CHAPTER 8
Fiduciary Duties of Officers, Directors, and Business Owners

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This chapter 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.

Section 8.1 describes the nature of the fiduciary relationship in general, with a focus on the necessity for providing practical advice to business clients. Sections 8.2 through 8.7 relate to Massachusetts business corporations. Section 8.2 introduces the subject of the fiduciary obligations of officers, directors and agents of Massachusetts business corporation, directors and stockholders of Massachusetts business corporations. Section 8.3 deals with the common law duty of care and related statutory standards. Section 8.4 discusses the related Business Judgment Rule in effect in Massachusetts. Section 8.5 outlines the duty of loyalty and the Demoulas doctrine and its various applications to corporate fiduciaries, as well as related statutory provisions dealing with director conflicts of interest. Section 8.6 describes the various statutory defenses and limitations of fiduciary liability available to Massachusetts business corporations, as well as the common law doctrine of ratification. Section 8.7 discusses the Massachusetts law of “close corporations” established by the Donahue case and its progeny. Section 8.8 deals briefly with the choice of law issues applicable to the fiduciary duties of foreign corporations doing business in Massachusetts. Section 8.9 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. Section 8.10 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.

§8.1 THE NATURE OF THE FIDUCIARY RELATIONSHIP

§8.1.1 Who Is A Fiduciary?

It is important to remember that officers, directors, and owners of business organizations are only a small subset of the universe 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. See 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 See Doe v. Harbor Schools, Inc., 446 Mass. 245, 252-253 (2006), containing an excellent discussion of the nature of the fiduciary relationship, which arises “when one reposes faith, confidence and trust in another’s judgment and advice.”

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).


§8.1.2 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 Corporate Structure, 25 UCLA L. Rev. 738 (1978) (footnotes omitted).

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. 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).

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 all of the duties of the fiduciary. 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.” Anderson, Conflicts of Interest: Efficiency, Fairness and Corporate Structure, 25 UCLA L. Rev. 738 (1978).


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 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.

§8.1.3 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. 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.” See JRY Corp. v. LeRoux, 18 Mass. App. Ct. 153, 166 (1984) (quoting from Meinhard).

Moreover, 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 my 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 appropriate procedural steps to avoid challenges to otherwise legitimate transactions.

§8.2 MASSACHUSETTS CORPORATIONS

§8.2.1 Corporate Fiduciaries

(a) 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 caselaw as having the same fiduciary duties as directors, even though their role within the corporation is quite different.


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”); Coggins 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).

(c) Key Employees. “Employees occupying a position of trust and confidence owe a duty of loyalty to their employer and must protect the interests of the employer.” Chelsea Industries, Inc. v. Gaffney, 389 Mass. 1, 11 (1983) (citations omitted).

(d) 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).

§8.2.2 Common Law Fiduciary Duties of Directors and Officers

The Massachusetts law of fiduciary duties of corporate officers, directors and employees is predominantly judge-made. 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.

§8.2.3 Fiduciary Duties under the Business Corporation Statutes

Chapter 156B, the Massachusetts Business Corporation Law (“BCL”), originally enacted in 1964, contained a statutory standard for the duty of care. G.L. c. 156B, §65. The BCL has been replaced by Chapter 156D, the new Massachusetts Business Corporation Act (the “Act”), a statute based on the 1984 version of the ABA Revised Model Business Corporation Act (“RMBCA”).

The new statute was signed into law on November 26, 2003 (St. 2003, c. 127) and became effective July 1, 2004. It is applicable to all business corporations subject to Chapter 156B and foreign corporations subject to Chapter 181. It applies to professional corporations (c. 156A), but does not apply to non-profit corporations (c. 180) or special classes of corporations such as banks, utilities and insurance companies. See §17.1 of the Act. The Act, like its predecessor, contains very few provisions articulating or regulating the duty of care or the duty of loyalty.

The principal provisions of the Act dealing with fiduciary duties are §§8.30 (General Standards for Directors), §§8.31 (Director Conflict of Interest), and §§8.42 (Standards of Conduct for Officers). Sections 8.30 and 8.42 are similar to the BCL in that they impose standards for the duty of care of corporate directors and officers. Section 8.31, which has no counterpart in the BCL, provides a statutory “safe harbor” for the validity of transactions involving director conflicts of interest.

The Act also contains most of the defenses and limitations of liability contained in the BCL, including the defense of good faith and reasonability (§§8.30(c) and 8.42(c)), consideration of non-stockholder constituencies (§8.30(a)(3)), reliance on reports, experts and committees (§§8.30(b) and 8.42(b)), exculpatory charter provisions (§2.02(b)(4)), contribution (§6.41), indemnification (§§8.50-8.59) and insurance (§8.57).
The Act makes no change in the common law of Massachusetts relating to fiduciary duties among shareholders of “close corporations.” The Comments to the Act make it clear that Donahue v. Rodd Electrotype Co., 367 Mass. 578 (1975) and its progeny remain unchanged by the Act. See Comment to §6.22. See also Section 9.7, supra.

§8.3 DUTY OF CARE

§8.3.1 General Standard of Care

Under §8.30(a) of the Act, a director shall discharge his duties

“(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 [he] reasonably believes to be in the best interests of the corporation . . . ”

Section 8.42(a) provides a similar standard for officers.

§8.3.2 “Ordinarily Prudent Person” Standard Eliminated

Under the BCL, an officer or director was required to act “with such care as an ordinarily prudent person in a like position would use under similar circumstances.” Under the Act, this standard of care is that which “a person in a like position would reasonably believe appropriate under similar circumstances.” The elimination of the phrase “ordinarily prudent person” as a guideline for director conduct in the RMBCA was meant to avoid suggesting the need for “caution or circumspection vis-à-vis danger or risk,” since risk-taking decisions are central to the role of directors in the business world. See Official Comment to §8.30, 53 Bus. L. 157 (1997).

This difference in language is also intended to emphasize that a director or officer is not to be held to “some undefined degree of expertise” in business, but rather is to be judged on the “basic director attributes of common sense, practical wisdom and informed judgment.” Comment No. 1 to §8.30(a).

Comment No. 1 to §8.30(a) elaborates on the language selected in the new Act:

“(1) The reference to reasonable care embodies long traditions of the common law, in contrast to suggested standards that might call for some undefined degree of expertise, like ‘ordinarily prudent businessman.’ The phrase recognized the
need for innovation, essential to profit orientation, and focuses on the basic director attributes of common sense, practical wisdom, and informed judgment.

(2) The phrase ‘in a like position’ recognizes that the ‘care’ under consideration is that which is reasonably believed to be appropriate by a director of the particular corporation.

(3) The combined phrase ‘in a like position . . . under similar circumstances’ is intended to recognize that (a) the nature and extent of responsibilities will vary, depending upon such factors as the size, complexity, urgency, and location of activities carried on by the particular corporation, (b) decisions must be made on the basis of the information known to the directors without the benefit of hindsight, and (c) the special background, qualification, and management responsibilities of a particular director may be relevant in evaluating his compliance with the standard of care. Even though the quoted phrase takes into account the special background, qualifications and management responsibilities of a particular director, it does not excuse a director lacking business experience or particular expertise from exercising the common sense, practical wisdom, and informed judgment of a reasonably careful person.

The process by which a director informs himself will vary but the duty of care requires every director to take steps to become informed about the background facts and circumstances before taking action on the matter at hand. . . . Furthermore, a director should not be expected to anticipate the problems which the corporation may face except in those circumstances where something has occurred to make it obvious to the director that the corporation should be addressing a particular problem.”

8.3.3 **Subjective Standards**

The standard of care under §8.30 is therefore a *subjective* one: Each director’s conduct will be evaluated based upon the unique combination of expertise, experience and qualifications -- or the lack thereof-- which he brings to the boardroom. No minimum level of expertise is required, so long as a
“director lacking business experience or particular expertise” does his best to exercise “common sense, practical wisdom, and informed judgment of a reasonably careful person.” The standard “focuses on the attentiveness the director brings to bear when discharging his duties.” Comment No. 1 to §8.30.

The hypothetical case illustrating this point of law is that of the widow of a large stockholder who succeeds to her late spouse’s position on the board, possessing absolutely no experience or training in business matters. Under the standard of §8.30, the director must act diligently to inform herself of the facts relevant to matters before the board (including reliance upon information, opinions and reports of others under §8.30(b)), and must use her common sense judgment in reaching a decision. In contrast, a director who is, say, the CEO of the corporation, or a certified public accountant or other professional, will be held to a higher standard commensurate with his or her greater skills and experience.

It is worth noting that even though the standard of care is nominally an individual responsibility, a board of directors commonly discharges its duties as a collegial body. Thus, deficient performance by one director may be overcome by acceptable conduct on the part of the others. See Official Comment to §8.30, 53 Bus. L. at 161. Furthermore, the process of collegial decision-making will often serve to educate and inform those directors unfamiliar with the subject matter.

