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SJC rejects court-imposed 'buy-out' of minority shareholder

By Andrew Botti

The Massachusetts Supreme Judicial Court recently overturned a court-ordered buy-out of a minority shareholder's interest in a closely held business, saying it was not an appropriate remedy for a "freeze-out" by the controlling shareholder group.

The trial court's equitable "buy-out" remedy had been affirmed by the Massachusetts Appeals Court in May 2006, but the SJC saw things differently.

"The problem with this remedy," according to the SJC, "is that it placed the plaintiff in a significantly better position than she would have enjoyed absent the wrongdoing, and well exceeded her reasonable expectations of benefit from her shares." Brodie v. Jordan, 2006 Mass. Lexis 696.

The SJC left untouched the lower court rulings in favor of liability.

The Appeals Court decision affirming the lower court ruling ordering the buy-out had been the first appellate case in Massachusetts to do so. See Brodie v. Jordan, 66 Mass. App. Ct. 371 (2006).

The long and circuitous path of the Brodie case is a stark reminder to business owners and their counsel of the necessity of careful advance planning for the inevitable changes in ownership and management that occur in privately held businesses.

The case is a wake-up call for all closely held businesses that currently operate without a clear and comprehensive buy/sell agreement and stock transfer restriction in place. A well-constructed buy/sell agreement should address a variety of contingencies relating to future stock disposition, such as an owner's death, retirement, disability, or simply the desire to walk away.

Even the best business marriages may end in divorce and the promoters of a closely held corporation need to anticipate a time when the honeymoon comes to an end.

Strained relations

A brief recounting of the facts of the case and the lower court findings and rulings is instructive. In 1973, three individuals - Walter S. Brodie, David J. Barbuto, and Guy J. Agri - organized Malden Centerless Grinding, Inc. to manufacture round metal objects such as ball bearings.

Six years later, Agri resigned and Brodie became president. Brodie and Barbuto remained the only two officers and shareholders of the company until 1984 when Robert J. Jordan became an equal shareholder with Brodie and Barbuto. Jordan soon assumed the daily operations of the company.

Eventually, considerable friction developed between Brodie and Jordan, culminating in the removal of Brodie as a director. Brodie remained, however, a co-equal shareholder with Barbuto and Jordan.

Walter Brodie died in 1997. Upon Brodie's death, his wife, Mary, became the owner of his shares. She apparently had little or no knowledge of the company's business. Nevertheless, she sought a position as a director of the corporation. Mary Brodie also sought information on Malden's financial condition, requested an audit, and sought a determination of the value of her 400 shares.

The majority shareholders denied her requests. As in the case of her husband, Walter, it appeared the controlling shareholders considered Mary Brodie a "nuisance" and an "aggravation."

Mary Brodie was not, however, without recourse. She sued the other shareholders for breach of fiduciary duty.

While the case was pending, the majority shareholders suggested that if Mary Brodie wanted to offer Malden her shares, she should follow the procedures outlined in the company's articles of organization.

The articles contained a stock transfer restriction with a built-in stock valuation procedure involving the use of arbitrators to determine share price. The articles, however, did not require the company to purchase the shares once valued. They only required that the shares be offered first to the company, which had the option to decline their purchase. Mary Brodie did in fact commence the requisite procedure, but the majority shareholders stymied her efforts to follow through when they realized the expense which such an appraisal process would entail. She found herself holding 400 shares of stock with no ready market for them, she had no meaningful financial information on the company of which she was part owner, and she was essentially barred from participating in the enterprise.

The lower courts weigh in

Massachusetts law has long held that stock-

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holders in a close corporation such as Malden owe one another "substantially the same fiduciary duty in the operation of the enterprise that partners own to one another." Donahue v. Rodd Electrotype Co. of New England, Inc. 367 Mass. 578, 593 (1975).

As the Massachusetts Superior Court stated in the trial court ruling in Brodie, the "[c]ontrolling shareholders' fiduciary duty to minority shareholders includes the duty not to interfere with the minority's reasonable expectations of the benefits of ownership in the corporation and the duty to disclose information to the minority."

