Woods v. Metzler, No. 302-6-06 Rdcv (Cohen, J., Feb. 13, 2009)

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**STATE OF VERMONT**
**RUTLAND COUNTY**

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| **DEWITT WOODS** | ) | **Rutland Superior Court** |
| | ) | **Docket No. 302-6-06 Rdcv** |
| **Plaintiff,** | ) | |
| | ) | |
| **v.** | ) | |
| | ) | |
| **PETER METZLER,** | ) | |
| **PATRICIA CARTER,** | ) | |
| **LENORE BIANCHI , AND** | ) | |
| **R.E. 7, Inc.,** | ) | |
| | ) | |
| **Defendants** | ) | |

## BENCH TRIAL DECISION

On September 15, 2008, a three-day bench trial was held regarding plaintiff Dewitt Woods's claims of corporate oppression, breach of fiduciary duties, and breach of contract against defendants Peter Metzler, Patricia Carter, Lenore Bianchi, and R.E. 7, Inc.

Plaintiff Dewitt Woods is represented by William H. Meub, Esq. and Andrew M. Carter, Esq. Defendants Peter Metzler, Patricia Carter, Lenore Bianchi, and R.E. 7, Inc. are represented by Robert Reis, Esq.

## Finding of Facts

1. This case involves the allegation of corporate oppression by the Defendants against the Plaintiff Dewitt Woods, as well as a claims for breach of the fiduciary duty and breach of contract.

2. The individual parties, Peter Metzler, Dewitt Woods, Patricia Carter, and Lenore Bianchi, joined together to form a corporation beginning in 1988.
3. Initially there was a fifth shareholder, Robert McGrath, but he left the cooperation early and is not relevant to this law suit.
4. Each of the individual parties are 25% shareholders of the corporation R.E. 7, Inc. (the "Corporation").
5. Each of the individual parties contributed nominal capital towards the startup of the Corporation.
6. Each of the individual parties were officers of the Corporation.
7. R.E. 7 Inc. is incorporated in the State of Vermont.
8. The Corporation is a real estate sales company in the town of Killington, VT.
9. The Corporation owns no real estate and has been renting office space since its inception.
10. The Corporation had no inventory except for listing agreements for the sale of real property.
11. The Corporation's assets were limited to desks, computers, a copier and other equipment necessary for running a business, such as a phone system and office furniture.
12. The Corporation generates the bulk of its revenue through real estate sales commissions.
13. The Corporation also generates revenue to a lesser extent through property management fees and rental fees.
14. The Corporation has two corporate documents.

15. The initial Articles of Association which set up the entity and a Shareholder Agreement.
16. The Corporation's Articles of Association has a share owners restriction clause.
17. In essence, the restriction clause acts as a right of first refusal to remaining shareholders.
18. Paragraph 6 of the Shareholder Agreement mandates that, "Shareholders shall equally share in the net profits, to be paid out on an annual basis, following payments of all expenses, debt repayment, salaries, and bonuses, if any."
19. The Corporation issued W2 forms to the shareholders for the years in which there was salary paid.
20. The Corporation maintained a separate method of compensation for commission sales for the sale of real estate, resulting in separate I.R.S. Form 1099 issued to the shareholders and to the non-owner sales agents from real estate sales.
21. The Corporation began slowly and developed into a successful real estate sales office.
22. Based upon the advice of its accountant, the Corporation distributed all of its earnings by the end of each year in order not to have retained earnings.
23. Shareholders never received any dividends.
24. Based upon the distribution of earnings and the lack of any real property, the corporation's value was made up of the good will it generated, its good name, and the hard work of each shareholder/officer.
25. The first opportunity the Corporation had to compensate its officers was 1993.

