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By Marc C. Laredo

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Cover: Lowell District Court. Photo by Hon. David S. Rou.
In 2007, the Massachusetts Law Review published Shareholder Duties and Disputes in Closely-Held Corporations in Massachusetts (“Shareholder Duties”); a review and analysis of the law governing closely-held Massachusetts corporations. This body of law can differ — sometimes significantly — from the law governing closely-held entities formed in other states as well as the law governing non-closely-held Massachusetts entities. Over the past decade, while the fundamental principles have remained the same, Massachusetts courts have refined and built upon those principles and addressed previously unresolved issues, including developing a body of law to govern closely-held Massachusetts limited liability companies. Court decisions regarding closely-held entities, while applying established principles, are often fact-specific, with the facts and equities of a particular situation frequently dictating the ultimate outcome. Guided by the format of Shareholder Duties, this article will remind the reader of the governing principles and authorities, review recent decisions, discuss unresolved issues, and provide practical suggestions for practitioners.

I. The General Standards and Basic Rules

The leading case regarding the duties of shareholders in closely-held Massachusetts corporations remains Donahue v. Rodd Electrotype Co. of New England Inc. In Donahue, a case discussed extensively in Shareholder Duties, the Supreme Judicial Court (SJC) applied the general law of partnerships to so-called “close” corporations, namely those entities with “(1) a small number of shareholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operation of the corporation.” Shareholders in a closely-held corporation “owe one another a strict fiduciary duty” and must act with “utmost good faith and loyalty.” Those duties, as the SJC held in Wilkes v. Springside Nursing Home Inc., are tempered by the doctrine that actions that harm another shareholder will be allowed if they have a “legitimate business purpose” and there is no practical “less harmful alternative.”

The law regarding closely-held Massachusetts corporations is not the same as general Massachusetts corporate law. In the closely-held context, Massachusetts courts have added on extra layers of rights and duties because of the special nature of the closely-held entity. Thus, for example, in a Massachusetts close corporation, the shareholders owe duties to the corporation and to one another. Those

1. My thanks to Payal Salsburg of Laredo & Smith, LLP, for her assistance with this article.
3. The terms “closely-held” and “close” have the same meaning in this context. This article will use both terms interchangeably.
4. In many respects, the word “owner” is a more accurate means of describing those covered by the rules regarding closely-held entities. The owners of a corporation are shareholders or stockholders (Mass. Gen. Laws ch. 156D, § 1.40 (2005)); the owners of a limited liability company are members (Mass. Gen. Laws ch. 156C, § 2 (2005)); and the owners of a limited liability partnership are partners (Mass. Gen. Laws ch. 108A, §§ 2 and 45 (2011)). The management structures differ for each form of entity.


In a limited liability company, the members may select a manager or managers, who then function as a combination of directors and officers. Mass. Gen. Laws ch. 156C, § 24 (2005). A limited liability company can (but is not required to) create officers or others to carry out the duties of the managers. Id.

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same duties carry over to their roles as directors (and other actions that they take in connection with the corporation). This is in contrast to the general rule of Massachusetts corporate law “that a director of a Massachusetts corporation owes a fiduciary duty to the corporation itself, and not its shareholders . . . .” 11 It also is important to note that the law governing Massachusetts closely-held entities is not necessarily the same as the law of entities formed in other states.14 The duties owed among owners of a close corporation to one another and to the corporation apply to all owners, majority and minority, thus requiring all owners to abide by the same rules.15 These duties remain in effect for all owners even if one owner violates them. As the SJC explained, “[a]llowing a party who has suffered harm within a close corporation to seek retribution by disregarding its own duties has no basis in our laws and would undermine fundamental and long-standing fiduciary principles that are essential to corporate governance.”16 The court added that “[i]f shareholders take it upon themselves to retaliate any time they believe they have been frozen out, disputes in close corporations will only increase. Rather, if unable to resolve matters amicably, aggrieved parties should take their claims to court and seek judicial resolution.”17

As practitioners in this area can attest, closely-held entities, even highly profitable ones, sometimes do a substandard job of adhering to the necessary corporate formalities, such as meetings (or consents in lieu of meetings) and record-keeping. The problems often start at the inception of the business when the founders may be unaccustomed to proper or good corporate governance and money may be tight, leading to less attention being paid to legal issues. An entity may be formed by the owners themselves (perhaps with the assistance of a non-lawyer professional, such as an accountant or a company that provides online assistance for individuals forming an entity) without documentation other than the articles of organization (or the certificate of organization for a limited liability company or certificate of registration for a limited liability partnership) on file with the Massachusetts Secretary of State. Even the amount of stock (or the percentage of membership or partnership interest) held by each owner can be unclear. As the entity grows, it may not have an attorney who regularly represents it, leading to a lack of attention to ongoing recordkeeping. Much of this may not be an issue until a problem or dispute arises, at which point the lack of documentation can cost the entity and its owners far more in time and expense than they would have spent getting the entity’s legal affairs in order in the first instance.

The Massachusetts courts have adopted a practical approach in such situations, looking to other sources of information, such as an entity’s income tax returns, to determine key issues, such as the percentage of ownership each individual has in the entity. An unpublished decision of the Appeals Court in Houser Buick Inc. v. Houser18 illustrates this practical approach. In Houser, a closely-held corporation filed suit against one of its shareholders for breach of fiduciary duty.19 After an adverse judgment, the shareholder claimed that the action against him had not been properly authorized by the corporation because “bringing a suit against a director is such an extraordinary act that it requires a meeting and vote of the directors.”20 Relying on the SJC’s holding in Samia v. Central Oil Co. of Worcester,21 the Appeals Court panel rejected that argument.22 Without condoning the absence of formalities often seen with closely-held businesses, the court refused to permit the director who had been complicit in this informality, including years without any formal directors’ meetings, to use this same informality as a shield against allegations of misappropriation.23 “Where rights of creditors or other outsiders are not involved, actions taken without compliance with corporate formalities have frequently been held to bind shareholders.”24 While the Houser court appropriately allowed the realities of the situation to govern, the arguments made by the dissident shareholder (and the resultant time and attorneys’ fees) could have been avoided in their entirety had the proper formalities been observed at the outset.

13. Id. One other exception to the general rule is “where a controlling shareholder who also is a director proposes and implements a self-interested transaction that is to the detriment of minority shareholders, a direct action by the adversely affected shareholders may proceed.” Id. at 562. Delaware, in contrast to Massachusetts, “has a history of asserting that directors stand in a fiduciary relation to stockholders of the company . . . .” Id. at 563. In Tucci, this meant that the claims of the shareholders in this publicly-held Massachusetts entity needed to be brought derivatively. Id. at 562-63.


17. Id. at 553 (citations omitted). The rationale for this ruling is that the courts are the appropriate forum to resolve claims of unfair conduct, and self-help is not appropriate. While perhaps understandable in the abstract, it ignores the difficulties that a minority shareholder can face if she is a victim of a breach of fiduciary duty and can lead to some seemingly harsh results. Take, for example, the shareholder whose employment is wrongfully terminated. Resort to the courts can take months or years (although preliminary injunctive relief might alleviate that delay if it is available). She needs to earn a living and so takes a job with a competitor. In doing so, she can be charged with breach of fiduciary duty. So, her alternatives are stark — follow the court’s required procedures and be unable to support herself or her family, or take new employment and be subject to a claim against her (perhaps at the same time that she is pursuing her own breach of fiduciary duty claim). Neither is a particularly attractive alternative. It also is at odds with the general duty that an aggrieved party has to mitigate its damages.


19. Id. at *1.

20. Id.


23. Id.

24. Id. (citing Pitts v. Halifax Country Club Inc., 19 Mass. App. Ct. 525 (1985)) (see O’Brien v. Pearson, 449 Mass. 377 (2007) (absent clear corporate action setting stock holdings, jury found that O’Brien “was a forty eight per cent shareholder in the corporation . . . .”). In its opinion, the O’Brien court noted that the articles of organization were filed “without detailing the shareholder distribution.” Id. at 379. Typically, however, the articles of organization do not identify the shareholders or their ownership percentages in an entity.
A. The Owner-Employee

One of the hallmarks of the closely-held entity is that the owners are often employees of the entity. Indeed, employment may be how the owners receive a return on their investment in the business. This leads to difficulties when the basic rules of employment in Massachusetts, such as that of employment generally being “at will” unless contractually altered, clash with the rights of owners to derive benefit from the business through the employment relationship.

While there is a heightened standard of scrutiny when the employment of a shareholder-employee is terminated, a pair of Superior Court decisions, Benesetter v. Data Plus Inc. and Holland v. Burke, serves as a reminder that any entitlement to employment is not unlimited. In Benesetter, a husband and wife were employees and shareholders of a closely-held business. The marriage founded and, during the divorce process, the husband terminated the wife’s employment. Although the court rejected some of the stated reasons for the discharge, it ruled that certain other ones were sufficient cause for termination and that “[m]aintaining a disgruntled, non-contributing, and self-serving employee such as Mrs. B. on the company’s payroll was not in the company’s best interest . . . [and] there was no effective alternative course of action less harmful to Mrs. B. that could have been taken . . . ” In Holland, a case involving the allegedly improper termination of an owner’s employment and the misappropriation of funds by the other owners, the court noted that “[w]ether there is a freeze out in this situation depends on the shareholders’ reasonable expectations of benefit.” There, the terminated shareholder-employee, unlike the other shareholder-employees, was not experienced in the business, did not establish “that he had a reasonable expectation of continued employment” and did not show “that a guaranty of employment was a major reason for his investment of capital, or that he was relying on employment . . . or his livelihood.” “Rather, the credible evidence established that Holland’s primary motivation in joining the enterprise was to invest in the land and the two businesses, an interest which Holland retains by virtue of his stock ownership.” Without an expectation of employment as a return for investment, depriving one of employment is not a freeze out. Both cases illustrate that whether the termination of a shareholder-employee is improper depends on the particular facts and circumstances of each case.

Sometimes, however, the employment relationship will be governed by an agreement among the owners or a separate employment agreement. In those circumstances, the contract will govern under the rules discussed in the section below on agreements among owners.

B. Diverting Corporate Opportunities

An owner of a closely-held business may not divert corporate opportunities away from the business without full disclosure and approval by the entity. But, as with other fiduciary duties, this too can be modified by agreement. In Pointer v. Castellani, the SJC held that where an operating agreement stated that a company had a limited business purpose and that its members were specifically permitted “to conduct any other business or activity whatsoever” a member was free to take an opportunity that was “not involved within [the company’s] line of business.” Thus, as in other areas of the law involving closely-held businesses, agreements among members or shareholders will often control and can limit or expand their rights and duties.

C. Which Law Applies

The Donahue rules only apply to Massachusetts entities. Whether an entity is a Massachusetts entity depends on its state of incorporation. Even if a business has its base of operations in Massachusetts, Donahue will not apply unless the entity is formed as a Massachusetts domestic entity. Thus, what seemingly can be a minor decision — the state in which the entity should be initially incorporated or registered — can have enormous ramifications should a dispute among the owners arise.

27. Benesetter, at *1 and 3.
28. Id. at *3-4.
29. Id. at *6.
30. Holland, at *6. Holland involved both a limited liability company and corporations. See id.
32. Id.
33. See Clay v. J.L. Hammett Co., No. 12–P–285, 2012 WL 5832460 (Mass. App. Ct. Nov. 19, 2012) (unpublished per Rule 1:28) (affirming lower court’s ruling that bonuses paid to shareholder/employees in connection with sale of company were permissible because “no facts in the summary judgment record would establish a violation of the business judgment rule. Indeed, the only evidence was that the bonus payments were reasonable.”).
34. “The existence of a contract ‘does not relieve stockholders of the high fiduciary duty owed to one another in all their mutual dealings,’ but where the parties have defined in a contract the scope of their rights and duties in a particular area, good faith action in compliance with that agreement will not implicate a fiduciary duty.” Merriam v. Demoulas Super Mkts., Inc., 464 Mass. 721, 727 (2013).
36. Id. at 555–56.
38. NetCentric, 433 Mass. at 470-72. The NetCentric court distinguished its prior ruling in Demoulas v. Demoulas Super Mkts., Inc., 424 Mass. 501 (1997). NetCentric, 433 Mass. at 470-72. In Demoulas, the court applied a “functional approach” in ruling that Massachusetts law governed “because the company involved was formed originally in Delaware but later merged into a Massachusetts corporation.” Id. at 470. Thus, the Demoulas ruling is an exception to the general rule that the law of the state of incorporation governs and it will take extraordinary circumstances for a court to stray from that rule. See id.
39. An entity is formed by filing the appropriate papers with the Secretary of State in the state of incorporation along with the requisite filing fee. An entity can then register to do business in another state by filing the appropriate papers with that state’s Secretary of State, again along with that state’s filing fee. Thus, an entity based in Massachusetts can be formed in Delaware and then registered as a foreign corporation doing business in Massachusetts. The entity will be a Delaware entity, not a Massachusetts entity.
Of note in *NetCentric* was that while the parties’ “stock and non-
competition agreements provide that they are governed by Massa-
chusetts law” that did not mean that Massachusetts law governed
the internal affairs of the entity. Thus, two different state’s laws
came into play — Delaware law for issues involving breach of fidu-
ciary duty and Massachusetts law for the stock and noncompetition
agreements. In this regard, *NetCentric* should serve as a cautionary
reminder to practitioners to consider the choice of law issue care-
fully in both forming the entity and creating agreements among its
owners and between the company and its owners.

In *Donahue*, a decision from the Business Litigation Ses-
sion of the Superior Court, illustrates the importance of carefully
crafting any choice of law provisions in agreements among share-
holders. In *Donahue*, the parties’ limited liability company oper-
ating agreement stated that “[i]t is this Agreement and the application or
interpretation hereof, shall be governed exclusively by the laws of the
State of Delaware, and specifically the Act” which, as the court held,
meant Delaware’s limited liability company statute. The court held
that Massachusetts law governed with respect to issues concerning
the statute of limitations even though the operating agreement stat-
ed that it was governed by Delaware law. The court found that the
parties’ “choice-of-law provision does not expressly address limitation
periods and, for that reason, does not control which State’s
statute of limitations applies here.”

The court then used Massachusetts’s functional approach to
determining the applicable statute of limitations to conclude that the Massachusetts statute of limitations controlled — a ruling that allowed contract-related claims to sur-
vive a statute of limitations challenge. Thus, while Delaware law
governed the standards for the parties’ internal disputes, Massachu-
setts law controlled when such claims had to be made.

**D. The Applicability of Donahue to New Types of Legal Entities**

Massachusetts courts have applied the *Donahue* standards to
limited liability companies. In *Pointer v. Castellani*, although the
entity in question was a limited liability company, the court applied
*Donahue’s* rules of fiduciary duties of shareholders of closely-held
corporations to the entity. Interestingly, the court used the word
“corporation” rather than “company,” leading to the conclusion that
it views these different forms of entities interchangeably for pur-
poses of applying closely-held entity law.

