MASSACHUSETTS LAWYERS WEEKLY

Shareholders' firing of president improper

By: tony.wright | July 4, 2005

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Shareholders in a closely-held corporation breached their fiduciary duty to the company president by firing him without pursuing less "harmful" alternatives to remedy the soured business relationship, a Superior Court judge has ruled.

The defendant shareholders argued that firing the president æ a minority shareholder, himself æ was warranted, because he did a poor job keeping the corporation's accounting straight, resulting in overdue accounts payable.

But Judge Allan van Gestel disagreed and awarded the plaintiff "fair compensation for his loss," totaling approximately $220,000.

"This Court rules that the termination of [the plaintiff president's] employment was not a legitimate business decision that expressed the least harmful alternative to his position as holder of a minority interest in a close corporation. Rather it constituted a breach of the fiduciary duties owed to [him] by each of his fellow shareholders."

The 19-page decision is *O'Connor v. U.S. Art Co., Inc., et al.*, Lawyers Weekly No. 12-201-05.

At-will inapplicable

Boston attorney Robert R. Pierce, who along with Jeff M. Seo represented the plaintiff, said that often in closely-held corporations business people are unaware of the duties they have to one another and to other shareholders.

"Some business people believe that the employee 'at-will' doctrine applies in every situation, and my sense was that the defendants believed that because the plaintiff was an employee-at-will, he could be fired at any time for any reason," said Pierce.

"But you must treat shareholders [in a corporation] with the fiduciary duty of utmost good faith and loyalty when you remove any benefit of ownership," he explained.

Braintree attorney Mark J. Gladstone, who represented the defendants, was unavailable for comment prior to deadline.

Sour business relationship

The plaintiff, William O'Connor, met one of the defendants, Mark S. Lank, at various art trade shows both men attended based on their international and domestic transportation of fine arts businesses, respectively.

In 1994, the pair decided to combine their businesses and form a Massachusetts corporation called U.S. Art International, Inc., of which Lank was a 52.5 percent shareholder and O'Connor was a 37.5 percent shareholder.

Two other parties, both defendants in the case, maintained a five percent ownership interest each in the corporation and worked as company employees.

O'Connor served as president and as an employee at-will; Lank as treasurer and clerk.

An unwritten arrangement existed where compensation received from the domestic transportation of fine arts would be paid to Lank's former company and compensation from international accounts would be paid to U.S. Art International.

The business partners referred to the settlement of such compensation divisions as “contras.”
But due to poor bookkeeping methods, the settling of contras between the two men became “frustrating and confusing.”
Over time, the poor bookkeeping along with differences between the men over other business practices progressively deteriorated.
By Spring 2002, the men began discussing the severance of the two companies.
In June of that same year, Lank’s attorney sent a letter to O’Connor expressing his desire to end the relationship and redeem his stock.
A contentious meeting followed where the men argued over which company owed money to the other.
Nonetheless, by September the parties and their attorneys appeared to have ironed out most of the details of a severance agreement, memorialized in a fax sent to O’Connor’s attorney by Lank’s attorney.
In response to the detailed agreement, O’Connor’s attorney replied to Lank’s lawyer with another fax highlighting three points included in the letter that he felt did not reflect what the parties had agreed to orally, but noting that he felt the men were “much closer” to coming to an amicable agreement.
But instead of ironing out the final points of contention, the very next day Lank appeared at the corporation’s office and delivered his own letter to O’Connor.
The letter stated that Lank, along with the two other shareholders, had voted to terminate O’Connor immediately and required him to turn over all company records and vacate the premises immediately.
Despite the statement in the termination letter, there never was a stockholder meeting called to take the vote to terminate O’Connor, and no notice of a meeting, as required by the corporate by-laws, was ever given.
In fact, the corporation never held a single meeting of stockholders or directors from its inception to the time of the termination letter.
O’Connor complied but sued the corporation and the three other stockholders, arguing that they impermissibly froze him out and that the same objective could have been achieved through an alternative course of action less harmful to his interest.

‘Less harmful alternatives’

Van Gestel, relying on precedent, explained that the test to determine whether the defendants had breached their fiduciary duty to the plaintiff weighed the legitimate business purpose for the termination against the practicality of a less harmful alternative.
Such an inquiry, according to van Gestel, began with identifying the business purpose for the plaintiff’s removal stated in the termination letter.
“In short, [the plaintiff] has been charged with poor bookkeeping practices that left receivables unaccounted for and payables outstanding,” the judge explained.
“But, if Lank is to be believed, these sloppy practices were known to [him], and were an aggravation to him, for years. Despite that knowledge, Lank, the majority interest holder and the company treasurer, did nothing about it,” stated van Gestel.
The judge noted that “[t]here were clearly less harmful alternatives to firing [the plaintiff] and creating a situation a U.S. Art International such that it could provide nothing to [him] for his 37.5 [percent] interest in the company.”
Van Gestel opined that the company could have hired a competent bookkeeper and made the plaintiff the vice president of marketing with an appropriate salary adjustment.
In the alternative, the company also could have “called a real meeting,” according to the judge, “and discussed among the four of them ways and means to correct the bookkeeping issues and still preserve a role for [the plaintiff] in the international sales aspect of the business, in which no one said his skills were lacking.”
The judge continued: “The action of the majority group, rather than a legitimate business decision, seems much more an act of pique or anger on [the majority shareholder's] behalf, or perhaps some clumsy effort to gain

leverage in any negotiations that might thereafter occur."
And because the defendants ended the corporation's operational existence following the plaintiff's termination, van Gestel said that allowing the plaintiff to return to his post was not an available remedy.
"[The plaintiff's] participation as an employee is, like the fallen egg, broken beyond repair," the judge stated.
As such, van Gestel calculated the plaintiff's fair compensation for lost wages along with his fair compensation for the loss of his 37.5 percent interest in the corporation, concluding that the defendants owed the plaintiff nearly $220,000.

Case: *O'Connor v. U.S. Art Co., Inc. et al.*, Lawyers Weekly No. 12-201-05
Court: Superior Court
Issue: Did the termination of a company president who was a minority shareholder in a closely-held corporation amount to a breach of fiduciary duty on the part of the majority shareholders?
Decision: Yes, because the decision to terminate the plaintiff was not a legitimate business decision that expressed the least harmful alternative to his position
Attorney: Robert R. Pierce, Boston (pictured), for the plaintiff

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