* case. First, the Court did not establish the differences between the fiduciary obligations of directors in close corporations and directors in publicly held corporations. Also, the Court failed to identify what additional function the business purpose test serves in analyzing the merger of a publicly held corporation with another corporation. Furthermore, the Court failed to provide guidance on what sufficed as a legitimate corporate purpose in a merger situation. Clearly, repaying Sullivan's personal indebtedness failed to serve any legitimate business purpose. Finally, the Court never even reached the inquiry into the fairness test. Therefore, what this fairness test entails in mergers involving publicly held Massachusetts corporations remains unclear. Thus, the full implications of the *Coggins* approach await further development.

§ 2.2. Fiduciary Duty — Closely Held Corporations.* During the Survey year the Supreme Judicial Court in *Goode v. Ryan* addressed the question

⁶¹ See, e.g., *Weinberger*, 457 A.2d at 711.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

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whether the fiduciary duty which shareholders in a close corporation owe one another requires the corporation or the majority shareholders to purchase the shares of a minority shareholder upon the death of that shareholder.¹ The Court answered the question in the negative, holding that neither the majority shareholders nor the corporation was under a duty to purchase the minority shares.² The majority's refusal to purchase the shares, stated the Court, was simply one of the risks of ownership of minority shares in a close corporation.³

In the 1975 case of *Donahue v. Rodd Electrotpe Co. of New England*, the Court established the rule that shareholders in a close corporation owe one another the same fiduciary duty of utmost good faith and loyalty as partners owe one another.⁴ Applying this rule, the *Donahue* Court held that where a close corporation seeks to purchase shares from a controlling shareholder, it also must offer to purchase shares ratably from all other shareholders.⁵ Thus, the Court observed the "true plight" of the minority shareholder in a close corporation who may be oppressed by majority control, with few avenues of escape from a disadvantageous situation.⁶ Noting that in these circumstances the close corporation more closely resembles a partnership as compared with a public-issue corporation,⁷ the Court stated that, as in a partnership, the relationship among the shareholders must be one of trust, confidence and absolute loyalty.⁸

This rule was further developed in a case involving the majority shareholders' termination of a minority shareholder's employment without cause.⁹ In the 1976 case of *Wilkes v. Springfield Nursing Home, Inc.*, the Court, "concerned that untempered application of the strict good faith standard enunciated in *Donahue*"¹⁰ would unduly hamper the majority's ability to manage the corporation, sought to balance the majority's rights to "selfish ownership" against their fiduciary duty owed to the minority.¹¹ In order to accommodate these competing interests, the *Wilkes* Court established a two part analysis of actions of the controlling shareholders when a minority shareholder alleges a breach of fiduciary

§ 2.2. ¹ 397 Mass. 85, 489 N.E.2d 1001 (1986).

² *Id.* at 92, 489 N.E.2d at 1005.

³ *Id.*

⁴ 367 Mass. 578, 593, 328 N.E.2d 505, 515 (1975). The *Donahue* Court defined a close corporation as typified by: "(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation." *Id.* at 586, 328 N.E.2d at 511.

⁵ *Id.* at 598, 328 N.E.2d at 518.

⁶ *Id.* at 591-92, 328 N.E.2d at 514-15.

⁷ *Id.* at 586, 328 N.E.2d at 512.

⁸ *Id.* at 587, 328 N.E.2d at 512.

⁹ *Wilkes v. Springfield Nursing Home, Inc.*, 370 Mass. 842, 353 N.E.2d 657 (1976).

¹⁰ *Id.* at 850, 353 N.E.2d at 663.

¹¹ *Id.* at 850-51, 353 N.E.2d at 663.

duty by the majority.¹² First, the Court asks whether the controlling group can demonstrate a legitimate business purpose for its action;¹³ and, second, if a business purpose is advanced, the minority shareholders are allowed to demonstrate that the legitimate objective could have been achieved through another course of action less harmful to the minority's interest.¹⁴ Thus, the *Wilkes* decision limited the impact of *Donahue* by allowing the majority to demonstrate a legitimate business purpose for its action alleged to violate the strict fiduciary duty to the harm of the minority.

In *Goode v. Ryan*, the most recent case of this group, the Supreme Judicial Court ruled that the refusal of the majority shareholders of a close corporation to purchase shares from the estate of a deceased minority shareholder did not violate the fiduciary duty owed to the minority shareholder.¹⁵ Plaintiff, Thomas E. Goode, was the administrator of the estate of Alice M. Marr, a deceased minority shareholder of the Gloucester Ice & Cold Storage Co. (Gloucester).¹⁶ Defendants were shareholders of Gloucester, as well as shareholders, officers or directors of defendant North Shore Management & Investment Co. (North Shore), the majority shareholder of Gloucester.¹⁷ It was undisputed, and the Court assumed, that Gloucester was a close corporation: the number of shareholders was small, no ready market existed for Gloucester stock, and majority shareholder participation in the management of Gloucester was substantial.¹⁸

During the winter of 1977-78, Goode informed Gloucester management that he wished to sell, or for the corporation to redeem, Alice Marr's minority shares of Gloucester stock.¹⁹ A few months later, North Shore offered to purchase the minority shares from the Marr estate at \$12.50 a share, or approximately one-third of its book value of \$38.87 a share.²⁰

¹² See *id.* at 851-52, 353 N.E.2d at 663.

¹³ *Id.* at 851, 353 N.E.2d at 663. The Court acknowledged that in asking this question, the majority must be afforded some room to maneuver in establishing the business policy of the corporation. *Id.*

¹⁴ *Id.* at 851-52, 353 N.E.2d at 663.

¹⁵ 397 Mass. at 91, 489 N.E.2d at 1005.

¹⁶ *Id.* at 86, 489 N.E.2d at 1002. The estate owned 800 shares of the 11,340 shares outstanding of Gloucester common stock. *Id.* Gloucester manufactured and sold ice to the fishing industry through its operating entity, Cape Pond Ice Co. *Id.*

¹⁷ *Id.* Defendants together owned 8,125 shares (71.6%) of Gloucester's stock. *Id.*

¹⁸ *Id.* See *supra* note 4 for definition of a close corporation. The Court noted that defendants John W. Ryan and John D. Hodges served as president and treasurer of Gloucester since 1978, and that John W. Ryan, John D. Hodges, William A. Eagan, Jr., James A. Ryan, and John D. Hodges, Jr. had been elected members of the Gloucester board of directors annually since 1978. *Id.* at 86 n.3, 489 N.E.2d at 1002 n.3.

¹⁹ *Id.* at 87, 489 N.E.2d at 1002.

²⁰ *Id.* The source of the book value was the unaudited financial statement of Gloucester for the year ending December 31, 1977. *Id.* Presumably this was an average price per share,

Goode declined, and the offer was withdrawn.²¹ Goode subsequently failed to take advantage of several opportunities to dispose of his shares, unrelated to the North Shore offer.²²

At the August 1982 annual meeting Goode renewed his request that the corporation redeem the shares.²³ Nothing in Gloucester's articles of organization or by-laws, or in any shareholder agreement required the corporation or the remaining shareholders to redeem its stock upon the death of a shareholder.²⁴ The president of Gloucester, John W. Ryan, responded in a letter by denying any legal obligation of the directors to redeem the stock.²⁵ Ryan agreed, however, to present to the directors any price and payment terms acceptable to Goode.²⁶ In reply, Goode

without reference to shares which constitute a majority, or minority interest. *See* 12A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5600 (rev. perm. ed. 1984) (actual value of closely held corporate stock is determinable from the then net worth of the corporation divided by the number of bona fide shares issued and outstanding). Professors O'Neal and Thompson have noted that majority shareholders value stock according to the amount of control the stock carries. 1 F.H. O'NEAL & R. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 2:15, at 38-39 (2d ed. 1985) [hereinafter OPPRESSION OF MINORITY SHAREHOLDERS]. A minority shareholder views all shares as equal in value, whereas a majority owner views minority shares as worth far less per share than majority stock, due to the inability of a minority interest to control the corporation. *Id.*

²¹ *Ryan*, 397 Mass. at 87, 489 N.E.2d at 1002.

