

*Michael H. Patterson v. Miles R. Patterson Jr., et al.* (motion to dismiss, complaint alleging breach of fiduciary duty, unfairness and fraud and seeking injunctive relief in connection with a reverse stock split and cash out of fractional shares)

In *Michael H. Patterson v. Miles R. Patterson Jr., et al.* [<sup>1</sup>], the Court considered the Defendants' motion to dismiss an action brought by plaintiff Michael Patterson ("Patterson") to enjoin certain corporate actions taken by the Defendants.

Defendant company Manor View Farms, Inc. ("Manor") is a closely held Maryland corporation, all of its issued capital voting stock being held by Patterson and his siblings, all of which are defendants in the present action. Each sibling held 288 shares. Manor had a board of three directors, two sibling defendants and the third the husband of another sibling defendant. Manor's charter contained two provisions which came into play in this case. First, the charter restricted the transfer of the Manor's stock, requiring that a transferor first offer their shares to Manor and then to each stockholder before offering them to any outsider. Second, the charter also required amendments to be approved by 80% of Manor's outstanding stock. In April 2005, Manor's directors met and called for the issuance of an additional 130 common shares to each of the shareholders except for Patterson, causing each of them to hold 418 shares to Patterson's 288. In May 2005, the directors then met to approve articles of amendment to Manor's charter and to call for a special stockholder's meeting to adopt those articles. The articles called for a reverse stock split whereby each share would be converted into a 1/418 share. The amendment also required each shareholder to hold at least one share and reserved the right to Manor to demand the surrender of any fractional shares. Despite Patterson's dissent, the amendments passed because the defendant shareholders held slightly over 80% of Manor's stock. The result of the stock split was to effectively remove Patterson as a shareholder by buying out his fractional share. Patterson filed his complaint in the Circuit Court for Baltimore County seeking to enjoin the defendants' actions.

In ruling on the defendants' motion to dismiss Patterson's complaint, under Maryland rules, the Court had to assume the truth of all well-pled facts as well as reasonable inferences that may be drawn from those facts. However, as the Court noted, Patterson's complaint could not contain argument because such is prohibited by Rule 2-303(b). The Court reviewed the various paragraphs of Patterson's complaint and determined that they included multiple instances of impermissible argument. Stripped of such arguments, the Court did not find any statement of fact in any of the counts of the complaint that created a claim upon which relief could be granted to Patterson. Patterson's first count was brought both as an action for breach of fiduciary duty of directors and by majority stockholders. Patterson asserted that Md. Corps. & Ass'ns §2-405.1 imposes a duty on corporate directors "to act in good faith, to act in a manner reasonably believed to be in the best interest of the corporation and to act with the care an ordinarily prudent person would use under similar circumstances." Additionally, Patterson cited to *Cooperative Milk Service, Inc. v. Hepner* [<sup>2</sup>] for the premise that majority stockholders violate their fiduciary obligations when they use their voting power for their own benefit or for some ulterior purpose

---

<sup>1</sup> 2006 WL 990998 (Md. Cir. Ct.).

<sup>2</sup> 198 Md. 104 (1951).

adverse to the interests of the corporation. While the Court agreed with Patterson's statement of §2-405.1, it determined that Patterson had alleged no facts that would overcome the statutory presumption that the act of a director satisfies the standards of the rule. It further stated that because Patterson had not brought a shareholder derivative action on behalf of Manor, he was barred from asserting a statutory claim because of §2-405.1. The Court pointed out that §2.405.1(g) states that nothing in that section created a duty of any director of a corporation enforceable otherwise than by the corporation or in the right of the corporation. In Patterson's complaint, he failed to make any statement of fact showing any injury or deprivation of a right suffered by the corporation. And, while Patterson alleged ulterior motives of the majority stockholders as a basis for breach of fiduciary duty, the Court held that for a breach of such duty, the ulterior purpose must be adverse to the interests of the corporation and the corporation's stockholders as equitable owners of the corporation. In this case, the Court found that Patterson only alleged injuries to himself.

Patterson next argued that the appropriate test in the case of a reverse stock split of a closely held corporation such as Manor that eliminated a stockholder was a fairness test under *Lerner v. Lerner Corp.* [<sup>3</sup>], and that if a reverse split is found to be unfair, a court must rescind it. However, the Court disagreed, holding that neither a business purpose nor fairness test need be applied where there was sufficient evidence to conclude there were reasons to effect the reverse stock split other than the desire to oust a minority. Here, Patterson set forth no facts to support his claim that there were no reasons for the split other than ousting him.

Finally, the Court disposed of Patterson's fraud claims and was unable to find any statement of fact to support his assertion that he had suffered the type of injury by the defendants' action for which relief could be granted. To recover for fraud in Maryland, a claimant must show that (1) the defendant made a false representation to the claimant, (2) the falsity of the representation was either known to the defendant or the representation was made with reckless indifference to its truth, (3) the misrepresentation was made for the purpose of defrauding the claimant, (4) the claimant relied on the misrepresentation and had the right to rely on it, and (5) the claimant suffered compensable injury as a result of the misrepresentation. However, because Patterson's complaint contained only impermissible argument and no factual statements, it failed to state a claim for which relief could be granted. With respect to the type of injury suffered, Patterson claimed injury from the issuance of additional shares to each of the shareholders other than himself, from the use of the extra voting power the other shareholders obtained from the issuance to amend the charter and create the reverse stock split where his fractional share was eliminated and from the loss of his share of Manor, which entailed a loss of voting rights and the ability to buy other shares of Manor before they would be sold to outsiders as provided for in the charter. However, the Court held that the additional stock was lawfully issued and that Manor had received adequate compensation for those shares. Further, the Court held that the reverse stock split was legitimate under Maryland law, a corporation being allowed to amend its charter to change issued or unissued shares into a different number of shares of the same class or into the same or a different number of shares of another class. Thus, the actions of the defendants in effecting the reverse stock split and paying fair value to Patterson for his fractional shares was proper.

---

<sup>3</sup> 132 Md. App. 32 (2000).