§8.3.4 “Best Interests” of the Corporation

Section 8.30(a)(3) requires that a director discharge his duties in a manner he “reasonably believes to be in the best interests of the corporation.” The phrase “reasonably believes” is “both subjective and objective in character.” The term “belief” focuses on what the particular director, acting in good faith, actually believes, not what a hypothetical reasonable director would objectively determine. However, even though a director has “wide discretion in marshalling the evidence and reaching conclusions,” this belief must be “reasonable” when judged by an objective standard. Official Comment to §8.30, 53 Bus. L. at 163.

§8.3.5 Hindsight Not Relevant

The introductory Comment to §8.30 makes it clear that compliance with the standard of care is a matter of process, not a matter of the wisdom or correctness of the decision.

“In determining whether to impose liability, the courts recognize that directors and corporate managers continuously make decisions that involve the balance of risks and benefits for the enterprise. Although some decisions turn out to be unwise or the result of mistake of judgment, it is unreasonable
to reexamine these decisions with the benefit of hindsight. Therefore, a director is not liable for injury or damage caused by his decision, no matter how unwise or mistaken it may out to be, if in performing his duties he met the requirements of §8.30.” Comment to §8.30.

§8.3.6 “Other Constituencies”

Unlike its counterpart in the RMBCA, §8.30(a)(3) permits directors to consider not only the interests of the corporation, but also “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.”

This language is taken from §65 of the BCL. However, unlike the BCL, under the Act only directors -- and not officers -- may take these “other constituencies” into account. Compare §8.30(a)(3) and §8.42(a)(3) of the Act. See Section 8.6(b) infra.

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).

§8.3.7 Liability for Breach of the Duty of Care

(a) The Road Not Taken. Section 8.31 of the RMBCA (Standards of Liability for Directors) provides rules for establishing liability which are different from the standard of care under §8.30. Under §8.31 of the RMBCA, a director shall not be liable for any action or inaction unless the challenged conduct was (i) not in good faith, or (ii) a decision (A) which the director did not reasonably believe to be in the best interests of the corporation; or (B) about which he was not appropriately informed, or (iii) affected by a lack of objectivity due to a familial, financial or business relationship or a lack of independence, or (iv) a sustained failure to oversee the business and affairs of the corporation, or (v) receipt of a financial benefit to which he was not entitled. Section 8.30(c) of the Act adopts a different rule.

(b) Compliance with §8.30 a Complete Defense. Section 65 of the BCL provides that compliance by a director or officer with the standards of care imposed by that section shall be a “complete defense” to any claim asserted
against him by reason of his being or having been a director or officer, except as expressly permitted by statute.

Section 8.30(c) and 8.42(c) of the Act adopt a similar rule. The difference in language between §8.30(c) and §65 (elimination of the words “complete defense” and “except as expressly provided by statute”) are not significant. Comment No. 3 to §8.30.

According to Comment No. 3 to §8.30,

“Section 8.30(c) is self-executing, and the individual director’s exoneration from liability is automatic. If compliance with the standard of conduct set forth in §8.30 is established, there is no need to consider possible application of the business judgment rule.”

The combination of §8.30(c), the Business Judgment Rule (see Section 8.4 infra) and the exculpatory charter provisions permitted by G.L. c. 156D, §2.02(b)(4) (see Section 8.6(f) infra) makes it difficult for a plaintiff to win a duty of care case in the absence of egregious conduct.

§8.4 THE BUSINESS JUDGMENT RULE

§8.4.1 Caselaw Prior to Harhen v. Brown


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.
§8.4.2 *Harhen v. Brown*


In the *Harhen* case, 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.

The supreme judicial court unequivocally affirmed the business judgment rule of *S. Solomont & Sons Trust*, *supra* 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). *Harhen*, 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). Subsequent cases have established that the business judgment rule applies to business corporations.
§8.4.3 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 caselaw. 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. Levien*, 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).

The Act does nothing to change the developing business judgment rule in Massachusetts. The introductory Comment to §8.30 states:

“The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts. In view of that continuing judicial development, §8.30 does not try to codify the business judgment rule or to delineate the differences, if any, between that rule and the standards of director conduct set forth in this section. That is a task left to the courts.”

Comment No. 1 to §8.30 states that “[t]he business judgment rule still exists to protect a director against liability arising from second-guessing by the courts.”

§8.5 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

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).


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.

§8.5.1 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. 424 Mass. at 505.

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%. See Demoulas v. Demoulas, 428 Mass. 555 (1998).

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 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 and numbering 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.

§8.5.2 Self-Dealing Transactions

(a) 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).

Self-dealing also arises in transactions between corporations with interlocking boards of directors. See Spiegel v. Beacon Participations, Inc., 297 Mass. 398 (1937); Johnson v. Witkowski, 30 Mass. App. Ct. 697 (1991); 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.

(b) Corporate Power to Engage in Self-Dealing Transactions

Section 8.31 of the new Massachusetts Business Corporation Act contains provisions regarding corporate approval of conflict of interest transactions in which directors are involved. These provisions overlap with, but do not displace, the Demoulas requirements. See Section 8.5.6(g), infra. Moreover, 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).

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. v. Nidal-Ginard, 73 F. 3d 429, 434 n. 4 (1st Cir.1996).

(c) 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.

few month before the Demoulas 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
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. Demoulas 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.

(d)  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.”
Demoulas, 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 American
Law Institute, Principles of Corporate Governance, §5.02.

§8.5.3  Corporate Opportunities

(a)  Definition

A corporate opportunity has been defined in the Demoulas 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).

The outer edge of this doctrine is not clearly delineated. In Hanover Insurance the “business activity” that was held to be within the scope of the corporate opportunity doctrine was the acquisition of a Connecticut-based insurance company by the defendant-fiduciary, who was an officer of a Worcester-based insurance brokerage company. Hanover Insurance Co. v. Sutton, 46 Mass. App. Ct. 153 (1999). This would seem to be comfortably within the scope of the framework established in Demoulas, which likewise involved investments in a business within the same industry as the existing corporation, i.e., groceries, but in a new geographic setting. Demoulas v. Demoulas Super Markets, Inc., 424 Mass. 501 (1997). Further from the center lies In re Cumberland Farms, wherein the business activity was the repayment by a corporation controlled by the fiduciary of a bank loan guaranteed by the fiduciary, rather than paying outstanding debt owed by the controlled corporation to Cumberland Farms of the fiduciary. In re Cumberland Farms, Inc., 284 F.3d 216, 228-229 (1st Cir. 2002) (“[T]he decision as to how to use that money was not his to make .... [it was] an ‘opportunity’ that rightfully belonged to [the company].”). See also In re Access Cardiosystems, Inc., 404 B.R. 593, 692 (Bkrtcy. D.Mass. 2009). The sale of a company’s own real estate is a corporate opportunity. Pointer v. Castellani, 455 Mass. 537, 557 (2009) (holding “[t]here is no question that the sale of [an LLC’s] parcel was a corporate opportunity”).

A recent superior court decision holds that one’s employment with a corporation, on the other hand, is not a corporate opportunity. National Economic Research Associates, Inc. v. Evans, 2008 WL 4352600 *12 (Mass. Super. Sept. 10, 2008) (Gants, J.) (“If one’s own employment were to be considered a corporate opportunity, then no officer of a corporation would be free to leave his employment unless he first offered ‘the opportunity’ of his services to his current employer and his employer rejected the opportunity.”).

(b) 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 explicitly 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 paramount obligations of the fiduciary.” 424 Mass. at 529.

(c) 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.

(d) 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).

(e) **Duty of Disclosure**

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 8.4 supra.

(f) **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 American Law Institute, *Principles of Corporate Governance*, §5.02.

§8.5.4 **Competing with the Corporation**

(a) **The General Rule.**

Officers, directors and key employees may not actively compete with the corporation during their employment. *Chelsea Industries, Inc. v. Gaffney*, 389 Mass. 1 (1983); *Lincoln Stores, Inc. v. 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 with it. In *Augat, Inc. v. Aegis, Inc.*, 409 Mass. 165, 172 (1991), the 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).


(b) 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 also 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).


(c) 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, disgorgement or constructive trust may also be granted in appropriate cases. Demoulas, 424 Mass. at 556, 558-559; Fidelity Management &

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.

(d) “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 discussion of these issues.

§8.5.5 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. Andreson, 254 Mass. 536, 539-540 (1926); Black v. Parker Mfg. Co., 329 Mass.
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 “vigorous 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.

In Charlette v. Charlette Bros. Foundry, Inc., 59 Mass. App. Ct. 34 (2003), the appeals court held that “[s]etting one’s own level of compensation, without corporate approval, is a form of self-dealing” which will be “subjected to close scrutiny by the court.” In that case, the corporate president set his own salary without disclosure to or approval of the other directors and stockholders. Under those circumstances, the court held that the burden of proof was on the president to prove that his actions were “intrinsically fair, and did not result in harm to the corporation,” citing Demoulas. The court, examining the evidence, found that the president’s salary was “well within the range of reasonable
compensation,” and that the president had sustained his burden of proof of “intrinsic fairness.” Significantly, the appeals court did not find that the failure to disclose was itself a fiduciary breach which may not be excused by proof of fairness.

