

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

HENNESSEY, CJ.

On August 5, 1971, the plaintiff (Wilkes) filed a bill in equity for declaratory judgment in the Probate Court for Berkshire County, naming as defendants T. Edward Quinn (Quinn), Leon L. Riche (Riche), the First Agricultural National Bank of Berkshire County and Frank Sutherland MacShane as executors under the will of Lawrence R. Connor (Connor), and the Springside Nursing Home, Inc. (Springside or the corporation). Wilkes alleged that he, Quinn, Riche and Dr. Hubert A. Pipkin (Pipkin) entered into a partnership agreement in 1951, prior to the incorporation of Springside, which agreement was breached in 1967 when Wilkes's salary was terminated and he was voted out as an officer and director of the corporation. Wilkes sought, among other forms of relief, damages in the amount of the salary he would have received had he continued as a director and officer of Springside subsequent to March, 1967.

On appeal, Wilkes argued in the alternative that ... (2) he should recover damages because the defendants, as majority stockholders in Springside, breached their fiduciary duty to him as a minority stockholder by their action in February and March, 1967.

We conclude that the master's findings were warranted by the evidence and that his report was properly confirmed. However, we reverse so much of the judgment as dismisses Wilkes's complaint and order the entry of a judgment substantially granting the relief sought by Wilkes under the second alternative set forth above.

A summary of the pertinent facts as found by the master is set out in the following pages. It will be seen that, although the issue whether there was a breach of the fiduciary duty owed to Wilkes by the majority stockholders in Springside was not considered by the master, the master's report and the designated portions of the transcript of the evidence before him supply us with a sufficient basis for our conclusion.

In 1951 Wilkes acquired an option to purchase a building and lot located on the corner of Springside Avenue and North Street in Pittsfield, Massachusetts, the building having previously housed the Hillcrest Hospital. Though Wilkes was principally engaged in the roofing and siding business, he had gained a reputation locally for profitable dealings in real estate. Riche, an acquaintance of Wilkes, learned of the option, and interested Quinn (who was known to Wilkes through membership on the draft board in Pittsfield) and Pipkin (an acquaintance of both Wilkes and Riche) in joining Wilkes in his investment. The four men met and decided to participate jointly in the purchase of the building and lot as a real estate investment which, they believed, had good profit potential on resale or rental.

The parties later determined that the property would have its greatest potential for profit if it were operated by them as a nursing home. Wilkes consulted his attorney, who advised him that if the four men were to operate the contemplated nursing home as planned, they would be partners and would be liable for any debts incurred by the partnership and by each other. On the attorney's suggestion, and after consultation among themselves, ownership of the property was vested in Springside, a corporation organized under Massachusetts law.

Each of the four men invested \$1,000 and subscribed to ten shares of \$100 par value stock in Springside. At the time of incorporation it was understood by all of the parties that each would be a director of Springside and each would participate actively in the management

and decision making involved in operating the corporation.<sup>7</sup> It was, further, the understanding and intention of all the parties that, corporate resources permitting, each would receive money from the corporation in equal amounts as long as each assumed an active and ongoing responsibility for carrying a portion of the burdens necessary to operate the business.

The work involved in establishing and operating a nursing home was roughly apportioned, and each of the four men undertook his respective tasks. Initially, Riche was elected president of Springside, Wilkes was elected treasurer, and Quinn was elected clerk. Each of the four was listed in the articles of organization as a director of the corporation.

At some time in 1952, it became apparent that the operational income and cash flow from the business were sufficient to permit the four stockholders to draw money from the corporation on a regular basis. Each of the four original parties initially received \$35 a week from the corporation. As time went on the weekly return to each was increased until, in 1955, it totalled \$100.

In 1959, after a long illness, Pipkin sold his shares in the corporation to Connor, who was known to Wilkes, Riche and Quinn through past transactions with Springside in his capacity as president of the First Agricultural National Bank of Berkshire County. Connor received a weekly stipend from the corporation equal to that received by Wilkes, Riche and Quinn. He was elected a director of the corporation but never held any other office.

In 1965 the stockholders decided to sell a portion of the corporate property to Quinn who, in addition to being a stockholder in Springside, possessed an interest in another corporation which desired to operate a rest home on the property. Wilkes was successful in prevailing on the other stockholders of Springside to procure a higher sale price for the property than Quinn apparently anticipated paying or desired to pay. After the sale was consummated, the relationship between Quinn and Wilkes began to deteriorate.

