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## Majority Shareholders of a Closely Held Delaware Corporation May Be Liable for “Freezeout”

On October 5, 2004, in *Clemmer v. Cullinane*, the Massachusetts Appeals Court held that a minority shareholder in a closely held Delaware corporation may be entitled to relief in the event of a “freezeout” by the majority shareholders.

The plaintiff claimed that the defendants, who held 55% of the corporation’s stock, had “breached their duty of good faith and fair dealings to the plaintiff and wrongfully froze the plaintiff out of his position as an employee.” The plaintiff further alleged that as the corporation paid no dividends, being removed as an employee deprived him of his sole economic benefit from the stock he held and that he had been effectively deprived of the ability to exert any influence over the affairs of the corporation, despite his status as a shareholder and director. The trial judge had dismissed the claim, holding that while the Delaware courts had not definitively ruled on the freezeout issue, they had generally declined to impose a fiduciary duty on the shareholders of closely held corporations unless they organized as a “close corporation” under Delaware law.

The Appeals Court noted that the Delaware courts had imposed an entire fairness test where the freezeout resulted in gains for the majority shareholders. Accordingly, the Appeals Court declined to dismiss the plaintiff’s complaint.

This case illustrates that while shareholders of closely held Delaware corporations may not be subject to the same fiduciary duties as those to which shareholders of closely held Massachusetts corporations are held under *Donahue* and its progeny, it may still be possible for a minority shareholder of a closely held Delaware corporation to state an actionable claim to the extent that the actions of the majority serve to deprive the shareholder of the value of his shares while enriching the majority. Shareholders of a closely held Delaware corporation should remain mindful of establishing a legitimate business purpose to the extent that they take actions that disproportionately and adversely affect the minority shareholders.