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SJC reinstates $45M bad-faith judgment

By Vincent J. Pisegna and Anthony J. Cichello

A corporate executive who accepted money from a friend's charitable foundation to purchase company stock for himself in return for his promise to split the proceeds with the foundation when he sold it, and then repeatedly ignored requests to sell the shares, breached the implied covenant of good faith and fair dealing, the Supreme Judicial Court has ruled.

The case involved veteran investor Robert James, who fronted defendant Daniel Meyers, chief of Boston student loan company First Marblehead, $650,000 to enable Meyers to purchase newly issued shares of company stock while avoiding dilution of his stake in the corporation.

The contract, which consisted of a pair of single-page letter agreements, didn't specify any terms under which Meyers actually had to sell the stock. Within a few years, the stock's value had exploded and Meyers, who was collecting significant dividends, did not respond to repeated requests from members of the James family that he sell the shares.

In 2011, a Superior Court judge found that a "gentleman's agreement" existed between the parties that obligated Meyers to seek to sell the stock upon James's reasonable request. Finding that the defendant's failure to do so violated the implied covenant, the judge awarded the plaintiff foundation nearly $45 million in damages.

The Appeals Court reversed in early 2015, finding nothing in the contract to support the plaintiffs' claim.

But on April 21, the SJC reinstated the judgment.

"[Meyers's] actions … violated the foundation's reasonable expectations that he would 'engage in reasonable efforts to arrive at a reasonable time for sale,'" wrote Justice Barbara A. Lenk for the court. "Otherwise put, by turning a deaf ear to the foundation's repeated requests, thwarting the effectuation of the agreements, he destroyed or injured the foundation's right to receive the fruits of those agreements."


BIERWIRTH

The 21-page decision is Robert and Ardis James Foundation, et al. v. Meyers, Lawyers Weekly No. 10-055-16. The full text of the ruling can be found at masslawyersweekly.com.

'Robust doctrine'

Plaintiffs' counsel Joseph L. Bierwirth Jr. of Boston said the case confirms that Massachusetts takes an expansive view of the implied covenant, which he described as a "robust doctrine" that makes sure contracting parties live up to their obligations.

"The SJC doesn't issue a lot of cases having to do with the implied covenant, so I think it's a doctrine where there'd been confusion out there about its scope," Bierwirth said.

Bierwirth also said the decision is important in that it reversed an Appeals Court ruling that took too narrow a view of the doctrine while failing to give adequate deference to the trial judge's view of the evidence.

Vincent J. Pisegna, a business litigator in Boston who wasn't involved in the case, said the decision serves as a reminder that the SJC won't tolerate certain practices in trade or business.

"In this case, a lot of the harm that befell Meyers was of his own making," Pisegna said. "A takeaway for practitioners is to counsel their client, even before a matter gets to litigation, that there's a real risk if they choose to engage in practices that could be interpreted as 'sharp practices' by the court."

The ruling also shows that the SJC won't hesitate to impose an affirmative duty on a contracting party that's not explicitly provided for in the contract where necessary to prevent harm to the other party, Pisegna said, pointing to the court's reliance on its 2015 decision in Bay Colony R.R. Corp. v. Yarmouth.

In that case, the SJC found that a town breached the implied covenant by failing to act affirmatively on a contractor's behalf in a situation where their contract didn't expressly dictate that it do so, but where the town's inaction nonetheless deprived the contractor of the "fruits" of the contract.

"Bay Colony stands for the proposition that a party might have to go beyond the four corners of the contract more than this case does, but the court does cite it favorably," said Pisegna. "This case makes it harder for a lawyer to argue that Bay Colony is an outlier."

Shepard Davidson of Boston, who practices business litigation, said the case reminds him of others he's seen where, in the glow of opportunity, people rush into business without having a very direct and detailed discussion of when and how to end that business relationship.

"People usually do not want to think about winding up a business before it even has started, but this case highlights one of the perils in failing to do so," said Davidson, who also was not involved in the case.

Defense counsel Kevin P. Martin of Boston declined to comment on the record beyond noting that his client is disappointed in the result and will be considering his options in light of the decision.

Stonewalling?

James got to know Meyers, who founded First Marblehead in 1991, through his children's involvement in the company. Impressed with its business plan, James eventually invested $360,000 of his own money in First Marblehead.

In 1998, First Marblehead offered shareholders the opportunity to purchase additional shares in a rights offering. Specifically, each shareholder could purchase up to a maximum number commensurate with the shareholder's existing percentage ownership at a price of $20 per share.