²² *Id.* at 87-88, 489 N.E.2d at 1002-03. At the 1980 annual meeting of Gloucester, the shareholders voted to merge with Cape Pond Ice Co. (Cape Pond), a Massachusetts corporation in which Gloucester was the majority stockholder. *Id.* at 87, 489 N.E.2d at 1002. Goode attended the meeting, but did not vote on the proposal. *Id.* In September of that year, the shareholders adopted a plan of liquidation and dissolution for Gloucester, which was later abandoned when Gloucester could not find a buyer for its assets. *Id.* Goode attended this meeting as well, but again he declined to vote on the proposal. *Id.* Neither did he exercise his rights under chapter 156B, section 85, to obtain an appraisal of, and payment for, the Marr estate's share in Gloucester, based on the vote to merge at the annual meeting. *Id.* G.L. c. 156B, § 85 provides:

A stockholder in any corporation organized under the laws of Massachusetts which shall have duly voted to consolidate or merge with another corporation or corporations under the provisions of sections seventy-eight or seventy-nine who objects to such consolidation or merger may demand payment for his stock from the resulting or surviving corporation and an appraisal in accordance with the provisions of sections eighty-six to ninety-eight, inclusive, and such stockholder and the resulting or surviving corporation shall have the rights and duties and follow the procedure set forth in those sections. This section shall not apply to the holders of any shares of stock of a constituent corporation surviving a merger if, as permitted by subsection (c) of section seventy-eight, the merger did not require for its approval a vote of the stockholders of the surviving corporation.

²³ *Ryan*, 397 Mass. at 87, 489 N.E.2d at 1002.

²⁴ *Id.* at 86, 489 N.E.2d at 1002.

²⁵ *Id.* at 87, 489 N.E.2d at 1002.

²⁶ *Id.*

stated that he had insufficient information to formulate a proposal and that the management of Gloucester was obligated to furnish him such information.²⁷

Having reached no agreement, Goode filed suit, claiming that Gloucester, or the majority shareholders, or both, were required to purchase the shares of stock in Alice Marr's estate.²⁸ While the suit was pending, Gloucester found a buyer for its assets, and the shareholders in June, 1983, voted to sell substantially all the assets of Gloucester and to liquidate and dissolve the corporation.²⁹ Goode did not exercise his statutory rights of appraisal and payment.³⁰ The sale of assets was consummated in August, 1983, and one month later Gloucester made a distribution of \$136.50 a share to those shareholders who surrendered their stock certificates.³¹ Goode was not among them.³²

A few weeks after the distribution, the defendants moved for partial summary judgment, claiming that neither the majority interest nor the corporation had a duty to purchase or to redeem stock of a minority shareholder.³³ A superior court judge allowed the motion, and Goode appealed.³⁴ In June, 1984, while Goode's appeal was pending, Gloucester made another distribution of \$17.34 a share, and Gloucester was dissolved.³⁵ In October, Goode surrendered all the Gloucester shares in the Marr estate, receiving \$153.84 a share, the total paid to other shareholders in the two liquidating distributions.³⁶

The Supreme Judicial Court granted a request for direct appellate review and affirmed the judgment.³⁷ As an initial matter, defendants argued that because the plaintiff received his pro rata share of liquidating distributions in exchange for the surrender of his shares, plaintiff had received the relief he sought — his pro rata share of the Gloucester assets — and thus the appeal should be dismissed as moot.³⁸ The Court, however, found that a real controversy still existed.³⁹ Assuming, stated the Court, that defendants were under a duty to make a reasonable offer to

²⁷ *Id.*

²⁸ *Id.* at 87–88, 489 N.E.2d at 1002–03.

²⁹ *Id.* at 88, 489 N.E.2d at 1003.

³⁰ *Id.* See *supra* note 22 for a discussion of Goode's previous refusal to exercise his statutory rights of appraisal and payment.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* at 86, 489 N.E.2d at 1002.

³⁸ *Id.* at 88, 489 N.E.2d at 1003.

³⁹ *Id.* at 89, 489 N.E.2d at 1003.

purchase shares upon the death of a shareholder at the value they would have had at that time (April 1977), then redemption of the shares seven years after the original request did not render the issue moot.⁴⁰

Having rejected defendant's argument that the appeal was moot, the Court began its analysis of the substantive issue by noting, as it had in *Donahue*, that one of the identifying characteristics of a close corporation is the absence of a ready market for corporate stock.⁴¹ A shareholder who is unhappy with management, observed the Court, or one who wants to convert his or her investment to cash, has only a limited number of opportunities for disposing of the stock.⁴² On the shareholder's death, the administrator of the shareholder's estate, left with shares which may have a high value in the estate but little dividend value for the beneficiaries, may encounter similar difficulties in selling the stock.⁴³ In both situations, said the Court, the remaining shareholders or the corporation itself may be the only prospective purchasers for the minority shares.⁴⁴

The Court continued by contrasting the limited opportunities for minority shareholders in a close corporation to dispose of their interests, with the mechanisms available to investors in large, public-issue corporations or in a partnership.⁴⁵ A shareholder in a public corporation, observed the Court, can sell shares on the financial markets with no price disadvantage, and a partner can convert the investment to cash by dissolving the partnership.⁴⁶ Those options are unavailable to the minority shareholder in a close corporation.⁴⁷

⁴⁰ *Id.*

⁴¹ *Id.* at 90, 489 N.E.2d at 1004. See *Donahue*, 367 Mass. at 586, 591, 328 N.E.2d at 511, 514.

⁴² *Ryan*, 397 Mass. at 90, 489 N.E.2d at 1004. See OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 20, § 2:15, at 38 (the authors explain that there is no ready market for shares representing less than a controlling interest in a close corporation and that corporate dissension further lessens market interest in such shares).

⁴³ *Ryan*, 397 Mass. at 90, 489 N.E.2d at 1004. See also 2 F.H. O'NEAL, CLOSE CORPORATIONS § 7.23, at 79 (2d ed. 1971) [hereinafter CLOSE CORPORATIONS] (shares of a deceased minority shareholder may have a high value in the estate but have little dividend value for the heirs).

⁴⁴ *Ryan*, 397 Mass. at 90, 489 N.E.2d at 1004. See also CLOSE CORPORATIONS, *supra* note 43, § 7.23, at 79; OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 20, § 2:15, at 38; Hornstein, *Stockholder's Agreements in the Closely Held Corporation*, 59 YALE L.J. 1040, 1049 (1950) ("As a practical matter, remaining parties are usually the only prospective purchasers of stock in a closely held corporation.").

⁴⁵ *Ryan*, 397 Mass. at 90, 489 N.E.2d at 1004.

⁴⁶ *Id.*

⁴⁷ *Id.* Unlike the investor in a large, public-issue corporation, the minority shareholder in a close corporation is at a price disadvantage relative to majority shareholders, due to the lack of a ready market. Thus, the minority shareholder cannot sell out and reinvest his or her cash. See OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 20, § 2:15, at 38. Nor can the minority shareholder dissolve the corporation as could a partner dissolve the

Having identified the plight of the minority shareholder in a close corporation, the Court nonetheless stated that in the absence of an agreement among shareholders or with the corporation, or a provision in the articles of organization or by-laws, "neither the corporation nor a majority of shareholders is under any obligation to purchase the shares of minority shareholders when minority shareholders wish to dispose of their interest in the corporation."⁴⁸ In refusing to require the corporation to purchase the minority shares in the absence of such an agreement or provision, the Court emphasized the lack of evidence of oppressive conduct on the part of the controlling shareholders directed at excluding the minority shareholders of the benefits derived from participation in corporate affairs.⁴⁹ Unlike the minority shareholders in *Donahue*⁵⁰ and *Wilkes*,⁵¹ the deceased shareholder had neither held corporate office, nor served on the board of directors, nor received a salary from the corporation.⁵² The majority shareholders, stated the Court, "made no effort to curtail, or interfere with, any benefits to which Marr or her estate was entitled as a minority shareholder in Gloucester."⁵³ Thus, concluded the Court, plaintiff was not the victim of a freeze-out.⁵⁴ The Court acknowl-

partnership. While a shareholder with a majority interest in a corporation may petition for the dissolution of the corporation for any reason under G.L. c. 156B, § 99(a), by definition that opportunity is not available to a minority shareholder. While forty percent of a corporation's shareholders may bring a petition for dissolution of a corporation if the directors or shareholders are deadlocked under G.L. c. 156B, § 99(b), that provision would not help a minority shareholder who simply is unhappy with management or who wants to convert his or her shares into cash.

