IN THE COURT OF APPEALS OF IOWA

No. 0-286 / 09-1328
Filed June 30, 2010

JOSEPH D. LEE,
Plaintiff-Appellee,

vs.

ELIZABETH MELOAN, Executor of the Estate of Bette F. Lee,
Defendant-Appellant.

Appeal from the Iowa District Court for Linn County, Kristin L. Hibbs, Judge.

An estate appeals a district court declaratory ruling determining the purchase price of shares and ordering specific performance of a stock purchase agreement. **AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.**

Donald G. Thompson, Janice J. Kerkove, and Kevin C. Papp of Bradley & Riley, P.C., Cedar Rapids, for appellant.

Stephen J. Holtman and Jason M. Steffens of Simmons, Perrine, Moyer & Bergman, P.L.C., Cedar Rapids, for appellee.

Heard by Sackett, C.J., and Eisenhauer and Mansfield, JJ.

MANSFIELD, J.

This appeal concerns a buy-sell agreement for a family-owned S corporation. The agreement provided that when Bette Lee died, her son Joseph had an option to purchase her shares at "fair market value." Fair market value was to be calculated using a base price per share and adjusting it by "the amount per share of profit or loss, as determined for Federal income tax purposes," that had accrued between 1991 and the time of Bette's death, net of dividends previously paid. Upon Bette's passing in July 2006, Joseph exercised the option. However, a dispute between Bette's estate and Joseph arose. Joseph argued that the adjusted price for the shares should be based upon the profit reflected in the corporation's actual tax returns, whereas Bette's estate argued that it should receive a price based upon the income the corporation would have reported if it had been truly following the tax laws. The parties also disagreed as to how corporate income for the partial year 2006, when Bette died, should be handled. Finally, Bette's estate objected to Joseph's decision (as president of the corporation) to discontinue the payment of dividends to shareholders, which meant that so long as the dispute was pending, the estate had to keep paying income taxes on its pro rata share of corporate profits, without any source of funds to pay those taxes or any prospect of recouping those tax payments.

The district court found for Joseph on all issues. That is, it held that "as determined for Federal income tax purposes" meant as reported on the company's federal income tax returns. It also adopted Joseph's, rather than the estate's, proposal for the treatment of the 2006 partial year. Additionally, it

declined to order Joseph to compensate Bette's estate for tax obligations incurred during the three-year pendency of the purchase price dispute. The estate now appeals. Upon our review, we affirm the district court's rulings on the purchase price of the shares, but reverse and remand the district court's determination regarding Joseph's need to compensate the estate for the tax liability.

I. Background Facts and Proceedings.

Dale Lee Distributing Company (DLDC) is an Iowa subchapter S corporation operating as a beer wholesale distributorship. In 1991 DLDC had only three shareholders: Dale Lee with 151 shares; Dale's wife, Bette Lee, with 146 shares; and Dale's son, Joseph Lee, with 3 shares. Until his death, Dale served as chairman of the board of directors of DLDC.

On February 5, 1991, Dale, Bette and Joseph executed a Stock Purchase Agreement (Agreement) "to provide for continuity and harmony in the management and policies of [DLDC], and to make provision for the future disposition of the shares of the common stock of [DLDC]." The Agreement provided Joseph with "the option to acquire all of the outstanding shares of the common stock of [DLDC]" owned by Dale or Bette upon their deaths so long as he survived them and was employed on a substantially full-time basis. If Joseph exercised this option, the personal representative of the decedent was required to sell the decedent's shares at the price "established under paragraph 4" and in accordance with "the terms and conditions of paragraph 5" of the Agreement.

