Chapter 3: Corporations and Business Associations

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CHAPTER 3

Corporations and Business Associations

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§ 3.1. Agency — Scope of Actual and Apparent Authority of Corporate Officers.* Under Massachusetts law, the authority to manage the business affairs of the corporation is vested principally in the board of directors.¹ Corporate officers, as agents of the corporation, possess no general authority to bind the corporation contractually.² An officer's authority to enter into binding contracts on behalf of the corporation devolves from either a delegation of actual authority by the board or an imputation of authority under the apparent authority doctrine.³

Delegation of actual authority by a board of directors may be either express or implied.⁴ Express actual authority is vested in a corporate officer as a result of explicit manifestations by the board to the officer.⁵ Such manifestations may include language of a by-law,⁶ a vote of the board explicitly giving an officer the power to bind the corporation in a particular matter,⁷ or a grant by the board to an officer of the powers of a general manager.⁸

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1 See G.L. c. 156B, § 54, which states, "The directors may exercise all the powers of the corporation, except such as by law, by the articles of organization or by the by-laws of the corporation are conferred upon or reserved to the stockholders."


3 Kelly, 306 Mass. at 532-33, 28 N.E.2d at 1006 (Appeals Court cited several Massachusetts cases in which officers were given general authority to make contracts as result of express or implied delegation of actual authority by board of directors).

4 Id. at 533, 28 N.E.2d at 1006.

5 W. CARY & M. EISENBERG, CORPORATIONS, A-95 (5th ed. 1980) (authors provide general background information regarding selected agency terms and doctrines).

6 Kelly, 306 Mass. at 533, 28 N.E.2d at 1006.

7 Id.

8 Id. See Selame Associates, Inc. v. Holiday Inns, Inc., 451 F. Supp. 412, 420 (D. Mass. 1978), where the court stated that a general manager has the broadest authority of all business agents. The agent in Selame was general manager of a Holiday Inns waterfront complex. Id. He was found to have actual authority to bind Holiday Inns to a contract which involved moorage operations of the complex. Id. See also Neilson v. Malcolm Kenneth Co., 303 Mass. 437, 440-41, 22 N.E.2d 20, 22-23 (1939) (general manager in charge of corporation's factory had implied actual authority to employ person to work on machine used in regular course of business).
Implied actual authority, on the other hand, is authority which may be reasonably or customarily inferred by the agent from a more general grant of express actual authority by the principal. In determining whether implied actual authority exists in a corporate officer, courts have focused on the question of how a person in the particular agent's position would have reasonably interpreted his authority given the particular manifestations of express authority by his principal. The presence of either express or implied actual authority is adequate to bind the corporation contractually. In addition, the third party contracting with the officer need not be aware that the officer has actual authority in order for the corporation to be bound.

If an officer lacks both express and implied actual authority, the corporation may still be bound by the officer's actions under the agency doctrine of apparent authority. Apparent authority is created by the words, conduct or acquiescence of a principal which leads an outside contracting party reasonably to believe that actual authority exists for an agent's actions. In determining whether apparent authority may be imputed to a corporate officer, courts have focused on the question of how an outside contracting party would reasonably interpret the putative agent's authority in light of the particular principal's manifestations.

The Supreme Judicial Court has stated on repeated occasions that a
corporate officer is not clothed with apparent authority as a result of merely holding a corporate position.\textsuperscript{15} Apparent authority also cannot be based on the putative agent’s own words or conduct; rather, the manifestations must emanate from the principal.\textsuperscript{16} The Appeals Court has stated that the “variety of circumstances” surrounding a given transaction must be examined to determine whether apparent authority to bind the corporation to the contract has been created.\textsuperscript{17} In examining claims based upon the purported apparent authority of a corporate officer, the Supreme Judicial Court has given consideration to the position the putative agent held within the corporation, the nature of the usual activities of the corporation, whether the particular contract was within the scope of these usual activities and, in some cases, whether the principal has had repeatedly acquiesced in the agent’s course of conduct.\textsuperscript{18} All of these considerations relate to one of the essential elements of apparent authority: the reasonableness of the third party’s belief that the agent had authority to bind the corporation.\textsuperscript{19}

\textsuperscript{15} Hurley v. Ornsteen, 311 Mass. 477, 481, 42 N.E.2d 273, 276 (1942) (putative agents’ positions as president and treasurer, and clerk, respectively, were not enough alone to confer authority to bind corporation); Kelly v. Citizens Finance Co. of Lowell, Inc., 306 Mass. 531, 532, 28 N.E.2d 1005, 1006 (1940) (position of president and treasurer not sufficient alone to bind corporation); James F. Monaghan Inc. v. M. Lowenstein & Jones Inc., 290 Mass. 331, 333, 195 N.E. 101, 102 (1935) (merely holding office of vice president not enough to bind corporation). See also Sheldon v. First Federal Savings & Loan Ass’n, Etc., 566 F.2d 805, 808 (1st Cir. 1977) (authority not conferred by mere fact alleged agent was an officer).

\textsuperscript{16} See Sheldon, 566 F.2d at 808 (where the United States Court of Appeals for the First Circuit stated the “fundamental rule” that apparent authority cannot be created by the putative agent’s own manifestations, only by the principal’s). See also Brownell v. Tide Water Associated Oil Co., 121 F.2d 239, 244 (1st Cir. 1941); Hennessey v. Cities Service Refining Co., 282 Mass. 487, 489, 185 N.E. 7, 8 (1933); and Restatement, supra note 10, at § 285.

\textsuperscript{17} Kanavos, 14 Mass. App. Ct. at 332, 439 N.E.2d at 315. See infra note 42 and accompanying text.

\textsuperscript{18} See, e.g., Hurley, 311 Mass. at 482, 42 N.E.2d at 276, where the Court stated that there was no apparent authority since the agent had neither entered previously into an accord and satisfaction on behalf of the corporation nor engaged in a course of conduct which could imply acquiescence on the part of the board. Similarly, in Kelly, 306 Mass. at 532-33, 28 N.E.2d at 1006, the Court stated that the evidence did not support a finding of apparent authority in the officer to bind the corporation to an employment contract which the agent entered into with an attorney for the purpose of defending the corporation in a lawsuit. The Court found the defense of such a suit did not fall within the customary duties of a president or a treasurer, and there was no evidence the alleged agent had exercised general management powers over the corporation or had dealt habitually in the defense of lawsuits. Id. In Monaghan, 290 Mass. at 333, 195 N.E. at 102, the Court found a vice president did not have apparent authority to enter into an employment contract with the plaintiff to draw up plans for a finishing plant, since the planned finishing plant was not a part of the regular business of the corporation.

\textsuperscript{19} See Restatement, supra note 10, at § 27. In Neilson v. Malcolm Kenneth Co., 303
In a recent application of these apparent authority principles, the Appeals Court stated that when a corporate officer is allowed to exercise general corporate duties, the corporation should be bound by his actions if he convincingly appears to have the power to enter into the particular transaction.\(^{20}\) The Appeals Court further stated, however, that this principle does not apply to transactions outside the scope of a corporation's normal activities.\(^{21}\) During the Survey year, the Appeals Court once again applied these principles and found apparent authority lacking in Rubel v. Hayden, Harding & Buchanan, Inc.\(^{22}\)

Rubel concerned an action brought against Hayden, Harding & Buchanan, Inc. (HHB), a civil engineering firm, for payment of a finder's fee.\(^{23}\) The issue before the Appeals Court was whether John Hayden (Hayden), president, treasurer, chairman of the board of directors and chief administrative officer of HHB, had either actual or apparent authority to bind HHB to pay the plaintiff, Warren Rubel (Rubel), a finder's fee.\(^{24}\) At the time of the disputed transaction, HHB was a wholly owned subsidiary of Peabody Gallion Company, a fact known to Rubel.\(^{25}\) HHB held a minority interest in Venusca, a Venezuelan engineering firm.\(^{26}\) Hayden had been asked by his associates in Venusca to help them locate a source of financing for a residential construction project in Venezuela which they wanted to undertake.\(^{27}\)

In an effort to assist Venusca, Hayden arranged several meetings with Rubel.\(^{28}\) At the second of their two meetings, Rubel broached the subject of compensation should he be able to locate a source of capital.\(^{29}\) Rubel advanced several compensation formulae, all of which seemed reasonable

Mass. 437, 440-41, 22 N.E.2d 20, 22-23 (1939), the Court found that the circumstances were such that it would be reasonable for a third party to assume that the agent had authority to bind the corporation. The alleged agent was both president and general manager of a corporation which manufactured men's clothing. \textit{Id.} at 440, 22 N.E.2d at 22. The agent entered into a contract with the plaintiff under which the plaintiff was to fix a machine. \textit{Id.} The Court found that since the plaintiff knew the agent was generally in charge of the manufacturing plant and since the machine which was to be repaired was related to the business of the corporation, the plaintiff could reasonably have believed that the agent had authority to bind the corporation contractually. \textit{Id.} at 441, 22 N.E.2d at 23.


\(^{21}\) \textit{Id.}


\(^{23}\) \textit{Id.} at 252-53, 444 N.E.2d at 1306-07.

\(^{24}\) \textit{Id.} at 253, 444 N.E.2d at 1307.

\(^{25}\) \textit{Id.} at 254, 444 N.E.2d at 1307. The parent corporation was also referred to as Peabody International in the trial testimony. \textit{Id.}

\(^{26}\) \textit{Id.} at 253, 444 N.E.2d at 1307.

\(^{27}\) \textit{Id.} Venusca required $1,160,000 in start-up capital. \textit{Id.}

\(^{28}\) \textit{Id.}

\(^{29}\) \textit{Id.}
to Hayden. Hayden, however, told Rubel that it would be necessary for Hayden himself to discuss the matter with others before making any decision. Hayden and Rubel did agree that Rubel would travel to Venezuela to familiarize himself with the project.

Shortly thereafter, Rubel presented Hayden with a preliminary agreement for the provision of the necessary financing by First National Bank of Chicago. Peabody Gallion, the parent of HHB, however, turned down the Venusca residential development, thus terminating the need for the funds. Subsequently, Hayden refused to discuss the matter with Rubel.

Rubel brought suit in superior court for payment of his finder's fee. Although the jury found in Rubel's favor, the judge granted a judgment notwithstanding the verdict in favor of HHB. Rubel appealed to the Appeals Court.

