Massachusetts high court declares that public company directors owe fiduciary duty to corporation rather than to shareholders

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The Massachusetts Supreme Judicial Court (SJC) provided guidance to directors of publicly traded Massachusetts corporations last week holding that, in determining how to act in the corporation’s best interest, public company directors owe fiduciary duties not to the shareholders (as in Delaware) but to the corporation itself.

Background

In *International Brotherhood of Electrical Workers Local No. 129 Benefit Fund v. Tucci, et al.*, and other cases with which it was consolidated, a group of shareholders of EMC Corporation asserted claims against the members of the corporation’s board of directors for breach of fiduciary duty in approving the acquisition of EMC by Dell Inc. in a transaction that was structured in a manner that, the plaintiffs asserted, cost shareholders millions of dollars in share value. EMC Corporation was organized as a holding company that owned numerous related but independently operating businesses in a structure characterized by the court as a “federation.” The transaction approved unanimously by EMC’s directors merged the parent company into Dell, rather than having EMC sell each of the separate operating companies individually. The shareholders argued that individual sales of some or all of the separate subsidiaries would have yielded a higher aggregate price, and that, by approving the merger structure, EMC’s directors breached a fiduciary duty to provide maximum value to EMC’s shareholders. The plaintiffs also asserted that the directors further breached their fiduciary duty to shareholders by including in the agreement with Dell a $2 billion “break-up fee” (thereby chilling alternative bids for the company at a higher price than Dell’s).

The SJC retracts broad statement that directors owed shareholders fiduciary duties

The standards of conduct required to be followed by a director of a Massachusetts corporation are set forth in Section 8.30(a) of the Massachusetts Business Corporation Act (MGL chapter 156D),...
which provides that a director shall discharge his or her duties in good faith, with the care that a person in a like position would reasonably believe appropriate under similar circumstances and in a manner the director reasonably believes “to be in the best interests of the corporation.”

Section 8.30(a) further provides that corporate directors, in determining whether a transaction is in the best interests of the corporation, may take into account the interests of numerous constituencies, including the corporation's employees, suppliers, creditors and customers; national, regional and local economic and societal considerations; and the long-term and short-term interests of the corporation's shareholders.

There is a long line of Massachusetts cases establishing that “in the case of a close corporation, which resembles a partnership, duties of loyalty extend to shareholders” and that such duty is “even stricter” than that required of directors in corporations generally. *Demoulas v. Demoulas Super Mkts., Inc.*, 424 Mass. 501 (1997). Indeed, even in a case involving a public company (*Chokel v. Genzyme Corp.*), the SJC had previously stated that “[d]irectors owe a fiduciary duty to their shareholders.” 449 Mass. 272 (2007). Such a view is consistent with the general rule applied in Delaware, and Massachusetts courts have frequently cited Delaware fiduciary duty cases with approval.

In *Tucci*, the SJC for the first time expressly rejected the Delaware approach, noting that “although directors of close corporations owe a fiduciary duty to the shareholders of such corporations, that is not the rule in Massachusetts for corporations generally.” The court distinguished *Tucci* from *Chokel*, noting that directors’ fiduciary duty to shareholders “was not necessary to the resolution” in *Chokel* and expressing the view that the *Chokel* statement regarding fiduciary duty “was too broad.”

There are, of course, exceptions to the *Tucci* general rule, as previously articulated in *Demoulas*. In addition to the fiduciary duty owed to shareholders by directors of close corporations, controlling shareholders of closely held corporations owe a fiduciary duty to other shareholders not to engage in self-interested transactions.

Concluding that directors of a Massachusetts corporation owe a fiduciary duty to the corporation itself, and not directly to the corporation’s shareholders, the court ruled that claims asserted by the *Tucci* shareholders could be brought only in a derivative action on behalf of the corporation and not directly by the shareholders.

**Implications for Massachusetts directors**

Massachusetts directors should feel some relief following the SJC’s decision in *Tucci*. Importantly, the decision provides directors of publicly traded companies incorporated in Massachusetts with a meaningful check on breach of fiduciary duty litigation brought in the context of mergers. Shareholders who wish to challenge director decisions on fiduciary duty grounds must first satisfy the Massachusetts demand prerequisite to a derivative claim prior to filing suit. A demand is necessary even if—as in *Tucci*—shareholders claim that the directors’ decision caused substantial loss to the shareholders’ stock value and even if such a demand on directors would normally be considered futile.

In the deal context, directors of Massachusetts corporations should keep in mind that *Tucci* does not relieve them of their fiduciary duties. Indeed, even though *Tucci* clarifies that public company directors owe a fiduciary duty to the corporations that they serve and not directly to the corporations’ shareholders, in considering sale or merger proposals, especially when weighing the
relative costs and benefits of alternative structures, Massachusetts directors must remain aware of their fiduciary duty. *Tucci* does not change that long-standing standard to which directors will be held or relieve them of the obligation to consider all factors that a reasonable director would believe relevant to a determination of the best interests of their corporation. But *Tucci* does make clear that the list in Section 8.30(a)(3) of stakeholders whose interests may be considered in weighing the best interests of the corporation is illustrative and not mandatory and that the best interests of any one constituency are not necessarily to be given priority. Nevertheless, a prudent director would certainly want to consider, among other factors, whether a proposed transaction is likely to maximize shareholder value.

**Conclusion**

Massachusetts directors should see benefit in the SJC's ruling in *Tucci*. Procedurally, *Tucci* assures directors an opportunity to review the merits of shareholder claims before they become the target of personal lawsuits. But it would be unwise for directors not to consider whether a proposed business transaction would be likely to maximize shareholder value.

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