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The Fiduciary Duties Owed in a New Mexico Closely Held Corporation: Walta v. Gallegos Law Firm, P.C.

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THE FIDUCIARY DUTIES OWED IN A NEW MEXICO CLOSELY HELD CORPORATION: *WALTA V. GALLEGOS LAW FIRM, P.C.*

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I. INTRODUCTION

In *Walta v. Gallegos Law Firm, P.C.*,[1] the New Mexico Court of Appeals addressed, as a matter of first impression in New Mexico, the nature of the fiduciary duties owed among shareholders in a closely held corporation. The significance of *Walta* is its practical import, since it defined the standards that must be followed by shareholders in New Mexico closely held corporations. As a result, *Walta* is likely to impact many individuals and corporate entities throughout New Mexico. Shareholders in closely held corporations will be bound by the default fiduciary duty standards established in *Walta* unless they expressly choose other standards of conduct.

This note will describe and discuss the factual particularities and procedural history of the *Walta* case,[2] the historical setting of the case,[3] and the New Mexico appellate court's analysis of the issues presented in *Walta*.[4] It will examine the court's rationale[5] and will conclude with a discussion of the implications stemming from the *Walta* decision.[6]

II. STATEMENT OF THE CASE

Walta arose when Mary Walta, a minority shareholder in a New Mexico closely held corporation, brought suit against the corporation itself, the Gallegos Law Firm, P.C. (Firm), and its majority shareholder, J.E. Gallegos (Gallegos).[7] Walta joined the Firm as an attorney-shareholder in January 1990,[8] and by November 1994, the Firm consisted of five attorney-shareholders.[9] Despite some measure of financial success in 1993 and 1994, the Firm experienced sporadic financial pressures during that time, resulting in conflict among the shareholders.[10] Walta, in particular, "had spoken in opposition to [the Firm's] acceptance of certain contingency fee cases" and its resultant indebtedness on the Firm's line of credit.[11] Gallegos responded to

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1. 2002-NMCA-015, 40 P.3d 449, *cert. denied*, 41 P.3d 345 (2002).
2. *See infra* Part II.
3. *See infra* Part III.
4. *See infra* Part IV.
5. *Id.*
6. *See infra* Part V.
7. *Walta*, 2002-NMCA-015, ¶ 26, 40 P.3d at 455.
8. *Id.* ¶ 4, 40 P.3d at 451.
9. *Id.* The shareholders consisted of Gallegos, Walta, Michael Condon, David Sandoval, and Glenn Theriot. *Id.* At that time, Gallegos was the majority shareholder, owning fifty percent of the Firm's stock. *Id.* The four minority shareholders owned varying percentages of the remaining stock. *Id.*
10. *Id.* ¶ 5, 40 P.3d at 451.
11. *Id.* The court further noted that "[o]n a number of occasions, Walta told Gallegos that the manner in which [the Firm] accepted contingency fee cases should be reformed." *Id.*

Walta's concerns with annoyance, asserting that his knowledge and experience made him more qualified to evaluate the caseload and manage the firm.[12]

In early November of 1994, Gallegos began hinting at his intention to phase out of the active practice of law within the next five years.[13] Shortly thereafter, Gallegos circulated a memorandum to each shareholder detailing a proposal to restructure the Firm.[14] The memorandum proposed that Gallegos could purchase all of the other shareholders' stock, leaving him as the sole shareholder of the Firm.[15] The proposal specifically stated that, for the buyout procedure, "stock will be surrendered and valued in accordance with the corporate by-laws as of December 31, 1994 and your employment terminated at that time."[16] Gallegos also suggested, as an alternative, that he could sell all of his stock to the four other shareholders and subsequently depart from the Firm.[17]

Walta believed that the memorandum meant that she was being fired from the Firm and that she had no control over her impending departure.[18] In addition to her apparently certain termination, Walta was concerned about the valuation of her stock under the terms proposed in the memorandum.[19] Walta and Gallegos met several

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12. *Id.* This initial dispute between Gallegos and Walta developed into a larger rift as time progressed. *Id.* ¶ 6, 40 P.3d at 451. "Walta felt Gallegos often singled her out as the source of his irritation." *Id.*

13. *Id.* ¶ 7, 40 P.3d at 452.

14. *Id.* ¶ 8, 40 P.3d at 452.

