

1 UNITED STATES COURT OF APPEALS

2 FOR THE SECOND CIRCUIT

3 August Term, 2010

4 (Argued: February 5, 2009

5 Question Certified: December 29, 2009

6 Certified Question Answered: August 23, 2010

7 Decided: May 6, 2011)

8 Docket No. 07-3750-cv

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10 JOHN HALEBIAN,

11 Plaintiff-Appellant,

12 - v -

13 ELLIOT J. BERV, DONALD M. CARLTON, A. BENTON COCANOUGH, MARK T.  
14 FINN, STEPHEN RANDOLPH GROSS, DIANA R. HARRINGTON, SUSAN B.  
15 KERLEY, ALAN G. MERTEN, R. RICHARDSON PETTIT,

16 Defendants-Appellees,

17 CITIFUNDS TRUST III,

18 Nominal Defendant-Appellee.\*

19 -----  
20 Before: SACK and PARKER, Circuit Judges, and STANCEU, Judge.\*\*

21 Appeal from a judgment of the United States District  
22 Court for the Southern District of New York (Naomi Reice  
23 Buchwald, Judge) dismissing a three-count complaint arising from

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\* The Clerk of Court is directed to amend the official caption as set forth above.

\*\* The Honorable Timothy C. Stanceu, of the United States Court of International Trade, sitting by designation.

1 the renegotiation of certain investment-advisory agreements. We  
2 certified a question to the Supreme Judicial Court of  
3 Massachusetts as to the circumstances under which that State's  
4 business judgment rule may be asserted in response to a  
5 shareholder derivative suit under the Massachusetts Business  
6 Corporation Act. Upon receipt of the answer, we affirm the  
7 district court's dismissal of two of the plaintiff's claims  
8 brought pursuant to various provisions of the Investment Company  
9 Act, 15 U.S.C. §§ 80a-15(a) & 80a-20(a), and Massachusetts state  
10 law. Regarding the third claim – a derivative state-law claim  
11 for breach of fiduciary duty to which the certified question  
12 related and as to which the district court granted a motion to  
13 dismiss – we vacate the district court's judgment and remand with  
14 instructions to the court to convert the motion to dismiss to a  
15 motion for summary judgment, and to rule on that motion, after  
16 further discovery should the court in the sound exercise of its  
17 discretion determine that such further discovery is warranted.

18 Affirmed in part; vacated and remanded in part.

19 JOEL C. FEFFER (Daniella Quitt, James G.  
20 Flynn, on the brief), Harwood Feffer  
21 LLP, New York, NY, for  
22 Plaintiff-Appellant.

23 JAMES S. DITTMAR, Goodwin Procter LLP,  
24 Boston, MA (Michael K. Isenman, Matthew  
25 M. Hoffman, Goodwin Procter LLP,  
26 Washington, DC, on the brief), for  
27 Defendants-Appellees.

1 SACK, Circuit Judge:

2 Descriptions of the facts underlying this appeal have  
3 now been published in three different reported decisions – in the  
4 opinion of the United States District Court for the Southern  
5 District of New York, Halebian v. Berv ("Halebian I"), 631 F.  
6 Supp. 2d 284, 287–91 (S.D.N.Y. 2007); in this Court's previous  
7 opinion certifying a question of state law to the Supreme  
8 Judicial Court of Massachusetts, Halebian v. Berv ("Halebian  
9 II"), 590 F.3d 195, 199–203 (2d Cir. 2009); and in the opinion of  
10 the Supreme Judicial Court answering our question on  
11 certification, Halebian v. Berv ("Halebian III"), 457 Mass. 620,  
12 621–24, 931 N.E.2d 986, 987–89 (2010). We see no need to  
13 reiterate them here except insofar as we think it necessary to an  
14 understanding of our resolution of the narrow issues remaining  
15 before us.

16 **BACKGROUND**

17 Halebian's Complaint

18 On May 30, 2006, John Halebian, a holder of shares in  
19 one of six separate investment funds (the "Funds") within  
20 CitiFunds Trust III (the "Trust"), a Massachusetts business  
21 trust, filed a complaint raising three claims in the United  
22 States District Court for the Southern District of New York  
23 against members of the Trust's board of trustees (the "Board").  
24 The suit arose in connection with the June 23, 2005 corporate  
25 sale (the "Transaction") of investment-adviser subsidiary

1 companies that advised the six Funds. Pursuant to the  
2 Transaction, Citigroup, Inc., which owned the adviser  
3 subsidiaries, sold substantially all of its asset-management  
4 business to Legg Mason, Inc., automatically terminating, under  
5 federal law, the Funds' existing investment-advisory contracts.  
6 Following the sale and contract termination, the Trust's Board  
7 approved new investment-advisory agreements (the "New  
8 Agreements") between the Trust and Legg Mason and then issued a  
9 proxy statement to Trust shareholders recommending that they vote  
10 to approve the New Agreements.