**E. The Identity of the Client**

Lawyers who work with closely-held entities must consider the
question: Who is the client? This question must be asked both at the
onset of the relationship and then again as significant matters arise.
The answers are not always easy.

Often, the client is the entity. But that does not address the
related problem of the inherent conflict in any agreement involving
two or more people that their interests differ in some respect. Who
does the attorney then represent?

The easiest course of action is for each of the entity’s owners to
have his or her own separate counsel. But that may not be a very
practical approach for a new entity with limited resources. An attor-
ney who suggests that a host of lawyers or law firms must be
involved soon may not have a client at all or, perhaps even worse,
a client who decides to do nothing rather than incur the added ex-
 pense of additional lawyers.

There is no perfect solution to this dilemma and the appropriate
approach will vary from case to case and also depend on the nature
of the relationship among the owners and the agreement in ques-
tion. Regardless of the approach, full disclosure should be made,
preferably in writing. If the owners are in a more adversarial situ-
ation, disclosure may not suffice and the individual owners should
be urged to consult with their separate attorneys (at least to review
what has been drafted) and, if the attorney is representing the entity,
the attorney should make clear that she does not represent anyone
individually.

The issue of the identity of the client came to the forefront in
*Bryan Corp. v. Abrano*, and led to lengthy litigation resulting in the
disqualification of counsel for one of the owners. *Abrano* involved a
dispute among the family members/owners of a closely-held corpo-
ratio. In 2014, the company had retained a law firm to represent it
in a lawsuit brought by a former company consultant. Several
months later, two of the company’s owners contacted the same law
firm about representing them individually in connection with their
dispute with the third owner. The law firm agreed to represent the
two individual owners; at the same time, the law firm advised all the


42. No. 1684CV0399BL2, 2017 WL 3080555, 34 Mass. L. Rptr. 304
(Mass. Super. Ct. June 1, 2017) (Salinger, J.). This case was featured in a front-
page article in *Massachusetts Lawyers Weekly*. Mass. Lawyers Weekly, Vol. 46,
Issue 25 (June 19, 2017).

43. *Id.* at *2.

44. *Id.* at *3.

45. *Id.*


47. *Id.* at 539, 549-51; see generally Beninati v. Borghi, 90 Mass. App. Ct. 556
(2016).

48. While the first sentence of the court’s decision stated that “[t]he plain-
tiff, Bernard J. Pointer, was part owner of Fletcher Granite Company LLC, a
closely-held corporate entity,” the court later stated that it was “uncontested
that FGC is a close corporation...” *Id.* at 538, 549. The *Pointer* court is not the
only Massachusetts appellate court to use terminology related to corporations in
the context of closely-held entities. In *One to One Interactive LLC v. Landrith,*
76 Mass. App. Ct. 142 (2010), the court began its opinion with the statement
that “[f]ormer founders of an Internet start-up company, One to One Interac-
tive LLC (OTO or company), sued each other for claims arising out of internal
disputes and the eventual demise of their closely-held corporation.” *Id.* at 143
(emphasis added). A limited liability company, however, is not technically a
corporation.

49. *Rule 1.13* of the Massachusetts Rules of Professional Conduct governs
the ethical duties of a lawyer who represents an entity.

50. *Take*, for example, a situation where a mother and her children or three
siblings are trying to put together a new business. The statement from the lawyer
that each one must have his or her own attorney is likely to be met with strong
resistance.

51. Having each owner have his or her counsel review any agreement before
it is signed can be very helpful should later disagreements arise. Of course, the
difficulty is in persuading clients with limited resources that they need separate
counsel.

52. *Id.* at 505-06.

53. *Id.* at 506.

54. *Id.*

55. *Id.*
owners that there might be a conflict of interest between them and the company and, if a conflict developed, the law firm would withdraw from the pending litigation. 57 Three weeks later, the law firm announced its intent to resign as counsel for the company in the lawsuit. 58 The law firm subsequently represented one of the owners in litigation against the third owner and in another lawsuit brought by the company against a third party. 59 The company then moved to disqualify the law firm, and the lower court granted the motion. 60 An appeal accepted for direct appellate review before the SJC followed. 61

Relying on the Massachusetts Rules of Professional Conduct, the SJC reasoned that at the time the law firm agreed to represent the two owners, it should have known “that their interests were adverse to, or were likely soon to become adverse to, those of the company and, in these circumstances, both the duty of loyalty and Rule 1.7 required it to decline representation, or at least seek the informed consent of the company.” 62 The court specifically rejected the argument that at the time the law firm agreed to represent the individual owners, there was no conflict between those owners and the company. 63 Even if no actual conflict existed, the potential for conflict existed, requiring the law firm to decline the representation or obtain informed consent for the representation. Nor could the firm eliminate the conflict by withdrawing from its representation of the company. The court held that

a firm may not undertake representation of a new client where the firm can reasonably anticipate that a conflict will develop with an existing client, and then choose between the two clients when the conflict materializes. Both the duty of loyalty and the rules clearly forbid such conduct. 66

In a similar vein, in another close corporation case, the failure to carefully identify the client led to a Superior Court ruling that

emails between an attorney and his clients/minority shareholders were not protected by the attorney-client privilege because the clients had shared them with their brother who, while also was a shareholder and only nominally adverse to them in litigation against another family member, was not represented by their attorney. 67

There, the clients unsuccessfully argued that the brother also was a client; the court rejected that theory, ruling that there was neither an express nor an implied attorney-client relationship between the brother and the attorney. 68 As a result, the privilege was waived when the communications were shared and the court ordered the communications to be produced. 69

The issue of the identity of the client also comes into play when there is litigation among owners and questions arise as to whether communications with counsel are privileged and whether certain corporate constituents are entitled to access corporate attorney-client privileged communications. 70 In Chambers v. Gold Medal Bakery Inc., the court ruled that where certain shareholders’ interests were adverse to the corporation’s interests in certain litigation, those shareholders were “not entitled to privileged or protected information relating to the two litigations.” 71 In so ruling, however, the court cautioned that “[t]he judge or discovery master should take particular care to distinguish Gold Medal’s privileged communications... from the underlying facts of Gold Medal’s financial health and status, information that may have been generated irrespective of litigation.” 72 The court added that “[w]e stress that no one factor or combination of factors is dispositive in determining when a director has interests adverse for attorney-client privilege purposes, particularly in the unique context of a close corporation. The analysis is ‘fact specific and necessarily depends upon the circumstances of each case.’” 73

A law firm’s involvement in a dispute among owners of a closely-held entity can trigger later claims against the law firm itself. 74 In Baker, the plaintiffs were minority members of a closely-held

57. Id. at 506-07.
58. Id. at 507.
60. Id. at 508-09.
61. Id. at 509. Although not discussed in the opinion, the appeal was interlocutory in nature because judgment had not yet entered in the lower court. It was before the SJC because the court had granted a request for direct appellate review. Id. at 509. Interlocutory appeals are permitted in cases involving the disqualification of counsel. See Borman v. Borman, 378 Mass. 775, 778-81 (1979).
62. Abrano, 474 Mass. at 510. Rule 1.7 of the Massachusetts Rules of Professional Responsibility provides that:

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest.

A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client; and

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

In Abrano, the court used the most recent version of the rule because the changes to the rule in 2015 were not substantive. Abrano, 474 Mass. at 510 n.9.
63. Id. at 512.
64. Bryan Corp. v. Abrano, 474 Mass. 504, 512-14 (2016). Only a disinterested company representative would have been in a position to provide the informed consent for the company. Abrano, 474 Mass. at 515 n.11.
65. Id. at 515.
66. Id. at 516.
68. Id.
69. Id. at *3.
71. Id. at 384.
72. Id. at 392.
73. Id. at 395-96.
Massachusetts limited liability company. They alleged that "the
majority members secretly retained the attorneys, one of whom is
the daughter of a majority member, to, at least ostensibly, represent
the closely-held company" in developing a plan to merge the Mas-
sachusetts entity into a new Delaware entity, "all for the purpose
of eliminating significant protections afforded minority members
under the Massachusetts company's operating agreement." The
Appeals Court reversed a Superior Court decision dismissing the
case against the defendant law firms and individual attorneys, rul-
ing that the complaint stated sufficient facts regarding claims "for
breach of fiduciary duty, aiding and abetting tortuous conduct, civil
conspiracy, and violation of G.L. c. 93A" to survive a motion to
dismiss. The court relied on a ruling of the SJC that counsel for a
close corporation can owe a fiduciary duty to individual sharehold-
ers. Here, the court concluded that the plaintiffs had alleged suf-
ficient facts to support the claim that the lawyers and the law firms
duties to both the corporation and the individual owners, even
though they never interacted with the individual minority owners.

Identifying the client is a difficult but extremely important issue
for counsel for a closely-held entity. Although litigation among
the owners is the most extreme example of where conflict exists, there
are numerous other situations where similar conflicts arise. Counsel
must carefully meet his or her ethical obligations while not losing
sight of the practical issues facing the entity and its owners.

F. Agreements among Owners

Shareholder agreements are specifically recognized both by Mas-
sachusetts statute and case law. Such agreements can cover a wide
array of issues, including how to deal with death, disability, internal
management and compensation, retirement or termination of em-
ployment and how to resolve internal disputes. Some of these issues,
such as employment, may be the subject of a separate agreement
rather than included in the shareholder agreement.

While shareholder agreements will be enforced — and in that
regard can, in certain circumstances, eliminate a challenge to an
action based upon a claim of breach of fiduciary duty — that en-
forcement is strictly limited to the terms of the agreement. In
Selmark Associates Inc. v. Ehrlich, the SJC was asked to construe
"the duties fellow shareholders and directors of a close corporation
owe to each other in a context where contractual agreements exist
defining in part their relationships.... The court reiterated the
rule that "when the challenged conduct at issue in a case is clearly
contemplated by the terms of the parties' written agreements, we
have declined to find liability for breach of fiduciary duty." The
court added, however, that "[w]hen the contract does not entirely
govern the other shareholders' or directors' actions challenged by
the plaintiff, a claim for breach of fiduciary duty may still lie."

Applying the principle of strict adherence to the terms and
scope of the agreement, the court held that there was no govern-
ing employment contract between the corporation and the minor-
ity shareholder because that contract had expired by its terms years
earlier and at that point the employee became an employee at will.
Therefore, the shareholders still owed one another fiduciary du-
ties in connection with the minority shareholder's claims relating
to the termination of his employment. Nor did the existence of
other agreements replace the fiduciary duties owed to the employee
because those agreements did not expressly deal with employment
after the employment agreement ended and before a right to conver-
station of stock contained in one of those other agreements (a conver-
sion agreement) ripened (the conversion agreement only created a
right to an employment agreement after conversion of the stock).

Yet, when the terms of an agreement are specific and on point,
they will control. In Balles v. Babcock Power Inc., a senior man-
agement employee was terminated "when it was discovered that he
was engaged in an ongoing extramarital affair with a young female
subordinate." The company argued that the termination was "for
cause." Carefully construing the stockholders' agreement, the
court held that the termination was not permitted under the precise
terms of the agreement, which listed what constituted cause and
allowed in some instances for an opportunity to cure any wrong-
ful conduct, which opportunity had not been provided. The court
rejected the claim that such an opportunity would have been futile,
an exception which, the court, held, "notably, is quite narrow...."
Balles is a reminder of the importance of the precise language used
in agreements among owners of close corporations.

Where shareholders of a closely-held corporation do not in ad-
advance establish the terms and conditions of permissible outside work
performed by directors, officers or shareholders, a court will not read
into their agreement a provision that curtails such activity where
such outside engagement does not pose a conflict of interest to the

75. Id.
76. Id.
77. Id. at 837.
78. Id. (relying upon Schaeffer v. Cohen, Rosenthal, Price, Mirkin, Jennings &
Berg PC, 405 Mass. 506, 513 (1989)).
79. Id. at 842-47. The court appeared particularly troubled by the allegations
that one of the attorneys was the daughter of one of the majority owners, the
secret nature of the attorneys' role, and that the attorney's actions appeared to be
directly adverse to the interests of the minority owners. Baker v. Wilmer Cutler
Court also allowed the claim under General Laws chapter 93A, with its poten-
tial for multiple damages and attorney's fees, to proceed. See id. at 849-51.
80. MASS. GEN. LAWS ch. 156D, §§ 7.30-7.32 (2005). The statute places some
limits on the agreements, such as that they must be set forth in the articles of
organization or signed by the shareholders and approved by the corporation and
that they are only valid for 10 years unless the agreement provides otherwise. Id.
The statute applies to all corporations, not just closely-held ones. See id.
81. See Butts v. Freedman, No. 1584CV03652BLS2, 2017 WL 6395705, *3
(Mass. Super. Ct. Oct. 27, 2017) (Sanders, J.) ("It is true that a contract (like an
operating agreement) can limit or even eliminate these fiduciary obligations.")
82. 467 Mass. 525 (2014).
83. Id. at 526.
84. Id. at 537.
85. Id. at 537-38.
86. Id. at 536.
87. Id.
90. Id. at 566.
91. Id. at 567.
92. Id. at 570-80. The detail involved in the court's discussion is worthy of
independent review by practitioners in this area, particularly those involved in
crafting such agreements, as a guide to the level of detail that may be scrutinized
by a reviewing court.
93. Id. at 577.
corporation (such as taking for personal gain work that might otherwise inure to the benefit of the corporation) and does not diminish the shareholder’s capacity to generate revenues for the corporation. In *McGrath v. Braney*, three shareholders of an accounting firm alleged that the fourth shareholder had breached his fiduciary duties to them by (1) deceiving them about his status as a compensated board director of a local bank, (2) diverting his time, attention, and best efforts away from the accounting firm, and (3) failing to turn over his earnings from the local bank to the closely-held corporation. The trial court found in favor of the fourth shareholder, explaining that “neither the Articles of Organization nor the By-Laws contained any restrictions on what a shareholder could or could not do beyond the singular limitation that all shareholders needed to be duly licensed CPAs in good standing in the Commonwealth of Massachusetts.” Despite their protests to the contrary, each of the three complaining shareholders engaged in “substantial amounts of outside activity unrelated to the business of the firm,” albeit only the fourth shareholder’s activity generated any actual compensation. The evidence demonstrated that the shareholder’s position as a board director for the local bank was conspicuously posted on the corporation’s website, disclosed annually on various regulatory filings, and listed on the accounting firm’s malpractice insurance application. Moreover, the shareholder exceeded two of the other three shareholders in his economic productivity for the firm. Thus, without any agreement specifically restricting outside business activities or obligating individual shareholders to turn over all income derived from outside activities to the corporation, the shareholder was free to engage in such activity.