15. *Id.*

16. *Id.* ¶ 10, 40 P.3d at 452. When determining the surrender value of a departing shareholder's stock, the Firm's corporate by-laws differentiated between vested and non-vested stock. *Id.* Walta's 2000 shares consisted of "both vested and non-vested stock." *Id.* The Firm's bylaws stated that, for non-vested stock, "the shareholder [was to] be paid the equivalent of the purchase price of the stock or no less than 'the exact cost of the stock to him or her.'" *Id.* Since "Walta and the other shareholders had paid $10 per share" of stock, that would be the surrender value assigned to their non-vested stock. *Id.* Because of her tenure at the Firm, Walta believed that half (1000 shares) of her stock had vested, the value of which was more difficult to assess. *Id.* ¶¶ 10, 17, 40 P.3d at 452–53. According to the Firm's by-laws, shares "became 'vested' only if [the] shareholder had at least three years of employment commencing from 'the date that he or she first acquired shares in the corporation.'" *Id.* ¶ 11, 40 P.3d at 452. Once the stock became vested, a departing shareholder surrendering the stock was to receive the "present book value...as of the effective date of termination" for his or her vested stock. *Id.* Under the by-laws, if the present book value computation produced "a negative value, or a value of less than [the acquisition price of] $10 per share, the [surrender] value of the vested stock would" be equal to the $10 acquisition price paid by the shareholders. *Id.*

17. *Id.* ¶ 8, 40 P.3d at 452.

18. *Id.* ¶ 22, 40 P.3d at 454.

19. *Id.* ¶ 12, 40 P.3d at 453. However, when the Firm's shareholders met on December 15, 1994, to discuss the proposed buyout, "Walta did not raise any [of her] concerns about [the] valuation of...stock or about the termination of her employment," despite the fact that she had concluded that the relevant proposals violated the standing by-laws of the firm. *Id.* ¶¶ 9, 12, 40 P.3d at 452–53.

On March 28, 1995, Walta had obtained a copy of a letter given to attorney-shareholder Theriot by Gallegos. *Id.* ¶ 17, 40 P.3d at 453. "[That] letter...stated that under the 'present book value' formula in the by-laws..., [vested] stock had a 'negative value' on [the operative] December 31, 1994 [date], and therefore would only be valued at...[the acquisition price of] $10 per share." *Id.* However, "Gallegos did not disclose that in arriving at a 'negative value' for [the Firm's vested] stock, he had omitted certain accounts receivable from the calculation because he thought" that they did not meet the collectible accounts receivable definition contained in the Firm's by-laws. *Id.* At trial, "Gallegos testified [that] he did not use actual 'collectible accounts receivable' as stated in the by-laws definition of 'present book value' because [the Firm's] business practices did not and had never included preparation of a report that provided such information." *Id.* ¶ 18, 40 P.3d at 454. Therefore, "Gallegos opined that it would have required considerable time and subjective judgment to collect information on accounts receivables and determine whether they were collectible" under the Firm's by-laws. *Id.* Gallegos testified that he had calculated the value of Walta's stock using the method that had been employed previously by the attorney-shareholders during "the only other time a shareholder with vested stock had left [the Firm]." *Id.* ¶ 19, 40 P.3d at 454. "Although that procedure did not comply with the letter of the [Firm's] by-laws, all the [shareholders], including Walta, had agreed

times to discuss various aspects of the buyout.[20] During those meetings, Walta failed to voice her concerns about her impending termination or the valuation of her stock.[21] It was only on Walta's last day of employment that she informed Gallegos, by way of a letter, that she objected to the terms of the proposal.[22]

Walta believed that Gallegos's actual intention was to convert the Firm into a corporation with a single shareholder—himself.[23] She subsequently sued "the [Firm] and Gallegos for money damages, alleging six separate claims for relief,"[24] the most relevant being the breach of fiduciary duties.[25] "The jury found in favor of Walta,...and against Gallegos...for 'breach of his fiduciary duties with respect to the [Firm's] shareholder agreement and to...Walta.'"[26] "The jury awarded Walta compensatory damages" for the value of her stock "in the amount of $62,550 against both [the Firm] and Gallegos."[27] The jury also awarded punitive damages "against Gallegos individually, in the amount of $100,000."[28]

Gallegos appealed only the punitive damages award to the New Mexico Court of Appeals.[29] He based his appeal on two general assertions. First, he claimed that Walta's "fiduciary duty claims should not have been submitted to the jury at all because if the proper definition of the fiduciary duty was applied, there was no question he fulfilled his obligations."[30] Second, Gallegos asserted that, "in the wake

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to it" at the time. *Id.* As a result of those calculations, Gallegos determined that the total valuation for 'both [Walta's] vested and non-vested stock [was] $20,000—the amount Walta had paid for the stock." *Id.* ¶ 20, 40 P.3d at 454.