Under paragraph 4, the purchase price was to represent the "fair market value" of the shares. The "fair market value" was originally determined by a

formula that made adjustments according to a total value of DLDC set at $2 million. However, this formula failed to consider the possibility that DLDC would issue additional shares. Throughout the 1990s, DLDC periodically issued additional shares to Joseph for prices starting at $6000 and increasing to $6666.66. To account for these additional shares, Dale, Bette, and Joseph executed an "Addendum to Stock Purchase Agreement" (Addendum) on August 5, 1996. The Addendum substituted a new paragraph 4, which provided "fair market value" would be calculated in the following manner:

> (a) The parties hereby agree that the total value of [DLDC] as of January 1, 1991, and as of the date hereof, is such that the resulting value of each outstanding share of common stock of [DLDC] as of January 1, 1991, and as of the date hereof, is $6,666.66 (the "Base Value Per Share"). For purpose of determining the fair market value of the common shares to be purchased and sold upon the exercise of any option granted hereunder, the said Purchase Price and fair market value shall be determined by reference to the said Base Price Per Share adjusted, however, in the following manner:
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> (i) By adding to or deducting from the Base Value Per Share the amount per share of profit or loss, as determined for Federal income tax purposes, realized by [DLDC] during all fiscal years ending on dates subsequent to January 1, 1991, including the applicable portion of the fiscal year during which such option is exercised and such valuation occurs.
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> (ii) By deducting from the Base Value Per Share the amount per share of any unpaid Federal or State income tax, if any, for any fiscal year of [DLDC] preceding the valuation date, as well as the estimated Federal or State income tax liability of [DLDC], if any, for that portion of the fiscal year during which the valuation of said shares occurs preceding the date of exercise of said option or options.
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> (iii) By deducting from the Base Value Per Share the amount per share of any dividends or other capital distributions paid to Shareholders from and after January 1, 1991.
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> (b) The Base Value Per Share established under subparagraph (a) above, as adjusted by the aggregate of the adjustments provided for under subparagraphs (i), (ii) and (iii) thereof shall be the agreed purchase price and fair market value of all shares of common stock of [DLDC] purchased and sold hereunder.

The Addendum did not make any adjustments to paragraph 5, which continued to state that in the event of the exercise of an option, "the closing of said transaction shall take place . . . at a date mutually agreed upon by the parties, which shall be not more than ninety (90) days following the date of exercise of such option."

Dale died on May 15, 2000. Following Dale's death, Joseph properly exercised the option and purchased all of Dale's shares, becoming DLDC's controlling shareholder. The purchase price was calculated to be $6517 per share using the profits and losses reported on DLDC's tax returns. At this time, neither the purchase price itself nor the method used in calculating the purchase price was challenged.

On July 30, 2006, Bette passed away. At the time of her death, Bette owned 132.5 shares of DLDC. Joseph and his sister, Elizabeth Meloan (Betsy), were appointed as co-executors of Bette's estate (the Estate). Joseph eventually resigned as co-executor in March 2007, leaving Betsy as the sole executor.

On September 14, 2006, Joseph delivered notice to the Estate of his intent to exercise the option to purchase Bette's stock. It is undisputed that Joseph met all the conditions for exercise of the option, and that he timely and properly sought to exercise the option.

Joseph initially offered to pay $6622 per share based on calculations made by DLDC's accounting firm, RSM McGladrey, Inc. However, when it was discovered that RSM McGladrey made an error in the calculation of the purchase price, the offer was increased to $8175 per share. RSM McGladrey calculated

the purchase price from the profits and losses as reported on DLDC's federal income tax returns, which they have prepared every year since 1991.

The Estate rejected the offer. The Estate argued the language "profit or loss, as determined for Federal income tax purposes," did not equate to what DLDC reported on its federal income tax returns. Rather, the Estate urged that the use of the word "determined" meant that the profit or loss adjustment must be "ascertained through a reasoned investigation and analysis under federal income tax laws." According to the Estate, once the purchase price were calculated in that manner, substantial retrospective adjustments would need to be made for inappropriate tax deductions for travel and entertainment expenses, excessive executive compensation paid to Joseph, and an uneconomic leasing arrangement for an operating facility. In short, the Estate argued that DLDC's reported taxable income actually understated its true taxable income. The Estate claimed that these adjustments to the purchase price would result in a fair market value of $28,251 per share.