In *Merriam v. Demoulas Super Markets Inc.*, the SJC held that the minority shareholders of a Subchapter S corporation could sell their shares consistent with the agreements contained in the corporation’s articles of organization and bylaws, regardless of whether the buyer’s ownership would terminate the corporation’s status as a Subchapter S corporation. Because the articles of organization did not contain any restrictions on stock transfers that required the corporation’s Subchapter S status to be maintained, and the shareholders had not elected to restrict transfers in a separate stock restriction agreement or by amendment to the articles of organization, the court found it entirely proper for a trial court to decline the invitation to impose such restrictions after the fact. Moreover, where the articles of organization did not contain a pre-emptive right of first refusal to the company, neither principles governing fiduciary duty nor the implied covenant of good faith and fair dealing would insert such a term where the parties chose not to do so themselves.

**II. Remedies**

**A. Derivative Actions**

Although it did not involve a closely-held entity, *International Brotherhood of Electrical Workers Local No. 129 v. Tucci* presents a useful summary of general Massachusetts law governing derivative actions, how such actions differ from direct actions, and the rules that must be followed in bringing a derivative action. The court noted that “[w]e continue to adhere to the view that whether a claim is direct or derivative is governed by whether the harm alleged derives from the breach of a duty owed by the alleged wrongdoer — here the directors-to the shareholders or the corporation.”

The importance of standing — and hence whether a claim is direct or derivative — in the context of actions brought against shareholders was highlighted yet again in *DeCroteau v. DeCroteau*. In *DeCroteau*, a corporation was owned by three brothers: 51 percent by Joseph and the remaining 49 percent collectively by Mark and Michael. The corporation owned and operated a funeral home on property rented from a limited liability company owned solely by Mark and Michael. When the lease to the property expired, Mark and Michael listed the property for sale, thus allegedly risking the existence and operation of the corporation and jeopardizing Joseph’s livelihood.

Acting in his individual capacity, Joseph sued his brothers. He sought a preliminary injunction, which was denied. On appeal, the court ruled that Joseph had not demonstrated that he had standing to bring most of the claims directly in the lawsuit, ruling that DeCroteau Corporation, not the plaintiff, is the tenant of DBR. DeCroteau Corporation, not the plaintiff, owns and operates the funeral home business. Consequently, the plaintiff’s claims, other than the count for breach of fiduciary duty . . . and the claims regarding the creation of a resulting trust or imposition of a constructive trust, belong to DeCroteau Corporation, an entity separate and distinct from the plaintiff.

Thus, only the direct claims were allowed to proceed.

Not only must an owner party bring a claim in the correct capacity — direct or derivative — the owner also must have been an
owner at the time of the wrongdoing (or ownership transferred to her as a matter of law) and throughout the litigation process in order to have standing. In *Mirra v. Mirra*, for example, the court ruled that shareholders lacked standing because they had not been shareholders at the time of the alleged wrongdoing. Nor were the shareholders saved by the “continuing wrong” doctrine because every wrongful transaction may be viewed as a continuing wrong to the corporation until remedied, ... the ‘test to be applied in such situations concerns whether the wrong complained of is in actuality a continuing one or is one which has been consummated ... [W]hat must be decided is when the specific acts of alleged wrongdoing occur, and not when their effect is felt.

Moreover, as discussed in *Shareholder Duties*, even if an owner has standing by virtue of ownership at the time of wrongdoing, the right to bring a derivative action is lost if the owner loses her ownership interest.

### B. Damages and Equitable Relief

Measuring damages often is a critical issue in shareholder disputes. That task can be complicated, involving expert testimony and challenges as to speculation. Illustrative of this issue is the SJC’s holding in *Selmark Associates*, where the court reversed a judgment awarding damages on account of speculation and duplicative damages. The court also reversed the lower court’s ruling that there had been a violation of the Massachusetts unfair and deceptive trade practices statute, General Laws ch. 93A, holding that the rule in *Szalla v. Locke*, which held that claims under chapter 93A do not apply to intra-corporate disputes, applied even though the parties’ dispute involved more than one entity.

Multiple considerations come into play in the determination of damages. For example, in *One to One Interactive LLC v. Landrith*, the Appeals Court held that post-breachment developments (in this case “up to the time that the balloon payment was due”) “are relevant to the consideration of what Landrith would have been able to recover but for the breach of fiduciary duty.” In *Rubin v. Murray*, the Appeals Court found no abuse of discretion in the trial judge ordering the return of an alleged overpayment of extra compensation and compelling the declaration of dividends. Moreover, even a transaction that is profitable for all shareholders can still be challenged on the grounds that it involved a breach of fiduciary duty and damages flowed from that breach.

### C. Dissolution of the Entity

In certain instances, dissolution of the entity may be a solution to deadlock among the shareholders of a corporation. General Laws ch. 156D, § 14.30 “allows any shareholder or group of shareholders who hold forty per cent of the total combined voting power of all the shares of [a] corporation’s stock outstanding and are entitled to vote on the question of dissolution” to petition the Superior Court for dissolution of the corporation on the basis of director or shareholder deadlock.” The corporate dissolution statute was examined by the SJC in *Kasby v. Sachtel*, where the court held that “[a] judge may allow a petition for dissolution due to deadlock between a corporation’s directors only in cases of ‘true deadlock.’”

To establish the existence of a ‘true deadlock’ between directors, the petitioning party must prove that (1) ‘the directors are deadlocklocked in the management of the corporate affairs’; (2) ‘the shareholders are unable to...
break the deadlock; and (3) ‘irreparable injury to the corporation is threatened or being suffered. . . . If the petitioning party can establish a ‘true deadlock,’ then the statute vests the judge with the discretion to order dissolution as a remedy.”

Delving deeply into the facts, the court ruled that “the utter impasse as to fundamental matters of corporate governance and operation shown to exist in these circumstances gave rise to a state of ‘true deadlock’ such that the remedy of dissolution provided by the statute is permissible.” The determination as to whether the court should exercise its discretion to dissolve the corporation was left to the trial court on remand.

The court listed four factors to be used in determining the existence of true deadlock: (a) “whether irreconcilable differences between the directors of a corporation have resulted in ‘corporate paralysis’”; (b) “the size of the corporation at issue . . . [since] deadlock is more likely to occur in a small or closely-held corporation, particularly one where ownership is divided on an even basis between two shareholder-directors”; (c) if “a party has manufactured a dispute in order to engineer a deadlock . . . [in which case], a court should view the party’s claim with skepticism”; and (d) the “degree and extent of distrust and antipathy between the directors.”

Significantly, the court held that while chapter 156D allows for an orderly dissolution, “it also authorizes lesser remedies, such as a buyout or the sale of the company as an ongoing entity.” While dissolution (and its companion remedies of buyout or sale) is only useful in certain limited circumstances, the statute provides a useful set of remedies in cases of true deadlock among equal owners of a corporation.

III. PRACTICAL CONSIDERATIONS AND FUTURE TRENDS

In many ways, owners of closely-held businesses in Massachusetts control their own destinies when it comes to determining the rules by which they will be governed. They decide in the first instance whether or not to be governed by Massachusetts law by their choice of the state of incorporation and then their choices of law (both substantive and procedural) and forum that they make in their shareholder, employment and other agreements (although unless they are advised properly by counsel they may not be aware of the significant considerations involved in these decisions).

Given the enforceability of agreements among owners — even if they are in conflict with the common law fiduciary duties owed by the owners to one another and the entity — it would seem imprudent in most instances for owners of closely-held businesses not to have detailed agreements among themselves. Yet, for many reasons, including inertia, cost, and the fear of causing strife, owners often do not have such agreements, leading to uncertainty and costly litigation. The critical lesson for any lawyer who represents a closely-held entity is that the lawyer should urge the owners to create the appropriate agreements at the outset of the relationship and then encourage the owners to revisit their agreements periodically, especially if circumstances and relationships change.

Not every situation will require the same type of agreement or agreements. In most cases, an owners’ agreement should address four key issues — death, disability, ceasing to work because of retirement or termination of employment, and a mechanism for the owners to buy out one another if they no longer can get along. Whether other types of agreements, such as an employment agreement, are warranted will depend on the particular situation and the interests of the owners, which might be quite different in this regard. Even the most carefully crafted agreement will not prevent disputes that may arise among owners of closely-held businesses, but a well-framed agreement can provide guidance and order to resolving disputes when they do arise.

Closely-held businesses offer significant benefits to their owners — entrepreneurship, a greater ability to control one’s future, and the opportunity to build a sustainable, multi-generational enterprise to name just a few. But with those benefits come the inevitable disputes and changed circumstances — disagreements among the owners, death, and disability, among others. It is in planning for those situations and then resolving them when they do arise that the law governing closely-held entities is so important. Practitioners and business owners alike would be well-advised to become familiar with Massachusetts law on closely-held entities.

131. Id. (citations omitted).
132. Id. at 760.
133. Id.
134. Id. at 766.
136. Id. at 767.
137. Id. at 767-68.
138. Id. at 771.
139. Of course, for every rule there is an exception and there may be circumstances where the parties’ best interests are served by no agreement at all or one that covers some, but not all, of these issues.
Decanting in Massachusetts: Where Do We Stand Now? 
*Ferri v. Powell-Ferri, 476 Mass. 651 (2017)*

*Ferri v. Powell-Ferri* addresses the issue of decanting trust agreements. Put simply, decanting involves the distribution of assets from one irrevocable trust to another trust, which for one reason or another has different terms from the original trust. As of December 2017, Massachusetts has not adopted a decanting statute although 25 other states have. Without a current decanting statute in place and given the scarcity of Massachusetts case law, there is great ambiguity when it comes to decanting trusts in Massachusetts, even with the benefit of the *Ferri* decision.

The Supreme Judicial Court (SJC) first authorized the decanting of an irrevocable trust in *Morse v. Kraft*. In *Morse*, the Kraft Family Irrevocable Trust was created for the benefit of the settlor’s four sons. Each child was an income beneficiary of his own sub-trust, but only the disinterested trustees were able to participate in distribution decisions. At the time the trust was created, the children were minors and therefore “it was impossible to know whether they would develop the skills and judgment necessary to make distribution decisions concerning their respective sub-trusts.” The disinterested trustees wanted to decant the trust to a new trust so that the children, who were now adults and able to manage their own financial matters, had distribution powers. In *Morse*, the court relied on language in the trust, which did not specifically and outwardly allow for decanting, and the trustee’s broad powers, to determine that the trustees had authority to decant the four sub-trusts into four new sub-trusts. The court reasoned that because the trustees had unlimited discretion to make distributions to and “for the benefit of” the children, the trustee also had the authority to make distributions in further trust by way of decanting.

*Morse* did little to clarify the status of decanting in Massachusetts, and the decision left estate planners with more questions than answers. Estate planners were eagerly awaiting legislative changes or new case law for clarification. Although there has been no legislation change to date, the decision in *Ferri* was highly anticipated by Massachusetts’s estate planners.

### The Ferri Decision

In *Ferri*, Paul J. Ferri Sr. created the Paul John Ferri Jr. Trust dated June 24, 1983 (“1983 trust”), for the sole benefit of his son, Paul John Ferri Jr. (“the beneficiary”), when the beneficiary was 18 years old. The 1983 trust was created in Massachusetts and was governed by Massachusetts law.

The terms of the trust provided that the trustee may “pay to or segregate irrevocably” trust assets for the beneficiary. Furthermore, after the beneficiary reached the age of 35 years, he could request to withdraw up to a fixed percentage of trust assets, increasing from 25 percent of the principal at age 35 to 100 percent after age 47.

In 2010, the beneficiary and his wife (“Powell-Ferri”), who were married in 1995, filed for divorce. In 2011, out of concern that Powell-Ferri would reach the assets of the 1983 trust as a result of the divorce, the then-trustees of the 1983 trust decanted the 1983 trust by creating the Declaration of Trust for Paul John Ferri Jr. (“2011 trust”) and transferring substantially all trust property from themselves as trustees of the 1983 trust to themselves as trustees of the 2011 trust. At the time of the decanting, the beneficiary had the right to withdraw up to 75 percent of the 1983 trust property based on the terms of the trust, but had not yet fully exercised this right.

Similar to the 1983 trust, the beneficiary was the sole beneficiary of the 2011 trust. Unlike the 1983 trust, however, the trustee of the 2011 trust had complete authority over whether and when to make payments to the beneficiary, and the beneficiary had no power to demand payment of trust assets by way of withdrawal rights or otherwise.

In August 2011, the trustees of the 1983 trust and the 2011 trust (“trustees”) commenced a declaratory judgment action against Powell-Ferri and the beneficiary in the Connecticut Superior Court, seeking a declaration that: (1) the trustees validly exercised their powers under the 1983 trust to distribute and to assign the property and assets held by them as trustees of the 1983 trust to the 2011

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2. See *id*.
3. Alaska, Arizona, Colorado, Delaware, Florida, Illinois, Indiana, Kentucky, Michigan, Minnesota, Missouri, Nevada, New Hampshire, New Mexico, New York, North Carolina, Ohio, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Virginia, Wisconsin and Wyoming have all adopted decanting statutes. As of December 2017, there were efforts underway in the Massachusetts Legislature to enact a decanting statute in Massachusetts.
5. *Id.* at 93.
6. *Id.*
7. *Id.* at 93.
8. *Id.* at 94.
9. *Id.* at 97, 99.
12. *Id*.
13. *Id*.
14. *Id*.
15. *Id*.
17. *Id.* at 653.
18. *Id*.
19. *Id*.
trust; and (2) Powell-Ferri had no right, title or interest, directly or indirectly, in or to the 2011 trust or its assets, principal, income or other property.30

Powell-Ferri moved for summary judgment, and the trustees filed a cross-motion, with a supporting affidavit from Paul J. Ferri Sr. that outlined his intent as settlor of the 1983 trust.31 In August 2013, the trial judge granted Powell-Ferri’s motion for summary judgment and denied the trustees’ cross motion, after having allowed Powell-Ferri’s motion to strike the affidavit.32 The judge ordered restoration of 75 percent of the assets of the 2011 trust, the amount the beneficiary was entitled to withdraw from the 1983 trust at the time of the decanting; an accounting of the 2011 trust from inception to the date of restoration; and awarded reasonable attorney’s fees to Powell-Ferri.33 On appeal, the Connecticut Supreme Court submitted three questions to the SJC because the 1983 trust was created in Massachusetts and governed by Massachusetts law.34

Question One — Under Massachusetts law, did the terms of the 1983 trust empower its trustees to distribute substantially all of its assets (that is, to decant) to the 2011 trust?35