⁴⁸ *Ryan*, 397 Mass. at 90–91, 489 N.E.2d at 1004. For a decision discussing stock purchase agreements see *Winchell v. Plywood Corp.*, 324 Mass. 171, 174–75, 85 N.E.2d 313, 315 (1949) (a Massachusetts corporation, unless forbidden by statute, may purchase its own stock; agreements are enforceable if purchase is made in good faith and without prejudice to creditors and stockholders). See also *Crimmins & Peirce v. Kidder Peabody Acceptance Corp.*, 282 Mass. 367, 376, 185 N.E. 383, 387 (1933) (right of redemption in principle is analogous to purchase by corporation of its own stock, which commonly is valid; contracts for redemption are unenforceable if the effect is to render the corporation insolvent).

⁴⁹ *Ryan*, 397 Mass. at 91, 489 N.E.2d at 1004.

⁵⁰ In *Donahue* the minority shareholder was an employee and corporate officer, although he never participated in the "management" aspect of the business. *Donahue*, 367 Mass. at 581, 328 N.E.2d at 509.

⁵¹ In *Wilkes* the minority shareholder was a director, corporate officer, and employee of the corporation. *Wilkes*, 370 Mass. at 843, 353 N.E.2d at 659.

⁵² *Ryan*, 397 Mass. at 91, 489 N.E.2d at 1004–05.

⁵³ *Id.* at 91, 489 N.E.2d at 1005. See *Hallahan v. Haltom Corp.*, 7 Mass. App. Ct. 68, 70, 385 N.E.2d 1033, 1034 (1979) (peremptory discharge of minority shareholders without warning fell short of *Donahue* standard, where the principal benefit minority shareholders derived was as employees of the corporation).

⁵⁴ *Ryan*, 397 Mass. at 91–92 n.6, 489 N.E.2d at 1005 n.6. A "freeze-out" or "squeeze-out" is "the use by some of the owners or participants in a business enterprise of strategic position, inside information, or powers of control, or the utilization of some legal device

edged that plaintiff's inability to dispose of the shares was "unfortunate," but in the absence of corporate or majority shareholder misconduct, the Court would not reallocate the risks inherent in the ownership of stock in a close corporation.⁵⁵

The Court's unwillingness to interfere in the refusal of the corporation to buy-out the deceased shareholder's shares is consistent with the *Donahue* standard.⁵⁶ The *Donahue* standard of "utmost good faith and loyalty" is aimed at reducing the ability of majority shareholders to disadvantage minority shareholders in the close corporation.⁵⁷ Such disadvantages include the inadequacy of legal remedies to protect them from the abuses of the controlling group who both own and manage the corporation, and abuse of the relationship of "trust and confidence" more typical of relationships among shareholders in a close corporation than in a public corporation.⁵⁸ In both situations, the disadvantage suffered by the minority shareholder must be attributable to misconduct by the majority interest.

In *Ryan* the minority shareholder was not disadvantaged by the inadequacy of legal remedies to protect him from abuses of corporate management.⁵⁹ The lack of a market for the shares was not caused by the

or technique, to eliminate from the enterprise one or more of its owners or participants." OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 20, § 1:01 at 1. See *Wilkes*, 370 Mass. at 849, 353 N.E.2d at 662 (an effective "freeze-out" device is to deprive minority shareholders of corporate offices and of employment with the corporation); *Donahue*, 367 Mass. at 592, 328 N.E.2d at 515 (majority "freeze-out" schemes that withhold dividends are designed to compel minority to sell stock at less than fair value; when minority agrees, majority has won).

⁵⁵ *Ryan*, 397 Mass. at 92, 489 N.E.2d at 1005. ("[T]he situation was not caused by the defendants but is merely one of the risks of ownership of stock in a close corporation.")

⁵⁶ See *supra* notes 4–8 and accompanying text for a discussion of the *Donahue* standard.

⁵⁷ See *Elephante, Corporations*, 1975 ANN. SURV. MASS. LAW § 17.2, at 476.

⁵⁸ See Comment, *Close Corporations — Stockholder's Duty of "Utmost Good Faith and Loyalty" Requires Controlling Shareholder Selling a Close Corporation its Own Shares to Cause the Corporation to Offer to Purchase a Ratable Number of Shares from Minority — Donahue v. Rodd Electrotype Co.*, 89 HARV. L. REV. 423, 425 (1975) [hereinafter Comment, *Close Corporations*]. The author identifies two themes in the Court's justifications for extending strict fiduciary liability to shareholders of a close corporation. *Id.* The first, "the inadequacy of legal remedies to protect minority stockholders from abuses arising from the conjunction of management and ownership in the controlling group," justifies close judicial supervision to guard against the risk that actions by the controlling shareholders will be motivated by self-interest. *Id.* at 425–26. The second theme identified by the author is that "shareholders in a close corporation stand in a closer personal relationship than those in public corporations." *Id.* at 427. A duty to act with utmost good faith and loyalty thus upholds an ideal of corporate citizenship for the protection of the "common enjoyment of the benefits of the joint enterprise." *Id.*

⁵⁹ The plaintiff in *Ryan* twice declined to exercise his statutory rights of appraisal and payment when the shareholders voted to liquidate the corporation. See *supra* note 22 and accompanying text for discussion of the plaintiff's failure to exercise his statutory rights

controlling shareholders, but was simply a fact of ownership of such shares.⁶⁰ Although the price per share offered to the shareholder's administrator may have seemed inadequate to the minority shareholder, the disparity in valuation reflects what minority shares are worth to the majority.⁶¹ In this sense, the disparity in valuation may be viewed as a permissible element of "selfish ownership," and does not necessarily constitute an abuse.⁶² In contrast, the majority shareholder in *Donahue* impermissibly exercised his selfish ownership to cause the corporation to buy his stock.⁶³

Nor was the treatment of plaintiff inconsistent with a standard of "trust and confidence" in shareholder relationships designed to protect the minority shareholder's enjoyment of the benefits of the common enterprise.⁶⁴ As administrator of the minority shareholder's estate, plaintiff did not stand in a close personal relationship to the other shareholders, as might a shareholder who was an original party to the enterprise and who contributed his or her capital, skills, experience and labor.⁶⁵ Alice Marr, the deceased shareholder, had never been an active member of the corporation.⁶⁶ In contrast to the minority shareholder in *Wilkes* who derived his primary benefits from employment in the corporation, Alice

of appraisal and payment. When the plaintiff eventually surrendered his shares, he received the same amount per share as did all other shareholders. See *supra* note 36 and accompanying text for amount received by the plaintiff in distribution. Thus, he was not denied an opportunity available to other shareholders. The minority shareholder in *Donahue*, by contrast, was denied the opportunity to sell his shares, an opportunity extended to a member of the controlling group. *Donahue*, 367 Mass. at 603, 328 N.E.2d at 520.

⁶⁰ *Ryan*, 397 Mass. at 92, 489 N.E.2d at 1005.

⁶¹ See *supra* notes 19–21 and accompanying text for a discussion of the valuation of majority and minority shares in a close corporation.

⁶² Professors O'Neal and Thompson note that the "premium paid for stock constituting a controlling interest is recognized by appraisers." OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 20, § 2:15, at 42 n.7.

⁶³ *Donahue*, 367 Mass. at 583, 328 N.E.2d at 510.

⁶⁴ See Comment, *Close Corporations*, *supra* note 58, at 427. The Court uses the fact that the plaintiff eventually received the same amount per share as did all other shareholders to demonstrate that the plaintiff was treated fairly by the majority shareholders. The use of this fact in support of the defendant's refusal to redeem the shares is inconsistent with the Court's conclusion that the payment to the plaintiff of his pro rata share of the corporation's assets did not moot the question as to whether the plaintiff's shares should have been redeemed seven years earlier. See *supra* notes 38–40 and accompanying text. Nonetheless, the Court's conclusion that the defendants were not required to purchase or redeem the plaintiff's shares does not depend on the fact that the plaintiff was treated fairly seven years after his request. The Court's conclusion is more properly attributed to its finding that the plaintiff's inability to dispose of his stock is merely one of the risks of owning minority shares in a close corporation. *Ryan*, 397 Mass. at 92, 489 N.E.2d at 1005.

⁶⁵ See *Wilkes*, 370 Mass. at 852–53, 353 N.E.2d at 664.

⁶⁶ *Ryan*, 397 Mass. at 91, 489 N.E.2d at 1004–05.

Marr did not look to her investment in Gloucester as a means of obtaining benefits, such as employment or corporate office.⁶⁷

The holding in *Ryan* demonstrates that attorneys cannot rely on the courts to reallocate the risks inherent in the ownership of minority shares. Instead, attorneys must provide for those risks by shareholder agreement or by a provision in the by-laws or articles of organization.⁶⁸ The requirement of an express agreement or governance provision to protect minor-

⁶⁷ See *Comment*, *supra* note 58, at 427.

