

# Boston Bar Journal

A Peer Reviewed Publication of the Boston Bar Association

Spring 2018  
Volume 62, Number 2

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## **The Nuts and Bolts of Crafting a Derivative Case**

**By Tara J. Myslinski and Stephanie R. Parker**  
**The Profession**

Filing a new complaint? If your client is part of a for-profit corporate entity and the dispute concerns that entity, there is a good chance that you are wondering whether some or all of your client's potential claims are derivative or direct claims. There are plenty of ways to get tripped up in this context; it is wise to think early about all of the possible pitfalls in such a case and understand the road ahead.

In this article we discuss the steps an attorney facing this issue must take, including understanding the nature of your client's entity at the outset of a case, determining whether your client has direct or derivative claims, and following the unique procedural and substantive rules applicable to derivative claims.

### **Understand the Nature of Your Client's Entity and its Place of Formation.**

The law of the state of the entity's incorporation or registration will dictate substantive issues of law for claims concerning that entity. Procedural rules for the forum will govern procedural issues.

Issues of substantive law include whether claims are derivative or direct and whether a plaintiff has standing to pursue derivative claims against the entity. See [Cannonball Fund, Ltd. v. Dutchess Capital Mgmt., LLC](#), 84 Mass. App. Ct. 75, 93 (2013) (quoting [Harrison v. NetCentric Corp.](#), 433 Mass. 465, 471 (2001)). The differences among the states on derivative suits can be substantial; for example, whereas under Massachusetts law a shareholder is required to make demand on directors in every case alleging derivative claims on behalf of a corporation, see [G.L. c. 156D, § 7.42](#), a suit on behalf of a Delaware corporation may still allege futility of such demand. See [Johnston v. Box](#), 453 Mass. 569, 578 & n. 15 (2009); [Del. Ct. Ch. R. 23.1](#); see also [6 Del. C. §§ 18-1001 & 18-1002](#) (allowing any LLC member to bring derivative action).

In addition to ascertaining the state of your entity's formation, study the entity's governing documents for specific provisions that may apply to derivative suits. See, e.g., [G.L. c. 156C, § 56](#).

### **Determine Whether Your Client has Direct or Derivative Claims, or Both.**

In your complaint, you must specify whether each claim is brought directly by your client as an individual or derivatively by your client on behalf of the entity. This distinction is important because, as discussed below, you must comply with special procedural requirements for any derivative claims you assert.

In general, a derivative claim asserts a wrong done to the corporation, as opposed to any particular shareholder. As such, a derivative claim belongs to the corporation and any damages

recovered on a derivative claim will go to the corporation. Examples of derivative claims include:

Wasting, mismanaging or misappropriating corporate assets, resulting in a general diminution of the value of corporate stock, assets, or cash on hand; *see, e.g., [Rubin v. Murray](#), 79 Mass. App. Ct. 64, 80 (2011)*;

- Engaging in acts of self-dealing and/or diverting corporate opportunities; *see, e.g., [Williams v. Charles](#), 84 Mass. App. Ct. 328, 338 (2013)*;
- Breach of a contractual obligation owed to the company, including breach of a non-competition provision; *see, e.g., [Pagounis v. Pendleton](#), 52 Mass. App. Ct. 270, 275 (2001)*; and
- Breach of a fiduciary or other duty owed by the defendant to the corporation. *See, e.g., [International Brotherhood of Electrical Workers Local No. 129 Benefit Fund v. Tucci](#), 476 Mass. 553, 558 (2017)*.

A direct claim, in contrast, alleges breach of a duty owed to the plaintiff as a shareholder, investor, or creditor of a corporation and seeks to remedy some harm that is distinct from that suffered by shareholders generally. *IBEW*, 476 Mass. at 558. As such, damages recovered on a direct claim will go directly to the plaintiff. Examples of direct claims include:

- Misrepresentation or fraud perpetrated on an individual investor in connection with his or her investment; *see, e.g., [Amorim Holding Financeria, S.G.P.S., S.A. v. C.P. Baker & Co.](#), 53 F. Supp. 3d 279, 306-07 (D. Mass. 2014)*;
- Failure to make payments owed directly to plaintiff, such as profit distributions; *see, e.g., [Reeve v. Folly Hill Limited Partnership](#), 36 Mass. App. Ct. 90, 97 (1994)*;
- Dilution of one shareholder's share value or equity while increasing the equity held by other shareholders; *see, e.g., [Donahue v. Rodd Electrotype Co.](#), 367 Mass. 578, 600 n.25 (1975)*; and
- Breach of a fiduciary duty owed to a shareholder/member or freeze out of a shareholder/member. *See id. at 579 n. 4.*

In certain contexts, particularly cases involving a close corporation, the line separating direct and derivative claims can be blurred. In those contexts, good pleading practice may require alleging certain claims both individually and derivatively.

## **Follow the Procedural Prerequisites and Substantive Rules that Apply Uniquely to Derivative Suits.**

### **1. As a Threshold Matter, Ensure Your Plaintiff has Standing.**

Massachusetts law on a plaintiff's standing to bring a derivative claim varies somewhat depending on the type of entity at issue. *See [G.L. c. 156C, §§ 56-57](#) (LLCs); [G.L. c. 156D, §§ 7.40-7.47](#) (corporations); [G.L. c. 109, §§ 56-59](#) (limited partnerships)*.

With respect to any entity in Massachusetts, however, to have standing to bring a derivative claim, a plaintiff must have been a shareholder (or member or partner) at the time of the alleged misconduct and must continue to be a shareholder throughout the entirety of the derivative litigation. *[G.L. c. 156D, § 7.41](#); see [Billings v. GTFM, LLC](#), 449 Mass. 281, 289-96 (2007)* (involuntary loss of ownership interest during pendency of litigation deprived plaintiff of

standing to press derivative claims); *see also* [Kolancian v. Snowden, 532 F. Supp. 2d 260, 262-263 \(D. Mass. 2008\)](#) (“a narrow exception to this rule arises where the [event causing the loss of the plaintiff’s ownership interest] itself is the subject of a claim of fraud. . . [t]o establish that a merger was fraudulent, a plaintiff must plead with particularity that it was undertaken ‘merely to eliminate derivative claims’”) (quotation omitted). If your client is concerned that, during the pendency of the case, the defendant may eliminate your client’s interest, preliminary injunctive relief to halt that transaction may be necessary. *See* [IBEW, 476 Mass. at 564 n.15](#).

If your client controls the entity by owning a majority of its shares or serving as its manager or president, your client may be able to bring a direct suit against a wrongdoer. But if the company is owned 50/50 and your client is one of the 50% owners seeking to sue the other 50% owner in the company’s name, the analysis is different. Although Massachusetts has yet to issue a clear decision on this issue, other jurisdictions uniformly hold that a 50% owner may not bring suit against another 50% owner in the company’s name without following derivative procedures. *See, e.g.,* [Swart v. Pawar, No. 1:14-cv-10, ECF #162 \(N.D.W.Va. Nov. 19, 2015\)](#); [Barry v. Curtin, 993 F. Supp. 2d 347, 352-53 \(E.D.N.Y. 2014\)](#); [Crouse v. Mineo, 189 N.C. App. 232, 238-39 \(2008\)](#).

If the entity is a limited liability company, [G.L. c. 156C, § 56](#) imposes additional constraints on a plaintiff’s standing. It requires that a plaintiff alleging a derivative claim be either: (1) a member authorized to sue by the vote of members owning more than 50% of the unreturned contributions to the LLC; or (2) a manager of the LLC authorized to sue by a vote of a majority of the managers. In either case, the vote of any member or manager who has an interest in the outcome of the suit that is adverse to the LLC’s interest must be excluded. Given this statutory rigor, unless the LLC’s operating documents state otherwise, a minority member, or single manager in a multi-manager LLC, would have to secure a favorable vote to obtain a non-interested majority in order to have standing to sue on behalf of the LLC. *Compare* [G.L. c. 156D, § 7.41](#) (any shareholder holding stock at the time of wrongdoing may commence a derivative proceeding so long as they “fairly and adequately” represent the interests of the corporation).