The court began its analysis by explaining that the term “decanting” is typically used to describe the distribution of irrevocable trust property to another trust pursuant to the trustee’s discretionary authority to make distributions to, or for the benefit of, one or more beneficiaries of the original trust.36 The rationale underlying the authority to decant is that if a trustee has the discretionary power to distribute property to or for the benefit of the beneficiaries, the trustee likewise has the authority to distribute the property to another trust for the benefit of those same beneficiaries.37 In the absence of a specific statutory provision allowing decanting, the court determines whether a trustee of a Massachusetts irrevocable trust has the authority to decant assets in further trust through language in the trust.38 The authority to decant does not need to be expressly granted to the trustee in the declaration of the trust, but such authority can exist based on other trust language, such as a trustee’s broad discretion to distribute trust assets to or for the benefit of one or more beneficiaries.39 Courts look heavily to whether or not the settlor had the intent to give the trustee the authority to decant.40 In determining whether a settlor had the requisite intent, the terms of the trust and other relevant evidence of the settlor’s intent must be assessed.41

Trustee’s Broad Discretion. The court first discussed the trustee’s discretion in the 1983 trust.42 The court stated that a trustee’s broad discretion to distribute the assets of an irrevocable trust may be evidence of a settlor’s intent to permit decanting.43 The court looked to the language of decanting provisions enacted in states that have decanting statutes, which rely heavily on a trustee’s broad authority to distribute principal from the trust for the benefit of one or more of the beneficiaries, when determining whether the trustee has the authority to decant.44 The court specifically noted three provisions in the 1983 trust that speak to the trustee’s discretion to distribute assets that were virtually identical to provisions in the Morse trust:45

1. “So long as [the beneficiary] is living, [the trustee] shall, from time to time, pay to or segregate irrevocably for later payment to [the beneficiary], so much of the net income and principal of this trust as [the trustee] shall deem desirable for [the beneficiary’s] benefit …”46

2. “Wherever provision is made hereunder for payment of principal or income to a beneficiary, the same may instead be applied for his or her benefit.”47

3. “The trustee shall have full power to take any steps and do any acts which he may deem necessary or proper in connection with the due care, management and disposition of the property and income of the trust hereunder … in his discretion, without order or license of the court.”48

The court concluded that the language through the entire 1983 trust evidently showed the trustees’ extremely broad discretion.49

Anti-alienation provision. Powell-Ferri pointed to the anti-alienation provision of the 1983 trust when arguing that decanting was not permitted in the 1983 trust.40 The 1983 trust provided that “neither the income nor the principal of any trust hereunder shall be alienable by any beneficiary … and the same shall not be subject to be taken by his or her creditors by any process whatever.”41 In looking at the 1983 trust document as a whole, and not merely reading the words of the anti-alienation clause in isolation from the rest of the trust, the court concluded that empowering the trustees to decant was consistent with this anti-alienation provision because it evidences the settlor’s intent to protect the trust income and principal from invasion by the beneficiary’s creditors.42 The court reasoned that if a settlor intended a trust’s assets to be protected from creditors, he or she therefore intended that the trustees have the means to protect the trust assets, consistent with their fiduciary duties.43

20. Id.
21. Id.
23. Id.
24. Id. at 652.
25. Id. The questions are taken verbatim from the opinion or slightly modified for stylistic purposes.
26. Id. at 655 (citing Morse, 466 Mass. at 95).
27. See id.
29. See id. at 655-57.
30. See id. at 656.
31. See id. at 658.
32. See id. at 657-58.
33. Id. at 656.
35. Id. at 657.
36. The court also noted that the authority of the trustee to “segregate irrevocably for later payment to” the beneficiary further indicated the settlor’s intention to allow decanting. Id.
37. The court emphasized the similarity between the language, “for his or her benefit,” included in both Ferri and in Morse, in stating that the ultimate conclusion that the settlor intended to authorize decanting in Ferri followed Morse necessarily. Id. at 657-58.
38. Id. at 657.
39. Id.
41. Id. at 659.
42. Id.
43. Id.
Beneficiary's withdrawal provisions. Powell-Ferri argued that the beneficiary's right under the 1983 trust to request a withdrawal of a certain percentage of trust assets was inconsistent with the authority to decant, and that decanting the 1983 trust into the 2011 trust impaired the ability of the beneficiary to withdraw trust assets upon written request. 44 As discussed above, at the time the trustees decanted the 1983 trust assets into the 2011 trust, the beneficiary had the right, based on the terms of the 1983 trust, to request a withdrawal of up to 75 percent of the principal of the 1983 trust. 45 During the pendency of the case, the beneficiary reached the age of 47 and his irrevocable vested interest matured into 100 percent of the corpus of the trust. 46

The court disagreed with Powell-Ferri's argument that the beneficiary's right of withdrawal was inconsistent with the authority to decant because: (i) if the trustees were unable to decant the portion of trust assets made "withdrawable" as the beneficiaries reached certain age milestones, the trustees correspondingly would lose the ability to exercise their fiduciary duties (including the duty to invest and protect the assets' purchasing power) over those assets, eventually losing power to control 100 percent of the assets upon the beneficiary turning 47 years of age; (ii) at the time the trustees decanted substantially all of the 1983 trust's assets to the 2011 trust, the beneficiary had only a small percentage of the assets of the trust, and therefore a substantial portion of the trust assets remained in the 1983 trust, subject to the beneficiaries' authority and stewardship; 47 and (iii) if the settlor intended to prevent decanting after the beneficiary gained withdrawal rights at the age of 35, the settlor would not have allowed irrevocable sequestration for "so long as [the beneficiary] is living." 48

The court concluded that unless and until all of the trust assets were distributed in response to the beneficiary's request for a withdrawal, the trustees could exercise their powers and obligations under the 1983 trust, including the power to decant if the trustees deemed decanting to be in the beneficiary's best interest. 49

Question Two: If the answer to question one is 'no,' should either 75 percent or 100 percent of the assets of the 2011 trust be returned to the 1983 trust to restore the status quo prior to the decanting? 50

This question became moot when the court answered "yes" in Question One, and it therefore did not address Question Two. 51

Question Three: Under Massachusetts law, should a court, in interpreting whether the settlor of the 1983 trust intended to permit decanting to another trust, consider an affidavit of the settlor, offered to establish what he intended when he created the 1983 trust? 52

The court analyzed whether, under Massachusetts law, it should consider an affidavit by the settlor stating his intent establishing the 1983 trust. 53 The court recognized the well-settled law that Massachusetts courts may consider extrinsic evidence where there is any question of ambiguity concerning a settlor's intent. 54 The court concluded that there was ambiguity in the trust as to whether or not the settlor had the authority to decant the trust assets, and it could therefore consider an affidavit of the settlor in interpreting whether the settlor intended to permit decanting to another trust. 55 The court further noted that the affidavit supported the settlor's intent outlined in the trust and did not contradict or attempt to vary the terms of the trust. 56

The court held:

after having examined the extremely broad authority and discretion afforded the trustees by the 1983 Trust declaration of trust, the anti-alienation provision of the 1983 Trust, the beneficiary withdrawal rights afforded under the terms of the 1983 Trust, and the settlor's affidavit, we conclude that the terms of the 1983 Trust, read as a whole, demonstrate the settlor's intent to permit decanting. 57

Accordingly, the court concluded that the trustees presumed authority to decant the 1983 trust and to distribute substantially all of the assets from the 1983 trust to the 2011 trust. 58

The concurring opinion stated that, although it agreed with the court's decision for all the reasons outlined above, it specifically emphasized that the court did not answer the question as to whether Massachusetts law permits trustees in Massachusetts to create a new spendthrift trust and decant to it all the assets from an existing non-spendthrift trust where the sole purpose of the transfer is to remove the trust's assets from the marital assets that might be distributed to the beneficiary's spouse in a divorce action. 59 The Connecticut Supreme Court had already determined that under its law, such an action was not against public policy because the beneficiary-spouse did not have a role in either creating a new trust or decanting the assets, and therefore the SJC appropriately did not address the implications decanting may have on public policy laws in Massachusetts. 60

44. Id. at 660.
45. Id. at 659.
47. The court compared this situation to that of a trust terminating, recognizing that when a trust terminates, the trustee retains ongoing duties to control and to protect the trust assets, and the trustee may continue to act pursuant to the powers provided under the trust instrument, regardless of the fact that the beneficiaries have a vested interest in the trust property. Id. at 661 (citing Rothwell v. Rothwell, 283 Mass. 563, 570, 572 (1933)).
48. Id. at 661.
49. Id. at 661-62.
50. Id. at 652.
51. Id. at 664.
53. Id. at 662.
54. Id.
55. Id.
56. Id. at 663.
57. Id. at 664.
59. Id. at 664.
60. Id.
DISCUSSION

Decanting

The Morse decision put all estate planners on notice that, for trusts created after the date of its decision (2013), decanting is only possible if the trust language specifically authorizes such an action.61 As a result, estate planners must now include in trust documents drafted after the decision a trustee’s power to decant, if the settlor so desires. Estate planners are now wondering, however, whether decanting will become more common among local estate planners when it comes to irrevocable trusts created before the Morse decision. With respect to these irrevocable trusts, estate planners should analyze the settlor’s intent at the time the trust was created when determining whether decanting is permissible. As in Ferri, the settlor’s intent to allow decanting comes predominantly from a trustee’s broad discretionary powers over the trust property.62 Ferri does, however, leave estate planners with questions as to how far a trustee can go when it comes to decanting.63 Can any trustee with broad powers decant a trust? Hopefully, future case law will clarify limitations that may exist when it comes to decanting.

Despite the Ferri decision, it is still unclear whether including withdrawal powers contradicts a trustee’s ability to decant. The Massachusetts Uniform Trust Code states that the holder of a non-lapsing withdrawal power under the terms of an irrevocable trust is treated as if he/she were the settlor of a revocable trust with respect to the property subject to the power.64 It can certainly be argued that because the beneficiary’s right to 75 percent of the trust property at the time the trust was decanted had vested, the trustees in Ferri did not have the control or power over 75 percent of the trust property.65 These withdrawal rights could arguably have negated the settlor’s alleged intent to allow decanting of the trust.66 The court, however, disagreed with the Ferri decision because the beneficiary had not, in fact, taken control of the trust property, and the trust specifically stated that the trustee’s obligations with respect to trust property remained for the beneficiary’s lifetime, regardless of whether or not withdrawal rights were exercised.67 The court compared the situation to the termination of a trust in stating that even though a trust may have terminated and interest in the trust may have already vested in the remainder beneficiaries, the trustees still have a duty with respect to the assets held in the trust until the time of distribution.68 Perhaps estate planners should advise clients not to withdraw trust property to the extent possible, so that the opportunity for decanting and its resulting protection remains viable.

It is worth commenting on the impact decanting might have on the use of revocable trust agreements going forward if the law around decanting becomes clearer. Irrevocable trusts provide certain tax benefits to clients that revocable trusts do not offer; one of the biggest drawbacks to an irrevocable trust, however, is the fact that it is “permanent” and cannot be amended or modified by the settlor once it is executed. If a settlor has the ability to essentially change the terms of an irrevocable trust by way of decanting, perhaps estate planners will trend towards using irrevocable trusts as opposed to revocable trusts.

Tax Consequences of Decanting

Decanting may have adverse tax consequences to the trust and its beneficiaries, but the Internal Revenue Service (“IRS”) has yet to issue a final decision on the tax consequences of decanting. Gift tax consequences may be triggered if property is transferred during a donor’s lifetime for less than full and adequate consideration; estate tax may be triggered if the transfer is made, or is deemed to be made, at death; and generation-skipping transfer tax consequences may arise if the transfer is to a trust of which a “skip” person is a beneficiary.69

There is very little law outlining the tax consequences of decanting. Many practitioners compare the power to decant to that of a special power of appointment.70 In fact, many decanting statutes in other states expressly state that the power of a trustee to invade trust principal in further trust is equivalent to a special power of appointment. Certain statutes in other states also expressly state that this power to invade in further trust is not exercisable in favor of the trustee, the trustee’s estate, the trustee’s creditors, or the creditors of the trustee’s estate, and thus is not to be treated as a general power of appointment under Section 2041 of the Internal Revenue Code.71 There is some uncertainty when it comes to making this comparison, however, because a special power of appointment is typically held in a non-fiduciary capacity by a beneficiary, who could include or exclude a beneficiary without any fiduciary duty to act in good faith when making such a determination. A power to decant, in contrast, is typically held in a fiduciary capacity by a trustee, who is obligated to act in good faith at all times.

Practitioners also have compared the power to decant to the exercise of a fully discretionary distribution when it comes to analyzing the tax consequences of decanting. A trustee’s exercise of a discretionary distribution will not ordinarily cause the trust to recognize gain or loss even if the asset transferred was a non-cash asset (as

63. See id. at 664.
65. See Ferri, 476 Mass. at 660.
66. See id.
67. See id.
68. Id. at 660-61.
70. See N.Y. Est. Powers & Trusts § 10-6.6(b)(1) (2014) (where an authorized trustee with unlimited discretion to invade trust principal may appoint part or all of such principal to a trustee of an appointed trust, for, and only for the benefit of, one, more than one or all of the current beneficiaries of the invaded trust (to the exclusion of any one or more of such current beneficiaries)).
71. See Del. Code Ann. tit. 12, § 3528(c) (2015) (where a trustee’s authority to invade principal in trust shall be considered the exercise of a power of appointment (other than a power to appoint to the trustee, the trustee’s creditors, the trustee’s estate, or the creditors of the trustee’s estate); see also Fla. Stat. § 736.04117 (2007) (where the exercise of a power to invade principal shall be considered the exercise of a power of appointment, other than a power to appoint to the trustee, the trustee’s creditors, the trustee’s estate, or the creditors of the trustee’s estate).
opposed to a pecuniary distribution made pursuant to a beneficiary’s power of appointment that would trigger capital gain or loss). Because courts have often concluded that a power to decant stems from a broad discretionary power of a trustee, practitioners often posit that a trust’s income tax consequences of decanting should be similar to the consequences of an exercise of a discretionary distribution.

Various IRS private letter rulings suggest that when assets are transferred from one trust to another trust, they are taxed in the same manner as the original trust. Questions arise, however, as to whether the new trust is indeed considered a “continuation” from the original trust if the new trust is created by someone other than the trustee or if the new trust has completely different dispositive provisions from the original trust.

Many questions also arise when determining whether a beneficiary is subject to gift tax if he or she forfeits all of or a certain portion of his or her interest in the trust by giving implied consent to the decanting of a trust. Questions also arise as to whether a gift tax is triggered when a beneficiary is serving as trustee and exercising a power to decant. Again, this might come down to whether the IRS views the power to decant to be similar to a special power of appointment (and thus not a completed gift) or a general power of appointment (and thus a completed gift).

If a beneficiary is deemed to have made a completed gift for gift tax purposes, then perhaps the act of decanting would subsequently bring the decanted assets into the beneficiary’s gross estate for estate tax purposes. Once again, the answer to this question may come down to whether the IRS views the holder of a power to decant as a holder of a general power of appointment.

