

SJC rules disgruntled shareholder can't use derivative action to relitigate claims

By: Roger L. Smerage September 16, 2021

The Supreme Judicial Court has some words of wisdom for the overly litigious shareholder of a closely held corporation. Specifically, the old adage “[i]f at first you don’t succeed, try, try again” does not apply “in litigation.”

Thus begins the court’s Aug. 26 decision in *Mullins v. Corcoran*, SJC-13049, in which the SJC affirmed the Superior Court’s entry of judgment in favor of the controlling defendant shareholders in a derivative action involving a real estate development company.



The decision makes clear that a disgruntled shareholder of a closely held corporation cannot use the mechanism of a derivative action to revive claims that were previously adjudicated in a personal shareholder action that the shareholder filed against co-shareholders and lost.

Background

Joseph Mullins was a minority shareholder of Corcoran, Mullins, Jennison, Inc., a Massachusetts closely held corporation comprised of three shareholders. Although the business had developed and owned residential apartment projects dating back to the early 1970s, in 1987 the shareholders executed an agreement governing both CMJ business and each of the shareholders’ non-CMJ business going forward, which agreement required the shareholders to conduct their business “in scrupulous good faith.”

The manner in which CMJ and the shareholders approached a redevelopment project in Somerville, however, put the agreement to the test.

Although Mullins originally provided his consent to CMJ’s proposal for redeveloping the Somerville site, a few months later he sent a letter to the defendants stating that he did not consent to the development.

CMJ nevertheless proceeded with the project. Mullins, in turn, filed a lawsuit against his co-shareholders of CMJ in 2014, alleging personal claims (as opposed to derivative ones on behalf of CMJ) for breach of the 1987 agreement and breach of fiduciary duty. His co-shareholders counterclaimed in light of Mullins’ about-face.

In 2018, the parties tried their claims on a jury-waived basis, with the court finding that Mullins had failed to prove his claims but that his co-shareholders had successfully proved Mullins’ own breaches of the 1987 agreement and his fiduciary duties by interfering with CMJ’s redevelopment of the Somerville site.

After applying an offset for the co-shareholders’ failure to mitigate part of their damages by passing on the opportunity to sell the site for \$15 million in 2015, the court awarded the controlling shareholders \$12 million in total damages.

In 2017, after the court denied Mullins’ request to amend his pleadings, Mullins filed a separate complaint that, among other things, asserted derivative claims on behalf of Cobble Hill Center LLC, the special-purpose entity that owned the Somerville site and was owned (indirectly but wholly) and operated by the CMJ shareholders.

The defendant shareholders moved for judgment on the pleadings, a form of summary disposition that tests the legal grounds for a claim without trial, arguing that the rulings in the 2014 action precluded the new lawsuit.

The Superior Court allowed the motion, dismissing the case.

Analysis

After spending several pages affirming the Superior Court's reasoning that the legal and factual issues brought in the two actions were the same, the SJC turned to the issue of whether the judgment in the 2014 action precluded Mullins' derivative claims against his co-shareholders on behalf of Cobble Hill.

Those claims specifically alleged that CMJ's decision to proceed with the Somerville redevelopment was not in Cobble Hill's best interest because the development proposal in question — the one Mullins initially agreed to but then reversed course — limited the site's potential value, eliminated revenue (by evicting existing tenants), and precluded exploration of other, purportedly higher-return, proposals.



The relative ease with which an unsuccessful plaintiff could improperly force co-shareholders to endure additional years of distraction and expense litigating the same case a second time, just in a different form, is something the SJC rightly sought to limit.

With the similarity of the underlying legal issues in the two actions already affirmed, the SJC considered whether the parties to the two actions were sufficiently similar to bar Mullins' derivative claims based on the legal doctrine of issue preclusion.

As a starting point, the SJC recognized that because a corporation is typically viewed as a separate legal entity from its shareholders, the general rule is that "in a direct action by a shareholder and a derivative action, the parties generally are not the same." Thus, "a judgment in an action involving a party who is [a] ... stockholder ... of a [c]losely held corporation ordinarily will not have preclusive effect on the corporation itself."

In a closely held corporation, however, such as the one involved in Mullins, things are different. Whereas a regular corporation has numerous stockholders and might be traded on a public or private stock market, a closely held corporation is typified by a small number of owners and the absence of a market for selling ownership interests.

Likewise, regular corporations are usually managed by a board of directors that has some level of independence from the stockholders, whereas the owners of a closely held corporation are usually its managers, as well. Many small businesses and family-owned businesses are closely held, for example.

Given the differences between a regular corporation and a closely held one, the SJC decided that a different rule applies to the identity of parties in a derivative action brought by a shareholder of a closely held corporation who already pursued and lost a "direct," or personal, action against the other shareholders. That is because "the interests of a stockholder, on the one hand, and of the closely held corporation, on the other, may be so similar as to warrant preclusion."

Indeed, "[t]he interests of the corporation, management, and shareholders of a closely held corporation 'generally fully coincide.'"

Thus, the SJC explained that when it comes to "affording opportunity for a day in court ... there is no good reason why a closely held corporation and its owners should be ordinarily regarded as legally distinct." This is particularly so because such corporations are often "really partnerships between two or three people who contribute their capital, skills, experience and labor," as the SJC recognized in *Donahue v. Rodd Electrotype Co. of New England*, 367 Mass. 578 (1975), the seminal case in which fiduciary duties were recognized among shareholders in closely held corporations.

Applying this reasoning to the case at bar, the SJC recognized that CMJ — like a typical closely held corporation — was "comprised of three owners" who managed the business. All three of the owners were parties to the 2014 action and the 2017 action, and there was "no other owner or creditor whose interest was unrepresented in the 2014 action." The closely held corporation's interests were also "adequately represented in the 2014 action," such that Mullins was "bound by that action."

As a result, the SJC concluded that, in light of this privity among the parties, "it [was] clear that the issues [Mullins] seeks to raise derivatively ... are precluded," such that the judgment on the pleadings in favor of the co-shareholders was affirmed.



Conclusion

Litigants, including shareholders of closely held corporations, understandably want every opportunity the law allows to pursue claims.

This can be particularly true in disputes among shareholders in such corporations, which often carry years (if not decades) of personal history between the parties. These disputes are often legitimate fights for control of the corporation, and Massachusetts law has set a relatively low bar to ensure that such shareholders have their day in court.

But the relative ease with which an unsuccessful plaintiff could improperly force co-shareholders to endure additional years of distraction and expense litigating the same case a second time, just in a different form, is something the SJC rightly sought to limit.

The SJC's decision in Mullins is an unmistakable step in this direction. While a derivative action is often the proper vehicle for asserting claims in a dispute among shareholders of a closely held corporation, the SJC made clear that such an action cannot serve as a back-door attempt to re-litigate claims that have already been decided.

Roger L. Smerage is a litigator at Ruberto, Israel & Weiner in Boston. He can be contacted at rls@riw.com.

Issue: SEPT. 20 2021 ISSUE

YOU MIGHT ALSO LIKE

The difficult but important task of letting someone go

🕒 February 4, 2022



Late judge's impact on District Court 'will be lasting'

🕒 February 4, 2022

Letter: Retired SJC justice dismayed by 'Sweeting-Bailey' ruling

🕒 February 4, 2022