20. *Id.* ¶ 15, 40 P.3d at 453. Several of the meetings involved Walta, Gallegos, and the Firm's accountant; during these meetings, year-end firm finances, client file transition, and pending cases were discussed. *Id.*

21. *Id.* The work environment at the Firm during this period was very strained, with limited communication and continued disagreement between Walta and Gallegos. *Id.* ¶ 16, 40 P.3d at 453. Walta had to pressure Gallegos to allow her access to the Firm's monthly financial statements and was excluded from some client presentations, despite access and involvement by shareholders Condon and Sandoval. *Id.* Further, Gallegos did not offer Walta any contract work during the transition period nor did he assist Walta in finding another job. *Id.*

22. *Id.* ¶ 22, 40 P.3d at 454. Specifically, Walta stated that she believed that "[her] termination of employment...[was] wrongful and without cause." *Id.* She also stated that she disputed both the valuation of her stock and the December 31, 1994, valuation date and had thus retained legal counsel. *Id.*

23. *Id.* ¶ 23, 40 P.3d at 454. Walta also learned that "contrary to [his] prior representations that" the Firm would consist "of only himself and [another] young associate" after the buyout, Gallegos had actually offered each of the existing attorney-shareholders, with the exception of Walta, continued employment with the Firm. *Id.*

24. *Id.* ¶ 26, 40 P.3d at 455. The claims were (1) "breach of employment contract," (2) "breach of obligations owed to shareholders under the shareholder agreement," (3) "breach of fiduciary duties," (4) retaliatory discharge, (5) promissory estoppel, and (6) "intentional interference with contractual relationship." *Id.* The Firm and Gallegos then filed a "counterclaim against Walta asserting malicious abuse of process." *Id.* "The trial court directed a verdict against Walta on her retaliatory discharge and promissory estoppel claims." *Id.* ¶ 27, 40 P.3d at 455. The court also directed a verdict "against Gallegos on his malicious abuse of process claim." *Id.* "Thereafter, Gallegos and the Firm withdrew all...remaining counterclaims." *Id.*

25. *Id.* ¶ 26, 40 P.3d at 455.

26. *Id.* ¶ 28, 40 P.3d at 455.

27. *Id.* "At trial, experts for Gallegos, [the Firm], and Walta had the advantage of hindsight in totaling the Firm's accounts actually collected after Walta left [the Firm]." *Id.* ¶ 21, 40 P.3d at 454. Gallegos's own expert concluded that the value of Walta's vested stock as of December 31, 1994, even using a conservative measure, was actually $41,275, not the $20,000 calculated by Gallegos. *Id.* The jury ultimately relied on the amount calculated by Gallegos's expert in arriving at the $62,550 figure for the total worth of Walta's stock. *Id.*

28. *Id.* ¶ 28, 40 P.3d at 455. "Walta [had] requested punitive damages against both [the Firm and Gallegos]." *Id.*

29. *Id.* ¶ 29, 40 P.3d at 455.

30. *Id.* "As a backstop [to that claim], [Gallegos] also argue[d] that the fiduciary duty instruction given was incomplete and did not provide sufficient guidance to the jury." *Id.*

of the jury's verdict against Walta on her breach of employment contract and interference with contract claims, there [was] no evidence of the kind of culpable state of mind necessary to support punitive damages."[31]

The appellate court held that, as the majority shareholder of the Firm, "Gallegos owed Walta a fiduciary duty in his efforts to restructure [the Firm], including the purchase of her...stock."[32] More specifically, the court held that Gallegos had the "fiduciary obligation to disclose material facts affecting the value of the stock which [were] known to [him] by virtue of his position, but not known to the selling shareholder."[33] After recognizing the existence of such a duty, the court went on to define the scope of the fiduciary duty in New Mexico closely held corporations as being "similar to that owed by directors, officers, and shareholders to the corporation itself; that is, loyalty, good faith, inherent fairness, and the obligation not to profit at the expense of the corporation."[34] The court concluded that Gallegos's actions, as a whole, constituted a breach of his fiduciary duties and therefore affirmed the jury's verdict and award of punitive damages.[35]

III. HISTORICAL BACKGROUND

Prior to *Walta*, New Mexico courts had not previously addressed the fiduciary duties owed in New Mexico closely held corporations; thus, this case established a new precedent. Since the New Mexico Court of Appeals had no direct precedent on which to base its analysis of the issue, the court looked to other sources for guidance. Specifically, the court relied on two main sources for its analysis of the fiduciary duties owed in closely held corporations: New Mexico partnership law[36] and caselaw from other jurisdictions that had previously addressed the issues raised in *Walta*.[37]