In assessing the superior court's decision, the Appeals Court found no evidence upon which to base a finding that HHB expressly delegated authority to Hayden to obligate the corporation to Rubel. The court noted the lack of any explicit manifestation, such as a vote of the board of directors of HHB, which would create an agency in Hayden to bind HHB in connection with the Venusca project. Though Hayden held several prominent positions within HHB, the court found this insufficient to ascribe authority. In support of its finding, the court cited cases in which the Supreme Judicial Court had been reluctant to allow titles or trappings of office to be the basis of a corporate officer's authority.

The Appeals Court noted that in a recent case, Kanavos v. Hancock Bank & Trust Co., it had found the "variety of circumstances" sufficient to ascribe to the executive vice president of the defendant bank the apparent authority to modify a loan agreement. The Rubel court,

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30 Id.
31 Id.
32 Id.
33 Id. at 254, 444 N.E.2d at 1307.
34 Id.
35 Id. at 252, 44 N.E.2d at 1307. The action commenced in the superior court, where the jury rendered a special verdict in favor of the plaintiff in the amount of $13,610. Id.
36 Id. Though no judgment to that effect had yet been entered, Rubel appealed to the Appeals Court. Id. The Appeals Court, on procedural grounds, stated that Rubel's appeal ought to be dismissed. Id. at 252-53, 444 N.E.2d at 1307. However, since the case had been briefed and argued, the court decided to reach the merits and leave it to the parties and to the superior court to straighten out the procedural details. Id. at 253, 444 N.E.2d at 1307.
37 Id. at 254, 444 N.E.2d at 1308.
38 Id.
39 Id. at 254-55, 444 N.E.2d at 1308. See supra note 15 for cases to which the court referred.
41 Id. at 333, 444 N.E.2d at 315-16. The Kanavos court also found implied actual author-
however, distinguished the circumstances in *Kanavos*. According to the court, unlike the situation in *Kanavos*, the subject matter of the alleged agent’s contract in *Rubel* was outside the normal scope of HHB’s business. The *Rubel* court noted that investment in real estate was not within the range of usual activities of HHB. This, together with the fact Rubel knew of HHB’s status as a wholly owned subsidiary of Peabody Gallion, led the court to conclude that Rubel could not have reasonably assumed that Hayden had authority to bind HHB in a business deal which was related only incidentally to its normal business.

In addition to finding that the "variety of circumstances" was insufficient to support a finding of apparent authority, the Appeals Court further stated that Hayden’s own words and conduct could not create apparent authority. According to the court, such authority could only be created by the principal’s words or conduct. Finally, the court noted that apparent authority could not be created in this case by the principal’s acquiescence, since it had not been shown that HHB had allowed Hayden to enter into such contracts over an extended period of time.

The *Rubel* court’s finding that neither actual nor apparent authority to bind the corporation existed on the basis of the facts presented is based on settled Massachusetts precedent. The Supreme Judicial Court has stated that express actual authority can be created by means of a by-law or vote of the board of directors of the corporation. Neither of these factors was present in *Rubel*. The "variety of circumstances" which the Appeals Court found created apparent authority in *Kanavos* was not present in *Rubel*. The nature of the agreement between Hayden and Rubel was not within the range of usual activities of HHB. Furthermore, HHB had not acquiesced over an extended period of time in Hayden’s binding the corporation to such agreements. In sum, it was not reasonable for a

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*Note: The text continues with a series of notes and references.*
person in Rubel’s position to assume that Hayden had the authority to bind HHB to pay Rubel a finder’s fee.

Rubel effects no change in Massachusetts law regarding creation of actual or apparent authority. However, the case does provide guidance on the minimum factual showing necessary to find apparent authority under the current “variety of circumstances” test. Rubel demonstrates that titles and trappings of office are not sufficient alone to establish apparent authority in a corporate officer to bind a corporation to specific contractual obligations. 50 Apparent authority is also not imputed from a putative agent’s words or conduct. 51 Finally, Rubel establishes that an outside contracting party is not reasonable in assuming authority on the part of a corporate officer when the substance of the contract is not within the usual day to day activities of the corporation. 52

§ 3.2. Personal Property Tax Exemption for Domestic Business Corporations.* While taxpayers may organize their affairs so as to minimize federal income tax liability, the federal tax law attempts to distinguish transactions where form is used to obscure the underlying substance. 1 In Massachusetts, the Supreme Judicial Court has made substance-over-form determinations concerning tax exemptions for charitable institutions 2 and for property used for religious purposes. 3 The substance-over-form issue may also be raised by the personal property tax exemption for a Massachusetts domestic business corporation.

The Massachusetts General Laws provide for a local tax on real and personal property owned by inhabitants of the Commonwealth. 4 The tax

51 Id. at 255, 444 N.E.2d at 1308.
52 Id.
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§ 3.2. 1 The substance over form distinction arises in the federal tax area in many situations, for example, sale-leaseback transactions. See, e.g., Helvering v. F. R. Lazarus & Co., 308 U.S. 252, 255 (1939) (seminal Supreme Court decision on tax consequences of sale and leaseback transactions). See also Fuller, Sales and Leasebacks and the Frank Lyon Case, 48 GEO. WASH. L. REV. 60, 60-65 (1972); Cahn, Some Reflections on the Quest For Substance, 30 GEO. L.J. 587, 587-609 (1942).


4 G.L. c. 59, § 2 provides: "All property, real and personal, situated within the commonwealth, and all personal property of the inhabitants of the commonwealth wherever situated, unless expressly exempt, shall be subject to taxation." All taxable personal property is assessed to the owner in the town in which he is an inhabitant. G.L. c. 59, § 18.
applies to all real and personal property, unless the property is statutorily exempt. Exemptions to the broad scope of local taxation are contained in chapter 59, section 5. Section 5(2) exempts from local taxation the personal property of a domestic business corporation. A domestic business corporation, according to Massachusetts law, is a corporation organized under, or subject to, the state incorporation statutes.

During the Survey year, the Supreme Judicial Court considered the question of whether a corporation organized for tax purposes by the partners of a Boston law firm qualified as a domestic business corporation within the meaning of chapter 59, section 5. In *Brown, Rudnick, Freed & Gesmer v. Board of Assessors of Boston*, the Court affirmed the Appellate Tax Board’s decision that a corporation organized solely for the purpose of avoiding taxes was not a domestic business corporation and therefore exempt from the local personal property tax.

The law partnership of Brown, Rudnick, Freed & Gesmer ("BRFG") organized a corporation, Briefing, Inc., under chapter 156B, for the stated purpose of leasing personal property. All the directors of the corporation were partners in BRFG. After forming Briefing, Inc., BRFG transferred title to all its personal property to the corporation in exchange for all of the corporation’s capital stock and a promissory note for $65,000. The corporation then leased the personal property back to BRFG under a one

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5 G.L. c. 59, § 2.
6 G.L. c. 59, § 5(2) exempts from taxation:
   [i]n the case of (a) a domestic business corporation or (b) a foreign corporation, both as defined in section thirty of chapter sixty-three, all property owned by such corporation other than the following: — real estate, poles, underground conduits, wires, and pipes, and machinery used in the conduct of the business.

A discussion of the early history of the exemption for the personal property of domestic business corporations can be found in *P. Nichols, Taxation in Massachusetts*, § 5 at 208-09 (3d ed. 1938). All domestic corporations are required to pay a corporate excise tax to the state. G.L. c. 63, § 32. A part of this excise tax is determined by applying a flat rate to the tangible property of the corporation. G.L. c. 63, § 32(a)(1)(i). As a result, in order to avoid a double taxation upon the personal property of a domestic corporation, the exemption from local taxation is provided. See *P. Nichols, Taxation in Massachusetts*, § 5 at 208 (3d ed. 1938).


7 G.L. c. 63, § 30(1).
9 *Id.* at 305, 450 N.E.2d at 166.
10 *Id.* at 299, 450 N.E.2d at 163. In its opinion, the Court summarized the findings of the Appellate Tax Board. A more detailed description of the facts is contained in the Board’s opinion, *Brown, Rudnick, Freed & Gesmer v. Board of Assessors of Boston*, 1 Mass. App. Tax Bd. Rep. 70 (1982).
11 389 Mass. at 299, 450 N.E.2d at 163.
12 *Id.* The personal property transferred included business and office equipment, furniture, furnishings, books, publications, and periodicals. *Id.*
year lease which was automatically extended from year to year.\textsuperscript{13} Briefing, Inc. leased additional equipment to BRFG from time to time at a rate predetermined in the lease.\textsuperscript{14} The corporation supplied BRFG with daily office supplies, and in addition, BRFG leased some office equipment from other sources.\textsuperscript{15} Briefing, Inc. never leased property to any entity other than BRFG although it had the power to do so by its incorporation under chapter 156B.\textsuperscript{16} Nor did Briefing, Inc. solicit business from any outside entity. Its leasing arrangement with BRFG was its exclusive source of income.\textsuperscript{17} Briefing, Inc. paid corporate excise taxes for the years 1977-1980.\textsuperscript{18} Any increase in Briefing, Inc.'s rental income resulted from additional purchases of equipment and its subsequent rental to BRFG.\textsuperscript{19} These additional rentals were made to accommodate the partnership's growth needs.\textsuperscript{20} No evidence was introduced that Briefing, Inc.'s business was in any way separate from BRFG, or that it had any employees.\textsuperscript{21} The business address of the corporation was the same as that of BRFG, and BFRG admitted that the lease was not an arms-length transaction.\textsuperscript{22}

For the years 1977 through 1981, BRFG filed a "Form of List" with the assessors of the city of Boston, claiming it owned no personal property of any kind.\textsuperscript{23} In each of the relevant years, however, BRFG was assessed a personal property tax by the city of Boston.\textsuperscript{24} BRFG paid the tax and applied for an abatement.\textsuperscript{25} The board of assessors of Boston denied the abatement and BRFG appealed to the Appellate Tax Board (the "Board").\textsuperscript{26} The Board upheld the assessment of the personal property taxes, finding that Briefing, Inc. did not qualify as a domestic business corporation entitled to a personal property exemption under chapter 59,
section 5. The Board reasoned that Briefing, Inc. was not a "domestic business corporation" within the meaning of the statute because it was not engaged in "business." In making this determination, the Board applied the following definition of "business":

"Business" is a word of large signification and is not susceptible of exact definition applicable to all cases. When the purpose of the statutes taxing income is considered, the word "business," as used in the section relating to the deduction of expenses, must be held to refer to an activity which occupies the time, attention and labor of men for the purpose of livelihood, profit or gain.

