FIDUCIARY DUTIES UNDER THE NEW MASSACHUSETTS BUSINESS CORPORATION ACT

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This article is a supplement to my earlier article on "Fiduciary Duties of Officers, Directors and Owners," appearing elsewhere on this web site. That article extensively discusses the fiduciary responsibilities of directors, officers and stockholders of Massachusetts business corporations and persons in similar relationships to other Massachusetts business organizations, such as general and limited partnerships and limited liability companies.

The scope of this article is more modest: To update my earlier article to discuss how the new Massachusetts Business Corporation Act (G.L. c. 156D), effective July 1, 2004, will affect the fiduciary and statutory duties of officers, directors and shareholders of Massachusetts business corporations.

Part I describes the new Act, its legislative history and its likely effect on corporate practice. Part II outlines the fiduciary duties provisions of the new Act and its impact on the law relating to the duty of care and the duty of loyalty. Part III compares the statutory standard of care of officers and directors under the old and new laws. Part IV discusses the duty of loyalty and how §8.31 of the new Act affects this common law duty. Part V compares the statutory liabilities of directors and officers under the two statutes. Part VI discusses the defenses and limitations of fiduciary liabilities under these statutes, including shareholder agreements under §7.32 of the new Act.

I. THE MASSACHUSETTS BUSINESS CORPORATION ACT

A. Background

Chapter 156B, the Massachusetts Business Corporation Law ("BCL"), originally enacted in 1964, has been replaced by Chapter 156D, the new Massachusetts Business Corporation Act (the "Act"), a statute based on the 1984 version of the ABA Revised Model Business Corporation Act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").[1]

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[1] The terminology "BCL," "Act," and 'RMBCA" used herein is consistent with that used in the commentary to the Act. See Comment to §1.01.

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 was drafted by the Task Force on the Revision of the Massachusetts Business Corporation Law, in cooperation with the Boston Bar Association and the Massachusetts Bar Association. The Task Force began its work in 1989 and consisted of over 50 attorneys, including private practitioners, law professors, governmental officials and judges. See Keller et ali, *A New Corporation Act for Massachusetts*, Boston Bar Assoc. Business Law Section Newsletter (Winter Edition 2004).

The Act is a massive undertaking, consisting of over 500 pages of statutory text and drafters' comments. The text of the new Act and commentary is available in booklet and CD form from MCLE.

B. "Design Principles" Underlying the Act

In drafting the Act, the Task Force followed five "design principles:"

1. Uniformity. The Act conforms to the format of the 1984 version of the RMBCA.[2] Section 1.50 of the Act and its commentary state that significant weight should be given, in the absence of controlling Massachusetts precedent, to the interpretations of the courts of other jurisdictions with substantially equivalent provisions of the RMBCA.

2. Preservation of Massachusetts Policy and Practice. The Act tries to preserve important Massachusetts policies and practices within the RMBCA framework. For example, the Act adopts the BCL provisions requiring two-thirds vote for major corporate actions (as opposed to a majority vote under the RMBCA), preserves existing Massachusetts anti-takeover provisions for public companies, and permits director exculpation by

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[2] According to the BBA newsletter cited above, the Task Force did not select the Delaware General Corporation Law as the model for the Act, since it felt that the Delaware law was unique, subject to frequent amendment, and awkward to work with.

charter provision. There is, of course, a serious tension between this design principle and the uniformity principle.

3. Avoidance of Need for Defensive Action. The Task Force endeavored to draft legislation under which existing Massachusetts corporations would not have to adopt new charter amendments or bylaws in order to maintain the status quo. Accordingly, the Act allows existing corporations to "opt in" by charter or bylaw amendment to some of the more innovative provisions of the Act, such as action by less than unanimous shareholder consent.

4. Balancing of Interests. The Task Force attempted to strike a balance between the various corporate constituencies (*e.g.*, management, shareholders, creditors) without unduly favoring one over another.