The fiduciary duties owed in New Mexico partnerships have been statutorily defined.[38] In New Mexico, the only fiduciary duties partners owe are the duty of loyalty and the duty of care.[39] Partners owe those duties to both the partnership itself

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31. *Id.*

32. *Id.* ¶ 38, 40 P.3d at 451. The court also held that "breach of [the] fiduciary duty [could] be asserted as an individual claim separate from the remedies available under [New Mexico] statutory corporate law for oppressive conduct." *Id.* (citing Fate v. Owens, 2001-NMCA-040, ¶¶ 23–25, 27 P.3d 990).

33. *Walta*, 2002-NMCA-015, ¶ 45, 40 P.3d at 458.

34. *Walta*, 2002-NMCA-015, ¶ 41, 40 P.3d at 458 (citing Dilaconi v. New Cal. Corp., 97 N.M. 782, 788, 643 P.2d 1234, 1240 (N.M. Ct. App. 1982); Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 515–16 (Mass. 1975)).

35. *Walta*, 2002-NMCA-015, ¶ 66, 40 P.3d at 462. In reaching its holding, the appellate court addressed and denied Gallegos's arguments regarding the adequacy of the jury instructions as to the scope of the fiduciary duties and the absence of the requisite culpable mental state. As the focus of this note is the court's holding with regard to fiduciary duties in closely held corporations, discussion of the procedural specifics regarding those arguments will be limited. *See id.* ¶¶ 49–66, 40 P.3d at 459–62.

36. *See, e.g.*, NMSA 1978, § 54-1A-401(f), (h)–(j) (1996).

37. *See, e.g.*, Fought v. Morris, 543 So. 2d 167, 171 (Miss. 1989); Donohue v. Rodd Electrotype Co., 328 N.E.2d 505, 511 (Mass. 1975); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 663 (Mass. 1976); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); Berreman v. West Publ'g Co., 615 N.W.2d 362, 367 (Minn. Ct. App. 2000).

38. NMSA 1978, § 54-1A-404 (1996).

39. *Id.* According to the statute,

> A partner's duty of loyalty to the partnership and the other partners is limited to the following:
> 1) to account to the partnership and hold as trustee for it any property, profit or benefit derived

and to other partners.[40] New Mexico caselaw regarding partnership fiduciary duties is well developed, providing ready precedent for subsequent courts examining fiduciary duty issues.[41] Thus, the New Mexico Court of Appeals had both statutory language and caselaw from its own jurisdiction from which to derive part of its analysis.

However, the New Mexico appellate court also relied heavily on authority from other jurisdictions in formulating its holding.[42] Prior to *Walta*, several other states had examined the issue of fiduciary duties in the context of closely held corporations.[43] The appellate court examined several of the various approaches taken by other jurisdictions[44] and formulated an integrated approach to defining the fiduciary duties owed in New Mexico closely held corporations. That approach established the existence of the fiduciary duty owed in New Mexico closely held corporations while preserving generally established business principles.

IV. RATIONALE AND ANALYSIS

In formulating the scope of the fiduciary duty owed by shareholders in closely held corporations in New Mexico, the New Mexico Court of Appeals was essentially working with a blank slate. *Walta* was a matter of first impression and New Mexico caselaw related to closely held corporations, even generally, is quite limited.[45] Therefore, the court could have taken any number of approaches in evaluating the fiduciary duty owed in closely held corporations: it could have specifically denied the existence of such a duty and left shareholders up to their own devices, created a novel approach to the fiduciary duty, adopted an already existing concept of the fiduciary duty, or embraced a combination of several existing formulations on the fiduciary duty. The latter was the approach taken by the New Mexico Court of Appeals.

The court's analysis began where it should, by examining existing New Mexico caselaw to see if there was any precedent related to the issues presented in *Walta*.[46] The court found that the few New Mexico cases involving closely held corporations

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> by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity; 2) to refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and 3) to refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

Id. at § 404(b). Additionally, "[a] partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law." *Id.* § 404(c).

40. *Id.*

41. *See, e.g.*, Homestake Mining Co. v. Mid-Continent Exploration Co., 282 F.2d 787 (10th Cir. 1960); Levy v. Disharoon, 106 N.M. 699, 749 P.2d 84 (1988); Fate v. Owens, 2001-NMCA-040, 27 P.3d 476; Bassett v. Bassett, 110 N.M. 559, 798 P.2d 160 (1990).