§8.5.6 Statutory Provisions Affecting the Duty of Loyalty

(a) Section 8.31 and the Automatic Rule of Voidability

Section 8.31 of the Act provides, in general terms, that no “conflict of interest transaction” with the corporation in which a director has a “material direct or indirect interest” is voidable by the corporation solely because of the director’s interest in the transaction, if (i) the material facts are disclosed to and approved by a majority of the disinterested directors or shareholders, or (ii) the transaction was fair to the corporation.

Section 8.31 has a very limited effect. Its purpose is only to “reject . . . the common law view that all conflict of interest transactions entered into by directors are automatically voidable at the option of the corporation without regard to the fairness of the transaction or the manner in which the transaction was approved by the corporation.” See Comment No. 1 to §8.31. Since Massachusetts courts have never explicitly adopted this common law rule of voidability (see Perry v. Perry, 339 Mass. 470 (1959); Spiegel v. Beacon Participations, Inc., 297 Mass. 398 (1937)), §8.31 operates to clarify the Massachusetts common law in this respect.

A similar statute is in effect in all U.S. states other than South Dakota (see J. Cox and T. Hazen, Cox & Hazen on Corporations §10.14 (2d ed. 2003)). Cases in most other jurisdictions hold that the statute only provides limited immunity: It shields the transaction from attack solely on the grounds that it is ipso facto voidable by the corporation merely because it involves a conflict of interest. Under these cases, even if disinterested director or shareholder approval is obtained, a shareholder may still challenge the transaction as unfair to the corporation, although in that case the shareholder, not the director, will have the burden of proof on this issue. See Remillard Brick Co. v. Remillard-Dandini Co., 109 Cal. App. 2d 405, 241 P.2d 86 (1952); Fliegler v. Lawrence, 361 A. 2d 218 (Del. 1976). Section 8.31 of the Act differs from these cases in that disinterested director or shareholder approval protects the transaction from application of the automatic voidability rule without regard to its fairness. However, a director who engages in a transaction with the corporation that is not voidable because one or more of the tests of §8.31 have been met is not thereby automatically protected against a claim of self-dealing or usurping a corporate opportunity. See Section 8.5.6(b) infra.

The intent of the drafters of §8.31 was to codify the common practice of providing protection in the corporate charter for conflict of interest
transactions approved by disinterested directors or shareholders. Comment No. 1 to §8.31 states that “[t]he sole purposes of §8.31 are to sharply limit the common law principle of automatic voidability.” Section 8.31 replaces the somewhat vague Massachusetts common law rule with a new statutory mandate. A conflict of interest transaction is now voidable by the corporation solely because of the director’s interest in the transaction unless one of the three tests of §8.31(a) is met. In other words, the statute codifies a rule of automatic voidability if §8.31(a) is not complied with. See Comment No. 2 to §8.31 (“Basically, these subsections require the transaction in question to be approved by an absolute majority of the [disinterested directors or shareholders]. . . If these votes are not obtained, the transaction is tested under the fairness test of subsection (a)(3).”)

Under subsections (a)(1) and (2) of §8.31, disclosure and approval of a particular transaction appear to be required. Thus, generic preapproval of conflict of interest transactions with directors or affiliates, including the types of charter and bylaw provisions involved in Spiegel v. Beacon Participations, Inc. supra (a case cited in Comment No. 1 to §8.31), will not suffice.

In summary, a conflict of interest transaction will be voidable by the corporation unless approval of disinterested directors or shareholders is obtained in compliance with §8.31 or the interested director establishes that the transaction is fair to the corporation.

(b) Effect of Approval under Section 8.31

i. Effect on Transaction Approval Requirements. The approval mechanisms set forth in §8.31(c) and (d) relate to the elimination of the automatic rule of voidability and do not address the manner in which the transactions must be approved under other sections of the Act. This is made clear by the express language of §8.31(d). See Comment No. 1 to §8.31.

For example, a merger of a corporation into another corporation owned by a director who is a 60% shareholder must receive two-thirds shareholder approval under G.L. c. 156D, §11.04, including (as provided in §8.31(d)) the interested director’s 60%. However, because the merger is a conflict of interest transaction, it must be also be approved by a majority of the disinterested shareholders owning a majority of the remaining 40% of the shares in order to satisfy §8.31(a)(2). This would make the required shareholder vote 80.1% rather than two-thirds. Of course, a majority of the disinterested directors may approve the transaction under §8.31(a)(1), but there may not be such a disinterested majority. Moreover, the fairness test of §8.31(a)(3) may not be of much practical value in a transactional context, since that test is not self-operating and involves factual matters as to which counsel cannot give assurance in a legal opinion.
ii. Transactions May Be Challenged on Other Grounds. The elimination of the automatic rule of voidability does not mean that all transactions that meet one or more of the tests set forth in §8.31(a) are automatically valid. These transactions may be subject to attack on a variety of grounds independent of §8.31 – for example, that the transaction constituted waste, that it was not authorized by the appropriate corporate body, that it violated other sections of the Act, or that it was unenforceable under common law fiduciary principles. See Comment No. 1 to §8.31.

To reiterate, the sole purpose of §8.31 is to limit the common law principle of automatic voidability and to establish procedures for dealing with situations involving director conflict of interests. A director who engages in a transaction with the corporation that is not voidable because one or more of the tests of §8.31 have been met is not thereby automatically protected against a claim of impropriety on his part.

(c) Procedural Requirements for Approval of Conflict of Interest Transactions

Sections 8.31(c) and (d) provide special rules for determining whether the board of directors (or a committee thereof) or the shareholders have authorized, approved or ratified a conflict of interest transaction under §8.31. Basically, these subsections require the transaction in question to be approved by an absolute majority of at least two of the disinterested directors (on the board of directors, or on the committee, as the case may be) or by an absolute majority of the holders of shares whose votes may be counted in determining whether the transactions should be authorized, approved or ratified. See Comment No. 2 to §8.31.

The vote required for authorization, approval, or ratification of a conflict of interest transaction is more onerous than the standard applicable to normal voting requirements for approval of corporate actions – i.e., that a quorum must be present and only the votes of directors or shares present or represented at that meeting be considered – because of the importance of assuring that conflict of interest transactions receive as broad consideration within the corporation as possible if independent review on the basis of fairness is to be avoided. See Comment No. 2 to §8.31.

i. Director Approval. For example, assume that the board of directors consists of seven persons, three of whom are “interested” in a proposed conflict of interest transaction and four of whom are not. The transaction must be approved by an absolute majority of the disinterested directors, that is, by at least three of the four persons who so qualify. Under §8.31(c), three of those directors constitute a quorum for the purpose of approving the transaction, even though less than a majority of the seven-person board. Comment 2(a) to §8.31 suggests that a vote “mistakenly cast” by an interested director does not
adversely affect the approval, if sufficient votes of disinterested directors exist. Under the statutory language of §8.31(c), the same result would obtain even if the vote was not a "mistaken" one.

ii. Committee Approval. An existing committee of the board of directors or a special committee appointed by the board (in each case, with appropriate delegated authority) may consider and approve a conflict of interest transaction under §8.31. For example, assume that in the above example, the board appoints a committee of two disinterested directors to consider the proposed transaction. An absolute majority of two directors on the committee may approve the transaction and a quorum of two is required for such action, even though two votes are less than a majority of the entire board and less than a majority of the disinterested directors. On the other hand, a committee consisting of a single member cannot approve a transaction under §8.31.

iii. Shareholder Approval. If approval of a disinterested majority of the board of directors or a committee is not or cannot be obtained, the transaction may be approved under §8.31 by an absolute majority of the shares held by persons other than (i) those owned by or voted under the control of the interested director or (ii) those owned by or voted under the control of an entity in which the director has a material financial interest or is a general partner. This can result in a rather high percentage approval needed to approve a corporate transaction. For example, if a merger of the corporation into a parent company owning 60% of its stock is proposed, the approval of 20.1% (a majority of the remaining 40%) will be necessary to comply with §8.31(a)(2). In effect, the transaction must receive the votes of 80.1% of the shares rather than the two-thirds vote required by §11.04.

(d) Conflict of Interest Transactions

Section 8.31 defines a conflict of interest transaction broadly as "a transaction with the corporation in which a director has a material direct or indirect interest." Consistent with the drafters’ intention to leave the development of the duty of loyalty to the courts, the statute does not comprehensively define the term "material direct or indirect interest," but rather provides two non-exclusive examples of "indirect" interests in §8.31(b). It is clear, however, that 8.31 does not apply to corporate opportunity transactions which, by definition, do not involve transactions “with the corporation.” Moreover, §8.31 does not apply to transactions with non-director officers. See Comment No. 1 to §8.31.

Section 8.31 is applicable to “indirect” as well as direct conflicts. Section 8.31(b) provides a non-exclusive definition of the term “indirect” which includes “without limiting the interests which may create conflict of interest transactions,” transactions between the corporation and an entity in which the director has a material financial interest or is a general partner. Furthermore,
§8.31(b) also covers indirect conflicts where the director is an officer or director of another entity (but does not have a material financial interest in the transaction) if the transaction is of sufficient importance that it is or should be considered by the board of directors of the corporation. The purpose of this last clause is to permit normal business transactions between large business entities that may have a common director to go forward without concern about the technical rules relating to conflict of interest unless the transaction is of such importance that it is or should be considered by the board of directors or the director may be deemed to have a material financial interest in the transaction. Thus, §8.31 covers transactions between corporations with interlocking or common directors as well as direct interested director transactions. See Comment No. 3 to §8.31.

