This article deals with the fiduciary responsibilities of directors, officers and stockholders of Massachusetts corporations and persons in similar relationships to other Massachusetts business organizations, such as partners in general partnerships, general and limited partners in limited partnerships, and members and managers of limited liability companies.

Part I describes the nature of the fiduciary relationship in general, with a focus on the necessity for providing practical advice to business clients. Part II discusses extensively the fiduciary obligations of officers, directors and stockholders of Massachusetts business corporations, including “close corporations.” Part III deals briefly with the choice of law issues applicable to the fiduciary duties of foreign corporations doing business in Massachusetts. Part IV summarizes the fiduciary duties of partners in general and limited partnerships, including joint ventures and limited liability partnerships and the extent to which such obligations may be varied by contract. Part V discusses the largely undeveloped law of fiduciary duties of members and managers of limited liability companies and the question of how far LLCs may go in limiting or eliminating those duties by contract. Part VI discusses the relevant provisions of the new Massachusetts Business Corporation Act enacted on November 26, 2003.

I. THE NATURE OF THE FIDUCIARY RELATIONSHIP

A. Who Is A Fiduciary?

It is important to remember that officers, directors, and owners of business organizations are only a small subset of fiduciaries and that fiduciary obligations can arise in a large number of relationships. In general, a fiduciary relationship arises whenever one party reposes trust and confidence in another person who has knowledge of the other’s reliance on him. Broomfield v. Kosow, 349 Mass. 749, 755 (1965). The nature of the duties imposed on the fiduciary depend on the pre-existing relations of the parties, the parties’ respective business capacity (or lack of it), the necessity for guidance in complicated transactions requiring specialized knowledge, and the readiness of the parties to follow such advice. Id.
Professor Scott observes that “[a] fiduciary is a person who undertakes to act in the interest of another person . . . The greater the independent authority to be exercised by the fiduciary, the greater the scope of his fiduciary duty. Thus, a trustee is under a stricter duty of loyalty than is an agent upon whom limited authority is conferred or a corporate director who can act only as a member of the board of directors or a promoter acting for investors in a new corporation.” Scott, The Fiduciary Principle, 37 Cal. L. Rev. 539, 540-541 (1949).


B. The Fiduciary Paradigm

Certain general characteristics of fiduciaries can be identified.

“Fiduciaries are typically decisionmakers; their specialized function is that of . . . making decisions of a discretionary nature about the management or investment of the property of others. Such decisions cannot easily be subjected to detailed standards or guidelines; instead, they require educated judgment about uncertain, problematical issues. In addition such decisions frequently require the use of specialized financial or business information. . . Because fiduciaries manage or have some control over very substantial property interests of others, they have the potential power to inflict great losses on those property owners. Finally, the economic interests of fiduciaries are frequently substantially affected by the discretionary decisions they make on behalf of others . . . As a result of all these characteristics, fiduciaries have unusually great opportunities to cheat without detection and they have unusually great incentives to do so. Moreover, the relative costs which their cheating may impose on those whose property they manage are frequently much greater than the relative costs that can be imposed without detection or remedy in simpler contractual exchanges.” Anderson, Conflicts of Interests: Efficiency, Fairness and
The duties of fiduciaries are often contrasted with the obligations of parties to a contract. The former require a subordination of the fiduciary’s self-interest to the interests of the beneficiary. The latter permit the contracting parties to act in their own self-interest constrained only by the terms of the contract.¹

Given the disparity of expertise between the fiduciary and the beneficiary, economists rationalize the doctrine of fiduciary duties on the basis of “efficiency”: It would be extremely difficult and costly for the beneficiary to negotiate and draft a contract detailing the duties of the fiduciary.² Moreover, it would be impractical to expect a beneficiary to monitor and enforce the actions of a fiduciary in areas in which the beneficiary has little or no knowledge or expertise. Thus, fiduciary duties “codify the reasonable expectations of the client, by obliging the fiduciary to do what the client would tell him to do if the client had the same expertise as the fiduciary.” ¹d.

The paradigm of a sophisticated fiduciary and an innocent and defenseless beneficiary is no doubt valid in many contexts in the business world. It is certainly unreasonable to expect a small investor in a business corporation to do more than passively delegate the operation of the business to experienced managers with broad discretion.

However, the paradigm is not always valid. Investors in business organizations are not always proverbial “widows and orphans;” some -- venture capitalists come to mind -- are highly sophisticated and possess great bargaining power. Moreover, imposing fiduciary duties on managers is not without its own social costs, particularly where a fiduciary must forego the opportunity to profit by engaging in related business ventures.

As the following materials illustrate, there is a tension between fiduciary principles and the policy of freedom of contract among parties with equal bargaining power. This is perhaps best illustrated by those cases where

¹ The implied covenant of good faith and fair dealing common to all contracts obligates the parties only to refrain from doing anything that “will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.” Drucker v. Wm. Jutras Assocs., 370 Mass. 383, 385 (1976).

Courts have found fiduciary duties to be inherently unwaivable or have imposed obligations of full disclosure, consent or judicial review of fairness as conditions to such waivers.

**C. Articulation of the Rule**

The duties of a fiduciary are usually described in terms of sweeping generality (“utmost good faith and absolute loyalty”) and with much eloquence but little specificity. However, the substance of the fiduciary’s obligation varies with the nature of the relationship and the specifics of the transaction under analysis.

Accordingly, the challenge to the attorney advising business clients is to translate the eloquent generalities of the law into specific recommendations for action. Clients always seem to ask practical questions like “can the company buy back this stock?” and are rarely served by answers like “act with the punctilio of an honor the most sensitive.”

One is reminded of Justice Frankfurter’s admonition that “to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations?” SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943).

Recent Massachusetts cases involving the business judgment rule, self-dealing transactions, and corporate opportunities emphasize the importance of process (particularly, full disclosure and assent of “disinterested” directors or stockholders) in defining the limits of a corporate fiduciary’s duties. The lesson to be learned from these cases is that the business attorney must be vigilant in advising his or her clients not only to avoid obvious misconduct, but also to take

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3 Justice Cardozo’s eloquent description in *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) is the “classic formulation” most often quoted: “Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this, there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the ‘disintegrating erosion’ of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a higher level than that trodden by the crowd.” *JRY Corp. v. LeRoux*, 18 Mass. App. Ct. 153, 166 (1984).
appropriate procedural steps to avoid challenges to otherwise legitimate transactions.

II. MASSACHUSETTS CORPORATIONS

A. Corporate Fiduciaries

1. Directors and Officers. Directors of a Massachusetts corporation clearly “stand in a fiduciary relationship toward the corporation” and owe it a “paramount duty . . . [to which] their personal pecuniary interests are subordinate.” Durfee v. Durfee & Canning, Inc., 323 Mass. 187, 196 (1948). Officers are usually referred to in the case law as having the same fiduciary duties as directors, even though their role within the corporation is quite different. Rosenblum, *Fiduciary Duties of Directors, Officers and Stockholders of Massachusetts Corporations*, in *Massachusetts Business Lawyering*, 28-2 (MCLE 2003).


However, this rule is not uniformly followed. See Wilson v. Jennings, 344 Mass. 608 (1962) (where corporation was “essentially a joint venture in corporate form”); Coggin v. N.E. Patriots Football Club, Inc., 397 Mass. 525 (1986) (controlling stockholder who was also a director of both corporations subject to fiduciary obligations in a “freeze-out” merger of public corporation).


4. Other Employees. As “agents” of the corporation, non-management employees have a fiduciary obligation to act in their employers’ interests. See Horn Pond Ice Co. v. Pearson, 267 Mass. 256, 258 (1929) (delivery driver); Essex Trust Co. v. Enwright, 214 Mass. 507, 508 (1913) (newspaper reporter); Restatement (Second) of Agency, §1 (1958); Restatement (Third) of Agency (Tentative Draft No. 2), §1.01 (2001).

B. Fiduciary Duties of Directors and Officers
The fiduciary duties of corporate directors and officers include the duty of care and the duty of loyalty. The former requires directors and officers to exercise ordinary care in the performance of their duties; the latter prohibits self-dealing and similar transactions.

1. Duty of Care

a. The Statutory Standard. Massachusetts has a statutory standard of care for directors and officers. G.L. c.156B, §65 provides that a director or officer:

“shall perform his duties as such . . . in good faith and in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in like position would use under similar circumstances . . .”

The Boston Bar Committee Reviser’s Notes on the 1964 legislation adopting Chapter 156B (St. 1964, c.723) state that §65 was derived from N.Y. Bus. Corp. Law §717 and comment that “[t]his is a new section which will make clear that for the purposes of statutory liabilities, a director or officer is to be held only to the standards of a prudent man.” See Polubinski, Business Corporations with Forms, 13 Mass. Prac. Series, Appx. V (2003). In 1980, §65 was amended (by St. 1980, c.265) to extend to any claim asserted against the director or officer (not merely statutory liabilities under §§60-64).


The Massachusetts standard has never been definitively construed by a Massachusetts appellate court, but the “prudent person” test implies a simple negligence standard, in contrast to the pre-1980 common law standard of “clear and gross negligence,” Rosenblum, Fiduciary Duties of Directors, Officers and Stockholders of Massachusetts Corporations, in Massachusetts Business Lawyering, 28-22 (MCLE 2003). Compare Spiegel v. Beacon Participations, Inc., 297 Mass 398, 410-11 (1937) (directors “must act, also, with reasonable intelligence, although they cannot be held responsible for mere errors in judgment or want of prudence . . . If directors, acting in good faith, nevertheless act imprudently, they cannot ordinarily be held to personal responsibility for loss
unless there is ‘clear and gross negligence’ in their conduct.’”) (citations omitted).

See §§8.30 and 8.32 of the new Massachusetts Business Corporation Act set forth in Exhibit F.


i. Articulation of the Rule.

Until 2000, it could be said that “Massachusetts has no explicitly formulated ‘business judgment rule’ fashioned on the Delaware model.” Rosenblum, Fiduciary Duties of Directors, Officers and Stockholders of Massachusetts Corporations, in Massachusetts Business Lawyering, 28-3 (MCLE 2003). Indeed, the Sixth Circuit observed in 1984 that Massachusetts would not follow the Delaware rule. Hasan v. CleveTrust Investors, 729 F. 3d 372, 377 (6th Cir. 1984).

Nevertheless, numerous Massachusetts cases have stated the general principle -- sometimes called the “business judgment rule” (see Johnson v. Witkowski, 30 Mass. App. Ct. 697, 711-712 (1991)) -- that courts should refrain from substituting their judgment for the business judgment of the corporation’s directors expressed in their authorization of corporate transactions. Uccello v. Gold’n Foods, Inc., 325 Mass. 319, 321 (1950) (officers of a business corporation not responsible for “mere errors of judgment”); Crowell Thurlow S.S. Co. v. Crowell, 280 Mass. 343, 359 (1932) (same); Spiegel v. Beacon Participations, Inc., 297 Mass. at 433 (“It is no part of the judicial function to substitute the court’s business view for that of those vested by law with the control of corporate affairs.”); Sagalyn v. Meekins, Packard & Wheat, Inc., 290 Mass. 434 (1935) (Directors “action taken in good faith, even though wanting in sound judgment” does not give rise to liability); Houle v. Low, 407 Mass. 810, 824 (1990) (“Massachusetts has always recognized the need for courts to abstain from interfering with business judgments”).
Another branch of the “business judgment rule” involves the discretion of the board of directors whether or not to bring suit against corporate fiduciaries in response to a stockholder demand. In S. Solomont & Sons Trust Inc. v. N.E. Theatres Operating Corp., 326 Mass. 99, 113-115 (1950) the Supreme Judicial Court held that disinterested directors may “as a matter of business policy . . . refuse to bring a suit” in response to a stockholder demand.