26. The Corporation continued to pay its officers on a yearly basis from non-commission based income.
27. All payments to the officers from 1993 until present were the result of management activities by the shareholders/officers.
28. All payments were deemed as ordinary income to the shareholders on their individual tax returns.
29. The shareholders as well as the real estate agents working for the corporation were compensated for commission sales.
30. Though the parties were aware of the lack of any formal process to either value the shares or to have a method of purchasing retiring shareholder's equity, the parties continued with the method of compensation of W2 income and 1099 commissions.
31. In 2005 the Plaintiff began his discussions with the other shareholders about his retirement and retirement package.
32. The company had no specific buy-out mechanism for a shareholder's retirement.
33. In 2005 the Plaintiff told the defendants that he had a bona fide purchaser for his shares, although there was no formal offer from a purchaser.
34. Daniel Pol was the alleged bona fide purchaser, but declined to make a written offer based upon advice of counsel.
35. There was no actual offer made which required the defendants to either accept or to purchase the Plaintiff shares, pursuant to the Articles of Association.
36. In October of 2005 the Plaintiff vacated his office and removed his personal items from the premises.

37. The Plaintiff also removed himself from the “up-line”. The “up-line” was a long standing policy of the business that required every realtor to participate in phone coverage.
38. The Plaintiff has received no income from the Corporation since leaving the business in October 2005.
39. Each shareholder accepted all economic risks of not having a buy-out agreement by distributing corporate earnings on a yearly basis.
40. Pursuant to Vermont law this closely held Corporation is valued on a “fair value” method instead of a traditional “fair market value”.
41. The shareholders minimized the value of the Corporation by not investing in a real property or retaining earnings.
42. During the trial conflicting evidence was introduced as to the fair value of the corporation.
43. Market fluctuations have greatly affected the real estate market in the town of Killington.
44. There is no formal method of valuing the shares and this risk was accepted by each of the shareholders during the prosperity that the business had during the real estate boom.
45. Each shareholder contributed hard work and professionalism on each of their respective abilities and skills as part of the daily operation of the business
46. Plaintiff contributed mentoring to other agents, was in charge of purchasing, and had good relationships with the owners of condominium projects in the Killington area.

47. The Plaintiff's expert, David Stevens, opined that Plaintiff's shares in R.E. 7, Inc. were worth $246,000.
48. Mr. Stevens utilized an income capitalization method in determining that value.
49. Mr. Stevens' method, though accurate in a formal sense, was not an appropriate method to determine the fair value of this corporation, and was not appropriate based upon the shareholders' acceptance of paying income to the four shareholders over a long period of time.
50. Mr. Steven's method could not take into account the fact that the Corporation retained no earnings and had no appreciable assets.
51. The Plaintiff alleges in his complaint that the other shareholders behavior amounted to corporate oppression against the Plaintiff.
52. Corporate oppression is a cause of action allowed by Vermont Law see 11A V.S.A. section 14.30.
53. The dispute is analyzed under a reasonable expectation theory.
54. Until 2005, all shareholders contributed 100% of their time to the Corporation as officers, and received equal officer compensation based on such participation.
55. Shareholders were never paid officer compensation based on their status as shareholders, but rather for work actually performed in the management of the Corporation.
56. There was no disproportionate share of the profits by salary and benefits.
57. All shareholders worked and received salary as well as retirement benefits.
58. Following Plaintiff's retirement, director salaries were still based on actual work performed by the shareholder/officers in their management duties that resulted in

the smooth running of the Corporation, and the ability of the Corporation to generate significant revenue through real estate sales.

59. There is no evidence of any disproportionate or oppressive behavior by any shareholder against any shareholder.
60. There was equal treatment of each shareholder throughout and each shareholder exercised her or her fiduciary obligations to the other shareholders.
61. The Corporation was not structured to allow a shareholder to stop working and continue to receive money based solely on his or her ownership of shares in the Corporation.
62. The Corporation never built wealth in a manner that would allow a shareholder to receive a retirement buyout.
63. Each shareholder was well aware of this structure and accepted this arrangement for 18 years, and they accepted the risks associated it with this arrangement.
64. Since his retirement, Plaintiff had no intention of actually returning to the Corporation and involving himself with the management of the Corporation.
65. Defendant shareholders offered to allow plaintiff to return the Corporation as an officer/employee.
66. Defendant shareholders offered to allow plaintiff to continue selling real estate outside of the Corporation.