In analyzing generation-skipping tax (GST) consequences of decanting, a trust created before September 26, 1985, (before the GST tax was put into law) is “grandfathered in” to the law at the time of its execution, and is thus exempt from GST tax. This remains true even if a beneficiary holds and exercises a special power of appointment or a power to pay the trust property over to another trust as long as the vesting of ownership of the trust property occurs by the end of the applicable perpetuities period and as long as the original trust provided for the special power of appointment. Although it is uncertain whether this extends to trusts that are GST-exempt by reason of allocation of GST exemption as opposed to the date of the trust’s creation, one could deduce that transferring assets from one trust to another by way of a power to decant would not trigger new GST tax consequences as long as the perpetuities period remained unchanged and the original trust contained the power to decant.

There is clearly much uncertainty surrounding the tax consequences of decanting, and estate planners are eagerly awaiting clarification from the IRS.


Estate planners are often asked for recommendations as to what distribution powers a settlor should give to a trustee. Often, clients are torn between providing the most protection to their beneficiaries but also giving them freedom and control over some or all of the trust assets. In determining whether an asset is to be included in a marital estate in the event of a divorce proceeding, the court will generally look at a divorcing spouse’s enforceable right to the asset. If an interest in an asset is determined to be so speculative that it is nothing more than a mere expectancy, it likely will not be included in the marital estate of the divorcing parties. Therefore, when advising clients, estate planners must understand what distribution powers constitute fixed and enforceable rights on the part of a beneficiary and what distribution powers constitute mere expectations.

Regardless of the beneficiary’s interest in the trust, however, a court may nevertheless conclude that trust distributions are sufficiently “woven into the fabric of a marriage” and/or “integral to the family unit” and thus includable in a marital estate. The use of an ascertainable standard and its effect on protection against divorce is not clear. In *Pfannenstiehl v. Pfannenstiehl*, an important and relatively recent Massachusetts decision, the husband was a beneficiary of a trust that was created by his father. The trust included distribution powers for his benefit limited to an ascertainable standard (health, education, support, and maintenance). In *Pfannenstiehl*, the SJC concluded that the beneficiary’s right to receive distributions from a trust with an ascertainable standard was speculative and did not render his right to future distribution from the trust to be “sufficiently certain such that it may be included in the marital estate.” However, estate planners must still be aware that less protection is offered in a trust with an ascertainable standard as opposed to a fully discretionary trust.

Fully discretionary lifetime trusts offer the greatest level of protection. With fully discretionary trusts, the beneficiary has no present, enforceable interest in the trust property, must rely on the trustee’s exercise of discretion, and cannot compel distributions. Future distributions are not certain from a fully discretionary trust, and as such, the trust assets are less likely to be includable in a marital estate for equitable division purposes during a divorce proceeding.

Given the *Ferri* decision, perhaps estate planning attorneys may

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72. See *Ferri*, 476 Mass at 657.
75. Zeydel and Blattmachr, *supra* n.69 at 151.
79. See *id.* at 113.
80. *Id.* at 107.
81. *Id.* at 113; see also Mass. Gen. Laws ch. 203E, §103 (2012).
82. *Id.* at 115.
83. One of the controlling factors in *Pfannenstiehl* was the fact that the husband was one of 11 beneficiaries of a trust that provided for unequal distributions and was designed to benefit future generations. The court relied heavily on this when determining that the beneficiary-spouse had a speculative interest in the trust property, which therefore was not to be included in the marital estate. *Id.* at 108.
want to recommend that clients include withdrawal rights, as opposed to outright distributions to beneficiaries, if fully discretionary lifetime trusts are not desirable to the client. There seems to be no doubt that withdrawal rights offer more protection in the event of a divorce as opposed to outright distributions, especially given the Ferri decision. Once property is distributed outright to a beneficiary, there is no protection whatsoever from a divorce or any other creditor.

**Spendthrift Provisions**

Estate planners often include spendthrift provisions (also known as “anti-alienation” provisions) in their trust documents to prevent creditors of a beneficiary from “reaching” the trust property. Powell-Ferri argued that, under Massachusetts law, a party to a divorce is not a “creditor” for the purposes of this type of provision, and that a trust is marital property subject to equitable distribution notwithstanding a spendthrift provision.

Although spendthrift provisions do prevent creditors from accessing trust property, they do not alone prevent a trust from being included as a “marital asset” in a divorce proceeding. A spouse’s generational trust may well become marital property for purposes of dividing assets between divorcing spouses, and a spendthrift provision does not prevent this from happening. When determining whether a trust becomes marital property, a spendthrift provision of a trust will be read in conjunction with the provisions of the trust to determine whether the beneficiary-spouse has a right to compel distributions from the trust in the first place. Once again, a court will also look at whether the trust distributions were sufficiently “woven into the fabric of the marriage” and/or “integral to the family,” regardless of the inclusion of a spendthrift provision.

Estate planners should keep in mind and clarify with their clients that a spendthrift provision does not necessarily prevent a trust from becoming marital property upon a divorce.

**Trustees’ Duties v. Public Policy**

After Ferri, trustees are left questioning whether or not they have a fiduciary duty to protect a divorcing beneficiary who has withdrawal rights by exercising a power to decant. Are trustees breaching their fiduciary duty if they do not decant a trust and, as a result, such trust becomes a marital asset for purposes of a divorce? On the other hand, is it ethical for a trustee to decant a trust, if a beneficiary’s divorce is imminent, for the sole purpose of removing the trust’s assets from the marital assets that might be considered in a divorce proceeding? This seems a bit harsh on the non-beneficiary spouse and could be considered against public policy. Even very broad discretionary powers are to be exercised in accordance with fiduciary standards and with reasonable regard for usual fiduciary principles. Trustees will have to balance their fiduciary duty with public policy issues; the interplay between these two issues is currently unclear in Massachusetts.

The concurring opinion in Ferri explained that the SJC specifically did not address whether Massachusetts law permits a trustee to create a new spendthrift trust and to decant to it all the assets from an existing non-spendthrift trust for the sole purpose of removing the trust’s assets from the marital estate in a divorce proceeding. The Connecticut Supreme Court held that the public policy would prevent one spouse during a divorce proceeding from transferring marital assets to deprive the other spouse of those assets did not apply in Ferri because the beneficiary had no role in or knowledge of the creation of the new trust or decanting the assets from the original trust. The SJC, therefore, did not answer the question as to whether decanting a trust in anticipation of, or as a result of, a divorce was against public policy under Massachusetts law because its task was merely to answer questions posed to it from the Connecticut Supreme Court.

Most states that have statutory decanting powers, however, require that the beneficiaries receive notice. An argument could certainly be made that a beneficiary’s knowledge of decanting and subsequent failure to disclose such asset during a divorce proceeding could violate a beneficiary’s obligation to fully disclose all assets in marital division in accordance with Supplemental Probate Court Rule 410. It is worth questioning whether there would have been a different outcome in Ferri, for public policy reasons, if the beneficiary had requested that the assets be decanted. Trustees may now be faced with a quandary if a beneficiary, knowing a divorce may be imminent, requests that a trustee decant the trust to ensure the trust is not considered a marital asset for equitable division purposes in a divorce.

The Massachusetts Uniform Trust Code provides that “a trust may be created only to the extent its purposes are lawful and not contrary to public policy.” An argument could be made that it is against public policy to decant a trust when a beneficiary’s divorce becomes imminent in order to ensure the trust does not become a marital asset for divorce purposes, and thus reduce (or eliminate) the amount that may pass to the non-beneficiary spouse. In Ferri, the decanting took place after the divorce proceeding had begun, which makes the outcome against the non-beneficiary spouse even more harsh. The Ferri court specifically stated that “any question concerning the equitable distribution of the trust assets is not part of the certified questions to this court and is not properly before us.” This leaves estate planners wondering what the future will hold when it comes to decanting and its potential effect on public policy.

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86. Id. at 651.
89. Id.
91. Id. at 664.
92. Id.
93. Id.
95. See Ferri, 476 Mass. at 653.
98. Id. at 666.
policy in Massachusetts. Although the SJC specifically did not address whether decanting a trust for the sole purpose of shielding its assets in a divorce proceeding was against public policy, this decision may disrupt the state’s overall policies that seem to favor broad marital asset identification. Until more clarity surfaces surrounding the public policy implications of decanting trusts for purposes of protection in a divorce proceeding in Massachusetts, estate planners may be in a bind if asked by a beneficiary to decant a trust for such sole purpose.

**Use of Affidavits or other Extrinsic Evidence**

Extrinsic evidence may be admitted when a contract is ambiguous on its face. Although the contents within the “four corners” of a trust document control when determining a question of law, if, and only if, an ambiguity exists among those four corners, extrinsic evidence may be used. In deciding whether there is ambiguity, the court must first examine the language of the contract by itself, independent of extrinsic evidence, concerning the drafting history or the intention of the parties.

Extrinsic evidence cannot be used to contradict or to change the written terms, but only to remove or to explain the existing uncertainty or ambiguity. In *Ferri*, the court needed to determine whether the settlor intended to give the trustees the power to decant. Therefore, the court concluded that the settlor’s affidavit as to his intent could be admitted as extrinsic evidence.

The use of an affidavit worked in *Ferri*, of course, because the settlor was alive at the time of the trial. In practice, estate planners may want to consider obtaining an affidavit from a settlor where decanting provisions are not clearly outlined in an already-executed irrevocable trust if they suspect that decanting may be advisable in the future.

**Conclusion**

There is still a lot of ambiguity in Massachusetts when it comes to decanting. Until a statute is put in place and the IRS issues clarity surrounding the tax implications of decanting, estate planners can only rely on case law, which generates as many questions as it answers. It is important that estate planners remain vigilant when it comes to the power to decant, both when drafting trust agreements and serving as trustee. Although *Ferri* makes decanting in Massachusetts a more viable and realistic tool to local estate planners, many questions remain unanswered with respect to its limits, its tax implications, and its effect on public policy. Estate planners will eagerly await a change in legislature and/or more case law to clarify decanting in Massachusetts.

— Rebecca Tunney (Flewelling)

99. *See id.*  
100. *Id.*  
101. *Id.* at 662.  
102. *Id.*  
CASE COMMENT

The Supreme Judicial Court Explains Statutory Criteria for Dissolution of a Corporation Due to Director Deadlock


In Koshy v. Sachdev, the Supreme Judicial Court (SJC) interpreted the Massachusetts General Laws ch. 156D, § 14.30, which governs judicial dissolution of a corporation due to a deadlock between directors. This decision, and the statute itself, make clear that judicial dissolution provides no easy escape for shareholders of deadlocked companies. Unlike the partnership statute, which permits a partner to dissolve a partnership on his or her own initiative, the corporate dissolution statute requires a shareholder of a deadlocked corporation to file a Superior Court action, prove all elements of a true deadlock, and entrust the remedy to the court’s discretion. To avoid such a scenario, shareholders would be wise to make precautionary arrangements. Shareholders, especially those of closely-held corporations, should be aware that, although they may go into business together with a common bond and a shared purpose, their relationships can deteriorate over time or across generations. Shareholders should agree on procedures for separating their estates in the event the parties’ relationship is no longer peaceful. As Koshy demonstrates, involuntary dissolution will not be a reliable or efficient fallback option.

The corporate dissolution statute and the comments thereto reflect an underlying policy that discourages involuntary dissolution as anything other than as a last resort. The statute states that the Superior Court “may dissolve a corporation” on the petition of a shareholder or shareholders holding at least 40 percent voting power and entitled to vote on dissolution, “if it is established that: the directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered.” The comment explains that these limits on dissolution-eligible circumstances “reflect continuation of the general policy … that involuntary dissolution should be available as a mechanism for resolving internal corporate disputes only in the case of true deadlock, and even then only when continuation of the deadlock will impose real and serious harm.” This policy must be considered in conjunction with the provisions of Section 14.02(a), which permit closely-held corporations to include voluntary dissolution procedures in their articles of organization. In the absence of such an agreed-upon dissolution process, however, Section 14.30 “does not contemplate broad availability of involuntary dissolution” consistent with the “policy that less extreme remedies are both more appropriate and more conducive to orderly negotiation of settlement in most situations.” The comment also emphasizes that “there is discretion on the part of the court as to whether dissolution is appropriate even though grounds exist under the specific circumstances.” Though the comment acknowledges that the dissolution “remedy is particularly important in small or family-held corporations in which share ownership may be divided on a 50-50 basis,” the comment and statutory text as a whole present a severe uphill climb for a shareholder seeking to dissolve a deadlocked corporation.

Against this policy backdrop, the Koshy court construed Section 14.30 in the context of a closely-held corporation owned on a 50-50 basis by director-shareholders whose relationship had descended from collaborative friendship to acrimony and distrust. After multiple lawsuits, more than five years of litigation, a trial, a preliminary injunction, and an appeal, the SJC concluded that all dissolution criteria were met — a deadlock existed, the shareholders could not break it, and the corporation was suffering or under the threat of irreparable injury. Nevertheless, the SJC remanded the case to the Superior Court to determine whether dissolution would be the appropriate remedy. This incomplete result, and the effort it took to get there, reinforces the importance of contractual exit plans for shareholders of closely-held corporations.

FACTS AND PROCEDURAL HISTORY

George Koshy and Anupam Sachdev were the only shareholders and directors of Indus Systems Inc. (Indus), a computer design company formed in 1987. Each of them owned 50 percent of the company’s shares. Indus grew steadily over time, exceeding $2 million in annual revenue by 2007. In the late 2000s, the parties’ relationship began to deteriorate.

2. A “closely-held corporation” is “typified by: (1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation.” Donahue, 367 Mass. at 586.
5. Id. at Comment ¶ 2.
6. Id.
7. Id.
8. Id.
9. Id.
11. Id. at 768-71.
12. Id. at 772.
13. Id. at 761.
14. Id.
15. Id.
Koshy and Sachdev disagreed about the fundamental direction of Indus’s future, as well as billing practices between Indus and an affiliate company. In 2011, the parties differed over whether to distribute retained earnings, and Koshy unilaterally paid himself a distribution from a company account. Sachdev sued on behalf of Indus and locked Koshy out of Indus’s business. Koshy later returned his unilateral distribution to Indus, and the derivative action was dismissed. The parties’ relationship continued to devolve, however, which negatively affected Indus’s operations. The situation came to a head when Sachdev hired an Indus employee without consulting Koshy and then blocked Koshy from firing the employee despite insubordinate conduct.

In June 2012, Koshy commenced an action against Sachdev. He asserted that the parties were deadlocked, and he requested dissolution of Indus pursuant to General Laws ch. 156D, § 14.30. While the case was pending, the Superior Court preliminarily enjoined each party from taking certain actions without either notice to, or consent from, the other party. The case proceeded to a bench trial in October 2013, and the trial judge issued rulings in August 2015. The trial judge concluded that the parties were not deadlocked and that dissolution was not appropriate. The court found that neither party had breached his fiduciary duties and also dismissed a post-trial contempt complaint that Koshy had filed in connection with the preliminary injunction. Koshy appealed all rulings adverse to him, including that the parties were not deadlocked.