(e) “Fairness” of a Transaction

If the approval of directors or shareholders is not obtained under subsection (a)(1) or (2), the transaction is tested under the fairness test of subsection (a)(3). Under this test, the burden is on the party seeking to sustain the challenged act. See Comment No. 2 to §8.31.

The fairness of a transaction for purposes of §8.31 should be evaluated on the basis of the facts and circumstances as they were known or should have been known at the time the transaction was entered into. This is also consistent with Massachusetts law. The terms of a transaction subject to §8.31 should normally be deemed “fair” if they are within the range that might have been entered into at arms-length by disinterested persons. See Comment No. 2 to §8.31.

(f) Who is an “Interested” Director?

The Act does not attempt to define precisely when a director should be viewed as “interested” for purposes of participating in the decision to adopt, approve or ratify a conflict of interest transaction. Curiously, Comment No. 3 to §8.31 states that “§8.31(b) does, however, define one aspect of this concept – the ‘indirect’ interest. For purposes of §8.31 a director should normally be viewed as interested in a transaction if he or the immediate members of his family have a financial interest in the transaction or a relationship with the other parties to be transaction such that the relationship might reasonably be expected to affect his judgment in the particular matter in a manner adverse to the corporation.” Although this Comment may well be correct as a matter of statutory interpretation, there is nothing in the statutory language which clearly defines an “indirect interest” to include family relationships.
(g) Section 8.31 and the Demoulas Doctrine

In Demoulas v. Demoulas Super Markets, Inc., 424 Mass. 501 (1977), the supreme judicial court articulated a standard for the duty of loyalty of corporate fiduciaries engaging in self-dealing or corporate opportunity transactions:

“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 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.” Id. at 532-533 (emphasis and numbering added). See Section 8.5.1 supra.

This standard is similar (but not identical) to the standard of §8.31 of the Act.

i. Senior Officers. As a preliminary matter, it should be noted that §8.31 applies only to conflict of interest transactions in which a director has a material direct or indirect interest. Thus, §8.31 does not apply to a conflict of interest transaction with a non-director officer. The Demoulas case clearly applies at least to “senior officers.”

ii. Corporate Opportunities. Moreover, §8.31 applies only to transactions with the corporation (i.e. self-dealing), and does not apply to corporate opportunities, which by definition do not involve transactions with the corporation. See Comment No. 1 to §8.31; Official Comment to RMBCA Subchapter F.

iii. Requirement of Disclosure. Furthermore, §8.31 does not contain, as does the Demoulas doctrine, a requirement that disclosure of the transaction be made to the corporation. Section 8.31(a) provides three alternative means of compliance: Either (i) disclose and obtain disinterested director or committee approval, or (ii) disclose and obtain disinterested shareholder approval, or (iii) demonstrate the fairness of the transaction. The Demoulas doctrine (quoted above) requires disclosure and provides that failure to disclose is in itself a breach of the duty of loyalty.

Accordingly, a transaction approved by the directors or shareholders under §8.31(a)(1) or (2) will ordinarily satisfy the Demoulas standard. However, unlike §8.31(a)(3), the defense of fairness may not be availed of under the Demoulas doctrine unless there has been prior disclosure to the corporation.

iv. What Percentage Approval is Necessary? As discussed in Section 8.5.6(c) supra, §8.31 requires the approval of (i) an absolute majority (but not
less than two) of the disinterested directors on the board of directors (or committee), or (ii) an absolute majority of the disinterested shareholders.

The *Demoulas* doctrine requires a fiduciary seeking to engage in self-dealing or a corporate opportunity transaction to make disclosure to the corporation and obtain the “assent of disinterested directors or shareholders,” if any. 424 Mass. at 533. The *Demoulas* court did not specify what proportion of the disinterested directors or shareholders must manifest their assent, since on the facts of that case, there were no disinterested directors or shareholders.

However, the *Demoulas* case indicates that the standards set out in the ALI *Principles of Corporate Governance* are in “conformance with the principles we have stated here.” 424 Mass. at 531 n 36. Under §1.15 of the ALI *Principles*, action by “disinterested directors” requires the affirmative vote of “a majority, but not less than two, of the directors on the board or on an appropriate committee who are not interested.” Section 1.16 states a similar rule for shareholders: “A majority of the votes cast by shareholders who are not interested.” The requirements for the percentage vote of disinterested directors or shareholders under §8.31 and the *Demoulas* doctrine would thus appear to be basically identical.

(h) Definition of “Interested Director”

The standard for determining who is an “interested directors” under the *Demoulas* doctrine may also be different from that of §8.31. Section 8.31 of the Act quite deliberately imprecise in defining when a director is deemed “interested” for purposes of that section. See Comment No. 5 to §8.31. The *Demoulas* case, on the other hand, adopts the more comprehensive definition of “interested” from the American Law Institute’s *Principles of Corporate Governance*. Whether this difference in definition is significant is a question left for future judicial development.

(i) Burden of Proof

Comment No. 2 to §8.31 contains a statement which implies that the effect of director or shareholder approval under subsection (a)(1) or (2) shifts the burden of proof of fairness to the plaintiff: “[T]he effect of obtaining these votes is to shift the burden of proof on any challenge to the acts for which the requisite vote was obtained to the complaining party.” It is difficult to understand what this comment means. If it is meant to prescribe a rule for cases not involving the automatic voidability rule, it squarely conflicts with the holding of the *Demoulas* case that the assent of disinterested directors or shareholders is a defense to a self-dealing or corporate opportunity transaction without regard to fairness. The language from Comment No.2 quoted above has no basis in the statutory language of the Act and may simply be an error.
Chapter 156D, like its predecessor, contains various provisions which provide defenses to and limitations of fiduciary liability.

§8.6.1 Defense of Good Faith and Reasonability

Section 8.30(c) and 8.42(c) of the Act provide that a director or 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 . . . if the duties of the [director or officer] are performed in accordance with [those sections]”. See discussion of §8.30(c) supra at §8.3.7. Section 15.11(b) of the Act provides directors and officers with similar protection, but uses the “prudent man” standard of §65 of the BCL.

§8.6.2 Consideration of Nonstockholder Constituencies

G.L. c. 156D, §8.30(a)(3) permits 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 shareholders, including the possibility that these interests may be best served by the continued independence of the corporation. Section 8.30(a)(3) of the Act adopts this provision in haec verba from §65 of the BCL, thus departing from the text of the RMBCA in favor of an important Massachusetts legislative policy.

§8.6.3 Reliance on Reports, Experts and Committees

G.L. c. 156B, §65 protects officers and directors 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] officers 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.”
The Act adopts substantially similar provisions protecting directors in §8.30(b). Section 8.42(c) provides a similar rule for officers, but excludes the right to rely on information from committees; only directors may rely upon such information.

The Comment to §8.42 suggests another difference between directors and officers: “[T]he ability of the officer to rely on information, reports or statements may, depending on the circumstances of the particular case, be more limited than in the case of a director in view of the greater obligation the officer may have to be familiar with the affairs of the corporation.”

§8.6.4 Indemnification

Sections 8.50-8.59 of the Act contain complex provisions relating to indemnification and advancement of expenses, which are briefly summarized below.

(a) Permissible Indemnification. Section 8.51 of the Act sets forth the “outer limits” of indemnification for directors in terms similar to §67 of the BCL. Section 8.56 provides similar rules for indemnification of officers.

Under these rules, indemnification may be provided only in cases where the director or officer (1) conducts himself in good faith, (2) reasonably believes that his conduct was in (or at least not opposed to) the interests of the corporation, and (3) in the case of criminal proceedings, had no reasonable cause to believe that his conduct was unlawful. Indemnification is also permissible for conduct covered by exculpatory charter provisions authorized under §2.02(b)(4) (see Section 8.6(b) supra).

However, conduct which falls within these outer limits does not automatically entitle directors and officers to indemnification, although the corporation may obligate itself under §8.58 (discussed below) to indemnify officers and directors to the maximum extent permitted by applicable law. See Comment No. 1 to §8.51.

(b) Determination and Authorization of Indemnification. Section 8.55 of the Act provides that the “determination” whether a director or officer’s conduct complied with the standard of §8.51 -- and is thereby entitled to indemnification – must be made by (1) a majority (but not less than two) of the “disinterested directors” or of a committee of two or more disinterested directors, (2) a majority of the shareholders, excluding shares owned by or voted under the control of an interested person, or (3) “special legal counsel” selected by a majority of the disinterested directors (or in certain cases, by a majority of the whole board of directors). The term “disinterested director” is specially defined for these purposes in §8.50.
Accordingly, no indemnification may be made unless there has been a “determination” of eligibility under §8.55 (except in cases of mandatory indemnification under §8.52 and court-ordered indemnification under §8.54, discussed below).