A court called upon to examine the actions of the majority shareholders vis-à-vis the minority must determine if there was a legitimate business purpose for the controlling group's actions, and "weigh the asserted business purpose against the practicality of any less harmful alternative."

The Superior Court, examining Mary Brodie's predicament, concluded there was "[a]mple evidence presented at trial to support a conclusion that [the] defendants engage[d] in a pattern of conduct that constituted a 'freeze-out' of the plaintiff in violation of the defendants' fiduciary duty."

The Appeals Court affirmed this finding, agreeing with the Superior Court's characterization of the majority's behavior as constituting a pattern of "stonewalling." The Appeals Court described the litany of oppressive behavior one might expect from the majority: "Typical majority actions constituting a freeze-out include denying a minority a corporate office or employment, refusing to declare dividends, treating the value of the minority's shares in an unequal manner, and excluding or isolating a minority shareholder from information, operations, and decision-making." 66 Mass. App. Ct. at 375-76.

In Mary Brodie's case, this pattern manifested itself when the majority denied her a corporate office, limited her to receiving annual, unaudited financials, and refused to pay dividends - the net effect of which was to ensure she would "derive no benefit from her shares."

Particularly egregious, the Appeals Court found, was the majority's refusal to abide the stock transfer restriction in the company's articles of organization – "a provision of corporate governance...not to be taken lightly." It was incumbent upon the company's directors – who were also its majority shareholders – to take the prescribed steps to determine, by arbitration, the value of Brodie's shares.

Although the directors were not obligated to purchase the shares once valued, their failure to follow through with the arbitration process was a breach of their fiduciary duty to Brodie as a minority shareholder.

The Superior Court ruled the appropriate remedy was a buy-out of plaintiff's shares at a price informed by the testimony of a court appointed expert.

In affirming this ruling, the Appeals Court wrote: "While there rarely is a market value for a small, close corporation's shares that bears any relation to the shares' true value, a freeze-out absolutely destroys whatever value otherwise exists. Where there is a freeze-out, the remedy ordered here restores to the plaintiff what she lost – or an approximation thereof – in the only way possible. Forcing the parties to maintain a relationship none of them wants is not good for them or for the corporation and is bound to breed more litigation." 66 Mass. App. Ct. at 386.

The SJC rejected this rationale for the forced buy-out remedy, concluding it "would require a forced share purchase in virtually every freeze-out case, given that resort to litigation is itself an indication of the inability of shareholders to work together."

Because neither the articles of organization nor the corporation's buy-laws required Malden to purchase Mary Brodie's shares, she had no "reasonable expectation of having her shares bought out."

The SJC also pointed out that minority shareholders in Massachusetts have no statutory right to involuntary dissolution because of majority shareholder misconduct. The SJC did not specify what would be a reasonable remedy under the circumstance, but remanded the case to the Superior Court for an evidentiary hearing on the issue.

The saga of Mary Brodie will doubtless continue.

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EMPLOYMENT LAW

Non-competes must be updated to remain effective

Job changes require new 'consideration' to support agreements

By Andrew P. Botti

An employer may not rely on a non-competition or nondisclosure agreement signed at the outset of employment. These agreements may need to be updated and re-signed each time the employee is promoted or their role changes.

Several recent Massachusetts court cases demonstrate the perils of not updating agreements and show that the circumstances under which an employee signs a non-competition agreement can determine whether it will be honored in a later dispute.

In Lycos, Inc. v. Lincoln Jackson, et.al., 18 Mass. L. Rep. 256 (August 2004), Lycos developed proprietary products for various online services and routinely required its employees to sign nondisclosure and non-competition covenants.

In March 2000, an employee signed the Lycos non-competition agreement at the commencement of her employment and her compensation was fixed at $55,000 per year, with additional bonus eligibility. The employee had access to Lycos' confidential business information, including proprietary plans for new products and marketing strategies.

In July 2001, the employee was promoted, and received an increased annual salary. The employee was responsible for the day-to-day search engine operations at Lycos. In January 2002, she received another pay increase. In neither of these instances was the employee asked to sign a new nondisclosure and non-competition agreement.

In March 2004, Lycos promoted the employee again. Her responsibilities expanded to include work on new product initiatives and marketing plans. Her salary increased substantially.

