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## Contractual Disclaimer of the Donahue Fiduciary Duty: The Efficacy of the Anti-Donahue Clause

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## NOTES

### CONTRACTUAL DISCLAIMER OF THE *DONAHUE* FIDUCIARY DUTY: THE EFFICACY OF THE ANTI-*DONAHUE* CLAUSE

One responsibility of the lawyer advising a client in structuring and incorporating a closely held business is to structure a corporate framework which will either preclude potential problems in the operation and management of the corporation, or which will enable the legitimate resolution of such problems in favor of the client. The decision of the Supreme Judicial Court of Massachusetts in the 1975 case of *Donahue v. Rodd Electrotype Company*<sup>1</sup> presented the Massachusetts corporate bar with a new element in the planning of close corporations. In *Donahue*, the Supreme Judicial Court imposed upon shareholders in Massachusetts close corporations<sup>2</sup> a strict duty of utmost good faith and loyalty toward all other shareholders of their corporation.<sup>3</sup> The decision reversed the court's prior rule of law, that the mere ownership of stock, independent of other considerations, imposed no fiduciary duty on shareholders.<sup>4</sup> The strict fiduciary standard of utmost good faith and loyalty imposed by *Donahue* on shareholders of closely held corporations was identical to that to which the court had previously held partners in their dealings with one another.<sup>5</sup> As such, the new *Donahue* duty was considerably

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<sup>1</sup> 367 Mass. 578, 328 N.E.2d 505 (1975).

<sup>2</sup> After noting that there is no single generally accepted definition of a close corporation, the *Donahue* court considered various scholarly and judicial descriptions, accepting aspects of delineation promulgated by several such sources. 367 Mass. at 585, 328 N.E.2d at 511 (citing *Galler v. Galler*, 32 Ill. 2d 16, 27, 203 N.E.2d 577, 583 (1965) (in close corporations "the stock is held in few hands, or in few families, and . . . not at all, or only rarely, dealt in by buying or selling"); *Kruger v. Gerth*, 16 N.Y.2d 802, 806, 210 N.E.2d 355, 357 263 N.Y.S.2d 1, 4 (1965) (Fuld, J., dissenting) ("management and ownership are substantially identical" in close corporations); Note, *Statutory Assistance for Closely Held Corporations*, 71 HARV. L. REV. 1498, 1498 (1958) (emphasizing integration of ownership and management)). The *Donahue* court defined a close corporation as having: "(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.

<sup>3</sup> *Id.* at 593, 328 N.E.2d at 515.

<sup>4</sup> See, e.g., *Cardullo v. Landau*, 329 Mass. 5, 9, 105 N.E.2d 843, 846 (1952) (stockholder relationship not one of trust and confidence even where relationship began as partnership); *Eno Sys., Inc. v. Eno*, 311 Mass. 334, 341, 41 N.E.2d 17, 20 (1942) (defendant's ownership of stock in the plaintiff imposed no duty on defendant to warn plaintiff of intent to terminate license); *Mairs v. Madden*, 307 Mass. 378, 380, 30 N.E.2d 242, 244 (1940) ("mere ownership of stock does not create a fiduciary relation between the stockholders"); *Bell v. Fred T. Ley & Co., Inc.*, 278 Mass. 60, 75, 179 N.E. 294, 299 (1932) (stockholders occupy no fiduciary relation to fellow stockholders).

<sup>5</sup> See 367 Mass. at 593-95, 328 N.E.2d at 515-16; *DeCotis v. D'Antona*, 350 Mass. 165, 168, 214 N.E.2d 21, 23 (1966); *Cardullo v. Landau*, 329 Mass. 5, 8, 105 N.E.2d 843, 845 (1952). See *infra* notes 20-25 and accompanying text.

more stringent than that of good faith and inherent fairness, which is applied in all jurisdictions to officers and directors,<sup>6</sup> and which in most jurisdictions is also applied to majority shareholders in a position of control.<sup>7</sup>

The language used by the *Donahue* court was broad and sweeping, and did not clearly delineate the boundaries for application of this partnership-like duty.<sup>8</sup> The following year, the Supreme Judicial Court more fully defined the nature and object of the *Donahue* duty in *Wilkes v. Springside Nursing Home, Inc.*<sup>9</sup> In *Wilkes* the court, acknowledging the right of majority shareholders to control a close corporation, established an analytical procedure for claims arising under *Donahue* in which a legitimate business purpose defense is balanced against the minority's rights under *Donahue*.<sup>10</sup>

*Donahue* and its progeny have been extensively and substantively cited in both state and federal courts,<sup>11</sup> and have attracted considerable legal discussion.<sup>12</sup> The court's declaration of the *Donahue* strict fiduciary duty and its subsequent clarification of that duty in *Wilkes* particularly drew the attention of the Massachusetts corporate bar. This new duty appeared to be one which could seriously impinge on the freedom of persons involved in a close corporation to define, through the vehicle of their corporate framework, the precise nature of their rights and duties *inter se*.<sup>13</sup> These considerations

<sup>6</sup> See, e.g., *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 109, 460 P.2d 464, 472, 81 Cal. Rptr. 592, 600 (1969); *Condec Corp v. Lunkenheimer Co.*, 43 Del. Ch. 353, 363, 230 A.2d 769, 775 (1967); *Winger v. Chicago City Bank & Trust Co.*, 394 Ill. 94, 108, 67 N.E.2d 265, 275 (1946), *rev'g* 325 Ill. App. 459, 60 N.E.2d 560 (1945); *Risvold v. Gustafson*, 209 Minn. 357, 359, 296 N.W. 411, 412 (1941); *Diamond v. Oreamuno*, 24 N.Y.2d 494, 496-97, 248 N.E.2d 910, 911-12, 301 N.Y.S.2d 78, 79-81 (1969); *Gilmore v. W.J. Gilmore Drug Co.*, 279 Pa. 193, 195, 123 A. 730, 730 (1924); *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 576 (Tex. 1963); *Grognet v. Fox Valley Trucking Serv.*, 45 Wis. 2d 235, 241, 172 N.W.2d 812, 816 (1969).

<sup>7</sup> *Donahue*, 367 Mass. at 594 & n.20, 328 N.E.2d at 516 & n.20; see also *Pepper v. Litton*, 308 U.S. 295, 306 (1939); see generally Note, *The Fiduciary Duty of Controlling Shareholders*, 7 CASE W. RES. L. REV. 467, 467 (1956).

<sup>8</sup> See *Donahue*, 367 Mass. at 593 & n.18, 328 N.E.2d at 515 & n.18. The breadth of the *Donahue* decision was forcefully criticized by Justice Wilkins in his concurrence to the decision. Justice Wilkins expressed his concern that this breadth of language implied too complete an analogy to partnership principles and thus imperiled all operations of the corporation as they pertained to minority stockholders. See *id.* at 604, 328 N.E.2d at 521 (Wilkins, J., concurring). See also *infra* notes 121, 225-36 and accompanying text.

<sup>9</sup> 370 Mass. 842, 353 N.E.2d 657 (1976). See *infra* notes 122-67 and accompanying text.

<sup>10</sup> *Wilkes*, 370 Mass. at 851, 353 N.E.2d at 663. See *infra* notes 154-64 and accompanying text.

<sup>11</sup> See O'Neal, *Close Corporations: Existing Legislation and Recommended Reform*, 33 BUS. LAW. 873, 886 (1978) [hereinafter cited as O'Neal, *Recommended Reform*].

<sup>12</sup> See, e.g., Note, *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 (1975) [hereinafter cited as Harvard Note]; Note, *Shareholders in a Close Corporation Owe to One Another Substantially the Same Fiduciary Duty Owed by Partners to One Another: Donahue v. Rodd Electrotype Co.*, 21 VILL. L. REV. 307 (1975-1976) [hereinafter cited as Villanova Note]; Elephante, *The Impact of Donahue v. Rodd Electrotype Co. on the Law of Corporate Freezeouts*, 1975 ANN. SURV. MASS. L. § 17.2 [hereinafter cited as Annual Survey of Massachusetts Law Note].

<sup>13</sup> Their right so to do is premised in their constitutional rights to freedom of contract, see U.S. CONST. art.I, § 10, cl.1, and in the fact that corporate structure and the common law rules of partnership have traditionally been bottomed on contract. The limitations on that right stem from the societal concerns voiced by the *Donahue* court, that "captive" minority shareholders in a close corporation (by definition, the stockholder in a close corporation has no ready market for his shares, *Donahue*, 367 Mass. at 586, 328 N.E.2d at 511; and in any event, assuming that an oppressed

prompted a concert of evasive action by corporations and incorporators who wished, insofar as the law would allow it, to draft their own definition of any and all legal duties which they owed to one another.<sup>14</sup> A substantial portion of the corporate bar therefore sought to circumvent the new duty, and their effort spawned a new variety of corporate legal devices designed for that purpose which the corporate bar has called "Anti-*Donahue* Clauses" (ADCs).<sup>15</sup>

As drafted by members of the Massachusetts corporate bar, ADCs may appear in a corporation's articles of organization, in its bylaws, in shareholder agreements, in employment contracts, or in share transfer restrictions. The ADCs currently employed by Massachusetts law firms for their corporate clients vary substantially in the extent of their intended effect. There are two general categories of ADCs: those which are narrowly tailored to permit specific corporate practices,<sup>16</sup> and those which cover a broader spectrum of the *Donahue* duty.<sup>17</sup> The latter variant may be drafted so broadly as to constitute a waiver by minority shareholders of substantially all rights to which they are entitled under the *Donahue* decision.<sup>18</sup> To date, the efficacy of any variant of these ADCs has yet to be tested by the Massachusetts judiciary. The purpose of this note is to examine the nature of the *Donahue* fiduciary duty, and on that basis to propose a method of dispositive analysis applicable to both broad and narrow disclaimers of the *Donahue* duty.

Part I of this note will examine the evolutionary development and application of fiduciary duty in *Donahue* and its progenitors and progeny, and will demonstrate that *Donahue* represents a protection of the reasonable expectations of investors in close financial relationships. Part II will discuss the response of the Massachusetts corporate bar to *Donahue*, including the development of the anti-*Donahue* clause. Part III of this note will briefly discuss the equitable doctrine of reasonable expectations in the law of the United States and the Commonwealth countries, and will describe the evolution in

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stockholder gives full disclosure of the difficulty which is causing him to sell, it certainly is unlikely that he will realize the full value of his shares in that sale) should not be treated abusively or unjustly due to the "avarice, expediency or self-interest" of the controlling shareholder(s). *Id.* at 591-94, 328 N.E.2d at 514-15.

<sup>14</sup> This assertion is based upon an informal survey, conducted by the author, of large Massachusetts law firms which include a substantial amount of corporate work in their practice. The author conducted the survey on the basis of entirely unscientific principles, by contacting a number of larger law firms with a corporate "department" and seeking out persons in that department who were familiar with the *Donahue* case and its immediate and current ramifications. The persons whom I contacted initially often suggested that I contact another member of their firm as being more knowledgeable on the subject than they were. Additionally, there were a select number of attorneys to whom I was referred by several sources. As a result, I spoke at some length with a number of attorneys who were extremely competent and experienced in the area of structuring close corporations and their concurrent fiduciary duties. I am confident that the results of this survey, although unscientific, are both an accurate representation of the current opinions and concerns among the Massachusetts corporate bar as they regard close corporate fiduciary concerns and an accurate portrayal of the evolution of those opinions and concerns.

The majority of those with whom I spoke requested that I preserve their anonymity. Consequently I have omitted all references to the names either of firms or of attorneys.

<sup>15</sup> The term "anti-*Donahue* clause" does not commonly appear in current writings on fiduciary duty in close corporations. The term, as it is used in this note, is a result of the informal survey described *supra* note 14.

<sup>16</sup> See *infra* notes 240-41 and accompanying text.

<sup>17</sup> See *infra* notes 242-43 and accompanying text.

<sup>18</sup> *Id.*

the Commonwealth countries' law of a similar analogy of partnership to close corporations with a concurrently stricter fiduciary duty. It will suggest that the history and purpose of the *Donahue* fiduciary duty and its sister duty in the law of the Commonwealth countries indicate that the courts should utilize a two-tiered test to judge the efficacy of an ADC as a contractual defense against a showing that a corporate shareholder has breached some aspect of his *Donahue* fiduciary duty. The first tier of the proposed test will be essentially contractual in nature. It should determine the adequacy of the shareholder's consent to the ADC by an examination of the sufficiency of understanding by the shareholder of the meaning and effect of the ADC at the time that the shareholder became a party to it. The second tier of the proposed test should examine the effect of the ADC upon the shareholder's legitimate although unwritten expectations of trust and loyalty, as they are embodied in the *Donahue* fiduciary duty. Further, it should examine the contract itself for unconscionability. It is the thesis of this note that carefully drawn ADCs, which satisfy the contractual tier and frankly alter a shareholder's expectations, should be given effect by the courts. The blanket ADC, however, by its very nature, will be held to be an inequitable obstacle to the unsophisticated shareholders' ability to formulate accurate expectations. As a result specific terms of the blanket ADC may be overlooked by the court in its consideration of any claimed fiduciary breach. Thus, while the *Donahue* fiduciary duty should prove difficult to contractually abolish except in relation to the most sophisticated shareholders, it should be possible to avoid the *Donahue* duty for a specific and legitimate purpose, at least to the extent that it has been interpreted to grant such rights as a rule of equal opportunity in stock repurchase, or an implicit guarantee of employment.

## I. THE EVOLUTION OF THE *DONAHUE* DUTY

### A. History

The *Donahue* fiduciary duty of utmost good faith and loyalty is derived from partnership law and is diametrically opposed to historical notions of corporate shareholder relations. In any situation where one exercises influence over the possessions or property interests of another, a fiduciary relationship may be said to arise.<sup>19</sup> The stringent fiducial standard for the relationship among partners has remained a universal constant in American law.<sup>20</sup> Numerous jurisdictions define the standard as one of "undivided loyalty."<sup>21</sup> The Massachusetts standard has long been held out as that of "utmost good faith and loyalty."<sup>22</sup> In the 1913 case of *Holmes v. Darling*,<sup>23</sup> the Supreme Judicial Court explained this standard with the observation that "the law imposes upon each partner the duty of exercising toward his copartner the utmost integrity and good faith in all partnership affairs. In transactions concerning the firm he must consider their mutual welfare, rather than his own private benefit."<sup>24</sup>

<sup>19</sup> 3 H. OLECK, MODERN CORPORATION LAW § 1569 at 624 (1959).

<sup>20</sup> See S. ROWLEY, ROWLEY ON PARTNERSHIP § 21.1(2) (2d ed. 1960). Rowley points out that while the joint adventurer's fiduciary duty is necessarily limited by the scope of the venture, there is no similar limitation on the partnership duty. *Id.*

<sup>21</sup> *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

<sup>22</sup> *DeCotis v. D'Antonia*, 350 Mass. 165, 168, 214 N.E.2d 21, 23 (1966); *Cardullo v. Landau*, 329 Mass. 5, 8, 105 N.E.2d 843, 845 (1952).

<sup>23</sup> 213 Mass. 303, 100 N.E. 611 (1913).

<sup>24</sup> *Id.* at 305, 100 N.E. at 612.