## **2. Comply with Procedural Rules for Derivative Claims in Massachusetts State or Federal Court.**

State and federal rules of civil procedure impose special pleading requirements on derivative claims. Specifically, in addition to any substantive law governed by the entity’s state of formation, [Massachusetts Rule of Civil Procedure 23.1](#) requires that the derivative complaint:

- Be verified;
- Allege that the plaintiff was a shareholder or member at the time of the transaction at issue, or that the plaintiff’s share or membership thereafter devolved on him by operation of law from someone who was a shareholder or member at the time; and
- Allege with particularity the efforts made by the plaintiff to obtain the action he or she desires from the directors or comparable authority and the reasons for his failure to obtain the action.

The requirements of [Federal Rule of Civil Procedure 23.1](#) are similar, but add that the plaintiff must plead that “the action is not a collusive one to confer jurisdiction that the court would otherwise lack.” The requirements of the Massachusetts Rule can be waived if a defendant

proceeds to trial without addressing these issues, see [Diamond v. Pappathanasi](#), 78 Mass. App. Ct. 77, 89 (2010) (involving a general partnership), but there is no analogous case law concerning the Federal Rule.

You also must name the company as a nominal defendant in any derivative action when filing suit in Massachusetts state or federal court, regardless of the state of formation of the entity. See [Fusco v. Rocky Mountain I Investments Ltd. P'ship](#), 42 Mass. App. Ct. 441, 447 (1997); [Gabriel v. Preble](#), 396 F.3d 10, 14-15 (1st Cir. 2005).

### **3. Properly Apply Substantive Law on Demand Requirements Prior to Filing a Derivative Suit.**

The most frequently litigated issue of substantive law in derivative cases is demand/demand futility. Massachusetts substantive law imposes hurdles additional to the procedural requirement of Mass. R. Civ. P. 23.1.

#### *Corporations*

A plaintiff intending to bring a derivative claim on behalf of a Massachusetts corporation must first demand that the corporation pursue the claim. [G.L. c. 156D, § 7.42](#). “The rationale behind the demand requirement is that, as a basic principle of corporate governance, the board of directors or majority of shareholders should set the corporation's business policy, including the decision whether to pursue a lawsuit.” [Harhen v. Brown](#), 431 Mass. 838, 844 (2010). The procedure for making demand is detailed and is set forth in [G.L. c. 156D, §§ 7.40, et seq.](#) Massachusetts is a universal demand state, which means that demand must be made even if the plaintiff believes it would be futile due to a board's interest or lack of independence. See [Johnston](#), 453 Mass. at 578 n.15.

A plaintiff may only initiate a derivative action once the corporation has either (i) refused a demand to bring suit; or (ii) ignored the demand for at least 90 days (or 120 days if the decision regarding whether to pursue the claims is submitted to the shareholders for a vote). A derivative plaintiff may file suit before expiration of the waiting period if the plaintiff can show that irreparable injury would result by waiting for the period to expire. [G.L. c. 156D, § 7.42](#).

If your client's demand is refused and she disagrees with the corporation's decision, you should carefully study [G.L. c. 156D, § 7.44](#) and be prepared to challenge the refusal in your complaint and in your opposition to the inevitable motion to dismiss. In this context, the “business judgment rule” precludes the suit if the corporation can show that it determined in good faith and after reasonable inquiry that the suit would not be in the best interests of the corporation. [G.L. c. 156D, § 7.44\(a\)](#). Although challenging a director vote to refuse a demand is difficult because of the protections of the business judgment rule, Judge Kaplan of the Superior Court's Business Litigation Session recently denied a motion to dismiss derivative claims in just that context. See [Brining v. Donovan](#), No. 1684-CV-3422-BLS1 (Mass. Super. Ct. Sept. 14, 2017). The court questioned the directors' independence given their close ties with the alleged wrongdoer and also found reasonable doubt as to whether the board conducted its investigation in good faith because

its conclusion in the face of glaring financial improprieties was “so different from what an independent Board would be expected to do.” *Id.*

### *Limited Liability Companies*

In contrast to corporation derivative suits, the futility exception is still alive in the context of LLC derivative suits, but must be well-pleaded to satisfy Mass. R. Civ. P. 23.1. See [Billings, 449 Mass. at 289-90 n.19](#); see also [Harhen, 431 Mass. at 844](#) (futility exception is pled by alleging that “a majority of [members] are alleged to have participated in wrongdoing, or are otherwise interested” and adopting definition of “interested” director as stated in ALI’s Principles of Corporate Governance, §§ 1.15 & 1.23); [Diamond, 78 Mass. App. Ct. at 89](#) (“to satisfy rule 23.1, a complaint in a derivative action must plead with particularity either the presuit demand the plaintiff has made or the reasons why making such demand would have been futile”).