5. Extensive Commentary. The Task Force comments on the Act are intended to serve as its legislative history. See Comments to §§1.01 and 1.50. These comments describe how the new Act differs from the BCL and the RMBCA; they differ from the RMBCA Comments in many ways.

C. The ABA Model Business Corporation Act

The Model Business Corporation Act was drafted and is periodically revised by the Committee on Corporate Laws of the American Bar Association. The Committee typically publishes proposed and final revisions to the model act in *The Business Lawyer*. The RMBCA is organized into seventeen "Chapters," each dealing with a separate topic of corporate law.[3]

The Model Business Corporation Act was first promulgated by the ABA in 1950 as the successor to the unpopular Uniform Corporation Act. The Model Act has been modified many times. In 1984, the Model Act was completely revised and renamed the Revised Model Business Corporation Act. Since 1984, there have been several major amendments to the RMBCA,

[3] These topics are: General Provisions; Incorporation; Purposes and Powers; Name; Office and Agent; Shares and Distributions; Shareholders; Directors and Officers; Domestication and Conversion; Amendment of Articles of Incorporation and Bylaws; Mergers and Share Exchanges; Disposition of Assets; Appraisal Rights; Dissolution; Foreign Corporations; Records and Reports; and Transition Provisions.

including important provisions relating to fiduciary duties in 1988, 1994 and 1998. Some version of the RMBCA is now in effect in 37 states.

The ABA publishes the *Model Business Corporation Act Annotated* (3d ed. 2002), which contains the text and commentary to the RMBCA and valuable historical and caselaw annotations.

D. Corporate Practice under the Act: Some Rash Predictions

The Act has only recently taken effect, and the Massachusetts corporate bar has had little practical experience dealing with the new law on an ongoing basis. Nonetheless, I will venture some predictions regarding the effect of the Act on Massachusetts corporate practice.

Although the Act completely rewrites the text of the BCL, it adopts so many of the familiar Massachusetts policies and principles from the BCL that it can be viewed as "old wine in new bottles." The transition from the BCL to the new Act should be painless for most business corporations; charter and bylaw amendments conforming to the more flexible new rules will be adopted over time. The Task Force goal of avoiding defensive action will be successfully achieved.

On the other hand, the Act differs from the BCL in many subtle ways, so practitioners will find that close attention to the statutory text is vital. The Act contains numerous provisions which are novel to Massachusetts practitioners, including share exchanges, conversions to non-profit corporations and non-corporate entities and less-than-unanimous shareholder consents. The Act also provides for greater flexibility in corporate practice than the BCL; the corporate bar will soon learn to love §7.32, which permits agreements among all shareholders to vary the statutory provisions of the Act in novel ways. See §VI(G) *infra*.

II. THE FIDUCIARY DUTIES PROVISIONS OF THE ACT

A. Fiduciary Duties under the BCL

The Massachusetts law of fiduciary duties of corporate officers, directors and employees is predominantly judge-made. The BCL contains very few provisions articulating or regulating the duty of care or the duty of loyalty. Section 65 of the BCL sets forth a statutory standard for the duty of care of directors and officers, permits directors and officers to consider "constituencies" other than stockholders, gives protection to fiduciaries relying on reports and information provided by employees, committees, and experts, and generally exonerates fiduciaries complying with these standards from liability. Except for a passing reference in §13(b)(1-1/2), the BCL does not contain any provisions regarding the duty of loyalty.

The BCL imposes statutory civil liabilities on corporate directors and officers for improper stock issuance (§60), improper dividends and stock redemptions (§61), loans to insiders (§62), filing of false statements or reports (§63), and filing of false articles (§64).

The BCL also provides for certain defenses to and limitations of fiduciary liabilities such as the defense of good faith and prudence (§65), consideration of non-stockholder constituencies (§65), reliance on reports, experts and committees (§65), exculpatory charter provisions (§13(b)(1-1/2)), contribution (§66), indemnification (§67) and insurance (§67).

B. Fiduciary Duties under the Act

The Act follows the BCL's approach of deferring to case law the articulation of the duties applicable to corporate fiduciaries.