Corporate shareholders, on the other hand, traditionally had no fiduciary duty among one another by virtue of the mere ownership of stock,<sup>25</sup> because they shared no commonality of interest in the corporate property.<sup>26</sup> That property was deemed to be vested in the corporation, not in the individuals who held the stock of the corporation.<sup>27</sup> Thus, a shareholder's only control over the corporation lay in his power to elect corporate officials,<sup>28</sup> and the sole fiduciary duty ran from these elected officials to the corporation.<sup>29</sup> This latter duty continues to the present day, both in the United States and in the Commonwealth countries: although not strictly regarded as trustees, a corporation's elected officials are equitably held to bear a fiduciary duty of good faith and inherent fairness to their corporation and its owners.<sup>30</sup> Because of shareholders' purportedly limited ability to exercise control, and because of the limited and beneficial nature of their interest in the corporate property, the shareholders were generally held free of any fiduciary duty *inter se*.<sup>31</sup> For fourteen decades prior to *Donahue* it was generally held by the Massachusetts judiciary that in this respect shareholders in a "corporation, in their legal relations to each other, differ essentially and radically from partners,"<sup>32</sup> and that "[t]he differences between partnerships and corporations are so strong, that it cannot be inferred that the equity powers of the Court in respect to the former were intended to apply to the latter."<sup>33</sup>

The view that corporate shareholders, unlike partners, owe no inherent fiduciary duty *inter se* is illustrated by the reasoning adopted by the Massachusetts Supreme Judicial Court in the 1905 case of *Von Arnin v. American Tubeworks*.<sup>34</sup> In that case the plaintiff

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<sup>25</sup> See, e.g., *Cardullo*, 329 Mass. at 9, 105 N.E.2d at 846 (stockholder relationship not one of trust and confidence even where relationship began as partnership); *Eno Sys., Inc. v. Eno*, 311 Mass. 334, 341, 41 N.E.2d 17, 20 (1942) (defendant's ownership of stock in the plaintiff imposed no duty on defendant to warn plaintiff of intent to terminate license); *Mairs v. Madden*, 307 Mass. 378, 380, 30 N.E.2d 242, 244 (1940) ("mere ownership of stock does not create a fiduciary relation between the stockholders"); *Bell v. Fred T. Ley & Co., Inc.*, 278 Mass. 60, 75, 179 N.E. 294, 299 (1932) (stockholders occupy no fiduciary relation to fellow stockholders).

<sup>26</sup> See *Pratt v. Bacon*, 27 Mass. (10 Pick.) 123 (1830). In *Pratt*, the plaintiff filed a plea to the court's jurisdiction in equity under St. 1823, c. 140, § 2 which granted equitable jurisdiction, *inter alia*, over partnerships. The court held that the bill could not be sustained because of the magnitude of the difference between the characteristics of corporations and partnerships. The court stated:

A corporation is an ideal body . . . which is deemed . . . to have an existence independently of that of all the members of which it is composed . . . Its real and personal property is deemed to be vested in the corporation and not in the individuals composing it; and these have no other interest in it, or control over it, than the qualified ones, of electing officers, and receiving dividends and profits . . .

27 Mass. (10 Pick.) at 125-26. See also *Flint v. Codman*, 247 Mass. 463, 472, 142 N.E. 256, 259 (1924) ("The corporation is a legal entity separate and distinct from its stockholders. Commonly the stockholders of a corporation occupy no fiduciary relation to their fellow stockholders or to the corporation.").

<sup>27</sup> *Pratt*, 27 Mass. (10 Pick.) at 126.

<sup>28</sup> *Id.*

<sup>29</sup> See, e.g., *Flint*, 247 Mass. at 472, 142 N.E. at 259 (the relation of a director to a corporation is fiduciary).

<sup>30</sup> See generally 3 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 838 & n.1 (1975 & Supp. 1984).

<sup>31</sup> *Pratt*, 27 Mass. (10 Pick.) at 126.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 125.

<sup>34</sup> 188 Mass. 515, 74 N.E. 680 (1905).

shareholder alleged misappropriation of corporate funds by shareholders who held corporate office.<sup>35</sup> In upholding an order overruling a demurrer to the plaintiff shareholder's bill,<sup>36</sup> the court relied on the general fiduciary duty owed a corporation by its officers<sup>37</sup> and made no mention of a fiduciary standard applicable to the defendants by virtue of their stock ownership.<sup>38</sup> The Massachusetts judiciary explicitly reaffirmed this traditional view in 1944 by stating, in *Leventhal v. Atlantic Finance Corp.*,<sup>39</sup> that the differences between relationships of corporate shareholders *inter se* and those of partners *inter se* was so broad that even in a two man corporation, neither shareholder owed the other a fiduciary duty.<sup>40</sup>

In spite of these holdings, however, the Massachusetts Supreme Judicial Court had already begun to make exceptions, based on equitable considerations, to its rigid rule that no fiduciary duty existed among corporate shareholders by virtue of their stock ownership. In the 1940 case of *Silversmith v. Sydeman*,<sup>41</sup> for example, the Massachusetts Supreme Judicial Court was faced with an accounting suit involving a two man corporation.<sup>42</sup> In contrast to its subsequent rationale in *Leventhal*,<sup>43</sup> the court responded to the demand of equitable considerations founded in the reasonable expectations of the complaining shareholder,<sup>44</sup> and held the defendant to a higher duty than that of good faith and inherent fairness.<sup>45</sup> The court based its holding on the notion that "the plaintiff and the defendant were acting as partners in the conduct of the . . . [corporation]."<sup>46</sup>

Six years after *Silversmith*, in the cases of *Sher v. Sandler*<sup>47</sup> and *Mendelsohn v. Leather Manufacturing Co.*,<sup>48</sup> the Massachusetts judiciary again imposed a fiduciary duty among shareholders in the close corporate context where once there had been none. In both cases the court imposed among shareholders in a close corporation a duty of full disclosure<sup>49</sup> similar to that imposed upon a fiduciary in dealing with a beneficiary.<sup>50</sup> In

<sup>35</sup> *Id.* at 518-20, 74 N.E. at 680-81.

<sup>36</sup> *Id.* at 521, 74 N.E. at 682.

<sup>37</sup> *Id.* at 519, 74 N.E. at 681.

<sup>38</sup> See *id.* at 519, 74 N.E. at 681. Because of the dual status of the defendants as both officers and shareholders, the *Von Armin* facts would have been an appropriate situation for application of a partnership standard, had the court been so inclined. *Id.*

<sup>39</sup> 316 Mass. 194, 55 N.E.2d 20 (1944).

<sup>40</sup> *Id.* at 198-99, 55 N.E.2d at 23-24.

<sup>41</sup> 305 Mass. 65, 25 N.E.2d 215 (1940).

<sup>42</sup> *Id.* at 66, 25 N.E.2d at 216.

<sup>43</sup> See *supra* notes 39-40 and accompanying text.

<sup>44</sup> See *Donahue*, 367 Mass. at 595, 328 N.E.2d at 516.

<sup>45</sup> *Silversmith*, 305 Mass. at 68, 25 N.E.2d at 218.

<sup>46</sup> *Id.* at 68, 25 N.E.2d at 217.

<sup>47</sup> 325 Mass. 348, 90 N.E.2d 536 (1950). In *Sher*, the two shareholders had agreed to an equal division of stock, profits, control and information. *Id.* at 350, 90 N.E.2d at 537-38. The court stated that under the agreement each party owed the other a duty, similar to that owed by a fiduciary, of "fullest disclosure." *Id.* at 353, 90 N.E.2d at 539. Therefore, general fiduciary principles were held to govern the case. *Id.*

<sup>48</sup> 326 Mass. 226, 93 N.E.2d 537 (1950). In *Mendelsohn*, the plaintiff filed a bill in equity against two defendants with whom he had formed a corporation, alleging failure to disclose material facts surrounding his divestiture of stock in the enterprise. *Id.* at 228, 232, 93 N.E.2d at 539, 541. Finding that the three had initially embarked upon a joint venture, the court held that their subsequent incorporation did not alter the partnership-like fiduciary duty of joint venturers, of "utmost good faith and loyalty." *Id.* at 233, 93 N.E.2d at 541.

<sup>49</sup> *Mendelsohn*, 326 Mass. at 232-33, 93 N.E.2d at 541; *Sher*, 325 Mass. at 354, 90 N.E.2d at 539.

<sup>50</sup> 325 Mass. at 353, 90 N.E.2d at 539.

each case the court imposed upon a shareholder a duty that was more exacting than that owed by a director to his corporation,<sup>51</sup> or by a majority shareholder to a minority shareholder.<sup>52</sup> Moreover, in each case the court described its imposition of a stringent fiduciary duty among the parties as an exercise of its equity powers based upon the facts peculiar to the close corporation under consideration.<sup>53</sup>

The Massachusetts Supreme Judicial Court also discerned a fiduciary duty among shareholders in the 1959 case of *Samia v. Central Oil Co. of Worcester*.<sup>54</sup> In *Samia*, three sisters who held minority interests in a close corporation controlled by their brothers<sup>55</sup> charged that their brothers had systematically excluded them from management of the corporation,<sup>56</sup> in part by refusing to issue a stock subscription inherited by the sisters.<sup>57</sup> Relying on the familial relationship as well as the nature of the close corporation, the *Samia* court found a strict fiduciary relationship among the shareholders of the oil company, and on that basis denied the defendants' arguments that the plaintiff's suit should be barred by laches or the statute of limitations.<sup>58</sup> Acting as a court of equity, the Massachusetts Supreme Judicial Court ordered an even redistribution of the corporate shares among the parties.<sup>59</sup>

The last exception made on a case-by-case basis to the Massachusetts rule that shareholders bore no fiduciary relationship among themselves by virtue of the mere ownership of stock occurred in the 1962 case of *Wilson v. Jennings*.<sup>60</sup> In *Wilson*, three men joined together to form a corporation, envisioning, as the trial court found, an equal division of the ownership of shares among the three of them.<sup>61</sup> Through a series of complex and apparently clandestine transactions one of the three men, Jennings, managed to cause the corporation to issue a substantial amount of additional stock to himself.<sup>62</sup> In affirming the lower court's holding, Justice Cutter stated that it could be found that the three shareholders were undertaking "a joint venture in corporate form . . ."<sup>63</sup> Because this was determined to be the shareholders' understanding, the court

<sup>51</sup> See *Donahue*, 367 Mass. at 597, 328 N.E.2d at 517. Compare *Mendelsohn*, 326 Mass. at 233, 93 N.E.2d at 541 (imposing on shareholders a duty of utmost good faith and loyalty); *Sher*, 325 Mass. at 353, 90 N.E.2d at 539 (relying on shareholder agreement rather than relations between corporate officials to find affirmative fiduciary duty to disclose), with *Spiegel v. Beacon Participations, Inc.*, 297 Mass. 398, 410-11, 8 N.E.2d 895, 904-05 (1937) (stating general standard of duty for directors of a corporation to be an avoidance of bad faith actions or gross negligence in the commission of good faith actions). See also *supra* note 6 and accompanying text, noting the standard for directors to be one of good faith and inherent fairness.

<sup>52</sup> See *Donahue*, 367 Mass. at 597, 328 N.E.2d at 517. Compare *Mendelsohn*, 326 Mass. at 233, 93 N.E.2d at 541 (imposing on shareholders a duty of utmost good faith and loyalty); *Sher*, 325 Mass. at 353, 90 N.E.2d at 539 (imposing affirmative fiduciary duty to disclose), with sources cited *supra* note 7 (imposing a duty of good faith and inherent fairness on majority shareholders).

<sup>53</sup> See *Donahue*, 367 Mass. at 597, 328 N.E.2d at 517; *Mendelsohn*, 326 Mass. at 233, 93 N.E.2d at 541; *Sher*, 325 Mass. at 353, 90 N.E.2d at 539.

<sup>54</sup> 339 Mass. 101, 158 N.E.2d 469 (1959).

<sup>55</sup> *Id.* at 106, 158 N.E.2d at 472.

<sup>56</sup> *Id.* at 106-07, 158 N.E.2d at 473-74.

<sup>57</sup> *Id.* at 107, 158 N.E.2d at 473.

<sup>58</sup> *Id.* at 112-13, 158 N.E.2d at 476-77. The court found these considerations to be strengthened by the surety-bond relationships among the brothers and sisters in the estates of the deceased. *Id.*

<sup>59</sup> *Id.* at 116-17, 158 N.E.2d at 478-79.

<sup>60</sup> 344 Mass. 608, 184 N.E.2d 642 (1962).

<sup>61</sup> *Id.* at 615, 184 N.E.2d at 646.

<sup>62</sup> *Id.* at 611-14, 184 N.E.2d at 643-45.

<sup>63</sup> *Id.* at 615, 184 N.E.2d at 646.



found it appropriate to apply the standard of fiduciary trust and confidence<sup>64</sup> applicable under the law of partnerships and joint ventures.<sup>65</sup> These case-by-case exceptions to the pre-*Donahue* rule concerning relationships among shareholders in a close corporation illuminate the *Donahue* court's statement that its holding was a "natural outgrowth of prior case law."<sup>66</sup>

For over thirty years prior to its decision in *Donahue*, the Massachusetts Supreme Judicial Court had consistently sanctioned the imposition of this higher level of duty on shareholders in close corporations,<sup>67</sup> as an exercise of judicial equity powers.<sup>68</sup> As an exercise in equity, however, the decisions of the Supreme Judicial Court in *Silversmith*,<sup>69</sup> *Sher*,<sup>70</sup> *Mendelsohn*,<sup>71</sup> *Samia*,<sup>72</sup> and *Wilson*<sup>73</sup> were based on and limited to the particular facts before the court in each case. The decision in *Donahue*, on the other hand, represents the solidification of these equitable decisions into a general principle.<sup>74</sup>

### B. *Donahue v. Rodd Electrotpe Company*

In 1975 the Supreme Judicial Court of Massachusetts, in *Donahue v. Rodd Electrotpe Company*,<sup>75</sup> declared a general rule that shareholders in a close corporation owed one another the same strict standard of "utmost good faith and loyalty"<sup>76</sup> to which the court had previously held partners in their dealings with one another.<sup>77</sup> This new standard was imposed where none had previously existed under Massachusetts law.<sup>78</sup> Importantly, the standard was even more stringent than that in those jurisdictions which, unlike Massachusetts, had held the mere ownership of stock to impose a duty of good faith and inherent fairness running from the majority to the minority.<sup>79</sup>

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* For a discussion of the applicable duty, see *supra* notes 4-7, 20-22 and accompanying text, and see *infra* note 120 and accompanying text.

<sup>66</sup> *Donahue*, 367 Mass. at 595, 328 N.E.2d at 516.

<sup>67</sup> See *supra* notes 41-65 and accompanying text.

<sup>68</sup> It is of import in postulating the efficacy of an ADC to note that a court acting in equity is far more likely to impose or retain a fiduciary duty where none had existed, than to erode that same duty. See, e.g., *Holmes v. Darling*, 213 Mass. 303, 305, 100 N.E. 611, 612 (1913); *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928). In discussing the rule binding partner-like fiduciaries, Chief Justice Cardozo noted that "[u]ncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions." *Meinhard*, 249 N.Y. at 464, 164 N.E. at 546 (quoting *Wendt v. Fischer*, 243 N.Y. 439, 444, 154 N.E. 303, 304 (1926)). It is evident that the partnership fiduciary duty serves to protect the expectation of partners that when they enter into the intimate partnership control relationship, they will be in a relationship of trust and loyalty. The duty imposed by *Donahue* reflects a recognition of the same expectations in the close corporate setting, and it is appropriate that it be guarded by the courts as jealously as is the partnership duty.