In the Board's view, Briefing, Inc. was not engaged in the business of leasing property for profit or gain, and therefore could not be characterized as a viable business entity with respect to the local property tax exemption. BRFG appealed the decision of the Board to the Supreme Judicial Court.

In analyzing the issue of whether Briefing, Inc. was entitled to the tax exemption, the Court stated that mere compliance with the statutory definition of a domestic business corporation would not ensure the exemption. The Court acknowledged that Briefing, Inc., having been properly organized under chapter 156B, was a corporation in form. In the Court's view, however, ending the inquiry at this point would elevate form over substance. The Court stated that in cases involving charitable institutions claiming an exemption under chapter 59, section 5, it has looked to the actual work performed by the charitable corporation to determine whether the corporation qualifies for the exemption. The Court concluded that the same type of analysis was applicable in the present case.

In determining whether Briefing, Inc. qualified for an exemption as a domestic business corporation, the relevant factor, according to the Court, was whether the corporation was operated for "dominantly business purposes." According to the Court, the definition of "business"
applied by the Board — "an activity which occupies the time, attention and labor of men for the purpose of livelihood, profit or gain" — was appropriate.\(^{38}\) The Court, reviewing the facts as found by the Board,\(^{39}\) agreed with the conclusion that Briefing, Inc. was not an "entity conducted for gain or profit."\(^{40}\)

Relying on a case decided under federal tax law, the Court rejected BRFG's argument that Briefing, Inc. was engaged in profit-seeking activities and was therefore within the definition of a business which was enunciated by the Court in *Whipple v. Commissioner of Corps. & Taxation.*\(^{41}\) In the tax case, *Higgins v. Smith,*\(^ {42} \) the taxpayer sold securities to a corporation wholly owned by him in order to realize a loss.\(^ {43}\) The taxpayer was denied the deduction by the United States Supreme Court.\(^ {44}\) The *Brown, Rudnick* Court identified two principles from *Higgins* as relevant to BRFG's situation. The first principle was that transactions which do not vary control or change the flow of economic benefits are to be dismissed from consideration.\(^ {45}\) Second, the government is not required to acquiesce to the taxpayer's choice of whatever form of doing business provides him with the most favorable tax consequences.\(^ {46}\) Rather, the government may look to the reality of the situation.\(^ {47}\) According to the Court, the Board implicitly recognized these principles when it decided that Briefing, Inc. was not organized for profit.\(^ {48}\) The Board could reasonably conclude, the Court noted, that the lease arrangement did not "vary control or change the flow of economic benefits" between BRFG and Briefing, Inc.\(^ {49}\) The Court approved the Board's close examination of the true nature of the relationship between Briefing, Inc. and BRFG,\(^ {50}\) and also affirmed the Board's ultimate finding that the activities of Briefing, Inc. were not undertaken for profit.\(^ {51}\) In conclusion, the Court held that

\(^{38}\) *Id.* (emphasis supplied by the Court).

\(^{39}\) Under Massachusetts law, the Board's decisions are final as to findings of fact. G.L. c. 58A, § 13.

\(^{40}\) 389 Mass. at 304, 450 N.E.2d at 166.

\(^{41}\) *Id.* at 304-05, 450 N.E.2d at 166 ("[T]he word 'business,' . . . must be held to refer to an activity which occupies the time, attention and labor of men for the purpose of livelihood, profit or gain." *Whipple v. Commissioner of Corps. & Taxation,* 263 Mass. 476, 485-86, 161 N.E. 593, 595 (1928)).

\(^{42}\) 308 U.S. 473 (1940).

\(^{43}\) *Id.* at 474-75.

\(^{44}\) *Id.* at 480.


\(^{46}\) *Id.* (citing *Higgins v. Smith,* 308 U.S. at 477-78).

\(^{47}\) *Id.*

\(^{48}\) *Id.* at 305, 450 N.E.2d at 166.

\(^{49}\) *Id.*

\(^{50}\) *Id.*

\(^{51}\) *Id.*
Briefing, Inc. was not entitled to an exemption as a domestic business corporation. The Court distinguished its holding from federal cases which stand for the proposition that the taxpayer may organize his affairs in any legal form so as to minimize taxes without being penalized by the government for doing so. The Court interpreted the Board’s decision as going only so far as to hold that BRFG failed to establish that Briefing, Inc. performed any function other than to shelter the firm from local taxation. In the Court’s view, “escaping taxation is not a ‘business’ in the ordinary meaning.” This result, the Court noted, does not mean, however, that a corporation set up to do business only with a parent entity could never qualify as a “domestic business corporation.”

Despite its affirmance of the Board’s decision that Briefing, Inc. did not qualify as a “domestic business corporation,” the Court nevertheless remanded the case to the Board for further proceedings. In addition to the exemption from local taxation provided for a domestic business corporation, the statute allows an exemption from local taxation for a “Massachusetts corporation.” According to the Court, the Board determined only that Briefing, Inc. was not a domestic business corporation, leaving open the question whether Briefing, Inc. was a “Massachusetts corporation.” Consequently, the Court remanded the case to the Board to determine whether Briefing, Inc. is a Massachusetts corporation within the meaning of the statute.

The Supreme Judicial Court’s decision in Brown, Rudnick, Freed & Gesmer makes it clear that compliance with the provisions in chapter 156B for the formation of a corporation will not, in and of itself, guarantee an exemption as a domestic business corporation. The Court, in determining whether an exemption should be allowed, applied a test which focused on whether the corporation was operated for “dominantly business purposes.” Application of the “dominantly business purposes” test, however, adds a gloss to the language of the statutory exemption. The exemption applies to a domestic business corporation “as defined in section

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52 Id.
54 389 Mass. at 305-06, 450 N.E.2d at 166.
55 Id. at 306, 450 N.E.2d at 167 (quoting Judge Learned Hand in National Investors Corp. v. Hoey, 144 F.2d 466, 468 (2d Cir. 1944)).
56 389 Mass. at 305, 450 N.E.2d at 166.
57 Id. at 306, 450 N.E.2d at 167.
58 G.L. c. 59, § 5(1).
60 Id.
61 Id. at 303, 450 N.E.2d at 165.
thirty of chapter sixty-three.'"62 The definition of domestic corporations in chapter 63, section 30 includes those "organized under or subject to . . . chapter one hundred and fifty-six B."63 The Court admitted that Briefing, Inc. was properly formed under chapter 156B.64 To avoid elevating form over substance, however, the Court applied both the "dominantly business purposes" test and the Whipple Court's definition of business.65

The decision in Brown, Rudnick, Freed & Gesmer will affect the ability of a Massachusetts corporation to gain an exemption under chapter 59, section 5. In determining whether such an exemption is proper, courts will now consider whether the corporation performs any function other than to shelter the taxpayer from personal tax liability. The inquiry made with respect to a corporation will be similar to the inquiry made with respect to the exemptions for charitable institutions and for property used for religious purposes. Courts will look beyond the form chosen by the taxpayer to the substance of the transaction.66

The Court left open the question whether Briefing, Inc. is a Massachusetts corporation and therefore exempt from personal property taxes under chapter 59, section 5(1).67 The statute imposes two requirements for an exemption under this section. First, the corporation must be a Massachusetts corporation.68 Second, the corporation must be subject to taxation under chapter 63.69 Briefing, Inc. appears to meet both of these requirements. As the Court acknowledged, Briefing, Inc. was properly formed under chapter 156B, which made it a Massachusetts corporation.70 Briefing, Inc. also had paid corporate excise taxes under chapter 63 every year since its formation.71

It is unlikely, however, that the Board would allow Briefing, Inc. an exemption as a Massachusetts corporation. The Board's denial of an exemption to Briefing, Inc. as a domestic business corporation was strongly worded. In the Board's view, Briefing, Inc. was not a "viable

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62 G.L. c. 59, § 5(2).
63 G.L. c. 63, § 30(1).
64 389 Mass. at 303, 450 N.E.2d at 165.
65 Id.
67 389 Mass. at 303 n.9, 450 N.E.2d at 165 n.9.
68 Id.
69 Id.
70 389 Mass. at 302, 450 N.E.2d at 165.
71 Id. For the years paid and amount of Briefing, Inc.'s corporate excise taxes, see Brown, Rudnick, 1 Mass. App. Tax Bd. Rep. at 71.
business entity conducted for gain or profit; wherefore, it does not merit recognition as a taxable entity.\textsuperscript{72} According to the Board, BRFG was the only taxable entity, and therefore BRFG, and not Briefing, Inc., was charged with the local tax.\textsuperscript{73} The Board will likely use the same approach in determining whether Briefing, Inc. is entitled to an exemption as a Massachusetts corporation.

The Massachusetts taxpayer who now seeks an exemption as a domestic business corporation would be unwise to incorporate solely for this tax advantage. Both the Board and the courts will scrutinize the substance of the corporation to determine whether it is a "business" for the purpose of the domestic business corporation exemption, with the courts applying a "dominantly business purpose" test. Whether a corporation which fails to qualify for the domestic business corporation exemption can qualify for the Massachusetts corporation exemption is still an unanswered question. Given the Board's and the Court's disinclination to allow an exemption for a corporation organized solely to avoid taxes, it is unlikely such an entity would be able to claim the exemption as a Massachusetts corporation.