## **Conclusions of Law**

### *I. Shareholder Oppression*

A corporation may be dissolved if in a proceeding by a shareholder it is established that the directors or those in control of the corporation have acted or are acting in a manner that is "oppressive" to the minority shareholder. 11A V.S.A. § 14.30.

Vermont case law is non-existent on the subject of what constitutes shareholder "oppression." New York, however, has a statute similar to that of Vermont, allowing dissolution when there has been a showing that "[t]he directors or those in control of the corporation have been guilty of illegal, fraudulent or oppressive actions toward the complaining shareholders." N.Y. Business Corporation Law § 1104-a (McKinney 2003).

Both plaintiff and defendants cite *Matter of Kemp & Beatley, Inc.*, 473 N.E.2d 1173 (N.Y. 1984) in support of their positions. It is one of the leading New York cases on shareholder oppression and clearly lays out the applicable law.

In identifying and measuring conduct alleged to be oppressive it is appropriate to analyze the complaining shareholder's "reasonable expectations." *Id.* at 1179. The Court must investigate what the majority shareholders knew, or should have known, to be the petitioner's expectations in entering the particular enterprise. *Id.* Majority conduct is not oppressive simply because the petitioner's subjective hopes and desires in joining the venture are not fulfilled. *Id.* Disappointment alone does not equate to oppression. *Id.*

Shareholder oppression should be deemed to arise only when the majority conduct substantially defeats expectations that, objectively viewed, were both reasonable under the circumstances and were central to the petitioner's decision to join the venture. *Id.* Much of this analysis depends on the circumstances of the individual case. *Id.*

In this case, R.E. 7, Inc. had a long standing policy of awarding officer compensation based on work actually performed in the management duties of the Corporation. Each one of the shareholder/officers approved of this method of compensation throughout the entire existence of the Corporation. The expectation of each shareholder was that if they worked for the Corporation as an officer, they would get paid above and beyond their salaries that were based on commissions as agents. This is not uncommon in close corporations. See *Id.* at 1178 (stating that "earnings of a close corporation, as is well known, are distributed in major part in salaries, bonuses, and retirement benefits.).

Objectively viewed, plaintiff cannot have reasonably expected that upon his retirement form the Corporation he would be compensated based solely on his status as a shareholder. The structure of the Corporation was such that it fully depended on the participation of each shareholder/officer in day to day management duties to make it successful. Revenue was generated solely from the hard work and skill that each shareholder/officer and agent put into the Corporation. The company had very few assets and no real estate investment income. The shareholders, including plaintiff, minimized the value of the Corporation by not investing in a real property or retaining earnings. Thus, looking at the circumstances objectively, it was not reasonable that plaintiff could expect to receive compensation when he was not working, when the hard work of each officer and agent was the main "asset" of the Corporation.

Plaintiff's expectation that he would be able to retire and still receive shareholder compensation was not central to plaintiff's decision to join the venture. This is evidenced by the Shareholder Agreement, which set forth that earnings would be distributed to

shareholders after salaries were paid. Furthermore, there was no buy-sell agreement in the Shareholder Agreement which would have been a vehicle for transferring shares. Finally, and most telling, there was no retirement buy-out plan among the shareholders. By not having agreements in place as to retirement, all shareholders in the Corporation, including plaintiff, bore the risk associated with that decision and all shared in it equally. The structure of the Corporation, set up by all shareholders, simply did not contemplate a buy-out at retirement, and thus the ability to receive compensation based solely on shareholder status. Once again, this ties into the reasonable expectation of all shareholders that working as an officer for the Corporation, and not shareholder status, was the basis of officer compensation.

Moreover, if each shareholder party decided to retire at the same time, the Corporation would effectively be left without management, yet each shareholder would still receive 25% of the corporate profits according to plaintiff's theory of the case. This is certainly not reasonable based on the structure of the Corporation, nor could this belief have been central to any of the parties joining the Corporation.