11 In his complaint, Halebian challenges two principal  
12 aspects of the Transaction. First, he questions the New  
13 Agreements' authorization of the payment of "soft dollars," which  
14 permitted Legg Mason to hire broker-dealers that also perform  
15 research services – a combination that often results in higher  
16 commissions for the chosen broker-dealer than those paid to  
17 standard broker-dealers. Second, he challenges shareholder  
18 voting procedures permitting "echo voting," which in this case  
19 allows Citigroup-affiliated service agents, as record holders of  
20 certain shares of the Funds, to vote their total number of shares  
21 in proportion to the votes they received from the shares'  
22 beneficial owners, even if the service agents had not received  
23 voting instructions from all of their customers. Halebian  
24 asserts, in sum, that the "defendants . . . failed to avail  
25 themselves of the opportunity to negotiate lower fees or seek

1 competing bids from other qualified investment advisers" and  
2 "utterly ignored their obligations of loyalty and good faith to  
3 CitiTrust and its beneficiaries." Complaint ¶¶ 35, 40, Halebian  
4 v. Berv, No. 06 Civ. 4099 (S.D.N.Y. May 30, 2006).

5 Halebian's Claim One, presented as a derivative claim  
6 on behalf of the Trust, alleges that the defendants breached  
7 their fiduciary duties to the Trust "in considering the . . .  
8 [T]ransaction and in recommending the new advisory agreements."  
9 Id. ¶ 54. Claims Two and Three, styled as direct claims, allege  
10 that the defendants violated federal and state law by issuing  
11 materially false and misleading statements and by omitting  
12 material information from the proxy statement as part of an  
13 effort to induce their shareholders to approve the Trust's New  
14 Agreements with Legg Mason. Id. ¶¶ 60-61, 64-65.

15 The Defendants' Motion to Dismiss

16 On October 24, 2006, the defendants' counsel moved to  
17 dismiss Halebian's complaint pursuant to, inter alia, Federal  
18 Rule of Civil Procedure 12(b)(6). Regarding Claims Two and  
19 Three, the defendants asserted that Federal Rules 12(b)(6) and  
20 23.1, and various provisions of the Investment Company Act (the  
21 "ICA"), 15 U.S.C. §§ 80a-15(a) & 80a-20(a), required dismissal of  
22 the two claims because these claims were derivative in nature,  
23 not direct, and as such failed as a matter of law. Specifically  
24 addressing their requested dismissal of Claim One, the defendants  
25 relied in part on a then-recently enacted provision of

1 Massachusetts law codifying the business-judgment rule permitting  
2 a corporation's directors to move to dismiss a derivative lawsuit  
3 as to the prosecution of which the leadership concluded would not  
4 be in the corporation's best interest.<sup>1</sup> See Mass. Gen Laws ch.  
5 156D, § 7.44(a).

6 Our Prior Panel Opinion

7 In Halebian II, we agreed with the defendants and the  
8 district court, classifying the second and third claims asserted  
9 in the plaintiff's complaint as derivative by looking to  
10 Massachusetts law, which all agree is applicable. Halebian II,  
11 590 F.3d at 210. We saw the gravamen of the second and third  
12 claims as Halebian's challenge to the use of echo voting. We  
13 then reasoned:

14 There is no indication that the alleged  
15 unlawfulness of echo voting under section  
16 15(a) of the ICA or Massachusetts law was  
17 called to the attention of the Board by  
18 Halebian or anyone else prior to the  
19 institution of this lawsuit. And the Board  
20 has consistently and strenuously denied that  
21 echo voting violates these laws. Since the  
22 Board was apparently not of the view, nor had  
23 it been told, that using a Citigroup-  
24 affiliated service agent other than a  
25 broker-dealer to echo vote shares violated  
26 the ICA or Massachusetts law, or indeed any  
27 law, its failure to inform shareholders to

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<sup>1</sup> The nominal defendant in this action is a business trust, not a corporation. However, as the Supreme Judicial Court explained, "[b]ecause a business trust in practical effect is in many respects similar to a corporation, the statute regulating derivative actions applies to a shareholder bringing such a claim against a corporation or a business trust." Halebian III, 457 Mass. at 623 n.4, 931 N.E.2d at 988 n.4 (citation and internal quotation marks omitted).

1 the contrary does not appear to us to have  
2 been potentially false and misleading so as  
3 to be cognizable under Massachusetts or  
4 federal law.

5 Id. (footnotes omitted). We thus expressed our inclination to  
6 affirm the judgment of the district court (Naomi Reice Buchwald,  
7 Judge) dismissing Halebian's second and third claims, but  
8 declined to resolve them at that time. We reserved decision on  
9 those claims so that we could consider any commentary or analysis  
10 that the Supreme Judicial Court of Massachusetts might offer in  
11 answering our certified question regarding Halebian's first  
12 claim. Id.