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 §65 of the BCL, in providing 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, similar to the provisions typically included in the charters of Massachusetts business corporations under the BCL.

The Act contains some, but not all, of the statutory liabilities imposed under the BCL. New provisions apply to improper dividends and stock redemptions (§6.41) and loans to directors (§8.32). The Act does not include provisions similar to §§60, 63 and 64, imposing liability for improper stock issuance or the filing of false statements, reports or articles.

The Act 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).

C. No Change in the Law of "Close Corporations"

The Act makes no change in the common law of Massachusetts relating to fiduciary duties among shareholders of "close corporations." See *Fiduciary Duties*, §I(D). The Comments to the Act make it clear that *Donahue v. Rodd Electrotype Co*. and its progeny remain unchanged by the Act. See Comment to §6.22.

D. Comparison of Fiduciary Duties Provisions in the BCL and the Act

Annexed hereto as Exhibit A is a table summarizing the principal provisions of the BCL and the Act relating to the fiduciary duties of directors and officers.

III. THE DUTY OF CARE

A. General Standard of Care

G.L. c. 156B, §65 contains a statutory standard of care for directors, officers and incorporators. See *Fiduciary Duties*, §II(A)(1). Sections 8.30 and 8.42 of the Act are substantially similar to §65 of the BCL. 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.

B. "Ordinarily Prudent Person" Standard Eliminated

Under the BCL, an officer or director must act "with such care as an ordinarily prudent person in a like position would use under similar circumstances." Under the new Act, this standard of care is that which " a person in a like position would reasonably believe appropriate under similar circumstances."[4] Earlier versions of the Model Act standard of care were similar to the BCL standard. 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

[4] Perhaps by oversight, §15.11(b) of the Act applies the "ordinarily prudent person" standard to foreign corporations doing business in Massachusetts.

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.
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> (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.
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> (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.
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> 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."

B. 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 is frequently 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.

C. "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.

D. 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.

E. "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 §VI(B) *infra*.

F. The Business Judgment Rule

In *Harhen v. Brown*, 431 Mass. 838 (2000), the Supreme Judicial Court adopted a Delaware-style business judgment rule under which transactions approved by a disinterested board of directors (including decisions not to pursue litigation by the corporation against corporate fiduciaries) are not to be disturbed by the courts. This doctrine is subject to further evolution by judicial decision. See *Fiduciary Duties,* §II (B)(1)(b)(ii).

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."

G. Liability for Breach of the Duty of Care

1. 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.

2. 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. See *Fiduciary Duties,* §II (B)(1).

Section 8.30(c) and 8.42(c) of the Act adopt a similar rule.[5] 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.

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[5] Sections 8.30(c) and 8.42(c) employ slightly different language: "A director is not liable for any action" (§8.30(c)) and "[a]n officer shall not be liable to the corporation or its shareholders" (§8.42(c)). Although this language would imply that directors have greater protection than officers (*e.g.*, from claims by creditors), the comments to the Act are silent as to the reason for this difference.

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."

IV. THE DUTY OF LOYALTY

The duty of loyalty is a common law, rather than a statutory duty. The BCL contains no provision defining the duty of loyalty. See *Fiduciary Duties,* §II(B)(2).

A. Another Road Not Taken

In drafting the Act, the Task Force made the deliberate decision not to follow the statutory provisions of the 1989 version of the RMBCA relating to the duty of loyalty. In the "Preliminary Note" to the commentary on §8.31, the Task Force states that it did not adopt Subchapter F of the 1989 and later versions of the RMBCA, but instead based §§8.31 and 8.32 of the Act on the 1984 version of the RMBCA.