⁶⁸ As the Court in *Ryan* noted, the Statutory Close Corporation Supplement to the Model Business Corporation Act (Close Corporation Supplement) leaves stock buy-out arrangements to the agreement of the parties by requiring a corporation to purchase shares from the estate of a deceased shareholder only if the articles of incorporation of the close corporation contain such a provision. 397 Mass. at 92, 489 N.E.2d at 1005.

Section 14 of the Statutory Close Corporation Supplement to the Model Business Corporation Act provides:

- (a) If the articles of incorporation of a statutory close corporation provide that this section shall apply to the corporation, the executor or administrator of the estate of any deceased shareholder shall, subject to any directions in the deceased shareholder's last will and testament, have the right to require the corporation to elect either to purchase or cause the purchase of all, but not less than all, of the shares of the decedent pursuant to sections (d) through (f), or to be dissolved.

MODEL BUSINESS CORP. ACT ANN., STATUTORY CLOSE CORP. SUPP. § 14, (Proposed Official Draft 1981) *reprinted in* 38 BUS. LAW. 1031, 1032 (1983).

The comments to this section state that it is designed to guarantee a buy-out at the death of a shareholder and that the decision to have any provision for mandatory buy-out is optional. MODEL BUSINESS CORP. ACT, STATUTORY CLOSE CORP. SUPP. § 14 comment 1 (Proposed Official Draft 1981) *reprinted in* 37 BUS. LAW. 269, 296 (1981). Designed to alleviate the problems caused by illiquidity of close corporation stock and the disputes which arise between the surviving shareholders and the successors in interest of a deceased shareholder, the advantage of electing section 14 is that:

- [I]t provides basic protection in the event the shareholders have failed to enter into an appropriate private agreement, or have a buy-out agreement but have failed to agree upon a buy-out price formula, or have a formula but have neglected to provide other necessary terms such as interest rates or number of installments in the event deferred purchases are authorized or necessary. This section does not prohibit the shareholders from having an all-inclusive private buy-out agreement drafted by competent counsel. An attorney may wish, however, to use the provisions of section 14 as the basis of the agreement, making such additions and modifications as are deemed necessary. This procedure could substantially reduce the amount of drafting the attorney will have to undertake.

Id. at 297.

The Comments to the Close Corporation Supplement provision for shareholder sales option at death note that an attorney may prefer to draft a private buy-out agreement, using the Close Corporation Supplement provision as a model. Professor O'Neal notes that such buy-out obligations are usually provided through an agreement among the shareholders or among the shareholders and the corporation, rather than through a corporate governance provision. CLOSE CORPORATIONS, *supra* note 43, § 7.23, at 79. A "buy-and-sell" agreement imposes an obligation to purchase on the surviving shareholders; a "stock-purchase" or "stock-retirement" agreement imposes the obligation on the corporation. *Id.*

ity shareholders may seem inconsistent with the operation of a close corporation where “informal understandings” frequently govern.⁶⁹ Such “informal understandings,” however, can become misunderstandings upon the death of a shareholder.⁷⁰ The advantage of pre-planning for the disposition of a stockholder’s shares upon death is that subsequent disputes regarding the shareholders’ understandings can be avoided.⁷¹ Not only can an agreement alleviate the inherent problems of an otherwise illiquid asset or an inadequate price, but it also can provide for the complexities of valuation, payment terms and tax consequences.⁷²

The Court’s ruling in *Ryan* draws a line between active majority oppression of minority shareholders in a close corporation, and the inherent risks of minority ownership which exist even absent any oppression by the majority shareholders. Unlike the actions of the controlling group in *Donahue* and *Wilkes*, the controlling group in *Ryan* did not act to oppress the minority shareholder or to deprive the shareholder of benefits she had come to expect from her participation in the common enterprise. Rather, the problem of disposing of minority shares is a risk inherent in ownership of such shares and is not necessarily a disadvantage caused by the controlling group. The risk can be alleviated, short of imposing an obligation on the majority based on the fiduciary standard, by shareholder agreement or by a provision in the corporate governance provisions. Thus, the *Ryan* Court’s refusal to reallocate the risk where the parties had not draws a line between the inherent risk of minority ownership and the fiduciary duties of the majority shareholders in a close corporation.

§ 2.3. Valuation of Stock: Sarrouf v. New England Patriots Football Club, Inc.* Chapter 156B of Massachusetts General Laws enables stockholders to apply to the corporation in which they own stock for an

⁶⁹ See Hornstein, *supra* note 44, at 1041.

⁷⁰ See *id.*

⁷¹ *Id.*

⁷² For a discussion of provisions for determining selling price see *id.* at 1049–51. See also 2 E. HOOD, S. KURTZ AND J. SHORS, CLOSELY HELD CORPORATIONS IN BUSINESS AND ESTATE PLANNING § 8.1.2 (1982). According to the authors, a properly drawn plan can:

- (a) establish the value of the shares for both gift and estate tax purposes,
- (b) shift control of a deceased owner’s interest to the surviving shareholders,
- (c) provide liquidity for the deceased stockholder’s estate,
- (d) avoid loss of Subchapter S status if decedent’s stock would otherwise pass in trust,
- (e) terminate the interest of the decedent’s beneficiaries who have no prior connection with the business and eliminate potential disaffected shareholders.

Id.

For a discussion of tax considerations in drafting a stock purchase agreement, see CLOSE CORPORATIONS, *supra* note 43, § 7.23, at 80.

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appraisal of their shares if the shareholders object to certain corporate action.¹ Upon formal application of appraisal, the shareholder is entitled to trade his stock to the corporation in exchange for the offered appraisal value or appeal the valuation to the superior court for further review.² The Massachusetts state legislature enacted chapter 156B, sections 86–98 in order to provide a method by which disgruntled shareholders might recover the value of their shares and terminate their relationship with the corporation.³ Several formalities and technical rules must be executed, however, before such objecting shareholders will be entitled to the appraised value of their shares.⁴ Furthermore, the value ultimately assigned by the court is a question of fact and will not be overturned unless the trial judge's determination of the value is clearly erroneous.⁵

One standard of stock valuation in Massachusetts is the “Delaware block” approach.⁶ This method, first used in Delaware, requires the trial judge to determine the price of shares in light of the corporation's earnings, market price of stock and net asset value.⁷ Although there has been a recent trend to abandon strict application of the “Delaware block” approach in favor of a more flexible standard which balances all the relevant facts of a particular case,⁸ the block approach remains a valid

§ 2.3. ¹ G.L. c. 156B, §§ 86–98 (West 1986).

² *Id.* The technical rules and formal requirements of these provisions are set out in greater detail *infra* note 4.

³ See G.L. c. 156B, § 86.

⁴ G.L. c. 156B, §§ 86–98. First, the shareholder must file a written notice of objection with the corporation before a vote is taken on the proposed action. G.L. c. 156B, § 86. Second, the dissenting shareholder cannot vote, or allow his shares to be voted, in favor of the proposed action. G.L. c. 156B, § 87. Therefore, if a shareholder is the beneficial owner, the owner of record being an agent, trustee or broker, the shares cannot be voted in favor of the action by *anyone* entitled to do so. See *infra* notes 75–79 and accompanying text. In light of this rule, it becomes incumbent upon a notified corporation to give notice to a dissenting shareholder that the action has become effective. G.L. c. 156B, § 88. See *Sarrouf v. New England Patriots Football Club*, 397 Mass. 542, 552, 492 N.E.2d 1122, 1130 (citing *Matter of Bowman*, 98 Misc. 2d 1028, 1034, 414 N.Y.S.2d 951, 955 (N.Y. Sup. Ct. 1978)).

Third, the shareholder must demand payment for his shares within twenty days of notice that the action has become effective. G.L. c. 156B, § 89. At this point the shareholder is entitled to receive the full appraised value for his shares within thirty days of the expiration of the demand period. G.L. c. 156B, § 89. Finally, if an agreement with the corporation is not reached within the prescribed time period, both the corporation and the shareholder are entitled to bring a suit in equity to determine the value of the shares. G.L. c. 156B, § 90. Such suit will be brought in the superior court of the county in which the corporation has its principal office. *Id.*

⁵ *Sarrouf v. New England Patriots Football Club, Inc.*, 397 Mass. 542, 550, 492 N.E.2d 1122, 1128 (1986).

⁶ See *id.* at 547–48, 492 N.E.2d at 1127.