13 As to Halebian's undisputedly derivative first claim,  
14 which alleges a breach of fiduciary duty for failure to  
15 investigate alternatives to the New Agreements between the Trust  
16 and Legg Mason, we first rejected the district court's reliance  
17 on Federal Rule of Civil Procedure 23.1 in dismissing the claim.  
18 We were of the view that Halebian's complaint satisfied this  
19 federal pleading rule for derivative claims and, accordingly,  
20 that the claim thus "stands or falls on whether it was properly  
21 dismissed pursuant to Massachusetts substantive law." Id. at  
22 211. On the state-law question, the district court had ruled  
23 that despite language in the state derivative-suit dismissal  
24 provision indicating that it applies only to derivative  
25 proceedings "commenced after the rejection of a demand," Mass.  
26 Gen. Laws ch. 156D, § 7.44(a) (emphasis added), the defendants  
27 could rely on the provision irrespective of the fact that the

1 plaintiff had filed suit before the Board's rejection of the  
2 demand, provided they rejected the plaintiff's demand "after a  
3 good faith review." Halebian I, 631 F. Supp. 2d at 294.

4 Proffering an alternative reading,<sup>2</sup> but "declin[ing] to  
5 resolve [the issue] in the first instance," Halebian II, 590 F.3d  
6 at 210, we certified to the Supreme Judicial Court of  
7 Massachusetts the following question: "Under Massachusetts law,  
8 can the business judgment rule, established under Mass. Gen. Laws  
9 ch. 156D, § 7.44, be applied to dismiss a derivative complaint  
10 filed timely under section 7.42 but prior to a corporation's

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<sup>2</sup> In our previous opinion, we expressed skepticism about the district court's approach and conclusion, first noting that "it is a well-established principle of Massachusetts law that when 'the language of the statute is clear, we must enforce it according to its own terms.'" Halebian II, 590 F.3d at 212 (quoting Town of Milford v. Boyd, 434 Mass. 754, 757-58, 752 N.E.2d 732, 735 (2001)) (internal quotation marks omitted in original). Though we recognized that "context matters," we were "unconvinced that the statutory context required the district court to take the path that it did." Id. at 212-13. In light of commentary in the legislative record that "clearly anticipates that in some instances, a corporation might require more than ninety days to investigate and respond to the shareholder's demand," we conceded that section 7.44 might apply to some instances in which a suit was filed before a board's demand rejection. Id. at 213 (emphasis in original). But we concluded that if section 7.44 applied to all such instances, the need for a stay – allowable by petition under section 7.43 of the statute – would be nil. Id. We thus reasoned that the proper reading of the statute as a whole might be that section "7.44 applies to timely derivative actions filed before the rejection of the demand that serves as the basis for the action not in all circumstances, as the district court's ruling suggests, but only when such an action was actually stayed in accordance with section 7.43." Id. We found this reading to be consistent with statutory commentary and, as a matter of policy, that it would not impose "an unfair hardship on Massachusetts corporations." Id. at 213-14.



1 rejection of the demand that serves as the basis for the suit?"<sup>3</sup>  
2 Id. at 214.

3 Supreme Judicial Court's Response

4 On August 23, 2010, the Supreme Judicial Court issued  
5 an opinion answering our certified question in the affirmative.  
6 Halebian III, 457 Mass. at 621, 931 N.E.2d at 987. The court  
7 reasoned, inter alia:

8 If we were to adopt the plaintiff's assertion  
9 that the Legislature's inclusion of the  
10 phrase, "commenced after rejection of a  
11 demand," was intended to deny a corporation  
12 the benefit of the business judgment doctrine  
13 where it failed to reject a shareholder's  
14 demand before the filing of a derivative  
15 complaint, we would be giving § 7.44 an  
16 interpretation that would be in direct  
17 conflict with other language in the same  
18 section and that would be inconsistent with  
19 the statutory scheme embodied in the Act and  
20 reflected in the commentary of its drafters.  
21 For these reasons, despite the statute's  
22 unfortunate inclusion of a phrase that, when  
23 read in isolation, would suggest that  
24 § 7.44(a) was intended to limit dismissals  
25 under the business judgment doctrine to  
26 derivative proceedings "commenced after  
27 rejection of a demand," we conclude that the  
28 Legislature did not intend such a limitation.  
29 Rather, we conclude that the Legislature  
30 intended that a derivative action must be  
31 dismissed under § 7.44 following a  
32 corporation's independent determination, made  
33 in good faith and after reasonable inquiry,  
34 that maintenance of the derivative proceeding  
35 is not in the best interests of the

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<sup>3</sup> We added, as is our practice, that "[t]he certified question may be deemed to cover any pertinent further issues of Massachusetts law that the Supreme Judicial Court thinks is appropriate and advisable to address, including" the issues presented by Halebian's second and third claims discussed earlier in the opinion. Halebian II, 590 F.3d at 215.

1 corporation, regardless whether the  
2 derivative complaint has been filed before or  
3 after the corporation's rejection of the  
4 shareholder's demand.

5 Id. at 632-33, 931 N.E.2d at 995.

6 We now resolve the instant appeal in light of the  
7 careful opinion of the Supreme Judicial Court of Massachusetts in  
8 response to our certified question.

9 **DISCUSSION**

10 I. Claims Two and Three

11 Because the Supreme Judicial Court said nothing in  
12 Halebian III that affects our analysis of Halebian's second and  
13 third claims as set forth in Halebian II, we affirm the judgment  
14 of the district court dismissing those claims for the reasons set  
15 forth in our prior opinion. See Halebian II, 590 F.3d at 207-10.