This is a bold choice. The 1989 version of the RMBCA, which replaced §8.31 with the provisions of Subchapter F (§§8.60-8.63), extensively regulate conflict of interest transactions by meticulously spelling out "safe harbor" procedures and adopting a "bright line" test for defining conflict of interest transactions. See Official Comment to RMBCA § 8.31 (1984).[6]

The Act, like the BCL, therefore leaves to the courts the development of rules applicable to the duty of loyalty of directors or officers, rather than following the RMBCA approach of codifying those rules in the statute. The introductory Comment to §8.31 makes it clear that section and §8.32 (relating to

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[6] Further revisions modifying Subchapter F and adding a new Subchapter G, relating to corporate opportunities, and other provisions relating to the duties of directors and officers, have recently been proposed. See ABA Committee on Corporate Laws, *Changes in the Model Business Corporation Act – Proposed Amendments Relating to Chapter 1 and Chapter 8 (including Subchapter F and G and Duties of Directors and Officers)*, 59 Bus. L. 569 (February 2004).

loans to directors) do "not attempt to define the full range of [the] duty [of loyalty]. Indeed any such attempt would probably be self-defeating since the language chosen might be used to limit prematurely the standards under which directors should act." Comment to §8.31.

B. 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 impropriety on his part. See §IV(C) *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. See *Fiduciary Duties,* §II (B)(2)(b)(ii) and Exhibit B thereto. 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.* (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.

C. Effect of Approval under Section 8.31

1. 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 §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 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 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.

2. 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.

D. 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.

1. 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.

2. 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 then 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.

3. 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.

E. 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.

F. “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.

G. 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.

H. 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 *Fiduciary Duties*, §II(B)(2)(a).

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

1. 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."

2. 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.

3. 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.

4. What Percentage Approval is Necessary?. As discussed in §IV (D) *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.

5. 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 ALI *Principles of Corporate Governance* See *Fiduciary Duties*, Exhibit A. Whether this difference in definition is significant is a question left for future judicial development.

6. 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.

V. STATUTORY LIABILITIES UNDER THE ACT

Section II (C) of *Fiduciary Duties* outlines various provisions of Chapter 156B which impose civil liability on directors and officers.

A. Improper Stock Issue

G.L. c. 156B, §60 provides that directors who vote to authorize the issuance of stock for a consideration which violates §18 or §21 of the BCL and the president and treasurer of the corporation are jointly and severally liable to the corporation. See *Fiduciary Duties*, §II (C)(1).

There is no corresponding provision in the Act. This is perhaps because the Act does not require any minimum consideration for the issuance of shares: Section 6.21(b) provides that shares may be issued for any consideration, including any property or "benefit" to the corporation, past services, or contracts for future services, which is deemed adequate by the board of directors. The Act supersedes "the historic prohibition against issuing par value stock for less than par." See Comment to §6.21.

Protection against the risk that shareholders will be diluted by the issuance of "watered stock" for inadequate or overvalued consideration is said to be provided by the requirements of §§8.30 (directors' standard of care) and 8.31 (directors' conflict of interest transactions). Id.

B. Improper Dividends and Redemptions

G.L. c. 156B, §61 provides for liability of directors who vote for a "distribution" (including a redemption of stock) in violation of the articles of organization or at a time when the corporation is, or will be rendered "insolvent." See *Fiduciary Duties,* §II(C)(2).

The Act contains a new definition of when a distribution results in insolvency: Section 6.40 provides that distributions must comply with an equitable solvency test and a balance sheet test (including the liquidation preference of senior securities). Under §6.41(a) directors who vote for an illegal distribution under the Act have personal liability, but only if their action is in violation of the standard of care of §8.30.

C. Loans to Insiders

G.L. c. 156B, §62 provides that directors who vote for, and officers who knowingly participate in, any loan of corporate assets to any of its directors or officers are jointly and severally liable for any portion of the loan which is not repaid, unless a majority of the directors or stockholders who are not direct or indirect recipients of such loan shall have approved or ratified the loan as one which in their judgment may reasonably be expected to benefit the corporation. See *Fiduciary Duties,* §II (C)(3).