\textsection{3.3. Fiduciary Duty of Employees in a Position of Trust — Competing with the Corporation.}\textsuperscript{*} Directors and officers traditionally have been held to occupy a fiduciary position within the corporation.\textsuperscript{1} As fiduciaries, they are bound to place the interests of the corporation above their own interests.\textsuperscript{2} This so-called duty of loyalty prevents corporate fiduciaries from competing with the corporation while in its employ.\textsuperscript{3} An inflexible application of this principle of loyalty, however, might unjustly hamper a fiduciary's right to seek independent entrepreneurial pursuits and discourage capable persons from holding positions of trust within the corporation.\textsuperscript{4} Accordingly, fiduciaries may make preparations for the creation

\textsuperscript{72} Id. at 77.
\textsuperscript{73} Id. at 74. Under this analysis, Briefing, Inc. should not have been paying any taxes, because it did not exist as a tax entity. It is confusing why Briefing, Inc.'s corporate excise taxes were accepted for four years if it was not a corporation. The explanation is that Briefing, Inc. was caught between two taxing bodies: the city, which was unwilling to recognize Briefing, Inc. as a corporation, and the state, which was willing to recognize it as such.
\textsuperscript{*} Anne T. Foley, staff member, \textit{Annual Survey of Massachusetts Law.} § 3.3 1 H. Henn & J. Alexander, \textit{Laws of Corporations} §§ 235-36, at 625-29 (1983).
\textsuperscript{1} Id.
\textsuperscript{2} § 236, at 628. For example, a fiduciary may not use corporate assets or employees for his own benefit, solicit business away from his corporation while in its employ, or make secret profits from corporate transactions. Id.
\textsuperscript{3} See id.; see also Maryland Metals, Inc. v. Metzner, 282 Md. 31, 39, 382 A.2d 564, 573 (1978). The Maryland Metals court stated that the policy of encouraging free competition has resulted in the recognition of the right of employees to make preparations to compete with
of a competing business, as long as in the course of such preparations they act in good faith.\(^5\) When a fiduciary breaches this duty of loyalty, the corporation is entitled to damages ranging from recovery of lost profits to repayment of salaries paid to disloyal employees.\(^6\)

These general corporate principles are embodied in the leading Massachusetts case, *Lincoln Stores, Inc. v. Grant*.\(^7\) In *Lincoln Stores*, the Supreme Judicial Court stated that directors and officers are not precluded from entering into a competing business as long as their actions are carried out in good faith.\(^8\) The defendants, two of whom were inside directors and one of whom held a nonmanagement position, were found to have breached their duty of loyalty by using confidential information acquired while in the plaintiff’s employ to help them set up their competing business.\(^9\) In addition, the defendants had wrongfully charged to the plaintiff corporation travel expenses incurred solely for the defendants’ benefit.\(^10\) For these violations, the defendants were ordered to reimburse the plaintiff for the profits it would have earned but for the defendants’ competition, for the travel expenses wrongfully charged to the plaintiff, and for the salaries paid to the defendants during the period of their unfaithfulness.\(^11\)

The application by the *Lincoln Stores* Court of the doctrine of fiduciary duty of loyalty to a defendant who was neither an officer nor a director was not unique. In several Massachusetts cases preceding *Lincoln Stores*, the Court had applied agency principles to hold employees who act in a representative capacity liable for disloyal acts.\(^12\) The broadest application their employers prior to leaving their employment without incurring liability for breach of their fiduciary duty of loyalty. *Id.* This recognition protects an employee from having to wait until he is unemployed before beginning preparations to enter into a competing business. *Id.*


\(^7\) 309 Mass. 417, 34 N.E.2d 704 (1941).

\(^8\) *Id.* at 423, 34 N.E.2d at 707.

\(^9\) *Id.* at 418, 424, 34 N.E.2d at 705, 708.

\(^10\) *Id.*

\(^11\) *Id.* at 420, 34 N.E.2d at 706.

\(^12\) See, e.g., Raymond v. Davies, 293 Mass. 117, 119, 199 N.E. 321, 323 (1936). The Raymond Court cited Little v. Phipps, 208 Mass. 331, 333, 94 N.E. 260, 261 (1911) for the proposition that an agent must exercise "utmost good faith" in his dealings with his principal and must act with complete loyalty toward his principal. *Id.* In both Raymond and Little, managers of real estate were found to have breached their duty of loyalty to their principals by taking secret profits. Similarly, in Quinn v. Burton, 195 Mass. 277, 81 N.E. 257 (1907), the Supreme Judicial Court stated:

It is a principle universally recognized, as founded not only on common business
of the duty of loyalty can be found in an early Massachusetts case, *Lindsay v. Swift*.  

The Lindsay Court stated that any employee in a position of trust is bound to act in good faith in his dealings with his employer. More specifically, the Court stated that an employee cannot use his employer’s business for his own profit or enter into conflicting transactions without the employer’s consent. Thus, in Massachusetts, the fiduciary duty of loyalty has been held to apply not only to directors and officers, but also to agents and employees who occupy a position of trust and confidence.

In *Chelsea Industries, Inc. v. Gaffney*, decided during the Survey year, the Supreme Judicial Court again addressed the issue of the fiduciary duties owed by employees in a position of trust and indicated the extent to which an injured employer may recover damages. The facts of *Chelsea* present a particularly egregious example of disloyal conduct by trusted employees. The case, therefore, is most instructive for its formulation of the remedies available to an employer who has been harmed by extensive disloyal conduct by such employees.

The defendants in *Chelsea*, Gaffney and McElroy, were executive officers of Ideal Tape Company (Ideal), one of several manufacturing

morality but on sound public policy, that persons who act in a representative capacity, ... are not permitted in the performance of their duties, to put themselves in a position antagonistic to the interests of those whom they represent.

*Id.* at 279, 81 N.E. at 257.

The Quinn Court held that a real estate broker was in breach of his fiduciary duty as a result of taking secret profits. *Id.* at 281, 81 N.E. at 258. See also Restatement (Second) of Agency § 387 (1958) [hereinafter cited as Restatement] (agent has duty to act solely for his principal’s benefit).


14 *Id.* at 412, 119 N.E. at 789.

15 *Id.* In Lindsay, the employee was held not to have breached any duty to his employer since he was found not to have induced a customer of his employer to transfer its business to a competing business set up by the employee. See also, American Circular Loom Co. v. Wilson, 198 Mass. 182, 206, 84 N.E. 133, 140 (1908), where the Court stated that an employee who holds a position of trust within the corporation is legally bound to not act adversely to the interests of the corporation. The defendant-employee was found to have violated his fiduciary duty of loyalty by purchasing property with the intention of reselling it to the corporation at an inflated price.


17 Since Lincoln Stores, the Supreme Judicial Court has addressed the specific issue of breach of fiduciary duty due to competing with the corporation or employer in Anderson Corp. v. Blanch, 340 Mass. 43, 162 N.E.2d. 825 (1959); Swaney v. Clark-Wilcox Co., 331 Mass. 471, 120 N.E.2d 281 (1954); Production Machine Co. v. Howe, 327 Mass. 372, 99 N.E.2d 32 (1951); and Walsh v. Atlantic Research Associates, Inc., 321 Mass. 57, 71 N.E.2d 580 (1947). In the Anderson and Production cases, the employees were inside directors. In Swaney and Walsh, the employees were agents.

18 See infra notes 19-51 and accompanying text.
divisions of Chelsea Industries, Inc. (Chelsea), a publicly held company. Gaffney had been employed by Ideal since 1970 and had been promoted to the position of president and general manager in 1973. In these positions, he had complete responsibility for all of Ideal's operations with only general supervision from Chelsea. McElroy, a chemist, had been employed by Ideal since 1964 and in 1976 became its vice president of research, development and engineering.

In December, 1975, Gaffney and McElroy, with the intention of leaving Ideal's employ, formed a joint venture to start up their own business in competition with Ideal. They were joined by two other employees of Ideal in 1976. Graff, who joined the venture in the spring of 1976, had been an employee of Ideal for several years. He had become its United States shoe industry sales manager in 1975 and was promoted to vice president for domestic shoe sales in 1977. Wormwood, who was vice president for manufacturing, joined the venture in December, 1976.

In 1976 and 1977, Gaffney and McElroy, accompanied frequently by Graff and Wormwood, engaged in several transactions designed to establish their competing business. One transaction involved the purchase of mixing equipment for both Ideal and the planned business. Gaffney wanted to buy one mixer for each enterprise; the seller, however, insisted on disposing of all five of the mixers he was offering in a single sale. Gaffney decided to buy all five mixers and to resell one of them to Ideal at

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19 389 Mass. at 3, 449 N.E.2d at 322. The findings of fact were drawn from the report of a master. Id. The superior court adopted the report of the master and confirmed this finding that the defendants were liable to Chelsea for setting up a competing business in violation of their fiduciary duty of loyalty. Id. at 2, 449 N.E.2d at 321. The defendants sought review in the Appeals Court; the case was transferred to the Supreme Judicial Court for direct appellate review on its own motion. Id.

20 Id. at 3, 449 N.E.2d at 322. Pressure sensitive tapes are fabrics coated with an adhesive substance which, when applied with pressure to another material, cause the tape to adhere to the material. Id. at 3 n.4, 449 N.E.2d at 322 n.4.

21 Id. at 3, 449 N.E.2d at 322.

22 Id.

23 Id. McElroy's responsibilities included product development, quality control and overall responsibility for Ideal's laboratory. Id. at 3-4, 449 N.E.2d at 322.

24 Id. at 4, 449 N.E.2d at 322.

25 Id.

26 Id. The facts do not indicate the number of years Graff had worked for Ideal.

27 Id. Graff was responsible for customer and sales personnel relations as well as for marketing Ideal's products. Id.

28 Id. Wormwood had responsibility for production at Ideal's three United States plants. Id. at 4 & n.6, 449 N.E.2d at 322 & n.6.

29 Id. at 4-5, 449 N.E.2d at 323.

30 Id. at 5, 449 N.E.2d at 323.
an inflated price. To effectuate the deal without disclosing the defendants’ participation, Gaffney arranged for an equipment broker to act as a "straw" to buy the equipment from the seller and to resell it to Ideal and the defendants.

During the same period of time, the defendants, accompanied by Wormwood and occasionally by the "straw," attended auctions in search of other equipment. At these events, Gaffney would decide which equipment would be bid for Ideal, which for the planned business, and the price to be bid. In addition, Wormwood attended an equipment fair in Europe and visited Ideal’s plant in Belgium for the purpose of taking photographs of Ideal’s plans and equipment, all to aid in setting up their new business and all at Ideal’s expense. The defendants also kept a dissatisfied Ideal maintenance mechanic on Ideal’s payroll for several months until he could be put to work on construction of the defendants’ factory.