16 II. Claim One

17 The Supreme Judicial Court, in agreement with the  
18 district court in this case, ruled that a defendant in a  
19 derivative suit governed by Massachusetts Law may employ the  
20 business judgment rule, codified at Mass. Gen. Laws ch. 156D,  
21 § 7.44, to dismiss a shareholder complaint that is filed prior to  
22 a corporation's rejection of the demand that serves as the basis  
23 for the suit. Halebian III, 457 Mass. at 621, 931 N.E.2d at 987.  
24 It does not follow, however, that we can affirm the district  
25 court's judgment in its present form.

26 A. Operation of Section 7.44

1           As stated by the Supreme Judicial Court, the business  
2 judgment rule embodied in section 7.44 "protects a corporation's  
3 decision that prosecution of [a] claim demanded by [a]  
4 shareholder is not in the best interests of the corporation where  
5 the decision is made in good faith by independent decision makers  
6 after reasonable inquiry."<sup>4</sup> Id. at 627 n.11, 931 N.E.2d at 991  
7 n.11. As applicable to this case after certification, section  
8 7.44 provides that a derivative proceeding commenced either  
9 before or after rejection of a demand "shall be dismissed by the  
10 court on motion by the corporation if the court finds that . . .  
11 a majority vote of independent directors present at a meeting of  
12 the board of directors . . . has determined in good faith after  
13 conducting a reasonable inquiry upon which its conclusions are  
14 based that the maintenance of the proceeding is not in the best  
15 interests of the corporation." Mass. Gen. Laws ch. 156D,  
16 §§ 7.44(a), 7.44(b)(1) (emphases added). Upon filing its motion  
17 to dismiss, the corporation must show by "a written filing with

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<sup>4</sup> In a derivative suit, of course, the plaintiff ostensibly brings his or her claims on behalf of the corporation in which he or she owns an interest, against certain corporate leadership. See 13 William Meade Fletcher, Fletcher Cyclopedia of the Law of Corporations § 5939. Inasmuch as it is ordinarily brought because the corporate leadership has declined to assert the claim in issue, however, the corporation is normally treated as a nominal defendant. See Meyer v. Fleming, 327 U.S. 161, 167 (1946). But see, e.g., Symes v. Harris, 472 F.3d 754, 761 (10th Cir. 2006) (aligning corporation as plaintiff where corporation was owned entirely by the plaintiffs and "no one within the company . . . would oppose bringing the suit"). It is not the nominal defendant "corporation" which moves to dismiss a derivative suit, but the actual defendants – e.g., board members – that make such a motion.

1 the court setting forth facts" that the corporation has  
2 established independence, good faith, and the conduct of a  
3 reasonable inquiry. Id. § 7.44(d). The court "shall" then  
4 "dismiss the suit unless the plaintiff has alleged with  
5 particularity facts . . . in its complaint or an amended  
6 complaint or in a written filing to the court" rebutting the  
7 corporation's filing. Id. (emphasis added). The statute further  
8 provides that if the independence requirement in subsection (a)  
9 is met, the plaintiff bears the burden of proving a lack of good  
10 faith and reasonable inquiry on the part of the directors; by  
11 contrast, if the independence requirement is not satisfied, the  
12 corporation must prove that those two elements are present. Id.  
13 § 7.44(e).

14 In ruling on Claim One, the district court adverted to  
15 the fact that the plaintiff did not plead or otherwise proffer  
16 "any reason why the Board's decision to reject the demand was  
17 illegitimate." Halebian I, 631 F. Supp. 2d at 296. But we think  
18 that relying solely on the failure of the plaintiff to contest  
19 the corporation's filing omits a crucial statutory step. The  
20 statute requires a court to "find[]" that various conditions have  
21 been satisfied: that the Board is independent, and that it in  
22 good faith determined after a reasonable inquiry that the  
23 plaintiff's suit was not in the corporation's best interests.  
24 Mass. Gen. Laws ch. 156D, § 7.44(d). The latter component – the  
25 existence of a good-faith, reasonable inquiry into the

1 corporation's best interests vis-à-vis the plaintiff's suit – is  
2 subject to the burden-shifting provisions of subsection (e). See  
3 id. § 7.44(e). However, that such burden-shifting turns on the  
4 independence of the decision maker unambiguously demonstrates  
5 that the court's evaluation of independence is a prerequisite to  
6 the operation of the dismissal statute in toto.<sup>5</sup>

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<sup>5</sup> Further counseling such a conclusion is section 7.44(c), which sets out various factors, none of which "shall by itself cause a director to be considered not independent for the purposes of" section 7.44. Mass. Gen. Laws ch. 156D, § 7.44(c) (emphasis added). We infer little from the inclusion of subsection (c) apart from that the Massachusetts legislature intended for the reviewing court to consider other factors in an evaluation of independence on a motion to dismiss brought under section 7.44.