On April 4, 2007, Joseph filed a petition for declaratory judgment and specific performance requesting the Estate comply with the Agreement and sell Bette's stock. The Estate answered, raising its valuation issues, and also counterclaimed alleging breach of fiduciary duty by Joseph, breach of implied covenant of good faith and fair dealing, and a request for declaratory judgment setting a purchase price. As subsequently amended, the counterclaims challenged (among other things) Joseph's refusal to cause DLDC to make distributions to stockholders after Bette's death. The Estate subsequently dismissed its counterclaims to the extent they were alleging harm to DLDC,

rather than direct harm to the Estate. The remaining counterclaims included, among other things, a claim that the price the Estate received for the shares from Joseph should be increased to account for Joseph's failure to direct the company to make distributions since Bette's death. Because DLDC was an S corporation, this strategy meant the Estate had been incurring significant tax liability without any distributions to cover such tax liability. The entire matter eventually went to trial on March 16, 17, and 18, 2009.

At trial, the district court received testimony from Michael McDermott, attorney for DLDC, and Gene Bender, accountant for DLDC.[1] Both individuals testified as to the circumstances leading up to the execution of the Agreement.

McDermott testified that he had done legal work for DLDC since the early 1970s. According to McDermott, he drafted the Agreement (including the subsequent Addendum) after participating in several meetings with Dale, Bette, Joseph, and Bender.

McDermott testified that in drafting the Agreement, the meaning and intent behind "as determined for Federal income tax purposes" was so the company and shareholders could determine "the profit or loss from the operation of the company and that would be determined by reference to the tax records of the company, presumably what was reported on the federal tax returns each year." He further stated that "the purpose of the language of the agreement was to fix a readily ascertainable and readily determinable purchase price for the shares" so that "the purchase price could be readily and rather efficiently or quickly determined" without "further investigation." As he put it, "It [the purchase price]

[1] Bender's deposition testimony was received in lieu of live testimony.

would simply be a review of the company records." He explained that the phrase "as determined" meant:

> as finally determined in the tax reporting process which would be the preparation of the return, the approval and filing of the returns, any amendment, if there were ever an amendment to the return, or if the final determination were audited, some subsequent determination that were made.

Bender is a retired general services partner with RSM McGladrey. He testified that he had done year-end tax planning and preparation of corporate tax returns for DLDC since approximately 1968. Bender testified that he worked with Dale, Bette, Joseph, and McDermott in structuring the Agreement. According to Bender, Dale had the Agreement drawn up so he could "virtually sell [DLDC] to Joseph for a price determined, but Dale wouldn't have to pay the income taxes." Therefore, the Agreement was to "freeze the value" of DLDC, subject to adjustments to the extent stockholder contributions lagged behind corporate profits. Bender further testified that he developed the language "as determined for Federal income tax purposes" because it was "intended to say that we needed to use the income tax method of accounting versus using generally accepted accounting principles in determining the income . . . ." Accordingly, Bender believed that one would only have to look at "[t]he corporate income tax returns [and] the books and records of the corporation" when making the adjustment to the purchase price under the Agreement.

The Estate presented the expert testimony of accountant James Brems in support of its claim that the payout should be over $24,000 per share. Brems testified that DLDC's tax returns actually understated its true profits for tax purposes. In particular, Brems focused on three areas: travel and entertainment

expenses, executive compensation, and DLDC's rental of a facility from a related entity owned by Joseph's immediate family. Brems testified that the corporation improperly deducted $523,224.21 over the relevant time period in unsubstantiated travel and entertainment expenses, $5,658,808 in excessive compensation to Joseph, and $3,682,597 in an imprudent and unnecessary rental of a facility from a related entity controlled by Joseph's immediate family. After adding back these deductions, and apportioning them over the total number of shares, Brems testified that the Estate was entitled to an increase in the price per share of $14,326.

In addition to this basic dispute over whether the purchase price of the shares should be based upon the actual tax reporting in previous years as opposed to a retrospective analysis of what *should have been* reported, Joseph and the Estate disagreed regarding how the "applicable portion" of tax year 2006 should be treated under paragraph 4(a)(i) of the Agreement. As noted, Bette passed away on July 30, 2006, about seven-twelfths of the way through the 2006 year. The parties stipulated that the correct price per share at the end of 2005, without any of the Estate's claimed adjustments, would be $8895 per share. They further agreed that this amount would need to be reduced by $1184 due to distributions made by DLDC to stockholders in 2006. However, the parties disagreed as to how corporate profits should be calculated for the 2006 partial year.