### *Partnership*

Limited partners alleging damage to the partnership must make demand upon the general partner or allege the reasons that doing so would be futile. [G.L. c. 109, § 58](#).

## **4. Follow Procedural and Substantive Rules at the Conclusion of a Derivative Case.**

A derivative proceeding filed in Massachusetts may not be discontinued or settled without court approval. Mass. R. Civ. P. 23.1; [G.L. c. 156D, § 7.45](#).

As discussed above, damages recovered on a derivative claim will go to the entity. The Massachusetts Appeals Court recently noted that there may be some irony, particularly in the context of a close corporation, if this rule results in the wrongdoer benefiting from a share in the recovery. See [Beninati v. Borghi, 90 Mass. App. Ct. 566, 567, n.11 \(2016\)](#). This irony can be mitigated by the trial judge, who is “free to take the equities into account in fashioning any remedy under c. 93A.” *Id.* In an effort to remedy that type of unfair result, on remand to the Business Litigation Session in *Beninati*, Judge Sanders recently reduced a G.L. c. 93A damages award by a wrongdoer’s percentage of ownership interest in the company and directed that the company “shall not permit” any distribution of the damages to the wrongdoer. *Beninati v. Borghi*, Nos. 1284-cv-1985-BLS2, 1384-cv-1772-BLS2 (Mass. Super. Ct. June 30, 2017). An [appeal of that decision](#) is currently pending.

Massachusetts law authorizes the court to award attorneys’ fees and costs to the plaintiff upon conclusion of a case if the court finds that the proceeding has resulted in a “substantial benefit to the corporation.” [G.L. c. 156D, § 7.46](#); see also [Beninati, 90 Mass. App. Ct. at 568](#) (affirming denial of fee application in part because time records failed to make that distinction). The court may award the defendant its fees and costs if the court finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose. [G.L. c. 156C, § 57](#) contains parallel fee-shifting provisions for derivative claims in the Massachusetts LLC context. Because Massachusetts law is not clear on the issue of whether an award of attorneys’ fees in derivative litigation is procedural or substantive, be sure to also understand the law of the entity’s formation state on this issue at the outset of your case.

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## A Signed Text Message Can Result in a Binding Real Estate Contract

By Peter F. Carr, II

### Practice Tips

The commonplace reliance upon and acceptance of text messaging in commercial dealings has forced courts to examine the legal implications of texting within the seminal rule that a contract concerning real estate shall not be enforced “[u]nless the promise, contract or agreement upon which such action is brought, or some memorandum or note thereof, is in writing and signed by the party to be charged therewith or by some person thereunto by him lawfully authorized.” G.L. c. 259, § 1, Fourth. At the trial court level, courts have embraced the concept of “contract by text message” for real estate so long as additional key elements are established. One, the text message must either contain or incorporate by express reference all material terms of an agreement concerning land. Two, the text message must conclude with the signature of the “party to be charged” or its authorized agent. A formal signature or even a complete first and last name is not required. However, the sequencing is critical. The cases to date largely have turned on whether the name of the sender appears at the end of the text message to signify the authentication of its preceding substance. The text message is sufficiently signed and binding provided that it concludes with a “mark” to indicate that the sender adopts the message.