In the recent case of Harhen v. Brown, 431 Mass. 838 (2000), the Supreme Judicial Court explicitly adopted a Delaware-like business judgment rule in a case involving a decision by a board committee of the John Hancock Mutual Life Insurance Company to dismiss a policyholder’s demand to bring suit against certain of its directors and employees for illegal lobbying activities.

In Harhen v. Brown, the Supreme Judicial Court unequivocally affirmed the business judgment rule of S. Solomont & Sons Trust, stating:

“The business judgment rule affords protection to the business decisions of directors, including the decision to institute litigation, because directors are presumed to act in the best interests of the corporation. See Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 101… (1991) (citing several Delaware cases…). To show that a [stockholder demand on the board for the corporation to bring suit] has been wrongfully refused, and that the directors are not entitled to the protection of the business judgment rule, a plaintiff must allege facts that challenge the board’s good faith or the reasonableness of the board’s investigation of the plaintiff’s demand. See, e.g., Scattered Corp. v. Chicago Stock Exch., Inc., 701 A.2d 70, 72-73 (Del. 1997).” 431 Mass. at 845.

The court noted that the business judgment rule it articulated was “consistent with what appears to be the unanimous consensus of other States,” citing Block, Barton & Radin, The Business Judgment Rule, 1611-1612 (5th ed. 1998) (collecting cases from other jurisdictions). 431 Mass. at 845 n 6.

The court in Harhen v. Brown did not refer to G.L. c. 156B, §65 since John Hancock was not a business corporation subject to Chapter 156B (see G.L. c. 170, §30). Nonetheless, the court’s language “strongly suggests that the business judgment rule also is available to protect business decisions of boards or committees of business corporations.” Southgate and Glazer, Massachusetts Corporation Law and Practice, §8.7[d] (2003).

iii. Scope of the Rule.
The court in Harhen did not attempt to describe the elements of the Massachusetts business judgment rule in great detail, but did cite a number of Delaware precedents. The business judgment rule under Delaware law is well developed in its case law. It consists of a presumption that “in making a decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citations omitted). Unless a plaintiff rebuts one of these three initial presumptions, a court will not disturb the decision itself, so long as the decision can be attributed to “any rational business purpose.” Sinclair Oil Corp. v. Leven, 280 A.12d 717, 720 (Del. 1971).

The business judgment rule will protect a challenged business transaction if it was authorized by a “disinterested” majority of the board of directors. It will also protect other corporate actions not specifically authorized by the board if a “disinterested” majority of the board has refused to bring suit against the alleged wrongdoers at the request of a stockholder. Harhen, 431 Mass. at 842. For the purpose of determining whether a director is “interested,” Massachusetts adopts the definition of “interested” directors in the American Law Institute’s Principles of Corporate Governance §§1.15 and 1.23 (1994). Harhen, 431 Mass. at 843-844, citing Demoulas v. Demoulas Super Markets, Inc., 424 Mass. 501, 523-524 (1997).

Where the business judgment rule applies, it will, as a practical matter, preclude the court from evaluating officer or director conduct under the prudent man standard of §65. Accordingly, the business judgment rule in most cases replaces the stringent statutory standard of care with a more deferential judicially-created standard.

2. **Duty of Loyalty.** The second type of fiduciary duty of directors and officers is the duty of loyalty. Unlike the duty of care, there is no explicit statutory standard for the duty of loyalty. Massachusetts common law holds corporate directors and officers to a standard of good faith and inherent fairness. Winchell v. Plywood Corp., 324 Mass. 171 (1949).

The duty of loyalty is well-established in Massachusetts jurisprudence. The directors and officers of a corporation stand in a fiduciary relation to the corporation. Durfee v. Durfee & Canning, Inc., 323 Mass. 187, 196 (1948). They owe to the corporation a paramount duty of loyalty. “They are bound to act with absolute fidelity and must place their duties to the corporation above every other financial or business obligation . . . They cannot be permitted to serve two masters whose interests are antagonistic.” Spiegel v. Beacon Participations, Inc., 297 Mass. at 410-411 (1937).

Unlike the duty of care, the duty of loyalty is not subject to the business judgment rule. Sagalyn v. Meekins, Packard & Wheat, Inc. 290 Mass. 434, 439
The duty of loyalty typically arises where corporate directors or officers or their affiliates enter into transactions with the corporation (“self-dealing”), seek to profit by exploiting business opportunities in which the corporation might be interested, engage in competition with the corporation, or set their own executive compensation.

a. The Demoulas Case.


The Demoulas supermarket chain was owned by two brothers, George and Telemachus Demoulas. Following George’s death in 1971, Telemachus assumed control of the corporation under the terms of a voting trust agreement. In 1990, a member of George’s family brought a derivative stockholder suit against the supermarket corporation and related corporations, complaining that in the years since George’s death, Telemachus and members of his family had exploited Telemachus’s control over these entities to transfer assets and to direct business opportunities away from those corporations which were jointly owned by George’s and Telemachus’s sides of the family, into other businesses that were solely owned by Telemachus’s branch. 4 424 Mass. at 505.

The court found that Telemachus had usurped corporate opportunities belonging to the corporations and had engaged in unfair self-dealing transactions in violation of his duty of loyalty.

The essence of the Demoulas standard for duty of loyalty is clearly articulated by the court:

‘to meet a fiduciary’s duty of loyalty, a director or officer who wishes to take advantage of a corporate opportunity or engage in self-dealing must [1] first disclose

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4 In a separate but related action, Telemachus was found liable for fraud, conversion, and breach of fiduciary duties with respect to transfers of estate and trust assets which resulted in an increase in ownership of the supermarket corporation by Telemachus’s family from 50% to 92% and a corresponding decrease in ownership by George’s family from 50% to 8%. 424 Mass. at 505. See Demoulas v. Demoulas, 428 Mass. 555 (1998).
material details of the venture to the
corporation and [2] then either [A] receive
the assent of disinterested directors or
shareholders, or [B] otherwise prove that the
decision is fair to the corporation.” 424
Mass. at 532-533 (emphasis added).

The Demoulas standard thus provides two requirements for corporate
fiduciaries who wish to engage in self-dealing transactions or to avail
themselves of corporate opportunities: A fiduciary must in any case, make full
disclosure of the material details of the transaction. Where possible, he must
also obtain the assent of the disinterested directors or stockholders before
engaging in the transaction. On the other hand, “where a corporate opportunity
or a self-dealing transaction is disclosed to the corporation, but the decision on it
is made by self-interested directors, the burden is on those who benefit from the
venture to prove that the decision was fair to the corporation.” 424 Mass. at
531.

It follows that failure to make full disclosure will ipso facto result in a
violation of the duty of loyalty, even if the board is not disinterested and the
transaction is fair to the corporation. 424 Mass. at 535. Failure to make full
disclosure—even to an “interested” board of directors—is a violation of the duty
of loyalty.

The Demoulas case also holds -- with a minor qualification discussed
below -- that the standards for directors reviewing self-dealing transactions and
corporate opportunities are essentially identical. 424 Mass. at 528.

b. Self-Dealing Transactions.

i. Definition.

Massachusetts courts have not developed a comprehensive
definition of a self-dealing transaction. Generally speaking, a self-dealing
transaction is one between the corporation and a director or officer, either
directly or indirectly with a business associate or family member of the
fiduciary, which would reasonably be expected to affect his judgment in a
manner adverse to the corporation. American Law Institute, Principles of
Corporate Governance, §1.23 (1994). Dean Clark proposes a simpler definition
of self-dealing: “[A] transaction which appears to be between two or more
parties but actually involves only one decision maker.” Clark, Corporate Law,
§4.1 (1986). Exhibit A sets forth the applicable ALI definitions in their entirety.

Self-dealing also arises in transactions between corporations with
Murphy v. Hanlon, 322 Mass. 683 (1948). See also Geddes v. Anaconda Mining Co., 254 U.S. 590, 599 (1921). The Demoulas court expressed no sympathy for directors of both corporations engaged in a business transaction. (“In serving as directors [of such corporations, those directors] created inevitable conflicts of interest between their fiduciary duties to different companies. A fiduciary who places himself in such a situation does not thereby gain the option of choosing which company to favor... A director faced with such a conflict can best satisfy the duty of loyalty by terminating the relationship with one or the other party.”) 424 Mass. at 542-543.

ii. Corporate Power to Engage in Self-Dealing Transactions.

Unlike Delaware, Massachusetts does not have a statute expressly authorizing corporations to engage in transactions with officers and directors. See Delaware General Corporation Law, §144, 8 Del. C. §144. However, most Massachusetts corporations include in their articles of organization or by-laws provisions to the effect that such transactions shall not be voidable merely because of a director’s or officer’s interest in the transaction and setting forth procedures for approval or ratification of such transactions. Southgate & Glazer, Massachusetts Corporation Law and Practice, §8.8 [a][8] (2003). Specimen charter provisions are set forth in Exhibit B.

Corporate charter provisions or by-laws permitting conflict of interest transactions by officers and directors may remove the risk that the corporation may not have the ability to engage in such transactions at all, but do not relieve those individuals of their duty of loyalty. Spiegel v. Beacon Participations, Inc., 297 Mass. 398 (1937); Boston Children’s Heart Foundation, Inc., 73 F. 3d 429, 434 n 4 (1st Cir.1996).

See §8.31 of the new Massachusetts Business Corporation Act set forth in Exhibit F.

iii. Duty of Disclosure.

The Demoulas case holds that officers and directors who wish to engage in self-dealing transactions must make full disclosure of all material details of the transaction and then either obtain the assent of disinterested directors or stockholders, or otherwise prove the inherent fairness of the transaction to the corporation. 424 Mass. at 532-533.

The Demoulas court suggested in dictum that the approval of a self-dealing transaction may be subject to “stricter scrutiny” than approval of a diverted corporate opportunity. The court cited the American Law Institute’s Principles of Corporate Governance, §§ 5.02 and 5.05, which state that a self-dealing transaction may be authorized by disinterested directors who “could
reasonably have concluded that the transaction was fair to the corporation,” and that a taking of a corporate opportunity may be approved “in a manner which satisfies the standards of the business judgment rule.” 424 Mass. at 528 n 33.

In Geller v. Allied-Lyons PLC, 42 Mass. App. Ct. 120 (1997), decided a few months before the Demoulos case, a senior vice president of Dunkin Donuts Incorporated sought to collect from Allied a $3 million finder’s fee with respect to Allied’s acquisition of Dunkin Donuts. The court held that the transaction constituted a breach of his fiduciary duty of loyalty to Dunkin Donuts and was thus unenforceable as a matter of public policy. The court found that the officer did not fully disclose the existence of the finder’s fee agreement to Dunkin Donuts, even though there was evidence in the summary judgment record that he “made a statement” regarding the fee at a meeting of Dunkin Donuts senior executives. The court held that such “sotto voce indications do not fulfill a fiduciary’s duty of full disclosure of self-dealing.” 42 Mass. App. Ct. at 126.5

iv. Fairness.

If disclosure is made, but there is no disinterested majority of the board or the stockholders, the fiduciary has the burden of demonstrating that “the transaction was fair to [the corporation] at the time it was entered into,” 424 Mass. at 538. The “fairness” of a transaction includes “both a fair approval process and a fair price.” 424 Mass. at 539 n 43, citing ALI, Principles of Corporate Governance, § 5.02.

c. Corporate Opportunities

i. Definition.