With this latest promotion, however, the employee was asked to sign an Offer Letter describing her promotion, and specifically referencing the nondisclosure and non-competition agreement she signed when her employment with Lycos began. The employee did not sign the letter.

Instead, four months later she resigned and went to work for a direct competitor. Lycos sought an injunction against the employee to enforce the nondisclosure and non-compete covenants. The court denied enforcement, finding that "Lycos cannot demonstrate that the agreement was supported by consideration."

The court pointed out that over the four plus years that the employee was employed by Lycos, the employment relationship varied with respect to her job title, increased responsibilities, salary, bonus, and reporting requirements.

The court stated: "Each time an employee's employment relationship with the employer changes materially such that they have entered into a new employment relationship a new restrictive covenant must be signed."

The decision emphasized that the Offer Letter itself demonstrated that Lycos understood that a material change had occurred in the employer-employee relationship, necessitating a new employment contract containing the desired restrictive covenants.

The Lycos court also explained that "[a]ny time a restrictive covenant is signed by an employee, the employer must provide some clear additional benefit" to the employee.

This is particularly important where the employer asks an employee to sign restrictive covenants after starting a job.

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The point is illustrated clearly in Engineering Management Support, Inc. v. Puca, et al., 19 Mass. L. Rep. 352 (April 2005). In Puca, the employer presented the employee with restrictive covenants a week after she began work. No one explained to the employee that she would be required to sign both non-compete and nondisclosure covenants as a condition of employment.

Under the circumstances, the court refused to enforce these covenants against the employee.

"Keeping one's job is insufficient consideration in this case for either the non-competition or confidentiality covenant," the judge wrote. The judge also found that presenting Puca with "the Hobson's choice of signing the restrictive covenants or losing her job" may be considered coercive.

Cypress Group, Inc. v. Stride & Associated, Inc., 17 Mass. L. Rep. 436 (February 2004), is another decision meriting attention by in-house counsel. In Cypress, three former employees of Stride, an I.T. placement company, sought a declaration that the non-competition and non-solicitation agreements they signed were unenforceable.

Stride required its employees to sign restrictive covenants prohibiting the solicitation of Stride's customers, or working for a Stride competitor, for 12 months following termination.

One employee worked for Stride for approximately seven years and left to start her own competing placement firm. To avoid litigation over the non-competition agreement, the employee and Stride agreed that the competing entity would refrain from soliciting a specified list of Stride clients for a period of six months.

A second employee began as a sales trainee in Stride's New York office. When promoted four months later he signed the Stride non-compete. In 2000, he signed another non-compete agreement when promoted to practice manager. In October 2001, Caracciolo was again promoted by Stride, but this time he was not required to sign a new non-compete agreement. Fifteen months later, he was fired for poor performance and soon thereafter began working for Stride's direct competitor.

The third employee began work with Stride as a low-level sales trainee. He signed the Stride non-competition agreement when promoted approximately two years later.

Between January 2000 and March 2003, he was promoted and/or changed positions three more times with Stride. None of these position changes required that he sign a new non-competition agreement.

In July 2003, he left Stride to work at the competitor. The court refused to enforce the restrictive covenants against either employee number two or number three, citing a lack of consideration.

Both Lycos and Cypress rely on the leading Massachusetts case of F.A. Bartlett Tree Expert Company v. Barrington, 353 Mass. 585 (1968). In Bartlett Tree, a salesman left to start his own tree care and landscaping business. His former employer sued, alleging breach of a two-year written non-competition agreement. The court refused to enforce the non-competition agreement, although finding it reasonable in both geographic scope and duration.

The Supreme Judicial Court reasoned that the salesman's terms of employment changed considerably during his 18 years at Bartlett Tree. In particular, compensation, sales territory and responsibilities were substantially different when he left the company in 1966, than when he began employment in 1948.

"Such far reaching changes strongly suggest that the parties had abandoned their old arrangement and had entered into a new relationship," the court wrote. Bartlett Tree, 363 Mass. at 587.