Recent cases from the Land Court bear out these core concepts. In a commercial real estate dispute that hinged on text message exchanges between the parties’ brokers, a judge denied a special motion to dismiss a *lis pendens* that was issued in favor of the plaintiff buyer seeking to enforce a sales contract. [\*St. John’s Holdings LLC v. Two Electronics, LLC\*, 24 LCR 190, 16 MISC 000090 \(RBF\), 2016 WL 1460477 \(Mass. Land Ct. April 14, 2016\)](#), *aff’d*, [\*92 Mass. App. Ct. 1114 \(2017\)\*](#). Although the defendant seller ultimately prevailed at trial, the Court steadfastly held that the text message of the seller’s broker satisfied the signed writing requirement of the Statute of Frauds. The text message incorporated by reference the final letter of intent for the purchase and sale of the property following ongoing negotiations between the parties. The contract was deemed signed and accepted by the seller when the seller’s broker concluded the text message with the inclusion of his first name. The Court held, “In the context of these exchanges between the parties, the court infers that the text message sent by [Tim, the seller’s broker] was intended to be authenticated by his deliberate choice to type his name at the conclusion of his text message.” In another case, the Court similarly found compliance with the Statute of Frauds because, “[t]he broker’s writing her first name ‘Laurie’ at the end of the text message constitutes a signature for the purpose of the Statute of Frauds.” However, the Court ruled that the text message did not contain or incorporate sufficient material terms to form a contract. [\*Fiore v. Lindsey\*, No. 17 MISC 000533 \(RBF\), 2017 WL 5969332 \(Mass. Land Ct. Nov. 29, 2017\)](#). In contrast and underscoring the critical nature of the sequencing, text exchanges between brokers did not satisfy the Statute of Frauds where none of the operative texts concluded with the names of the brokers, even though those names appeared in the bodies of the messages. [\*Donius v. Milligan\*, 24 LCR 440, 443, No. 16 MISC 00277 \(HPS\), 2016 WL 3926577 \(Mass. Land Court July 25, 2016\)](#). The Court denied relief because the “text messages here are not signed by either the proposed buyer or seller, nor are they signed by the agents.” In addition, the Court ruled that the substance of the text messages evidenced mere negotiations.

Although no appellate court has yet addressed squarely text messages in the context of the Statute of Frauds, the prior appellate decisions affirming the binding nature of informal email exchanges coupled with the expanding usage of electronic communications arguably signal that reviewing courts are likely to embrace the theories established at the trial court level.

Accordingly, to avoid being bound to an agreement involving land that may never have been intended, parties should insist upon more formal means of communicating with clear documentation, at least as negotiations proceed. A party involved in a transaction may be wise to limit or eliminate all text messaging with a counterparty during the course of negotiations, or to include written disclaimers to memorialize that text messages will not be accepted as part of a deal. At a minimum, parties must avoid a course of conduct which creates the presumption that a text message is sufficient to express offer and acceptance. Otherwise, as the judge observed in *St. John's Holdings*, “a text message, all too familiar to most teenagers and their parents, can constitute a writing sufficient under the Statute of Frauds to create an enforceable contract for the sale of land.”

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**Trustees of Cambridge Point Condominium Trust v. Cambridge Point, LLC - SJC  
Proscribes “Poison Pill” and Prescribes an Uncertain Way Forward  
By Samuel B. Moskowitz  
Case Focus**

On January 19, 2018, the Supreme Judicial Court ruled that a condominium bylaw that, “for all practical purposes, makes it extraordinarily difficult or even impossible” for condominium trustees to sue the developer for defects in the common areas and facilities, is void as contravening public policy. [\*Trustees of Cambridge Point Condo. Trust. v. Cambridge Point, LLC\*](#) (“*Trustees*”), [478 Mass. 697, 709 \(2018\)](#). Condominium boards celebrated the demise of this “poison pill” that developers increasingly insert in condominium documents to shield themselves from liability. Yet that celebration was premature, because the decision has limited reach and the “poison pill” continues to limit condominium trustees’ ability to initiate litigation in almost all other contexts.

**Background**

When the trustees of the seven-year-old Cambridge Point Condominium decided to sue the developer for \$2 million in alleged common area defects, a condominium bylaw severely restricted their ability to initiate litigation. Under that bylaw, before suing anyone other than a unit owner, the trustees had to obtain the written consent of at least 80% of the unit owners. To do so, they first had to circulate their proposed complaint, specify a limit on legal fees and costs to be paid, and institute a special assessment to collect that sum. To prevent the owners from easing these requirements, the bylaw required that at least 80% of the owners must consent to its amendment. Making matters worse, the developer owned at least 20% of the units.