1           We see no such finding of independence in Halebian I.<sup>6</sup>  
2    Though the court's factual summary and legal discussion appear to  
3    assume the Board's independence, see id. at 290, 295-96, the  
4    statute by its own terms requires more, see Mass. Gen. Laws ch.  
5    156D, § 7.44(a). Supporting this reading of the statutory text,  
6    the Massachusetts Superior Court – in two of only four opinions

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<sup>6</sup> We also are not entirely in agreement with the district court's characterization of the plaintiff's opposition to the defendants' 12(b)(6) motion. The court stated that "in opposing defendants' motion, plaintiff explicitly decline[d] to offer any reason why the rejection of the demand was illegitimate," and it expressed "concern[ about the] plaintiff's unwillingness to even attempt to engage this issue." Halebian I, 631 F. Supp. 2d at 296 n.8. However, we view the plaintiff's opposition to the defendants' motion to dismiss in this case in a different light.

To be sure, the plaintiff devoted much of his memorandum of law in opposition to the 12(b)(6) motion to argument for additional discovery, rather than to a direct refutation of the defendants' section 7.44 filing. Pl.'s Mem. in Opp. to Def.'s Mot. to Dismiss Compl., Halebian v. Berv, No. 06 Civ. 4099 (S.D.N.Y. Dec. 7, 2006). But the plaintiff made clear that his goal in seeking additional discovery was precisely to rebut the Board's assertions. See, e.g., id. at 11 (asserting that defendants are "simultaneously acting as defendants, judge, and jury"), 12 (arguing that "discovery is necessary to address the danger of allowing the [Board] to appoint a few 'good ol' boys' as a special litigation committee [("SLC")] and have legitimate claims 'whitewashed' through the relative ease of constructing a record of apparently diligent investigation (internal quotation marks omitted)), 13 (expressing concern about the "strong potential for structural bias in" SLCs), 14 (articulating the "very serious danger that the [Board] . . . would be inherently biased and fail to investigate plaintiff's allegations against them and their fellow trustees in good faith").

Those statements are not factual assertions, and insofar as the district court rejected their value as such, the court clearly did not err. However, in our view, the plaintiff's opposition here did not constitute an "explicit" refusal or "unwillingness" to contest the Board's assertions under section 7.44.

1 of which we are aware to discuss the statute at issue here, three  
2 of which are part of the same lawsuit – determined that in  
3 evaluating a motion to dismiss under section 7.44, the court must  
4 "begin[] with an evaluation of the independence of the" board or  
5 committee charged with responding to a shareholder demand. Blake  
6 v. Friendly Ice Cream Corp., No. 030003, 2006 WL 1579596, at \*14,  
7 2006 Mass. Super. LEXIS 241, at \*47 (Super. Ct. Hampden County  
8 May 24, 2006); see also Pinchuck v. State St. Corp., No. 09-2930,  
9 2011 WL 477315, at \*11-\*13, 2011 Mass. Super. LEXIS 11, at  
10 \*29-\*36 (Super. Ct. Suffolk County Jan. 19, 2011). The Blake  
11 court then embarked upon a lengthy consideration of the  
12 corporation's factual submissions purporting to demonstrate the  
13 independence of the members of its special litigation committee  
14 ("SLC") as well as the propriety of the committee's formation,  
15 evaluating their sufficiency against Massachusetts law. See  
16 Blake, 2006 WL 1579596, at \*14-\*22, 2006 Mass. Super. LEXIS 241,  
17 at \*47-\*77; see also Pinchuck, 2011 WL 477315, at \*11-\*13, 2011  
18 Mass. Super. LEXIS 11, at \*29-\*36 (conducting a factual inquiry  
19 into the independence of the special committee that rejected the  
20 plaintiffs' demand). Having rejected the SLC's assertion of  
21 independence based on the court's evidentiary review, the Blake  
22 court next assessed the SLC's burden under section 7.44(e) "of  
23 proving that its determination was in good faith and after a  
24 reasonable inquiry upon which its conclusions were based."  
25 Blake, 2006 WL 1579596, at \*22, 2006 Mass. Super. LEXIS 241, at

1 \*78; see also Pinchuck, 2011 WL 477315, at \*13-\*15, 2011 Mass.  
2 Super. LEXIS 11, at \*36-\*42.

3 In light of the requirement that a deciding court, in  
4 ruling on a motion brought under section 7.44 to dismiss a  
5 derivative suit, must evaluate the movant's evidentiary  
6 submissions to determine whether the corporate entity rejecting a  
7 plaintiff's demand is independent, and because the district court  
8 did not do so in evaluating the defendants' motion under Federal  
9 Rule of Civil Procedure 12(b)(6), we vacate the court's judgment  
10 as to Claim One.

11 B. Relationship Between Section 7.44 and Rule 12(b)(6)

12 In Halebian II, we noted that the plaintiff also  
13 pressed the argument that even assuming section 7.44 did apply to  
14 the facts of this case – a question the Supreme Judicial Court  
15 has now settled definitively in the affirmative – the district  
16 court erred by failing to convert the Board's motion to dismiss  
17 into a motion for summary judgment and in barring the plaintiff  
18 from seeking discovery before deciding such a motion. Halebian  
19 II, 590 F.3d at 211 n.13. We now conclude that, under the  
20 circumstances presented here, the dictates of section 7.44 are  
21 sufficiently in conflict with the contours of Federal Rule of  
22 Civil Procedure 12(b)(6) as to require the district court to  
23 complete its evaluation of this matter on remand by converting  
24 the defendants' motion to dismiss into one for summary judgment.