Meanwhile, in April, 1977, DeMartino, the only salesperson working out of Ideal’s home office, complained to Graff of an excessive workload. In response, Graff suggested that DeMartino turn over several of his major accounts to Gaffney’s eighteen-year-old son, who had no sales experience. DeMartino refused and resigned. For several months thereafter, Ideal was left with no salesperson in the New England area. Graff and Gaffney, in the meantime, traveled extensively throughout the United States, meeting and socializing with Ideal’s major customers and salespersons, all at Ideal’s expense. Additionally, in August, 1977, on an

31 Id. The five mixers were bought as a unit for $31,000. Gaffney resold one of them to Ideal for $14,000, a price $5,000 in excess of the market value of the mixer. Id.
32 Id. In order to obtain the necessary requisition from Chelsea, Gaffney instructed the "straw" to pay the comptroller a $500 bribe. Id. The defendants then delivered a check from Ideal for $14,000 to the straw, together with cashier’s checks for the balance. Id.
33 Id.
34 Id. The master found there was a “clear” conflict of interest on the part of the defendants at such events. Id. at 5 n.9, 449 N.E.2d at 323 n.9.
35 Id. at 6, 449 N.E.2d at 323. The master found this trip was not in the best interests of Ideal. Id.
36 Id. When the mechanic left Ideal’s employ, he was replaced with a part-time mechanic. The master found this resulted in Ideal’s equipment receiving inadequate maintenance. Id. at 6 & n.11, 449 N.E.2d at 323 & n.11.
37 Id. at 7, 449 N.E.2d at 324. DeMartino was described in the Chelsea Court’s opinion as “a very competent salesman, who had established good personal relationships with major customers of Ideal in his area.” Id. Furthermore, DeMartino’s sales had increased steadily over the four years he had been employed by Ideal. Id.
38 Id.
39 Id.
40 Id.
41 Id. The master found that their intent was to further their competing business’s future sales. Id. at 7 & n.13, 449 N.E.2d at 324 & n.13.
application for a Small Business Administration loan for the planned business, Gaffney listed current customers of Ideal as prospective customers of the competing business he was setting up.\footnote{Id. at 7-8, 449 N.E.2d at 324.} Gaffney also discussed with some of these customers the possibility of continuing to sell to them after he left Ideal.\footnote{Id. at 8, 449 N.E.2d at 324.}

By this time, the two defendants and Wormwood and Graff had met frequently to discuss their plans.\footnote{Id. at 6, 449 N.E.2d at 323-24.} Every effort was made to keep their activities secret.\footnote{Id. at 6, 449 N.E.2d at 324.} The four agreed that should any of their plans be discovered, they would all leave Ideal simultaneously.\footnote{Id. at 6-7, 449 N.E.2d at 324.} Gaffney, who was responsible for recommending salary increases and bonuses to Ideal, continued to recommend increases in compensation and bonuses for McElroy, Graff, and Wormwood, despite his knowledge of their disloyal acts.\footnote{Id. at 7 n.12, 449 N.E.2d at 324 n.12.} In addition, during their two years of planning, from 1975 until their plans were discovered in 1977, the defendants made no effort to train replacements for themselves or for Graff and Wormwood, or to allow Chelsea to do so.\footnote{Id. at 9, 449 N.E.2d at 325.}

Shortly after the defendants incorporated their new business in November, 1977, one of Chelsea's vice presidents discovered the incorporation and the defendants resigned.\footnote{Id. at 9, 449 N.E.2d at 325.} When Graff's and Wormwood's participation was discovered, they too resigned.\footnote{Id.} The void left by the unexpected departure of four of the six executive officers at Ideal forced Chelsea to divert the services of three Chelsea vice presidents to Ideal so that Ideal could continue in operation.\footnote{Id. Two of these officers spent several hours a week for almost eight months at Ideal, while the third worked many more hours per week at Ideal for a period of almost two months. Id. In addition to the defendants and Graff and Wormwood, Ideal employed two other executives, a comptroller and a person in charge of international sales. Id. at 4, 449 N.E.2d at 322. The latter was brought back from abroad to manage Ideal's sales. Id. at 9 n.17, 449 N.E.2d at 325 n.17.}
The Chelsea Court found that the record more than substantiated the master’s finding that the defendants’ acts of disloyalty constituted a breach of their fiduciary duty.\textsuperscript{52} The Court stated that employees who occupy a position of trust and confidence owe their employer a duty of loyalty and must place their employer’s interests above their own.\textsuperscript{53} The Court supported the master’s finding that though the defendants and Graff and Wormwood were not directors or officers of Chelsea, they were trusted executives who made up most of Ideal’s management.\textsuperscript{54} As such, they owed a fiduciary duty to the corporation.\textsuperscript{55} The Court further stated that, although there was no express contractual provision barring the defendants from directly competing with Ideal, an executive employee is bound to act solely in the best interests of his employer while in his employ.\textsuperscript{56}

In fashioning the appropriate remedies, the Court noted the clear precedent in Massachusetts for the legal principle that a corporate officer, director, or trusted employee can be required to forfeit the right to retain his compensation because of acts in violation of his fiduciary duty.\textsuperscript{57} This principle holds, the Chelsea Court stated, even when there is no showing of actual injury to the employer.\textsuperscript{58} At the defendants’ urging, the Court also recognized that there was some precedent for allowing a disloyal employee to prove the value of his services to the employer and to repay

\textsuperscript{52} Id. at 12, 449 N.E.2d at 326.
\textsuperscript{53} Id. at 11, 449 N.E.2d at 326.
\textsuperscript{54} Id.
\textsuperscript{55} Id.
\textsuperscript{56} Id. at 11-12, 449 N.E.2d at 326. The Court cited RESTATEMENT, supra note 12, at § 393, which states that an agent is under a duty not to compete with his principal on matters within the scope of his agency unless the principal consents. The Chelsea Court also cited a Maryland case to support its proposition, Maryland Metals, Inc. v. Metzner, 282 Md. 31, 38, 382 A.2d 564, 568 (1978), which held that a corporate officer or other key employee is prohibited from actively competing with his employer while still in his employ despite the absence of an express contractual provision to that effect.

The Chelsea Court left open the issue of how long prior to termination an employee can plan a competing business without informing his employer. 389 Mass. at 12 n.20, 449 N.E.2d at 326 n.20. In Chelsea, the defendants planned for two years, during the entire time of which they acted in breach of their fiduciary duty. \textit{Id.}

\textsuperscript{57} Id. at 12, 449 N.E.2d at 326-27. See Swaney v. Clark-Wilcox Co., 331 Mass. 471, 475-76, 120 N.E.2d 281, 284 (1954) (salesperson who breached duty of loyalty by attempting to obtain distributive rights to market products to disadvantage of employer ordered to forfeit entitlement to commissions); Production Machine Co. v. Howe, 327 Mass. 372, 379, 99 N.E.2d 32, 36 (1951) (corporate officer-director who diverted a corporate opportunity required to repay salary to the corporation); Raymond v. Davies, 239 Mass. 117, 119-20, 199 N.E. 321, 323 (1936) (manager of employer’s business breached fiduciary duty by taking secret profits and thus lost right to compensation); Little v. Phipps, 208 Mass. 331, 333-34, 94 N.E. 260, 261 (1911) (agent who managed principal’s property and took secret profits ordered to forfeit compensation).

\textsuperscript{58} 389 Mass. at 13, 449 N.E. 2d at 327.
only that portion of his compensation which is in excess of that value. The defendants argued that they were entitled to retain their compensation, since their job as executives of Ideal was to produce profits and during their employ Ideal was a profitable company. The Court responded that an injured corporation’s profitability during a disloyal employee’s tenure does not eradicate a proven breach of fiduciary duty. The Court concluded that unless the defendants proved the value of their services, they would be required to forfeit their entire compensation. Since the defendants were unable to sustain this burden of proof, the Court affirmed the superior court’s award to Chelsea of damages equal to the compensation paid the defendants over the two-year period of disloyal conduct.

The Court also affirmed the superior court’s award to Chelsea of damages equal to the compensation paid to Graff and Wormwood during the period they assisted the defendants in their venture. The Court found that the services of the two accomplices benefited the defendants, not Chelsea. In its affirmance, the Court also noted the direct role the defendants played in securing salary increases and bonuses for Graff and Wormwood, while concealing from Chelsea the disloyal conduct of these employees. The Court applied to trusted employees the principle that directors and officers are jointly and severally liable if they participate in, or approve of, or conceal a breach of fiduciary duty by a fellow officer or director.

59 Id. at 12-13, 449 N.E.2d at 327. See infra text accompanying notes 88-96.
60 Id. at 13, 449 N.E.2d at 327. The master found that Ideal actually lost $140,000 in profits in fiscal 1977. Id. at 13 n.21, 449 N.E.2d at 327 n.21. Since the master was unable to determine how much of this loss was due to the defendants’ disloyalty, Chelsea’s claim for lost profits was denied. Id.
61 Id. at 14, 449 N.E.2d at 327. The Court found support for this proposition in Wilshire Oil Co. of Texas v. Riffe, 406 F.2d 1061, 1062-63 (10th Cir. 1969), in which the Tenth Circuit stated that it is no defense to a breach of fiduciary duty that the division for which a disloyal corporate officer was responsible made a profit during the period he engaged in competitive enterprises.
62 389 Mass. at 14, 449 N.E.2d at 327.
63 Id. at 15, 449 N.E.2d at 328. The defendants were given two opportunities to present evidence as to the fair value of their services: at the master’s initial hearing and at a recommittal hearing which the superior court ordered to give the defendants a second chance to present proof. Id. The defendants, however, did not utilize this second opportunity, since they neither presented evidence on the scheduled date of recommittal hearing nor appeared at the scheduled hearing on their motion for a continuance. Id. at 14-15, 449 N.E. 2d at 328.
64 Id. at 17, 449 N.E.2d at 329.
65 Id.
66 Id. at 16, 449 N.E.2d at 329.
67 Id. The Court cited 3 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1002 (Perm. ed. 1975). RESTATEMENT, supra note 12, at § 405(2) states that an agent is liable to his principal if he directs or permits improper conduct by other agents.
liable since they were found by the master to have "approved, concealed, and acquiesced" in Graff's and Wormwood's breaches of their fiduciary duties. 68