The bad blood between Quinn and Wilkes affected the attitudes of both Riche and Connor. As a consequence of the strained relations among the parties, Wilkes, in January of 1967, gave notice of his intention to sell his shares for an amount based on an appraisal of their value. In February of 1967 a directors' meeting was held and the board exercised its right to establish the salaries of its officers and employees. A schedule of payments was established whereby Quinn was to receive a substantial weekly increase and Riche and Connor were to continue receiving \$100 a week. Wilkes, however, was left off the list of those to whom a salary was to be paid. The directors also set the annual meeting of the stockholders for March, 1967.

At the annual meeting in March, Wilkes was not reelected as a director, nor was he reelected as an officer of the corporation. He was further informed that neither his services nor his presence at the nursing home was wanted by his associates.

The meetings of the directors and stockholders in early 1967, the master found, were used as a vehicle to force Wilkes out of active participation in the management and operation of the corporation and to cut off all corporate payments to him. Though the board of directors had the power to dismiss any officers or employees for misconduct or neglect of duties, there was no indication in the minutes of the board of directors' meeting of February, 1967, that the failure to establish a salary for Wilkes was based on either ground. The severance of Wilkes

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<sup>7</sup> Wilkes testified before the master that, when the corporate officers were elected, all four men 'were . . . guaranteed directorships.' Riche's understanding of the parties' intentions was that they all wanted to play a part in the management of the corporation and wanted to have some 'say' in the risks involved; that, to this end, they all would be directors; and that 'unless you (were) a director and officer you could not participate in the decisions of (the) enterprise.'

from the payroll resulted not from misconduct or neglect of duties, but because of the personal desire of Quinn, Riche and Connor to prevent him from continuing to receive money from the corporation. Despite a continuing deterioration in his personal relationship with his associates, Wilkes had consistently endeavored to carry on his responsibilities to the corporation in the same satisfactory manner and with the same degree of competence he had previously shown. Wilkes was at all times willing to carry on his responsibilities and participation if permitted so to do and provided that he receive his weekly stipend.

1. We turn to Wilkes's claim for damages based on a breach of the fiduciary duty owed to him by the other participants in this venture. In light of the theory underlying this claim, we do not consider it vital to our approach to this case whether the claim is governed by partnership law or the law applicable to business corporations. This is so because, as all the parties agree, Springside was at all times relevant to this action, a close corporation as we have recently defined such an entity in *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 328 N.E.2d 505 (Mass. 1975).

In *Donahue*, we held that 'stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.' 328 N.E.2d at 515. As determined in previous decisions of this court, the standard of duty owed by partners to one another is one of 'utmost good faith and loyalty.' Thus, we concluded in *Donahue*, with regard to 'their actions relative to the operations of the enterprise and the effects of that operation on the rights and investments of other stockholders,' '(s)tockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation.' 328 N.E.2d at 515.

In the *Donahue* case we recognized that one peculiar aspect of close corporations was the opportunity afforded to majority stockholders to oppress, disadvantage or 'freeze out' minority stockholders. In *Donahue* itself, for example, the majority refused the minority an equal opportunity to sell a ratable number of shares to the corporation at the same price available to the majority. The net result of this refusal, we said, was that the minority could be forced to 'sell out at less than fair value,' 328 N.E.2d at 515, since there is by definition no ready market for minority stock in a close corporation.

'Freeze outs,' however, may be accomplished by the use of other devices. One such device which has proved to be particularly effective in accomplishing the purpose of the majority is to deprive minority stockholders of corporate offices and of employment with the corporation. This 'freeze-out' technique has been successful because courts fairly consistently have been disinclined to interfere in those facets of internal corporate operations, such as the selection and retention or dismissal of officers, directors and employees, which essentially involve management decisions subject to the principle of majority control.

The denial of employment to the minority at the hands of the majority is especially pernicious in some instances. A guaranty of employment with the corporation may have been one of the 'basic reason(s) why a minority owner has invested capital in the firm.' *Symposium--The Close Corporation*, 52 NW.U.L.REV. 345, 392 (1957) The minority stockholder typically depends on his salary as the principal return on his investment, since the 'earnings of a close corporation . . . are distributed in major part in salaries, bonuses and retirement benefits.' 1 F. H. O'NEAL, CLOSE CORPORATIONS §1.07 (1971). Other noneconomic interests of the minority stockholder are likewise injuriously affected by barring him from corporate office. Such action severely restricts his participation in the management of the enterprise, and he is relegated to

enjoying those benefits incident to his status as a stockholder. In sum, by terminating a minority stockholder's employment or by severing him from a position as an officer or director, the majority effectively frustrate the minority stockholder's purposes in entering on the corporate venture and also deny him an equal return on his investment.