**SJC’s Legal Discussion**

As to the standard of review, an appellate court reviews de novo a trial court’s decision about whether a deadlock exists. If a deadlock exists, then the trial court’s decision as to whether dissolution is appropriate is a matter of discretion. The SJC stated that dissolution is a permissible remedy if there is a “true deadlock,” which means that all three statutory criteria are present. Those criteria are: (1) the existence of a deadlock; (2) inability of the shareholders to break the deadlock; and (3) irremovable injury to the corporation. The petitioning party has the burden to prove all three elements.

The SJC court began its analysis by exploring what it means for a “deadlock” to exist. Lacking a statutory definition of “deadlock,” the court crafted a four-factor test to determine whether there is a deadlock. The first factor is whether irreconcilable differences between the directors have resulted in “corporate paralysis,” which the court defined as “a stalemate between the directors concerning one of the primary functions of management.” The second factor is the size of the corporation. The court explained that “[a] deadlock is more likely to occur in a small or closely-held corporation, particularly one where ownership is divided on an even basis between two shareholder-directors.” The third factor is whether there is any indication that a party has “manufactured a dispute” to create a deadlock. The fourth factor is the level of “distrust and antipathy between the directors.”

Applying these four deadlock factors, the court found it “inescapable” that a deadlock existed between Koshy and Sachdev. The parties disagreed on corporate operational matters large and small; were locked in a stalemate by virtue of their respective 50 percent ownership share; had genuine, rather than manufactured, disputes; and distrusted and disliked one another.

Satisfied that a deadlock existed, the court moved to the next statutory criterion for dissolution, which is irreconcilability of the deadlock. The SJC stated that courts must determine “whether the shareholders are able to work around the deadlocked directors.” Making that determination requires deciding “whether there is a mechanism by which the deadlock can be broken.” The court mentioned, as examples, buy-sell agreements and agreements for alternative dispute resolution. Neither such agreement existed in Koshy. Though Indus’s articles of incorporation provided for a potential buyout of one shareholder at a price determined by a panel of arbitrators, the court was not persuaded that this mechanism could be used to break the deadlock. The court reasoned that the article

17. Id. at 761-62.
18. Id. at 762.
19. Id.
20. Id.
21. Id. at 762-63.
23. Id. Koshy and Sachdev each brought claims against the other for breach of fiduciary duty. Shareholders in closely-held corporations owe a fiduciary duty of “utmost good faith and loyalty” to their fellow shareholders and to the corporation itself. Donahue, 367 Mass. at 593. This is substantially the same duty that partners owe to one another. Id.
24. Koshy, 477 Mass. at 763.
25. Id. at 763-64.
26. Id. at 764.
27. Id.
29. Id. at 765.
30. Id.
31. Id.
33. Id. at 766.
34. Id. at 766.
“requires the parties to agree upon an arbitrator,” and there was no indication that they could do so. Accordingly, the court determined that Koshy and Sachdev were unable to break the deadlock.

The final element of the dissolution statute is whether “irreparable injury to the corporation is being threatened or suffered.” Applying the common law understanding of “irreparable injury” as “a harm which cannot be vindicated by litigation on the merits,” the court explained that irreparable injury is not limited to financial harm. A corporation can suffer such injury due to “severe corporate dysfunction or a frustration of the company’s purpose, or by placing the company’s business in jeopardy.” Also, whether irreparable injury is “threatened” is not limited to the corporation’s short-term status. The SJC counseled that “a court must examine the nature and impact of a deadlock to determine if the company can remain viable in the long term. If not, then the corporation is threatened with irreparable injury.” With respect to Koshy and Sachdev, the court determined that the parties’ resort to “management by litigation” presented a threat to Indus’s future viability. Thus, the court concluded that Koshy, as the petitioning party, had established all of the statutory criteria of a “true deadlock,” rendering Indus eligible for judicial dissolution.

The court then turned to the issue of remedy. Because the statute states that a court “may dissolve a corporation,” the court reasoned that the statute “also authorizes lesser remedies, such as a buyout or the sale of the company as an ongoing entity.” The SJC remanded the case to the Superior Court to decide a remedy in the first instance.

**Lessons for Shareholders of Closely-Held Corporations**

The Koshy analysis and conclusion confirm that Massachusetts law places shareholders of closely-held corporations in a precarious position. Such shareholders owe partner-type fiduciary duties to one another but do not have partner-type abilities to dissolve a relationship gone sour. This situation is especially problematic for 50-50 shareholders, neither of whom can determine the direction of the corporation, sell the corporation, or expeditiously dissolve it without the cooperation of the other. These limitations, when mixed with a toxic relationship among shareholders, invite what the Koshy court derides as “management by litigation.” As Koshy instructs, an action for judicial dissolution under Massachusetts General Laws ch. 156D, § 14.30 provides no easy way out of this litigation spiral. A shareholder who petitions for dissolution must meet an exacting multi-prong test to establish a true deadlock. That process is likely to impose great time and expense on all parties. It also could subject the corporation to litigation-induced paralysis while the courts determine the company’s fate. In the case of Koshy, the parties had litigated continuously for more than five years, and the litigation continued while the courts sort out a remedy. The discretionary nature of the remedy provides another cautionary note. Even if a petitioning shareholder proves all statutory criteria for involuntary dissolution, the court might impose a remedy that is different from what the petitioning shareholder wants.

To guard against these developments, shareholders of closely-held corporations should recognize that Massachusetts law does not provide them with a ready escape route. Shareholders should further understand that the sort of valuation-by-arbitration agreement that the SJC enforced in Merriam v. Demoulas, but disregarded in Koshy, will not necessarily guide them out of a deadlock. Instead, shareholders should agree as early as possible on a robust contractual exit plan, such as a mandatory buy-sell or arbitration agreement, in case there comes a time when they wish to separate their interests.

— Mark D. Finsterwald

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49. *Id.* The SJC’s characterization is curious given that the arbitration provision’s plain language would not require the parties to agree on an arbitrator. Rather, each party would separately name an arbitrator, and those two arbitrators would name a third. Indeed, in 2013, the SJC had construed a similar corporate article and rejected interpretations that would impose requirements beyond the article’s plain language. Merriam v. Demoulas Super Mkts. Inc., 464 Mass. 721, 728-32 (2013). Under that language, the prerequisite to activating the buyout procedure is not the parties’ agreement on an arbitrator, but is instead one shareholder’s desire to sell his shares. The *Koshy* court did not say whether either Koshy or Sachdev had manifested a desire to sell.


51. *Id.* at 770.

52. *Id.*

53. *Id.*

54. *Id.* at 771.

55. *Id.*


57. *Id.*

58. *Id.*

59. *Id.* at 772. The court also affirmed the trial court’s determination that Sachdev did not breach his fiduciary duty. In addition, the court reversed the dismissal of Koshy’s complaint for contempt of the preliminary injunction and remanded for further consideration of that complaint. *Id.* at 772-74.
Case Comment

Accommodating Employee Use of Medical Marijuana


I. INTRODUCTION

Since President Nixon signed the Comprehensive Drug Abuse Prevention and Control Act in October 1970, the use of marijuana by anybody for any purpose has been flatly prohibited in this country as a matter of federal law. The prohibition lived in relative harmony with state law for the better part of three decades, until 1996, when California voters passed a ballot initiative legalizing the use of marijuana for medicinal purposes by qualifying patients. That act set off a wave of similar action in states across the country, including the 2012 ballot initiative that adopted the Act for the Humanitarian Medical Use of Marijuana in Massachusetts.

There are now more than 46,000 registered medical marijuana patients and 22 medical marijuana dispensaries in Massachusetts alone, with close to 300 others seeking approval to sell the drug. This means that many residents and businesses are in open defiance of federal law, and although Congress has forbidden the United States Department of Justice (DOJ) from interfering with state medical marijuana programs since 2014 that restriction has little impact on the average Massachusetts workplace. In that context, the tension between the CSA and the Medical Marijuana Act remains profound.

For one thing, and most obviously, marijuana is still illegal under federal law. In fact, the DOJ reaffirmed its classification as a Schedule I drug in 2016, when it rejected a petition filed by the governors of Rhode Island and Washington seeking to reclassify the drug. This raises the question whether employers themselves commit some legal wrong by turning a blind eye to employee conduct that amounts to a drug crime. As a more practical matter, marijuana contains tetrahydrocannabinol, or THC, an intoxicating substance known to produce feelings of euphoria, relaxation, heightened sensory perception, increased appetite and pain relief, as well as anxiety, paranoia, memory loss, difficulty concentrating and reduced coordination, among other things. If experienced by an employee while working, these effects can create legal, safety, and other types of risks for an

2. The prohibition is found in Title II of that statute, known as the Controlled Substances Act (hereinafter, “CSA”). See § 202, 84 Stat. at 1249 (codified as amended at 21 U.S.C. § 812 (2012)) (classifying marijuana and tetrahydrocannabinols as Schedule I drugs, which are defined as having a “high potential for abuse,” “no currently accepted medical use in treatment in the United States” and a “lack of accepted safety for use” even under medical supervision). Despite this longstanding official policy, the federal government did (and may still) provide marijuana to a small number of patients on the basis of “medical necessity” as part of the Compassionate Investigational New Drug program. The program launched in 1978 as a result of a civil lawsuit against the Food and Drug Administration and several other federal agencies, but it was closed to new applicants in 1992.
3. 2012 Mass. Acts ch. 369 (hereinafter, “Medical Marijuana Act”). Today, medical marijuana programs are up and running in 29 states and the District of Columbia, and the movement to legalize marijuana for recreational purposes is also gaining steam — the drug is now legal recreationally in Colorado, Washington, Alaska, Oregon, California, Massachusetts, Maine, Nevada and Vermont.
6. Known as the Rohrabacher-Blumenauer amendment, the legislation prohibits the DOJ from spending federal funds on activities that would interfere with the implementation of state medical marijuana programs. The amendment was passed as part of a spending bill, and it must regularly be renewed by Congress as part of the federal budget. President Trump signed the current version in early February 2018, ending a brief government shutdown and renewing the prohibition through March 23, 2018, but the amendment’s future is far from certain. In May 2017, President Trump attached a vague signing statement to a previous appropriations bill stating that he would treat the provision “consistently with [his] constitutional responsibility to take care that the laws be faithfully executed.” Statement by President Donald J. Trump on Signing H.R. 244 into law, May 5, 2017, available at https://www.whitehouse.gov/briefings-statements/statement-president-donald-j-trump-signing-h-r-244-law/ (last visited Feb. 28, 2018). In late July 2017, the Senate Appropriations Committee approved inclusion of the Rohrabacher-Blumenauer amendment in the appropriations bill for fiscal year 2018, but Attorney General Jeff Sessions urged Congress not to renew the prohibition and directed the DOJ’s recently-constituted Task Force on Crime Reduction and Public Safety to re-evaluate the department’s current policies for ensuring compliance with the spending restriction. See Letter from J. Sessions, U.S. Attorney General, to M. McConnell, Majority Leader, U.S. Senate, et al. (May 1, 2017), available at https://www.massroots.com/news/exclusive-sessions-asks-congress-to-undo-medical-marijuana-protections (last visited Feb. 28, 2018). The task force’s findings and recommendations were due by July 27, 2017, but as of this writing, they had not been publicly released. But see Sadie Gurman, “Huff, puff, pass? AG’s pot fury not echoed by task force,” AP News, Aug. 5, 2017, available at https://apnews.com/ad37624f-cb8e485a8d75a03d48a227c (last visited Feb. 28, 2018) (reporting task force’s report was “not slated to be released publicly,” but included "no new policy recommendations to advance the attorney general’s aggressively anti-marijuana views"). And, in early January 2018, Sessions issued a memorandum giving federal prosecutors carte blanche to prosecute marijuana cultivation, distribution and possession as they would any other federal crimes and rescinding enforcement guidance dating back to 2009 that had adopted a hands-off approach to marijuana programs regulated by the states. See Memorandum from J. Sessions to U.S. Attorneys (Jan. 4, 2018), available at https://www.justice.gov/opa/press-release/file/1022196/download (last visited Mar. 6, 2018).
7. See supra note 2.
8. In support of its decision, the DOJ reiterated Congress’s original rationale for classifying marijuana as a Schedule I drug 47 years ago, concluding that the drug still “does not have a currently accepted medical use in treatment in the United States, there is a lack of accepted safety for its use under medical supervision, and it has a high potential for abuse.” Letter from C. Rosenberg, Acting Administrator, Drug Enforcement Administration, U.S. Department of Justice, to G. Raimondo, Governor, State of Rhode Island, et al. (Aug. 11, 2016), available at https://www.dea.gov/divisions/hq/2016/Letter081116.pdf (last visited Feb. 28, 2018).

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employer, while also potentially reducing the employee’s accuracy, efficiency, and productivity. And, finally, because the effects of THC on any given user vary greatly depending on a variety of factors — including the type of marijuana consumed, the manner of consumption, the age and size of the user, and how often he or she uses the drug — conventional drug tests cannot accurately identify the subject’s current level of impairment, which makes it challenging for an employer to blame a specific event or circumstance on an employee’s use of medical marijuana.

At the same time, employers must attempt to satisfy both state and federal law on a whole host of work-related issues, including the Americans with Disabilities Act (ADA) and its state law counterpart, Chapter 151B, both of which forbid employers from discriminating against prospective and current employees on the basis of disability, require employers to make reasonable accommodations if they would allow disabled employees to perform the essential functions of the job, and impose potentially devastating civil liability for any missteps.9

For these reasons, the question that has been at the forefront of many employers’ minds is how to reconcile these seemingly inconsistent legal provisions and, more specifically, whether employers have a legal obligation to tolerate the use of medical marijuana by an employee as an accommodation for a disability even though the drug remains illegal under federal law and even though its use could increase safety risks and create other problems in the workplace.

According to a recent ruling by the Supreme Judicial Court (SJC), the answer to that question in Massachusetts is a resounding “yes.” The decision leaves Massachusetts employers very little room to refuse to accommodate the use of medical marijuana by disabled employees without facing uncapped liability for handicap discrimination under Chapter 151B.