Finally, the *Chelsea* Court affirmed the superior court's award of damages to Chelsea for the fair value of the services of the three Chelsea vice presidents who were required to divert their services to Ideal after the departure of the defendants and their accomplices. 69 The defendants argued that they should not be held liable for compensation paid to their replacements because they and Graff and Wormwood were employees at will. 70 The defendants had further maintained that had they stayed, Chelsea would have spent far more in salaries. 71 According to the Court, these arguments ignored the master's finding that Chelsea incurred these expenses because of the weakened position in which Ideal was left as a direct result of the four employees' disloyal conduct. 72 The Court thus held that Chelsea was entitled to the reasonable value of these executive officers' services measured by their salaries and the time they otherwise would have spent on work for Chelsea. 73

The *Chelsea* decision solidified the legal principle first laid down by the Supreme Judicial Court in *Lincoln Stores* that employees who occupy a position of trust and confidence owe a duty of loyalty to their employer. 74 This duty of loyalty mandates that the trusted employee place the interests of his employer above his own interests. 75 More specifically, the *Chelsea* Court stated that an executive employee is prohibited from "actively competing" with his employer while in his employ, even though there is no covenant not to compete in his contract. 76 The Court also agreed with *Lincoln Stores* that an employee may plan to compete with his employer as long as the execution of these plans does not include acts in violation of his fiduciary duty to his employer. 77

The *Chelsea* case provides the most egregious example of disloyal

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68 389 Mass. at 16, 449 N.E.2d at 329.
69 Id. at 17-18, 449 N.E.2d at 329.
70 Id. at 18, 449 N.E.2d at 329. As they were employees at will, "Chelsea was free to discharge [the defendants] at any time, and the defendants were free to leave at any time without incurring liability for compensation paid to their replacements." Id.
71 Id.
72 Id. at 18, 449 N.E.2d at 330.
73 Id. The Court found that Chelsea was entitled to recover the cost of the three executives' services in training replacements for Graff and Wormwood, as well as for the defendants, since the defendants interfered with Chelsea's relations with these two employees. Id. at 19 n.23, 449 N.E.2d at 330 n.23.
75 389 Mass. at 11-12, 449 N.E.2d at 326.
76 Id. at 12, 449 N.E.2d at 326.
77 Id. at 10, 449 N.E.2d at 326. *See Lincoln Stores*, 309 Mass. at 423, 34 N.E.2d at 707.
conduct found in the Massachusetts cases. Previous cases involved the utilization of confidential information of the employer in the formation of a competing business, the taking of secret profits from the employer’s business, or generally, less pervasive acts of disloyalty. The Boston record included instances of each of these examples of disloyal conduct as well as others. The defendants overcharged Ideal for equipment that they bought, utilized a straw to conceal their involvement in the purchases, used Ideal’s customer list to solicit customers for their competing business, charged Ideal for travel and entertainment expenses incurred solely for their own benefit, and caused Chelsea to pay out salary increases and bonuses to themselves and other disloyal employees. The sheer number and diversity of disloyal acts by these defendants make the case most instructive in the corresponding number and diversity of remedies available to a similarly injured corporation.

Among the damages awarded to Chelsea was restitution of the entire compensation paid to the defendants during their two years of disloyal conduct. There is clear precedent in Massachusetts for the proposition that a corporate director, officer, or trusted employee can be required to forfeit the right to retain or to receive compensation for conduct in violation of his fiduciary duty. One of the earliest statements to this effect was a 1911 Massachusetts case, Little v. Phipps. The Little Court stated that an agent who does not act with total loyalty towards his principal forfeits his right to compensation. The Supreme Judicial Court

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78 See Harry R. Defter Corp. v. Kleeman, 19 A.D.2d 396, 400, 243 N.Y.S.2d 930, 934 (1963) for another example of egregious conduct on the part of disloyal employees. The New York court stated, “[the defendants’] audacity probably reached its peak when they paid, with the plaintiff’s funds, the legal fees incurred in connection with the incorporation of [their competing business]. Their conduct was not only reprehensible, but completely astounding.” Id.

79 See Lincoln Stores, 309 Mass. at 419, 34 N.E.2d at 706 (employees used confidential information to determine size of inventory and capital needs for competing business).


81 See Anderson Corp. v. Blanch, 340 Mass. 43, 162 N.E.2d 825 (1959) (corporate officer-director found to have violated fiduciary duty by purchasing unneeded materials for corporation and concealing from corporation plans for competing business); Production Machine Co. v. Howe, 327 Mass. 372, 99 N.E.2d 32 (1951) (officer-director violated fiduciary duty by diverting corporate opportunity to company in which he owned substantially all the stock); Walsh v. Atlantic Research Associates, Inc., 321 Mass. 57, 71 N.E.2d 580 (1947) (employee found unfaithful in secretly joining a competitor).

82 389 Mass. at 12, 449 N.E.2d at 326.

83 Id. See infra note 87 and accompanying text for cases in which total forfeiture was awarded.

84 208 Mass. 331, 94 N.E. 260 (1911).

85 Id. at 333-34, 94 N.E. at 261.
recognized that while the principal may have been benefited by some valuable service from the agent, the law's concern with preventing such corrupt behavior mandated total forfeiture.\footnote{Id. at 334, 94 N.E. at 261.} Several subsequent Massachusetts cases have agreed with the Little Court's reasoning and ordered forfeiture of the entire compensation.\footnote{See Swaney v. Clark-Wilcox Co., 331 Mass. 471, 475, 120 N.E.2d 281, 284 (1954) (Court stated unfaithful employee or fiduciary forfeits right to compensation); Production Machine Co. v. Howe, 327 Mass. 372, 379, 99 N.E.2d 32, 36 (1951) (Court held entire compensation must be forfeited); Lincoln Stores, Inc. v. Grant, 309 Mass. 417, 420, 34 N.E.2d 704, 706 (1941) (Court ordered reimbursement of compensation); and Raymond v. Davies, 239 Mass. 117, 120, 199 N.E. 321, 322 (1936) (Court ordered forfeiture of salary). See also RESTATEMENT, supra note 12, at § 469 (which states that "an agent is entitled to no compensation for conduct . . . which is a breach of his duty of loyalty.").}

There is also precedent in Massachusetts for allowing a disloyal employee to prove the value of his services and to repay only that portion of his compensation which is in excess of this amount.\footnote{See infra text accompanying notes 89-96.} The source of this precedent may be found in \textit{Lydia E. Pinkham Medicine Co. v. Gove}.\footnote{303 Mass. 1, 20 N.E.2d 482 (1939).} The Pinkham Court recognized the general principle of forfeiture as enunciated by the Little Court, but stated that the principle was not inflexible.\footnote{Id. at 4, 20 N.E.2d at 486.} The Court found that the appropriateness of its application should be determined in the discretion of the court with reference to the particular facts.\footnote{Id. at 4-5, 20 N.E.2d at 486.} Applying this standard, the Court held that only partial forfeiture was appropriate in Pinkham because the salaries had not been paid as compensation for services but had been distributed to ensure that two factions of shareholders received equal sums from corporate distributions.\footnote{321 Mass. 57, 71 N.E.2d 580 (1947).} Similarly, in \textit{Walsh v. Atlantic Research Associates, Inc.},\footnote{Id. at 62-63, 71 N.E.2d at 584.} the Supreme Judicial Court ordered only partial forfeiture where a written employment contract provided that the employee was entitled to recover compensation irrespective of a breach of contract or the fact that it was a breach in bad faith.\footnote{340 Mass. 43, 162 N.E.2d 825 (1959).} Finally, in \textit{Anderson Corp. v. Blanch},\footnote{Id. at 46-47, 162 N.E.2d at 827-28.} the Supreme Judicial Court allowed a disloyal officer to retain the value of the services he properly performed. The Court, however, also found that the officer had not neglected his managerial duties, though he had purchased unnecessary materials for the corporation and had concealed his plans for a competing business from his employer.\footnote{See also infra text accompanying notes 89-96.}
Given this latter precedent, it is not clear why the Chelsea defendants were given any opportunity, much less two opportunities, to prove the fair value of their services. The facts in Chelsea evince none of the mitigating factors found in those Massachusetts cases which ordered only partial forfeiture. Rather, the Chelsea record would seem to clearly mandate total forfeiture. The Supreme Judicial Court thus may have rejected the absolutism of the Little decision, which dictates total forfeiture in all cases in which a fiduciary is found to have breached his fiduciary duty and, which allows no opportunity for a disloyal employee to prove the value of his services. At the same time, the Chelsea Court appears to have expanded the holding in Pinkham that an imposition of total forfeiture is not mandated in every case. According to Pinkham, the court in its discretion should make a case-by-case determination, based on the facts, as to whether a disloyal employee will be allowed to offer proof as to the value of his services. The Chelsea Court seems to have gone even further and indicated that disloyal employees will always be allowed to prove the value of their services, regardless of the factual circumstances of the case.

The Chelsea Court's stance will clearly have a less powerful deterrent effect on future corrupt behavior by disloyal employees than the inflexible Little rule. Under Chelsea, disloyal employees who can prove the value of their services will receive or be allowed to retain the part of their compensation which represents services properly performed. Although, unlike Pinkham, Chelsea extends this opportunity to all disloyal employees, the practical effect of this extension may be minimal. Employees, such as the defendants in Chelsea, who engage in extensive disloyal conduct, will face a heavy if not insurmountable burden in proving the value of their services. Thus, at least in the more egregious cases, the result reached by the Chelsea Court's approach will be the same as that reached by using the approach of the Pinkham Court.

The Chelsea Court did make clear that forfeiture of compensation was not conditioned upon a showing of actual injury to the employer. The fact that Ideal was a profitable company during the period of disloyal conduct was irrelevant to the question of breach or resulting damages. The master, however, found that Ideal suffered a loss in profits during fiscal 1977, the year in which the defendants' tenure with Ideal was terminated. The Court stated that Chelsea might have been successful in

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97 389 Mass. at 13, 449 N.E.2d at 327.

98 Id. at 14, 449 N.E.2d at 327. In Quinn v. Burton, 195 Mass. 277, 81 N.E. 257 (1907), the Court stated that though the principal "suffers no harm, or may have been benefited, this inquiry is unimportant, as the object of the law is to secure fidelity in the discharge of fiduciary duties, uninfluenced by considerations which necessarily are corrupt in their tendencies." Id. at 279, 81 N.E. at 257.