Meyers had the right to buy up to 18,627 new shares but lacked the capital to buy them on his own. Fearing that the offering would dilute his interest in the company, he secured an agreement from James in a one-page letter executed Feb. 20, 1998, that James — through his charitable foundation, plaintiff Robert and Ardis James Foundation — would front him the money to buy the additional shares. In exchange, the foundation would share the proceeds from a future sale of the stock.

The parties executed a nearly identical letter agreement a year later in connection with another rights offering. Between the two agreements, Meyers purchased 31,107 shares with $653,000 of foundation money. Neither letter agreement stated if and when Meyers would be required to liquidate the shares.

First Marblehead went public in 2003 and the value of its stock increased dramatically over the next several years. The company also effectuated several stock splits between 2003 and 2006, increasing the number of shares subject to the letter agreements from 31,107 to 1.8 million by the time of trial in 2011. The value of each share peaked at more than $56 in early 2007.

In 2006, a lawyer who was advising the foundation on its tax-exempt status urged that it secure its fair share of proceeds from the Meyers stock so it could be put toward to the foundation's charitable purpose.

Meanwhile, James's daughter had approached Meyers several times via telephone and email between 2004 and 2006 about liquidating the shares in question, but he did not respond.

During this period, however, Meyers sold more than 3 million shares of other First Marblehead stock he owned, taking in more than $86 million on the transactions while continuing to collect dividends on the shares purchased with foundation funds.

In a letter dated July 10, 2006, James approached Meyers about liquidating the stock, offering to "negotiate a resolution." Through a letter from his attorney, Meyers implied that he would not do so under the threat of litigation but would consider proposals that would make him "reasonably whole" in exchange for surrendering control of a portion of his company stock and foregoing future dividends.

No further progress was made, and on Nov. 16, 2006, the foundation sued Meyers in Superior Court alleging that his failure to unwind the agreements upon request constituted a breach of contract and breach of the implied covenant of good faith and fair dealing.

Following a 2011 bench trial, Judge Christine M. Roach found that Meyers didn't violate any contractual duty to sell on demand but did breach the implied covenant by unfairly rewarding his own interests at the expense of the plaintiffs' "reasonable expectations." Roach awarded James and the foundation $45 million based on the fair market value of the shares at the time of the breach.

The Appeals Court vacated the judgment in February 2015 and the plaintiffs appealed to the SJC.

Robert and Ardis James Foundation, et al. v. Meyers

THE ISSUE Could a corporate executive who accepted money from a friend's charitable foundation to purchase company stock in return for his promise to split the proceeds with the foundation when he sold it — and then repeatedly ignored requests to sell the shares — be found liable for bad faith?

DECISION Yes (Supreme Judicial Court)

LAWYERS Joseph L. Bierwirth Jr. and Ryan P. McManus, of Hemenway & Barnes, Boston; and Thomas J. Carey Jr. of Hingham (plaintiff)
Kevin P. Martin and Katherine C. Sadeck, of Goodwin Procter, Boston (defense)

'Twelfth of never'

The SJC rejected Meyers's argument that the absence of a specific time by which he had to sell reflected a bargained-for decision by the parties that he had complete discretion over when or even if the shares would be sold.

"The agreements here clearly contemplated sale at some point, because they set out formulas for the distribution of the eventual proceeds '[u]pon the sale of the stock,'" said Lenk, adding that as long as Meyers continued to hold the shares, the foundation would receive no return on its initial investment while having zero recourse against Meyers personally should the stock decrease in value.

On the other hand, the justice continued, any time of sale would have netted Meyers a profit since he risked no money of his own in the purchase of the shares.

"Given the trial testimony and documentary evidence, the judge did not err in concluding that the foundation had a reasonable expectation that it would share in the eventual profits from sale before the proverbial Twelfth of Never," said Lenk, alluding to a 1956 hit song by Johnny Mathis.

The SJC also found that Roach was well within her discretion in finding that Meyers's conduct breached the implied covenant.

"The totality of the circumstances found by the trial judge shows that Meyers failed to effectuate in good faith the sales of stock that the agreements clearly contemplated," said Lenk.

"Taking an unwarranted view of his contractual rights, he thus sought to achieve for himself a better deal than the sharing of risks and rewards for which the judge found he had originally bargained," the court concluded, affirming Roach's judgment. MLW