II. RECONCILING THE MEDICAL MARIJUANA ACT AND CHAPTER 151B

The Medical Marijuana Act allows qualifying patients to obtain access to marijuana for medical purposes by lawful means and eliminates criminal penalties that users, healthcare providers and suppliers might otherwise face under state law.10 Qualifying patients are defined as persons who have been “diagnosed by a licensed physician as having a debilitating medical condition.”11 A medical condition is “debilitating” if it causes “weakness, cachexia, wasting syndrome, intractable pain, nausea, or impairing strength or ability, and progress[es] to such an extent that one or more of a patient’s major life activities is substantially limited.”12 Patients who suffer from such conditions may apply for a registration card from the Department of Public Health (DPH) by submitting a written certification from a registered physician that the potential benefits of medical marijuana as a treatment would likely outweigh the health risks to the patient.13 If the application is approved, the patient is registered with DPH and receives a registration card that allows him or her to legally purchase marijuana products from a registered marijuana dispensary and to consume the drug in private without fear of criminal prosecution.14

Both the Medical Marijuana Act and its implementing regulations expressly provide that nothing in the law “requires any accommodation of any on-site medical use of marijuana in any place of employment” or “requires the violation of federal law.”15 Despite these assurances, however, employers had good reason to remain nervous. First, the Act grants anyone who “meets the requirements” of the statute protection not just from prosecution, but from the denial of “any right or privilege for such actions.”16 The Act also provides that nothing in the law “purports to give immunity under federal law” or “poses an obstacle to federal enforcement of federal law,”17 and the regulations further state that they shall not be construed “to limit the applicability of other law as it pertains to the rights of . . . employers, law enforcement authorities, or regulatory agencies.”18 Finally, and perhaps most importantly, neither the statute nor the regulations specifically immunize employers from civil liability arising out of employment decisions associated with the use of medical marijuana by their employees, and they are silent as to whether employers have an obligation to accommodate off-site use of the drug.19

Chapter 151B, meanwhile, was not amended to address the potential impact of the Medical Marijuana Act in the workplace. Rather, that statute continues to require employers to make reasonable accommodations to enable handicapped persons to perform the essential functions of their jobs “unless the employer can demonstrate that the accommodation required to be made to the physical or mental limitations of the person would impose an undue hardship to the employer’s business.”19

Reconciling these laws is no easy task. It seems reasonably clear that employers may forbid on-site use of medical marijuana as well as being under the influence of medical marijuana while working. But what about off-site, off-duty use? The Medical Marijuana Act says that employers cannot deny medical marijuana users any “right or privilege,” and Chapter 151B gives handicapped employees the right to reasonable accommodations, but that law does not specifically address the use of drugs or medication. So does an employer’s refusal to tolerate a handicapped employee’s off-site use of medical marijuana deny the employee a “right or privilege” under Chapter 151B? Until recently, the answer was widely presumed to be no — and with good reason.

11. Id. at § 2(K).
15. Id. §§ 7(D) & 7(F); 105 Code Mass. Regs. § 725.650(H) (2017).
17. Id. § 7(G).
For one thing, guidance published by the Massachusetts Commission Against Discrimination (MCAD) specifically provides that “[c]urrent illegal drug use does not fall within the definition of handicap” and further states that employers may “establish and enforce drug and alcohol-related work rules, including but not limited to . . . requiring employees to comply with all state and federal drug and alcohol-related laws or regulations to which the employing unit and/or its employees are subject.” Accordingly, the state agency charged with enforcing Chapter 151B appeared to agree with the propositions that a handicapping medical condition is distinct from any medication the employee may use to treat it and employers may lawfully require their employees to comply with federal drug laws. Based on that guidance, it was logical to conclude that Massachusetts employers do not engage in disability discrimination by refusing to tolerate the off-site use of medical marijuana by a handicapped employee.

When faced with the very same question, moreover, courts around the country have reached the same conclusion. In Ross v. Ragingwire Telecommunications Inc., for example, the Supreme Court of California held that an employer did not commit disability discrimination when it terminated an employee who used medical marijuana for failing a drug test. According to that court, California’s version of Chapter 151B “does not require employers to accommodate the use of illegal drugs” and the state’s medical marijuana statute does not “address the respective rights and duties of employers and employees,” so California employers remain free to require drug tests and to take the results into consideration when making employment decisions.

Similarly, in Emerald Steel Fabricators Inc. v. Bureau of Labor and Industries, the Supreme Court of Oregon concluded that an employer had no obligation to accommodate an employee’s use of medical marijuana because, to the extent state law could be read to require such an accommodation, it was preempted by the CSA. That court reasoned that any state law that affirmatively authorized the use of marijuana for any reason would stand as “an obstacle to the accomplishment and execution of the full purposes and objectives of the Controlled Substances Act.”

Likewise, in Garcia v. Tractor Supply Co., the United States District Court for the District of New Mexico concluded that a medical marijuana user who was terminated for failing a drug test had no claim for wrongful termination under the New Mexico Human Rights Act. According to that court, being terminated for violating a workplace drug policy is not the same thing as being terminated on the basis of a disability, and the duty of employers to accommodate employee disabilities under the state’s Human Rights Act does not extend to the use of drugs that are illegal under federal law.

And yet, in Barbuto v. Advantage Sales and Marketing LLC, our SJC reached exactly the opposite conclusion.

III. BARBUTO V. ADVANTAGE SALES AND MARKETING LLC

Cristina Barbuto has Crohn’s disease, a gastrointestinal condition that is expressly identified as a “debilitating medical condition” under the Medical Marijuana Act. A registered physician certified that the benefits of using medical marijuana would outweigh any risks to her health, and she applied for and received a registration card from DPH, allowing her to legally obtain and use medical marijuana to treat her condition. She used the drug several times a week, in small quantities, usually in the evenings.

After she started using medical marijuana, Barbuto applied for and was offered an entry-level position at Advantage Sales

21. But see infra note 42 (discussing the position taken by the MCAD as amicus curiae in Barbuto).
23. Id. at 387.
24. Id. at 385.
25. Id.
27. Id. at 529.
28. Garcia v. Tractor Supply Co., 154 F. Supp. 3d 1225 (D.N.M. 2016); see Shepard v. Kohl’s Dept. Stores Inc., No. 1:14-cv-01901-DAD-BAM, 2016 BL 249936 (E.D. Cal. Aug. 2, 2016) (relying on Ragingwire to hold that an employer terminated for failing a drug test due to his use of medical marijuana could not maintain claims for disability discrimination, failure to accommodate, failure to engage in the interactive process or invasion of privacy, in part because he was terminated only for his manner of treating his disability, not the disability itself); Steele v. Stallion Rockies Ltd., 106 F. Supp. 3d 1205, 1212 (D. Colo. 2015) (“Even if Plaintifff is attempting to argue that his termination was related to his disability by virtue of the fact that marijuana was what he used to treat his disability . . . anti-discrimination law does not extend so far as to shield a disabled employee from the implementation of his employer’s standard policies against employee misconduct.”) (citation omitted); cf. Coats v. Dish Network LLC, 350 P.2d 849 (Colo. 2015) (concluding Colorado law prohibiting discharge based on lawful out-of-work activities did not cover the use of medical marijuana because of illegality under federal law); Casias v. Walmart Stores Inc., 695 F.3d 428 (6th Cir. 2011) (holding neither Michigan medical marijuana statute nor public policy provide a right of action for an employee who was discharged for using the drug); Roe v. Teletech Customer Care Mgmt. (Colo.) LLC, 257 P.3d 586 (Wash. 2011) (same under Washington law); Beinor v. Indus. Claim Appeals Office, 262 P.3d 970 (Colo. Ct. App. 2011) (upholding denial of unemployment to Colorado employee who was terminated for using medical marijuana, observing “the illegality of marijuana under federal law made its presence in any worker’s system inappropriate under employer’s [drug] policy”). But see Nofsinger v. SSC Niantic Operating Co. LLC, No. 3:16-cv-01938, 2017 BL 276576 (D. Conn. Aug. 8, 2017) (concluding an applicant whose job offer was rescinded because she uses medical marijuana could bring a claim under the Connecticut medical marijuana statute, which expressly forbids discrimination against registered users by employers, finding that the state statute is not preempted by the Controlled Substances Act, the ADA or the federal Food, Drug and Cosmetic Act); Callaghan v. Darlington Fabrics Corp., No. PC-2014-5680, 2017 BL 216178 (R.I. Super. Ct. May 23, 2017) (same under Rhode Island medical marijuana statute, which likewise expressly forbids discrimination against cardholders by employers, and also allowing a disparate impact claim to go forward under a state law barring disability discrimination in the making of contracts, finding neither claim to be preempted by the Controlled Substances Act).
32. Barbuto Brief at 11.
Barbuto appealed the Superior Court’s decision, and the SJC allowed her application for direct review. After hearing oral argument and considering the views of nine different amici curiae, the court upheld the dismissal of Barbuto’s claim under the Medical Marijuana Act and her wrongful termination claim, but reversed the dismissal of her claim under Chapter 151B. According to the court, the mere fact that marijuana remains illegal under federal law does not relieve employers from their obligations under state law — specifically, the obligation under Chapter 151B to engage in the interactive process and to provide reasonable accommodations for handicapped employees. And unless an “equally effective alternative” exists, the court concluded, accommodating a handicapped employee’s off-site use of marijuana pursuant to a valid prescription is facially reasonable irrespective of federal law.

In support of this conclusion, the court reasoned that the Medical Marijuana Act expressly guarantees that patients will not be denied any “right or privilege” based on their use of the drug, that the right to a reasonable accommodation for a disability is within the scope of that guarantee, and that there is no logical distinction between accommodating a medication and accommodating the condition the medication is used to treat. As the court put it, “where a handicapped employee needs medication to alleviate or manage the medical condition that renders her handicapped, and the employer fires her because company policy prohibits the use of this medication, the law does not ignore the fact that the policy resulted in a person being denied employment because of her handicap.”

Barbuto Brief at 10-11.
37. Id. at 11-12.
38. Mass. Gen. Laws ch. 214, § 1B (“A person shall have a right against unreasonable, substantial or serious interference with his privacy. The superior court shall have jurisdiction in equity to enforce such right and in connection therewith to award damages.”).
39. Barbuto, No. 15-02677, slip op. (Mass. Super. Ct. May 31, 2016). Significantly, the court allowed Barbuto’s claim under the Massachusetts Privacy Act to proceed, reasoning that the requirement of a pre-employment drug test could be an unreasonable invasion of privacy if it is not commensurate with the applicant’s anticipated duties and responsibilities. See id. at 3-4 (relying on Webster v. Motorola Inc., 418 Mass. 425, 431 (1994) (holding employee’s right to privacy was violated by a drug test where the employee was not engaged in a dangerous or safety-sensitive occupation, reasoning that a urinalysis “involves a significant invasion of privacy” and that the “nexus” between the employee’s duties and any safety risk was “attenuated”)). In Barbuto’s case, however, it is hard to understand how her privacy interest outweighed Advantage’s interest in identifying employee drug use. For one thing, she had already disclosed, voluntarily, that she was a medical marijuana user, seemingly wanting any expectation of privacy associated with that information. Additionally, she was never required to take the test — she chose to do so because she wanted a chance at the job, a decision that arguably constitutes consent to the invasion of her privacy.
40. Id. at 2-3.
41. Id. at 3 (citing Ross, 174 P.3d at 204; Coats, 350 P.3d at 852).
42. As noted above, the MCAD has published guidance stating that employers “may establish and enforce drug and alcohol related work rules,” including rules that require employees to “comply with all state and federal drug and alcohol-related laws or regulations to which the employing unit and/or its employees are subject.” See supra n. 20. As amicus curiae in Barbuto, however, the MCAD sought to distance itself from the apparent meaning of this guidance in two ways. First, the MCAD took the position that such work rules must nonetheless yield to the accommodation requirement, quoting its rather cryptic caveat that “the duty to reasonably accommodate handicapped employees pertains to these as well as to other work rules.” See Brief and Addendum of Amicus Curiae Massachusetts Commission Against Discrimination p. 16 n.9, Barbuto, 477 Mass. 456 (2017) (quoting MCAD Guidelines § X.C.4). Second, the MCAD suggested that the “federal drug and alcohol-related laws” to which it is referring are only those that govern employees as employees, e.g., U.S. Department of Transportation regulations that apply to certain types of safety-sensitive positions, and not to all federal drug laws “to which . . . its employees are subject” more generally. See id. at 46 n.25. The first of these arguments would seem to allow the exception to swallow the rule, requiring employers to ignore their own drug policies whenever an employee’s off-site use of an illegal drug as a treatment for a disabling condition would not create an undue burden, while the second is difficult to reconcile with the actual language of the MCAD’s own guidance. In light of these interpretive difficulties, the MCAD should consider updating its published guidance to reflect the unique status of medical marijuana.
44. Id. at 463-66.
45. Id. at 464-65. The court largely ignored decisional authority from other states, noting only that the “right or privilege” guarantee in the Medical Marijuana Act distinguished Barbuto’s case from Ross and that Coats and Roe involved different types of claims. Id. at 464 n.7.
46. Id. at 466. In light of this broad language, query whether the requirement of a registration card will withstand scrutiny after marijuana becomes available for purchase in Massachusetts without such a card. Indeed, it is not difficult to imagine employees using marijuana to treat disabling conditions without bothering to become a registered user, and employers may have a tough time justifying treating such employees differently than other disabled employees on that basis if they otherwise demonstrate an entitlement to reasonable accommodation.
The court also observed that the Medical Marijuana Act says only that on-site use of marijuana does not have to be accommodated, which the court viewed as an implicit recognition that off-site use might have to be. And finally, the court noted that employers commit no crime by merely tolerating use of the drug, and can lawfully refuse to do so if they can demonstrate that the accommodation would be unduly burdensome to their business, e.g., that it would “impair the employee’s performance of her work,” create an “unacceptably significant safety risk” or require the employer to violate a contractual or statutory obligation.

Importantly, the court did not consider whether its interpretation of state law might be preempted by the CSA, noting that Advantage had waived the argument. The court also cited Emerald Steel, pointing out that the Supreme Court of Oregon had rejected an analogous claim on the basis of federal preemption. This otherwise superfluous reference could be viewed as an invitation to employers to challenge Barbuto on preemption grounds. In light of the court’s apparent antipathy toward federal marijuana policy, however, it seems unlikely that the court would be willing to reverse itself in deference to that policy. Indeed, the court carefully pointed out that the CSA is contrary to the law in “ninety per cent of the States,” where voters and legislatures have determined that marijuana does in fact have an accepted medical use. The court stated that allowing employers to evade Chapter 151B’s accommodation mandate entirely out of respect for federal law would not respect the will of the voters in Massachusetts.

As a result, Barbuto will remain good law unless and until a federal court or the Massachusetts legislature decides otherwise, and that means employees now have a broad avenue of relief against employers who take adverse action against them for using medical marijuana off-site. More specifically, unless an employer can demonstrate that there was an “equally effective alternative” to medical marijuana or that the accommodation would be an undue hardship, a disabled applicant or employee who is rejected, disciplined, or fired for using the drug off-duty will have a strong claim of handicap discrimination under Chapter 151B.