If a “determination” of eligibility has been made under §8.55(b), a majority of the disinterested directors (or in certain cases, a majority of the whole board of directors) must decide whether to “authorize” payment of all or a portion of the indemnification amount, unless the corporation has previously obligated itself to provide indemnification under §8.58. The Comment to §8.55 states that the corporation, in deciding whether to “authorize” indemnification, may consider the reasonableness of the expenses, the financial ability of the corporation to make payment, and the judgment whether to use scarce corporate resources for this purpose.

(c) **Obligatory Indemnification.** Section 8.58 of the Act provides that a corporation may in its charter or bylaws or in a resolution or contract approved by the directors or the shareholders, obligate itself in advance to provide indemnification in accordance with §8.51 or §8.56. Such a provision will satisfy the requirement for “authorization” under §8.55(c), but not the “determination” of eligibility under §8.55(b).

(d) **Mandatory Indemnification.** Section 8.52 of the Act provides that a corporation shall indemnify a director or officer who was “wholly successful” on the merits or otherwise in the defense of a proceeding to which he was a party because he was a director or officer, against reasonable expenses incurred by him in connection with the proceeding.

(e) **Court-Ordered Indemnification.** Section 8.54 of the Act provides that a director or officer who is a party to a proceeding may apply to a court for indemnification. The court shall order indemnification if it determines that (1) the director or officer is entitled to mandatory indemnification under §8.52 or obligatory indemnification under §8.58, or (2) indemnification is “fair and reasonable” under the circumstances. The Comment to §8.54 makes it clear that the court may override an adverse “determination” by the corporation under §8.55(b), but cautions that the court should be reluctant to do so.

(f) **Advancement of Expenses.** Under §8.53(a) of the Act, a corporation may authorize the advance of funds to a director or officer who is a party to a legal proceeding if he delivers to the corporation (i) a written affirmation of his good faith belief that he has met the standards of §8.51 and (ii) a written undertaking to repay any funds advanced if (A) he is not entitled to mandatory indemnification under §8.52 (i.e., he is not “wholly successful” in his defense of the proceeding) and (B) there is a “determination” by the court under §8.54 or by the corporation under §8.55 that he has not met the standards of
§8.51. Under §8.53(c), authorization of advances shall be made by the disinterested directors or shareholders or “as otherwise permitted by law.”

A corporation may obligate itself to advance expenses under §8.58(a). If so, a written affirmation is required, but “authorization” under §8.55(c) is not. A court may also order advancement of expenses under §8.54.

(g) Statutory Provisions not Exclusive. Unlike the RMBCA, §8.59 of the Act provides that the rights to indemnification and advancement of expenses pursuant to §§8.50-8.58 are not exclusive of any other rights to which a person seeking indemnification may be entitled. This clearly preserves the rights of persons other than directors and officers, but also raises the possibility that the carefully constructed system of indemnification in the Act can be avoided at will.

The Comment to §8.59 states that the “underlying philosophy” of the indemnification provisions is “one of permissiveness and its structure one of guidance.” The drafters also observe that “the courts will ultimately have to determine the extent to which public policy considerations limit what can be done in the area of indemnification.” See also Comment No. 1 to §7.32, infra.

§8.6.5 Directors’ and Officers’ Liability Insurance

G.L. c. 156B, §67 authorizes Massachusetts corporations to purchase D&O liability insurance, including insurance for liabilities for which the corporation may not provide indemnification.

Section 8.57 of the Act, like §67 of the BCL, authorizes a corporation to purchase and maintain insurance on behalf of officers and directors against liabilities imposed upon them by reason of acts in their official capacity, or their status as such, or arising from their services to the corporation or another entity at the corporation’s request. Section 8.57 does not include insurance for the benefit of employees and agents within its scope; this power is provided in §3.02 and confirmed in §8.58(e). See Comment to §8.57.

§8.6.6 Exculpatory Charter Provisions

G.L. c. 156D, §2.02(b)(4) 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 §2.02(b)(4) may be made retroactive to cover acts or omissions occurring prior to the date the charter provision becomes effective.

Section 2.02(b)(4) of the Act adopts a corresponding provision contained in c.156B, §13(b)(1-1/2), thus departing from the text of the RMBCA in favor of an important Massachusetts legislative policy.

§8.6.7 Ratification

Neither the BCL nor the Act deals in any detail with ratification by directors or shareholders, which is governed by the common law. Ratification is a principle of agency law that an agent’s unauthorized act will be valid and retroactively binding upon the principal, if the principal knowingly consents or acquiesces in said action. Murray v. C.N. Noble Lumber Co., 143 Mass. 250, 251 (1887).

Boylan v. Boston Sand & Gravel Co., 22 Mass. L. Rptr. 290 (Suffolk Super. Ct., March 16, 2007) was a derivative action claiming a violation of the corporate opportunity doctrine by certain directors and officers of Boston Sand & Gravel Co. when its wholly-owned subsidiary entered into a lease with an option to purchase 42 acres of New Hampshire real estate to an affiliate of the parent company’s principal stockholder.

(a) Corporate Opportunity. The superior court (Gants, J.) found that the fiduciaries had failed to comply with the Demoulas doctrine when they failed to make “full and honest disclosure of all material facts of the proposed transaction,” specifically their failure to disclose to the board of directors that no notice had been given to a substantial minority stockholder as required by a written “separation agreement” and that the minority stockholder opposed the transaction as being financially disadvantageous to the corporation. The court also held that the fact that a wholly-owned subsidiary, rather than the parent company, had entered into the transaction did not excuse compliance with the Demoulas requirements of disclosure and disinterested director approval. Therefore, the board of directors vote approving the transaction did not comply with the Demoulas standard. See Section 8.5, supra.

(b) Ratification. The court held, however, that the board of directors could nonetheless retroactively ratify the challenged transaction by a proper formal ratification vote by its board of directors. The court then proceeded to consider whether a unanimous ratification vote adopted by the board in 2006 (ten years after the execution of the lease and four years after commencement of litigation) satisfied the standards of the business judgment rule.
The court found that the ratifying vote must meet the requirements of the business judgment rule adopted in the *Harhen* case (see Section 8.4 supra). Applying this rule, the court found that the seven directors, three were parties or family members of parties and were thus “interested,” and that another three were “disinterested.” It found that the seventh director, an attorney with the corporation’s principal law firm, had a “business [or financial . . . relationship]” with a party to the transaction which would “reasonably be expected to affect [his] . . . judgment with respect to the transaction . . . in a manner adverse to the corporation,” applying §1.23(a) of the ALI’s *Principles of Corporate Governance*, endorsed in *Harhen v. Brown*, 431 Mass. 838, 842 (2000) and *Demoulas v. Demoulas Super Markets*, 424 Mass. 501, 523-524 (1987). Thus, a majority of the board of directors was not “disinterested.”

The court held that the “relatively deferential business judgment rule” of *Harhen v. Brown* did not apply since a majority of the board was not disinterested. However, it treated the ratification vote by the three disinterested directors as a committee vote under the “far more demanding” standards for ratification by “special litigation committees” adopted by the supreme judicial court in *Houle v. Low*, 407 Mass. 810, 813-814 (1990). That test requires evaluation of the committee’s decision under a “heightened standard of review” involving a “three-tiered” test:

(a) whether the directors who made the decision were “independent, unbiased and [acted] in good faith,” and if so,

(b) whether the independent directors conducted a “thorough and careful analysis,” and if so,

(c) whether the decision was “contrary to the great weight of the evidence.”

Following a later evidentiary hearing, the court held that the *Houle* standard had not been met, since two of the three “disinterested” directors under *Harhen* were not “independent” under the *Houle* standard and neither had made a thorough and careful analysis of the challenged transaction. The court ruled that a further hearing on the “fairness” of the challenged transaction would be necessary. *Boylan v. Boston Sand & Gravel Co.*, (Suffolk Superior Ct. No. 06-2296 Jan. 22, 2009). The case was settled before the fairness hearing took place.

(c) Implications under the Act. The *Boston Sand & Gravel Co.* case was a derivative action permitted under the “demand excused” rule of Mass. R. Civ. P. 23.1. The Act abolishes the “demand excused” rule in favor of a requirement that demand be made in every derivative case. See G.L. c. 156D, §7.42. Section 7.44(a) of the Act permits a corporation in a derivative action to move for dismissal of the case if a majority of the independent directors or of a committee consisting of two or more independent directors has
determined “in good faith after conducting a reasonable inquiry upon which its conclusions are based, that the maintenance of the derivative proceedings is not in the best interest of the corporation: The judge’s decision in *Boston Sand & Gravel* is consistent with the Official Commentary to §7.44, which states that:

“Section 7.44 steers a middle ground, applying the business judgment rule when a majority of the board is independent (which would include the situation presented in *Harhen*), with the burden of proof being on the plaintiff, and the “reasonable and principled” review standard of *Houle*, with the burden of proof being on the corporation, when a majority of the board is not independent. Unlike *Harhen*, the corporation is required in either case, in connection with a motion to dismiss, to present the court a filing containing facts justifying application of the business judgment rule. The plaintiff then has an opportunity to rebut those facts.”

Under the Act, the issues raised on summary judgment in the *Boston Sand & Gravel Co.* case will be raised much earlier in the proceedings, at a time when the parties have not had the opportunity to engage in extensive discovery (see §7.44(d)).