A corporate opportunity has been defined in the Demoulos case as “any opportunity to engage in a business activity of which a director or senior executive becomes aware, either in connection with performing the functions of those positions or through the use of corporate information or property, if the resulting opportunity is one that the director or senior executive should reasonably be expected to believe would be of interest to the corporation.” 424 Mass. at 530 (footnote and internal quotation marks omitted), citing American Law Institute, Principles of Corporate Governance, § 5.05(b)(1) (1994).6

5 The Dunkin Donuts code of ethics required disclosure of potential conflicts of interest to the corporation’s general counsel, controller and director of financial reporting. 42 Mass. App. Ct. at 126 n 7. Demoulos and other cases require disclosure to the board of directors or stockholders. The Geller case does not answer the question whether the board of directors may delegate its approval function to its officers.
Later decisions have shown a propensity to expand the concept of corporate opportunity beyond the Demoulas definition. In Hanover Ins. Co. v. Sutton, 46 Mass. App. Ct. 153, 163-170 (1999), the court held that a corporate opportunity existed even though the officer did not become aware of it either in connection with performing his duties or through the use of corporate information or property. In In re Cumberland Farms, Inc., 284 F. 3d 216 (1st Cir. 2002), the First Circuit upheld the Bankruptcy Court’s determination that a director of Cumberland Farms, Inc. had usurped a “corporate opportunity” by causing a corporation wholly owned by him to repay its indebtedness to a bank lender (which the director had personally guaranteed), rather than repay indebtedness owed to Cumberland Farms. It is difficult to equate Cumberland Farms’s “opportunity” to receive payment of a debt with the Demoulas definition of a corporate opportunity as an “opportunity to engage in a business activity.” 424 Mass. at 530.

ii. The “Interest or Expectancy” Test

Prior to the Demoulas case, Massachusetts courts had been inconsistent regarding whether the corporation must have some “interest or expectancy” in the business opportunity. Compare Lincoln Stores, Inc. v. Grant, 309 Mass. 417, 421 (1941) and Black v. Parker Mfg. Co., 329 Mass. 105, 111 (1952) (applying the test) with Durfee v. Durfee & Canning, Inc., 323 Mass. 187 (1948) and Puritan Medical Center, Inc. v. Cashman, 413 Mass. 167 (1992) (test is one of “unfairness in the particular circumstances”). These cases are difficult to reconcile and turn on very subtle distinctions. Southgate & Glazer, Massachusetts Corporation Law and Practice, §8.8 [b] (2003).

Demoulas rejects the interest or expectancy test in favor of a broad (and somewhat more amorphous) standard:

“In selecting a test for determining which ventures rightfully belong to a corporation, and are subject to the corporate opportunity doctrine, the corporation deserves broad protection. Rather than limiting the doctrine’s coverage only to those instances where the proposed venture is demonstrably similar to existing and prospective corporate activities, the focus is on the

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6 Numerous reported cases have relied upon the ALI Principles as an authority on corporate governance in Massachusetts. Exhibit C contains a summary of those cases.
 paramount obligations of the fiduciary.”
424 Mass. at 529.

iii. The Corporation’s Ability to Exploit the Opportunity.


This issue was squarely presented in the Demoulas case. There, the defendants argued that engaging certain business ventures in New Hampshire would be barred by liquor laws which made it impossible for the corporation to own these businesses. The Demoulas court emphatically rejected the relevance of such putative impediments:

“‘We disagree with this argument, which would limit a fiduciary’s duty of disclosure to those enterprises judged by the fiduciary to be within the corporation’s legal, financial, or institutional capabilities . . . [A] fiduciary who is interested in pursuing an opportunity should not make the decision as to whether the venture is also of interest to the corporation.” 424 Mass. at 532.

iv. Indirect Conflicts of Interest.

The Demoulas case makes it clear that a fiduciary breaches his duty of loyalty even when benefits flow not directly to the fiduciary, but rather to a family member or another company under the fiduciary’s control. In that case, Telemachus was held to have violated his duty of loyalty by diverting business opportunities to corporations owned by various members of his family. 424 Mass. at 535-536, citing American Law Institute, Principles of Corporate Governance, §§1.03, 5.08 (1994) (fiduciary violates duty of loyalty by advancing pecuniary interest of an associate, such as a child or sibling).


Under the Demoulas standard,
“[a] director or officer is not entirely barred from pursuing a corporate
opportunity, but [he] cannot do so unless the opportunity is first offered to the
corporation and rejected by it. In this aspect, the corporate opportunity
doctrine may be considered to be a rule of disclosure.” 424 Mass. at 530, citing
In re Tufts Electronics, Inc., 746 F. 2d 915, 917 (1st Cir. 1984).

The duty of disclosure is identical to that for the approval of self-dealing transactions, except that in the case of corporate opportunities, a
disinterested board is subject to the protection of the business judgment rule.
See Section II (B)(2)(b)(ii) supra.

vi. Fairness.

If disclosure is made, but there is no disinterested majority of the board or the stockholders, the fiduciary has the burden of demonstrating that
“the transaction was fair to [the corporation] at the time it was entered into.”
424 Mass. at 538. The “fairness” of a transaction includes “both a fair approval
process and a fair price.” 424 Mass. at 539 n 43, citing ALI, Principles of
Corporate Governance, §5.02.

d. Competing with the Corporation

i. The General Rule.

Officers, directors and key employees may not actively compete with the corporation during their employment. Chelsea
Grant, 309 Mass. 417, 423 (1941). However, unless restricted by a
valid non-competition agreement, an officer, director, or key employee
may resign his position with the corporation and enter into competition
court held that:

“An at-will employee may properly plan
to go into competition with his employer
and may take active steps to do so while
still employed. . . Such an employee has
no general duty to disclose his plans to
his employer, and generally he may
secretly join other employees in the
endeavor without violating any duty to his employer. . . The general policy considerations are that at-will employees should be allowed to change employers freely and competition should be encouraged. . . If an employer wishes to restrict the post-employment competitive activities of a key employee, it may seek that goal through a non-competition agreement…” (citations omitted).


ii. Limits on Employee Conduct.

On the other hand, a former employee may not appropriate his employer’s trade secrets, solicit customers while still working for the employer, or “act for his future interests at the expense of his employer by using the employer’s funds or employees for personal gain or by a course of conduct designed to hurt the employer.” Augat, 409 Mass. at 172-173. See G.L. c. 93, §§ 42-42A (civil liability for actual and double damages and injunctive relief for misappropriation of “trade secrets” as defined in G.L. c. 266, §30).


iii. Remedies for Violations; “Equitable Forfeiture”

Employees who violate their duty of loyalty are liable to the employer for all losses caused by their conduct, usually measured by the value of lost business. Demoulas, 424 Mass. at 556; Orkin Extermination, Inc. v. Rathje, 72 F. 3d 206, 207 (1st Cir. 1995). Equitable relief in the form of injunction, accounting, rescission,

In addition, Massachusetts courts will often grant “equitable forfeiture” of compensation paid to the employee during any period of disloyal conduct. Little v. Phipps, 208 Mass. 331, 333-334 (1911). In cases of “egregious” conduct, the entire amount of compensation may be forfeited. Production Machine Co. v. Howe, 327 Mass. 372 (1951); Boston Children’s Heart Foundation, Inc. v. Nidal-Ginard, 73 F. 3d 429 (1st Cir. 1996). Other cases limit the amount of the forfeiture to the portion of the disloyal employee’s compensation in excess of his worth to the employer. Anderson Corp. v. Blanch, 340 Mass. 43, 50-51 (1959); Walsh v. Atlantic Research Assoc., 321 Mass. 57, 66 (1947); Chelsea Industries, 389 Mass. at 12-14.

See Weigand, Employee Duty of Loyalty and the Doctrine of Forfeiture, 42 Boston Bar J. 6 (September/October 1998) for a fuller discussion of these issues.

iv. “Employee Raiding.”

Massachusetts does not recognize “employee raiding” as an independent business tort. Indeed, the Augat case holds that an employee may “secretly join other employees” in preparing to compete with his employer. 409 Mass. at 172. However, if a key management employee acts as a “pied piper” and leads all of the corporation’s employees away, there is a breach of the duty of loyalty. Id. at 173. Likewise, if a general manager secretly solicits key management employees to join him in competing with the employer, there may also be a breach of the duty of loyalty. Id. at 174-175.

Employee raiding may also give rise to liability for breach of contract, aiding and abetting wrongful conduct, interference with contract, Chapter 93A violations, unfair competition and even Sherman Act violations. See Reece, Employee Raiding, 47 Boston Bar J. 18 (September/October 2003) for a recent discussion of these issues.

e. Executive Compensation.

Massachusetts law with respect to executive compensation is not particularly well developed. Earlier cases seem to adopt an absolute standard of reasonableness. “The reasonableness of the salary voted by the directors of a corporation to one of their members may be examined in a court of equity . . . and if the payment is excessive . . . it may be recovered for the benefit of the
corporation.” Calkins v. Wire Hardware Co., 267 Mass. 52, 67 (1929); Stratis v. Andreaon, 254 Mass. 536, 539-540 (1926); Black v. Parker Mfg. Co., 329 Mass. 105, 116 (1952) (salary must bear a reasonable relation to the officers’ ability and quality of his services; responsibilities assumed, difficulties involved and success attained are to be considered.); Sagalyn v. Meekins, Packard & Wheat, Inc., 290 Mass. 434 (1935) (directors who increased their salaries by the amount of a deceased colleague’s salary, but without a corresponding increase in duties, violated their duty of loyalty to the corporation).

See also Uccello v. Gold’n Foods, Inc., 325 Mass. 319, 327 (1950) (payment of salaries was actually a division of profits without proper authorization by the corporation); Crowley v. Communications for Hospitals, Inc., 30 Mass. App. Ct. 751 (1991) (compensation of virtually the entire net income of the corporation held excessive).

The Demoulas case suggests that executive compensation may be a subset of self-dealing transactions requiring adequate disclosure and approval by a disinterested board or disinterested stockholders or proof of inherent fairness. Polubinski, Business Corporations with Forms, 13 Mass. Prac. Series, §17.8(c) (2003).

In Boston Children’s Heart Foundation, Inc. v. Nadel-Ginard, 73 F. 3d 429 (1st Cir. 1996), the defendant was an officer of a non-profit Massachusetts corporation. Acting in accordance with written corporate policies, he set his own salary and established a generous severance plan under which he was to receive $4 million. The court found that his action constituted a “self-interested transaction” subject to “vigorou scrutiny,” obligating the officer to prove that he acted in good faith and that the transaction was “inherently fair” to the corporation. The court interpreted the requirement of good faith as obligating a corporate fiduciary to fully and honestly disclose any information to the disinterested board members, citing Dynan v. Fritz, 400 Mass. 230 (1987). It found that the officer’s failure to disclose to the board the salary and benefits he was receiving as an investigator for another medical institute and the nature and magnitude of his severance benefit plan, was ipso facto a violation of his duty of loyalty to the corporation. The court deemed irrelevant whether or not his salary was objectively fair and reasonable. 73 F. 2d at 433. In this respect, the First Circuit’s interpretation of Massachusetts law is consistent with the Demoulas standard announced the following year.

C. Statutory Liabilities

Various provisions of the Massachusetts Business Corporation Law provide for civil liability of officers and directors.

1. Improper Stock Issue. G.L. c. 156B, §18 provides that capital stock may be issued for cash, tangible or intangible property or services or for a
debt, note or expenses. Stock having par value shall not be issued for cash, property, services or expenses worth less than the par value. A debt or note of the purchaser (secured or unsecured) shall not be considered "property" for the purpose of the preceding sentence. Thus, par value stock may not be issued solely for a debt or note of the purchaser.

G.L. c. 156B, §21 provides that authorized but unissued capital stock may be issued from time to time by vote of the stockholders or by the directors under authority of the by-laws or articles of organization or a stockholder vote. No stock shall be issued unless the cash, property, services or expenses have been actually received by the Corporation. Thus, stock may not be issued for future services.

G.L. c. 156B, §60 provides that if stock of a corporation is issued for a consideration which does not comply with the requirements of §§18 or 21, the directors who voted to authorize such issuance and the president and the treasurer of the corporation shall be jointly and severally liable to any stockholder to the extent of the actual damage sustained by such stockholder by reason of such issuance.