Employers seeking to protect confidential and proprietary information or to impose non-competes, must provide new agreements supported by additional consideration when the employee's role changes within the company. Otherwise, enforcement may prove futile and the old restrictive covenants not worth the paper they are printed on.

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EMPLOYMENT LAW

Who owns customer goodwill, after all?

By Andrew Botti

Customer goodwill, the lifeblood and soul of any business, has long been defined in Massachusetts as "all that goes with a business in excess of its mere capital and physical value, such as reputation for promptness, fidelity, integrity, politeness, business sagacity and commercial skill in the conduct of its affairs, solicitude for the welfare of costumers and other intangible elements which contribute to successful commercial adventure." *Martin v. Jablonski*, 253 Mass. 451, 457 (1925).

Goodwill is a well-recognized property right.

But in the context of enforcing non-competition agreements and other restrictive employment covenants, Bay State courts have struggled with the question: "whose goodwill is it, anyway?"

Does customer goodwill belong to sales or account executives - often the only "face" of the corporation known to the consuming public? Or does it belong to the corporation, which provides and produces the desired services, products and know-how, albeit often "behind the scenes?"

Or is goodwill some unique proprietary hybrid, the product of symbiotic relationships not easily divisible like tangible business assets?

Massachusetts trial courts have struggled with the question of goodwill ownership while seeking to strike a balance between the various competing interests involved. The results have not always proven consistent.

Carefully drafted non-competition and non-solicitation agreements can go a long way toward minimizing conflicts over the provenance and ownership of customer goodwill. As the Massachusetts Superior Court cases discussed below illustrate, however, until the appellate courts issue some "bright line" rules, the outcome of the continued imbroglio over customer goodwill promises to remain somewhat unpredictable.

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Balancing act

In *American Express Financial Advisors, Inc. v. Walker*, 9 Mass L. Rep. 242, 1998 Mass. Super. Lexis 577, American Express sought to enforce certain restrictive covenants prohibiting its financial advisors for a one-year period after termination from "directly or indirectly offer[ing] for sale, sell[ing] or seek[ing] an application for any Product or Service issued or provided by any company to or from a Client you contacted, dealt with or learned about while you represented [American Express]."

Several financial advisors left American Express to start their own financial advisory business. They planned to offer the financial and investment products of a broker-dealer entirely unrelated to American Express.

On their way out the door, the departing financial advisors sent thinly veiled solicitations to their current American Express clients, informing them of their new venture. A number of American Express clients subsequently transferred their accounts worth millions of dollars to the new broker-dealer so they could continue receiving financial planning advice from the departing American Express advisors.

American Express sued the departing employees to bar them from accepting any business from their former clients for a period of one year.

The Massachusetts Superior Court recognized that American Express had a legitimate business interest in the clients that had switched over to the new venture, i.e., protection of its own goodwill.

It did so even while noting the financial advisors themselves were encouraged by American Express to be one-on-one "personal" advisors and planners, who cultivated and maintained these sensitive financial relationships.

Nevertheless, the court found that American Express had developed its own goodwill with these clients by: 1) offering a wide range of finan-

cial products to them albeit through the conduit of the financial advisors; 2) providing important investment information and analysis "gathered and conducted by its 'back-room' employees"; and 3) appropriately supervising and training the financial advisors.

The court recognized that "[f]inancial advisors will look good to their clients only if the clients' portfolios prosper, and those portfolios will not prosper unless the information and analysis furnished to the financial advisors by American Express is sound and the investment vehicles offered by American Express perform as promised."

Conversely, no matter how good American Express' "back room" may be, it will have no "loyal clients unless those clients are satisfied with the advice, attention and 'bedside manner' of their financial advisor."

The court also recognized that the financial advisors had particularly close and sensitive relationships with these clients that warranted a large degree of deference despite the restrictive covenants. Moreover, because of the close nature of the advisor/client relationship, the court was loath to issue an order that in effect prevented the client from using the financial advisor of its choice.

The court noted that "[w]hile the relationship may not be as intimate as that of a doctor and patient or attorney and client... it is plainly a valuable and important personal and financial relationship whose significance... the common law should not categorically ignore."