42. *See, e.g., Fought*, 543 So.2d at 167; *Donohue*, 328 N.E.2d at 505; *Wilkes*, 353 N.E.2d at 657; *TSC Indus. Inc.*, 426 U.S. at 438; *Berreman*, 615 N.W.2d at 362.

43. *See, e.g., Fought*, 543 So.2d at 167; *Donohue*, 328 N.E.2d at 505; *Wilkes*, 353 N.E.2d at 657; *TSC Indus., Inc.*, 426 U.S. at 438; *Berreman*, 615 N.W.2d at 362.

44. *Walta*, 2002-NMCA-015, ¶¶ 32–37, 40 P.3d at 456–57.

45. *Id.* ¶ 31, 40 P.3d at 456.

46. *Id.*

did not address the fiduciary duties owed therein.[47] For example, in *Schwartzman v. Schwartzman Packing Co.*,[48] a 1983 New Mexico case, the New Mexico Supreme Court had addressed the common law and statutory duty to allow examination of corporate books but did not expand its discussion into other areas of shareholders' duties.[49] In *McCauley v. Tom McCauley and Son, Inc.*,[50] the New Mexico Court of Appeals "examined the concept of 'oppressive conduct' sufficient to support judicial intervention in corporate affairs under the New Mexico corporation statute in effect at that time."[51] While *McCauley* was useful to the *Walta* court "for its general approach and observations about the characteristic features of a close corporation...it [did] not address the idea of an enforceable fiduciary duty between shareholders outside...of the corporation statute's provision for relief from illegal, oppressive or fraudulent conduct."[52] In conducting its examination of prior caselaw, the *Walta* court ascertained that it was not bound to a particular approach under existing New Mexico precedent.

The court then began the second phase of its analysis by setting forth the traditional characteristics of a closely held corporation. Citing a Massachusetts Supreme Judicial Court opinion,[53] the New Mexico court identified a closely held corporation as "one typified by: (1) a small number of stockholders; (2) no ready market for corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation."[54] The court then noted that the characteristics of a closely held corporation could be abused to enable majority shareholders to take advantage of minority shareholders.[55] By using oppressive tactics such as "refusing to declare dividends, draining of corporate earnings in the form of exorbitant salaries and bonuses paid to majority shareholders, denying minority shareholders corporate offices and employment, and selling corporate assets to majority shareholders at reduced prices," majority shareholders could subordinate minority shareholder interests in the closely held corporation.[56] Similarly, the traditional characteristics of a closely held corporation make minority shareholders vulnerable to the "freeze out" or "squeeze out" devices sometimes used by majority shareholders.[57]

The device used by courts to combat such tactics has been the recognition of a fiduciary duty owed by the majority shareholders to minority shareholders.[58] Some appellate decisions have expanded the fiduciary duty rule and held that the fiduciary

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47. *Id.*
48. 99 N.M. 436, 659 P.2d 888 (1983).
49. *Walta*, 2002-NMCA-015, ¶ 31, 40 P.3d at 456 (citing *Schwartzman*, 99 N.M. at 439, 659 P.2d at 891).
50. 104 N.M. 523, 724 P.2d 232 (N.M. Ct. App. 1986).
51. *Walta*, 2002-NMCA-015, ¶ 31, 40 P.3d at 456 (citing *McCauley*, 104 N.M. at 529, 724 P.2d at 338; NMSA 1978, § 53-16-16(A)(1)(b) (1967)).
52. *Id.* (citing *McCauley*, 104 N.M. at 526–29, 724 P.2d at 235–38).
53. *Walta*, 2002-NMCA-015, ¶ 32, 40 P.3d at 456 (citing Donohue v. Rodd Electrotype Co., 328 N.E.2d 505, 511 (Mass. 1975)).
54. *Id.*
55. *Id.* ¶ 33, 40 P.3d at 456.
56. *Id.*
57. *Id.* (citing *McCauley*, 104 N.M. at 527, 724 P.2d at 236).
58. *Id.* ¶ 34, 40 P.3d at 456.

duty owed is not dependent on the level of shareholder control.[59] Instead, those courts have indicated that, because the fiduciary duty arises directly from the nature of the closely held corporation, the duty applies equally to both majority and minority shareholders.[60] The New Mexico Court of Appeals specifically stated that "the minority may do equal damage through unscrupulous and improper sharp dealings with an unsuspecting majority,"[61] thereby eliminating the distinction between majority and minority shareholders in relation to the fiduciary duty.