2. Improper Dividends and Redemptions. G.L. c. 156B, §61 provides that directors who vote to authorize a "distribution" by way of dividend, repurchase or redemption (except a stock dividend) in violation of the articles of organization shall be jointly and severally liable to the corporation to the extent that such distribution exceeds the amount which could have been made under the articles of organization, but only to the extent that such excess distribution is not repaid to the corporation.

Directors who vote for a distribution at a time when the corporation is "insolvent" or which renders the corporation "insolvent," are similarly liable to the corporation. The statute does not define the term "insolvent." These provisions may be enforced by a trustee in bankruptcy for the corporation. In re Ipswich Bituminous Concrete Products, Inc., 79 B.R. 511 (Bankr. D. Mass. 1987). The statute provides relief from liability from the so-called "insolvency cut-off" for distributions authorized when the corporation was solvent, but which are actually made at a time when the corporation is or is thereby rendered insolvent.

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7 See G.L. c. 156B, §16, providing that any reference to the by-laws in Chapter 156B includes the provisions of the articles of organization.

8 See G.L. c. 156B, §§19, 22, 24 and 25, relating to stock issued for cash payable in installments.
See §§6.40 and 6.41 of the new Massachusetts Business Corporation Act set forth in Exhibit F.

3. Loans to Insiders. G.L. c. 156B, §62 provides that directors who vote for, and officers who “knowingly participate” in any loan of corporate assets to any of its officers or directors shall be jointly and severally liable to the corporation for any portion of such loan which is not repaid, unless a majority of the directors or stockholders who are not direct or indirect recipients of such loan have approved or ratified the making of the loan on which in the judgment of the directors or stockholders may be reasonably expected to benefit the corporation.

See §8.32 of the new Massachusetts Business Corporation Act set forth in Exhibit F.

4. False Statements or Reports. G.L. c. 156B, §63 provides that the directors or officers who sign any statement or report required by Chapter 156B which is false in any material representation shall be jointly and severally liable to any creditor of the corporation who has relied on such false representation to the extent of the actual damage sustained by him by reason of such reliance.

5. False Articles. G.L. c. 156B, §64 provides that the incorporators and officers of a corporation (but not the directors) who sign any articles of organization, amendment, consolidation or merger required by Chapter 156B which are false in any material respect with regard to the corporation shall be jointly and severally liable to any stockholder of the corporation (or the resulting or surviving corporation in a consolidation or merger), for the actual damage sustained by such stockholder by reason of reliance on such false statement.

D. Close Corporations

1. Introduction.

Donahue v. Rodd Electrotype Co., 367 Mass. 578 (1975) has aptly been called the “single most important judicial decision in the modern development of the law of corporate governance in Massachusetts.” Southgate & Glazer, Massachusetts Corporate Law and Practice, §16.2 (2003). The Donahue case created a new fiduciary duty of “utmost good faith and loyalty” among the stockholders of “close corporations” as well as a new right on the part of aggrieved stockholders to sue other stockholders personally for certain claims, rather than resort to a derivative action in the name of the corporation.

2. Donahue v. Rodd Electrotype Co.
a. **Facts.**

Members of the Rodd family owned 80% of the stock of Rodd Electroteype Company of New England, Inc., and controlled its board of directors. Members of the Donahue family owned a minority of the stock.

When Harry Rodd retired, the board of directors authorized the corporation to purchase 45 of his shares for $36,000 ($800 per share). The Donahue family objected to this transaction and offered its shares to the corporation on the same terms as Rodd’s purchase; they were told the corporation could not afford to purchase their shares. The corporation subsequently offered to purchase the Donahue shares for amounts between $40 and $200 per share.

b. **Holding.**

The Supreme Judicial Court found that stockholders of closely held corporations owe each other a fiduciary duty of “utmost good faith and loyalty” and an equal opportunity in stock repurchases. The court held that the corporation was “closely held” and thus had to either offer the Donahue family an equal opportunity to redeem its shares at the same price per share or the court would require Rodd to repurchase his shares from the corporation at the purchase price plus interest.

3. **Definition of a “Close Corporation.”**

The court defined a close corporation as being typified by three characteristics: “(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation.” 367 Mass. at 586.

In the court’s view, a close corporation is an “incorporated partnership.” The corporate form is chosen for certain benefits, but otherwise the players and their roles remain as they were or would be in a partnership.

4. **Minority Stockholders in a Close Corporation Need Protection.**

Due to the particular characteristics of a close corporation, minority stockholders can find themselves vulnerable to oppression by the majority stockholders. Majority stockholders can effectively prevent the minority from receiving any financial benefits of ownership in the corporation, for example, by restricting or eliminating dividends, paying themselves excessive compensation and preventing the minority stockholder from having employment in the corporation. The minority stockholders cannot avoid such actions by selling their shares since there is no market for the stock. Moreover, a derivative action
seeking to compel dividends or payment of salaries may not be viable in the absence of demonstrable harm to the corporation. Unlike a partnership, where a partner could dissolve the partnership, or a publicly held corporation, where there is a market for the minority’s shares, a close corporation often presents an impossible situation for the minority stockholders with no potential for recourse.

5. **The Duty of Utmost Good Faith and Loyalty.**

a. **Scope of the Duty.**

Due to the unique relationships in a close corporation, the Donahue court found that stockholders of such corporations owe each other the same “strict” fiduciary duty of “utmost good faith and loyalty” that partners in a partnership owe each other. Stockholders “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.” 367 Mass. at 593.

b. **Comparison to Traditional Duties of Corporate Fiduciaries.**

Traditionally, stockholders in corporations do not owe one another fiduciary duties. See Section II (A) (2) supra. Corporate directors owe a duty of good faith and inherent fairness to the corporation (not to the stockholders). The Donahue court believed the particular trust and confidence between stockholders in close corporations require a stricter standard. The close corporation standard is stricter in three ways: (i) the duty requires “utmost” good faith and loyalty, not simply good faith and inherent fairness, (ii) the duty is owed among the stockholders, not only to the corporation, and (iii) stockholders have a direct right of action rather than a derivative right of action. As to the practical difference between “utmost” good faith and loyalty and mere good faith and inherent fairness, the courts have yet to explain what, if any, distinction actually exists.

6. **Elements of the Duty.**

The Supreme Judicial Court addressed the elements of the duty of utmost good faith and loyalty in Wilkes v. Springside Nursing Home, 370 Mass. 842 (1976). It held that in order to determine whether corporate actions are subject to the duty, a court should analyze (i) whether the majority had a legitimate business purpose for its actions and (ii) whether the legitimate business purpose could have been accomplished in an alternative manner that would have been less harmful to the other stockholder’s interest.

a. **Legitimate Business Purpose.**

There are instances when unpleasant and difficult business decisions must be made. A close corporation should not be prevented from making
necessary decisions because of the duty of utmost good faith and loyalty. Furthermore, the majority has a right to “selfish ownership,” which should be balanced against the duty of utmost good faith and loyalty. The legitimate business purpose test addresses these concerns by determining whether the majority acted to achieve a bona fide corporate objective or to harm the minority stockholders. See Merola v. Exegen Corp., 38 Mass. App. Ct. 462, 466-467 (1995). A reverse stock split that froze out the minority of a thinly traded public corporation was found not to violate the duty of utmost good faith and loyalty due to the legitimate business purpose of eliminating the expense and other burdens of public ownership. Leader v. Hycor, Inc., 395 Mass. 215 (1985). However, the legitimate business purpose test can be difficult to meet. In King v. Driscoll, 418 Mass. 576 (1994), the business reasons proffered for the employment termination of a minority stockholder were found to be “pretextual” based on the totality of the evidence.

b. **The Less Harmful Alternative Test.**

Even if there is a legitimate business purpose for the actions complained of, the duty of utmost good faith and loyalty is breached if the same business purpose could have been accomplished by alternative methods that would have been less harmful to the other stockholders. For example, in Leader, 395 Mass. at 223, the court found that there were no other means of eliminating the burdens of operating a public company other than by going private. It is therefore insufficient to claim a legitimate business purpose if a less harmful alternative exists.

7. **Substantive Scope of the Duty.**

Any conduct that harms a fellow stockholder could potentially be a breach of the duty of utmost good faith and loyalty. Since Donahue, such conduct usually falls in one of three categories: equal opportunity in repurchase of shares, proscription of “freeze outs,” and protection of rightful expectations.

a. **Equal Opportunity in Repurchase of Shares.**

As the Donahue case set forth, a close corporation must offer an equal opportunity to all stockholders to redeem their shares at the same price and terms. The majority cannot give itself an exclusive right or a more favorable price on terms.

b. **Proscription of “Freeze Outs.”**

A freeze out can take many forms, all of which involve forcing minority stockholders to surrender shares at less than fair value or denying them an equitable share of the benefits of stock ownership. A minority stockholder may be granted relief when (i) he receives an offer to purchase his shares at a
lower than fair value price and (ii) there are efforts to coerce acceptance of such an offer. *Sugarman v. Sugarman*, 797 F.2d 3 (1986) (the defendant overcompensated himself and made low offers for the plaintiff’s stock while denying the plaintiff dividends and employment benefits).

c. Protection of Rightful Expectations.

The courts have protected the rightful expectations of stockholders with the duty of utmost good faith and loyalty. This rightful expectation doctrine was advanced in *Hallahan v. Haltom Corp.*, 7 Mass. App. Ct. 68 (1979), which involved expectations regarding the distribution of voting power. Each of four stockholders had 22.75 shares, with the understanding that the fifth shareholder with five shares would not participate in the business and that the balance of power would remain among the four major stockholders. When two of the four shareholders fired the other two by using their combined voting power and a proxy from the minority stockholder, the court found the fired stockholders had a rightful expectation to an equal balance of power and required the minority stockholder to sell his five shares to the corporation. The Supreme Judicial Court backed this rightful expectation doctrine in *Bodia v. Ellis*, 401 Mass. 1 (1987), which involved a similar dispute over expectations concerning management control. Under both cases, rightful expectations are to be protected even if the express or implied understanding is not an enforceable contract.

8. Duty of the Minority to the Majority.

The duty of utmost good faith and loyalty is owed among stockholders regardless of stock ownership percentages. In *Donahue*, the Court stated in a footnote that its holding was to apply to the minority stockholders as well as the majority, as it realized that the minority may “do equal damage through unscrupulous and improper ‘sharp dealings’ with an unsuspecting majority.” 367 Mass. at 593 (citations omitted). In *Smith v. Atlantic Properties*, 12 Mass. App. Ct. 201 (1981), a stockholder in a corporation with four equal stockholders caused the corporation to incur substantial taxes and legal expenses by refusing to vote on the declaration of sufficient dividends necessary to avoid the penalty tax on accumulated earnings; he was found to have breached his fiduciary duty to his fellow stockholders. The Supreme Judicial Court has found that the duty arises regardless of the percentage of share ownership; i.e., a fifty percent stockholder who has the power to dissolve the corporation is still owed the duty by the other stockholder. *Zimmerman v. Bogoff*, 402 Mass. 650 (1988).

9. Limitations of Duties by Agreement.

In *Donahue*, 367 Mass. at 598, the Supreme Judicial Court stated that the equal opportunity requirement would not apply “if all other stockholders give advance consent to the stock purchase arrangements through acceptance of an appropriate provision in the articles of organization, the corporate by-laws, or
a stockholder’s [sic] agreement.” The Appeals Court found, based on Donahue, that the fiduciary duty does not apply when the stockholders have agreed upon methods for the purchase and sale of stock from a withdrawing or deceased stockholder. Evangelista v. Holland, 27 Mass. App. Ct. 244 (1989). In Evangelista, the court found that even though the current fair market value of the stock was $191,000, the stockholders’ agreement with a buy-out price of $75,000 was controlling. 27 Mass. App. Ct. at 249.