Joseph presented the testimony of accountant James Moore. Moore stated that he determined the "applicable portion" of 2006 by taking DLDC's actual book income through July 31, and making adjustments to establish

DLDC's taxable income through July 31, as if DLDC's taxable year ended on that date. This method resulted in an increase in the price per share of $631, or an overall price per share of $8342 ($8895 minus $1184 plus $631).

The Estate disagreed with this valuation and presented testimony from Brems. Brems took DLDC's full year 2006 taxable income, as reported on DLDC's tax return, and multiplied that amount by seven-twelfths. This pro rata method resulted in an increase in the price per share of $866. Brems testified that his method, unlike Moore's, was consistent with the Internal Revenue Code, which requires income to be allocated evenly throughout the year in circumstances where stock ownership only exists for a partial year.

On July 29, 2009, the district court ruled as follows:

> The use of the phrase "determined" means the information that was reported by DLDC on its federal income tax returns. The interpretation supports the intent of the parties at the time the agreement was executed and the practice of the parties upon the death of Dale Lee. The [Agreement] and Addendum do not set forth any procedure that would support a conclusion that Dale and Bette intended for a more complicated procedure to be followed. Additionally, the testimony of Mr. Bender and Mr. McDermott supports a conclusion that Dale and Bette merely intended for the purchase price to be calculated by using the information that was reported on the federal income tax returns. There is simply no convincing evidence that the intent behind the [Agreement] and Addendum was for any steps to be taken, at the time an offer to purchase the stock was made, to reevaluate the information entered into the federal income tax returns. The clear intent was for the information put in the tax returns (as determined by DLDC and its accountants at the time the returns were prepared) to constitute the profit or loss that would lead to an adjustment, if any, of the purchase price of the stock.

The court further determined that

> DLDC's income is not evenly distributed throughout the year, but rather, it earns more in the latter part of the year. Moore's method, then, is more accurate. The method used by Mr. Moore is the

> method used when Dale died. The Court concludes the method proposed by Mr. Moore is the best method for which to determine the 2006 taxable income adjustment.

Accordingly, the district court set a purchase price of $8342 per share and ordered the Estate to specifically perform the Agreement at that price.

The district court also rejected the Estate's claim for compensation for tax liabilities incurred during the pendency of the dispute, due to Joseph's discontinuance of the prior practice of paying dividends. As the court put it,

> Betsy [the executor] has not met her burden of proof on her defenses/counterclaims . . . . Betsy has not provided the Court with any specific legal authority or contractual obligation that would require Joe to be responsible for the Estate's tax obligations stemming from the purchase price dispute . . . .
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> Additionally, the intent of the agreement was for the value of Bette's stock to be set as of the date of her death, and the Court will not make adjustments upwards to the per share price due to any factors that could have affected the value of DLDC since Bette's death, since it was not the intent of Dale and Bette to have such adjustments made.

The Estate appeals.

II. Scope and Standard of Review.

We review declaratory judgment actions according to the manner the case was tried in the district court. *Passehl Estate v. Passehl*, 712 N.W.2d 408, 414 (Iowa 2006). The parties agree that this case was tried in equity; thus, our review is de novo. Iowa R. App. P. 6.907. In a de novo review, we have the responsibility to examine the facts as well as the law and decide the issues anew. *SDG Macerich Props., L.P. v. Stanek, Inc.*, 648 N.W.2d 581, 584 (Iowa 2002). In doing so, we give weight to the district court's factual findings, especially when considering the credibility of witnesses, but we are not bound by

those findings. *Id.* In addition, Joseph sought specific performance according to the terms of the Agreement. This is a form of equitable relief also justifying de novo review. *Passehl*, 712 N.W.2d at 414.

III. Purchase Price for the Shares

Stock purchase agreements are subject to ordinary principles of contract law. *See Fausel v. JRJ Enters., Inc.*, 603 N.W.2d 612, 618 (Iowa 1999). In interpreting a contract,

> [t]he cardinal rule is to determine what the intent of the parties was at the time they entered into the contract. Words and other conduct are interpreted in the light of all the circumstances, and if the principal purpose of the parties is ascertainable it is given great weight.