Ultimately, in balancing the competing interests of American Express, the personal financial advisors, and the clients themselves, the court enjoined the advisors for four months from contacting their former clients - a period long enough "to allow American Express to demonstrate to its clients that the goodwill generated by the departing financial advisor was attributable more to American Express than to the particular skills of that individual."

Massachusetts courts have struggled with the question of goodwill ownership while seeking to strike a balance among the various interests involved. The results have not always proven consistent.

Face time with clients

Not all customer goodwill is recognized as belonging to the employer simply because it may have been developed during the employee's tenure. In *William Gallagher Associates Insurance Broker, Inc. v. Everts*, 13 Mass. L. Rep. 716, 2000 Mass. Super. Lexis 705, the Massachusetts Superior Court, when asked to enforce certain non-compete and non-solicitation covenants against a former salesman, seemed to discount substantially the company support and "back room" aspects of company goodwill expressly recognized in *American Express*.

Everts was a long-time salesman for the William Gallagher company, an insurance broker. During his tenure, Everts serviced more than two dozen accounts. When he left William Gallagher to work for a competing company, 13 of these customers followed him.

Of these, Everts himself had procured the business of ten anew while employed with William Gallagher. Two other customers Everts had brought with him to William Gallagher from a previous employer. The remaining customer had been a William Gallagher house account.

William Gallagher promptly sued Everts and his new employer over the loss of these 13 customers, and the company goodwill ostensibly associated with them.

William Gallagher argued the goodwill associated with these customers belonged to it, not Everts, for numerous reasons. As Evert's employer, William Gallagher had provided the clerical staff, supplies and customer service representatives needed to service these customers' accounts. The company had also sponsored Evert's attendance at certain sales training programs, and Everts had been accompanied on various sales calls by the company's CEO, as well as a young assistant.

The Superior Court, however, rejected all of these arguments, saying: "While hiring an employee and providing him with an infrastructure necessary for him to do his job undoubtedly gives an employer significant rights to control the employee's conduct, this does not mean that the good will which develops belongs to the employer. There is no evidence ... this type of support served to enhance plaintiff's reputation with its customers in such a way as to generate good will."

The court found that when Everts left he did not disparage his ex-employer, or otherwise tell these customers that his new employer was superior in the products or services it offered.

That these customers followed Everts upon his mere announcement of resignation did "not show that plaintiff's support created any loyalty to plaintiff. To the contrary, it tends to indicate trust in Everts," according to the court.

As to the ten customers Everts had solicited and developed himself while employed by William Gallagher, the court said the goodwill was of "Everts' own making, which he had developed with customers as a result of his own enthusiasm, personality and abilities.'" The court pointed out that "[t]he objective of a reasonable noncompetition clause is to protect the employer's good will, not to appropriate the good will of the employee."

Confidential customer information

More recently, the Superior Court in *RIS Paper Company, Inc. v. Wave Graphics, Inc.*, 2006 Mass. Super. Lexis 446, grappled with both the provenance and ownership of customer goodwill in a dispute over misappropriation of allegedly proprietary customer information.

In 1989, a man named DeStefano incorporated a small commercial printer eventually called Wave Graphics, Inc. When the company went bust in late 2003, its name, goodwill and customer lists were auctioned off to Unigraphics, Inc., another commercial printer for which DeStefano and several former Wave Graphics' salesmen had gone to work.

Two of Wave Graphics creditors mounted a legal challenge to the sale of its customer information to Unigraphics, claiming the information was confidential and proprietary to Wave Graphics, and shouldn't be used by DeStefano and the other former Wave Graphics salesmen to generate sales for a competing entity.

But the Superior Court disagreed.

Analyzing the practice in the commercial printing business, the court noted it was "customary for salesmen in the industry to change employment and to go with another competitor, taking their customers with them."

In fact, a departing salesman would typically take up to 80 percent of his customers to his new employer. The court concluded that, at least in the commercial printing industry, "What is valuable is not the identity of a customer as such, but rather a salesman's personal relationship with such a customer." These personal relationships "were not a proprietary asset of Wave Graphics" but had been properly acquired by Unigraphics through the hiring of DeStefano and the other former Wave Graphics salesmen, none of whom had signed any form of restrictive employment covenants with Wave Graphics.