The New Mexico court then went on to state that several courts have noted the striking resemblance of the closely held corporation to a partnership. The appellate court cited the Massachusetts Supreme Judicial Court's formulation of the fiduciary duty in *Donohue v. Rodd Electrotype Co.* as the "purest expression" of that duty:[62]

> Because of the fundamental resemblance of the close corporation to the partnership, the trust and confidence which are essential to this scale and manner of enterprise, and the inherent danger to minority interests in the close corporation, we hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe one another. In our previous decisions, we have defined the standard of duty owed by partners to one another as the "utmost good faith and loyalty." Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation.[63]

In several cases following *Donohue*, the Massachusetts Supreme Judicial Court further refined its concept of the fiduciary duty.[64] The Massachusetts court's holding in *Wilkes v. Springside Nursing Home, Inc.* reflected its understanding that "self-interest is not necessarily synonymous with improper motivation"; as a result, it held that controlling shareholders in a closely held corporation "should be allowed to demonstrate a legitimate business purpose for their actions."[65] Upon a showing of a legitimate business purpose by the controlling majority, courts should then determine if "the practicability of a less harmful alternative" to the minority interest existed.[66] Since this type of "common sense approach" allows the majority to pursue legitimate business actions while ensuring that minority interests are safeguarded, it protects both corporate management interests and minority vulnerabilities.[67] The

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59. *Id.* The New Mexico court noted that "some courts have explicitly recognized that the duty extends to minority shareholders in close corporations." *Id.* (citing Zimmerman v. Bogoff, 524 N.E.2d 849, 863 (Mass. 1988); A.W. Chesterton Co. v. Chesterton, 128 F.3d 1, 6 (1st Cir. 1997)).

60. *Walta*, 2002-NMCA-015, ¶ 34, 40 P.3d at 456.

61. *Id.* (citing Donohue v. Rodd Electrotype Co., 328 N.E.2d 505, 515 n.17 (Mass. 1975)).

62. *Id.* ¶ 35, 40 P.3d at 456.

63. *Id.* (citing *Donohue*, 328 N.E.2d at 515).

64. *Id.* ¶ 36, 40 P.3d at 457.

65. *Id.* (citing Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 663 (Mass. 1976)).

66. *Id.*

67. *Id.*

Massachusetts court's concern "that 'untempered application of the strict good faith standard' could unduly hamper corporate management" was thereby alleviated.[68]

The basic Massachusetts formulation developed in *Donohue* and *Wilkes* has been followed, with slight variation, by several other jurisdictions.[69] For example, in *Fought v. Morris*,[70] the Mississippi Supreme Court held that the "relationship between shareholders in close corporations was one of trust and confidence—the same relationship which prevails in partnerships."[71] Therefore, the Mississippi court stated that "majority action must be 'intrinsically fair' to minority interests."[72] Similarly, the courts of Minnesota have also recognized the analogy of close corporations to partnerships in establishing a basis for the existence of fiduciary duties among shareholders in closely held corporations.[73]

The New Mexico Court of Appeals chose to embrace the reasoning and approach employed by the aforementioned jurisdictions.[74] The court acknowledged the usefulness in analogizing closely held corporations to partnerships but noted that the analogy "is incomplete because partners are provided more protection by statute from freeze-out tactics than corporate shareholders."[75] Despite that difference, the New Mexico court chose to embrace the analogy because it "recognizes the nature of close corporation organization and, because our [New Mexico] partnership case law is reasonably well-developed, it provides a ready source of precedent helping to provide content to the concept of fiduciary duty."[76] While noting a reluctance to specify the elements of the fiduciary duty, because stating "too narrow a definition of an expansive term would be ossifying,"[77] the court placed the duty in the context of other recognized standards of lawful conduct in order to provide guidance in future cases with circumstances similar to those in *Walta*.[78]

In beginning its discussion of lawful conduct, the appellate court first noted that "it seems self-evident that a fiduciary duty is inconsistent with the standards of conduct typically at play in arm's length commercial or business transactions."[79] The court then cited Chief Justice Cardozo: "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties....Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."[80]

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68. *Id.* (quoting *Wilkes*, 353 N.E.2d at 663).

69. *Id.* ¶ 37, 40 P.3d at 457.

70. *Fought*, 543 So. 2d at 171.

71. *Walta*, 2002-NMCA-015, ¶ 37, 40 P.3d at 457 (citing *Fought*, 543 So. 2d. at 171).

