IADC COMMITTEE NEWSLETTER

BUSINESS LITIGATION

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Thanks,
Chris
Chair, Business Litigation Committee

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Massachusetts Appeals Court Finds That Attorneys May Have a Fiduciary Duty to Minority Shareholders of Close Corporations Even in the Absence of an Attorney-Client Relationship

ABOUT THE AUTHORS

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ABOUT THE COMMITTEE

The Business Litigation Committee consists of members involved in business and commercial litigation including business torts, contract and other commercial disputes, e-commerce, antitrust issues, trade secrets and intellectual property, unfair competition and business defamation and disparagement. The Business Litigation Committee helps connect members involved in these areas around the world through networking and referral opportunities; developing and keeping current in the substantive, strategic and procedural aspects of business litigation; and affords members an international forum for sharing current developments and strategies with colleagues. Among the committee's planned activities are newsletters, publications, sponsorship of internal CLEs, and Webinars. Learn more about the Committee at www.iadclaw.org. To contribute a newsletter article, contact:

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In a recent decision that should serve as a cautionary tale for attorneys representing close corporations, the Massachusetts Appeals Court found that, in certain circumstances, attorneys may owe a fiduciary duty to minority shareholders of close corporations even when those shareholders are not their clients. The case, *Baker v. Wilmer Cutler Pickering Hale & Dorr LLP*, 91 Mass. App. Ct. 835 (2017), involved an alleged "freeze out" of the minority members of a closely held corporation, Applied Technologies, a company that manufactures wound therapy treatments. The minority members alleged that the defendants, attorneys from two different law firms, secretly helped Applied Technologies merge into a separate company for purposes of diluting minority members' rights in the operating agreement.

By way of background, in 2000, W. Robert Allison ("Allison") and Elof Eriksson ("Eriksson") organized Applied Tissue Technologies, LLC, as a Massachusetts limited liability company for the purpose of developing and marketing wound therapy technologies. *Id.* at *2. Originally, Allison and Eriksson owned 25 and 75 percent of the company respectively; however, they subsequently assigned portions of their individual interests to two separate trusts benefitting their families, the W. Robert Allison 2003 Irrevocable Trust ("Allison Family Trust") and the Elof Eriksson Irrevocable Trust-2003 ("Eriksson Family Trust"). *Id.* At the time of the events giving rise to the claims at issue, Allison and the Allison Family Trust held a 22.5 percent interest, Eriksson and the Eriksson Family Trust held a 75.5 percent interest, while a key employee, Christian Baker retained the remaining 2 percent interest. *Id.*

In early 2012, Applied Technologies faced significant financial difficulties, however, Allison and Eriksson could not agree on a solution to the company's financial problems. *Id*. Eriksson offered to contribute additional funds, but wanted additional equity in return. *Id.* Because Eriksson's proposed solution would result in a dilution of the minority members' shares, the operating agreement required consent from the minority members. *Id*. Although Allison was willing to have his shares diluted, he would only agree to the dilution on the condition that outside investors provided the necessary additional capital. *Id.*

In a bid to gain control of the company, Eriksson and Applied Technologies's chief executive officer, Karl Proppe engaged Eriksson's daughter, Emma Eriksson Broomhead ("Broomhead") and Gary Schall both of Gunderson Dettmer Stough Villeneuve Franklin & Hachigian LLP ("Gunderson"), as counsel for Applied Technologies. *Id.* at *3. The engagement letter expressly provided that Gunderson would not represent any individual members of Applied Technologies. *Id.* Schall subsequently relocated his practice to Wilmer Culter Pickering Hale & Dorr ("WilmerHale"). *Id.* As a result, a new engagement letter between WilmerHale and Applied Technologies was executed that expressly stated the firm would only represent Applied Technologies. *Id*.