The Act adopts a different approach: Section 8.32 provides that a corporation may not lend money to or guaranty the obligations of a director unless (1) the specific loan or guaranty is approved by a majority of the outstanding voting shares of all classes (voting as a single voting group), excepting shares owned by or voted under the control of the benefited director, or (2) the board of directors determines that the loan or guaranty benefits the corporation and either approves the specific transaction or a "general plan" authorizing loans and guaranties.

The Act recognizes the fact that loans to insiders "may be proper and desirable in some situations" See Comment to §8.32.

Section 8.32(b) makes clear that an irregular or improper loan is nevertheless enforceable by the corporation against the borrower.

The interaction between §§8.31 and 8.32 is unclear: A loan to a director would be a conflict of interest transaction governed by §8.31, and the savings clause of §8.32(b) (which makes an improper loan enforceable against the borrower), does not provide that it is not "voidable" by the corporation if §8.31 is not complied with. However, the Comment to §8.32 states that it "treats specially a second type of conflict of interest transaction," and points to §8.30 as the standard for director liability and exculpation in §8.32 cases. This implies that compliance with §8.31 is not required for §8.32 loans and guaranties covered by §8.32.

D. Liability For False Statements or Reports

G.L. c. 156B, §63 provides that directors or officers who sign any statement or report required under the BCL which is false in any material respect with respect to the corporation are jointly and severally liable to creditors who rely on such statement or report. See *Fiduciary Duties*, §II(C)(4).

The Act contains no corresponding provision for domestic corporations, but the analogous provisions of G.L. c. 181, §10 applicable to foreign corporations are retained in §15.11(a) of the Act.

E. False Articles

G.L. c. 156B, §64 provides that the incorporators and officers of a corporation who sign any articles of organization, amendment, consolidation or merger required by the BCL which are false in any material respect with regard to the corporation are jointly and severally liable to any stockholder for actual damage sustained by reliance on such articles. See *Fiduciary Duties,* §II(C)(5). The Act contains no corresponding provision for domestic corporations.

However, §1.29 of the Act provides for civil fines not exceeding $100,000 for signing false documents with the intent that they be delivered to the Secretary of State. (Compare BCL §68, providing fines not exceeding $5,000 or imprisonment for not more than three years.)

VI. DEFENSES AND LIMITATIONS OF FIDUCIARY LIABILITY UNDER THE ACT

Section II (E) of *Fiduciary Duties* outlines various provisions of Chapter 156B which provide defenses to and limitations of fiduciary liability.

A. Defense of Good Faith and Reasonability

Under G.L. c. 156B, §65, the fact that a director or officer performed his duties in accordance with the standard of care set forth in that section "shall be a complete defense to any claims asserted against him . . . except as expressly provided by statute, by reason of his being or having been a director [or] officer . . . of the corporation. See *Fiduciary Duties,* §§II (B)(1)(a), II (E)(1).

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 §III(G)(2). 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.

B. Consideration of Non-Stockholder Constituencies

G.L. c. 156B, §65, as amended in 1989, 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." See *Fiduciary Duties,* §II (E)(2).

Section 8.30(a)(3) of the Act adopts this provision *in haec verba*, thus departing from the text of the RMBCA in favor of an important Massachusetts legislative policy.

C. 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." See *Fiduciary Duties* ,§II(E)(3).

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."

D. Contribution, Indemnification and Insurance

1. Contribution. G.L. c. 156B, §66 provides that a director or officer against whom a claim is successfully asserted under Chapter 156B is entitled to contribution from the other directors who voted for, and the other officers who participated in, the action and did not perform their duties in accordance with the standards of §65. See *Fiduciary Duties,* §II(E)(4)(a).

The Act contains provisions relating to contribution only with respect to improper dividends and distributions. Section 6.41(b) allows a director who is liable to the corporation for an improper distribution to seek contribution from other directors who would have liability with respect to the distribution and, in certain cases, from the shareholders receiving the distribution.