99 389 Mass. at 13 n.21, 449 N.E.2d at 327 n.21. See supra note 60.
recovering these lost profits if it had been able to isolate how much of the loss was attributable to the defendants’ disloyal conduct.100

In addition to forfeiture of their entire compensation, the Chelsea defendants were also required to repay compensation which had been paid to Graff and Wormwood. This particular form of relief is novel to Massachusetts, in that no prior case dealing with breach of fiduciary duty has awarded such damages.101 The Court found that because the defendants had utilized Graff’s and Wormwood’s services for their own enterprise and not for Chelsea’s, they must compensate Chelsea.102 The Court made clear that the defendants were not being ordered to make restitution to Chelsea of another employee’s salary, but only to compensate for services they used to their own benefit.103 This clarification may have been made to emphasize that in the normal course of events, a defendant would not be required to make restitution of compensation paid to disloyal fiduciaries who were not named as defendants. Such recovery would only be ordered where a defendant made use of another employee’s services in order to effectuate his own personal goals.104

Finally, the Court allowed Chelsea recovery for the fair value of the services of the three Chelsea executives who devoted a substantial amount of time to Ideal’s management after the defendants and their two accomplices left.105 The Court used a “but for” argument to link the diversion of the executives’ services with the defendants’ misconduct. The Court found that had it not been for the breaches of fiduciary duty by the defendants and Graff and Wormwood, the Chelsea executives would have been engaged in other profitmaking activities for Chelsea.106 The Court also stated that Chelsea was entitled to recover the costs of training replacements for the defendants and Graff and Wormwood.107 The costs of training replacements for the latter two employees were ascribed to the

100 Id. The master was unable, based on the evidence presented, to determine how much of Ideal’s loss in profits was the defendants’ responsibility.

101 The Chelsea opinion does not indicate why Chelsea did not name Graff and Wormwood as defendants, for under the legal principles stated in Chelsea, they too would clearly have been found to have acted in violation of their fiduciary duties of loyalty. In fact, the master found that Graff and Wormwood had acted in violation of their fiduciary duties. Id. at 11, 449 N.E.2d at 326.

102 Id. at 16, 449 N.E.2d at 328. In addition, the defendants were directly responsible for the payment by Chelsea of salary, salary increases, and bonuses to the two accomplices. Id. at 16, 449 N.E.2d at 329.

103 Id. at 17, 449 N.E.2d at 329. See supra text accompanying note 65.

104 See RESTATEMENT, supra note 12, at § 405(2) (which states that an agent is liable to his principal if he directs or permits the improper conduct of other agents).

105 389 Mass. at 17-18, 449 N.E.2d at 329.

106 Id. at 18, 449 N.E.2d at 330.

107 Id. at 19 n.23, 449 N.E.2d at 330 n.23.
§ 3.4 CORPORATIONS AND BUSINESS ASSOCIATIONS

defendants because the defendants had interfered with Chelsea's relations with these two employees.  

The Chelsea Court provided the injured corporation with a wide range of recoveries. As has been stated, one of the recoveries awarded, the required repayment by the defendants of the compensation which had been paid to Graff and Wormwood by Ideal, was especially significant in that it had not been awarded previously in Massachusetts for a violation of the fiduciary duty of loyalty. This indicates that the Court is concerned not only with providing a deterrent to future corrupt behavior by fiduciaries, but also with compensating an injured employer to the greatest extent possible.

In summary, the Chelsea Court held that employees in a position of trust owe a fiduciary duty of loyalty to their employers. Although, as fiduciaries, these employees may not actively compete with their employer while in his employ, they are not totally precluded from entering into a competing business. Rather, they may plan for the creation of a competing business provided that their actions do not otherwise violate their fiduciary duties. The Chelsea Court found the record replete with acts of disloyalty by the defendants including, inter alia, soliciting customers of Ideal for the defendants' planned business, misappropriating confidential information from Ideal, and enticing fellow employees away from their duties. The Court ordered the defendants to forfeit the entire compensation they received over their two years of disloyal conduct. They also were required to repay the compensation that Chelsea paid to two fellow employees, whose services the defendants diverted from the corporation for their own benefit. Finally, the defendants were ordered to pay the cost of the services of the three Chelsea executives whose energies were deflected to repair the damage done to Ideal as a result of the defendants' misconduct and abrupt departure.

§ 3.4. Dissolved Corporation — Personal Liability of Officers.* In Massachusetts, a corporation may be dissolved by the Supreme Judicial Court upon petition by the state secretary. The secretary may petition for the involuntary dissolution in Massachusetts, see C. Pears, Business Corporations, 13 Mass. Practice Series, §§ 161, 163 at 311-16 & 323-25 (1971).

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108 Id. See also BBF, Inc. v. Germanium Power Devices Corp., 13 Mass. App. Ct. 166, 176, 430 N.E.2d 1221, 1227 (1982) (Court allowed injured corporation opportunity to prove cost of training or finding replacements for employees whose services were diverted by defendants).

109 The damages in Chelsea amounted to almost $459,000. 389 Mass. at 20 n.25, 449 N.E.2d at 330 n.25.

* Thomas Finigan, staff member, Annual Survey of Massachusetts Law.
returns for two consecutive years, or if, in the opinion of the secretary of state, the corporation has become inactive and its dissolution would be in the public's interest. Under Massachusetts law, even after the corporation has been dissolved, it can continue to operate for three years to wind up its affairs and liquidate. During this three year period, however, the corporation may not operate for the purpose of continuing the business for which it was established. Prior to the Survey year, no case in the Commonwealth had considered whether an officer can be held personally liable on contracts entered into on behalf of a dissolved corporation. Recently, the Appeals Court of Massachusetts considered for the first time whether officers of a dissolved corporation are personally liable when the corporation continues its regular business operation after dissolution.

In Barker-Chadsey v. W. C. Fuller Co., Inc., the defendant corporation, W. C. Fuller Co., Inc. ("Fuller, Inc.") was engaged in the retail hardware business and was operated by Claire Quintin and Girard Quintin. The Quintins were the sole officers, directors and shareholders of the company. On September 11, 1969, Fuller, Inc. was dissolved upon the application of the state secretary for failure to file annual reports or to pay franchise taxes, but continued to do business as before. The plaintiff corporation, Barker-Chadsey Company ("Barker"), a wholesale supplier, had supplied merchandise to Fuller, Inc. for some time. On May 9, 1975, Claire Quintin, acting as treasurer of Fuller, Inc., executed a promissory note from Fuller, Inc. to Barker for $37,721. At the same time, Quintin executed a security agreement which covered the Fuller inventory. In February of 1977, Fuller, Inc. defaulted, and Barker then

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4 Id.
5 In Massachusetts, the rules regarding pre-incorporation contracts are firmly established. The promoter of an unformed corporation can be held personally liable on contracts entered into on behalf of the nonexistent corporation. See Corporations, 1979 ANN. SURV. MASS. LAW § 2.1, at 17.
6 On the liabilities of officers as trustees after dissolution, see W. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS, § 7.04 at 173 (3d ed. 1978).
8 Id. at 1-2, 448 N.E.2d at 1284.
9 Id. at 2, 448 N.E.2d at 1284.
10 Id.
11 Id.
12 Id. The note represented the amount Fuller owed Barker for goods bought plus interest.
13 Id.
brought an action to foreclose on the security and recover on the note.\textsuperscript{14} Fuller, Inc. gave up the inventory voluntarily and ceased business operations.\textsuperscript{15} Barker realized $9,639 by private sale of the inventory.\textsuperscript{16}

Subsequently, Barker discovered that Fuller, Inc. had been dissolved over seven years earlier.\textsuperscript{17} After making this discovery, Barker amended its complaint to include a claim against Claire Quintin personally on the note.\textsuperscript{18} Barker also added an alternative claim against both Claire and Girard Quintin personally for goods sold.\textsuperscript{19} The Quintins denied the claims, and the case was sent to a master for report, "facts final."\textsuperscript{20}

The master concluded that the Quintins were not personally liable but that Fuller, Inc., as a corporate entity, was liable for the balance of the note plus interest, costs and expenses.\textsuperscript{21} In the master's view, when Claire Quintin executed the note as treasurer of Fuller, Inc., she did not know the corporation had previously been dissolved.\textsuperscript{22} According to the master, Quintin did not intend to make the note as an individual.\textsuperscript{23} Rather, she believed Fuller, Inc. was still an ongoing corporate entity.\textsuperscript{24} Quintin believed that the annual report, required by statute, had been filed.\textsuperscript{25} She did not know, according to the master's findings, for which years a filing had been done.\textsuperscript{26} The master found that the last corporate tax return filed by Fuller, Inc. was for the fiscal year ending in June, 1975.\textsuperscript{27} This return was not filed, however, until 1978.\textsuperscript{28} With respect to Barker, the master found that Barker did not know that Fuller, Inc. had been dissolved when it took the note.\textsuperscript{29} According to the master's report, Barker looked to the corporate assets of Fuller, Inc. for security, and not to the individual assets of the Quintins.\textsuperscript{30}

On cross-applications to adopt and modify the master's report, the superior court judge affirmed the master's conclusion that the Quintins

\textsuperscript{14} Id.
\textsuperscript{15} Id.
\textsuperscript{16} Id.
\textsuperscript{17} Id.
\textsuperscript{18} Id.
\textsuperscript{19} Id.
\textsuperscript{20} Id.
\textsuperscript{21} Id. at 3, 448 N.E.2d at 1284.
\textsuperscript{22} Id. at 2-3, 448 N.E.2d at 1284.
\textsuperscript{23} Id. at 3, 448 N.E.2d at 1284.
\textsuperscript{24} Id.
\textsuperscript{25} Id.
\textsuperscript{26} Id.
\textsuperscript{27} Id.
\textsuperscript{28} Id. The master noted that a fire caused by lightning destroyed all the corporate records of Fuller, Inc. in 1974. Id. at 3 n.4, 448 N.E.2d at 1284 n.4.
\textsuperscript{29} Id. at 3, 448 N.E.2d at 1284.
\textsuperscript{30} Id.
were not personally liable.\textsuperscript{31} The judge, however, charged the Quintins as trustees in Barker's favor to the extent of any property that they held to which Fuller, Inc. would be entitled if revived.\textsuperscript{32} Barker then appealed the judgment of the superior court to the Appeals Court of Massachusetts.\textsuperscript{33}