Furthermore, plaintiff was not "frozen out" by the other shareholders, as it was his decision to retire, and since his retirement he has had no intention of actually returning to work to participate in management. See *Brodie v. Jordan*, 857 N.E.2d 1076, 1079 (Mass. 2006) (describing various methods of "freeze out" as majority refusing to declare dividends, draining corporate earnings by paying exorbitant officer salaries, depriving minority shareholder of corporate office and of employment by the company). If the majority shareholders did in fact bar plaintiff from working for the Corporation and

effectively left his 25% stake in the company "worthless," that would be a different story altogether, but that is not the case here.

## *II. Breach of Fiduciary Duties*

Vermont, like nearly all jurisdictions, recognizes that "shareholders in a closely held corporation owe one another a fiduciary duty of good faith and loyalty." *P.F. Jurgs & Co. v. O'Brien*, 160 Vt. 294, 304 (1993) (citing *Solomon v. Atlantis Development, Inc.*, 147 Vt. 349, 356 (1986) (interpreting Massachusetts law)).

Various states, including Massachusetts, analyze shareholder oppression in terms of whether there was a breach of the fiduciary duties owed by the other shareholders. See *Brodie*, 857 N.E.2d at 1079 (analyzing shareholder oppression "freeze out" in terms of breach of fiduciary duties); see also *Davis v. Brockamp & Jaeger Inc.*, 174 P.3d 607, 614 (Or. Ct. App. 2007) (stating "[i]n closely held corporations, a breach of fiduciary duty by majority shareholders normally constitutes oppression."); see also *Scott v. Trans-System Inc.*, 64 P.3d 1, 6 (Wash. 2003) (stating "oppressive conduct by majority shareholders is closely related to the fiduciary duty of good faith and fair dealing owed by them to the minority shareholders."); see also *Balvik v. Sylvester*, 411 N.W.2d 383, 387 (N.D. 1987) (stating "courts have analyzed alleged 'oppressive' conduct by those in control in terms of 'fiduciary duties'."). These cases treat claims of shareholder oppression and breach of fiduciary duties as essentially one in the same.

"Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with [a] 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." *Balvik*, 411 N.W.2d at 387.

There has been no showing by plaintiff that defendant shareholders acted out of avarice, expediency or self-interest in derogation of their duty in declining to compensate plaintiff based solely on his share ownership. To the contrary, the Court finds that defendants conformed to a strict good faith standard in following the agreed upon, and long standing, practice of paying officer compensation based on actual management work performed by the shareholder/officers. There has been equal treatment of all shareholders throughout the existence of the Corporation. As previously noted, if the majority shareholders allowed compensation based solely on ownership, management of the Corporation would cease to exist due to a lack of incentive to work, and the Corporation would cease to be a profitable venture. Thus the majority's decisions were "made in good faith and reflect legitimate business purposes rather than the private interests of those in control." *Brockamp & Jaeger Inc.*, 174 P.3d at 614.

### *III. Breach of Contract*

The Shareholder Agreement, paragraph 6, states that "[s]hareholders shall equally share in the net profits, to be paid out on an annual basis, following payment of all expenses, debt repayment, salaries, and bonuses, if any."

The Shareholder Agreement calls for net profits to be paid out after salaries. The Court finds that officer compensation was in fact paid out according to work performed and was a salary. This was the long standing practice which all shareholders, including plaintiff, agreed upon since the founding of the Corporation in 1988. Therefore, there is no breach of contract.

## ORDER

On the claims for (1) Shareholder Oppression, (2) Breach of the Fiduciary Duties,

and (3) Breach of Contract, the Court finds in favor of DEFENDANTS.

Based on the Court's Decision, the Motion to Dismiss the defendant shareholders from individual liability is MOOT.

The Court will set this for a Status Conference on the issue of prevailing party fees.

Dated at Rutland, Vermont this _____ day of ________________, 2009.

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Hon. William Cohen
Superior Court Judge