More recently, courts have found that employment and stock purchase agreements can by-pass the Donahue duty. See Blank v. Chelmsford OB/GYN, P.C., 420 Mass. 404 (1995); Vakil v. Anesthesiology Assoc. of Taunton, Inc., 51 Mass. App. Ct. 114 (2001). Agreements can displace the duty of utmost good faith and loyalty, provided the actions that led to the agreements are not a breach of the duty.

10. Limitations of Duties by Charter Amendment.

Generally, limitations of the duty of utmost good faith and loyalty are not included in the close corporation’s articles of organization. Instead, separate agreements among the stockholders usually address specific concerns, e.g., employment contracts, voting agreements, and stock transfer agreements. Note, Contractual Disclaimer of the Donahue Fiduciary Duty: The Efficacy of the Anti-Donahue Clause, 26 B.C.L. Rev. 1215, 1237 (1985). Separate agreements are used for two reasons: (i) there is uncertainty as to whether a court would enforce an anti-Donahue provision in a corporation’s charter and (ii) explaining to stockholders the multitude of possible implications of an anti-Donahue clause can be very difficult. The validity of an anti-Donahue clause may “turn upon a court’s finding of whether the [clause] reflects the reasonable expectations of all the parties to the agreement in which it is included.” Id. at 1240. Therefore, the general practice of using separate agreements instead of amending the corporation’s charter has evolved among Massachusetts corporate practitioners.

11. Application of Duties to Corporate Counsel.

Corporate counsel may also owe a fiduciary Donahue – like duty to the individual stockholders. In dictum, the Supreme Judicial Court explained that “[j]ust as an attorney for a partnership owes a fiduciary duty to each partner, it is fairly arguable that an attorney for a close corporation owes a fiduciary duty to the individual shareholders.” Schaeffer v. Cohen, Rosenthal, Price, Mirkin, Jennings & Berg, P.C., 405 Mass. 506, 513 (1989). Therefore, an attorney may violate a fiduciary duty owed to a stockholder by representing both a close corporation and a principal stockholder. See also Cacciola v. Nellhaus, 49 Mass. App. Ct. 746, 750-752 (2000) (attorney for partnership has fiduciary duty to partners).

E. Defenses and Limitations
Chapter 156B contains a number of statutory defenses and limitations on liability of corporate fiduciaries.

1. **Defense of Good Faith and Prudence.** Under G.L. c 156B, §65, the fact that a director or officer performed his duties in accordance with the standard of care set forth in that section “shall be a complete defense to any claims asserted against him . . . except as expressly provided by statute, by reason of his being or having been a director [or] officer . . . of the corporation.” The statutory standard, discussed in Section II(B)(1)(a) above, is the performance of his duties “in good faith and in a manner he reasonably believes to be in the best interests of the corporation, and with such case as an ordinarily prudent person in a like position would use under similar circumstances.”

2. **Consideration of Non-Stockholder Constituencies.** Legislation enacted in 1989 (St. 1989, c. 242, §13), motivated by a wave of corporate takeovers perceived to be a threat to the state economy, amended §65 to permit directors to consider in determining what they reasonably believe to be in the best interests of the corporation “the interests of the corporation’s employees, suppliers, creditors and customers, the economy of the state, region and nation, community and societal considerations, and the long-term and short-term interests of the corporation and its stockholders, including the possibility that those interests may be best served by continued independence.”

3. **Reliance on Reports, Experts and Committees.** Section 65 also protects directors and officers who rely upon “information, opinions, reports or records, including financial statements, books of account and other financial records, in each case prepared by or under the supervision of (1) one or more officers or employees of the corporation whom the director [or] officer reasonably believes to be reliable and competent in the matters presented, or (2) counsel, public accountants or other persons as to matters which the director [or] officer . . . reasonably believes to be within such person’s professional or expert competence, or (3) in the case of a director, a duly constituted committee of the board upon which he does not serve, as to matters within its delegated authority, which committee he reasonably believes to merit confidence, but he shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would cause such reliance to be unwarranted.”

4. **Contribution, Indemnification and Insurance.**

   a. **Contribution.** G.L. c. 156B, §66 provides that a director or officer against whom a claim is successfully asserted under Chapter 156B is entitled to contribution from the other directors who voted for, and the other officers who participated in, the action and who did not perform their duties in accordance with the standards set forth in §65.
b. **Indemnification.** G.L. c. 156B, §67 permits, but does not require, Massachusetts corporations to indemnify their directors, officers, employees and other agents in accordance with provisions set forth in the articles of organization, by-laws adopted by the stockholders, or a majority stockholder vote. Indemnification of persons who are not directors may also be provided by resolution of the directors.

Indemnification may not be provided with respect to any matter as to which an indemnified person shall have been adjudicated in any proceeding not to have acted in good faith in the reasonable belief that his action was in the best interest of the corporation. Indemnification may include payment by the corporation of expenses of defending a civil or criminal action or proceeding in advance of a final disposition thereof, upon receipt of an undertaking by the indemnified person to repay such payment if he should be adjudicated not to be entitled to indemnification. Specimen charter provisions are set forth in Exhibit D.

c. **Directors’ and Officers’ Liability Insurance.** Section 67 also authorizes Massachusetts corporations to purchase D&O liability insurance, including insurance for liabilities for which the corporation may not provide indemnification.

5. **Exculpatory Charter Provisions.** G.L. c. 156B, §13(b) (1½) provides that a Massachusetts corporation may include in its articles of organization a provision eliminating or limiting the personal liability of a director (but not an officer) to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit liability for (i) breach of the duty of loyalty, (ii) acts or omissions not in good faith or which involve intentional misconduct or knowing violation of law, (iii) under §61 or §62, or (iv) for any transaction from which the director derived an improper personal benefit. No exculpatory provision adopted under §13(b) (1½) may be made retroactive to cover acts or omissions occurring prior to the date the charter provision becomes effective. Specimen charter provisions are set forth in Exhibit E.

See Nutt, *The Massachusetts Limit on Director Liability: A Comment on Chapter 156B, Section 13(b) (1 1/2),* 32 Boston Bar J. 5 (March/April 1988).

6. **Ratification.** Unauthorized actions by a corporate officer, including self-dealing, may be validated by ratification by the directors or stockholders if they have full knowledge of the transaction in question. *Puritan Medical Center, Inc. v. Cashman,* 413 Mass. 167, 172 (1992) (rent payments to officer and director in excess of those required by written lease). Ratification may be implied, in the absence of a formal corporate vote, by acceptance of the benefits of the transaction with “knowledge of such facts or circumstances as
would put a reasonable person on inquiry and which would lead to full discovery.” 413 Mass. at 172-173 and cases cited.

However, failure of the directors to exercise their duty of care does not constitute ratification. 413 Mass. at 172 (the directors’ “duty of reasonable supervision . . . is for the benefit of the corporation, not the wrongdoer”). See In re Cumberland Farms, Inc., 284 F. 3d 216, 229-231 (1st Cir. 2002) (officers’ knowledge of challenged payments and entry of same in records kept by corporate employees does not constitute knowledge by directors). Moreover, a fiduciary’s half-hearted, misleading, inaccurate or materially incomplete disclosure may violate his duty of full disclosure and preclude the defense of ratification. 284 F. 3d at 230.

III. FOREIGN CORPORATIONS

A. General

Corporations organized under the laws of other states (or other nations) may do business in Massachusetts subject to compliance with the registration requirements of G.L. c. 181. Many corporations with headquarters in Massachusetts are domiciled in other states, particularly Delaware. The fiduciary duties of officers and directors under the laws of the states of incorporation of such “foreign” corporations may vary significantly from those imposed by Massachusetts law. For example, Delaware does not recognize the Donahue doctrine with respect to close corporations. Nixon v. Blackwell, 626 A. 2d 1366, 1380-1381 (Del. 1993). The Delaware General Corporation Law also permits a majority of stockholders to act by written consent; Massachusetts requires unanimous written consent. Compare 8 Del C. §228 with G.L. c. 156B, §43.

Although in my experience, the choice of domicile of a business corporation rarely involves analysis of the fiduciary duties under the law of the state of incorporation, the opportunity for “forum shopping” nonetheless exists. For example, a sure-fire way to avoid the imposition of Donahue duties is to incorporate in Delaware.

B. Choice of Law

1. The “Internal Affairs Doctrine.” Under the traditional “internal affairs” doctrine, the law of the jurisdiction of incorporation is applied with regard to corporate governance issues involving foreign corporations, including fiduciary obligations of their officers, directors and stockholders. See Beacon Wool Corp. v. Johnson, 331 Mass. 274, 279 (1954) and cases cited.

Massachusetts law would apply to the fiduciary duties of officers, directors and stockholders of a Massachusetts corporation, even though some of the transactions complained of had occurred at a time when the corporation was incorporated in Delaware. The court described its choice of law decision as a "functional approach" to applying the law of the state with the most "significant relationship" to the issue. See also In re Cumberland Farms, Inc., 284 F. 3d 216 (1st Cir. 2002) (applying Massachusetts law to the duties of a director of a Delaware corporation doing business in Massachusetts).

Chapter 156B of course applies by its terms only to Massachusetts corporations (G.L. c. 156B, §3). However, the Demoulas case raised questions whether Massachusetts courts might apply to foreign corporations doing business in Massachusetts, its common law doctrines of corporate law, such as those relating to the fiduciary duties of shareholders of close corporations, piercing the corporate veil and successor liability.

3. Harrison v. NetCentric Corp. These questions were answered in Harrison v. NetCentric Corp., 433 Mass. 465 (2001). There, the Supreme Judicial Court emphatically rejected the argument that a "functional approach" should be employed to the choice of law applicable to the internal affairs of a corporation.

"The Demoulas case was an exceptional one, as it concerned a company that had changed its State of incorporation as well as conduct that spanned both periods . . . Nothing in [Demoulas] suggested that we were overruling our long-standing policy of applying the law of the State of incorporation to internal corporate affairs . . . Today, we adhere to and reaffirm our policy that the State of incorporation dictates the choice of law regarding the internal affairs of a corporation . . . including the treatment of alleged breaches of fiduciary duty." 433 Mass. at 471-472.

IV. MASSACHUSETTS PARTNERSHIPS, LIMITED PARTNERSHIPS and LLPs

A. General Partnerships


The fiduciary duties of partners are governed by the provisions of the Massachusetts Uniform Partnership Act, G.L. c. 108A, and by common law principles. Because stockholders of close corporations are subject to the
fiduciary standards applicable to partners under the Donahue case, most of the case law dealing with close corporations is equally applicable to Massachusetts partnerships.

1. Duty of Care. The Uniform Partnership Act does not contain any reference to the duty of care. (Section 4.04(c) of the Revised Uniform Partnership Act [not adopted in Massachusetts] obligates partners to refrain from “engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.”) Surprisingly, there is no common law duty of care on the part of the partners in a partnership under Massachusetts law.

“There is no general principle of partnership which renders one partner liable to his copartners for his honest mistakes. So far as losses result to a firm from errors of judgment of one partner not amounting to fraud, bad faith or reckless disregard of his obligations, they must be borne by the partnership. Each partner owes to the firm the duty of faithful service according to the best of his ability. But, in the absence of special agreement, no partner guarantees his own capacity.” Hurter v. Larrabee, 224 Mass. 218, 220-221 (1916).

The Hurter case has been most recently cited for this proposition in dictum in Shain Inv. Co., Inc. v. Cohen, 15 Mass. App. Ct. 4, 12 n 3 (1982).

2. Duty of Loyalty. Section 21 of the Massachusetts Uniform Partnership Act (G.L. c. 108A, §21) provides that every partner must account to the partnership for any benefit and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use of its property. This duty proscribes all forms of self-dealing, misuse of partnership property, competition with the partnership and pursuit of partnership business opportunities without the consent of all the partners. Bromberg & Ribstein, 2 Bromberg & Ribstein on Partnership, §6.07.