§8.6.8 Shareholder Agreements under §7.32 of the Act.

(a) Scope of Section 7.32. The Act contains a new and far-reaching provision authorizing all of the shareholders to enter into agreements governing the operation of the corporation in ways which conflict with the usual statutory rules and norms, including those set forth in the Act. Section 7.32 of the Act is derived from similar provisions in §7.32 of the RMBCA. Agreements among shareholders adopted in accordance with §7.32 of the Act may go far beyond the typical voting agreements, stock restrictions, buy-sell agreements and rights of first refusal authorized elsewhere in the Act (e.g., §6.27 and §7.31).

Section 7.32(a) contains a non-exclusive list of examples of the type of provisions which may be the subject of such shareholder agreements. These include provisions such as one which:

“(1) eliminates the board of directors or restricts the discretion or powers of the board of directors;

(2) governs the authorization or making of distributions whether or not in proportion to ownership of shares, subject to the limitations in section 6.40;
(3) establishes who shall be directors or officers of the corporation, or their terms of office or manner of selection or removal;

(4) governs, in general or in regard to specific matters, the exercise or division of voting power by or between the shareholders and directors or by or among any of them, including use of weighted voting rights or director proxies;

(5) establishes the terms and conditions of any agreement for the transfer or use of property or the provision of services between the corporation and any shareholder, director, officer or employee of the corporation or among any of them;

(6) transfers to 1 or more shareholders or other persons all or part of the authority to exercise corporate powers or to manage the business and affairs of the corporation, including the resolution of any issue about which there exists a deadlock among directors or shareholders;

(7) requires dissolution of the corporation at the request of 1 or more of the shareholders or upon the occurrence of a specified event or contingency; or

(8) otherwise governs exercise of the corporate powers or management of the business and affairs of the corporation or the relationship among the shareholders, the directors and the corporation, or among any of them, and is not contrary to public policy.”

(b) May a Shareholder Agreement Modify Fiduciary Duties? For purposes of this discussion, we will focus on the question of whether a shareholder agreement under §7.32 may explicitly vary, limit, or exclude the fiduciary duties of directors, officers or shareholders of Massachusetts business corporations. See Sections 8.7.9, 8.9.6 and 8.10.3, infra (discussing agreements modifying fiduciary duties in close corporations, partnerships and limited liability companies).

Section 7.32(a)(8) contains a “catch-all” provision authorizing any provision in a shareholder agreement that “otherwise governs exercise of the corporate powers or management of the business and affairs of the corporation or the relationship among the shareholders, the directors and the corporation, or among any of them, and is not contrary to public policy” (emphasis added).
This “public policy” exception is the subject of an extensive discussion in Comment No. 1 to §7.32. That comment expresses the view that an agreement that provides that the directors of the corporation would have no fiduciary duties to the corporation or its shareholders would be contrary to public policy and would therefore not be enforced by the courts.

“While the outer limits of the catch-all provision of subsection 7.32(a)(8) are left uncertain, there are provisions of the Act that cannot be overridden by resort to the catch-all. Subsection (a)(8), introduced by the term "otherwise," is intended to be read in context with the preceding subsections and to be subject to a ejusdem generis rule of construction. Thus, in defining the outer limits, courts should consider whether the variation from the Act under consideration is similar to the variations permitted by the first seven subsections. Subsection (a)(8) is also subject to a public policy limitation, intended to give courts express authority to restrict the scope of the catch-all where there are substantial issues of public policy at stake. For example, a shareholder agreement that provides that the directors of the corporation have no duties of care or loyalty to the corporation or the shareholders would not be within the purview of § 7.32(a)(8), because it is not sufficiently similar to the types of arrangements suggested by the preceding subsections of § 7.32(a) and because such a provision could be viewed as contrary to a public policy of substantial importance. Similarly, a provision that exculpates directors from liability more broadly than permitted by § 2.02(b)(4) likely would not be validated under § 7.32 because, as the Comment to § 2.02(b)(4) states, there are serious public policy reasons which support the few limitations that remain on the right to exculpate directors from liability. Further development of the outer limits is left, however, for the courts.”

While I agree that a provision which completely eliminated fiduciary duties would be contrary to public policy, I think that the comment goes too far in condemning provisions which may limit fiduciary duties in ways that are not inconsistent with, and may in fact further, important public policies. For example, consider a so-called “corporate joint venture” between a real estate developer and the owner of a large parcel of property. The parties may wish to limit the scope of the parties’ fiduciary duties to enable the developer to acquire or develop other unrelated parcels of land without regard to principles of corporate opportunity. Such a provision may be an essential inducement to the developer, who may be unwilling for business reasons to include the owner as a partner in unrelated projects. It is difficult to perceive a public policy reason
why such an agreement should not be enforced, particularly since another form of business entity might be permitted to use such a restriction.

Likewise, a corporation organized by two construction companies to bid on a large public construction project might well involve a similar agreement enabling the participants to independently bid and perform other construction projects. In this case, strong public policies in favor of competitive bidding would be served by allowing the parties to compete for other projects. And an agreement between two oil companies which organize a corporation to explore and develop a new oil field may well have antitrust implications unless the parties are able to compete with each other outside the joint venture.

Compare Comment No. 3(g) to §2.02, which suggests that when subsidiaries or corporate joint ventures are being formed, special consideration should be given to inclusion of corporate charter provisions “designed to limit or avoid the unexpected application of the doctrines of corporate opportunity and conflict of interest,” even though this type of clause, in the view of the drafters, “will not provide total protection.” See Knapp v. Neptune Towers Assoc., 72 Mass. App. Ct. 502 (2008) (upholding provision of limited partnership agreement permitting general partners to engage in self-dealing transactions with the limited partnership upon reasonable terms, even if no disclosure made to limited partners); Fronk v. Fowler, 456 Mass. 317 (2010) (upholding provision of limited partnership agreement permitting general partners to engage in other businesses); see also Pointer v. Castellani, 455 Mass. 537, 555 (2009) (upholding similar provision in limited liability company operating agreement);

§8.7. CLOSE CORPORATIONS

§8.7.1 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.

§8.7.2 Donahue v. Rodd Electrotype Co.

(a) Facts

Members of the Rodd family owned 80% of the stock of Rodd Electrotype 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.

§8.7.3 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 Donahue 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.

§8.7.4 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.
§8.7.5 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) “Personal Transactions” Between Shareholders

Adelson v. Adelson, 60 Mass. App. Ct. 753 (2004) creates a major exception to the Donahue doctrine for “personal transactions” between stockholders of a close corporation. In that case, a majority stockholder of a close corporation purchased the stock of his adult son, a minority stockholder, for $1,800 per share. Five months later, the corporation was sold for $6,000 per share. The son claimed his father had breached his fiduciary duties as a majority stockholder under the Donahue doctrine by failing to disclose information material to the valuation of the stock. The appeals court held that the majority stockholder owed fiduciary duties to the minority stockholder only as to matters relating to the operation of the corporation, but owed no such duty relating to a “personal transaction” involving a sale of the corporation’s stock. The court also noted that the father did not owe a fiduciary duty to his adult son merely because of their family relationship.

In Jernberg v. Mann, 358 F. 3d 131 (lst Cir. 2004), a case decided before the Adelson decision, the First Circuit Court of Appeals ruled (consistently with Adelson) that an officer or director of a corporation does not have a fiduciary obligation to stockholders of the corporation with respect to purchases of stock, citing Goodwin v. Agassiz, 283 Mass. 358 (1933) and Gladstone v. Murray Co., 314 Mass. 584 (1943). However, the Jernberg court also pointed out that under Goodwin v. Agassiz, the purchasing officer or director does have a duty to “disclose material facts within [his] peculiar knowledge” when purchasing stock “when [he] seeks out a stockholder in order to purchase stock.” 283 Mass. at 363. The court rejected a jury instruction which imposed on the officer or director an additional duty to prove “that the sale was, in addition, fair and reasonable to the seller.”

(c) Comparison to Traditional Duties of Corporate Fiduciaries

Traditionally, stockholders in corporations do not owe one another fiduciary duties. See Section 8.2(b) supra. Corporate directors owe a duty of good faith and inherent fairness to the corporation (not to the stockholders). But see Chokel v. Genzyme Corp., 449 Mass. 272, 278 (2007). 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.

§8.7.6 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. Exergen 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.

In O’Connor v. U.S. Art Co., Inc., 2005 WL 1812512 (Suffolk Super. Ct., June 27, 2005), aff’d, 66 Mass. App. Ct. 1118 (2006) (unpublished decision), the court considered the termination of the employment of a minority stockholder under the “legitimate business purpose” defense of Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842 (1976). O’Connor was the president and a 37.5% stockholder of a close corporation. The majority stockholders, frustrated with O’Connor’s allegedly mismanagement, sloppy bookkeeping practices, and failure to collect receivables and pay bills, entered into negotiations with O’Connor to sell their stock back to the corporation. After only a few days, the majority stockholders abruptly terminated negotiations, fired O’Connor, evicted him from the corporate offices and transferred all of the corporate assets to an affiliated corporation owned by the majority stockholder.