72. *Id.*

73. *Id.* ¶ 37, 40 P.3d at 457 (citing Berreman v. West Publ'g Co., 615 N.W.2d 362, 367 (Minn. Ct. App. 2000)).

74. *Id.* ¶ 38, 40 P.3d at 457. The court specifically noted in a later paragraph that, "while some commentators would label the approach we adopt as the 'minority view,' our review of case law informs us that it is actually the prevalent view among those courts which have addressed the issue." *Id.* ¶ 42, 40 P.3d at 458.

75. *Id.* ¶ 38, 40 P.3d at 457. *See also* NMSA 1978, § 54-1A-401(f),(h)–(j) (1997); NMSA 1978, § 54-1A-404 (1996).

76. *Walta*, 2002-NMCA-015, ¶ 38, 40 P.3d at 457.

77. *Id.* ¶ 39, 40 P.3d at 457 (citing McCauley v. Tom McCauley & Son, Inc., 104 N.M. 523, 527, 724 P.2d 232, 236 (N.M. Ct. App. 1986)).

78. *Id.*

79. *Id.* ¶ 40, 40 P.3d at 458.

80. *Id.* (citing Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928)).

The *Walta* court held that the duty imposed on shareholders in a closely held corporation is similar to that owed by directors, officers, and shareholders to the corporation itself: loyalty, good faith, inherent fairness, and the obligation not to profit at the expense of the corporation.[81] In essence, by aligning itself with the Massachusetts approach and current New Mexico partnership law, the court chose to impose a high duty of candor and good faith when majority shareholders are dealing with minority shareholders.[82]

In giving content to that duty, the New Mexico Court of Appeals sought to construct broad guidelines rather than rigid standards of conduct. The court began by noting that it did not wish to catalog the specifics of the fiduciary duty owed, but rather sought to place the duty in the context of other recognized standards of lawful conduct.[83] The court's analysis led it to adopt the approach that it felt was most aligned with longstanding principles of corporate law. This approach protects the interests of minority shareholders but does not interfere with shareholders' rights to contract freely. Additionally, it preserves the essential need for managers to make business decisions without undue judicial interference. Thus, this case sets manageable, but not intrusive, standards. The court, obviously cognizant of the need for business entities to conduct business free from judicial interference, provided limited but valuable guidance to closely held corporations operating in New Mexico.

After giving some content to the rigor of the fiduciary duty, the court went on to discuss the duty in the areas in which it commonly arises in closely held corporations: "valuation of the stock, the related matter of disclosure of material facts relating to corporate officers, and adherence to contractual obligations between shareholders."[84] With regard to the full disclosure of material facts affecting the valuation of stock, which has been widely discussed by various courts,[85] the majority of the cases impose a duty that requires full, voluntary disclosure.[86] The duty requires disclosure beyond mere access to the books and records of the corporation.[87] According to the New Mexico court, the underlying rationale of this requirement is to equalize the bargaining positions of shareholders where valuation of stock is typically difficult.[88] Thus, the New Mexico rule is as follows:

> [A] majority shareholder, as well as an officer or director of such a close corporation, when purchasing the stock of a minority shareholder, has a fiduciary obligation to disclose material facts affecting the value of the stock

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81. *Id.* ¶ 41, 40 P.3d at 458 (citing Dilaconi v. New Cal. Corp., 97 N.M. 782, 788, 643 P.2d 1234, 1240 (N.M. Ct. App. 1982)).

82. *Id.* ¶ 42, 40 P.3d at 458.

83. *Id.* ¶ 39, 40 P.3d at 458.

84. *Id.* ¶ 43, 40 P.3d at 458.

85. *See, e.g.*, Van Schaack Holdings, Ltd. v. Van Schaack, 867 P.2d 892, 898 (Colo. 1994); Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 435 (7th Cir. 1987) ("Close corporations buying their own stock, like knowledgeable insiders of closely held firms buying from outsiders, have a fiduciary duty to disclose material facts."); *Walta*, 2002-NMCA-015, ¶ 44, 40 P.3d at 458.

86. *Walta*, 2002-NMCA-015, ¶ 44, 40 P.3d at 458.

87. *Id.* (citing *Van Schaack Holdings, Ltd.*, 867 P.2d at 898–99; Michaels v. Michaels, 767 F.2d 1185, 1200 (7th Cir. 1985)). Furthermore, under New Mexico partnership law, partners, as fiduciaries, are "required to fully disclose material facts and information relating to partnership affairs to other partners, even if the other partners have not asked for the information." Fate v. Owens, 2001-NMCA-40, ¶ 25, 130 N.M. 503.