1           As we have noted, section 7.44 sets forth both  
2 substantive standards for adjudicating the effectiveness of a  
3 board's rejection of a demand and instructions regarding the  
4 procedure by which that rejection must be communicated to – and  
5 its validity established before – a court. The dismissal  
6 procedure requires a defendant to submit various extrinsic  
7 evidentiary materials that the plaintiff may not have referenced  
8 or included within his complaint. See Mass. Gen. Laws ch. 156D,  
9 § 7.44(d).

10           By contrast, the purpose of Federal Rule of Civil  
11 Procedure 12(b)(6) "is to test, in a streamlined fashion, the  
12 formal sufficiency of the plaintiff's statement of a claim for  
13 relief without resolving a contest regarding its substantive  
14 merits." Global Network Commc'ns, Inc. v. City of New York, 458  
15 F.3d 150, 155 (2d Cir. 2006) (emphasis omitted); accord LaBounty  
16 v. Adler, 933 F.2d 121, 123 (2d Cir. 1991). The court therefore  
17 does not ordinarily look beyond the complaint and attached  
18 documents in deciding a motion to dismiss brought under the rule.  
19 Staehr v. Hartford Fin. Servs. Grp., Inc., 547 F.3d 406, 425 (2d  
20 Cir. 2008).

21           On the other hand, of course, on a motion for summary  
22 judgment under Federal Rule of Civil Procedure 56, the parties  
23 test the substantive merits of the claim or claims and their  
24 evidentiary support based on "additional supporting material" in  
25 their possession or obtained during discovery. Chambers v. Time

1 Warner, Inc., 282 F.3d 147, 154 (2d Cir. 2002); see Global  
2 Network Commc'ns, 458 F.3d at 155 (Although Rule 12(b)(6)  
3 "assesses the legal feasibility of the complaint, [it] does not  
4 weigh the evidence that might be offered to support it."). When  
5 "matters outside the pleadings are presented to and not excluded  
6 by the court, the motion must be treated as one for summary  
7 judgment under Rule 56," Fed. R. Civ. P. 12(d), in order to  
8 ensure that the party against whom the motion to dismiss is made  
9 may respond. Cortec Indus., Inc. v. Sum Holding L.P., 949 F.2d  
10 42, 48 (2d Cir. 1991), cert. denied, 503 U.S. 960 (1992).

11 The procedure contemplated by section 7.44 of the  
12 Massachusetts statute does not easily fit within the constraints  
13 of Rule 12(b)(6), even as it has been broadened by occasional  
14 judicial glosses on its terms.<sup>7</sup> While a dismissal pursuant to  
15 Rule 12(b)(6) is, at bottom, a declaration that the plaintiff's

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<sup>7</sup> There are exceptions to Rule 12(b)(6)'s general prohibition against considering materials outside the four corners of the complaint. For example, it is well established that on a motion to dismiss for failure to state a claim pursuant to Rule 12(b)(6), the court may also rely upon "documents attached to the complaint as exhibits[] and documents incorporated by reference in the complaint." DiFolco v. MSNBC Cable L.L.C., 622 F.3d 104, 111 (2d Cir. 2010) (citing Chambers, 282 F.3d at 153). Courts may also properly consider "matters of which judicial notice may be taken, or documents either in plaintiffs' possession or of which plaintiffs had knowledge and relied on in bringing suit." Chambers, 282 F.3d at 153 (ellipsis omitted) (quoting Brass v. Am. Film Techs., Inc., 987 F.2d 142, 150 (2d Cir. 1993) (dicta)). In Chambers, we noted that "a plaintiff's reliance on the terms and effect of a document in drafting the complaint is a necessary prerequisite to the court's consideration of the document on a dismissal motion; mere notice or possession is not enough." Id. (emphasis in original) (citing Cortec, 949 F.2d at 47-48).

1 complaint and incorporated materials are insufficient as a matter  
2 of law to support a claim upon which relief may be granted, see  
3 Cortec, 949 F.2d at 47, Massachusetts section 7.44 provides a  
4 procedure by which a defendant must introduce extraneous material  
5 in order to secure dismissal. The Massachusetts statute "imposes  
6 an initial burden on the corporation to come forward with facts  
7 to show it is entitled to the section's protection." Mass. Gen.  
8 Laws ch. 156D, § 7.44, cmt. 2. To avail itself of section 7.44,  
9 "the corporation is required . . . to present to the court a  
10 filing containing facts justifying application of the business  
11 judgment rule." Id.; see id. § 7.44(d); see also Blake, 2006 WL  
12 1579596, at \*11, 2006 Mass. Super. LEXIS 241, at \*38 (concluding  
13 that the party moving to dismiss under section 7.44 has an  
14 "initial hurdle of showing that the [board committee which  
15 decided to reject the plaintiff's demand] was properly  
16 constituted" and also "bears the burden of submitting a written  
17 filing with the court setting forth facts to show that a majority  
18 of the Board was independent when the independent directors made  
19 their determination, and that the independent directors . . .  
20 made the determination in good faith after conducting a  
21 reasonable inquiry upon which its conclusions are based").