The *Donahue* decision acknowledged, as a 'natural outgrowth' of the case law of this Commonwealth, a strict obligation on the part of majority stockholders in a close corporation to deal with the minority with the utmost good faith and loyalty. On its face, this strict standard is applicable in the instant case. The distinction between the majority action in *Donahue* and the majority action in this case is more one of form than of substance. Nevertheless, we are concerned that untempered application of the strict good faith standard enunciated in *Donahue* to cases such as the one before us 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. The majority, concededly, have certain rights to what has been termed 'selfish ownership' in the corporation which should be balanced against the concept of their fiduciary obligation to the minority.

Therefore, when minority stockholders in a close corporation bring suit against the majority alleging a breach of the strict good faith duty owed to them by the majority, we must carefully analyze the action taken by the controlling stockholders in the individual case. It must be asked whether the controlling group can demonstrate a legitimate business purpose for its action. In asking this question, we acknowledge the fact that the controlling group in a close corporation must have some room to maneuver in establishing the business policy of the corporation. It must have a large measure of discretion, for example, in declaring or withholding dividends, deciding whether to merge or consolidate, establishing the salaries of corporate officers, dismissing directors with or without cause, and hiring and firing corporate employees.

When an asserted business purpose for their action is advanced by the majority, however, we think it is open to minority stockholders to demonstrate that the same legitimate objective could have been achieved through an alternative course of action less harmful to the minority's interest. If called on to settle a dispute, our courts must weigh the legitimate business purpose, if any, against the practicability of a less harmful alternative.

Applying this approach to the instant case it is apparent that the majority stockholders in Springside have not shown a legitimate business purpose for severing Wilkes from the payroll of the corporation or for refusing to reelect him as a salaried officer and director. The master's subsidiary findings relating to the purpose of the meetings of the directors and stockholders in February and March, 1967, are supported by the evidence. There was no showing of misconduct on Wilkes's part as a director, officer or employee of the corporation which would lead us to approve the majority action as a legitimate response to the disruptive nature of an undesirable individual bent on injuring or destroying the corporation. On the contrary, it appears that Wilkes had always accomplished his assigned share of the duties competently, and that he had never indicated an unwillingness to continue to do so.

It is an inescapable conclusion from all the evidence that the action of the majority stockholders here was a designed 'freeze out' for which no legitimate business purpose has been suggested. Furthermore, we may infer that a design to pressure Wilkes into selling his shares to the corporation at a price below their value well may have been at the heart of the majority's plan.

In the context of this case, several factors bear directly on the duty owed to Wilkes by his associates. At a minimum, the duty of utmost good faith and loyalty would demand that the

majority consider that their action was in disregard of a long-standing policy of the stockholders that each would be a director of the corporation and that employment with the corporation would go hand in hand with stock ownership; that Wilkes was one of the four originators of the nursing home venture; and that Wilkes, like the others, had invested his capital and time for more than fifteen years with the expectation that he would continue to participate in corporate decisions. Most important is the plain fact that the cutting off of Wilkes's salary, together with the fact that the corporation never declared a dividend, assured that Wilkes would receive no return at all from the corporation.

2. The question of Wilkes's damages at the hands of the majority has not been thoroughly explored on the record before us. Wilkes, in his original complaint, sought damages in the amount of the \$100 a week he believed he was entitled to from the time his salary was terminated up until the time this action was commenced. However, the record shows that, after Wilkes was severed from the corporate payroll, the schedule of salaries and payments made to the other stockholders varied from time to time.

Therefore our order is as follows: So much of the judgment as dismisses Wilkes's complaint and awards costs to the defendants is reversed. The case is remanded to the Probate Court for Berkshire County for further proceedings concerning the issue of damages. Thereafter a judgment shall be entered declaring that Quinn, Riche and Connor breached their fiduciary duty to Wilkes as a minority stockholder in Springside, and awarding money damages therefor. Wilkes shall be allowed to recover. ... the salary he would have received had he remained an officer and director of Springside.

So ordered.