There was no misappropriation of trade secrets, proprietary information or goodwill by DeStefano and his new employer, the court ruled.

The court's reasoning seems to echo that of *Richmond Brothers, Inc. v. Westinghouse Broadcasting Company*, 357 Mass. 106, 111 (1970) where the Supreme Judicial Court, citing *Club Aluminum Co. v. Young*, 262 Mass. at 226-227, wrote: "[A]n employer cannot by contract prevent his employee from using the skill and intelligence acquired or increased and improved through experience or through instruction received in the course of the employment. The employee may achieve superiority in his particular department by every lawful means at hand and then, upon the rightful termination of his contract for service, use that superiority for the benefit of rivals in trade of his former employer."

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Reach of retaliation claims expanded

By Andrew P. Botti

The U.S. Supreme Court recently gave a big weapon to employees when it ruled that a Civil War era statute – 42 U.S.C. §1981 – encompasses retaliation claims related to workplace discriminatory animus.

Interestingly, the statute itself does not even contain the words "retaliation" or "employment," yet the court in *CBOCS West, Inc.*, v. *Humphries*, 553 U.S. ___ (2008), reasoned that based on precedent §1981 applies to the employer-employee relationship.

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This ruling has significant ramifications.

For instance, an employee proceeding under §1981 for retaliation in the employment context doesn't have to first go to the Equal Employment Opportunity Commission, and can proceed directly to federal court, using the liberal discovery rules and broad subpoena power typically available in the judicial forum.

Also, a claimant may be a co-employee – perhaps not even a member of a protected class – who seeks to expose and rectify what appears to be unlawful workplace discriminatory animus.

And §1981 claims are not subject to the same cap on damages that limit the monetary recovery available to Title VII claimants. *See e.g. Pollard v. E.I. du Pont de Nemours & Co.*, 532 U.S. 843, 851 (2001).

Unlike Title VII, §1981 allows for personal liability of corporate officers, directors, and employees where they intentionally infringe rights protected under the statute, regardless of whether the corporation may also be liable. *See, e.g., Al-Khazraji v. Saint Francis College*, 784 F.2d 505, 518 (3d Cir. 1986). Such intentional conduct may also raise insurance coverage issues for these corporate agents.

Employers must ensure that all employees understand the importance and reach of the right of freedom from retaliation that §1981 grants to individuals seeking to vindicate rights under anti-discrimination laws.

In the wake of *Humphries*, failure to train personnel on the scope of potential retaliation liability under §1981 could prove extremely costly.

A look back

The relevant portion of §1981 analyzed in *Humphries* states: "All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts[ ] … as is enjoyed by white citizens."

The predecessor of this statutory language first appeared in Section 1 of the Civil Rights Act of 1866, 14 stat. 27, enacted by Congress shortly after the Dec. 6, 1865 ratification of the 13th Amendment, which Amendment effectively abolished slavery and involuntary servitude in the United States.

After ratification of the 14th Amendment on July 9, 1868, guaranteeing due process and equal protection of the laws to all citizens, Congress passed the Enforcement Act of 1870, 16 stat. 140, which in essence became §1981.

The overarching purpose of these statutes was to eradicate "state-imposed civil disabilities and discriminatory punishments" that Southern legislatures sought to visit on the recently freed slaves. *See General Building Contractors, Inc. v. Pennsylvania United Engineers and Constructors, Inc.*, 458 U.S. 375, 384-88 (1982).

In 1976, the Supreme Court reaffirmed that §1981 applied to the making of private contracts. *See Runyon v. McCrary*, 427 U.S. 160 (1976). From this recognition, it was not a far leap for lower courts to apply §1981 to the at-will "employment contract."

§1981 retaliation recognized

A good example of such an application is *Choudhury v. Polytechnic Institute of New York*, 735 F.2d 38 (2nd Cir. 1984), where the 2nd Circuit addressed for the first time the question of whether an employee's claim that his employer retaliated against him for filing a complaint for racial discrimination was recognized by §1981.