The test to be applied when one partner alleges a violation of the duty of strict faith is whether the alleged violator can demonstrate a “legitimate business purpose” for his action. Starr v. Fordham, 420 Mass. 178, 183-184 (1995); Zimmerman v. Bogoff, 402 Mass. 650, 657 (1988). However, the business judgment rule does not apply in cases of self-dealing. Starr v.

a. Use of Partnership Property. Under §25(2)(a) of the
Massachusetts Uniform Partnership Act (G.L. c. 108A, §25(2)(a)), a partner has
no right to possess partnership property for non-partnership purposes without the
consent of his partners. Section 21(1) requires a partner to account to the
partnership for any profits derived from the use by him of its property.

In Loft v. Lapidus, 936 F. 2d 633 (1st Cir. 1991), the court held that the
defendant partner’s rights under a real estate purchase and sale agreement, and
the proceeds of a monetary settlement of claims for breach of that agreement,
were “partnership property” and his co-partners were entitled to an accounting
for all profits therefrom. See also Holmes v. Darling, 213 Mass. 303 (1913)
(exclusive agency contract in the name of one partner deemed partnership
property); Shelley v. Smith, 271 Mass. 106 (1930) (contingency fee contracts).

b. Self-Dealing Transactions. When a partner has engaged in
self-dealing, that partner has the burden of proving the fairness of his actions
and that his actions did not harm the partnership. Meehan v. Shaughnessey, 404
Mass. 419 (1989). As a fiduciary, a partner must consider his or her partners’
welfare, and refrain from acting for purely private gain. 404 Mass. at 434 and
cases cited.

c. Business Opportunities. Partners also have a fiduciary
obligation, similar to the corporate opportunity doctrine, to refrain from
exploiting partnership business opportunities Wartski v. Bedford, 926 F. 2d at
lease taken by partner).

d. Compensation. A court has the power to determine whether a
partner’s share of the profits is fair and equitable as a matter of law. Noble v.
178 (1995), the court held that where the founding partners of a law firm had the
power to determine another partner’s share of the profits, they were engaged in
self-dealing (“positioned . . .on both sides of the transaction”) because the
percentage of profits assigned to the other partner had a direct impact on their
own share of the profits. 420 Mass. at 183. As such, the business judgment rule
was inapplicable and the compensation decision would be “vigorously
scrutinized.” 420 Mass. at 184. The court affirmed the trial judge’s finding that
the defendant founding partners had acted unfairly in determining the share of
profits assigned to the plaintiff.

3. Duty of Disclosure. Section 20 of the Massachusetts Uniform
Partnership Act (G.L. c. 108A, §20) imposes a statutory duty on partners to
render on demand true and full information of all things affecting the partnership

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to any partner or legal representative of a deceased partner. Section 19 requires that partnership books and records be kept at the partnership’s principal place of business and be available for inspection by partners.

B. Joint Ventures

A “joint venture” is a species of partnership under which the partners agree to engage in a single discrete business venture (such as development of a parcel of real estate), rather than a continuous business enterprise. The parties to a joint venture are subject to the same fiduciary duties as partners. DeCotis v. D’Antona, 350 Mass. 165 (1966); Cardullo v. Landau, 329 Mass. 5, 8 (1952). By definition, joint venturers may engage in other business ventures without obligation to offer such business opportunities to the joint venture. See Bromberg & Ribstein, 2 Bromberg & Ribstein on Partnership, §6.07(d) and cases cited.

C. Limited Partnerships


Section 24 of the Massachusetts Uniform Limited Partnership Act (G.L. c. 109, §24) provides that, except as provided in the Act, a general partner of a limited partnership is subject to the liabilities of a partner in a partnership without limited partners and except as provided in the Act or in the partnership agreement, is subject to the restrictions of a partner in a partnership without limited partners. G.L. c. 109, §62 adds that in any case not provided for in the Uniform Limited Partnership Act, the provisions of the Uniform Partnership Act shall control.

A limited partner may bring a derivative action in the right of the limited partnership to recover a judgment in its favor if the general partners have refused to bring the action or if an effort to bring the action is not likely to succeed. G.L. c. 109, §§56-59.

D. Limited Liability Partnerships
Since an LLP is a species of general partnership which enjoys statutory limitation of liability, the common law and statutory fiduciary standards applicable to partners apply to LLPs as well.

E. Corporate General Partners

General partners are often corporations or other business entities. Some cases have held that individual officers, directors and stockholders of corporate general partners have fiduciary duties to the other partners in the partnership, or are liable for aiding and abetting a breach of fiduciary duty by the corporate general partner. See Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A. 2d 160 (Del. 2002); In re USA Cafes, L.P. Litigation, 600 A. 2d 93 (Del. Ch. 1991); Bromberg & Ribstein, 2 Bromberg & Ribstein on Partnerships, §6.07(a)(8); Peterson and Zirn, Corporate Directors, LLCs and Liability, 12 Bus. Law Today 57 (July/August 2003).


F. Limitation of Fiduciary Duties by Contract

The extent to which the parties to a partnership agreement may waive or limit their fiduciary duties inter se has been the subject of considerable academic debate. See Bromberg & Ribstein, 2 Bromberg & Ribstein on Partnership, §6.07(h) n 122 and 123 (citing authorities).

1. Consent to Specific Transactions. Section 21 of the Massachusetts Uniform Limited Partnership Act (G.L. c. 108A, §21), makes it clear that a partner is liable only for benefits “derived by him without the consent of the other partners.” Accordingly, the partners of a partnership may waive a partner’s fiduciary obligations in respect of particular transactions. Presumably, consent must be unanimous, and in appropriate circumstances may be implied by course of conduct. Bromberg & Ribstein, §6.07(h)(l). The Demoulas standard of disclosure plus either assent by “disinterested” parties or proof of fairness (see Section II B(2) supra), which is applicable to “close corporations,” appears to conflict with the statutory standard of §21, which requires neither consent of “disinterested” partners, nor proof of fairness.

2. Effect of Partnership Agreement. Partnership agreements frequently contain provisions authorizing parties to engage in transactions with the partnership under certain circumstances (for example, “upon terms and
conditions not less favorable than those available from third parties dealing at arm’s length”), or to engage in competition with the partnership or exploit business opportunities without accounting to the partnership.

Since all partners are parties to the partnership agreement, the partnership agreement can be viewed as an expression of consent by all of the partners to such future transactions under G.L. c. 108A, §21.

Numerous courts in other states have enforced partnership agreements modifying partners’ fiduciary duties. Bromberg & Ribstein, §6.07(b)(2). As a matter of policy, partners’ freedom of contract should enable them to agree upon their respective rights and obligations.

“Certainly partnerships are amenable to greater freedom contractually to shape the set of legal relationships that constitute the partnership, than are corporations, and this freedom may include clear contracting with respect to ‘fiduciary duties.’” U.S. West, Inc. v. Time Warner, Inc., 1996 WL 307445 at *22 (Del. Ch., June 6, 1996).

Nonetheless, Massachusetts courts have been hostile to the idea that partnership agreements may limit fiduciary duties. In Starr v. Fordham, 420 Mass. 178 (1995), the provisions of a law firm partnership agreement which empowered the founding partners to determine partner compensation was held to be a self-dealing transaction subject to strict scrutiny to determine fairness. And in Wartski v. Bedford, 926 F. 2d 11 (1st Cir. 1991), a contract providing that the general partners of a limited partnership “shall not be prevented from engaging in other activities for profit . . . whether or not competitive with the business of the partnership” did not negate the general partners’ overriding fiduciary duties or permit them to acquire a related business opportunity.

V. MASSACHUSETTS LIMITED LIABILITY COMPANIES

Massachusetts was one of the last U.S. states to adopt the limited liability form of business organization. The Massachusetts Limited Liability Companies Act, G.L. c. 156C, was enacted in 1995 and took effect on January 1, 1996. St. 1995, §18. Massachusetts case law regarding fiduciary duties of members and managers of LLCs is basically non-existent.

A. Members and Managers are Common Law Fiduciaries

Because of the obvious similarities of members and managers to partners of partnerships and general partners of limited partnerships, it is likely
that the courts will consider them as “fiduciaries” under the broad common law definition of that term. See Section I above. Furthermore, the statutory language of the Act implies that members and managers may have fiduciary duties and liabilities to the LLC or to other members and managers. See G.L. c. 156B, §§8(b), 63(b).

B. Statutory Provisions Respecting Fiduciary Duties

The Massachusetts Limited Liability Companies Act contains several provisions dealing with fiduciary duties of managers and members.

1. Self-Dealing. G.L. c. 156C, §7 expressly authorizes dealings between a member or manager and the LLC. Except as otherwise provided in a written operating agreement, a member or manager may lend money to, borrow money from, act as a surety, guarantor or endorser for, or otherwise transact business with the LLC with the same rights and obligations as a person who is not a member or manager.

2. Good Faith Reliance. G.L. c. 156C, §11 provides (in a manner similar to G.L. c. 156B, §65) that a member or manager of an LLC shall be fully protected in relying in good faith upon information, opinions, reports or statement presented to the LLC by any other managers, members, officers, employees, or committees or by any other person, as to matters believed to be within said person's professional or expert competence and who has been selected with reasonable care by the LLC.

3. Indemnification. G.L. c. 156C, §8(a) empowers an LLC to indemnify any member or manager from and against any and all claims and demands whatsoever. Such indemnification may include advancement of expenses incurred in defending any civil or criminal proceeding, upon an undertaking to repay such advances if the indemnified person shall be adjudicated not to be entitled to indemnification. No indemnification shall be provided as to any matter as to which an indemnified person has been adjudicated in any proceeding not to have acted in good faith in the reasonable belief that his action was in the best interest of the LLC.

4. Exculpation. G.L. c. 156C, §8(b) permits the certificate of organization or written operating agreement to eliminate or limit the personal liability of a manager (but not a member) for breach of any duty to the LLC.

5. Limitation of Fiduciary Duties. G.L. c. 156C, §63(b) provides that to the extent that a member or manager has duties, including fiduciary duties to the LLC or to other members or managers, (a) any such member or manager acting under the operating agreement shall not be liable to the LLC or any other member or manager if he acts in good faith reliance upon any provision of the operating agreement, and (b) the member's or manager's duties
and liabilities may be expanded or restricted by provisions in the operating agreement.

C. May an LLC Eliminate Fiduciary Duties?

The Massachusetts Limited Liability Companies Act makes it clear that fiduciary duties and liabilities may be expanded, restricted or eliminated by provisions in the certificate of organization or operating agreement. These statutory provisions raise interesting questions as to what extent an LLC may restrict or eliminate any fiduciary duties of its members or managers. This is an issue over which much ink has been spilled in academic journals. See Ribstein, *Fiduciary Duty Contracts in Unincorporated Firms*, 54 Wash. & Lee L. Rev. 537 (1997) for a review of the literature.

Section 63(b) of the Massachusetts act is taken nearly verbatim from §18-1101(d) of the Delaware Limited Liability Company Act, 6 Del. C. §18-1101, and is similar to the provisions of §17-1101 of the Delaware Revised Uniform Limited Partnership Act, 6 Del. C. §17-1101.


These decisions prompted the Delaware Supreme Court to comment, in dictum of its own, that the language of the Delaware statute authorizes only that fiduciary duties to be “expanded or restricted,” not eliminated, by the limited partnership agreement. The court expressed the view that the lower courts’ “dictum should not be ignored because it could be misinterpreted in future cases as a covert rule of law.” Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A. 2d 160, 167-168 (Del. 2002).