Pillsbury Co. v. Wells Dairy, Inc., 752 N.W.2d 430, 436 (Iowa 2008). We may look to relevant extrinsic evidence like "'the situation and relations of the parties, the subject matter of the transaction, preliminary negotiations and statements made therein, usages of trade, and the course of dealing between the parties.'" *Fausel*, 603 N.W.2d at 618 (quoting Restatement (Second) of Contracts § 212 cmt. b, at 126 (1979)). However, the most important evidence of the parties' intention remains the words of the agreement. *Pillsbury*, 752 N.W.2d at 436. "When the interpretation of a contract depends on the credibility of extrinsic evidence or on a choice among reasonable inferences that can be drawn from the extrinsic evidence, the question of interpretation is determined by the finder of fact." *Id.*

We agree that the phrase "profit or loss, as determined for Federal income tax purposes," is potentially ambiguous. It could mean the profit or loss as determined by the corporation (and/or by the Internal Revenue Service following

an audit) for purposes of the taxes that were actually paid. Or, it could mean the profit or loss as later determined (i.e., by the court) based on an evaluation of what should have been reported to the IRS for federal tax purposes. Joseph argues for the former interpretation; the Estate for the latter.

Upon our review, we find Joseph's interpretation more logical and more compelling. In the first place, the Agreement recites that it was intended "to provide for continuity and harmony in the management of the corporation." It appears that the purpose of this buy-sell agreement was to establish a "formula" (the term used by the Addendum) whereby the purchase of the shares could occur within ninety days of the exercise of the option. Joseph's interpretation provides such a clear-cut formula. The Estate's interpretation, on the other hand, appears to be an invitation to disputes. Tax advice is an art rather than a science, and one can always debate the propriety of certain past deductions. We believe that Joseph's interpretation, unlike the Estate's, serves the goals of avoiding conflict within the family and enabling the purchase price to be determined within ninety days as required for closing under the Agreement. *See Fashion Fabrics of Iowa, Inc. v. Retail Investors Corp.*, 266 N.W.2d 22, 26 (Iowa 1978) ("[A]n interpretation which gives a reasonable, lawful, and effective meaning to all terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect.").

Also, we find the Estate's interpretation unwieldy in some respects. If the parties were going to select a method of determining price that was open to considerable debate, rather than a readily ascertainable formula, why not just

provide that Joseph would pay the fair market value for the shares, without any formula at all? This would seem a more straightforward approach.

Additionally, like the district court, we give some weight to the testimony of Bender and McDermott. While the Estate complains that Bender and McDermott were not themselves parties to the buy-sell agreement, they were present at meetings where it was discussed, prepared, and executed. Jointly, they drafted the language in question. Their testimony about what was said or not said in those meetings, and what they as the co-authors of the Agreement understood it to mean, supports Joseph's interpretation of the agreement.

Moreover, there was a prior course of dealing following Dale's death. At that time, when Joseph exercised the option and purchased all of Dale's shares, no party objected to the calculation of the purchase price using the profits as previously reported on the federal income tax returns. *Miller v. Geerlings,* 256 Iowa 569, 579, 128 N.W.2d 207, 213 (1964) (holding the court will adopt the practical construction placed upon a contract by the parties). We do not agree with the Estate's contention that a "course of dealing," or "practical construction," needs to be repeated in order to be relevant. *See Pillsbury*, 752 N.W.2d at 438 (finding a practical construction based on Pillsbury's wording of a notice of assignment that it provided at one time to three separate parties).

Accordingly, we hold that the share purchase price under the Agreement was properly calculated by the district court based upon DLDC's actual, historic federal income tax reporting. Therefore, we need not address the merits of the specific adjustments proposed by the Estate.