<sup>69</sup> 305 Mass. 65, 25 N.E.2d 215 (1940). See *supra* notes 41-46 and accompanying text.

<sup>70</sup> 325 Mass. 348, 90 N.E.2d 536 (1950). See *supra* notes 47-53 and accompanying text.

<sup>71</sup> 326 Mass. 226, 93 N.E.2d 537 (1950). See *supra* notes 48-53 and accompanying text.

<sup>72</sup> 339 Mass. 101, 158 N.E.2d 469 (1959). See *supra* notes 54-59 and accompanying text.

<sup>73</sup> 344 Mass. 608, 184 N.E.2d 642 (1962). See *supra* notes 60-65 and accompanying text.

<sup>74</sup> See *infra* notes 106-21 and accompanying text.

<sup>75</sup> 367 Mass. 578, 328 N.E.2d 505 (1975).

<sup>76</sup> *Id.* at 593, 328 N.E.2d at 515.

<sup>77</sup> See *DeCotis*, 350 Mass. at 168, 214 N.E.2d at 23; *Cardullo*, 329 Mass. at 8, 105 N.E.2d at 845.

<sup>78</sup> See 367 Mass. at 593-95, 328 N.E.2d at 515-16; see *supra* note 4 and accompanying text.

<sup>79</sup> See *supra* note 7 and accompanying text.

Harry Rodd and Joseph Donahue were hired in 1935 and 1936, respectively, by Royal Electrotype of New England ("Royal of New England"), a wholly owned subsidiary of Royal Electrotype Company ("Royal").<sup>80</sup> Prior to 1955, Harry Rodd was made general manager and treasurer of Royal of New England, and purchased two hundred shares of Royal of New England common stock from Royal.<sup>81</sup> During this same period Joseph Donahue, at Harry Rodd's suggestion, purchased an additional fifty shares of the same stock for himself.<sup>82</sup> In June of 1955, Royal of New England purchased the remaining 750 of the 1,000 shares of its own stock then outstanding.<sup>83</sup> A substantial portion of the cash used in this transaction was loaned to Royal of New England by Harry Rodd.<sup>84</sup> The purchase of these outstanding shares left Harry Rodd the 80% sole majority shareholder of Royal of New England, and Joseph Donahue the 20% sole minority shareholder.

In June of 1960, Royal of New England was renamed Rodd Electrotype Company of New England, Inc. ("Rodd Electrotype").<sup>85</sup> Harry Rodd's controlling influence resulted in the appointment of his sons Frederick and Charles to positions of control within Rodd Electrotype, and in 1965, Charles succeeded Harry as president and general manager of Rodd Electrotype.<sup>86</sup> From 1959 to 1967, Harry Rodd gave 117 shares equally to his three children, resulting in ownership by each child of thirty-nine shares.<sup>87</sup> He returned two shares to the Rodd Electrotype treasury, and retained the remaining eighty-one shares for himself.<sup>88</sup> In 1968, Joseph Donahue and his wife Euphemia gave five shares to their son, Dr. Robert Donahue, such that on Joseph Donahue's death, Euphemia became the sole owner of the remaining forty-five share block of stock.<sup>89</sup>

Against this background, between May of 1970 and March of 1971, Harry Rodd's sons negotiated with him an amicable retirement arrangement whereby Rodd Electrotype purchased from Harry forty-five shares for \$800 per share (\$36,000), each of his three children purchased two shares from him for \$800 per share, and Harry donated to each child ten shares.<sup>90</sup> The result was the complete divestiture of Harry's holdings, and ownership by each child of a block of fifty-one shares.<sup>91</sup> The Donahue family still held fifty shares.<sup>92</sup>

The Donahues first learned of Rodd Electrotype's purchase of Harry Rodd's shares at a special shareholders meeting convened on March 31, 1971.<sup>93</sup> At this meeting, the Donahues voted their disapproval of the purchase of Harry Rodd's shares for \$800 per

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<sup>80</sup> 367 Mass. at 580-81, 328 N.E.2d at 509.

<sup>81</sup> *Id.* at 581, 328 N.E.2d at 509.

<sup>82</sup> *Id.* Donahue was hired as a finisher of electrotype plates and received promotions, in 1946, to plant superintendent, and in 1955, to corporate vice president, but he never participated in the management side of the business. *Id.*

<sup>83</sup> *Id.* Royal of New England purchased 725 shares from Royal Electrotype Company and 25 from Lawrence W. Kelly. *Id.*

<sup>84</sup> *Id.* at 581-82, 328 N.E.2d at 509.

<sup>85</sup> *Id.* at 582, 328 N.E.2d at 509.

<sup>86</sup> *Id.* at 582, 328 N.E.2d at 509-10.

<sup>87</sup> *Id.* at 582, 328 N.E.2d at 510.

<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at 584 n.8, 328 N.E.2d at 510 n.8.

<sup>90</sup> *Id.* at 583, 328 N.E.2d at 510.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.* at 584, 328 N.E.2d at 510.

share.<sup>94</sup> Between 1965 and 1969, Rodd Electrotpe had offered to purchase the Donahues' shares for between \$40 and \$200 per share.<sup>95</sup> During the weeks following the March 31 meeting, the Donahues formally requested that the corporation purchase their shares for \$800 per share;<sup>96</sup> Rodd Electrotpe refused to do so.<sup>97</sup>

Euphemia Donahue brought an action in Middlesex Superior Court, seeking to have the Rodd Electrotpe purchase of Harry Rodd's shares rescinded.<sup>98</sup> The trial court dismissed the case on the merits.<sup>99</sup> Although it was not explicitly stated in the opinion of the trial court, it was clear from the principles expounded and the authorities cited that the trial judge had found the purchase to be made in good faith and inherent fairness, and without prejudice either to the corporation or to the plaintiff.<sup>100</sup> In a rescript opinion, the Massachusetts Appeals Court affirmed the holding of the lower court.<sup>101</sup>

The Supreme Judicial Court of Massachusetts, however, reversed the lower court's decision,<sup>102</sup> holding that "shareholders in a close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another, namely, a duty of the utmost good faith and loyalty."<sup>103</sup> The court then found that the majority shareholders' group had breached this fiduciary duty by causing Rodd Electrotpe to purchase a majority shareholder's shares without offering to purchase a ratable number of shares for the same price from the minority shareholders.<sup>104</sup> By so holding, the Supreme Judicial Court created an equal opportunity standard for the repurchase of shares applicable to all Massachusetts close corporations.<sup>105</sup>

The *Donahue* court began its analysis with the identification of three essential factors which, taken together, it deemed to typify a close corporation: "1) a small number of shareholders; 2) no ready market for the corporate stock; and 3) substantial majority shareholder participation in the management, direction and operations of the corporation."<sup>106</sup> Corporations which fit these criteria, the court stated, bear a "striking resemblance" to partnerships,<sup>107</sup> and require among the shareholders a similar relationship of "trust, confidence and absolute loyalty if the enterprise is to succeed."<sup>108</sup>

The court pointed to the vulnerability of minority shareholders in close corporations to "freeze-outs," "squeeze-outs" and related forms of majority oppression, such as: refusal to declare dividends; siphoning off of corporate assets via unreasonably high salaries or rents paid to majority shareholders; deprivation of office or employment for minority

<sup>94</sup> *Id.*

<sup>95</sup> *Id.* at 584 n.10, 328 N.E.2d at 511 n.10.

<sup>96</sup> *Id.* at 584, 328 N.E.2d at 511.

<sup>97</sup> *Id.*

<sup>98</sup> *Donahue v. Rodd Electrotpe Co.*, 1 Mass. App. Ct. 876, 307 N.E.2d 8 (1974).

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 876-77, 307 N.E.2d at 9 (noting the trial court's citation to *Winchell v. Plywood*, 324 Mass. 171, 174-75, 85 N.E.2d 313, 315 (1949), for the "good faith and without prejudice" standard); see also 367 Mass. at 580 & n.5, 328 N.E.2d at 508 & n.5 (same).

<sup>101</sup> 1 Mass. App. Ct. at 876-77, 307 N.E.2d at 9.

<sup>102</sup> 367 Mass. 578, 328 N.E.2d 505 (1975).

<sup>103</sup> *Id.* at 593, 328 N.E.2d at 515.

<sup>104</sup> *Id.* at 603, 328 N.E.2d at 520.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.* at 586, 328 N.E.2d at 511.

<sup>107</sup> *Id.* at 586, 328 N.E.2d at 512.

<sup>108</sup> *Id.* at 587, 328 N.E.2d at 512.

shareholders, and so on.<sup>109</sup> The court recognized that at the time that the injury occurs, there usually are virtually no means by which the minority shareholder may positively resolve this vulnerability.<sup>110</sup> Generally, the minority shareholder cannot sell his shares.<sup>111</sup> Neither can he generally afford to wait for a share market which by the court's own definition does not currently exist,<sup>112</sup> nor for an alleviation of the majority oppression, because he has invested the majority of his assets in the corporation and relies thereon for his livelihood income.<sup>113</sup> According to the court, the vulnerability of the minority shareholder in a close corporation is typically exacerbated by the general absence of alternative recourses.<sup>114</sup> The court cited the difficulty of effective suit given the standard of public corporation officer/director fiduciary duties.<sup>115</sup> The court further noted that partners are able to dissolve their partnerships.<sup>116</sup> The corporate shareholder, on the other hand, lacking an enabling clause in the articles of organization, is denied the ability to call for corporate dissolution unless he owns at least 50% of the stock.<sup>117</sup> Thus, according to the court, the minority close corporation shareholder may be trapped in a situation "[n]o outsider would knowingly assume."<sup>118</sup> The court stated that the minority shareholder, unable to sell, may have to accede to the majority's demands, which often take the form of relinquishment of the stock at an inadequate price, completing an effective "freeze-out."<sup>119</sup>

The court noted the eloquent description by Justice Cardozo, then Chief Justice of the New York Supreme Court, of the rigorous duty owed by partners and joint venturers *inter se*:

Joint venturers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties . . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.<sup>120</sup>

On the basis of the similarity of the attributes of, and the needs and expectations of the participants in, the partnership and the close corporation, and the comparatively greater vulnerability to oppression of the minority shareholder in the close corporation, the court held that all shareholders in close corporations owe one another a strict and reciprocating fiduciary duty of "the utmost good faith and loyalty."<sup>121</sup>

<sup>109</sup> *Id.* at 588-89, 328 N.E.2d at 513. For a good early discussion of the treatment in the United States and Britain of oppression in close corporations, see O'Neal, *Oppugnancy and Oppression in Close Corporations: Remedies in America and in Britain*, 1 B.C. IND. & COMM. L. REV. 1 (1959).

<sup>110</sup> *Id.* at 589-91, 328 N.E.2d at 513-14.

<sup>111</sup> *Id.* at 592, 328 N.E.2d at 515.

<sup>112</sup> *Id.* at 586, 328 N.E.2d at 511.

<sup>113</sup> *Id.* at 591, 328 N.E.2d at 514.

<sup>114</sup> *Id.*

<sup>115</sup> *Id.* at 589-90, 328 N.E.2d at 513-14.

<sup>116</sup> See MASS. GEN. LAWS ANN. ch. 108A, §§ 31(1)(b), 31(2) (West 1970).

<sup>117</sup> 367 Mass. at 591-92, 328 N.E.2d at 514-15. See MASS. GEN. LAWS ANN. ch. 156B, § 100(a)(2) (West 1970).

<sup>118</sup> 367 Mass. at 592, 328 N.E.2d at 515.

<sup>119</sup> *Id.* at 592-93, 328 N.E.2d at 515.

<sup>120</sup> *Id.* at 594, 328 N.E.2d at 516 (quoting *Meinhard v. Salmon*, 249 N.Y. 458, 463-64, 164 N.E. 545, 546 (1928) (Cardozo, C.J.)).

<sup>121</sup> *Id.* at 593, 328 N.E.2d at 515 (citing partnership fiduciary language from *Cardullo v. Landau*,

### C. *The Progeny of Donahue*

#### 1. *Wilkes v. Springside Nursing Home, Inc.*

In the 1976 case of *Wilkes v. Springside Nursing Home, Inc.*,<sup>122</sup> the Massachusetts Supreme Judicial Court held that in terminating the employment of the plaintiff, Wilkes, a minority shareholder, without a legitimate business purpose, the majority shareholders had breached their duty of utmost good faith and loyalty.<sup>123</sup> Wilkes, who had "a reputation locally for profitable dealings in real estate,"<sup>124</sup> entered into an agreement with defendant T. Edward Quinn, defendant Leon L. Riche, and Dr. Hubert A. Pipkin to purchase a building as a real estate investment.<sup>125</sup> Wilkes, Quinn, Riche and Pipkin incorporated the property under the name, "Springside Nursing Home, Inc.," to be operated as a nursing home in which the four were equal shareholders.<sup>126</sup> Prior to their incorporation, the four men entered into an agreement<sup>127</sup> that each of them would: 1) be a director of Springside Nursing Home, Inc.; 2) participate actively in corporate decisionmaking and management; and 3) receive equal shares of money in return for carrying out these responsibilities, as long as corporate resources permitted payment.<sup>128</sup> Each of the four men assumed duties approximating one fourth of the total required to operate the home, and each held various positions of corporate office.<sup>129</sup> Pipkin's interest was transferred to defendant Lawrence T. Connor in 1959,<sup>130</sup> and was held by his estate at the time of trial.<sup>131</sup>

The relationship between Wilkes and Quinn began to deteriorate in 1965 when Wilkes convinced Riche and Connor to raise the price of a portion of the Springside Nursing Home, Inc. which Quinn was negotiating to purchase for his independent corporation.<sup>132</sup> By January of 1967 Wilkes had fallen out with all three of the other men,

329 Mass. 5, 8, 105 N.E.2d 843, 845 (1952)). The breadth of the *Donahue* decision was forcefully criticized by Justice Wilkins in his concurrence to the decision. Justice Wilkins expressed his concern that this breadth of language implied too complete an analogy to partnership principles and thus imperiled all operations of the corporation as they pertained to minority stockholders. See *Donahue*, 367 Mass. at 604, 328 N.E.2d at 521 (Wilkins, J., concurring). In his concurrence, Justice Wilkins stated:

I agree with much of what the Chief Justice says in support of granting relief to the plaintiff. However, I do not join in any implication (see, e.g., footnote 18 and the associated text) that the rule concerning a close corporation's purchase of a controlling stockholder's shares applies to all operations of the corporation as they affect minority stockholders. That broader issue, which is apt to arise in connection with salaries and dividend policy, is not involved in this case. The analogy to partnerships may not be a complete one.

*Id.* See also *infra* notes 225-36 and accompanying text.

<sup>122</sup> 370 Mass. 842, 353 N.E.2d 657 (1976).

<sup>123</sup> *Id.* at 852-53, 353 N.E.2d at 663-64.

<sup>124</sup> *Id.* at 844, 353 N.E.2d at 659.

<sup>125</sup> *Id.* at 843-44, 353 N.E.2d at 659.

<sup>126</sup> *Id.* at 843-45, 353 N.E.2d at 659-60.

<sup>127</sup> *Id.* at 845, 353 N.E.2d 660.

<sup>128</sup> *Id.*

<sup>129</sup> *Id.* at 845-46, 353 N.E.2d at 660.

<sup>130</sup> *Id.* at 843 n.4, 353 N.E.2d at 659 n.4.