22           According to the statute, then, the corporation first  
23 must file its motion to dismiss and "make a written filing with  
24 the court setting forth facts to show . . . whether a majority of  
25 the board of directors was independent at the time of the

1 determination by the independent directors." Id. § 7.44(d). If,  
2 as discussed in Part II(A), above, the trial court determines  
3 that the board is independent, the plaintiff bears the burden of  
4 demonstrating that the independent directors did not make the  
5 determination "in good faith after conducting a reasonable  
6 inquiry upon which their conclusions are based."<sup>8</sup> Id. §§  
7 7.44(d), 7.44(e). In this scenario, "the court shall dismiss the  
8 suit unless the plaintiff has alleged with particularity facts  
9 rebutting the corporation's filing in its complaint or an amended  
10 complaint or in a written filing with the court." Id. Thus the  
11 state statute explicitly contemplates an additional opportunity  
12 for the plaintiff to rebut – if he or she has not done so in the  
13 original complaint – the defendant's factual showings of  
14 independence, good faith, and reasonable inquiry, either through  
15 an amended complaint or some other "written filing with the  
16 court."<sup>9</sup> See Blake, 2006 WL 1579596, at \*11, 2006 Mass. Super.

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<sup>8</sup> If the court concludes the board is not independent, the burden shifts to the defendant in demonstrating good faith and a reasonable inquiry. Id. § 7.44(e).

<sup>9</sup> Section 7.44 permits plaintiffs to dispute by "alleg[ing] with particularity facts rebutting the corporation's filing" in three distinct ways: (1) pointing the court back to allegations made in the plaintiff's initially filed complaint; (2) filing an amended complaint; and (3) making some other "written filing." Mass. Gen. Laws ch. 156D, § 7.44(d). In responding to a defendant's 12(b)(6) motion to dismiss in federal court, a plaintiff will generally have the ability to identify allegations in the complaint, or amend the complaint to add specific allegations, which call the purported bases for dismissal into question. See Fed. R. Civ. P. 15(a)(1)(B), 15(a)(2). Insofar as that is the case, section 7.44 would likely not conflict with the Federal Rules of Civil Procedure. As, however, the instant case implicates section 7.44(d)'s third, "written filing" response –

1 LEXIS 241, at \*38 ("If the SLC satisfies this burden of setting  
2 forth such facts regarding independence and the plaintiff alleges  
3 with particularity facts rebutting the SLC's written filing under  
4 § 7.44(d), the court assesses the evidence as to whether or not  
5 the SLC was independent and whether it determined in good faith  
6 after conducting a reasonable inquiry upon which its conclusions  
7 are based that maintenance of the derivative proceeding is not in  
8 the best interests of the corporation."). Section 7.44(d) also  
9 requires that discovery be stayed upon the filing of the motion  
10 to dismiss and the required supporting materials until the court  
11 rules on the motion, unless a motion for discovery is made and  
12 "good cause" shown for "specified discovery." Mass. Gen. Laws  
13 ch. 156D, § 7.44(d).

14           Insofar as the section 7.44 procedure encourages or  
15 requires the parties to submit, and under which it is expected  
16 that the court will review, evidentiary materials outside the  
17 scope of what the plaintiff has already included or incorporated  
18 into his or her complaint, the section 7.44 procedure appears to  
19 be incompatible with a federal court's limited powers to grant a  
20 Rule 12(b)(6) motion to dismiss. Although we cannot foreclose  
21 the possibility that there may be cases in which the two regimes

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and given that, in any event, section 7.44 requires an initial  
supplementary evidentiary filing by the moving defendant – we  
still view the two procedural dictates as incompatible, at least  
on the facts before us here. See also infra note 10 and  
accompanying text.

1 would not conflict,<sup>10</sup> this is not one of them. The materials  
2 submitted by the defendants to comply with section 7.44 fall  
3 outside the bounds of what a federal court may properly consider  
4 on a Rule 12(b)(6) motion, and the district court must examine

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<sup>10</sup> For example, if a plaintiff files his or her complaint after the board of directors has already formally rejected the demand, a federal district court faced with a motion to dismiss might deem the board's written rejection of the plaintiff's demand to be incorporated by reference within, or integral to, the plaintiff's complaint. That, we surmise, would obviate one of the potential conflicts between section 7.44 and Rule 12(b)(6). Moreover, even where a plaintiff files his complaint before a board's formal rejection of his demand, there might be cases in which conversion will be unnecessary – for instance, if a court permits the plaintiff to amend her complaint after the board's rejection, the court might very well consider the written rejection to be properly incorporated by reference. In such a circumstance, a Rule 12(d) conversion might be unnecessary to a district court's evaluation of evidence regarding the inquiries mandated by section 7.44, in light of the policies undergirding the conversion rule. See Cortec, 949 F.2d at 48 ("Where plaintiff has actual notice of all the information in the movant's papers and has relied upon these documents in framing the complaint the necessity of translating a Rule 12(b)(6) motion into one under Rule 56 is largely dissipated."). Even though we decline to rule out the possibility that a case of that nature will eventually arise in this Circuit, we do note that a conclusion contrary to ours here might be in tension with Circuit law governing the incorporation of material into a complaint. See, e.g., Global Network Commc'ns, 458 F.3d at 157 ("In most instances where th[e] 'integral to the complaint' exception is recognized, the incorporated material is a contract or other legal document containing obligations upon which the plaintiff's complaint stands or falls, but which for some reason . . . was not attached to the complaint. The exception thus prevents plaintiffs from generating complaints invulnerable to Rule 12(b)(6) simply by clever drafting.").