2. Indemnification. G.L. c. 156B permits, but does not require, Massachusetts corporations to indemnify their directors, officers, employees and other agents in accordance with provision set forth in the articles of organization, by-laws adopted by the stockholders, or majority stockholder vote. Indemnification of persons who are not directors may also be provided by resolution of the directors.

Under the BCL, indemnification may not be provided with respect to any matter as to which an indemnified person shall have been adjudicated in any proceeding not to have acted in good faith in the reasonable belief that his action was in the best interest of the corporation. Indemnification may include payment by the corporation of expenses of defending a civil or criminal action or proceeding in advance of a final disposition thereof, upon receipt of an undertaking by the indemnified person to repay such payment if he should be adjudicated not to be entitled to information. See *Fiduciary Duties,* §II(E)(4)(b).

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 §VI(E) *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, discussed in §VI(G)(2) *infra*.

3. 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. See *Fiduciary Duties*, §II(E)(4)(c).

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 it scope; this power is provided in §3.02 and confirmed in §8.58(e). See Comment to §8.57.

E. Exculpatory Charter Provisions

G.L. c. 156B, §13(b)(1-1/2) provides that a Massachusetts corporation may include in its articles of organization a provision eliminating or limiting the personal liability of a director (but not an officer) to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit liability for (i) breach of the duty of loyalty, (ii) acts or omissions not in good faith or which involve intentional misconduct or knowing violation of law, (iii) under §61 or §62, or (iv) for any transaction from which the director derived an improper personal benefit. No exculpatory provision adopted under §13(b)(1-1/2) may be made retroactive to cover acts or omissions occurring prior to the date the charter provision becomes effective. See *Fiduciary Duties*, §II(E)(5).

Section 2.02(b)(4) of the Act contains a corresponding provision, thus departing from the text of the RMBCA in favor of an important Massachusetts legislative policy.

F. Ratification

Neither the BCL nor the Act deals in any detail with ratification by directors or shareholders, which is governed by the common law. See *Fiduciary Duties,* §II(E)(6). However, §8.31(a) of the Act, relating to director conflict of interest, does permit a director or shareholder vote to "ratify" a conflict of interest transaction to avoid the rule of automatic voidability. See §IV *supra*.

G. Shareholder Agreements under §7.32 of the Act.

1. Scope of §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. "

2. <u>May an Agreement Modify Fiduciary Duties?</u> For purposes of this discussion, we will focus on the question of whether a shareholder agreement under §7.32 may vary, limit, or exclude the fiduciary duties of directors, officers or shareholders of Massachusetts business corporations. See *Fiduciary Duties*, §§ II(D)(10), IV(F) and V(C) (discussing agreements modifying fiduciary duties in 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, <u>and is not contrary to public policy</u>" (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. See *Fiduciary Duties*, §§IV(F), V(C).

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."

EXHIBIT A

COMPARISON OF FIDUCIARY DUTIES PROVISIONS UNDER THE BCL AND THE ACT

The following table compares in summary fashion selected provisions of the Massachusetts Business Corporation Law (G.L. c. 156B) and the new Massachusetts Business Corporation Act (G.L. c. 156D). This table is intended to provide a handy and compendious reference tool, but readers are cautioned that, as a summary of statutory provisions, it is necessarily selective and oversimplified and is thus no substitute for a careful analysis of the statutory text.

Subject	156B	156D
	1. Duty of Care	
Standard of Conduct for Directors	A director shall perform his duties (1) in good faith, (2) in a manner he reasonably believes is in the best interests of the corporation, and (3) with the care an ordinarily prudent person in like position would use in similar circumstances (§65).	A director shall discharge his duties (1) in good faith, (2) with reasonable care, and (3) in a manner he reasonably believes is in the best interests of the corporation (§8.30).
Standard of Conduct for Officers	Same as directors (§65).	Same as directors (§8.42).
Other Constituencies	Directors may consider interests of employees, suppliers, creditors, customers, the economy, community and society, and the short and long-term interests of the corporation (§65).	Same (§8.30).
Exculpation of Directors	Charter may limit liability of directors for monetary damages for breach of fiduciary duty of care (§13(b) (1-1/2)).	Same as (§2.02(b)(4).