<sup>131</sup> *Id.* at 843, 353 N.E.2d at 658-59.

<sup>132</sup> *Id.* at 846, 353 N.E.2d at 660.

and gave notice of his intention to sell his shares.<sup>133</sup> The next month the directors sat to determine formally for the first time<sup>134</sup> what the salaries of the officers and employees of the corporation would be: Quinn was to receive a substantial raise; Riche and Connor were to maintain their then current income;<sup>135</sup> and Wilkes' name was omitted from the list entirely.<sup>136</sup> In March the annual shareholders' meeting was held in Wilkes' absence.<sup>137</sup> The meeting was attended by Wilkes' attorney, however, who held Wilkes' proxy vote.<sup>138</sup> Pursuant to a shareholder vote, Wilkes was informed that "neither his services nor his presence at the nursing home was wanted by his associates."<sup>139</sup> Furthermore, Wilkes was denied reelection as either a director or an officer of the corporation.<sup>140</sup>

Wilkes filed suit in the Berkshire County Probate Court on August 5, 1971, seeking, *inter alia*, declaratory judgments of the rights of the parties<sup>141</sup> under an alleged pre-incorporation partnership agreement entered into by Quinn, Riche, Pipkin and Wilkes,<sup>142</sup> and portions of a stock transfer restriction agreement between the same four men.<sup>143</sup> Under a claim that these rights had been breached by the 1967 termination, against his will, of his salary and positions of office, Wilkes filed a bill in equity, seeking declaratory relief and restitutionary damages in an amount equal to that which he would have received had his salary not been terminated.<sup>144</sup> The suit was referred by a probate judge to a master whose report was issued in 1973.<sup>145</sup> In 1974 the Berkshire County Probate Court confirmed the master's report over Wilkes' objections and dismissed Wilkes' action on the merits.<sup>146</sup> The Supreme Judicial Court of Massachusetts granted direct appellate review in 1974.<sup>147</sup>

On appeal Wilkes pressed his argument that the alleged partnership agreement had been breached,<sup>148</sup> and argued in the alternative that the defendants had breached the fiduciary duty owed to him as the minority shareholder.<sup>149</sup> The court held that Wilkes' severance was not the result of a legitimate termination for misconduct or neglect of duties which the directors were empowered to effect.<sup>150</sup> Rather, the court characterized Wilkes' treatment as a "freeze-out" of a minority shareholder in a close corporation by

<sup>133</sup> *Id.* at 846-47, 353 N.E.2d at 660-61.

<sup>134</sup> This was the first exercise by the directors of their power under the corporate bylaws to set salaries of officers and employees. *Id.* at 847 n.10, 353 N.E.2d at 661 n.10. Previously, all such decisions were made by unanimous and informal approval. *Id.*

<sup>135</sup> *Id.* at 846-47, 353 N.E.2d at 660-61. From 1955 until the meeting in February of 1967, each of the directors of Springside Nursing Home, Inc. had received \$100 per week. *Id.*

<sup>136</sup> *Id.* at 847, 353 N.E.2d at 661.

<sup>137</sup> *Id.* at 847 & n.11, 353 N.E.2d at 661 & n.11.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.* at 847, 353 N.E.2d at 661.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.* at 843, 353 N.E.2d at 658.

<sup>142</sup> *Id.* at 843 n.2, 353 N.E.2d at 658 n.2.

<sup>143</sup> *Id.*

<sup>144</sup> *Id.* at 843, 353 N.E.2d at 659. Wilkes also sought other forms of relief. *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.* at 843-44, 353 N.E.2d at 659. From the court's language in the decisions, it would appear the Supreme Judicial Court was the first tribunal to consider Wilkes' argument of fiduciary breach.

<sup>150</sup> *Id.* at 847, 849, 852, 353 N.E.2d at 661-64.

the majority.<sup>151</sup> The court held that in terminating Wilkes, the majority shareholders had "breached their [Donahue] fiduciary duty to Wilkes as a minority shareholder . . . ."<sup>152</sup> It was on this basis that the court awarded to Wilkes a monetary recovery from each of his three fellow shareholders in the amount by which they had been "inequitably enriched."<sup>153</sup>

In deciding *Wilkes*, however, the court, for the first time, established an analytical procedure for suits brought by minority shareholders in a close corporation alleging a breach of the *Donahue* fiduciary duty by the majority shareholders.<sup>154</sup> In essence, the court adopted a legitimate business purpose defense, to be used by majority shareholders against *Donahue*-based claims.<sup>155</sup> According to the court, when suit is brought against a close corporation's control group, the group may demonstrate as an affirmative defense that the action complained of was taken for a legitimate business purpose.<sup>156</sup> If the purpose asserted is determined by the trier of fact to be legitimate, it is then open to the complaining shareholder to rebut the defense by a showing that the same objective could have been achieved via an alternative course of action less harmful to the plaintiff.<sup>157</sup> If the plaintiff successfully demonstrates a "preferable" alternative, the court must balance the "legitimate business purpose"<sup>158</sup> against the practicability of the "less harmful alternative."<sup>159</sup> In *Wilkes*, this balancing was made unnecessary by the defendants' failure to demonstrate a legitimate business purpose.<sup>160</sup>

The *Wilkes* court established its legitimate business purpose test in acknowledgement that the *Donahue* fiduciary duty to minority shareholders<sup>161</sup> must be balanced against the majority's need to have "room to maneuver" in directing the course of the corporation's business,<sup>162</sup> and also in recognition of the majority's right to "selfish ownership."<sup>163</sup> The

<sup>151</sup> *Id.* See *supra* text accompanying notes 109-19 for a general discussion of freeze-outs; see generally F.H. O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS § 3.06, at 78-80 (1975); *id.* § 3.06, at 27 (Supp. 1984).

<sup>152</sup> 370 Mass. at 854, 353 N.E.2d at 664.

<sup>153</sup> *Id.* at 854, 353 N.E.2d at 665.

<sup>154</sup> *Id.* at 851, 353 N.E.2d at 663.

<sup>155</sup> *Id.* at 851-52, 353 N.E.2d at 663. The court's citations indicate that it adopted the legitimate business purpose test not from Massachusetts precedent but from decisions in the federal courts and in the state courts of other jurisdictions, and from legal commentators. *Id.* at 851, 353 N.E.2d at 663 (citing *Bryan v. Brock & Blevins Co.*, 343 F. Supp. 1062, 1068 (N.D. Ga. 1972), *aff'd*, 490 F.2d 563, 570-71 (5th Cir. 1974); *Schwartz v. Marien*, 37 N.Y.2d 487, 492, 335 N.E.2d 334, 338, 373 N.Y.S.2d 122, 127 (1975); *Hancock, Minority Interests in Small Business Entities*, 17 CLEV.-MAR. L. REV. 130, 132 (1968); *Vorenberg, Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1192-93, 1195-96, 1204 (1964); Comment, *Recent Developments in the Law of Corporate Freeze-Outs*, 14 B.C. IND. & COMM. L. REV. 1252, 1256 (1973); Comment, *Minority Rights and the Corporate "Squeeze" and "Freeze"*, 1959 DUKE L.J. 436, 448, 458; Note, *Freezing Out Minority Shareholders*, 74 HARV. L. REV. 1630, 1638 (1961); Note, *Close Corporations — Bad Faith of Majority*, 35 N.C.L. REV. 271, 273-75 (1957); Symposium — *The Close Corporation*, 52 NW. U.L. REV. 345, 389 (1957); Comment, *Corporate Freeze-Outs Effected by Merger: A Search for a Rule*, 37 U. PITT. L. REV. 115, 118 (1975); Comment, *Minority Shareholders' Power to Compel Declaration of Dividends in Close Corporations — A New Approach*, 10 RUTGERS L. REV. 723, 725, 735 (1956)).

<sup>156</sup> *Wilkes*, 370 Mass. at 851, 353 N.E.2d at 663.

<sup>157</sup> *Id.* at 851-52, 353 N.E.2d at 663.

<sup>158</sup> *Id.* at 852, 353 N.E.2d at 663.

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* at 852, 353 N.E.2d at 663-64.

<sup>161</sup> *Id.* at 851, 353 N.E.2d at 663.

<sup>162</sup> *Id.* at 851, 353 N.E.2d at 663.

<sup>163</sup> *Id.* at 850-51, 353 N.E.2d at 662-63.

court stated that in establishing analytical guidelines for *Donahue*-based claims it sought to avoid the "untempered application of the strict good faith standard enunciated in *Donahue* . . . ."<sup>164</sup>

The *Wilkes* case provided for the *Donahue* fiduciary duty those boundaries which had previously been missing. Yet the decision also demonstrated the breadth of the domain to which it applied, for *Wilkes* made clear that the intent of the *Donahue* court had been more extensive than merely to establish an equal opportunity rule for the repurchase of stock by a close corporation. *Wilkes* demonstrated an intent by the court, within boundaries which protected the essential discretion of the control group, to equitably protect the reasonable purposes of the close corporate shareholder from frustration.<sup>165</sup> Thus, while *Wilkes* supplied some of the narrowing boundaries called for by Justice Wilkins in his concurrence in *Donahue*,<sup>166</sup> the decision also expanded the equitable protection afforded by the *Donahue* fiduciary duty beyond the domain of stock repurchases, so that it also protected a shareholder's reasonable expectation of continued salaried employment as a return on his investment.<sup>167</sup>

## 2. Post-*Wilkes* Progeny of *Donahue*

In *Donahue* and *Wilkes*, the Massachusetts Supreme Judicial Court, on the basis of equitable considerations,<sup>168</sup> set out and refined a heightened standard of fiduciary duty among close corporate shareholders *inter se*.<sup>169</sup> An important element of this refinement was the *Wilkes* rule, permitting the assertion of a legitimate business purpose defense, in order that protection of close corporate shareholders would not overshadow the practical requirements of a close corporation for legitimate control and maneuverability by the majority.<sup>170</sup> The court's reasoning in each of these cases was equitable in nature, as was the injunctive remedy provided in *Donahue*<sup>171</sup> and the restitutionary relief ordered in *Wilkes*.<sup>172</sup>

After *Wilkes*, the case in which the Supreme Judicial Court next relied on the *Donahue* fiduciary standard was *Jessie v. Boynton*,<sup>173</sup> which was decided in 1977. In *Jessie*, the plaintiffs alleged that the directors and officers of the corporation had induced them, through fraudulent statements and omissions, to vote for their own disenfranchisement.<sup>174</sup> The court, citing the higher *Donahue* standard of fiduciary duty applicable to close corporations, reversed the lower court's rejection of the plaintiffs' proposed amended complaint.<sup>175</sup> The court held that the defendants' failure to disclose the creation

<sup>164</sup> *Id.* at 850, 353 N.E.2d at 662.

<sup>165</sup> *Id.* at 850, 353 N.E.2d at 662-63.

<sup>166</sup> 367 Mass. at 604, 328 N.E.2d at 521 (Wilkins, J., concurring). For the text of Justice Wilkins' concurrence, see *supra* note 121.

<sup>167</sup> 370 Mass. at 845, 850, 353 N.E.2d at 659-60, 662.

<sup>168</sup> See *supra* notes 106-21 and accompanying text.

<sup>169</sup> See *supra* notes 75-77, 102-21, 152-67 and accompanying text.

<sup>170</sup> See *supra* notes 154-64 and accompanying text.

<sup>171</sup> *Donahue*, 367 Mass. at 603-04, 328 N.E.2d at 521.

<sup>172</sup> *Wilkes*, 370 Mass. at 854, 353 N.E.2d at 664-65.

<sup>173</sup> 372 Mass. 293, 361 N.E.2d 1267 (1977).

<sup>174</sup> *Id.* at 294-303, 361 N.E.2d at 1268-73.

<sup>175</sup> *Id.* at 293-94, 304-05, 361 N.E.2d at 1268, 1273. The trial court held that the original complaint failed to allege with sufficient particularity circumstances constituting fraud. *Id.* at 293-



of a new class of nonvoting stock<sup>176</sup> in proposed bylaws, at a meeting called to ratify those bylaws, constituted a breach of the *Donahue* fiduciary duty, regardless of the existence of actual fraud or even bad faith.<sup>177</sup> The importance placed by the *Jessie v. Boynton* court on the adequacy of disclosure is emphasized by their holding that the plaintiffs had alleged a breach of the *Donahue* fiduciary duty despite the fact that all procedures followed by the defendants, in proposing the bylaw changes, had been proper.<sup>178</sup> The holding is equitable in nature, in that it invalidates an act, which is in every sense legally proper, on the basis of its unjust result.

One year later, in *Pupecki v. James Madison Corp.*,<sup>179</sup> the Massachusetts Supreme Judicial Court again exercised its equity powers to impose a fiduciary duty among shareholders in close corporations, which duty narrowed the legal rights of a majority shareholder to cause the sale of corporate assets.<sup>180</sup> In *Pupecki*, the plaintiff brought a derivative suit, claiming that the 90% shareholder, Fisher, had caused substantially all of the assets of James Madison Corporation (JMC) to be sold for less than fair value.<sup>181</sup> Although the suit was brought on behalf of the corporation, rather than *Pupecki* suing Fisher personally, the court relied on *Donahue* and *Wilkes* to define the fiduciary duty of Fisher towards JMC, of assuring the adequacy of the sale price of the assets.<sup>182</sup> This requirement was imposed despite Fisher's statutory<sup>183</sup> right as majority shareholder to cause the sale of the assets of JMC,<sup>184</sup> and enabled *Pupecki* to pursue relief beyond his statutory<sup>185</sup> appraisal rights.<sup>186</sup>

In 1978 the Massachusetts Appeals Court decided *Hallahan v. Haltom Corp.*,<sup>187</sup> citing *Donahue* fiduciary principles as the basis for their decision to override a contractually valid agreement where majority shareholders had utilized it to oppress minority share-

94, 361 N.E.2d at 1268. The judge permitted the plaintiffs twenty days within which to amend the complaint, which they seasonably did. *Id.* The amended complaint was rejected by another superior court judge who then dismissed the case. *Id.* The appeals court characterized the defendant's argument as premised on a judge's ability to deny a motion to amend, where the proposed amended complaint failed to state a claim. *Id.* at 294, 361 N.E.2d at 1269. On that basis, the Massachusetts Supreme Judicial Court analyzed the case in terms of the complaint as it was proposed to be amended. *Id.*

<sup>176</sup> The plaintiffs fell within the class of members who by the creation of this stock would lose their votes and thus by voting for the proposed bylaws, voted to disenfranchise themselves. *Id.* at 297, 361 N.E.2d at 1270.

<sup>177</sup> *Id.* at 303-04, 361 N.E.2d at 1273.

<sup>178</sup> *Id.*

<sup>179</sup> 376 Mass. 212, 382 N.E.2d 1030 (1978).

<sup>180</sup> *Id.* The court imposed the duty under the authority of *Donahue* and *Wilkes*, which are as discussed *supra* notes 106-21 and accompanying text, decisions based on equitable considerations, and which offered equitable relief. See *supra* notes 171-72 and accompanying text.

<sup>181</sup> 376 Mass. at 213-14, 382 N.E.2d at 1031-32. Fisher apparently lost his enthusiasm for the sale after its fruition, and joined with *Pupecki* in seeking its rescission to the extent of subrogating his legal expenses. *Id.* at 219-20, 382 N.E.2d at 1034-35. The court discarded allegations of champerty by the purchasers, Breco, Inc., Breco Associates, Harold N. Cotton and Robert M. Bretholtz, who were also named as defendants. *Id.*

<sup>182</sup> *Id.* at 216-17, 382 N.E.2d at 1033.