Choudhury, an Asian Indian, was a professor in the physics department of the Polytechnic Institute of New York. After five years he was appointed a full professor with tenure. Several years later, Choudhury discovered he was the lowest paid full professor in the Institute's physics department.

He filed a discrimination complaint with the Equal Employment Opportunity Commission. The matter settled when the Institute agreed to a salary increase and additional research monies for Choudhury.

Approximately one year later, Choudhury claimed his treatment by Polytechnic "took a dramatic turn for the worse." *Id.* at 40. The poor treatment he alleged included the cancellation of Choudhury's main course offering, failure to reappoint him to departmental committees, and receipt of the lowest merit salary increases.

Choudhury filed a §1981 claim for retaliation, alleging these adverse job actions were "payback" for having filed the earlier discrimination claim.

Joining the 5th, 6th and 8th Circuits, the 2nd Circuit recognized Choudhury's cause of action for retaliation under Section 1981.

The 2nd Circuit went on to hold that a §1981 retaliation claimant need not show the retaliation itself was motivated by racial animus, or even prove the underlying discrimination complaint to maintain a successful retaliation action.

However, in June 1989 the U.S. Supreme Court ruled that "racial harassment relating to the conditions of employment *is not actionable* under §1981 because that provision does not apply to conduct which occurs *after* the formation of a contract, and which does not interfere with the right to enforce established contract obligations." *Patterson* v. *McLean Credit Union*, 491 US 164, 171 (1989). (Emphasis added.)

This reasoning effectively eliminated retaliation claims under §1981 since such claims naturally arise during the course of the employment relationship – not at its inception. The court in *Patterson* also noted that extending §1981 claims to "post-employment conduct" would "undermine the detailed and well-crafted procedures for conciliation and resolution of Title VII claims."

Title VII claims of race discrimination are subject to the comprehensive administrative apparatus established by Congress and implemented by the EEOC, while §1981 provides no administrative review or opportunity for conciliation. *Patterson*, 491 U.S. at 181-82.

Congress reacts

In 1991, Congress passed the Civil Rights Act of 1991, 105 Stat. 1071, largely to supersede *Patterson's* narrow reading of §1981. The 1991 Civil Rights Act added a provision – §1981(b) – expanding the meaning of "contract" to include performance, modification and termination of the agreement.

The House report stated that the statute is meant "to bar all race discrimination in contractual relations. ... In the context of employment discrimination ... this would include, but not be limited to, claims of harassment, discharge, demotion, promotion, transfer, *retaliation*, and hiring." (Emphasis added.) H.R. Rep. No. 102-40(I), at 92 (1991), reprinted in 1991 U.S.C.C.A.N 549, 630.

The *Humphries* ruling

For the first time since passage the Civil Rights Act of 1991, the Supreme Court in *Humphries* addressed whether §1981 encompassed a claim for retaliation in the employment context.

The plaintiff-employee in *Humphries* complained to his managers about what he believed to be the racially-motivated discharge of a black co-employee. Humphries claimed he was, in turn, fired for doing so, and sued for retaliatory discharge under §1981.

In affirming that §1981 encompassed retaliation claims like Humphries', the court relied on *Sullivan* v. *Little Hunting Park, Inc.*, 396 U.S. 225 (1969), a case involving §1982 – long recognized as a companion statute to §1981 – which provides that "[a]ll citizens of the United States shall have the same right, in every State and Territory, as is enjoyed by white citizens thereof, to inherit, purchase, lease, sell, hold, and convey real and personnel property."

Sullivan, a white man, rented his home to a black man. Sullivan also assigned to the black renter shares in a corporation that allowed the owner to use an adjacent private park.

The corporation controlling the park refused to allow the assignment because the rentor/assignee was black. When Sullivan protested, the association expelled him and took back his membership shares. Sullivan sued the association, claiming a violation of §1982, and the Supreme Court upheld Sullivan's claim.

Interestingly, both the *Humphries* and *Sullivan* retaliation claimants ultimately were not the individuals asserting claims of racial discrimination on their own behalf. Thus, the Supreme Court's reading of §1981 confers broad-based protection to all employees seeking to vindicate anti-discrimination rights – regardless of whether such employees are the original victims of workplace discrimination.

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