On appeal, Barker maintained that the Quintins should be personally liable based on the absence of a valid agency relationship between the Quintins and Fuller, Inc.\textsuperscript{34} Barker argued that when Claire Quintin signed the note as treasurer, no corporation existed, and therefore no principal existed.\textsuperscript{35} Because there was no principal, Barker theorized, the Quintins could not have acted as agents.\textsuperscript{36} Therefore, if the Quintins had not acted as agents, then they must be personally liable.\textsuperscript{37}

In its analysis, the court noted that Barker's argument relied on the long line of Massachusetts cases dealing with promoter liability.\textsuperscript{38} In Massachusetts, promoters have traditionally been found personally liable on contracts entered into on behalf of intended, but unformed, corporations on the theory that when a corporation does not yet exist, there can be no agency relationship.\textsuperscript{39} As a result, the promoter's contract is personal and he is individually responsible for obligations assumed thereby.\textsuperscript{40}

The court rejected the promoter liability analogy, and relied instead on \textit{Fay v. Noble},\textsuperscript{41} an ancient Massachusetts case involving stockholder liability for the debts of an unformed corporation. In \textit{Fay}, a corporation was supposedly organized and capital stock distributed.\textsuperscript{42} Later examination of corporate records indicated that the corporation had never been properly formed.\textsuperscript{43} The \textit{Fay} court rejected the theory that because no corporation had been formed, the stockholders were personally liable as copartners.\textsuperscript{44} On the contrary, the court stated that the stockholders had not contemplated or assented to liability as copartners.\textsuperscript{45} It would be

\textsuperscript{31} \textit{Id.}
\textsuperscript{32} \textit{Id.}
\textsuperscript{33} \textit{Id.}
\textsuperscript{34} \textit{Id.}
\textsuperscript{35} \textit{Id.} at 3, 448 N.E.2d at 1284-85.
\textsuperscript{36} \textit{Id.}, 448 N.E.2d at 1285.
\textsuperscript{37} \textit{Id.}
\textsuperscript{38} \textit{Id.} at 3, 448 N.E.2d at 1284.
\textsuperscript{39} For a discussion of Massachusetts law with respect to corporate promoters, see \textit{Corporations, 1979 Ann. Surv. Mass. Law} § 2.1, at 17.
\textsuperscript{40} \textit{Id.}
\textsuperscript{41} 61 Mass (7 Cush.) 188 (1851).
\textsuperscript{42} \textit{Id.} at 189.
\textsuperscript{43} \textit{Id.}
\textsuperscript{44} \textit{Id.} at 192-93.
\textsuperscript{45} \textit{Id.} at 192.
unfair, the court reasoned, to impose copartner liability upon shareholders who had not intended to assume such responsibility.46

The Barker-Chadsey court adopted the reasoning of Fay as the basis of its analysis of the liability of officers of dissolved corporations. The proper inquiry, according to the court, was whether the parties contracted with the understanding that the liability was corporate rather than personal.47 In the court’s view, it would be unfair to hold an individual personally liable if the mutual understanding of the parties to the agreement was that the corporation was the contracting party and no misrepresentation occurred.48 In the Quintins’ case, the court stated, all parties to the transaction understood that the liability was to be corporate and not individual.49 In addition, the court noted that no manipulative purpose appeared to exist on the basis of the record before it.50

The court next analyzed the statutes dealing with dissolution and revival of corporations to determine whether any statutory policy mandated personal liability.51 The court acknowledged that a corporation’s existence does not entirely terminate upon dissolution.52 Rather, it maintains some dormant form of life for three years for the purposes of winding up and liquidation.53 In Fuller, Inc.’s case, however, the court stated that active business was carried on because Claire Quintin was simply ignorant of the fact of dissolution.54 The court noted that in such a situation, officers and other interested parties may apply to the state secretary for “revival” of the corporation.55

The effect of revival under chapter 156B, section 108 of the General Laws, according to the court, is to confirm the corporate acts of officers made before revival.56 The confirmation of corporate acts correspondingly relieves the officers of personal liability.57 As persuasive authority for this contention, the court cited a decision of the Delaware

48 Id.
49 Id. at 5, 448 N.E.2d at 1285.
50 Id.
51 Id.
52 Id.
53 G.L. c. 156B, § 102.
55 Id.
56 Id. at 5-6, 448 N.E.2d at 1286.
57 Id. The Court pointed to the language contained in the revival statute, G.L. c. 156B, § 108, which states in relevant part, “all acts and proceedings of its [corporation’s] officers, directors and stockholders, acting or purporting to act as such, which would have been legal and valid but for such dissolution, shall, except as aforesaid [apparently referring to revival on terms], stand ratified and confirmed.” Id.
Supreme Court, Frederic G. Kropf & Son v. Gorson. In Gorson, the president of a one-man corporation entered into a contract after the corporation had been dissolved for reasons identical to the present case — failure to file annual reports and pay franchise taxes. The court also found that the president in Gorson was unaware of the dissolution and that both parties had intended that the corporation be obligated under the contract. The Delaware court relied on Delaware statutory law to hold that the president was relieved of personal liability by reason of the revival of the corporation. In Barker-Chadsey, the Appeals Court stated that the Massachusetts revival statute implies what the Delaware statute explicitly states — that contracts shall be the exclusive liability of the revived corporation. The policy of relieving the officers of a dissolved corporation of personal liability evidenced by section 108 is highlighted, according to the court, by the contrast to statutes in other states which expressly declare that revival does not affect the personal liability of officers for acts following dissolution.

The court next addressed the question of whether the Quintins should be barred from seeking revival because of the time lapse involved between the dissolution and the present action. According to the court, section 108 sets no precise time limit for seeking revival of a dissolved corporation. The court acknowledged, however, that the opportunity for revival had arguably lapsed a reasonable time after the Quintins received notice by means of Barker's amended complaint that Fuller, Inc. had been dissolved. To decide whether Fuller, Inc. should be denied revival, the court considered the competing interests involved. On the one hand, the court noted, holding the Quintins personally liable would give Barker a

58 243 A.2d 713 (Del. 1968).
59 Id. at 714.
60 Id.
61 Id. at 715. The relevant Delaware statute is DEL. CODE ANN. tit. 8, § 312(e) (1975):
Upon the filing of the certificate in accordance with § 103 of this title the corporation shall be renewed and revived with the same force and effect as if its certificate of incorporation had not been forfeited pursuant to subsection (c) of § 136 of this title, or inoperative and void, or had not expired by limitation. Such reinstatement shall validate all contracts, acts, matters and things made, done and performed within the scope of its certificate of incorporation by the corporation, its officers and agents during the time when its certificate of incorporation was forfeited pursuant to subsection (c) of § 136 of this title, or was inoperative or void after its expiration by limitation, with the same force and effect and to all intents and purposes as if the certificate of incorporation had at all times remained in full force and effect.
63 Id.
64 Id. at 7-8, 448 N.E.2d at 1287.
65 Id. at 8, 448 N.E.2d at 1287.
66 Id.
windfall beyond its contractual expectations. On the other hand, according to the court, the fact remained that Fuller, Inc. had been delinquent to the state. In order to achieve a fair result, the court decreed that its order relieving the Quintins of personal liability would be contingent upon their timely application for the revival of Fuller, Inc. Until such a revival was obtained, however, the Appeals Court upheld the ruling of the superior court that the Quintins be charged as trustees in Barker’s favor to the extent of any property they might hold to which Fuller, Inc. would be entitled if revived. The court again cited Gorson as authority for giving effect to a revival obtained after an action had been brought against the corporate officer. While the court stated that no case could be found where securing revival figured explicitly as a condition of relief granted on appeal, it had no objections to this idea in principle.

Although not readily apparent, the decision in Barker-Chadsey can be reconciled with the general rule in Massachusetts concerning promoter liability. In Massachusetts, as in most other jurisdictions, the general rule of promoter liability is that the promoter will be held personally liable on contracts entered into on behalf of intended but unformed corporations. This rule does not adhere, however, when the parties agree that the corporation alone will be liable on the contract. In Barker, all parties appear to have operated under the assumption that Fuller, Inc. still existed. In effect, this assumption was treated by the Barker court as an implicit agreement that the corporation alone would be liable. The court, therefore, held the agency theory that an agent cannot contract for a nonexistent principal inapplicable.

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67 Id.
68 Id.
69 Id.
70 Id.
71 Id.
72 Id.
73 Id.
74 Corporations, 1979 ANN. SURV. MASS. LAW, § 2.1 at 17.
75 Id. See also 1A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 215 at 466 (1983).
76 The master concluded both parties intended that Fuller’s assets be the security for the note. 16 Mass. App. Ct. at 3, 448 N.E.2d at 1284.
77 The agency principle, stated in RESTATEMENT (SECOND) OF AGENCY § 326, comment a (1958), reads:

There is an inference that a person intends to make a present contract with an existing person. If, therefore, the other party knows that there is no principal capable of entering into such a contract, there is a rebuttable inference that, although the contract is nominally in the name of the nonexistent person, the parties intend that the person signing as agent should be a party, unless there is some indication to the contrary. Id. (emphasis added).

The Court determined that the Quintins avoided the application of this principle on two
The Barker-Chadsey decision, however, will not likely be useful precedent for the typical case involving liability of officers of a dissolved corporation. For reasons unexplained by the court, the Quintins were unaware of the dissolution of Fuller, Inc. Such lack of knowledge will not normally form the basis for a defense because the dissolution statute expressly provides for notice prior to decree. Hence, the typical officer will know of the dissolution of the corporation. The officer’s activities are then limited to the winding up of affairs. Should the officer continue to enter into contracts on behalf of the nonexistent corporation, it is unlikely a Massachusetts court would rely on Barker-Chadsey to absolve the officer from personal liability. Rather, the officer will likely be held personally liable on the theory that chapter 156B had been violated because the officer had knowingly gone beyond the settlement of affairs after dissolution. As a result, the impact of Barker-Chadsey upon Massachusetts corporation law appears to be limited to its rather peculiar facts.

grounds. First, it was found that they were unaware that no principal existed, and second, the indications were that the parties intended the Quintins not to be personally liable. 16 Mass. App. Ct. at 3, 448 N.E.2d at 1284.


79 G.L. c. 156B, § 101.

80 G.L. c. 156B, § 102.