<sup>183</sup> See MASS. GEN. LAWS ANN. ch. 156B, § 75 (West 1970).

<sup>184</sup> *Id.*

<sup>185</sup> See MASS. GEN. LAWS ANN. ch. 156B, § 98 (West 1970).

<sup>186</sup> 376 Mass. at 216-17, 382 N.E.2d at 1033.

<sup>187</sup> 7 Mass. App. Ct. 68, 385 N.E.2d 1033 (1979).

holders.<sup>188</sup> The facts of *Hallahan* are similar to those of *Wilkes*, in that the control group fired a substantial minority group from their position of employment.<sup>189</sup> In *Hallahan* two pairs of brothers, the Hallahans and the Thompsons, had incorporated their joint venture, an establishment called the Quarter Deck Lounge.<sup>190</sup> The four brothers intended that they own the corporation as four equal shareholders,<sup>191</sup> but, in fact, they issued themselves twenty-three and three quarters shares each,<sup>192</sup> issuing the remaining five shares to the Thompson brothers' cousin, David, as consideration for his carpentry improvements to the establishment.<sup>193</sup> The four agreed that David would have no active participation in the corporation. David assigned his proxy to Charles Thompson indefinitely and without apparent limitation.<sup>194</sup> Four months after incorporation the Thompson brothers called a meeting without notice of its purpose and, utilizing David's proxy, fired the Hallahan brothers from their positions as bartenders.<sup>195</sup>

Although the brothers Hallahan had agreed to the issuance of five shares to David, the court found that they had not envisioned the issuance as affecting their control arrangement.<sup>196</sup> It had been their intention and assumption that each pair of brothers would exercise a one-half control over the corporation.<sup>197</sup> Relying on the fiduciary principles enunciated in *Donahue* and *Wilkes*, the trial court fashioned the unique equitable remedy of causing the return by David to the corporation of his five shares in order to restore the equal division of control among the four shareholders.<sup>198</sup> The Massachusetts Appeals Court upheld the decision to restore the balance of power initially envisioned by the shareholders, because of the "generic similarity" between the fiduciary duties owed by partners and by close corporate shareholders.<sup>199</sup>

Six years after the *Donahue* case, the Massachusetts Appeals Court decided *Smith v. Atlantic Properties, Inc.*,<sup>200</sup> giving vitality to the *Donahue* court's dictum that the strict fiduciary duty ran not only from the majority to the minority, but also from the minority toward the majority.<sup>201</sup> In *Atlantic Properties* the defendant, Dr. Louis E. Wolfson, was one of four 25% shareholders in a close corporation which he had promoted.<sup>202</sup> Included in the corporate charter at Wolfson's request was an 80% vote requirement clause, which provided that in order for the corporation to take virtually any substantial action, an 80% majority vote was required.<sup>203</sup> Any combination of three shareholders commanded only a 75% majority, and consequently the 80% vote requirement provided each of the four 25% shareholders with a veto power.<sup>204</sup> Serious disagreements soon arose between

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<sup>188</sup> *Id.* at 70-71, 385 N.E.2d at 1034-35.

<sup>189</sup> *Id.* at 69-70, 385 N.E.2d at 1034.

<sup>190</sup> *Id.* at 69, 385 N.E.2d at 1033-34.

<sup>191</sup> *Id.* at 69, 385 N.E.2d at 1033.

<sup>192</sup> *Id.* at 69, 385 N.E.2d at 1034.

<sup>193</sup> *Id.*

<sup>194</sup> *Id.*

<sup>195</sup> *Id.*

<sup>196</sup> *Id.* at 69, 71, 385 N.E.2d at 1033, 1035.

<sup>197</sup> *Id.* at 69, 385 N.E.2d at 1033.

<sup>198</sup> *Id.* at 70, 385 N.E.2d at 1034.

<sup>199</sup> *Id.* at 71, 385 N.E.2d at 1035.

<sup>200</sup> 12 Mass. App. Ct. 201, 422 N.E.2d 798 (1981).

<sup>201</sup> See *Donahue*, 367 Mass. at 593 n.17, 328 N.E.2d at 515 n.17.

<sup>202</sup> 12 Mass. App. Ct. at 202, 422 N.E.2d at 799.

<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

Wolfson and the three shareholder majority.<sup>205</sup> During the course of these disagreements, Wolfson, at least partly to avoid an increase in his own taxes, consistently refused to cast his vote to enable the declaration of dividends.<sup>206</sup> He refused to acquiesce in the declaration of dividends despite substantial corporate profits,<sup>207</sup> an increasingly excessive<sup>208</sup> accumulation of retained earnings,<sup>209</sup> and warnings that failure to declare dividends could incur penalty liabilities under the Internal Revenue Code.<sup>210</sup> Such penalties were, in fact, incurred.<sup>211</sup>

In defense of having permitted the accumulation of the retained earnings and of having consistently vetoed dividend declarations, Wolfson attempted to invoke the *Wilkes* legitimate business purpose test, stating that the corporate realty required repairs for which the majority had refused to authorize expenditure.<sup>212</sup> The trial court rejected this contention that his purpose was thus legitimated by business needs,<sup>213</sup> finding that Wolfson's true motivation rested on animosity and tax evasive intent.<sup>214</sup>

The Massachusetts Appeals Court agreed and upheld the decision of the trial court.<sup>215</sup> In considering Wolfson's actions, the appeals court found itself faced with "[a] question . . . concerning the extent to which . . . [a legal] power . . . may be exercised as its holder may wish, without a violation of the 'fiduciary duty'" referred to in the *Donahue* and *Wilkes* decisions.<sup>216</sup> The court noted that the 80% veto clause in the Atlantic Properties charter was a "sensible precaution"<sup>217</sup> and recognized that the clause was an effective protection of Wolfson's minority interest. However, the court held that Wolfson was bound to exercise his power under the veto provision in a manner consistent with the *Donahue* duty of "utmost good faith and loyalty."<sup>218</sup> The court found that Wolfson's consistent exercise of his veto power to the prejudice of the majority shareholders constituted unreasonable conduct in violation of that duty.<sup>219</sup>

As it had in *Hallahan*,<sup>220</sup> the appeals court sanctioned an equitable remedy fashioned by the trial court upon its finding of a violation of the *Donahue* duty by Wolfson. The relief upheld by the appeals court included an injunction to declare dividends.<sup>221</sup> The remedy was applied to restrict a contractual right, Wolfson's veto power, where the exercise of that right worked an injustice.

<sup>205</sup> *Id.* at 203, 422 N.E.2d at 800.

<sup>206</sup> *Id.* at 203-04, 422 N.E.2d at 800-01.

<sup>207</sup> *Id.* at 202, 422 N.E.2d at 799.

<sup>208</sup> *Id.* at 203, 422 N.E.2d at 800.

<sup>209</sup> *Id.*

<sup>210</sup> See I.R.C. § 531 (1954).

<sup>211</sup> 12 Mass. App. Ct. at 203, 422 N.E.2d at 800. Wolfson, however, continued to disregard the wishes of the 75% majority by voting against declaration of dividends. *Id.* Further penalties were assessed. *Id.* at 204, 422 N.E.2d at 801.

<sup>212</sup> *Id.* at 203-04, 209, 422 N.E.2d at 800-01, 803.

<sup>213</sup> *Id.* at 204, 422 N.E.2d at 801.

<sup>214</sup> *Id.*

<sup>215</sup> *Id.* at 209, 422 N.E.2d at 803.

<sup>216</sup> *Id.* at 207-08, 422 N.E.2d at 802.

<sup>217</sup> *Id.* at 207, 422 N.E.2d at 802.

<sup>218</sup> *Id.* at 209, 422 N.E.2d at 803.

<sup>219</sup> *Id.*

<sup>220</sup> 7 Mass. App. Ct. at 70, 385 N.E.2d at 1034. See *supra* notes 197-99 and accompanying text.

<sup>221</sup> *Atlantic Properties*, 12 Mass. App. Ct. at 210, 422 N.E.2d at 803-04. The appeals court modified the trial court's injunction. *Id.* That modification, however, was for the purpose of increasing the supervision of the corporation, not altering the underlying injunction. *Id.*

## 3. Summary

In *Donahue v. Rodd Electrotype Company*, the Massachusetts Supreme Judicial Court formalized a fiduciary standard which had previously been applied as an equitable exception<sup>222</sup> to the general rule of Massachusetts law that mere ownership of stock imposed no fiduciary duty among shareholders *inter se*.<sup>223</sup> The sweeping breadth of this change in the law was refined and affirmed by the court's decision in *Wilkes*, in which it limited the *Donahue* duty by instituting a legitimate business purpose test.<sup>224</sup> In subsequent decisions the Massachusetts courts refined this new doctrine into a general limit on the actions of all shareholders in a close corporation. *Donahue* and its progeny indicate that actions by such a shareholder, while technically legal, may still be subject to regulation by the courts under essentially equitable principles of justice and fairness.

## II. THE ANTI-DONAHUE CLAUSE AS A RESPONSE TO DONAHUE

The dramatic changes in the law heralded by *Donahue*, of a new, stricter fiduciary duty stirred a flurry of speculation by commentators, none of whom were quite sure just what the court meant by "the punctilio of an honor the most sensitive."<sup>225</sup> Authors suggested that the "dangerous fiduciary obligation"<sup>226</sup> and "hazardous dicta"<sup>227</sup> in the case could mean the introduction of an active judicial role in such traditionally private corporate concerns as "the direction of dividend . . . decisions,"<sup>228</sup> "determination of salaries [and the] hiring of employees" as well as in other areas of corporate decision making.<sup>229</sup> Authors surmised the abolition of formal corporate election requirements and the abolition of the Massachusetts close corporation qua corporation for tax purposes.<sup>230</sup> Some authors went so far as to suggest that the *Donahue* strict fiduciary duty would also be applied to relatively larger corporations<sup>231</sup> and public corporations.<sup>232</sup>

The concerns of these commentators were not unreasonable at the time that they were voiced. They reflected, rather, a reasonable cautionary reaction to the sweeping language of the *Donahue* decision and the court's specific declination to express any opinion as to whether the strict fiduciary duty pertained to transactions among shareholders where such transactions were unrelated to the corporation.<sup>233</sup> To at least some extent this commentary was merely an amplified echo of the concerns voiced by Justice Wilkins in his concurrence with *Donahue*.<sup>234</sup> Had the Supreme Judicial Court not heeded such expressions of concern and refined the applicability of this new stricter duty in its

<sup>222</sup> See *supra* notes 40-74 and accompanying text.

<sup>223</sup> See *supra* notes 19-40 and accompanying text.

<sup>224</sup> See *supra* notes 154-67 and accompanying text.

<sup>225</sup> 367 Mass. at 594, 328 N.E.2d at 516 (quoting *Meinhard v. Salmon*, 249 N.Y. 458, 463-64, 164 N.E. 545, 546 (1928) (Cardozo, C.J.)). See *supra* note 120 and accompanying text.

<sup>226</sup> Villanova Note, *supra* note 12, at 315.

<sup>227</sup> *Id.*

<sup>228</sup> Harvard Note, *supra* note 12, at 431.

<sup>229</sup> Villanova Note, *supra* note 12, at 317.

<sup>230</sup> See, e.g., Annual Survey of Massachusetts Law Note, *supra* note 12, at 476.

<sup>231</sup> See, e.g., Villanova Note, *supra* note 12, at 314-15.

<sup>232</sup> Note, *The Standard of Fiduciary Duty in a Close Corporation: Donahue v. Rodd Electrotype*, 61 IOWA L. REV. 876, 898 (1976).

<sup>233</sup> See *Donahue*, 367 Mass. at 593 n.18, 328 N.E.2d at 515 n.18.

<sup>234</sup> See *id.* at 604, 328 N.E.2d at 521 (Wilkins, J., concurring). See also *supra* note 8 and accompanying text; see *supra* note 121.

*Wilkes v. Springside Nursing Home, Inc.*<sup>235</sup> decision the following year, it is conceivable that some of these potential extremes would have been realized.<sup>236</sup>

The immediate response of the Massachusetts corporate bar to the *Donahue* decision was one of moderate turmoil.<sup>237</sup> Attorneys sought to determine some basis by which to measure the import of the decision to their clients. The primary concern expressed by attorneys in the immediate wake of the *Donahue* decision was not that the effect of the case on Massachusetts law was undesirable, but that it seemed not to be concretely determinable. Lawyers found that their ability to predict the outcomes of hypothetical corporate situations was restricted, and in consequence, so was their ability to confidently plan an appropriate corporate structure to achieve a desired result.<sup>238</sup>

It was in this atmosphere of uncertainty that many of Massachusetts' larger firms with a significant corporate practice began to consider whether the *Donahue* decision required a change in the standard forms they used in the incorporation of new businesses. Initially there was a fairly uniform movement among Massachusetts law firms to draft some form of anti-*Donahue* clause, a legal device the sole purpose of which was to modify or eliminate the new and apparently unpredictable element in corporate planning which *Donahue* represented.<sup>239</sup> Two general categories of ADC emerged from these efforts: those which are narrowly tailored to specific corporate practices, and those which cover a broader spectrum of the *Donahue* duty. The most narrowly drawn ADC is designed to do no more than to permit the corporation to pursue a single specific course of action, which, in the absence of the ADC, would be proscribed by the *Donahue* fiduciary duty. One plain example of a narrowly drawn ADC is that described by the Massachusetts Supreme Judicial Court in footnote twenty-four of the *Donahue* decision,<sup>240</sup> in which all shareholders give advance consent to arrangements permitting a corporate repurchase of shareholder stock where the price offered is not to be extended to more than a single

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<sup>235</sup> 370 Mass. 842, 353 N.E.2d 657 (1976). See *supra* notes 154-64 and accompanying text.

<sup>236</sup> In *Wilkes*, the court verbalized its own recognition of the generative nature of *Donahue*, stating that it was "concerned that untempered application of the strict . . . [*Donahue*] standard . . . will result in the imposition of limitations on legitimate action by the controlling group in a close corporation which will unduly hamper its effectiveness in managing the corporation in the best interests of all concerned." 370 Mass. at 850, 353 N.E.2d at 662. *Wilkes* was, in several respects, an ideal case with which to demonstrate the breadth of the strict *Donahue* duty, and outline the boundaries within which it was to be temperately applied. See *supra* notes 162-64 and accompanying text.

<sup>237</sup> See *supra* note 15 and accompanying text.

<sup>238</sup> Concerns were raised that the duty would be applied not only to businesses organized and incorporated in Massachusetts, but also to businesses whose principal place of business was in Massachusetts, or to businesses which merely operated in Massachusetts. Massachusetts lawyers were unsure what size a corporation had to be before its number of stockholders exceeded the *Donahue* court's first criterion in defining a close corporation, that there be "a small number of stockholders." See *Donahue*, 367 Mass. at 586, 328 N.E.2d at 511. Neither were most attorneys confident of how saleable a corporation's stock had to be, in order that its market might be considered "ready" and thereby elude the court's second criterion. See *id.* Nor could any bright line test be perceived by which to determine whether the participation of a corporation's majority stockholders in the management of the corporation was insignificant enough to fall short of the last of the court's criteria, that such participation be "substantial." See *id.*

<sup>239</sup> This movement toward drafting an anti-*Donahue* clause was echoed by the New England Law Institute in its Massachusetts Continuing Legal Education.

