

Massachusetts Supreme Judicial Court Affirms Application of Business Judgment Rule to Mutual Fund Board's Decision to Dismiss Shareholder Derivative Suit

On August 23, 2010, the Massachusetts Supreme Judicial Court (SJC) ruled in *Halebian v. Berv* that the business judgment rule can be applied to a derivative complaint that is filed prior to a board's rejection of the demand that serves as the basis for the suit. The ruling reaffirmed the plenary power of a board, acting in good faith and after reasonable inquiry, to determine whether maintenance of a derivative proceeding is in the best interest of the company. Additionally, the decision is notable because it applied the derivative proceeding provisions of the Massachusetts Business Corporations Act to a mutual fund organized as a Massachusetts business trust, rather than a corporation.

The case arose from a shareholder suit brought against Citifunds Trust III, an investment company organized as a Massachusetts business trust. Following receipt of a demand letter from a shareholder, the board organized a special committee of independent trustees to consider the demand. More than ninety days after the date of the original demand letter, having received no definitive response from the board, the plaintiff filed suit. Six weeks later, the board rejected the shareholder's demand and formally declined to bring any action against the trustees. The district court then dismissed the case, citing Section 156D of the Massachusetts Business Corporations Act, which provides that "[a] derivative proceeding commenced after rejection of a demand" by the board shall be dismissed if the court finds that the independent members of the board have "determined in good faith after conducting a reasonable inquiry" that "the maintenance of the derivative proceeding is not in the best interests of the corporation." The Court of Appeals for the Second Circuit declined to rule on the plaintiff's appeal, instead certifying to the SJC the question of whether the phrase "commenced after rejection of a demand" limits the power of a board where the derivative suit is commenced before rejection of a demand. The SJC held that the statute was not intended to impose any temporal limit on the plenary authority of the board to reject a demand and affirmed that the business judgment rule should apply to such determinations. In its analysis, the SJC closely followed the analysis set forth in an amicus brief filed by Ropes & Gray on behalf of the Co-Chairs of the Task Force on the Revision of the Massachusetts Business Corporation Law, the group that drafted the statute. A copy of that brief is available [here](#).

In reaching its conclusion, the SJC also held that "[b]ecause a business trust 'in practical effect is in many respects similar to a corporation,' . . . the statute regulating derivative actions applies to a shareholder bringing such a claim against a corporation or a business trust." Given the substantial number of mutual funds organized as Massachusetts business trusts, the SJC's ruling will have significant impact on derivative suits involving mutual funds, including the plethora of pending derivative claims concerning auction rate securities. Mutual fund companies organized in Massachusetts that are facing derivative suits can now dependably rely on the procedures and protections set forth in the Massachusetts statutory framework.

If you have interest in discussing the potential impact of *Halebian v. Berv*, please do not hesitate to contact your regular Ropes & Gray attorney or [John D. Donovan, Jr.](#) who filed the [amicus brief](#) in the case.