Judge Van Gestel, following the Wilkes case, found that the defendants had a “legitimate business purpose” in dealing with the president’s mismanagement and sloppy bookkeeping, but that “[t]here were clearly less harmful alternatives” to firing O’Connor and shutting down the business. The court suggested that the “hiring of a competent bookkeeper,” making O’Connor vice-president of marketing at a lower salary, or calling a stockholders’ meeting to discuss ways and means of solving the bookkeeping problems while preserving a role for O’Connor in the business, would have been proper alternatives. The court was highly critical of the defendants’ cutting off negotiations with O’Connor in an apparent “act of pique or anger . . . or perhaps some clumsy effort to gain leverage in any negotiations that might thereafter occur.”

§8.7.7 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).

i. Definition of “Freeze Out.” A “freeze out” has been referred to by the supreme judicial court as an “elastic concept.” *O’Brien v. Pearson*, 449 Mass. 377, 386 (2007). In *Brodie v. Jordan*, 66 Mass. App. Ct. 371 (2006) *affirmed in part, reversed in part and remanded*, 447 Mass. 866 (2006), the appeals court held that the majority stockholders in a close corporation had violated their fiduciary duties to the minority stockholder by denying her a corporate office or employment, limiting her financial information, excluding her from a meaningful role in corporate operations, not paying dividends, and “stonewalling” her efforts to obtain a valuation of her stock. The supreme judicial court, as discussed *infra*, limited its review to the question of remedies. Nevertheless, the trial court’s finding of a freeze-out, affirmed by the appeals court, was unusual. The corporation was owned by three stockholders, each with a one-third interest. The minority stockholder was the executrix of the estate of one of the founders of the business, who prior to his death had become inactive in the business and was removed as a director in 1992 as a result of disagreements with the two remaining stockholders.

The court held that a freeze-out occurred when the majority (1) refused to vote for the plaintiff’s election as a corporate director; (2) refused to provide her with more than annual unaudited financial statements; (3) declined to purchase her stock, waiving the charter restrictions on transfer of shares which called for an arbitration of value; and (4) declined to pay dividends.

Each of the four items seems to be a clearly lawful action within the discretion of corporate management. Yet, the trial court and the appeals court held that, together, they constituted a freeze-out, which raises the question: Do “four rights make a wrong?” In any event, this case is an illustration of the proposition that a party cannot always defend a breach of fiduciary duty claim on the basis that he complied with all corporate procedural requirements. See *A.W. Chesterton Co., Inc. v. Chesterton*, 128 F. 3d 1, 8 (1st Cir. 1997).

ii. Remedies for Freeze Outs. In *Brodie v. Jordan*, *supra*, the appeals court affirmed (by a 2 to 1 vote) the trial court’s order providing for the remedy of requiring the defendants to purchase the plaintiff’s shares.
The supreme judicial court reversed the appeals court decision as to remedies, holding that the proper remedy in a freeze-out case is to protect the “reasonable expectations” of the plaintiff (see Section 8.7.7(c) infra) by “restor[ing] to the minority shareholder those benefits which she reasonably expected, but has not received because of the fiduciary breach.” The court found that ordering the defendants to buy out the plaintiff (“a remedy that no Massachusetts appellate court has previously authorized”) would “place the plaintiff in a better position than she enjoyed absent the wrongdoing and well exceeded her reasonable expectations of benefit from her shares.”

The Jordan case is sometimes referred to as barring the remedy of a buy-out for breaches of fiduciary duties under Donahue. This is an overstatement, as illustrated by Puro v. Popkin, 26 Mass. L. Rptr. 41 (Norfolk Super. Ct. No. 06-0533, Aug, 11, 2009). In that case, the minority shareholders of a business trust claimed that the dominant shareholder had represented to them, in connection with a 25-year extension of the trust, that the trust would be dissolved at the end of the 25-year extension period if the minority shareholders were not bought out in the interim. The superior court held that these claims, if proven at trial, would constitute a frustration of the “reasonable expectations” of the minority shareholders of a liquidity event, which would invalidate the majority shareholders’ attempt to further extend the trust.

(c) Protection of Rightful Expectations

The courts have protected the rightful expectations of stockholders with the duty of utmost good faith and loyalty. The caselaw uses the terms “rightful expectations” and “reasonable expectations” interchangeably; the latter term seems to have replaced the former over time. The rightful expectation doctrine was first 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 Bodio 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.

The reasonable expectations doctrine has become the standard in Massachusetts for evaluating breaches of fiduciary duties in close corporations. See Brodie v. Jordan, 447 Mass. 866, 869-870 (2006) (discussing reasonable

Determining the shareholder’s reasonable expectations often requires courts to make inferences from the parties’ conduct or from unarticulated understandings:

“In a close corporation, the parties’ entire business bargain is not completely set forth in the corporation’s charter or bylaws or even in a separate signed preincorporation or shareholders’ agreement. The agreements ‘often are oral, perhaps just vague and half-articulated understandings. Even when the participants formalize their bargain in a written shareholders’ agreement, their participation in the business is often grounded on assumptions that are not mentioned in the agreement.’ Expectations, therefore, must be gleaned from the parties’ actions as well as their written documents. Courts permit expectations to be established outside of formal written agreements ...” 2 O’Neal and Thomson, Oppression of Minority Shareholders and LLC Members, § 7:15 (2007) (footnotes omitted).

§8.7.8 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 seventy 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).

§8.7.9 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. In *Evangelista v. Holland*, 27 Mass. App. Ct. 249 (1989), 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.

A long line of Massachusetts cases holds that technical compliance with the corporate statute, the articles of organization or the corporate bylaws does not preempt the parties’ fiduciary duties under *Donahue* and its progeny. In other words, the duty of utmost good faith and fair dealing is imposed in addition to the parties’ obligations to abide by the terms of the corporation statute and the organizational documents of the corporation. *Donahue*, 367 Mass. at 598 (statutory authority to repurchase corporate shares is “subject to the additional requirement” that shareholders act with the “utmost good faith and loyalty”); *Pupecki v. James Madison Corp.*, 376 Mass. 212, 215-217 (1978) (compliance with statutory requirements for sale of corporate assets is subject to *Donahue* fiduciary duties); *Hallahan v. Haltom Corp.*, 7 Mass. App. Ct. 68, 70-71 (1979) (valid contract for sale of shares subject to *Donahue* duties); *Smith v. Atlantic Properties, Inc.*, 12 Mass. App. Ct. 201, 207-208 (1981) (supermajority voting requirement in corporate charter subject to *Donahue* duties); *Jessie v. Boynton*, 372 Mass. 293, 303-304 (1977) (corporate bylaws subject to *Donahue* duties). See *Starr v. Fordham*, 420 Mass. 178, 184-185 (1995) (partnership agreement vesting sole authority in founding partners to determine partners’ compensation subject to partners’ fiduciary duties); and *Wartski v. Bedford*, 926 F.2d 11, 20 (1st Cir. 1991) (limited partnership agreement “cannot nullify the fiduciary duty” owed by a partner).

As discussed above, the provisions of the organizational documents of a close corporation do not trump the fiduciary duties under *Donahue*. Rather, the fiduciaries’ broad powers and sweeping discretion are limited by their fiduciary obligations.

“If the strict *Donahue* fiduciary obligations did not restrict otherwise legitimate actions, they would add nothing to a shareholders’ legal duty ... [A shareholder of a close corporation] cannot defend a breach of fiduciary duty claim on the basis that he has not violated the Articles of Organization.” *A.W. Chesterton Company, Inc. v. Chesterton*, 128 F. 3d. 1, 8 (1997).

More recently, courts have found that employment and stock purchase agreements can by-pass the *Donahue* duty. See *Blank v. Chelmsford OB/GYN*,...
Such 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.

In a quartet of recent cases, the supreme judicial court and the appeals court held that the specific terms of the organizational documents of a close corporation, a limited partnership and a limited liability company may modify the fiduciary duties of the majority. *Chokel v. Genzyme Corp.*, 449 Mass. 272 (2007) (provisions of articles of organization relating to terms of “tracking stock”); *Knapp v. Neptune Towers Assoc.*, 72 Mass. App. Ct. 502 (2008) (enforcing provisions of limited partnership agreement authorizing general partners to engage in self-dealing transactions with the limited partnership on reasonable terms); *Pointer v. Castellani*, 455 Mass. 537 (2009) (provisions of LLC operating agreement authorizing members to engage in “any other business or activity whatsoever” other than quarrying); and *Fronk v. Fowler*, 456 Mass. 317 (2010) (provisions of real estate limited partnership agreement authorizing general parties to engage in “any other business or investment, including . . . real estate”).

The supreme judicial court has been inconsistent in its interpretation of the *Chokel* case. In *Pointer v. Castellani*, 455 Mass. 537 (2009) the court considered an argument by the majority owners that the terms of an employment contract with a minority owner controlled, rather than their fiduciary duty. The court “easily distinguished” *Chokel on the grounds that it “involved a corporation whose stock was publicly traded.” 455 Mass. at 554. Yet, less than a year later, the court imposed sanctions under G.L. c. 231, §6F on a plaintiff on the grounds that “*Chokel did not announce a new rule of law; rather it affirmed a long-standing rule in Massachusetts law that ‘[w]hen a director’s contested action falls entirely within a contract between the director and the shareholder, it is not subject to question under fiduciary duty principles,’” *Fronk v. Fowler*, 456 Mass. 317, 331 (2010), citing *Blank v. Chelmsford Ob/Gyn, P.C.*, 449 Mass. at 408.