In addition, we uphold the district court's decision to follow Joseph's (Moore's) rather than the Estate's (Brems's) approach in making the adjustment for the 2006 partial year under paragraph 4(a)(i) in the Agreement. First, under the Estate's approach, which would base the adjustment on a pro rata share of the entire year's taxable income, regardless of the date of death, it would have been impossible to finalize the purchase price for the shares until after the end of the year. This is contrary to the parties' expressed intent to have a closing within ninety days. If, for example, Bette had died on January 31, 2006, it would be necessary to wait until the end of 2006 and then allocate 1/12 of the 2006 profits. Second, as the district court noted, DLDC's income is variable throughout the year with more income being produced at year's end. Therefore, by using the profits and losses booked through the date of the decedent's death, a more accurate adjustment results. Finally, as noted by the district court, Joseph's (Moore's) approach was the one followed earlier when Dale died.

For the foregoing reasons, we affirm the district court's determination that paragraph 4(a) provides for the Estate to receive $8342 per share. However, we now turn to the question whether the Estate should have received compensation for the income taxes it was required to pay on income earned by the corporation after Bette's death.

IV. Offset for the Estate's Income Tax Liability

The Estate argues that the district court erred in refusing to order Joseph to compensate the Estate for income tax liability it incurred during the three-year pendency of this dispute. From July 2006 through August 31, 2009, the Estate continued to own Bette's shares, and DLDC continued to make money. As a

result, the Estate had to pay federal and state income taxes totaling at least $367,238, plus an undetermined amount for the 2009 partial year.

Historically, the company had typically paid out one hundred percent of its profits to its stockholders. This gave the stockholders funds with which to pay the corresponding taxes on those profits. (Because DLDC was an S corporation, each shareholder received an annual K-1 and was legally responsible for income taxes on his/her corresponding share of corporate profits, whether distributed or not.) Yet, Joseph admittedly caused the company after Bette's death to stop making distributions:

> Q. But since her death, [DLDC] has made no distributions of its profits to the shareholders, has it? A. Correct.
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> Q. You were the person who made the decision to withhold distribution of profits following your mother's death, weren't you? A. The company was as a board, yes. I represented the company, correct.
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> Q. And it was Joe Lee's decision as the chairman of the board to do that; is that not true? A. Correct.

This practice resulted in the Estate being placed in a "lose-lose" situation. The price that the Estate would receive for Bette's shares was never going to account for profits that accrued after her death in 2006, and none of those posthumous profits were being distributed to the Estate, but the Estate was being forced to pay taxes on them. Joseph offered no practical justification for causing the company to fail to pay dividends at a level that would cover the ongoing tax liability. He argues now that the Estate could have prevented this situation by agreeing to close on the sale of its shares immediately. But this overlooks the fact that Joseph did not offer the $8342 per share price at the time. Moreover, each dollar in post-July 2006 taxes paid by the Estate meant a dollar of taxes

that Joseph saved. Joseph's financial benefit was directly proportionate to the financial harm suffered by the Estate.

Joseph argued, and the district court found, that there was no legal remedy available for this situation. We disagree. The declaration of dividends generally rests within the discretion of management "unless in case of fraud and bad faith on their part." *Sexton v. C.L. Percival Co.*, 189 Iowa 586, 601, 177 N.W. 83, 88 (1920). "It is clear in Iowa that once oppression . . . [by a majority stockholder] has been found, the trial court, sitting in equity, can devise a remedy to meet the situation." *Maschmeier v. Southside Press, Ltd.*, 435 N.W.2d 377, 383 (Iowa Ct. App. 1988). As the Estate noted, Joseph was invoking the court's authority to obtain specific performance of his contract with Bette, an equitable remedy. *See Lyon v. Willie*, 288 N.W.2d 884, 893 (Iowa 1980) ("A contract for sale of stock of a closely held corporation which is not procurable in any market is a proper subject for specific performance."). Specific performance of a contract is a remedy resting in the equitable discretion of the court, and should be "granted upon such terms and conditions as justice requires." *Berryhill v. Hatt*, 428 N.W.2d 647, 657 (Iowa 1988); *see also Moser v. Thorp Sales Corp.*, 256 N.W.2d 900, 907 (Iowa 1977) ("[T]he invocation of equity jurisdiction permits the necessary reach and flexibility in working out the equities among the[] parties."). We have also said, in a prior case involving oppressive conduct against minority stockholders:

> Whenever a situation exists which is contrary to the principles of equity and which can be redressed within the scope of judicial action, a court of equity will devise a remedy to meet the situation though no similar relief has been granted before.