<sup>240</sup> 367 Mass. at 598 n.24, 328 N.E.2d at 518 n.24.

shareholder.<sup>241</sup> The second and more common type of ADC, however, is very broadly drawn to uniformly preclude application of the *Donahue* fiduciary duty to any of a corporation's actions. The broadly drawn ADC is framed in terms of the affairs of the corporation generally, rather than in terms relating to a specific proposed action or type of action. There are commonly two general parts to the broadly drawn, or blanket, ADC. The first part states that the corporation shall be governed by the Massachusetts corporation law,<sup>242</sup> and shall not be governed by partnership principles or any other obligations of fiduciary duty not generally applicable to all corporations governed by Massachusetts General Laws, chapter 156B. Commonly appended to the blanket ADC is a recitation denying that the factors used by the *Donahue* court to define a close corporation shall be construed to define the business in question as a close corporation. The second part of the blanket ADC generally consists of an amalgamation of narrow ADCs, stating that: 1) the corporation shall be bound by no equal opportunity rule; 2) the ownership of stock shall confer no right to election as a director or officer of the corporation; 3) the ownership of stock shall confer no right to employment, salary, or the continuation of either, except as otherwise provided by express agreement; and 4) the ownership of stock shall confer no right to direct the amount of dividends or to require the declaration of dividends.<sup>243</sup>

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<sup>241</sup> *Id.*

<sup>242</sup> See MASS. GEN. LAWS ANN. ch. 156B (West 1970).

<sup>243</sup> It should be noted that these amalgamated narrow ADC provisions are derived from the court's language in *Donahue*, see 367 Mass. at 588-89, 328 N.E.2d at 513 (quoting F.H. O'NEAL & J. DERWIN, EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES 42 (1961)), and from *Donahue*'s progeny. The second and third would apply to the holding in *Wilkes v. Springside Nursing Home, Inc.*, 370 Mass. 842, 353 N.E.2d 657 (1976), that the defendants had violated their fiduciary duty by denying office, salary and employment to the plaintiff. The fourth would answer to the holding in *Smith v. Atlantic Properties, Inc.*, 12 Mass. App. Ct. 201, 422 N.E.2d 798 (1981), that the defendant had violated his *Donahue* fiduciary duty by the exercise of his veto power in regard to the declaration of dividends.

Furthermore, the *Wilkes* court made clear in the language of its decision that judicial notice had been taken of the importance that the control group have discretion in 1) the determination of dividend policy; 2) the decision to merge or consolidate; 3) the determination of corporate salaries; 4) the dismissal of directors with or without cause; and 5) the hiring and firing of corporate employees. 370 Mass. at 851, 353 N.E.2d at 663.

The following are examples of some of the anti-*Donahue* clause formats used by Massachusetts firms.

#### ADC No. I

The affairs of the corporation shall not be governed by principles of partnership law or fiduciary obligations between and among shareholders of close corporations, except as they may be applicable generally to all corporations organized under Chapter 156B of the Massachusetts General Laws.

#### ADC No. II

The affairs of the corporation shall not be governed by principles of partnership law or fiduciary obligations between and among shareholders of close corporations, except as they may be applicable generally to all corporations organized under Chapter 156B of the Massachusetts General Laws. The corporation may purchase or otherwise acquire shares of its capital stock from one or more shareholders and may issue, sell or otherwise transfer shares to one or more persons without purchasing or otherwise

The uniformity among Massachusetts law firms ended at the fact and manner of drafting some sort of disclaimer in response to the *Donahue* decision. Some firms included ADCs as a matter of course in some of their draft articles of organization or bylaws. Others formulated ADCs as shareholder agreements separate from the corporate organizational documents. Still other firms simply decided not to use them at all, because

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acquiring shares from or issuing, selling, or otherwise transferring shares to any other persons.

#### ADC No. III

Subject to the provisions of Chapter 156B of the Massachusetts General Laws, no special rights or duties among the shareholders *inter se* or between any shareholder and the corporation shall arise by virtue of the number of shareholders of the corporation, the absence of a ready market for the sale of its capital stock or the existence of shareholder participation in the management of the corporation. In furtherance, and not in limitation of the foregoing:

1. The corporation may purchase or redeem shares of its capital stock from any purchaser without offering other shareholders an equal opportunity to have their shares purchased or redeemed by the corporation;
2. The status of shareholder of the corporation shall confer no right to be elected a director of the corporation;
3. Except as otherwise provided by written agreement, the status of shareholder of the corporation shall confer no right to be employed by the corporation in any capacity or to receive any salary from the corporation or, in the event that such employment should exist or such salary should be paid, the status of the shareholder of the corporation shall confer no right to the continuation of such employment or salary; and
4. The Board of Directors of the corporation shall have full and absolute discretion to determine whether to declare dividends upon the capital stock of the corporation from funds legally available therefor or to refrain from declaring such dividends; the status of shareholder of the corporation shall confer no right to require that any dividend be declared.

#### ADC No. IV

The relationship of investors in stock and debt securities of the corporation is that of a shareholder of a corporation in the case of holders of the corporation's stock, and a creditor of a corporation in the case of a holder of debt securities of the corporation, with their rights and obligations being determined by the articles of organization of the corporation, its bylaws, the Business Corporation Law as in effect from time to time, and any agreement with respect thereto that they may enter into with the corporation; their relationship is not that of partners and no holder of debt securities of the corporation or holder of stock of the corporation has the fiduciary obligation of a partner to any other such holder. Without limiting the generality of the foregoing:

1. no such investor or holder shall, by reason of holding or having held stock or debt securities of the corporation, have any right to payment of any moneys (sic) from the corporation or to receive any other property, benefits or rights from the corporation, other than the payment of interest and principal on the debt securities of the corporation, the payment of dividends on the stock when and if declared by the directors of the corporation, the payment from the corporation for Common Stock purchased pursuant to Article — hereof, and the right to receive his pro rata share of the net assets of the corporation in liquidation;
2. nor shall any such investor or holder have any right to (or to continue in) any office, employment or business relationship with the corporation on account of holding or having held any stock or debt securities of the corporation, notwithstanding that one or more other investors or holders may be appointed to

they were undesirable or because they felt that the ADCs would not be upheld by the courts. A few firms felt that a fiduciary duty could not be affected by contract language. Today, the firms appear fairly evenly divided in their use of ADCs, between those who continue to use them, and those who feel that the ADC is either not useful or effective. ADCs are now generally used not as a matter of course, but rather under specific circumstances in which one or more shareholders desires to avoid one or more aspects of the *Donahue* duty.

### III. REASONABLE EXPECTATIONS AS AN ANALYTIC STANDARD BY WHICH TO DETERMINE THE EFFICACY OF THE ANTI-DONAHUE CLAUSE

#### A. Reasonable Expectations

The use of ADCs by the Massachusetts corporate bar raises the question of their legal efficacy. ADCs themselves represent contracts, some of which are presumably valid. Certain ADCs, however, probably seek to effect a result inconsistent with the principles enunciated by the Massachusetts Supreme Judicial Court in *Donahue*. As this note has demonstrated, the *Donahue* line of cases has developed along equitable lines, with the actions of all shareholders in a close corporation being measured against a standard of utmost good faith and loyalty, as balanced by legitimate business objectives.<sup>244</sup> In effect, analysis under *Donahue* and its progeny devolves into an attempt to identify and protect the reasonable expectations of close corporate shareholders, an exercise of equity.<sup>245</sup> It follows that these ADCs would be contrary to the principles of *Donahue* where they serve to frustrate those expectations, and may therefore be unenforceable, if not reformable, under the equity powers of the courts.

The question of equitable enforceability of an otherwise valid contractual provision is not raised here for the first time. In *Smith v. Atlantic Properties, Inc.*,<sup>246</sup> the Massachusetts Appeals Court examined the extent to which a contractual right could be exercised without violating a fiduciary duty.<sup>247</sup> In that case the appeals court held that the defendant Wolfson's right to veto corporate actions was bounded by his partner-like fiduciary duty.<sup>248</sup> Had the court found the provisions granting Wolfson his veto power to be

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(or hold) an office, employment or a business relationship with the corporation; and

3. nor shall any such investor or holder have any right to compel the corporation, nor shall the corporation be obligated, to purchase shares of stock or other securities of the corporation or other property from him (except as provided in Article —) or to sell stock, other securities of the corporation or other property to him, notwithstanding that the corporation shall have purchased or sold or offered to purchase or sell stock, other securities of the corporation or other property from or to one or more other investors or holders at any price.

These represent but a few examples of the ADC. Many of Boston's larger law firms have drafted a plethora of variations of this theme. Even among the firms which do not utilize ADCs as a matter of course, there are likely to be a few drafts of these or similar clauses which the attorneys consider using from time to time. In the following section there will be a discussion of the probable efficacy of these clauses in light of the nature and purpose of the *Donahue* duty.

<sup>244</sup> See *supra* notes 1-223 and accompanying text.

<sup>245</sup> See *infra* notes 268-70 and accompanying text.

<sup>246</sup> 12 Mass. App. Ct. 201, 422 N.E.2d 798 (1981).

<sup>247</sup> *Id.* at 207-08, 422 N.E.2d at 802.

<sup>248</sup> *Id.* at 208-09, 422 N.E.2d at 802-03.



contractually deficient, presumably the court's inquiry would have ended there. It did not. Rather, the court tacitly accepted the contract represented by the 80% provisions, and considered the extent to which that valid contractual right could be exercised, before equity demanded its curtailment.<sup>249</sup> In considering this question, the court also stressed the importance of considering all of the "relevant circumstances" of the case.<sup>250</sup> The court described Wolfson's refusal to declare dividends as objectively unreasonable and "inconsistent with any reasonable interpretation"<sup>251</sup> of his *Donahue* duty.<sup>252</sup>

According to the reasoning of the *Atlantic Properties* court, a court of equity may seek to determine whether intervention is warranted in order to protect the reasonable expectations of the parties involved. The existence of the veto provisions in the *Atlantic Properties* articles of organization is evidence that the shareholders expected that each would have a veto power, and yet it is equally evident that in the judgment of the court the plaintiffs reasonably believed that Wolfson would not exercise that power in the oppressive manner in which he did.

The *Atlantic Properties* court's methodology is entirely in accord with the evolution of the *Donahue* duty. The *Donahue* court emphasized that it was not only the similarity between close corporations and partnerships which warranted holding shareholders *inter se* to the stricter partnership fiduciary duty.<sup>253</sup> The court noted that, to an even greater degree than partners, close corporate shareholders are peculiarly vulnerable to oppressive tactics<sup>254</sup> which could result in their being "trapped in a disadvantageous position"<sup>255</sup> or even being forced to abandon their interest by being frozen out.<sup>256</sup> Thus, as a contract entered into in a close corporate setting, an ADC will be subject to an analytic scrutiny similar to that employed by the Massachusetts Appeals Court in *Atlantic Properties*.

The purported goal behind the use of an ADC is to maintain the contractual flexibility inherent in corporations; and yet in a pragmatic sense the goal of an ADC is to imbue one or more of the shareholders, or the corporation, with particular power. An ADC may give the power to pursue a legitimate and minutely defined course of action, or it may give the power to select and execute any of several methods of "freezing out."<sup>257</sup> Working within the parameters defined by the *Donahue* court, the latter purpose is an impermissible exercise of oppressive conduct,<sup>258</sup> while the former is probably entirely acceptable.<sup>259</sup> This potentially conflicting position is a tenable one only to the extent that definitions, which are succinct enough to adequately differentiate these two purposes, can be formulated.

<sup>249</sup> The court described Wolfson's right to withhold his vote under the provisions in the articles and bylaws requiring an 80% vote for shareholder action (the 80% provisions), *id.* at 202, 206-07, 422 N.E.2d at 799, 802, as a "sensible precaution," *id.* at 207, 422 N.E.2d at 802, and as a "veto power." *Id.* at 208, 422 N.E.2d at 802. See *supra* notes 200-19 and accompanying text.

<sup>250</sup> 12 Mass. App. Ct. at 209, 422 N.E.2d at 803.

<sup>251</sup> *Id.*

<sup>252</sup> *Id.*

<sup>253</sup> See *Donahue*, 367 Mass. at 588-92, 328 N.E.2d at 513-15.

<sup>254</sup> *Id.* at 592, 328 N.E.2d at 515.

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> *Id.* at 588, 328 N.E.2d at 513. For a discussion of "freeze-outs," see Note, *Freezing Out Minority Shareholders*, *supra* note 155, at 1630-34; also see generally F.H. O'NEAL, *supra* note 151, §§ 3-7.

<sup>258</sup> See *Donahue* at 588-92, 328 N.E.2d at 513-15.

<sup>259</sup> *Id.* at 598 n.24, 328 N.E.2d at 518 n.24.

The *Donahue* court referred to "freeze-outs"<sup>260</sup> as "oppressive devices,"<sup>261</sup> quoting extensively from *Expulsion or Oppression of Business Associates* by F.H. O'Neal and J. Derwin,<sup>262</sup> but did not offer finite guidance as to precisely what actions by corporations or shareholders would constitute oppression. Professor O'Neal, whose work the *Donahue* court described as "authoritative,"<sup>263</sup> has promulgated a useful definition of oppression in the close corporate context as "exercise by . . . controlling shareholders of powers given them by . . . the company's charter in a way that unfairly prejudices minority shareholders or disappoints their reasonable expectations . . ." <sup>264</sup> Other commentators have described oppression in similar terms,<sup>265</sup> but O'Neal's definition has won the imprimatur of courts<sup>266</sup> and legislatures.<sup>267</sup>

The reasonable expectations rule is an equitable doctrine<sup>268</sup> similar to the equitable doctrine of trust and confidence generally associated with fiducial relations<sup>269</sup> and particularly associated with the partner-like fiduciary duty applied by the *Donahue* court.<sup>270</sup> The reasonable expectations rule is also tied to traditional contract law, to the extent that in an examination of a contract courts seek to determine what the contracting parties contemplated.<sup>271</sup>

The *Donahue* court did not use the words "reasonable expectations," but the court's language is clearly couched in terms of equity and its analysis is framed in terms of the reasonable expectations of the shareholders.<sup>272</sup> The court's application of principles of partnership law to the close corporation, moreover, signals an invocation of those equitable doctrines associated with the partnership duty.<sup>273</sup> The equitable nature of the *Donahue* duty is further exemplified by the application in *Wilkes* of the restitutionary theory of "inequitable enrichment."<sup>274</sup> Finally, as this note has demonstrated, the duty

<sup>260</sup> *Id.* at 588, 328 N.E.2d at 513.

<sup>261</sup> *Id.*

<sup>262</sup> *Id.* at 588-89, 328 N.E.2d at 513 (quoting F.H. O'NEAL & J. DERWIN, *EXPULSION OR OPPRESSION OF BUSINESS ASSOCIATES* 42 (1961)).

<sup>263</sup> *Id.* at 588, 328 N.E.2d at 513.

<sup>264</sup> O'Neal, *Recommended Reform*, *supra* note 11, at 886. O'Neal cites the United Kingdom case, *Ebrahimi v. Westbourne Galleries Ltd.*, [1973] A.C. 360, 379 (1972), [1972] 2 W.L.R. 1289, [1972] 2 All E.R. 492, *rev'g* *In re Westbourne Galleries, Ltd.* [1971] Ch. 799, as authority for this definition. O'Neal, *Recommended Reform*, *supra* note 11, at 886. *See also infra* notes 277-310 and accompanying text.