IV. CONCLUSION

Like many watershed decisions, Barbuto raises more questions than it answers — such as what is acceptable proof of registered status, how can an employer determine whether off-site use of medical marijuana would impair job performance, what is an “unacceptably significant” safety risk, who should decide whether there is an “equally effective alternative” and what process should an employer follow to obtain such a determination, can an employer challenge that determination or obtain a second opinion, when can an employer obtain recertification of an employee’s continued need for the accommodation. Until the legislature or the courts provide further guidance, however, Massachusetts employers would be wise to be proactive about Barbuto — to examine and to revise existing drug-related employment policies, including testing policies; to think critically about which positions involve real safety concerns or are subject to federal oversight; to scrutinize federal contracts; to update job descriptions; and to consider implementing specific procedures for handling accommodation requests related to medical marijuana, including a process for determining whether there may be an “equally effective alternative.” An employer faced with accommodation requests should also make sure to engage the employee in the interactive process, and to proceed with caution before taking action against an employee who tests positive for marijuana. In this way, employers and employees alike can avoid unnecessary disputes and get back to work.

— Erica E. Flores

47. Id. at 464-65. This reading of the statute seemingly could have, but did not, motivate the Supreme Court of Montana to reach a similar conclusion in Johnson v. Columbia Falls Aluminum Co. There, the court held that Montana’s anti-discrimination law did not provide a remedy for a medical marijuana user who was terminated for failing a drug test because the statute expressly provides that it cannot be construed to require employers “to accommodate the medical use of marijuana in any workplace” even though the employee only used the drug while he was off duty. No. DA 08-0358, slip op. (Mont. Mar. 31, 2009); cf. Swav v. Safeway Inc., No. 2:15-cv-00939, slip op. at p.3 (W.D. Wash. Nov. 20, 2015) (dismissing discrimination claim on the grounds that medical marijuana is illegal under federal law and the state medical marijuana statute broadly disclaimed requiring employers who have a drug-free workplace to accommodate its use, without qualification). But see Ros, 174 F.3d at 391 (rejecting argument that later-enacted provision in Compassionate Use Act impliedly required employers to accommodate off-site use of medical marijuana because it expressly disclaimed any requirement that employers accommodate on-site use, reasoning that a failure to infer such an obligation would not render statute meaningless).

48. Id. at 465 (“The only person at risk of Federal criminal prosecution for her possession of medical marijuana is the employee. An employer would not be in joint possession of medical marijuana or aid and abet its possession simply by permitting an employee to continue his or her off-site use.”).

49. Id. at 467.

50. Id. at 466, n.9.

51. Id. (citing 230 P.3d at 535-36). In Emerald Steel, the Supreme Court of Oregon held that “[a]ffirmatively authorizing a use that federal law prohibits stands as an obstacle to the implementation and execution of the full purposes and objectives of the Controlled Substances Act.” 230 P.3d at 529. However, a Rhode Island Superior Court reached exactly the opposite conclusion, holding that the CSA did not preempt Rhode Island law because the purposes of the CSA are “quite distinct from the realm of employment and anti-discrimination law.” Callaghan v. Darlington Fabrics Corp., No. PC_2014-5680, 2017 BL 216178 at *17-18 (R.I. Super. Ct. May 23, 2017); see Noffsinger v. SSC Niantic Operating Co. LLC, No. 3:16-cv-01938, 2017 BL 270576 at *5-6 (D. Conn. Aug. 8, 2017) (relying on Callaghan to reach the same conclusion as to the Connecticut medical marijuana statute, noting that “the CSA nowhere prohibits employers from hiring applicants who may be engaged in illegal drug use”). Arguably, the federal court’s analysis in Noffsinger carries more weight than the state court rulings in Emerald Steel and Callaghan.


53. It bears noting that Advantage did not cross-appeal the Superior Court’s conclusion that Barbuto had stated a viable claim for invasion of privacy, meaning the Superior Court’s ruling on that issue remains the law of the case. Whether the opinion will persuade other judges is hard to predict, but in the absence of contrary authority, the decision could prompt similar challenges to pre-employment drug screens for non-safety-sensitive positions, even in cases where the disqualifying drug is illegal under both state and federal law.
Legal treatises are rarely described as monumental, at least since the days of Powell, Scott, and Williston, yet *Business and Commercial Litigation in Federal Courts*, has earned that encomium. The treatise covers not only the procedural topics one would expect, but also substantive law in many of the fields most commonly encountered by business and commercial litigators. Editor-in-Chief Robert L. Haig and many contributing authors turned out the first to third editions of this treatise in 1998, 2005, and 2011 to great praise. Its 2011 third edition, reviewed in the *Massachusetts Law Review*, had 130 chapters in 11 volumes totaling 12,742 pages by 251 authors including 22 judges. The current fourth edition (2016) has 153 chapters in 14 volumes and contains 17,142 pages of text by 296 authors including 27 judges. The subjects of chapters from earlier editions have been updated with new insights by authors who expand upon their earlier contributions, and 25 new chapters have been introduced (Foreword, p. vi). The quality and expanded content of this fourth edition fully deserves the encomium “monumental” and then some, having managed to keep, build upon, and expand the strong foundation of earlier editions.

Reviewing a treatise of such breadth and length obviously poses a challenge. We have carefully sampled the work, with special attention to particular factors and selected chapters. The lists and biographies of the contributing authors (Vol. 1, pp. xi-clxix) show senior lawyer authors hailing mostly from large firms (backed up by associates aiding the research and drafting) and esteemed judges (aided by law clerks). Judging by their curricula vitae, the authors’ qualifications are uniformly impressive. Many are involved in the American Bar Association, state bar associations and the American Law Institute; engaged in pro bono, teaching and civic activities; and have established public records of successful handling of cases at every level of our legal system. The quality of the writing, careful attention to precedent and sources, refreshing understanding that context and overview must precede diving into detail, and disciplined editorial hand all contribute to the value of the treatise.

Each chapter of the treatise contains a helpful table of contents, numerous sub-headings, generous references for further reading on the topic, and practice aids consisting of checklists and forms. The checklists are particularly helpful since few practitioners keep every rule or element on an issue in their heads. The CD-ROM included with the treatise contains jury instructions, checklists and forms that are included in the printed volumes, permitting easy use. Annual pocket part supplements will be provided for each volume covering new developments. An appendix (Vol. 15, currently 2,314 pages), contains an index and tables of all cases, laws, jury instructions, forms and rules cited in the work, and will be updated annually as well.

The treatise is a step-by-step practice guide that covers every aspect of a business or commercial case, from the investigation and assessment that takes place at the inception, through pleadings, discovery, motions, trial, appeal and enforcement of judgments. It includes in-depth features on subject matter jurisdiction (in 85 subsections of chapter 1, each a significant resource on its own); personal jurisdiction and service (ch. 2); venue and forum selection (ch. 3); case investigation and tools (ch. 4); internal investigations (ch. 5); case analysis and evaluation (ch. 6); the complaint (ch. 7); responses to complaints (ch. 8); and third party practice (ch. 9). In volumes 2–7, jury and bench trials are exhaustively covered, including use of technology in court, evidence, persuasion, ethics, judgments, post-judgment practice, appeals, and collection and enforcement of judgments.

Chapters 10 through 12 focus on forum. The choice of a state or federal forum has a major impact on many aspects of litigation, including cost, and the treatise analyzes in great depth the strategic factors to be considered in making the choice (ch. 10) or resisting choice of a state court by removal to federal court (ch. 12). Widespread concerns that business litigation has become too complicated, complex, and expensive are addressed in one of the new chapters entitled Civil Justice Reform (ch. 11). The chapter also discusses efforts in progress to restore an ability to handle in federal courts routine business disputes in diversity jurisdiction or federal question cases that may be primarily state law in nature. The pros and cons of reform proposals are thoroughly discussed.

The treatise does not neglect alternative methods of dispute resolution, such as negotiations (ch. 50) and settlements (ch. 35), and new chapters have been added on mediation (ch. 51), arbitration under federal statutes (ch. 52), and international arbitration (ch. 53). Litigation management strategies in use today by law firms and corporations are also addressed. New chapters address other issues in the business side of law practice, including marketing to potential business clients (ch. 70) and teaching litigation skills to younger lawyers (ch. 71).

1. The list price for the entire treatise in printed book form is $1,811 (though discounts are available [30 percent as this review is being written]). Monthly payment arrangements are available (including updates). And electronic access through Westlaw is available by various configurations and packages. It is estimated that the authors and their firms have invested more than $80 million of billable time in producing the treatise over the years (Foreword, p. v). All royalties from the treatise and its pocket parts go to the American Bar Association Section of Litigation, and the amounts have been substantial (Forward, p. viii).
The treatise also covers regulatory litigation (ch. 78) and practice before administrative agencies and tribunals (ch. 139) whose rulings are ultimately reviewable in federal courts (albeit more often than not with issues based on *Chevron U.S.A. Inc. v. Nat. Res. Def. Council Inc.*). This includes such areas as labor-employment (ch. 92); bankruptcy’s impact on commercial litigation (ch. 56); collections (ch. 94); commodities and futures (ch. 81); communications (ch. 97); construction (ch. 145); consumer protection (ch. 95); copyright (ch. 100) … (and so on through the alphabet). There is extensive coverage of state law issues that may be litigated in federal courts including insurance (ch. 90) and reinsurance (ch. 91); director and officer liability (ch. 82); merger and acquisitions transactions (ch. 83); medical malpractice (ch. 86); contracts (ch. 89); agency (ch. 113); joint ventures (ch. 115); the wide range of subjects governed by the Uniform Commercial Code, including sale of goods (ch. 119), warranties (ch. 117), and negotiable instruments (ch. 120); unfair competition torts (ch. 121); commercial real estate (ch. 127); franchising (ch. 129); construction (ch. 145); and project finance (ch. 146). It is hard to think of any significant omission.

Newly introduced in the fourth edition are chapters on substantive areas that have increased in importance in recent years, including health care institutions (ch. 87); securitization and structured finance (ch. 77); fiduciary duty litigation (ch. 116); advertising (ch. 124); media and publishing (ch. 126); social media (ch. 67); and fashion and retail (ch. 149). Special emphasis is given to international trade and cross-border litigation.

Page constraints limit us, but let us mention a few specifics that illustrate how valuable this treatise can be to practicing lawyers and what we like about this work.

In addition to civil litigation or administrative enforcement, attorneys who litigate business and commercial law cases must be aware of criminalization trends that have introduced volatile issues involving the use or non-use of criminal prosecution in such disputes. Notwithstanding the too-big-to-fail/too-big-to-jail trope, potential criminal or punitive consequences lurk behind almost every business dispute of any significance. Like it or not, business and commercial lawyers and law firms and in-house legal departments must become well versed in both criminal law and civil law to deal directly with disputes that implicate both areas (or at least be knowledgeable enough to spot issues and engage the timely assistance of specialized teams and resources). The treatise gives special attention to these matters in Volume 13, including, among others, fraud (ch. 130); white collar crime (ch. 131), which is one of the longest chapters of this multi-volume treatise; the interplay between commercial litigation and criminal proceedings (ch. 132); money laundering (ch. 133), the Foreign Corrupt Practices Act (ch. 134); export controls (ch. 135); and the False Claims Act (ch. 138).

The treatise also places great emphasis on strategic considerations specific to commercial cases. Details are always related to the broader picture, with various options and their consequences clearly set forth. Each chapter, which is the product of the authors’ involvement in high-stakes cases with no-stone-unturned efforts, results in an admirable comprehensive scope and precision. The old adage “Don’t make a federal case out of it” has effectively been replaced by a reality that almost all commercial litigation today gets very complicated very fast. Nevertheless, modest stakes cases demand consideration of proportionality, without limitation of quality counseling and advocacy. Knowing the full range of available tactics and options makes it easier to scale down for such cases without sacrificing essentials. The quality of analysis and litigation skills needed for such cases will be assisted by consulting this treatise because, after all, good lawyering counts in every case, large or small.

Chapters 60 (Appeals to the Courts of Appeal) and 61 (Appeals to the Supreme Court) deal with the appellate process in federal courts. The treatise clearly describes complicated procedural issues and highlights traps for the unwary. The skills required for appellate litigation differ from those at trial in several respects and these chapters do an outstanding job of alerting the reader to the essential perspective needed to handle an appeal successfully.

Chapter 60 is excellent; it encompasses all of the technical requirements for briefing and arguing a federal appeal and contains advice from a sitting Second Circuit Judge about what really counts and how cases are really decided. This sort of insider advice can be quite helpful and is reminiscent of Chief Judge Frank Coffin’s books,4 which those of us in the First Circuit have long known, of course, are indispensable reading if one wants to understand how federal appeals are processed, not to mention the insightful observations of Chief Judge Magruder5 (echoed on the state side by Justice Benjamin Kaplan6). Since the essentials of success on appeal are not that different between the state and federal courts in Massachusetts, much of Chapter 60’s guidance is applicable to state practice.” Chapter 60’s succinct coverage of the appellate process and the quality of the advice given about how to handle an appeal is impressive and well worth consulting, the earlier the better, whenever the prospect of appeal exists in a case.

Chapter 61 highlights the essentials of Supreme Court practice, covering the basics, and informing counsel of the extensive resources available to understand the unique issues that may arise in handling a Supreme Court case.

Chapter 71, entitled “Teaching Litigation Skills,” is superbly done, not simply on the merits, but because it exhorts every lawyer to teach and transmit litigation skills to the generation of lawyers who will follow us. This review is not the place to debate alleged failings in legal education or the merits of curricular changes designed to emphasize “experiential learning.” Suffice it to say, no one is a complete lawyer after a mere three years of study; mentorship in practice has always been and will doubtless remain an essential part of becoming an accomplished lawyer. This chapter gives sound advice about how this teaching role can be subsumed into the process of effectively representing the client’s interests in any given case, and can in fact improve the representation. The chapter emphasizes the need for partners and senior attorneys to teach the ephemeral skills of persuasion, written advocacy, oral advocacy, credibility, and, above all, professional integrity.

In a multi-volume treatise with innumerable procedural and substantive details on business and commercial litigation in federal courts, it is refreshing to see that the fundamentals of the lawyer’s role have not been overlooked. As Justice Holmes remarked, it is the lawyers who provide the “implements of decision” to the judges, and Justice Robert H. Jackson memorably described how important the Bar is to the development of our law. The entire treatise exhibits an understanding of counsel’s essential role in our legal system — from private resolution of disputes to trial litigation to the highest appellate courts in the land — and offers the knowledge needed to fulfill every aspect of that role with distinction.

Your reviewers commend this treatise unreservedly to any lawyer, novice or experienced, who wants to excel at business and commercial litigation in federal courts or elsewhere.

— Jerry Cohen and Thomas J. Carey Jr.


10. Attorney Cohen practices at Burns and Levinson, Boston, teaches at Roger Williams Law School, and is a mediator/arbitrator at JAMS, Inc. Attorney Carey practices at the Boston office of the global law firm Hogan Lovells and teaches at Boston College Law School. Both serve on the Editorial Board of the Massachusetts Law Review.
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