Sauer v. Moffitt, 363 N.W.2d 269, 274 (Iowa Ct. App. 1984) (quoting earlier decision).

Furthermore, the contract to which Joseph and Bette were parties, like any other agreement, contained an implied covenant of good faith and fair dealing. *Harvey v. Care Initiatives, Inc.*, 634 N.W.2d 681, 684 n.4 (Iowa 2001). Good faith emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party. Restatement (Second) of Contracts § 205, cmt. a (1981). The Estate specifically alleged that Joseph's decision to have the corporation stop making distributions sufficient to cover the ongoing tax liabilities breached that duty. Joseph acknowledged in his testimony that he caused DLDC to cease paying distributions. We conclude that this conduct was in bad faith, since it had the purpose and effect of forcing the Estate to bear the tax liabilities while Joseph received the corresponding profits on the Estate's shares, with no apparent justification.[2]

We draw some guidance from the Maine Supreme Court's decision in *Shostak v. Shostak*, 851 A.2d 515 (Me. 2004). In that case four sibling owners of an S corporation (RDC) entered into an agreement that the two of them would be bought out. *Shostak*, 851 A.2d at 515. The agreement was signed in February 2001 but the closing on the share purchase did not occur until September 2001.

[2] In fact, Bender testified that the overall purpose of the buy-sell agreement was to "freeze" the value of the shares but with "adjustments" to "compensate the shareholders to the extent that income has not been paid out subsequent to the agreement." However, when Joseph arranged for dividends to be stopped despite ongoing tax liabilities, this purpose was defeated. In effect, the value of the shares was being drained by the tax liabilities, rather than frozen, and no compensation was being provided. Otherwise stated, we disagree with the district court's view that compensating the Estate for the tax liabilities contradicts the "intent" of the Agreement. Rather, we believe it furthers the overall intent of "freezing" the value of the shares.

Id. The two siblings whose shares were purchased alleged that the other siblings and RDC had breached a fiduciary duty by not declaring dividends during the first three quarters of 2001. *Id.* The district court agreed, made an award to the two siblings in the amount of the taxes, and the supreme court affirmed. *Id.* As it explained:

> Jeffrey, Diane, and RDC contend that the evidence was insufficient for a finding of bad faith. There was evidence that, since at least 1990, RDC had always paid dividends to the shareholders. RDC's income in 2001 was sufficient to pay dividends. The court could have found that the significant increase in Jeffrey and Diane's shares of RDC on September 10 was enough incentive to keep them from declaring distributions for the first three quarters of 2001. John's and Craig's respective tax liabilities for 2001 for the RDC income were $7024.50 and $7239, which is the amount the court awarded to them. Based on this evidence, we cannot conclude that the court clearly erred in its implicit finding that the failure of RDC to pay 2001 distributions in an amount at least equal to the shareholders' tax liability for the corporate income was bad faith. Therefore, the court did not err in its judgment for John and Craig on Count II of the amended complaint.

Id. at 520. Although the procedural posture of the *Shostak* case was somewhat different, in that the corporation was also a party, this in our view is a distinction without a difference. Joseph was the controlling stockholder of DLDC at all relevant times; he personally owed a fiduciary duty as well as contractual duties to the Estate; he made the determination himself that DLDC would not pay dividends after Bette's death; and he became the sole stockholder of DLDC and the sole beneficiary of the earlier refusal to pay dividends as soon as the purchase closed.

Accordingly, we hold that in fashioning an appropriate specific performance decree in this case, the district court could and should have included compensation for the income tax liabilities that the Estate incurred after

Bette’s death. Joseph engaged in bad faith and oppressive conduct, and breached the covenant of good faith and fair dealing in the buy-sell agreement, by discontinuing the longstanding practice of paying dividends during the pendency of this dispute. We agree with the Estate that the federal and state income taxes it was forced to pay on post-July 2006 profits without any distributions to pay them should be added to the compensation it receives from Joseph for its shares.

V. Conclusion.

For the foregoing reasons, we affirm in part, reverse in part, and remand for further proceedings consistent herewith.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.