<sup>265</sup> *See, e.g.*, Afterman, *Statutory Protection for Oppressed Minority Shareholders: A Model for Reform*, 55 VA. L. REV. 1043, 1064 (1969), and sources cited therein.

<sup>266</sup> *See, e.g.*, *O'Donnel v. Marine Repair Services, Inc.*, 530 F. Supp. 1199, 1207 (S.D.N.Y. 1982); *Capitol Toyota, Inc. v. Gervin*, 381 So. 2d 1038, 1039 (Miss. 1980); *Exadaktilos v. Cinnaminson Realty Co.*, 167 N.J. Super. 141, 152-55, 400 A.2d 554, 559-61 (1979); *Bolstein v. Gimpel Farms, Inc.*, 125 Misc. 2d 45, 50, 477 N.Y.S.2d 1014, 1018 (Sup. Ct. 1984); *Topper v. Park Sheraton Pharmacy, Inc.*, 107 Misc. 2d 25, 32-33, 433 N.Y.S.2d 359, 364-65 (Sup. Ct. 1980) (analyzing the legislative history of N.Y. BUS. CORP. LAW § 1104(a) (McKinney 1963), and finding an intent to adopt O'Neal's definition); *Meiselman v. Meiselman*, 309 N.C. 279, 290, 307 S.E.2d 551, 563 (1983).

<sup>267</sup> *Topper v. Park Sheraton Pharmacy, Inc.*, 107 Misc. 2d 25, 33, 433 N.Y.S.2d 359, 364-65 (Sup. Ct. 1980).

<sup>268</sup> F.H. O'NEAL, *supra* note 151, § 7.15 at 329 & n.6.5 (Supp. 1984).

<sup>269</sup> *See, e.g.*, BALLENTINE'S LAW DICTIONARY 469 (3d ed. 1969).

<sup>270</sup> *See Donahue*, 367 Mass. at 592-93, 328 N.E.2d at 515.

<sup>271</sup> *See* E. FARNSWORTH, *CONTRACTS* §§ 3.6-3.8 (1982).

<sup>272</sup> *See Donahue*, 367 Mass. at 591, 598 n.24, 328 N.E.2d at 514, 518 n.24.

<sup>273</sup> *See id.* at 597, 328 N.E.2d at 517.

<sup>274</sup> *See Wilkes*, 370 Mass. at 854, 353 N.E.2d at 665.

announced by the *Donahue* court derives from a line of equitable decisions<sup>275</sup> and has developed into an equitable analysis designed to protect, through equity, the reasonable expectations of all close corporate shareholders.<sup>276</sup> It follows that evaluation of the validity of an ADC will turn upon a court's finding of whether the ADC reflects the reasonable expectations of all of the parties to the agreement in which it is included. The history of post-*Donahue* jurisprudence in Massachusetts indicates that where an ADC does not reflect such expectations, or where oppressive actions taken by shareholders under the auspices of an ADC are contrary to such expectations, a court will implement corrective measures from the full range of remedies available to a complaining shareholder in a court of equity.

B. *The Commonwealth Countries' Utilization of Reasonable Expectations in the Partnership Analogy*

The law of the Commonwealth countries<sup>277</sup> provides useful precedent for application of an express reasonable expectations standard to corporate agreements such as an ADC.<sup>278</sup> The Commonwealth countries have long adopted the reasonable expectations of the parties as the standard for equitable evaluation of the actions of partners, joint venturers and shareholders in private companies.<sup>279</sup> Commonwealth countries cases employing a reasonable expectations analysis have been relied on or cited by numerous state courts in the United States to identify the nature of the relationship among persons in these contexts.<sup>280</sup>

The 1905 Scottish case, *Symington v. Symington's Quarries, Ltd.*,<sup>281</sup> set influential precedent in the employment of a reasonable expectations standard for evaluating the actions of shareholders in private companies.<sup>282</sup> In that case the session court found the private company there under consideration to be similar to a partnership<sup>283</sup> and on that basis found it to be "just and equitable"<sup>284</sup> to grant dissolution when the petitioners demon-

<sup>275</sup> See *supra* notes 41-74 and accompanying text.

<sup>276</sup> See *supra* notes 122-221 and accompanying text.

<sup>277</sup> The Commonwealth countries include England and Scotland (as members of the United Kingdom), and Australia among others. D.M. WALKER, *OXFORD COMPANION TO THE LAW* 255 (5th ed. 1982) [hereinafter referred to as *OXFORD COMPANION TO THE LAW*]. Although there is no body of Commonwealth law per se, there are a great number of elements of law which are common to the legal systems of these countries which are members of the Commonwealth. *Id.* at 257.

<sup>278</sup> See, e.g., *Ebrahimi v. Westbourne Galleries*, [1973] A.C. 360 (1972).

The rationale for considering United Kingdom case law in this regard has been recognized by the courts, for example in their citation to the United Kingdom case, *Scottish Wholesale Society, Ltd. v. Meyer*, [1959] A.C. 324, 361 (Scot. 1958). See, e.g., *Fix v. Fix Material Co., Inc.*, 538 S.W.2d 351, 358 & n.4 (Mo. App. 1976); *Exadaktilos v. Cinnaminson Realty Co., Inc.*, 167 N.J. Super. 141, 152, 400 A.2d 554, 560 (1979); *Baker v. Commercial Body Builders, Inc.*, 264 Or. 614, 628-29 & n.9, 507 P.2d 387, 393-94 & n.9 (1973); *White v. Perkins*, 213 Va. 129, 134, 189 S.E.2d 315, 320 (1972).

<sup>279</sup> See *Symington v. Symington's Quarries, Ltd.*, 1905-06 Sess. Cas. 121 (Scot. 1st Div. 1905).

<sup>280</sup> See *supra* note 278 and sources cited therein.

<sup>281</sup> 1905-06 Sess. Cas. at 121.

<sup>282</sup> See, e.g., *Westbourne Galleries*, [1973] A.C. 360, 375 (Lord Wilberforce).

<sup>283</sup> *Symington*, 1905-06 Sess. Cas. at 130 (Lord M'Laren).

<sup>284</sup> *Id.* (construing the "just and equitable" clause of the United Kingdom Companies Act, 1862, 25 & 26 Vict. ch. 89, § 79(5), which reads, "A company under this Act may be wound up by the Court . . . (5) whenever the Court is of opinion that it is just and equitable that the company should be wound up").

strated to the satisfaction of the court that the controlling shareholder/director had "persistently defied [their] views."<sup>285</sup> *Symington* may have marked the beginning of the application of some form of equitable reasonable expectations doctrine to cases involving oppression in close corporations. A line of cases flowing from *Symington* demonstrates the effect of contract on an equitable consideration of oppression in close corporations.

*In re Straw Products Pty., Ltd.*,<sup>286</sup> a case decided by the Supreme Court of Victoria, Australia in 1942, cited to the *Symington* case as support for the proposition that a close corporation is analogous to a partnership.<sup>287</sup> The corporation at issue was comprised of five shareholders.<sup>288</sup> Irwin Hinds was the governing director and controlling shareholder.<sup>289</sup> Hinds denied the petitioner, E.C. Robertson, a shareholder and director, access to the company books.<sup>290</sup> Hinds also consistently refused to declare reasonable dividends<sup>291</sup> and concurrently loaned large unsecured sums of money to another company under his control, against petitioner's protests.<sup>292</sup>

In analyzing the relative position of the parties, the *Straw Products* court equated Robertson's ability to sell his shares to retiring from a partnership, and noted that Robertson could not do so "except at the will of Hinds and at Hinds' own price."<sup>293</sup> Chief Justice Mann then analyzed the case as follows:

All that Hinds has done in the past in exercise of his control has been within his legal powers. The question is whether he has used these powers in such a way as to make it just and equitable that Robertson should be allowed by the Court to retire from the *partnership*. The analogy of a partnership seems to me to clarify discussion.<sup>294</sup>

On these grounds the court held that considerations of justice and equity served as a boundary to Hinds' contractual rights under the terms of the company's charter to either refuse to purchase Robertson's shares or to undervalue them, and consequently, the order of the court below to wind up the company was affirmed.<sup>295</sup> The similarity of the *Straw Products* court's logic to that of the *Atlantic Properties* court is remarkable. In each case the court used its equity powers to restrict a contractual right where the exercise of that right worked an injustice.<sup>296</sup>

The rationale of the Australian court's logic in *Straw Products* was followed and elaborated upon nine years later in another Australian case, *In re Wondoflex Textiles Pty., Ltd.*<sup>297</sup> In *Wondoflex*, the controlling shareholders were a father and son whom, the court found, had devised a nefarious scheme to humiliate and financially embarrass the unre-

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<sup>285</sup> *Symington*, 1905-06 Sess. Cas. at 124.

<sup>286</sup> *In re Straw Products Pty. Ltd.*, [1942] V.L.R. 222.

<sup>287</sup> *Id.* at 223.

<sup>288</sup> *Id.* at 227.

<sup>289</sup> *Id.*

<sup>290</sup> *Id.*

<sup>291</sup> *Id.*

<sup>292</sup> *Id.*

<sup>293</sup> *Id.* at 223.

<sup>294</sup> *Id.* (emphasis in original) (applying the "just and equitable" clause of the Victorian Companies Act, 1938, § 166(1)(f), 3 Geo. VI § 4602 (comparable to the Scottish "just and equitable" clause *supra* at note 284)).

<sup>295</sup> *Id.* at 238.

<sup>296</sup> *But see supra* notes 200-21 and accompanying text.

<sup>297</sup> [1951] V.L.R. 458.

lated minority shareholder into selling his shares at a grossly undervalued price.<sup>298</sup> The *Wondoflex* court noted two general principles of law which govern the arena of equitable dissolution.<sup>299</sup> The first principle was the analogy to partnership, relied on by the *Symington* court for companies with a limited number of shareholders and the consequently stricter duty of trust and confidence which that analogy implies.<sup>300</sup> The second and related principle was that of lost confidence,<sup>301</sup> whereby a court may grant dissolution of a private company when a petitioner successfully demonstrates the existence of a situation "entirely outside what was intended by the parties concerned when the petitioner joined the company."<sup>302</sup> According to the *Wondoflex* court, the second rule was more stringently applied if under the first principle a company were deemed analogous to a partnership.<sup>303</sup> The court further observed that the equitable principle would obtain even where the actions complained of were technically legal and consistent with the express terms of the agreement of the parties.<sup>304</sup> In granting a petition for equitable dissolution, the *Wondoflex* court emphasized the contemplations and assumptions of the shareholders at the outset<sup>305</sup> of their corporate venture.

The *Wondoflex* court's analysis relied on precepts promulgated by the English House of Lords in the 1942 case of *Loch v. John Blackwood, Ltd.*<sup>306</sup> In *Loch*, the House of Lords restored the winding-up order of the Court of Common Pleas of Barbados, on the grounds that the controlling shareholder had proposed to purchase all of the minority shares held by two families for a grossly insufficient price.<sup>307</sup> An integral part of this scheme, the court found, was to dupe a widow into acting as the controlling shareholder's agent to bilk her fellow minority shareholder.<sup>308</sup> *Loch* is taken to stand for the broader principle of breached expectations, referred to by the courts of the Commonwealth countries as the doctrine of lost confidence, which constitutes grounds for winding up a corporation on the basis of unconscionability, even without the supporting analogy to partnership.<sup>309</sup>

<sup>298</sup> *Id.* at 462, 468-69.

<sup>299</sup> *Id.* at 465.

<sup>300</sup> *Id.*

<sup>301</sup> *Id.*

<sup>302</sup> *Id.* at 463.

<sup>303</sup> *Id.* at 465.

<sup>304</sup> As the *Wondoflex* court stated, in terms reminiscent of the reasoning of the Massachusetts Appeals Court in *Atlantic Properties*:

[E]ven when there has been nothing done in excess of power it is necessary to consider whether the situation which has arisen is not quite outside what the parties contemplated by the arrangements they entered into, and whether what has been done is not contrary to the assumptions which were the foundation of their agreement.

*Id.* at 467.

<sup>305</sup> *Id.*

<sup>306</sup> [1924] A.C. 783 (P.C.) (W. Ind. Ct. App. (Barbados)).

<sup>307</sup> *Id.* at 795-96.

<sup>308</sup> *Id.* at 796. Lord Shaw of Dunfermline summed up the case there at hand as follows: "Their Lordships do not care to characterize these suggestions in the language which perhaps they fully deserve . . . No confidence in the directorate could survive such a proposal." *Id.*

<sup>309</sup> *Wondoflex*, [1951] V.L.R. at 465. An earlier case, *In re Yenidje Tobacco Company, Ltd.*, [1916] 2 Ch. 426, relied on by both the *Loch* and *Wondoflex* courts, used the partnership analogy to support a finding of justifiable lost confidence. See *Yenidje Tobacco Company*, [1916] 2 Ch. at 432. Again, in so doing, the Master of the Rolls, Lord Cozens-Hardy, relied upon an analysis of present circumstances in contrast with the original contemplations of the parties. *Id.* He emphasized that

It is thus evident that the law of the Commonwealth countries looks closely at the expectations of close corporate shareholders, due in part to a perceived similarity between private companies and partnerships, to determine an appropriate disposition of discord among the participants in a venture. In so doing, the Commonwealth countries courts look both to the initial intentions of the parties, and their contemporaneous expectations of treatment. Based upon a determination shaped by the extent to which these expectations are reasonable, the Commonwealth countries courts then formulate a resolution to the discord, using their powers of equity. The analysis used, of analogizing close corporations to partnerships and in consequence imposing a stricter fiduciary duty, is remarkable in its similarity to the equitable considerations which formed the bases of the reasoning and decisions in the *Donahue* line of cases.<sup>310</sup>

### C. *An Analysis of the Efficacy of the Anti-Donahue Clause*

An analogy between the close corporation and the partnership has evolved in both the United States and the Commonwealth countries. That analogy carries with it the principle that the strict fiduciary duty of partners *inter se* should be applied to the relations between close corporate shareholders.<sup>311</sup> The evolution of this duty in the close corporation context represents the intention of both the American and Commonwealth courts, acting in equity, to protect the reasonable expectations of shareholders in close corporations.

Implicit in the partnership analogy is an understanding that close corporate shareholders in general reasonably believe that they are in a partnership-like relationship with their fellow shareholders. That is not to say that the close corporate shareholder is laboring under an erroneous assumption that he has entered into a partnership agreement rather than incorporating. Rather, he reasonably holds out the hope that the relationship into which he has entered with his fellow shareholders has certain attributes which are partnership-like in nature.<sup>312</sup>

The fact of incorporation does little to alter the assumption of typical close corporate shareholders that regardless of the corporate facade which they present to the world they will act as partners *inter se*.<sup>313</sup> This is often demonstrated in a close corporation's charter, bylaws and shareholder agreements, which typically reflect an effort to obtain a number of partnership attributes.<sup>314</sup>

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the company's outright commercial success was no answer to the petitioner's request for winding up on the grounds of lost confidence. *Id.*

<sup>310</sup> See *supra* notes 41-224 and accompanying text.