⁷ *Piemonte v. New Boston Garden Corp.*, 377 Mass. 719, 724, 387 N.E.2d 1145, 1148 (1979).

⁸ See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 712 (Del. 1983). In *Weinberger*, the

method of valuation in Massachusetts.⁹ Under this approach, it is strictly up to the trial judge to determine the relative weights to be given to each of the three factors in determining the value of the stock.¹⁰

During the *Survey* year, in *Sarrouf v. New England Patriots Football Club, Inc.*, the Supreme Judicial Court upheld the trial judge's determination of the value of dissenting shareholders' stock under the Delaware block approach.¹¹ In its opinion, the Court held that the trial court's assignment of the relevant weights to the three factors was not clearly erroneous under the circumstances.¹² Additionally, the Court upheld the award of compound interest on the judgment.¹³ Finally, the Court reversed the trial court's decision excluding beneficial owners from the suit¹⁴ but upheld the exclusion of various shareholders who had failed to comply with the provisions of chapter 156B.¹⁵ In its decision, the Court granted a great deal of discretion to the trial judge and acknowledged the unique problems that arise in evaluating the price of shares in a professional football franchise.¹⁶

The facts of the *Sarrouf* case centered around the financial dealings of William Sullivan and his attempt to acquire and retain full control of the New England Patriots organization.¹⁷ Prior to 1974, two classes of outstanding Patriots stock existed.¹⁸ In 1974, after being ousted as president

Delaware Supreme Court did not invalidate the block approach but rather indicated that valuation should not be conducted exclusively by that method. In short, the Court in that case held that a better mode of analysis would be to balance *all* of the relevant factors which impact on the price of shares. *Id.* at 713. Although the Delaware decisions are not binding in Massachusetts, the issues handled in the Delaware courts are often illustrative of common problems encountered in all jurisdictions and the decisions handed down are often very instructive for practitioners everywhere. HENN AND ALEXANDER, LAWS OF CORPORATIONS 185-86 (3d ed. West 1983).

⁹ *Sarrouf*, 397 Mass. at 547, 492 N.E.2d at 1126.

¹⁰ See *id.* at 544, 492 N.E.2d at 1125 (citing *Piemonte*, 377 Mass. at 724, 387 N.E.2d at 1148; *Martignette v. Sagamore Mfg. Co.*, 340 Mass. 136, 142-43, 163 N.E.2d 9, 13 (1959)).

¹¹ 397 Mass. 542, 554, 492 N.E.2d 1122, 1130 (1986).

¹² *Id.* at 550-51, 492 N.E.2d at 1128. The trial judge assigned the following weights to the three factors: market value-5%, earnings-5%, net asset value-90%. *Id.* at 548 n.9, 492 N.E.2d at 1127 n.9.

¹³ *Sarrouf*, 397 Mass. at 551, 492 N.E.2d at 1128-29. Interest on any award is to be paid from the date of the vote approving the corporate action. See G.L. c. 156B, § 95.

¹⁴ *Sarrouf*, 397 Mass. at 551-53, 492 N.E.2d at 1129-30.

¹⁵ *Id.* at 553-54, 492 N.E.2d at 1130. See generally G.L. c. 156B, §§ 86-98 (rules governing all aspects of the appraisal procedures).

¹⁶ *Sarrouf*, 397 Mass. at 549-50, 492 N.E.2d at 1128.

¹⁷ The facts of this case are laid out in full detail in *Coggins v. New England Patriots Football Club, Inc.*, 397 Mass. 525, 526-29, 492 N.E.2d 1112, 1114-16 (1986). These facts have been the subject of several suits in the Massachusetts courts. See, e.g., *Coggins*, 397 Mass. 525, 492 N.E.2d 1112 (1986); *Pavlidis v. New England Patriots Football Club, Inc.*, 737 F.2d 1227 (1st Cir. 1984).

¹⁸ The two classes of stock referred to here were voting, 100% of which was held by

of the organization, Sullivan purchased all of the outstanding voting stock at a price of \$102 per share.¹⁹ He then created a new organization (New Patriots) and, in an effort to totally eliminate the non-voting shares, sought to merge the two corporations.²⁰ As part of the merger agreement, Sullivan offered to exchange non-voting stock in the Old Patriots for \$15 per share.²¹ In addition Sullivan secured the transfer of his 100% holding of Old Patriots voting stock for 100% of the newly issued stock in the New Patriots.²²

Plaintiff stockholders in *Sarrouf* sought review in Norfolk Superior Court in order to appeal the \$15 per share offer by Sullivan.²³ In search of the “fair value”²⁴ of the shares, the trial judge employed the Delaware block method of valuation.²⁵ The judge found the market value of the shares and the earnings of the corporation to be of relatively little significance and therefore assigned a weight of five percent to each of these components.²⁶ The market value of the shares was deemed insignificant because of the limited amount of trading in the shares by a small number of investors.²⁷ Similarly, the earnings were of “little or no consequence” because potential purchasers of the club, according to the court, would likely be willing to pay a premium, regardless of current or projected earnings, for the right to become members in the elite group of franchise owners.²⁸ The court concluded, therefore, that the net asset value of the organization as a going concern was the most important factor to be considered in this particular valuation and thus the remaining 90% weight was assigned to that element.²⁹ Using the resulting weighted average, the

Sullivan, then the President of the Patriots organization, and nine other investors, and non-voting stock which was held by Sullivan and the plaintiffs in this and other suits against the Patriots. *Coggins*, 397 Mass. at 527–28, 492 N.E.2d at 1114–15. Both classes of stock enjoyed identical rights and privileges but for the power to vote which was held exclusively by the voting shares. *Sarrouf*, 397 Mass. at 545, 492 N.E.2d at 1125.

¹⁹ *Coggins*, 397 Mass. at 527, 492 N.E.2d at 1114.

²⁰ *Id.* at 528, 492 N.E.2d at 1115.

²¹ *Id.*

²² *Id.*

²³ *Sarrouf*, 397 Mass. at 543, 492 N.E.2d at 1124.

²⁴ *Id.* at 545, 492 N.E.2d at 1125.

²⁵ *Sarrouf*, 397 Mass. at 548 n.9, 492 N.E.2d at 1127 n.9.

²⁶ *Id.*

²⁷ *Id.* at 548, 492 N.E.2d at 1127. In cases such as *Sarrouf*, where there is not a widely held and active market, other factors such as earnings and net assets become more important to the valuation process. *Id.* at 544, 492 N.E.2d at 1125. As the Court in *Sarrouf* pointed out by quoting the trial judge, “it is for the fact-finder in the particular case to determine the weight of the relevant factors.” *Id.* (citing *Piemonte*, 377 Mass. at 724, 387 N.E.2d at 1148; *Martignette*, 340 Mass. at 142–43, 163 N.E.2d at 13).

²⁸ *Id.* at 544–46, 492 N.E.2d at 1125–26.

²⁹ *See id.* at 548 n.9, 492 N.E.2d at 1127 n.9.

trial judge found each non-voting share in the Old Patriots organization to be worth \$80.³⁰

The trial court found a conservative estimate of the Old Patriots' net asset value to be \$19 million.³¹ Dividing this figure by the total number of outstanding shares, the court reached a value of \$85.51 per share which, when assigned to 90% of the weighted average, accounted for \$76.80 of the total \$80 per share.³² This amount, \$76.80, was then combined with the court's finding of \$1.19 per share for earnings and \$.75 per share for market value for a total of \$78.74 which the court rounded off to \$80 per share.³³

The Supreme Judicial Court had faced a similar valuation problem in the 1979 case of *Piemonte v. New Boston Garden Corp.*³⁴ In *Piemonte*, the Court determined that the earnings factor was less important than the net asset value because a sports franchise is a somewhat unique corporate structure which relies more on its assets for value than its earnings.³⁵ The *Piemonte* Court also held that earnings were of little significance because the corporation was largely a family run organization.³⁶ In light of these facts, facts which parallel those in *Sarrouf* fairly closely, the *Piemonte* Court held that the earnings and net asset value of the Boston Garden Corp. should be weighted 40% and 50% respectively.³⁷ In *Sarrouf*, the trial court decided that the earnings and net asset value of the Patriots should be weighted at 5% and 90% respectively and found the per share value of the organization to be \$80.

The trial court in *Sarrouf* went on to award plaintiffs compound interest

³⁰ The actual value reached by the trial court was \$78.74 which was rounded off to \$80. This value was reached by adding the value of \$76.80 for net asset value, to \$1.19 (\$23.90 x 5%) per share for earnings and \$.75 (\$15 x 5%) per share for market value.