The *Chokel, Knapp, Pointer and Fronk* cases make it clear that the parties to organizational documents of corporations, partnerships and limited liability companies have the freedom of contract to vary fiduciary duties, but are difficult to reconcile with prior decisions like *Pupecki, Smith, Jessie, Starr and Chesterton, supra*, which hold that compliance with the terms of organizational documents does not displace fiduciary duties. Why, for example, were the supermajority voting rights granted to shareholders in *Smith v. Atlantic Properties, Inc., supra*, not considered an example of the kind of freedom of contract which trumps fiduciary duties, as in *Chokel*, rather than a mere procedural requirement which does not displace those duties?
The distinguishing principle, I think, is the degree of specificity of the contractual provision, and whether it gives the shareholders fair notice that it displaces traditional fiduciary obligations.

The American Law Institute’s Principles of Corporate Governance, frequently cited by the supreme judicial court and the appeals court, adopts the position that Donahue duties may be varied by contract, but only with respect to specific, well-defined transactions. The comment to Section 5.09 of the ALI’s Principles states:

“Limits of consensual arrangements. A concept underlying § 5.09 is that consensual arrangements [limiting the duty of fair dealing] should be effective when the results that will be achieved by such arrangements are relatively clear and the arrangements are based on informed consent. These limitations on the effectiveness of consensual arrangements are directly applicable to the question whether the substantive and procedural rules governing the duty of fair dealing can be varied by provisions in the certificate of incorporation. First, the shareholders could not possibly be informed as to the myriad factual situations to which such a broad waiver would be applicable. Section 5.09 reflects the view that a shareholder could not foresee the consequences of agreeing to waive every rule, because the varying circumstances to which such a waiver would be applicable could not be anticipated for at least some rules.” Id., p. 323. (emphasis supplied).

“Similarly, shareholder approval of a specific conflict-of-interest transaction usually does not present the danger of systematically underinformed consent and exploitation, because the approval relates to a specific event rather than to an unknowable future.” Eisenberg, The Structure of Corporation Law, 89 Colum. L. Rev. 1461, 1470 (1989), citing § 5.09 of the ALI Principles.

Professor Scott has observed that “[t]he greater the independent authority to be exercised by a fiduciary, the greater the scope of his fiduciary duty.” Scott, The Fiduciary Principle, 37 Cal. L. Rev. 539, 540-541 (1949). The grant of broad power and sweeping discretion to majority shareholders in generic terms argues for an enhancement of their fiduciary duties, rather than a restriction of the fiduciary rights of the shareholders.

§8.7.10 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.

§8.7.11 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).

In Pasquale v. Brody, Hardoon, Perkins & Kester, LLP (Suffolk Sup. Ct. No. 2006-02667, Mar. 23, 2010), a superior court judge sitting in the Business Litigation Session held that “[i]t does not appear that any Massachusetts court has allowed a breach of fiduciary duty claim on the theory that counsel to a close corporation owes such a duty to the corporation’s shareholders” Id at n.7.

§8.7.12 Application of Donahue to Non-Corporate Entities


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(2009), the supreme judicial court implicitly held that a limited liability company, described in the case as a “closely-held entity” (455 Mass. at 538), was a close corporation under *Donahue* (455 Mass. at 549).

§8.8 FOREIGN CORPORATIONS

§8.8.1 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).

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. However, in *Clemmer v. Cullinan*, 62 Mass. App. Ct. 904 (2004), the appeals court held that notwithstanding *Nixon v. Blackwell*, the Delaware “entire fairness test” may apply to a wrongful freeze-out of a minority stockholder. The court in the *Clemmer* case therefore reversed the trial court’s dismissal of a freeze-out claim involving a Delaware corporation.

§8.8.2 Choice of Law

(a) 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.

(b) The *Demoulas Case.* In *Demoulas v. Demoulas Super Markets, Inc.*, 424 Mass. 501, 511 (1997), the supreme judicial court held that 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).

The Demoulas case thus 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.

(c) 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.

§8.9 MASSACHUSETTS PARTNERSHIPS, LIMITED PARTNERSHIPS AND LLPs

§8.9.1 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.

(a) 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).

(b) 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.


i 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).
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.

Business Opportunities. Partners also have a fiduciary obligation, similar to the corporate opportunity doctrine, to refrain from exploiting partnership business opportunities 13-14. See Lurie v. Pinanski, 215 Mass. 229 (1913) (renewal of partnership lease taken by partner); Wartski v. Bedford, 926 F. 2d 11, 13-14 (1st Cir. 1991).

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. Joseph Burnett Co., 208 Mass. 75, 82 (1911). In Starr v. Fordham, 420 Mass. 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.

(c) 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 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.

§8.9.2 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.
§8.9.3  Limited Partnerships


Section 24 of the Massachusetts Uniform Limited Partnership Act (G.L. c. 109, §24) provides that, except as provided in that 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. General Laws 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.

§8.9.4  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.

§8.9.5  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 Partnership, §6.07(a)(8); Peterson and Zirn, Corporate Directors, LLCs and Liability, 12 Bus. Law Today 57 (July/August 2003).

Massachusetts precedent on this issue is sparse, but indicates that Massachusetts courts would hold the stockholders of a corporate general partner

In Ray-Tek Services, Inc. v. Parker, 64 Mass. App. Ct. 165 (2005), the appeals court held that an officer of a corporation which was a party to an oral joint venture was jointly and severally liable for his acts, in his capacity as an officer of the corporate joint venturer, in making misrepresentations and misappropriating funds. The court based its conclusion on the fact that a "breach of fiduciary duty is a tort" citing Latucca v. Robsham, 442 Mass. 205 (2004) and that an officer who personally participates in a tort committed by the corporation has personal liability.

§8.9.6 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).

(a) 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 8.5.1, 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.

(b) 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(h)(2). As a matter of policy, partners’ freedom of contract should enable them to agree upon their respective rights and obligations.

“It 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 were initially 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. More recently, the courts have concluded that the clear terms of the parties’ contract should prevail. See *Knapp v. Neptune Towers Assoc.*, 72 Mass. App. Ct. 502 (2008)(upholding provision of limited partnership agreement permitting general partners to engage in self-dealing transactions with the limited partnership upon reasonable terms, even if no disclosure made to limited partners); *Fronk v. Fowler*, 456 Mass. 317 (2010) (upholding provision of limited partnership agreement permitting general partners to engage in other businesses); see also *Pointer v. Castellani*, 455 Mass. 537, 555 (2009) (upholding similar provision in limited liability company operating agreement);

§8.10 MASSACHUSETTS LIMITED LIABILITY COMPANIES

Massachusetts was one of the last U.S. states to adopt the limited liability company 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 caselaw regarding fiduciary duties of members and managers of LLCs is sparse.

§8.10.1 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 9.1, supra. 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. 156C, §§8(b), 63(b). See also, Pointer v. Castellani, 455 Mass. 537 (2009).

§8.10.2 Statutory Provisions Respecting Fiduciary Duties

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

(a) **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.

(b) **Good Faith Reliance.** G.L. c. 156C, §11 provides (in a manner similar to G.L. c. 156D, §8.30(b)) 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.

(c) **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.

(d) **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.

(e) **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.
§8.10.3 May an Operating Agreement Eliminate Fiduciary Duties?

Section 63(b) of the Massachusetts Act 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. These statutory provisions raise interesting questions as to what extent an LLC may 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 the original version of §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, in each case prior to the legislative amendments described below. The tale of the judicial reaction in Delaware to the argument that the original version of the law permitted the “elimination” of fiduciary duties, and the legislative response to that reaction in 2004 is enlightening.


These decisions prompted the Delaware Supreme Court to comment, in dictum of its own, that the original 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 correct rule of law.” Gotham Partners, L.P. v. Hallwood Realty Partners, L.P., 817 A. 2d 160, 167-168 (Del. 2002).

Similar doubts were 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 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”).
The Delaware General Assembly amended §18-1101 of the Delaware Limited Liability Company Act, effective August 1, 2004, to provide that the fiduciary duties of members or managers “may be expanded or restricted or eliminated by provisions in the limited liability company agreement . . . provided that the limited liability company agreement may not eliminate the implied contractual duty covenant of good faith and fair dealing.” (emphasis supplied). See 74 Del. Laws c. 275. Similar amendments were made to the Delaware Revised Uniform Limited Partnership Act. See 74 Del. Laws c. 265.

The differing judicial and legislative philosophies of fiduciary duties and are discussed at length by Chief Justice Steele in his article on Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies, 32 Del. J. Corp L. 1 (2007).

The Massachusetts and Delaware LLC statutes differ in one respect affecting fiduciary duties. The Delaware Limited Liability Company Act (and the Delaware Revised Uniform Limited Partnership 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.

§8.11 ACKNOWLEDGEMENT AND DISCLAIMER

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