88. *Walta*, 2002-NMCA-015, ¶ 44, 40 P.3d at 458.

> which are known to the purchasing shareholder, officer, or director by virtue of his position, but not known to the selling shareholder.[89]

The appellate court concluded its primary analysis by noting that, in many cases, including *Walta*, a shareholder agreement exists among the members of the closely held corporation.[90] Therefore, the court faced two additional issues: the nature of the fiduciary duty arising from a shareholder agreement and whether non-compliance with a shareholder agreement could be deemed to be a breach of the fiduciary duty.[91] In holding that a breach of a shareholder agreement could also constitute a breach of the majority shareholder's duty, the New Mexico court chose to adopt the approach taken by the Mississippi Supreme Court in *Fought*.[92] There, the court reasoned that breach of the agreement could illustrate a departure from the absolute good faith required of a majority shareholder.[93] The New Mexico court cautioned, however, that every noncompliance with a shareholder agreement does not necessarily imply a breach of fiduciary duty.[94] The determination of "whether the breach of fiduciary duty has occurred will normally be a question of fact for the jury."[95]

Finally, the court acknowledged that the fiduciary duty defined in *Walta* is the default standard applicable only in the absence of a contrary agreement between shareholders stating, "shareholders are free to agree to different standards as long as the essence of right conduct is preserved."[96] In so concluding, the New Mexico appellate court emphasized the *Walta* decision as being a default standard, rather than a conclusive mandate, for New Mexico closely held corporations.

V. IMPLICATIONS

Under the new precedent established in *Walta*, shareholders in closely held corporations will have much more guidance as to their rights and duties than they did prior to the decision in this case. Majority shareholders, when taking action that significantly impacts minority shareholders, or vice versa, will be under the obligation of law to act in utmost good faith and fairness with respect to their fellow shareholders. This is not to say that particular shareholders cannot take action that may adversely affect other shareholders; they have the freedom to make business judgments to that end, so long as they have a legitimate business purpose for doing so.

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89. *Id.* ¶ 45, 40 P.3d at 459–60. After defining the fiduciary duty standard, the New Mexico court then adopted the standard established by the U.S. Supreme Court for what constitutes material information: "An omission or misstatement is material if there is a 'substantial likelihood that, under all the circumstances, the omitted (or misstated) fact would have assumed actual significance in the deliberations of the reasonable shareholder.'" *Id.* (citing *TSC Indus., Inc.*, 426 U.S. at 449).

90. *Walta*, 2002-NMCA-015, ¶ 46, 40 P.3d at 459.

91. *Id.*

92. *Id.* ¶¶ 46–47, 40 P.3d at 459.

93. *Id.* ¶ 46, 40 P.3d at 459.

94. *Id.* ¶ 47, 40 P.3d at 459.

95. *Id.*

96. *Id.* ¶ 48, 40 P.3d at 459. In so stating, the court illustrated the longstanding deference given to the formation of contractual agreements among shareholders.

Newly formed closely held corporations in New Mexico should now include a provision in their bylaws that contains the essence of this duty: the requirement that each shareholder exercise good faith and fairness toward each other in all actions. Thus, a breach of that agreement could definitively indicate a breach of the general fiduciary duty.[97]

However, while the court in *Walta* sought to equalize the bargaining positions of shareholders and ensure that their interests are protected by establishing the fiduciary duty, it specifically noted that the duty stated is merely the default standard "applicable in the absence of a contrary agreement between shareholders. Shareholders are free to agree to different standards as long as the essence of right conduct is preserved."[98] Thus, while shareholders are bound to that general standard of right conduct, they are free to draft shareholder agreements in any number of ways that do not necessarily correlate with the standard given in *Walta*. Again, this preserves the fundamental right to contract freely in a business enterprise.

VI. CONCLUSION

By adopting and explaining the existence of a fiduciary duty for shareholders in closely held corporations in New Mexico, the New Mexico Court of Appeals set general guidelines for closely held corporations to follow. As in partnerships, shareholders in closely held corporations are required to exercise utmost good faith and loyalty in their dealings with the corporation and other shareholders. That standard must be met in order for shareholders to escape liability for actions that negatively impact other shareholders in a closely held corporation. However, shareholders in closely held corporations still retain the fundamental right to contract and exercise business judgment. Thus, the rights of both minority and majority shareholders, and the general standards of conduct established in New Mexico corporate law, are preserved and protected under the holding of *Walta*.

97. *Id.* ¶¶ 46–47, 40 P.3d at 459.
98. *Id.* ¶ 48, 40 P.3d at 459.