In this case, though, the district court necessarily relied on the defendants' extrinsic submissions in granting dismissal to the defendants. Although the court was careful to disclaim any consideration of materials improperly before it on a 12(b)(6) motion, see Halebian I, 631 F. Supp. 2d at 287 n.1, we conclude that on the instant facts, the dictates of section 7.44 made such a task impossible.

1 those materials in order to make the findings mandated by section  
2 7.44 as a prerequisite to dismissal. Because of these unique  
3 circumstances, we instruct the district court, on remand, to  
4 adjudicate the claim within the framework of summary judgment by  
5 converting the defendants' motion to dismiss pursuant to Federal  
6 Rule of Civil Procedure 12(d). See Fagin v. Gilmartin, 432 F.3d  
7 276, 285 (3d Cir. 2005) (discussing a New Jersey state procedural  
8 rule applicable in shareholder derivative cases and concluding  
9 that "it would be better for the [d]istrict [c]ourt to consider  
10 [the sufficiency of the board's rejection of a shareholder  
11 demand] on summary judgment," rather than on a motion to  
12 dismiss).

### 13 C. Discovery

14 Although Halebian contended in the district court, and  
15 does so again on appeal, that he should have been afforded the  
16 opportunity to conduct additional discovery in order to rebut the  
17 Board's filing, under both Federal Rule 56 and section 7.44, the  
18 availability of further discovery is a matter within the district  
19 court's discretion. Cf. Fagin, 432 F.3d at 285 (noting that the  
20 appellate panel remanding to the district court for resolution by  
21 summary judgment "d[id] not intrude on the [district c]ourt's  
22 discretion as to the extent of discovery it needs to decide the  
23 issue"). While we decline to decide the question, the district  
24 court may well have acted within its discretion in denying the  
25 plaintiff's request for discovery, particularly in light of the

1 defendants' submission of "thousands of pages detailing the  
2 backgrounds of the directors at issue, as well as the extensive  
3 efforts made by the independent counsel in preparing its review  
4 of the demand for the committee and the Board." Halebian I, 631  
5 F. Supp. 2d at 298. We nonetheless think that a reevaluation of  
6 any such application by the plaintiff for more discovery in light  
7 of Rule 56 case law and procedures would be advisable on remand.

8 In rejecting the plaintiffs' discovery request, the  
9 district court wrote: "Absent a specific allegation in the  
10 complaint as to why the Board was not disinterested, nor why the  
11 demand was refused, and absent a specific argument from plaintiff  
12 as to what more discovery would yield, we decline to allow  
13 plaintiff to avail himself of a premature opening of the  
14 floodgates to discovery in an effort to cure the deficiencies in  
15 the complaint."<sup>11</sup> Halebian I, 631 F. Supp. 2d at 298. In  
16 addition, the district court suggested that the plaintiff – even  
17 though filing his complaint before the Board's rejection – might  
18 have anticipated that he would have to make allegations about  
19 independence, and therefore could have done so in the original

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<sup>11</sup> We note that the various allegations in plaintiff's opposition to the defendants' motion discussed in note 6, supra, seem to us to arguably present "a specific argument . . . as to what more discovery would yield," Halebian I, 631 F. Supp. 2d at 298. Whether the plaintiff's arguments on that issue are convincing, though, is a question left to the sound discretion of the district court on remand.



1 filing.<sup>12</sup> But we do not see how the plaintiff can be expected  
2 to have made "specific allegation[s]" in the complaint as to "why  
3 the demand was refused" when the Board had not yet taken final  
4 action on the plaintiff's demand at the time his complaint was  
5 filed. And the statute does not require the plaintiff to predict  
6 the content of the defendants' submissions on its motion to  
7 dismiss and preemptively rebut those submissions in its  
8 complaint.

9 **CONCLUSION**

10 For the foregoing reasons, we affirm the judgment of  
11 the district court dismissing Claims Two and Three of the  
12 complaint. We vacate that portion of the district court's  
13 judgment dismissing Claim One under Rule 12(b)(6) and remand this  
14 matter to the district court for its resolution of Claim One in a  
15 manner consistent with this opinion.

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<sup>12</sup> The court stated:

We realize that the complaint could not have  
pled reasons why the Board's decision to  
reject the demand was improper in light of  
the fact that the complaint was filed prior  
to the rejection. However, the complaint  
could have asserted various reasons as to why  
the Board was constituted of interested  
trustees, or why the [Board's demand review  
committee], as constituted, was inadequate as  
a review mechanism for the Board.

Halebian I, 631 F. Supp. 2d at 296 n.8.