Subject	156B	156D
Directors' Rights of Inspection	No statutory provision.	Directors entitled to inspect and copy books and records if reasonably related to performance of duties as director; enforceable by court order on expedited basis (§16.05).

2. Duty of Loyalty

Director Conflict of Interests	No statutory provision. Charter customarily validates self-dealing transactions if approved by disinterested directors or stockholders.	Statutory safe harbor: conflict of interest transaction not voidable if (1) approved by disinterested directors after full disclosure, (2) approved by disinterested shareholders after full disclosure, or (3) fair to the corporation (§8.31).
Validity of Loans to Directors	No statutory provision. See "Liability of Directors for Insider Loans" below.	A corporation may not loan money to, or guarantee obligations of a director unless (1) the specific transaction is approved by a majority of the voting shareholders (voting as a single voting group), other than shares owned or controlled by the director, or (2) the board of directors determines the transaction benefits the corporation and approves the specific transaction or a general plan authorizing loans and guaranties (§8.32(a)).
Liability of Directors for Insider Loans	Directors who vote for, and officers who knowingly participate in, a loan to an officer or director are jointly and severally liable to the corporation for unpaid loan unless disinterested majority of directors or stockholders approve or ratify the loan as one reasonably expected to benefit the corporation (§62).	Governed by standards of §8.30.

Subject	156B	156D
	3. Dividends and Distributions	
Distributions	Stockholders and directors liable for distributions if corporation is or is thereby rendered "insolvent" (§§45, 61).	Distributions must comply with equitable solvency test and balance sheet test (including liquidation preference of senior securities) (§6.40(c)).
Director Liability for Improper Distributions	Joint and several liability of directors who voted for distribution in violation of charter or if corporation insolvent or thereby rendered insolvent (§61).	Personal liability if director votes for distribution and action is in violation of §8.30 (§6.41(a)).
Shareholder Liability for Improper Distributions	Personal liability to extent of amount received (§45).	Pro rata liability for improper dividends to extent of excess over proper amount (§6.41(c)).
Contribution for Improper Distributions	Stockholders entitled to contribution from other stockholders (§45); directors entitled to contribution from other directors (§66).	Directors allowed contribution from shareholders and others (§6.41(b)).
Limitation on Claims for Improper Distributions other than Liquidating Distributions	No statutory provision.	Two years (§§6.41(f) and (g)). See "Liability for Improper Distributions in Liquidation" below.
Distributions in Liquidation	Corporation must pay debts or obligations before making distributions (§102).	Distributions in liquidation must make adequate provisions for (1) existing and foreseeable liabilities, including contingent liabilities and (2) liquidation preferences of senior securities (§6.40(h)).
Director Liability for Improper Distribution in Liquidation	Directors liable for improper liquidation distributions (§61). See "Director Liability for Improper Distributions" above.	Directors who vote for liquidating distributions in violation of the Act are liable if in violation of standard of care under §8.30 (§6.41(a)).

Subject	156B	156D

4. Indemnification and Insurance

Permissible Indemnification	Corporation may indemnify (1) directors, officers, employees and agents to the extent provided in charter, bylaws or stockholder vote, and (2) officers, employees and agents to the extent authorized by the directors (§67).	A corporation may indemnify a director who is a party to a legal proceeding as a director if (1) he (a) acted in good faith, (b) reasonably believed his conduct was in, or not opposed to, the best interests of the corporation, and (c) in the case of criminal proceedings, had no cause to believe his conduct was unlawful, or (2) his liability is eliminated under a charter provision adopted under §2.02(b)(4) (§8.51). See "Indemnification and Advances for Expenses of Officers" below.
Mandatory Indemnification of Directors	No statutory provision.	A corporation shall indemnify a director against reasonable expenses incurred in the wholly successful defense of any proceedings to which he was a party because he was a director (§8.52).
Advances for Expenses of Directors	A corporation may pay expenses incurred by directors, officers, employees or agents upon receipt of an undertaking to repay such funds if adjudicated not to be entitled to indemnification (§67).	A corporation may advance or reimburse expenses incurred by a director in a legal proceeding if he (1) affirms in writing his good faith belief that his conduct met the standards of §8.51 or his liability is eliminated under a §2.02(b)(4) charter provision and (2) he undertakes in writing to repay such funds if a court determines otherwise (§8.53).