Earnings per share are calculated by averaging the earnings over the past several years (usually five) and multiplying that figure by a multiplier which is determined at the discretion of the court in light of industry wide risks and future prospects. See *Piemonte*, 377 Mass. at 726-29, 387 N.E.2d at 1149-51; Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1467 (1966).

³¹ *Sarrouf*, 397 Mass. at 548, 492 N.E.2d at 1127. The trial court found, in light of all the evidence, that the value of the net assets belonging to the Old Patriots was between \$19 and \$22 million. The choice of the lower figure was not held to be reversible error by the Supreme Judicial Court. *Id.*

³² *Sarrouf*, 397 Mass. at 548 n.9, 492 N.E.2d at 1127 n.9. The net asset value was divided by the total number of both the voting and non-voting stock, because all of the shares enjoyed identical rights but for the power to vote. *Sarrouf*, 397 Mass. at 545, 492 N.E.2d at 1125.

³³ *Sarrouf*, 397 Mass. at 548 n.9, 492 N.E.2d at 1127 n.9.

³⁴ 377 Mass. at 719, 387 N.E.2d at 1145.

³⁵ *Id.* at 733-34, 387 N.E.2d at 1153.

³⁶ *Id.*

³⁷ *Id.* at 733, 387 N.E.2d at 1153.

from the date of the vote approving the merger of the two corporations.³⁸ Finally, the court excluded various plaintiffs from the action.³⁹ The excluded plaintiffs had either held their shares in “street name” only, that is were beneficial owners and not owners of record, or had failed to comply with the provisions of chapter 156B.⁴⁰

The defendant corporation appealed the trial court’s valuation and award of compound interest to the Supreme Judicial Court.⁴¹ Specifically, the defendant urged that the trial judge violated chapter 156B, section 92 because the value of \$80 per share “gave effect to the results of the corporate merger to which plaintiffs objected.”⁴² Additionally, defendant objected to the \$80 per share valuation and 90% weight attributed to the net asset value of the corporation as a going concern under the Delaware block approach.⁴³ Finally, defendant sought to invalidate the award of compound, rather than simple, interest on the judgment.⁴⁴

The Supreme Judicial Court, after acknowledging the validity of the Delaware block approach,⁴⁵ examined the method by which the trial court applied the Delaware block analysis to the facts of this case.⁴⁶ The Court reasoned that it was within the court’s discretion, in light of all the circumstances, to assign a 90% weight to the net asset value while assigning very little weight to the market value and earnings components.⁴⁷

³⁸ *Sarrouf*, 397 Mass. at 546, 492 N.E.2d at 1126.

³⁹ *Sarrouf*, 397 Mass. at 551–54, 492 N.E.2d at 1129–30. The trial judge also determined that several plaintiffs were excluded from the appraisal action. *Id.* See *infra* notes 64–79 and accompanying text for the Supreme Judicial Court’s findings as to these exclusions.

⁴⁰ See *id.* at 546, 492 N.E.2d at 1126.

⁴¹ *Id.* at 546, 492 N.E.2d at 1126.

⁴² *Id.* G.L. c. 156B, § 92 provides in pertinent part:

The value of the shares shall be determined as of the day preceding the day of the vote approving the proposed corporate action and shall be exclusive of any element of value arising from the expectation or accomplishment of the proposed corporate action. (emphasis added).

⁴³ See *Sarrouf*, 397 Mass. at 546, 492 N.E.2d at 1126. Additionally, defendant argued with the trial court’s determination that the net asset value of the Patriots as a going concern was \$19 million.

⁴⁴ *Id.* Plaintiffs urged that the trial court opinion be upheld except for the exclusion of several shareholders. *Id.* at 547, 492 N.E.2d at 1126.

⁴⁵ *Id.* at 547–48, 492 N.E.2d at 1127. Although the Court in *Piemonte* did approve the Delaware block method it did not require the use of that technique in all valuation cases. *Id.* *Accord* *Leader v. Hycor, Inc.*, 395 Mass. 215, 479 N.E.2d 173 (1985). Interestingly, the *Sarrouf* Court mentioned in a footnote that Delaware has recently abandoned the exclusive use of the block approach in favor of a more flexible analysis which seeks to determine value through the use of “generally accepted techniques.” *Sarrouf*, 397 Mass. at 547 n.8, 492 N.E.2d at 1127 n.8. See *Weinberger*, 457 A.2d at 712–13. Such techniques might include a comparative analysis of premium paid over market value in ten other merger-offer combinations or a discounted cash flow analysis. *Id.* at 712.

⁴⁶ *Sarrouf*, 397 Mass. at 544–47, 492 N.E.2d at 1125–26.

⁴⁷ *Id.* at 548–51, 492 N.E.2d at 1127–28.

In making such a determination, the Court held, the trial judge has discretion in assigning the weights to the relevant factors⁴⁸ and will not be overturned unless his or her findings are clearly erroneous.⁴⁹

The Court agreed with the lower court that the most important factor, using the block approach, in the valuation of the stock of a National Football League team is the net asset value of the club as a going concern.⁵⁰ The Court thus rejected defendant's objections to both the assignment of a 90% weight and the finding of \$19 million as the net asset value.⁵¹ The Court concluded that the judge's determinations were not clearly erroneous in light of the particular circumstances of the case and therefore deferred to his discretion in finding a value of \$80 per share.⁵²

The Supreme Judicial Court next addressed the trial court's finding that market value is only an accurate indicator of price in cases where the stock is widely held and actively traded by informed investors.⁵³ The Court explained that where the shares are not widely held, as in the case of the Old Patriots, a judge would have to reconstruct a hypothetical market in order to estimate the market price for the shares.⁵⁴ The Court in *Sarrouf* noted that such a requirement is unnecessary because in constructing such a hypothetical market, the trial judge would merely be duplicating the analysis of earnings and net asset value.⁵⁵ Moreover, the Court pointed out that it had held previously in the 1959 case of *Martignette v. Sagamore Mfg. Co.*⁵⁶ that even where an actual market does exist, it is up to the discretion of the fact-finder to determine the weight and relative importance of the various factors involved in a particular case.⁵⁷ In light of the absence of an active market for Old Patriots stock, the Court thus affirmed the lower court's assignment of a small weight to the \$15 per share price.⁵⁸

⁴⁸*Id.* at 544–49, 492 N.E.2d at 1125–28.

⁴⁹ *Id.* at 550, 492 N.E.2d at 1128.

⁵⁰ *Id.* at 548, 492 N.E.2d at 1127.

⁵¹ *Id.* at 546–48, 492 N.E.2d at 1126–27.

⁵² See *Sarrouf*, 397 Mass. at 547–51, 492 N.E.2d at 1126–28. See *supra* note 30 and accompanying text for a detailed accounting of the trial court's calculations. See *infra* note 65 and accompanying text for a discussion of some of the unique circumstances affecting this case.

⁵³ See *Sarrouf*, 397 Mass. at 548–49, 492 N.E.2d at 1127 (citing *Martignette*, 340 Mass. at 141–42, 163 N.E.2d at 12–13).

⁵⁴ *Sarrouf*, 397 Mass. at 549, 492 N.E.2d at 1127.

⁵⁵ *Id.* See also *Piemonte*, 377 Mass. at 725, 387 N.E.2d at 1149.

⁵⁶ 340 Mass. at 136, 163 N.E.2d at 9.

⁵⁷ *Sarrouf*, 397 Mass. at 549, 492 N.E.2d at 1127 (citing *Martignette*, 340 Mass. at 142, 163 N.E.2d at 13).

⁵⁸ *Sarrouf*, 397 Mass. at 548–49, 492 N.E.2d at 1127–28. The \$15 per share was used as the "market price" because it represented Sullivan's own offer on the merger. See *id.* at 548 n.9, 492 N.E.2d at 1127 n.9.

