

Malpractice

Nonclient Minority Owners Can Press Freeze-Out Claims Against WilmerHale

Minority members of a limited liability company can sue WilmerHale for supposedly orchestrating a “freeze-out” to benefit the majority members while the firm was representing the LLC, the Massachusetts Appeals Court held July 21 (*Baker v. Wilmer Cutler Pickering Hale & Dorr LLP*, 2017 BL 252474, Mass. App. Ct., No. 16-P-639, 7/21/17).

WilmerHale and another firm may have had a fiduciary duty to the minority owners in light of significant protections for them in the company’s operating agreement, even if the minority owners didn’t have any dealings with the lawyers and even if their interests clashed with the corporate client’s interests, Chief Justice Scott L. Kafker said.

The decision heightens the precarious high-wire act that lawyers have to perform when power struggles are going on within closely held corporate clients. Whether corporate counsel has a fiduciary relationship with individual shareholders in a close corporation is largely a question of fact, the court said.

The case will make it difficult to know when lawyers representing a closely held business may have a fiduciary duty to minority owners, Boston attorney Paula M. Bagger of Cooke Clancy & Gruenthal LLP told Bloomberg BNA. She represents clients in business disputes and is the author of a recent article on ethical issues facing corporate counsel in closely held business disputes.

The Massachusetts Supreme Judicial Court suggested in dictum in a 1989 case that corporate counsel owes a fiduciary duty to each shareholder in a closely held company. There’s been lots of activity on the issue since then in Massachusetts superior courts, but the issue hasn’t been addressed in Massachusetts appellate courts, Bagger said.

Bagger said that the facts of this case are unlike other cases finding a fiduciary relationship between corporate counsel and minority shareholders in closely held companies. Here, the attorney-client relationship was hidden, and the appeals court focused on minority protections in the operating agreement rather than an actual reposing of trust and confidence in corporate counsel.

“The way in which the court found the requisite duty here makes it hard to predict what set of facts would cause counsel to be worried about whether or not

there’s a fiduciary relationship with the minority,” Bagger said.

It’s troublesome enough to have a fact-based inquiry, as opposed to a bright line, and the atypical facts here will make it even harder to know when a fiduciary duty exists, she said.

Trial Court Dismissed Claims According to the complaint, the majority members of Applied Tissue Technologies LLC secretly consulted the lawyer-daughter of one majority member, and she introduced her father to another attorney in her firm, Gary R. Schall. The LLC ostensibly engaged that firm, Gunderson Dettmer Stough Villeneuve Franklin & Hachigian LLP, as its counsel. Schall took the matter with him when he relocated his practice to Wilmer Cutler Pickering Hale & Dorr LLP about two months later.

The plaintiffs claimed that the lawyers worked behind the scenes to help the majority members merge the company into a newly created Delaware LLC, and that by time their involvement came to light, the majority members had unfettered control of the new entity with an operating agreement that extinguished the minority’s rights to participate in management, access company records, and prevent dilution of the interests.

The law firms contended that the complaint didn’t state any viable claim against them, either for breach of fiduciary duty or aiding and abetting the same, or for deceptive practices in trade or commerce. The trial court agreed with them and dismissed the claims.

The appeals court resuscitated all three claims. It took the allegations in the complaint at face value for the purpose of analyzing the sufficiency of the claims, without making any findings about what the lawyers actually did.

Fiduciary Duty Issue Whether counsel for a close corporate has a fiduciary relationship with individual shareholders in a particular case is largely a question of fact, the court said.

Here, “we conclude that [plaintiffs] have alleged enough to plausibly suggest that the defendants, acting as counsel for a limited liability company governed by an operating agreement providing significant minority protections, owed them a fiduciary duty,” the court said.

The lawyers may have had a fiduciary duty to the minority owners despite the lack of interaction here between them and despite the actual or potential conflict between the corporate client and the minority members, the court said.

Given the protections for minority members in the operating agreement, they should have been able to re-

pose trust and confidence that any lawyer hired by the company would have consulted with them before undoing those protections, the court said.

The plaintiffs stated a viable claim for breach of fiduciary duty by alleging that the defendants secretly worked to eliminate the minority protections in the operating agreement, the court ruled.

Other Claims Revived Too The court also reinstated the plaintiffs' claim that the lawyers knowingly aided and abetted and conspired with the majority members in breaching the majority's fiduciary duties to the plaintiffs.

In addition, it decided that the plaintiffs can pursue their claims under the Massachusetts consumer protection law, Massachusetts General Laws Chapter 93A. Their allegations were sufficient, at this early stage, to

suggest that the defendants were engaged in "trade or commerce" under the act, the court found.

The other panel members were Justice Judd J. Carhart, who participated in the case before his retirement, and Justice Kenneth V. Desmond Jr.

Dana A. Curhan, Boston, argued for the plaintiffs. Erin K. Higgins of Conn Kavanaugh, Boston, argued for Gunderson Dettmer and Emma Eriksson Broomhead. Richard M. Zielinski of Goulston & Storrs, Boston, argued for WilmerHale and Gary Schall.

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