Subject	156B	156D
Court-Ordered Indemnification or Advances for Expenses of Directors	No statutory provision.	A director may apply to the court for indemnification or advances for expenses if he is entitled thereto under §8.52 or §8.58 or if the court determines such an order is fair and reasonable (§8.54(a)).
Limitation on Indemnification	No indemnification shall be provided for any person who is adjudicated not to have acted in good faith in the reasonable belief that his action was in the corporation's best interest (§67).	See "Permissible Indemnification" above.
Determination and Authorization of Indemnification of Directors	See "Permissible Indemnification" above.	Entitlement to indemnification must be determined by disinterested directors, by special legal counsel or by the disinterested shareholders; payment may be authorized by disinterested directors or shareholders (§8.55).
Indemnification and Advances for Expenses of Officers	See "Permissible Indemnification" above.	A corporation may indemnify and advance expenses of an officer to the same extent as a director, and to a greater extent if provided in charter, bylaws or contract and actions are not in bad faith, intentional misconduct or knowing violation of law; officers entitled to mandatory indemnification under §8.52 and court-ordered indemnification under §8.54 (§8.56).

Subject	156B	156D
D&O Insurance	A corporation may purchase insurance covering directors, officers, employees or agents, whether or not the corporation has the power to indemnify (§67).	A corporation may purchase insurance covering directors' and officers' liability, whether or not acts covered by indemnification provisions (§8.57).
Advance Commitment for Indemnification	No express statutory provision, but implied by §67.	A corporation may by charter, bylaws, director vote or contract obligate itself in advance to provide indemnification or advance expenses to the extent permitted by the Act (§8.58).

5. Shareholder Agreements

Shareholder Agreements Varying Statutory Provisions	No statutory provision.	Agreement among all shareholders is effective and binds transferees, even if inconsistent with the Act, so long as statutory formalities are complied with (§7.32).

6. Derivative Actions

Derivative Actions: Standing	Plaintiff must be stockholder at time of act complained of (§46). Stockholder must adequately and fairly represent corporation (Mass. R. Civ. P. 23.1; Fed. R. Civ. P. 23.1).	Plaintiff (1) must be a shareholder at the time of the act complained of or have acquired shares by operation of law from such a shareholder, and (2) fairly and adequately represent the interests of the corporation (§7.41).
Derivative Actions: Demand	No statutory provision. See Harhen v. Brown.	Plaintiff must in all cases make written demand on corporation at least 90 days (in some cases, 120 days) before commencing action (§7.42).

Subject	156B	156D
Derivative Actions: Dismissal	No statutory provision. See Harhen v. Brown.	Case must be dismissed if (1) majority of independent directors or a committee thereof or a majority of independent shareholders determine in good faith that suit is not in best interests of the corporation, or (2) a panel of independent persons appointed by the court so determines (§7.44).
Derivative Actions: Independence of Directors	Defined by common law. See Harhen v. Brown.	No statutory definition, but (1) nomination or election of director by a defendant, (2) naming of a director as a defendant, or (3) approval of the challenged action by a director is not disqualifying (§7.44 (c)).
Discontinuance or Settlement of Derivative Actions	No statutory provision. See Mass. R. Civ. P. 23.1; Fed. R. Civ. P. 23.1.	A derivative action may not be discontinued or settled without court approval and notice to all shareholders affected (§7.45).
Derivative Actions: Payment of Expenses	No statutory provision. Governed by common law.	On termination of derivative action, court may order either party to pay the other party's counsel fees and expenses (§7.46).