Finally, in considering the earnings of the Old Patriots, the Court agreed that the sale of a football franchise is a unique transaction and one for which the earnings of the corporation do not represent the actual value of the shares.⁵⁹ Potential purchasers of the enterprise, the Court explained, would look less toward the earnings of the club than to the prestige and recognition that seem to accompany ownership automatically.⁶⁰ Thus, reasoned the Court, the amount that an individual would be willing to pay for a franchise may not reflect the earnings that the club has received, or will receive.⁶¹ The Court recognized that partial owners of a franchise, such as the plaintiffs in this case, should not be forced to suffer a deflated price for their shares merely because the earnings history of the corporation is not an accurate reflection of the value of their holdings in the corporation.⁶² The Court concluded, therefore, that the trial judge acted within his discretion in attributing a 5% weight to the earnings portion of the valuation.⁶³

The Court stated that the trial judge was justified, in reaching his own conclusion as to value, in looking beyond the limited Delaware block considerations to all the evidence before him including recent purchase prices of other NFL franchises.⁶⁴ The Court concluded that in light of the particular circumstances,⁶⁵ the trial judge's valuation was not in error.⁶⁶ Such an analysis of the totality of the circumstances the Court noted, is helpful to the judge in determining an accurate net asset value in his search for a fair value for the shares. Because valuation is a question of fact, the Court could not overturn the lower court's decision

⁵⁹ *Sarrouf*, 397 Mass. at 549, 492 N.E.2d at 1128.

⁶⁰ *Id.* The Court noted here that:

[Ownership of an NFL franchise] is not only a business venture, but, as the judge pointed out, a sportsman's endeavor. A team owner is a celebrity, a member of an exclusive club. By the use of his capital, the armchair athlete may become a participant in the public spectacle of professional sports. Most teams are owned outright by extremely wealthy individuals.

Id.

⁶¹ *Id.* at 549, 492 N.E.2d at 1128.

⁶² *Id.* at 549–50, 492 N.E.2d at 1128.

⁶³ *Id.* at 549–51, 492 N.E.2d at 1128.

⁶⁴ *Id.* at 550, 492 N.E.2d at 1128. The two deals specifically mentioned by the Court were the 1974 transactions which created the Seattle Seahawks and the Tampa Bay Buccaneers each of which sold for \$16 million.

⁶⁵ *Id.* Such particular facts impacting uniquely on the Patriots included the monopoly enjoyed by the club over all of New England; the marked increase in operating revenue and operating income between 1973 and 1975; the value of the stadium lease; valuable television contracts; concessions contracts; interest and support in the community; player contracts and the caliber of the athletes on the team which indicated a positive future for the club. *Id.* at 550, 492 N.E.2d at 1128.

⁶⁶ *Sarrouf*, 397 Mass. at 551, 492 N.E.2d at 1128.

unless it was “clearly erroneous” and not warranted by the evidence.⁶⁷ In light of this constraint, the Court found no reversible error in the superior court’s use of the Delaware block method of valuation or in the ultimate finding of \$80 per share.⁶⁸

Having approved the trial court’s use and application of the Delaware block method, the Court next turned to the question of interest and upheld the trial court’s award of compound interest.⁶⁹ As sections 92 and 95 of chapter 156B are silent as to whether the interest award should be simple or compounded, the Court again left the issue to the discretion of the trial judge and found his decision not clearly erroneous.⁷⁰ The Court reasoned that the award of interest, generally, is an equitable remedy and a judge acts within reason when he or she decides to grant compound interest if he or she finds that it is necessary to fairly compensate the plaintiff for the losses incurred.⁷¹ The Court pointed out that a judge should consider the inability of the plaintiffs to use the money during the interim period between the corporate action and the suit.⁷² Moreover, the Court indicated that a plaintiff is entitled to that return which could have been earned by a prudent investor during that same period.⁷³

Finally, in determining the validity of the trial court’s exclusion of various plaintiffs, the Court in *Sarrouf* relied on the language and intent of chapter 156B in determining the validity of the trial court’s exclusion of various plaintiffs from the appraisal proceedings.⁷⁴ The Court’s primary holding on this issue was that beneficial owners of stock may file a written objection with the corporation even though their name might not appear as the holders of record on the books of the corporation.⁷⁵

⁶⁷ *Id.* at 550–51, 492 N.E.2d at 1128 (citing *Leader v. Hycor*, 395 Mass. at 223, 479 N.E.2d at 178).

⁶⁸ *Sarrouf*, 397 Mass. at 551, 492 N.E.2d at 1128.

⁶⁹ *Id.* at 551, 492 N.E.2d at 1128–29.

⁷⁰ *Id.* at 551, 492 N.E.2d at 1129. G.L. c. 156B, § 92 states only that the court “shall order the corporation to make payment of such value, together with interest, if any, as herein provided” Similarly, § 95 provides only that “[i]nterest shall be paid upon any award from the date of the vote approving the proposed corporate action, and the court may on application of any interested party determine the amount of interest to be paid in the case of any stockholder.”

⁷¹ *Sarrouf*, 397 Mass. at 551, 492 N.E.2d at 1129. *Accord* *Shulkin v. Shulkin*, 301 Mass. 184, 195, 16 N.E.2d 644, 652 (1938).

⁷² *Sarrouf*, 397 Mass. at 551, 492 N.E.2d at 1129 (citing *Piemonte*, 377 Mass. at 735, 387 N.E.2d at 1154).

⁷³ *Id.* (citing *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 222 (Del. 1975) and *Grant, Appraisal Rights: Allowance for Prejudgment Interest*, 17 B.C. INDUS. & COM. L. REV. 1 (1975)).

⁷⁴ *Sarrouf*, 397 Mass. at 551–52, 492 N.E.2d at 1129. See *supra* notes 3–4 and accompanying text for an explanation of the rules governing appraisal rights.

⁷⁵ *Id.* at 552, 492 N.E.2d at 1129–30. Thus the Supreme Judicial Court reversed the trial

The Court pointed out that the only purpose of the written objection was to put the corporation on notice of possible dissenters to the corporate action.⁷⁶ The intent behind the statute is to provide shareholders with “an equitable, simple and expeditious remedy” and therefore “should not be construed strictly against them.”⁷⁷ Moreover, the Court pointed out that once the corporation is on notice of the dissension, although it can still seek further proof of beneficial ownership, it cannot ignore the existence of the shareholders’ rights.⁷⁸ The Court thus reversed the trial court’s exclusion of those plaintiffs who were holding the shares in “street name” only.⁷⁹

In analyzing the Supreme Judicial Court’s decision in *Sarrouf*, the primary issue is whether or not the trial judge actually exercised his

court’s denial of an action by an owner holding in “street name” stating that the trial court was being “unduly strict” on the beneficial owner. *Id.* at 552, 492 N.E.2d at 1129.

⁷⁶ *Id.* This notice does not necessarily represent a firm indication as to who the actual dissenters will be at the vote because all shareholders remain free to change their mind at any time preceding the formal vote. *Sarrouf*, 397 Mass. at 552, 492 N.E.2d at 1129 (citing *Raab v. Villager Indus. Inc.*, 355 A.2d 888, 891, 893 (Del.), *cert. denied sub nom.*, *Mitchell v. Villager Indus. Inc.*, 429 U.S. 853 (1976)).

⁷⁷ *Sarrouf*, 397 Mass. at 552, 492 N.E.2d at 1129.

⁷⁸ *Id.* (citing *Matter of Bowman*, 98 Misc. 2d at 1034, 414 N.Y.S.2d at 955).

⁷⁹ *Sarrouf*, 397 Mass. at 552, 492 N.E.2d at 1130. Other exclusions were analyzed by the Court strictly by the letter of chapter 156B. *Id.* at 553–54, 492 N.E.2d at 1130. Several shareholders were denied appraisal because their written objections were received after the vote. *Id.* at 553, 492 N.E.2d at 1130. In another case, the shareholder had already accepted the offer of \$15 per share by Sullivan. *Id.* Once the offer was accepted, the objecting shareholder was precluded by statute from entering the action. *See G.L. c. 156B, § 91.* In these cases the exclusions by the lower court were affirmed. *Sarrouf*, 397 Mass. at 553, 492 N.E.2d at 1130.

