

# Debtor's majority owner not liable for commissions

## Corporate veil wasn't pierced

By Eric T. Berkman

Representatives of a manufacturer who were allegedly owed sales commissions by an electronics company that went bankrupt could not sue the private equity firm that owned a majority stake in the company, a Superior Court judge has decided.

The plaintiff manufacturer's reps argued that the defendant company — in tandem with various affiliated entities of the company — exercised such pervasive control over the manufacturer that they were in essence the same company.

Accordingly, the plaintiffs asserted, they should be able to pierce the corporate veil to go after the defendants directly.

But Judge Maynard M. Kirpalani disagreed. "It appears that [the defendants] had some 'common control' of [the manufacturer]," Kirpalani wrote, granting summary judgment for the defendants. "Yet, [the defendants were] not in complete control of [the manufacturer]; [they] still had a fiduciary duty to ... non-voting stockholders who held 30 [percent] of the shares."

Additionally, the judge said that "separate corporate boundaries were maintained, and third parties did not think of themselves as dealing with [the defendants] directly. [The plaintiffs] in this case entered into a conventional brokering sales arrangement with [the manufacturer], and were not misled into doing so on the belief it was doing business with one of the defendants."

The 27-page decision is *Supply Chain Associates, LLC, et al. v. ACT Electronics, Inc., et al.*, Lawyers Weekly No. 12-086-12. The full text

of the ruling can be ordered at [mass-lawyersweekly.com](http://mass-lawyersweekly.com).

### Staying on course

Brian D. Gross and Daniel McCarthy, who practice at Cooley, Manion, Jones in Boston, represented the defendants, Boca Raton, Fla.-based Sun Capital Partners and affiliated entities.

Gross said a decision the other way would have changed the course of private equity.

"Companies like Sun Capital and [Boston-based] Bain Capital that own so many companies would all of a sudden be on the hook for all the liabilities of the portfolio companies they own," he said.

In terms of broader implications, Gross said the ruling shows that a private equity firm can have lawful control of a company, even as the lone shareholder, as long as the firm recognizes and follows all corporate formalities.

"That's incredibly important because the private equity model is to come in, control the company, suggest whatever changes need to be made, and then turn around the company and sell it to get a return for the investors," he said.

Thomas R. Burton III, who practices private equity law at Mintz, Levin, Cohn, Ferris, Glovsky & Popeo in Boston, said the court "rightly applied" a "high threshold" for veil-piercing in the case.

Burton, who was not involved in *Supply Chain*, added that the ruling demonstrates how important it is for private equity funds to use experienced counsel to structure their investments appropriately.

"A little bit of good-faith planning and up-front observance of corporate formalities, de-



GROSS  
Counsel for  
defendants

spite their seeming inconvenience at times, can save a lot of money down the road," he said.

Donald R. Pinto Jr., a business litigator at Rackemann, Sawyer & Brewster in Boston, agreed.

Despite significant interrelationships between and among corporate defendants, "it appears that the defendants made legitimate efforts to maintain their separate corporate identities, and that's ordinarily enough to avoid veil piercing," Pinto said.

Plaintiffs' counsel Michael C. Fee of Pierce & Mandell in Boston declined to comment.

### Unpaid obligations

Defendant ACT Electronics, Inc. was a Delaware corporation, 70 percent of whose shares and all of whose voting shares were held by defendant Sun Act, an affiliate of defendant Sun Capital Partners.

ACT purchased the assets of its predecessor, Massachusetts electronics manufacturer ACT Manufacturing, out of bankruptcy in July 2002.

After the purchase, ACT began to generate significant cash flow and working capital, collecting outstanding payments from ACT Manufacturing's customers, selling its excess inventory and closing several of its manufacturing facilities, and establishing favorable credit terms with major vendors.

At the time of the asset purchase, ACT entered into an agreement with defendant Sun Management, another Sun Capital affiliate, under which Sun Management would provide consulting services. Meanwhile, defendant Sun Advisors, yet another Sun Capital affiliate, contracted with Sun Management to provide advisory services.

At all times, ACT maintained separate headquarters, minute books, accounting records, bank accounts and budgets from Sun Capital and its various affiliates.