Similar doubts have been expressed regarding the Delaware Limited Liability Company Act. See Walker v. Resource Development Co., Ltd., L.L.C., 791 A. 2d 799, 817 (Del. Ch. 2000) (“I have no doubt that the legislature

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9 Section 8(b) provides that the certificate or operating agreement may “eliminate or limit” personal liability of a manager for breach of duty to the LLC; Section 63(b) provides that a member’s or manager’s fiduciary duties to the LLC or other members or managers may be “expanded or restricted” by the operating agreement.
never intended this provision to allow the members of an LLC to misappropriate property from another member and avoid returning that property or otherwise compensating the wronged member”).

However, the Delaware Revised Uniform Limited Partnership Act and the Delaware Limited Liability Company Act do not contain a counterpart to G.L. c. 156C, 8(b), which explicitly provides that the certificate of organization or operating agreement may “eliminate or limit” personal liability of a manager for breach of duty to the LLC. This statutory provision appears to permit the elimination of all liability for breach of fiduciary duty by a manager (but not a member) to the LLC (but not to the members). This statutory language leads to a curious result: Because a manager would ordinarily have a fiduciary duty to the members, the elimination of liability for breach of duty to the LLC alone would seem to provide little protection.

VI. NEW MASSACHUSETTS BUSINESS CORPORATION ACT


Chapter 156D (the "Act") supersedes current Chapter 156B, the existing Business Corporation Law of the Commonwealth, and will be applicable to all previously existing and newly organized business corporations. The Act also embodies the foreign corporation law currently set forth in Chapter 181, which statute is repealed upon effectiveness of the Act.

The Act thoroughly revamps current Chapter 156B, blending elements of Delaware's General Corporation Law with portions of the Revised Model Business Corporation Act while preserving certain aspects of Chapter 156B.

Selected provisions of the new Business Corporation Act affecting the statutory and fiduciary duties of officers and directors are set forth in Exhibit F.

VII. ACKNOWLEDGEMENT AND DISCLAIMER

I am grateful for the kind and patient assistance of many of my colleagues at Davis, Malm & D'Agostine, P.C. (some of whom participated in litigating certain of the leading cases discussed herein) for explaining the intricacies of the law of fiduciary duties summarized in this article. Nonetheless, opinions expressed in this article are my own and not necessarily those of the firm.
EXHIBIT A

Definition of “Interested” and “Associate”

1. Definition of “Interested”. The ALI Principles of Corporate Governance (1994) define the term “interested” as follows:

“(a) A director or officer is ‘interested’ in a transaction or conduct if either:

(1) The director or officer, or an associate of the director or officer, is a party to the transaction or conduct;

(2) The director or officer has a business, financial, or familial relationship with a party to the transaction or conduct, and that relationship would reasonably be expected to affect the director’s or officer’s judgment with respect to the transaction or conduct in a manner adverse to the corporation;

(3) The director or officer, an associate of the director or officer, or a person with whom the director or officer has a business, financial, or familial relationship, has a material pecuniary interest in the transaction or conduct (other than usual and customary directors’ fees and benefits) and that interest and (if present) that relationship would reasonably be expected to affect the director’s or officer’s judgment in a manner adverse to the corporation; or

(4) The director or officer is subject to a controlling influence by a party to the transaction or conduct or a person who has a material pecuniary interest in the transaction or conduct, and that controlling influence could reasonably be expected to affect the director’s or officer’s judgment with respect to the transaction or conduct in a manner adverse to the corporation.

(b) A shareholder is interested in a transaction or conduct if either the shareholder or, to the shareholder’s knowledge, an associate of the shareholder is a party to the transaction or conduct, or the shareholder is also an interested director or officer with respect to the same transaction or conduct.

(c) A director is interested in [a derivative] action if:
(1) The director is interested, within the meaning of Subsection (a), in the transaction or conduct that is the subject of the action, or

(2) The director is a defendant in the action, except that the fact a director is named as a defendant does not make the director interested under this section if the complaint against the director:

(A) is based only on the fact that the director approved of or acquiesced in the transaction or conduct that is the subject of the action, and

(B) does not otherwise allege with particularity facts that, if true, raise a significant prospect that the director would be adjudged liable to the corporation or its shareholders.”

American Law Institute, 1 Principles of Corporate Governance: Analysis and Recommendations, § 1.23 (1994) (cross-references omitted).

2. Definition of “Associate”. The Principles of Corporate Governance defines the term “associate” as follows:

“(a) ‘Associate’ means:

(1) (A) The spouse (or a parent or sibling thereof) of a director, senior executive, or shareholder, or a child, grandchild, sibling, or parent (or the spouse of any thereof) of a director, senior executive, or shareholder, or an individual having the same home as a director, senior executive, or shareholder, or a trust or estate of which an individual specified in this Subsection (A) is a substantial beneficiary; or

(B) A trust, estate, incompetent, conservatee, or minor of which a director, senior executive, or shareholder is a fiduciary; or

(2) A person with respect to whom a director, senior executive, or shareholder has a business, financial, or similar relationship that would reasonably be expected to affect the person’s judgment with respect to the transaction or conduct in question in a manner adverse to the corporation.
(b) Notwithstanding § 1.03(a)(2), a business organization is not an associate of a director, senior executive, or shareholder solely because the director, senior executive, or shareholder is a director or principal manager of the business organization. A business organization in which a director, senior executive, or shareholder is the beneficial or record holder of not more than 10 percent of any class of equity interest is not presumed to be an associate of the holder by reason of the holding, unless the value of the interest to the holder would reasonably be expected to affect the holder’s judgment with respect to the transaction in question in a manner adverse to the corporation. A business organization in which a director, senior executive, or shareholder is the beneficial or record holder (other than in a custodial capacity) of more than 10 percent of any class of equity interest is presumed to be an associate of the holder by reason of the holding, unless the value of the interest to the holder would not reasonably be expected to affect the holder’s judgment with respect to the transaction or conduct in question in a manner adverse to the corporation.”

American Law Institute, 1 Principles of Corporate Governance: Analysis and Recommendations, §1.03 (1994) (cross-references omitted).
EXHIBIT B

Specimen Charter Provision Relating to Director Conflicts of Interest

“In the absence of fraud, no contract or other transaction of the Corporation shall be affected or invalidated by the fact that any of the directors of the Corporation are in any way interested in or connected with any other party to such contract or transaction or are themselves parties to such contract or transaction, provided that the interest in any such contract or transaction of any such director shall at the time be fully disclosed or otherwise known to the Board of Directors. Any director of the Corporation may be counted in determining the existence of a quorum at any meeting of the Board of Directors which shall authorize such contract or transaction and may vote and act upon any matter, contract or transaction between the Corporation and any other person without regard to the fact that he is also a stockholder, director or officer of, or has any interest in, such other person with the same force and effect as if he were not such stockholder, director or officer or not so interested. Any contract or other transaction of the Corporation or of the Board of Directors or of any committee thereof which shall be ratified by a majority of the holders of the issued and outstanding stock entitled to vote at any annual meeting or any special meeting called for that purpose shall be as valid and as binding as though ratified by every stockholder of the Corporation; provided, however, that any failure of the stockholders to approve or ratify such contract or other transaction, when and if submitted, shall not be deemed in any way to render the same invalid or deprive the directors and officers of their right to proceed with such contract or other transaction.”
EXHIBIT C

Massachusetts Cases Citing the ALI Principles of Corporate Governance


4. **Harhen v. Brown**, 46 Mass. App. Ct. 793, 801 n 7, 803-808, 810-11, 815 (1999) (cites § 3.02 – “a basic function of the board is to select the principal senior executives and to oversee their performance;” observes that courts can use the Principles to determine the common law applicable to corporations; cites § 4.01(c), comment c – the business judgment rule only protects business judgments; §4.01(a) – a director or officer violates duty of good faith if he knowingly causes corporation to disobey the law; § 7.04 – if specific reasons for rejecting demand are given, must allege that complaint reasons are incorrect or legally insufficient; §7.10 – description of events which make the business judgment rule applicable to board or committee decisions to terminate derivative actions; § 7.05 – board’s authority to delegate certain decisions; § 7.03 – need for demand on stockholders in derivative action is eliminated).

5. **Demouls v. Demouls Super Markets, Inc.**, 424 Mass. 501, 523, 528, n 33, 530 n 35, 531 (1997) (cites § 1.23 for definition of “interested” directors; §§ 5.02 and 5.05 comparing standards of review of self-dealing or corporate opportunity; §§ 1.27 and 1.33 for definition of “senior executive;” § 5.05 relating to obligations of interlocking boards of directors; § 5.02(2)(a) for method of determining fairness).


8. BNE Massachusetts Corp. v. Sims, 32 Mass. App. Ct. 190, 197, 201 n 18 (1992) (cites §7.22 for proposition that the going concern value of the “company as a whole” is the standard for determining value of shares in a merger appraisal rights proceeding, and that the price accepted by the board in the merger should be presumed to be the fair value of the corporation).


12. Houle v. Low, 407 Mass. 810, 819-20, 823-825 (1990) (states the ALI position on the use of special litigation committees; declines to adopt “a per se rule that special litigation committees should have more than one director,” unlike the ALI standard which requires two or more; instructs courts to consider the factors in § 7.08 when deciding whether a special litigation committee’s decision is reasonable and principled).

13. Dynan v. Fritz, 400 Mass. 230, 241, 243 (1987) (cites § 5.02 for standard that an interested director has the “burden of proving that [a self-dealing transaction] was made in good faith and was fair to the corporation” and that good faith requires full disclosure).
EXHIBIT D

Specimen Charter Provision Relating to Indemnification

“The Corporation shall, to the extent legally permissible, indemnify each person (and his heirs, executors, administrators, or other legal representatives) who is, or shall have been, a director or officer of the Corporation or any person who is serving, or shall have served, at the request of the Corporation as a director or officer of another corporation, against all liabilities and expenses (including judgments, fines, penalties and attorneys’ fees and all amounts paid in compromise or settlement) reasonably incurred by any such director, officer or person in connection with, or arising out of, any action, suit or proceeding in which any such director, officer or person may be a party defendant or with which he may be threatened or otherwise involved, directly or indirectly, by reason of his being or having been a director or officer of the Corporation or such other corporation, except in relation to matters as to which any such director, officer or person shall be finally adjudged, other than by consent, in such action, suit or proceeding not to have acted in good faith in the reasonable belief that his action was in the best interests of the Corporation; provided, however, that indemnity shall not be made with respect to such amounts paid in compromise or settlement, unless:

(a) such compromise or settlement shall have been approved as in the best interests of the Corporation, after notice that it involves such indemnification by:

(i) the Board of Directors by a majority of a quorum consisting of directors who were not parties to such action, suit or proceeding, or by

(ii) the stockholders of the Corporation by a majority vote of a quorum consisting of stockholders who were not parties to such action, suit or proceeding, or

(b) in the absence of action by disinterested directors or stockholders as above provided, there has been obtained at the request of a majority of the Board of Directors then in office a written opinion of independent legal counsel to the effect that the director or officer to be indemnified appears to have acted in good faith in the reasonable belief that his action was in the best interests of the Corporation.

Upon request therefore by any director, officer, or person enumerated in the preceding paragraph of this Article, the Corporation may from time to time, if authorized by the Board of Directors, prior to final adjudication or
compromise or settlement of the matter or matters as to which indemnification is claimed, advance to such director, officer or person all expenses incurred by him to date of such request. Any advance made pursuant to this provision shall be made on the condition that the director, officer or person receiving such advance shall repay to the Corporation any amounts so advanced if, upon the termination of the matter or matters as to which such advances were made, such director, officer or person shall not be entitled to indemnification under the preceding paragraph of this Article.

The foregoing right to indemnification shall not be exclusive of any other rights to which any such director, officer or person is entitled under any agreement, vote of stockholders, statute, or as a matter of law, or otherwise.