Additionally, the Court reversed the exclusion of a plaintiff who was denied relief because he had failed to file a written demand of appraisal within the twenty day notification of effectiveness period. *Sarrouf*, 397 Mass. at 553, 492 N.E.2d at 1130. G.L. c. 156B, § 89. G.L. c. 156B, § 88 requires the corporation, upon notice of dissension, to notify the stockholders that the corporate action to which they object has become effective. In *Sarrouf*, the shareholder was never notified that the merger had been approved by the board and therefore the twenty day limitation period of demand for appraisal never began to run against him. The Court therefore held that the shareholder’s failure to respond within the twenty day period was no ground to deny him relief in this case. *Sarrouf*, 397 Mass. at 553, 492 N.E.2d at 1130. Similarly, the Court reversed the exclusion of plaintiffs who had indicated their dissension through handwritten notes on the proxy cards sent by the defendant. *Id.* Finding that the shareholders had indeed voiced their objection to the proposed corporate action, the Court reasoned, as it had done in analyzing the beneficial owner problem, *see supra* notes 75–79 and accompanying text, that the purpose, if not the letter, of the statute was fulfilled by the shareholders and therefore they should not be denied relief. *Id.* The Court was unable to determine the reason for the exclusion of one individual plaintiff and therefore remanded his case for a determination not inconsistent with the other holdings and principles laid out in the opinion. *Id.* at 554, 492 N.E.2d at 1130–31.

discretion in a reasonable fashion. The lower court couched its decision in the Delaware block approach and used the totality of the record before it in making its decision.⁸⁰ The single most glaring problem in this analysis, which was apparently accepted without question by the Supreme Judicial Court, was the assignment of a 5% weight to the earnings component.⁸¹

The finding by the trial court that the nature of a professional football club attracts a unique type of owner⁸² more interested in prestige than earnings is not, on its face, unreasonable. Nonetheless, the realm of reason seems to have been stretched to its outermost limits in holding that a potential purchaser would only attribute 5% of his concern to the earnings of the franchise he or she was about to buy.⁸³ Stock valuation is up to the discretion of the trial judge in light of the record before him and the Court will defer to that judgment unless it is clearly erroneous. Any discretionary determination, especially under the unique circumstances of *Sarrouf*, is likely to result in a wide array of varying conclusions. Nonetheless, there must be some point at which the Supreme Judicial Court recognizes the inconsistency and unpredictability that accompanies this broad deference and steps in to hold the trial court to a higher standard. Thus, even conceding that purchasers of a football franchise would be somewhat less interested in earnings than a purchaser of a normal business, the fact remains that a football franchise is a business and those seeking to buy a club are not, perhaps, as unconcerned in this element as the Court would have us believe.

Normally, an appellate court will defer to the judgment and discretion of the trial court because the trial judge is in a better position to weigh all the evidence.⁸⁴ In the case of stock valuation, however, this reasoning does not necessarily hold true. Indeed, as the evidence in these cases will largely consist of financial statements and economic predictions, there is no reason to believe that the appellate court cannot reassess the

⁸⁰ *Sarrouf*, 397 Mass. at 548–52, 492 N.E.2d at 1127–28.

⁸¹ *Id.* at 548 n.9, 492 N.E.2d at 1127 n.9. The assignment of a 5% weight to the market value element in *Sarrouf*, is less notable in light of the inactive trading in Old Patriots stock and the relatively small number of stockholders. Compare *Sarrouf* with *Piemonte*, 377 Mass. at 725–26, 733, 387 N.E.2d at 1143, 1152 (market value weight set at 10% in light of limited trading on a largely closed market).

⁸² *Sarrouf*, 397 Mass. at 545, 549, 492 N.E.2d at 1125, 1128.

⁸³ See Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1470 (1966). In this article, the author points out that “typical” weights might be as follows: market value–35%, earnings–35%, net asset value–30%. These weights will necessarily have to be varied in order to fit the particular circumstances of an individual case. Naturally the importance of one element will be directly affected by an increase or decrease in the relative importance of one of the other elements. *Id.* at 1471.

⁸⁴ See *infra* note 90 and accompanying text.

figures if they appear to be unreasonable. Certainly it is not appropriate for the appellate court to reanalyze every stock valuation conducted by the lower court. This article only suggests that where the value reached by the court seems to be facially unreasonable, the appellate court should not refrain from a closer analysis.

Perhaps a better test than the “clearly erroneous” standard in these cases would be for the appellate court to defer to the trial court’s discretion unless the variation in weights assigned to the Delaware block factors exceeds a certain margin. Thus if any one factor was weighted 50% more than either of the other two, the court would recalculate the valuation on its own to make sure the trial judge’s finding was indeed reasonable in light of all the circumstances. In *Sarrouf*, therefore, the assignment of a 90% weight to net asset value would have activated a higher standard of review.

The problem in stock valuation cases is that there are so many different variables and circumstances affecting the price of shares that without some kind of meaningful review on appeal the trial court is virtually free to find any value it desires. Because there are so many factors involved, it will be extremely unlikely that an appellate court will find a trial court’s determination to be unreasonable under the clearly erroneous standard. For this reason it is necessary for the Court to step in in certain situations to add some element of consistency and predictability to the proceedings.

Despite the similarity between the fact patterns of *Piemonte* and *Sarrouf*, the Court found no reversible error in weighting the earnings of the Old Patriots at only 5% in *Sarrouf*. Even if one accepts, as a consequence of judicial discretion, the possibility of differing results in similar fact patterns,⁸⁵ the Court in *Sarrouf* should have questioned the 5% weight more closely especially in light of the fact that in *Piemonte*, the outcome of which the Court admits controls its decision in *Sarrouf*,⁸⁶ the earnings were weighted at 40%.⁸⁷

The cornerstone of the Supreme Judicial Court’s decision in *Sarrouf* is that the trial judge’s determination of the value of the Old Patriots shares was valid as long as the method used was reasonable and the result not clearly erroneous.⁸⁸ The primary goal of stock valuation is to provide a method by which disgruntled stockholders might recover the value of their shares and terminate their relationship with the corporation. The key to determining “fair value,” as well as reaching an overall

⁸⁵ Indeed, the Court in *Piemonte* held that “we would have found no fault with a determination to give even greater weight to the price per share based on the net asset value of Garden Arena” 377 Mass. at 734, 387 N.E.2d at 1153.

⁸⁶ *Sarrouf*, 397 Mass. at 547–48, 492 N.E.2d at 1126–27.

⁸⁷ *Piemonte*, 377 Mass. at 733, 387 N.E.2d at 1153.

⁸⁸ *Sarrouf*, 397 Mass. at 550–51, 492 N.E.2d at 1128.

equitable solution in light of the particular circumstances of the case, appears to depend on a careful and thoughtful analysis of the evidentiary record.⁸⁹ *Sarrouf* shows that the Court will not overturn a trial court's finding of fact provided that such findings are reasonably supported by the record and the rational inferences that can be drawn from it.⁹⁰ Thus the trial judge's powers of analysis and decision are further enhanced by his or her exclusive ability to review the entire record and balance all of the relevant factors in reaching what he or she perceives to be an equitable remedy.⁹¹

The conclusion reached in *Sarrouf* has both a negative and a positive effect on Massachusetts law. The negative impact is that with so much deference afforded to the trial court, the possibility of unpredictable, inconsistent, and even somewhat arbitrary decisions is great and practitioners may find themselves in the untenable position of not knowing what to expect for their client. Conversely, on the positive side, there is a great opportunity for creative lawyers to interpret the facts in a light most favorable to their client and persuade the court to support their position.

The issue of stock valuation is a common one and one which is likely to continue to appear in the Massachusetts courts. As an equitable remedy by which disgruntled shareholders seek compensation, appraisal rights represent an important asset to the financial investing community. As in all equity cases, however, the Supreme Judicial Court will be faced with questions of fact that have already been carefully scrutinized and analyzed at the lower court level. Although reason and discretion are malleable concepts which expand and contract with every piece of new evidence which is proffered, the Court should be mindful of the freedom and power of the trial courts and strive to protect and preserve the reason and rationality behind these decisions. As long as the trial courts continue to be upheld unless clearly erroneous, however, the future of stock valuation in Massachusetts will continue to be the result of specific fact pattern analysis and creative argument by the corporate bar.

⁸⁹ See generally *Sarrouf*, in which the Court permitted the trial judge to examine the entire record in determining the appropriate allocation of weights and values under the Delaware block approach. *Sarrouf*, 397 Mass. at 550, 492 N.E.2d at 1128.

⁹⁰ See *Sarrouf*, 550-51, 492 N.E.2d at 1128. See also *Building Inspector of Lancaster v. Sandersen*, 372 Mass. 157, 161, 360 N.E.2d 1051, 1054 (1977) (reasoning that the trial judge is "in a superior position to appraise and weigh the evidence" than is the appellate court).

⁹¹ See *Sarrouf*, 397 Mass. at 549, 492 N.E.2d at 1127. This trend toward broadening the reach and power of the trial court is not unique to Massachusetts. Indeed, even in Delaware, where the block approach originated, the courts have abandoned their exclusive reliance on the block method in favor of the more flexible "all relevant factors" test which emphasizes fairness in both dealing and price. See *Weinberger*, 457 A.2d at 713 (courts should consider "all relevant factors" in evaluating stock prices). See also *Universal City Studios*, 334 A.2d 216 (use of 16.1 as a multiplier held valid in light of all relevant circumstances).