On Jan. 14, 2003, plaintiff Estream, a Connecticut company that brokered sales of electronic products, entered into an agreement with ACT under which it would receive commissions for selling ACT products to customers. The commissions would be calculated based on a certain percentage of ACT's gross profit on a sale.

At some point, some of ACT's vendors expressed concern to Estream executive Edward Duffy that ACT was not paying them on time.

Meanwhile, Duffy sought to enter an agreement with Bloomberg LP, the New York-based financial information company, to purchase ACT products. In negotiating the deal, Duffy held several conference calls with Bloomberg representatives, as well as two ACT executives, John Pino Sr. and John Pino Jr., and Kevin Calhoun, a Sun Capital vice president.

During the calls, the ACT and Sun Capital executives apparently assured Bloomberg that ACT was financially stable and sufficiently capitalized.

In July 2003, backed by Sun Capital's letter of guarantee for ACT, Bloomberg agreed to buy electronic goods from ACT, which would be required to maintain one month's "buffer inventory."

Between 2003 and 2005, ACT allegedly failed to report or pay commissions to Estream on its Bloomberg sales. On Sept. 30, 2004, ACT terminated its agreement with Estream, which was dissolved in 2005.

On April 11, 2006, ACT entered into a sales representative agreement with plaintiff Supply Chain Associates, another Connecticut company, for whom Duffy served as president. The terms of the agreement were similar to those in the Estream contract. A month later, Supply Chain was authorized to solicit orders from Bloomberg.

In the spring of 2007, Bloomberg demanded ACT's buffer inventory. ACT did not have the required inventory on hand, and Bloomberg cancelled their agreement. ACT also allegedly failed to pay commissions that Supply Chain had earned on Bloomberg sales.

Sometime during the fall of 2007, Pino Jr.

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**COURT:** Superior Court

**ISSUE:** Could manufacturer's representatives who were allegedly owed sales commissions by an electronics company that had gone bankrupt sue the private equity firm and affiliated entities that owned a majority stake in the company?

**DECISION:** No, because the representatives did not show that the private equity firm had exercised the pervasive level of control necessary to justify piercing the corporate veil

orally told Duffy that Sun Capital had ordered ACT not to pay commissions to either Estream or Supply Chain until a lawsuit between Duffy and his partners was resolved.

In February 2008, after Duffy settled the suit, Pino Jr. allegedly inferred once again that ACT's board, which included two employees of Sun Capital affiliates, believed it did not owe any more commissions.

Several months later, ACT filed for bankruptcy. In September 2010, the plaintiffs sued ACT as well as the various Sun Capital affiliates in Superior Court alleging breach of contract, abuse of ACT's corporate form and violation of Chapter 93A.

Sun Capital and its affiliates moved for summary judgment, arguing that they were not liable through a veil-piercing theory or any other theory for any of ACT's conduct.

#### Unpierced veil

Kirpalani found that the plaintiffs could not pierce the corporate veil to sue the Sun Capital entities directly.

In a veil-piercing case, the judge said, the key consideration is whether the corporation

in question operated as a separate entity. Based on the record, Kirpalani found that the defendants indeed operated separately from ACT.

First, the judge found, while the defendants had some "common control" of ACT — such as majority ownership of its shares — they still had a fiduciary duty to nonvoting shareholders.

Additionally, he said ACT still had to deliver value to the consumers of its manufactured products.

Kirpalani also rejected the plaintiffs' argument that there was common control of ACT because two of ACT's board members were employees of Sun Advisors, one of Sun Capital's affiliates.

"Directors and officers, not employees, control companies," the judge said. "[The two individuals in question,] as Sun Ad-

visor employees, could not have controlled Sun Advisors and there was thus no common control between Sun Advisors and ACT when ACT refused to pay the commissions."

The judge was similarly not persuaded by the plaintiffs' arguments that the defendants exercised "pervasive control" over ACT, noting that ACT maintained its own headquarters, minute books, accounting records, bank accounts and budgets while filing its own tax returns.

All in all, Kirpalani found, the defendants and ACT maintained separate corporate boundaries, and third parties dealing with ACT did not believe they were dealing with Sun Capital directly.

"Defendants have shown that, as a matter of law, plaintiffs cannot establish that the corporate veil should be pierced in this case," the judge concluded, granting summary judgment to the defendants. MLW

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