The provisions of this Article are separable, and if any provision or portion hereof shall for any reason be held inapplicable, illegal or ineffective, this shall not prevent any other provision or portion hereof from applying, and shall not affect any right of indemnification existing otherwise than under this Article."
EXHIBIT E

Specimen Exculpatory Charter Provisions Under G.L. c.156B, §13(b) (1 ½)

“No director shall be personally liable to the Corporation or its stockholders for monetary damages for any breach of fiduciary duty by such director as a director, except (to the extent provided by applicable law) for liability (i) for breach of the director’s duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 61 or 62 of Massachusetts General Laws Chapter 156B, or any amendatory or successor provisions thereto, or (iv) for any transaction from which the director derived an improper personal benefit.

No amendment to or repeal of the provisions of this paragraph shall apply to or have any effect on the liability or alleged liability of any director of the Corporation for or with respect to any act or failure to act of such director occurring prior to such amendment or repeal.”
EXHIBIT F

Selected Provisions of the New Massachusetts Business Corporation Act


Chapter 156D (the "Act") supersedes current Chapter 156B, the existing Business Corporation Law of the Commonwealth, and will be applicable to all previously existing and newly organized business corporations. The Act also embodies the foreign corporation law currently set forth in Chapter 181, which statute is repealed upon effectiveness of the Act.

The Act thoroughly revamps current Chapter 156B, blending elements of Delaware's General Corporation Law with portions of the Revised Model Business Corporation Act while preserving certain aspects of Chapter 156B.

Selected provisions of the new Business Corporation Act affecting the statutory and fiduciary duties of officers and directors are set forth below:

1. Liability for Improper Dividends and Distributions

   “Section 6.40. DISTRIBUTIONS TO SHAREHOLDERS [Compare G.L. c. 156B, §61].

   (a) A board of directors may authorize and the corporation may make distributions to its shareholders subject to restriction by the articles of organization and the limitations in subsections (c) and (h).

   (b) If the board of directors does not fix the record date for determining shareholders entitled to a distribution, other than one involving a purchase, redemption or other acquisition of the corporation's shares, it is the date the board of directors authorizes the distribution.

   (c) No distribution may be made by a corporation which is a going concern if, after giving it effect,

   (1) the corporation would not be able to pay its existing and reasonably foreseeable debts, liabilities and obligations, whether or not liquidated, matured, asserted or contingent, as they become due in the usual course of business; or

   (2) the corporation's total assets would be less than the sum of its total liabilities plus, unless the articles or organization permit otherwise, the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon
dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

(d) The board of directors may base a determination that a distribution is not prohibited under subsection (c) either on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances or on a fair valuation or other method that is reasonable in the circumstances.

(e) Except as provided in subsection (g), the effect of a distribution made in accordance with subsection (c) is measured:

   (1) in the case of distribution by purchase, redemption, or other acquisition of the corporation’s shares, as of the earlier of (i) the date money or other property is transferred or debt incurred by the corporation, or (ii) the date the shareholder ceases to be a shareholder with respect to the acquired shares;

   (2) in the case of any other distribution of indebtedness, as of the date the indebtedness is distributed; and

   (3) in all other cases, as of (i) the date the distribution is authorized if the payment occurs within 120 days after the date of authorization or (ii) the date the payment is made if it occurs more than 120 days after the date of authorization.

(f) A corporation’s indebtedness to a shareholder incurred by reason of a distribution made in accordance with subsection (c) is at parity with the corporation’s indebtedness to its general, unsecured creditors except to the extent subordinated by agreement.

(g) Indebtedness of a corporation, including indebtedness issued as a distribution, is not considered a liability for purposes of determinations under subsection (c) if its terms provide that payment of principal and interest are made only if and to the extent that payment of a distribution to shareholders could than [sic] be made under this section. If the indebtedness is issued as a distribution, each payment of principal or interest is treated as a distribution, the effect of which is measured on the date the payment is actually made.

(h) No distribution in liquidation may be made by a corporation unless adequate provision has been made, after giving effect to the provisions of PART 14, to satisfy:

   (1) the corporation’s existing and reasonably foreseeable debts, liabilities and obligations, whether or not liquidated, matured, asserted or contingent, as they thereafter arise; and
the preferential liquidation rights of shares whose preferential rights are superior to such rights of the shares which would receive the distribution.

A distribution in liquidation means a distribution made by a corporation in dissolution under PART 14, or a distribution, or 1 of a series of related distributions, of all or substantially all of the corporation’s assets.

Section 6.41. LIABILITY FOR IMPROPER DISTRIBUTIONS

(a) A director who votes for or assents to a distribution, including a distribution in liquidation as described in subsection (h) of section 6.40, made in violation of this chapter or the articles of organization, is personally liable to the corporation for the amount of the distribution that exceeds what could have been distributed without violating this chapter or the articles of organization, if it is established that he did not perform his duties in compliance with section 8.30. In any proceeding under this section, a director has all of the defenses ordinarily available to a director.

(b) A director who pays the corporation on account of liability for an improper distribution under subsection (a) is entitled to:

(1) contribution from every other director who could be held liable under subsection (a) for the distribution;

(2) reimbursement from each shareholder who received the distribution knowing it was improper, for the amount that exceeded what could properly have been distributed to him; and

(3) reimbursement from each shareholder who received the distribution without knowing it was improper, to the extent determined appropriate in the circumstances by a court.

(c) Each shareholder who receives a distribution, including one in liquidation, knowing it was made in violation of this chapter or the articles of organization, shall be personally liable to the corporation for the amount of the distribution he received in excess of what could have been distributed to him without violating this chapter or the articles of organization.

(d) If a distribution in liquidation in violation of this chapter is made before 3 years after the effective date of the corporation’s dissolution under PART 14, shareholders who receive the distribution without knowing it is improper are personally liable to the corporation on account of any claim against the corporation existing at the end of the 3-year period, to the extent of each shareholder’s respective pro rata share of the claim, with pro rata [sic] to be
determined by reference to the respective amounts distributed to shareholders in excess of what could properly have been distributed to them.

(e) Any shareholder’s total liability for all claims under this section on account of distributions in liquidation may not exceed the total amount of assets distributed to the shareholder in liquidation.

(f) A proceeding by or on behalf of the corporation under this section is barred unless it is commenced by:

(1) in the case of a distribution not in liquidation, 2 years after the date on which the effect of the challenged distribution was measured under subsection (e) or (g) of section 6.40;

(2) in the case of a distribution in liquidation by a corporation in dissolution under PART 14, the later of the time specified in the preceding clause (1) and 6 months after the end of the two-year period referred to in subsection (d); or

(3) in the case of a distribution in liquidation by a corporation not in dissolution, as described in the second clause in the last sentence of subsection (h) of section 6.40, three years after the date on which the effect of the challenged distribution was measured under subsection (e) or (g) of section 6.40.

(g) A proceeding under subsection (b) against a director for contribution or against a shareholder for reimbursement is barred unless it is commenced by the later of (1) two years after the date on which the effect of the challenged distribution was measured under subsection (e) or (g) of section 6.40, and (2) 6 months after payment to the corporation on account of liability under subsection (a) of this section by the party seeking contribution or reimbursement.”

2. Standard of Care for Directors and Officers.

“STANDARDS OF CONDUCT

Section 8.30. GENERAL STANDARDS FOR DIRECTORS [Compare G.L. c. 156B, §65]

(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

(1) in good faith;
(2) with the care that a person in a like position would reasonably believe appropriate under similar circumstances; and

(3) in a manner the director reasonably believes to be in the best interests of the corporation. In determining what the director reasonably believes to be in the best interests of the corporation, a director may consider the interests of the corporation’s employees, suppliers, creditors and customers, the economy of the state, the region and the nation, community and societal considerations, and the long-term and short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.

(b) In discharging his duties, a director who does not have knowledge that makes reliance unwarranted is entitled to rely on information, opinions, or statements, including financial statements and other financial data, if prepared or presented by:

(1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent with respect to the information, opinions, reports or statements presented;

(2) legal counsel, public accountants, or other persons retained by the corporation, as to matters involving skills or expertise the director reasonably believes are matters (i) within the particular person’s professional or expert competence or (ii) as to which the particular person merits confidence; or

(3) a committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

(c) A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.

* * *

“Section 8.42. STANDARDS OF CONDUCT FOR OFFICERS
[Compare G.L. c.156B, §65]”

(a) An officer shall discharge his duties:

(1) in good faith;

(2) with the care that a person in a like position would reasonably exercise under similar circumstances; and
(3) in a manner the officer reasonably believes to be in the best interests of the corporation.

(b) In discharging his duties an officer, who does not have knowledge that makes reliance unwarranted, is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

(1) one or more officers or employees of the corporation whom the officer reasonably believes to be reliable and competent with respect to the information, opinions, reports or statements presented; or

(2) legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the officer reasonably believes are matters (i) within the particular person’s professional or expert competence or (ii) as to which the particular person merits confidence.

(c) an officer shall not be liable to the corporation or its shareholders for any decision to take or not to take any action taken, or any failure to take any action, as an officer, if the duties of the officer are performed in compliance with this section.”


(a) A conflict of interest transaction is a transaction with the corporation in which a director of the corporation has a material direct or indirect interest. A conflict of interest transaction is not voidable by the corporation solely because of the director’s interest in the transaction if any one of the following is true:

(1) the material facts of the transaction and the director’s interest were disclosed or known to the board of directors or a committee of the board of directors or committee authorized, approved, or ratified the transaction;

(2) the material facts of the transaction and the director’s interest were disclosed or known to the shareholders entitled to vote and they authorized, approved, or ratified the transaction; or

(3) the transaction was fair to the corporation.
(b) For purposes of this section, and without limiting the interests that may create conflict of interest transactions, a director of the corporation has an indirect interest in a transaction if: (1) another entity in which he has a material financial interest or in which he is a general partner is a party to the transaction; or (2) another entity of which he is a director, officer, or trustee or in which he holds another position is a party to the transaction and the transaction is or should be considered by the board of directors of the corporation.

(c) For purposes of clause (1) of subsection (a), a conflict of interest transaction is authorized, approved, or ratified if it receives the affirmative vote of a majority of the directors on the board of directors (or on the committee) who have no direct or indirect interest in the transaction, but a transaction may not be authorized, approved, or ratified under this section by a single director. If a majority of the directors who have no direct or indirect interest in the transaction vote to authorize, approve, or ratify the transaction, a quorum is present for the purpose of taking action under this section. The presence of, or vote cast by, a director with a direct or indirect interest in the transaction does not affect the validity of any action taken under clause (1) of subsection (a) if the transaction is otherwise authorized, approved, or ratified as provided in that subsection.

(d) For purposes of clause (2) of subsection (a), a conflict of interest transaction is authorized, approved, or ratified if it receives the vote of a majority of the shares entitled to be counted under this subsection. Shares owned by or voted under the control of a director who has a direct or indirect interest in the transaction, and shares owned by or voted under the control of an entity described in clause (1) of subsection (b), may not be counted in a vote of shareholders to determine whether to authorize, approve, or ratify a conflict of interest transaction under clause (2) of subsection (a). The vote of those shares, however, is counted in determining whether the transaction is approved under other sections of this chapter. A majority of the shares, whether or not present, that are entitled to be counted in a vote on the transaction under this subsection constitutes a quorum for the purpose of taking action under this section.

4. Loans to Insiders.

“Section 8.32. LOANS TO DIRECTORS [Compare G.L. c.156B, §62]

(a) Except as provided by subsection (c), a corporation may not lend money to, or guarantee the obligation of a director of the corporation unless:

(1) the specific loan or guarantee is approved by a majority of the votes represented by the outstanding voting shares of all classes,
voting a single voting group, except the votes of shares owned by or voted under the control of the benefited director; or

(2) the corporation’s board of directors determines that the loan or guarantee benefits the corporation and either approves the specific loan or guarantee or a general plan authorizing loans and guarantees.

(b) The fact that a loan or guarantee is made in violation of this section shall not affect the borrower’s liability on the loan.

(c) This section shall not apply to loans and guarantees authorized by statute regulating any special class of corporations.”