After engaging Schall and Broomhead, Applied Technologies embarked on a plan to eliminate the minority shareholders. The plan

involved an offer by Eriksson to purchase Allison's interest in Applied Technologies. *Id*. In the event that Allison rejected this offer, the company would be merged into a new entity controlled by Eriksson. *Id*. As part of this plan, Broomhead, Schall, Eriksson, and Proppe secretly hired an appraiser to value Applied Technologies. *Id*. Schall then drafted an email that Eriksson sent to Allison with an offer to purchase his interests in Applied Technologies. *Id.* Because the email was written in Schall's style, he advised Eriksson to revise it to reflect his own style before sending it to Allison. *Id*. Allison ultimately declined the majority's offer, indicating that he preferred to maximize Applied Technologies' value and sell his interest at a later date under more favorable circumstances. *Id*.

Unhappy with Allison's response, Eriksson began secretly working with Proppe, Broomhead, and Schall to devise a plan to merge Applied Technologies into a separate company for purposes of diluting the minority members' shares. Specifically, in May 2012, Eriksson, Proppe, Broomhead, and Schall created a new Delaware limited liability company, also called Applied Tissue Technologies, LLC ("Delaware Applied Technologies"). *Id*. Then, without holding a meeting or securing the unanimous written consent of all members, the defendants prepared documents effectuating the merger. *Id.* at *4. These documents included a new operating agreement that eliminated all of the minority shareholder protections contained in the original operating agreement. *Id.* After the merger was consummated, Delaware Applied Technologies issued additional preferred shares to Eriksson, Proppe, and Broomhead's husband. *Id*.

Plaintiffs originally sued the defendants and their respective law firms in Massachusetts Superior Court alleging breach of fiduciary duty; aiding and abetting tortious conduct, civil conspiracy and violations of the Massachusetts Consumer Protection Act. *Baker v. Wilmer Cutler Pickering Hale & Dorr LLP*, No. 1584CV01586-BLS2, 2016 WL 805308 (Mass. Super. Feb. 17, 2016), *aff'd in part, rev'd in part*, 91 Mass. App. Ct. 835 (2017). A trial court judge dismissed Plaintiff's suit finding that the defendants owed no fiduciary duties to the individual shareholders of Applied Technologies. *Id.* at *10. The Superior Court also dismissed Plaintiffs' aiding and abetting claim noting that: "A lawyer does not become liable for aiding and abetting the commission of a tort by a client merely because the lawyer advised the client that it could lawfully engage in a course of conduct, the client did what the lawyer advised was permissible, and it turned out that the client's actions were tortious." *Id*. Finally, the Court dismissed claims brought by Plaintiffs pursuant to the Massachusetts Consumer Protection Act (Chapter 93A) finding that the Defendants had not inserted themselves into any business dealings or competition with the Plaintiff. *Id.* at *12.

The Massachusetts Appeals Court overturned the Trial Court's decision holding that Plaintiffs "have alleged enough to plausibly suggest that Defendants, acting as counsel for a limited liability company governed by an operating agreement providing significant minority protections owed them a fiduciary duty." 91 Mass. App. Ct. at *1.

The Court's decision in Baker is significant for a variety of different reasons. First, in reaching its decision, the Court found that,

even though counsel for a closely held corporation does not by virtue of that relationship alone have an attorney client relationship with individual shareholders, counsel nevertheless owes each shareholder a fiduciary duty. *Id*. at *6-7. The decision also highlights the ethical traps that attorneys face when representing close corporations. Specifically, attorneys representing majority shareholders need to be cognizant of potential conflicts of interest between majority and minority shareholders. *See id.* at *7. At a minimum, attorneys representing close corporations must provide full disclosure to both majority and minority shareholders concerning the nature of the engagement between the attorney and the corporation, so that all members of the corporation fully understand whose interests are being represented by the attorney. *See id*. The *Baker* decision is also important in that the Appeals Court revived claims asserted by the Plaintiff under the Massachusetts Consumer Protection Act. *See id*. at *9-10. In doing so, the Court recognized that a factfinder could reasonably conclude that the minority shareholders and the defendant attorneys were engaged in trade or commerce, a necessary prerequisite to a successful Chapter 93A claim, even though no attorney-client relationship existed between these parties. *Id*. In reaching this conclusion, the Court adopted an extremely expansive interpretation of the terms "trade or commerce", an interpretation that should raise serious concerns for practitioners representing close corporations in Massachusetts. *See id*.

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