<sup>311</sup> See *Donahue*, 367 Mass. at 594, 328 N.E.2d at 516 (quoting *Meinhard v. Salmon*, 249 N.Y. 458, 463-64, 164 N.E. 545, 546 (1928) (Cardozo, C.J.)); see also *id.* at 593, 328 N.E.2d at 515 (citing partnership fiduciary language from *Cardullo v. Landau*, 329 Mass. 5, 8, 105 N.E.2d 843, 845 (1952)).

<sup>312</sup> The attributes referred to here are not at all limited to the formal structural characteristics which typify a partnership or a corporation. They include also those less tangible qualities which are of at least equal import: qualities of trust, confidence, loyalty and utmost good faith. Taken together, these attributes create an expectation that no action will be taken which favors an individual shareholder or group of shareholders to the detriment or exclusion of any of their fellow shareholders.

<sup>313</sup> F.H. O'NEAL, *CLOSE CORPORATIONS, LAW & PRACTICE* § 1.07 at 21 (1st ed. 1975) [hereinafter referred to as F.H. O'NEAL, *CLOSE CORPORATIONS*].

<sup>314</sup> *Id.* These efforts include such devices as supermajority voting requirements and veto provisions. *Id.*

There generally is, however, no corresponding written embodiment of a shareholder's expectations of the intangible qualities of his relationship with his fellow shareholders, such as trust and loyalty. It is in recognition of the unspoken nature of these legitimate expectations that the courts discussed have imposed a partnership-like fiduciary duty among close corporate shareholders. While the Commonwealth countries have exercised their powers in equity under the authority of the Companies Act,<sup>315</sup> the *Donahue* line of cases demonstrates the evolution of a similar equitable principle in the common law, in derogation of the prior common law rule that shareholders bore no fiduciary duty *inter se* by virtue of the mere ownership of stock.<sup>316</sup> Where, as in Massachusetts, courts had specifically recognized that the common law held shareholders free of any fiduciary duty, they acted in equity to impose such a duty, in order to protect the reasonable expectations of close corporate shareholders.<sup>317</sup> The breadth of this evolution in the United States and throughout the Commonwealth countries towards protecting close corporate shareholders, lends a tenacious power and legitimacy to that protection.

Any analysis of the legal efficacy of the ADC must perforce be consistent with the *Donahue* doctrine as currently developing under Massachusetts law. As this note has shown, *Donahue* and its progeny operate to impose a rule of equity protecting the reasonable expectations of close corporate shareholders.<sup>318</sup> It follows that analysis of an ADC must also turn on the effect of the ADC on the reasonable expectations of the close corporate shareholder at the outset of the corporate venture.<sup>319</sup>

The following two-tiered test is a method of analysis through which to consider the efficacy of an ADC. Under the first tier a court should consider the contractual validity of an ADC. This level of the analysis would include standard considerations and would concern fairly uniform and fundamental legal issues which surround contractual agreements, such as adequacy of consent and disclosure.<sup>320</sup> Under the second tier, which comprises the heart of the test, a court should inquire into the effect which a valid contract may have on the *Donahue* genre of fiduciary duty, as defined by a shareholder's reasonable expectations.

Thus, when confronted with an attack on the validity of an ADC, a court should first examine the ADC in light of traditional defenses to contract. If, for example, the ADC is unsupported by adequate consideration, or is the result of fraud, the ADC will of course not stand.<sup>321</sup> If, on the other hand, the contract is free from formal or general

<sup>315</sup> See, e.g., the "just and equitable" clause of the Victorian Companies Act, 1938, § 166(1)(f), 3 Geo. VI § 4602.

<sup>316</sup> See *supra* notes 25-40 and accompanying text.

<sup>317</sup> See *supra* notes 106-224, 245-76 and accompanying text.

<sup>318</sup> *Id.*

<sup>319</sup> See *supra* notes 311-18 and accompanying text.

<sup>320</sup> Accordingly, this tier of analysis will not be discussed in this note in any but the most elementary terms.

<sup>321</sup> Inquiry would end upon a determination of contractual invalidity of the ADC, presumably resolving the litigation in favor of the plaintiff, if the ADC at issue itself granted the defendant the enabling power to exercise the complained of action. Conversely, if that power is unquestionably granted elsewhere and the ADC was claimed to represent the plaintiff's acquiescence in the specific result of that action, the court should proceed to the second tier of inquiry.

Generally, courts should reach the second stage of analysis only if the ADC is valid contractually. Ironically, however, depending on the nature of the relation between the action complained of and the ADC, it is conceivable that the second stage of analysis proposed here may be reached even in

equitable defects, the fact of its validity should prove to be only the first step in a court's analysis.

At the second tier of inquiry, given the nature and purpose of the *Donahue* duty,<sup>322</sup> the trier of fact should conduct its analysis under the equitable doctrine of reasonable expectations.<sup>323</sup> Courts should therefore predicate their analysis of the efficacy of a valid ADC in the second tier upon a realistic assessment of the extent to which the ADC has actually altered the shareholder's reasonable expectations that the relationship among shareholders *inter se* would be marked by the trust and loyalty expectations of partnerships.<sup>324</sup> The policy foundation upon which the *Donahue* fiduciary duty is based dictates that the close corporate shareholder be presumed to harbor such expectations.<sup>325</sup> The *Donahue* defendant should bear the burden of rebutting that presumption. The defendant may rebut the presumption by presenting the court with a valid contractual agreement in the form of an ADC to which the plaintiff is a party and in which the plaintiff disclaims the existence of precisely those expectations which *Donahue* requires the court to presume.

Mere presentation of an ADC, however, will not end the inquiry. The court must finally proceed to determine if the disclaimer embodied by the ADC in fact expressed the true intent and understanding of the plaintiff signatories at the time of making the agreement.<sup>326</sup> One of the integral factors that a court should look to in determining whether there is a valid contractual disclaimer is the comprehensibility of the ADC. Given the presumed existence of a shareholder's legitimate assumption that he and his fellow shareholders are bound by utmost good faith and a loyalty to the enterprise as a whole which supersedes each shareholder's "avarice" and "self-interest," the ADC should be held to a stringent standard of comprehensibility to the extent that it purports to diminish that intangible quality of trust. In this regard such factors as the candor and simplicity of an ADC should be important factors in the court's evaluation. These would

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the event that the trier of fact determines the ADC to be contractually invalid. This would depend upon whether the ADC at issue were perceived as the enabling source of the defendant's power to commit the act complained of by the plaintiff shareholder. In this respect, the form of the analysis of a claimed fiduciary breach should be one and the same, whether in the absence or presence of an ADC. If it is conducted in the presence of an ADC, the method of analysis should be a constant, regardless of the ADC's contractual validity, except insofar as such invalidity, as discussed above, has already given the court cause to end its inquiry. However, in the event that the court has adjudged an ADC to be contractually invalid, the effect which that ADC will have in the second, equitable tier of inquiry should presumably be *de minimis*. Therefore, in the interest of simplicity, ADCs which are contractually invalid but do not preclude the court's reaching the second stage of analysis will be classed with the general structural enabling provisions which grant a defendant the legal power to perform the action from or for which the plaintiff is seeking relief. Examples of these latter provisions would include the veto power considered in *Atlantic Properties*, *see supra* notes 200-21 and accompanying text, or a section from the articles of organization or bylaws which granted the power to remove an officer or fire an employee. Essentially, this latter category of invalid ADC will be classed with those cases in which no ADC exists, cases which are considered here merely as a measure of comparison, in order to illustrate the effect which a valid ADC might have if examined under the test proposed here.

<sup>322</sup> *See supra* notes 106-224, 253-312 and accompanying text.

<sup>323</sup> *See supra* notes 311-19 and accompanying text.

<sup>324</sup> *Id.*

<sup>325</sup> *Id.*

<sup>326</sup> *Id.*



become particularly pertinent in the case of a less sophisticated plaintiff, or one who is inexperienced in the corporate arena.<sup>327</sup>

Considerations of comprehensibility and fairness of presentation will frequently lend greater credence to a narrowly drawn ADC<sup>328</sup> than to a blanket ADC.<sup>329</sup> The logic of fulfilling expectations which are carefully and comprehensively enunciated in shareholder agreements was clearly recognized by the *Donahue* court in footnote 24 of that decision, where the court stated:

Of course, a close corporation may purchase shares from one shareholder without offering the others an equal opportunity if all other shareholders give advance consent to the stock purchase arrangements through acceptance of an appropriate provision in the articles of organization, the corporate by-laws . . . , or a shareholder's agreement.<sup>330</sup>

In light of this language, it could be strongly argued that the *Donahue* court had no intention of restricting the potential flexibility of the close corporation available through the vehicle of shareholder agreements. Rather, the court sought to ensure that when that flexibility was exercised, it was done with the full and meaningful consent of all concerned, rather than being exercised at the expense of the peculiarly vulnerable close corporate shareholder.<sup>331</sup> This reading of the court's intent is consistent with the equitable nature of the *Donahue* opinion,<sup>332</sup> and with the emphasis on preservation of the reasonable expectations of shareholders which permeates both the precedent on which *Donahue* is based<sup>333</sup> and the cases which *Donahue* has spawned.<sup>334</sup>

The *Donahue* court's suggestion that shareholders may freely contract away their duties *inter se*, if untempered by a reasonable expectations standard, would yield the result reached by the United States Court of Appeals for the Third Circuit in its recent decision of *Coleman v. Taub*.<sup>335</sup> In *Coleman* the court held that a plaintiff bargained away his right to expect continued corporate participation when he entered into an employment contract with the corporation which allowed the majority shareholder to repurchase his stock in the event of the termination of his employment, and which permitted termination of employment for "any reason whatsoever."<sup>336</sup>

It is quite conceivable that a Massachusetts court, or any other court working within the parameters of the analysis posited here, would not have reached the same result as the Third Circuit in *Coleman*. The basis for a different outcome would lie in the fact that the termination provision in the employment contract, which contains language similar to an ADC, may be too generally framed to withstand a reasonable expectations

<sup>327</sup> As an illustrative guide, see *Hackbart v. Holmes*, 675 F.2d 1114, 1120 (10th Cir. 1982), where the court, based on the plaintiff's naivety and trust, held the defendant responsible for ensuring that the plaintiff understood that he would receive no growth interest when issued nonparticipating preferred stock. *Id.*

<sup>328</sup> See *supra* notes 239-41 and accompanying text.

<sup>329</sup> See *supra* notes 241-43 and accompanying text.

<sup>330</sup> *Donahue*, 367 Mass. at 598 n.24, 328 N.E.2d at 518 n.24.

<sup>331</sup> See *supra* notes 106-21 and accompanying text.

<sup>332</sup> See *supra* notes 102-21 and accompanying text.

<sup>333</sup> See *supra* notes 41-74 and accompanying text.

<sup>334</sup> See *supra* notes 122-224 and accompanying text.

<sup>335</sup> 638 F.2d 628 (3d Cir. 1981).

<sup>336</sup> *Id.* at 636.

scrutiny. A plaintiff could argue, in the face of such a provision's language, that he had nonetheless presumed that his termination would be made only within circumstances which would not violate his trust and confidence in his fellow shareholder. A court might find it plausible, in the perspective of the partnership analogy, that the plaintiff had understood that he would only be fired for good cause shown.

The employment context is particularly amenable to such an argument by a plaintiff, because it is a context in which plaintiffs are particularly likely to appear vulnerable and inexperienced. A court may readily find that such a shareholder failed to fully comprehend the ramifications of an ADC which permits his termination and/or divestiture of interest without cause. Under the equitable principles of *Donahue* and the test proposed in this note, the burden of clarifying those ramifications falls to the defendant at the time that the agreement is executed. For that reason an ADC, the purpose of which is to preclude a presumption of guaranteed employment, should probably be narrowly formulated to expressly state that termination may be predicated solely upon the selfish interests of the employee/shareholder's fellow shareholders, even to the injury of the plaintiff.

For similar reasons, the blanket ADC may be virtually useless when used in relation to an unsophisticated shareholder. A blanket ADC to which an inexperienced and unsophisticated shareholder was a party would, under the instant test, require such explicit clarity in explanatory language that it is difficult to conceive of conditions under which the shareholder would be willing to sign, and in any event would probably be found unconscionable.

Conversely, the case of a highly sophisticated shareholder, or a shareholder which is itself a corporation, would be far less likely to present problems under this two-tiered test, even with a blanket ADC. The *Donahue* presumption of pre-existing expectations would be comparatively easy to rebut, and in fact might even be rebutted by the court as a matter of law. As agreed to by a sophisticated, experienced or incorporated shareholder, a narrowly tailored ADC would be virtually inviolate, as it would be almost impossible to argue that the fiduciary disclaimer had not been understood, or that the shareholder had no meaningful alternative to signing the ADC. Similar considerations would probably operate to validate a blanket ADC as regards such a shareholder. In either case, the reasonable expectations of the sophisticated shareholder would provide the standard for evaluating the efficacy of the ADC. As with an unsophisticated shareholder, the court would exercise its equitable powers to evaluate the ADC to determine its effect on those reasonable expectations, as they existed at the time the ADC was executed or adopted.

Thus, the reasonable expectations test operates to impose a duty upon the most sophisticated shareholder entering into an ADC to ensure that it is fully comprehensible to the least sophisticated, particularly if it is to later be exercised to the disadvantage of the latter. The reasonable expectations of each, however, will serve as the standard of conduct by which the other shareholders are to be judged. That evaluation should be conducted by the court exercising the full range of its equitable powers, consequently permitting it to consider all pertinent factors, including those, such as parol evidence, which might ordinarily be excluded from evidence. In the exercise of its equitable powers, the court would have available to it the full range of equitable remedies, including restitution, reformation, rescission and avoidance, in addition to pecuniary or punitive damages.

## CONCLUSION

This note has explored the evolution of the close corporate/partnership analogy and its concomitantly stricter fiduciary duty as demonstrated by the progenitors and progeny of the *Donahue* case in Massachusetts, and a similar development in the law of the Commonwealth countries. Consistent with this analogy, the note has argued that the purpose and nature of the *Donahue* fiduciary duty is to protect the legitimate expectations of close corporate shareholders that they are entering into a relationship of trust, confidence, loyalty and utmost good faith with their fellow shareholders. The note has outlined a responsive effort by the Massachusetts corporate bar to control the extent of the *Donahue* duty by contractual disclaimer. The stated purpose of the note has been an analysis of the efficacy of such a disclaimer.

The *Donahue* duty dictates a presumption that expectations of trust, confidence, loyalty and utmost good faith are legitimately harbored by close corporate shareholders. The consequence of that presumption, that such expectations are reasonably entertained by the shareholders upon their entrance into the corporation, is a shifting of the burden of proof to the defendant. The defendant may rebut this presumption by introducing an ADC, a contractual disclaimer of those expectations.

Finally, the note has proposed a two-tiered test by which the efficacy of an ADC may be considered. The first tier of this test operates in contract. It considers the contractual validity of the ADC by examining the essential contractual criteria of adequacy of consent, disclosure and consideration. The second tier operates in equity. It considers the literal effect of the ADC on the reasonable expectations of the shareholder/plaintiff. It also examines the ADC for unconscionability in result. On the basis of these criteria it is suggested that an ADC is most likely to be effective where a shareholder is well-informed, either by prior experience or by the explicit language of the ADC. It is also suggested that these considerations will tend to lend greater credence to a narrowly tailored ADC than to a blanket ADC because of the proportionately greater likelihood that carefully formulated restrictive language has been understood. Although these criteria should provide guidance, due to the nature of the fiduciary genre they cannot pretend to provide a concise dispositive rule.

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