The trustees sued without first obtaining the requisite consent, seeking damages and a declaration voiding the bylaw. The superior court dismissed their suit, concluding that the bylaw was not prohibited by the condominium statute, [G.L. c. 183A](#) (the “Act”), and its use by developers did not constitute “overreaching” in contravention of public policy.” *Trustees, supra* at 691-701. The SJC granted direct appellate review.

**No Violation of Condominium Act**

Writing for the Court, Chief Justice Gants first addressed whether a “bylaw provision requiring unit owner consent to initiate litigation is ... per se void because it is ‘inconsistent’ with the [A]ct.” *Trustees, supra* at 703. The Court rejected the trustees’ argument that the Act’s grant, in [§ 10\(b\)\(4\)](#), to trustees of the exclusive authority to litigate common area claims proscribes *any* bylaw restricting that authority, reiterating the Court’s view that the Act is “essentially an enabling statute” that lays out minimum requirements for establishing condominiums and otherwise provides developers and unit owners with “planning flexibility” to work out in condominium bylaws matters not specifically addressed by the statute. *Id.* at 701-02 (citing [Scully v. Tillery, 456 Mass. 758, 770 \(2010\)](#)). The Court also declined to apply the maxim of negative implication to invalidate a bylaw requiring unit owners’ consent for trustee litigation simply because such consent is statutorily required for some other trustee actions.

## Invalid as Against Public Policy

The Court next determined whether developers' use of the bylaw to shield themselves from common area defect claims contravenes public policy. Recognizing that the bylaw's cumulative requirements "make it extraordinarily difficult for the trustees to sue the developer for defective construction," the Court ruled that the "well-established public policy in favor of the safety and habitability of homes" outweighs the "public interest in freedom of contract." *Trustees, supra* at 705-708. The Court noted that the right to obtain legal redress for homes that fail to meet minimum standards of safety and habitability are so vital they cannot be waived, and that "[t]his clear expression of public policy" required that the bylaw "be carefully scrutinized to determine whether it contravenes that ... policy." *Id.* at 708. Doing so, the Court found the bylaw more sweeping and unfair than a broad, express waiver, and it struck its use as overreaching by the developer, citing a long-standing exception to freedom of contract in condominium developments first laid out in [Barclay v. DeVeau, 384 Mass. 676, 682 \(1981\)](#) ("Absent overreaching or fraud by a developer, [courts] find no strong public policy against interpreting [the Act] to permit the developer and unit owners to agree on the details of administration and management of the condominium..."). *Trustees, supra* at 709. In *Trustees*, the SJC determined that "it is overreaching for a developer to impose a condition precedent that, for all practical purposes, makes it extraordinarily difficult or even impossible for the trustees to initiate any litigation against the developers regarding the common areas and facilities of a condominium." *Id.* (emphasis in original)

## Where Does That Leave Us?

*Trustees* continues the Court's expansion of the rights of residential property owners to sue builders for defective construction, which the Court initiated in [Albrecht v. Clifford, 436 Mass. 706, 710-11 \(2002\)](#) (applying warranty of habitability to new home sales). It also continues the expansion of the rights of condominium trustees to sue developers for common area defects, following [Berish v. Bornstein, 437 Mass. 252, 265 \(2002\)](#) (organization of unit owners may sue for breach of the implied warranty of habitability over latent common area defects that implicate the habitability of individual units) and [Wyman v. Ayer Properties, LLC, 469 Mass. 64 \(2014\)](#) (economic loss rule does not apply to damage caused to common areas by builder's negligence).

Yet, for condominiums, the decision is also quite narrow, because it invalidates the use of the bylaw only for building defect claims against developers. Even here, the Court provided little guidance on whether a modified bylaw might be acceptable. Would, for example, a bylaw requiring the same 75% owner consent that is statutorily required for improvements and casualty repairs be acceptable, especially if developer units cannot vote? *Trustees* does not say.

Moreover, the Court's refusal to strike the provision universally presents far-reaching consequences for condominium boards. Outside of common area defect claims against developers, the provision continues to apply to *all* litigation by condominium trustees except suits against unit owners. Other litigation must be preapproved and specially assessed in condominiums where the bylaw exists. Is this a useful check on board power or an overly restrictive set of handcuffs that make condominium management more difficult? Those boards

who celebrate the demise of the “poison pill” may come to realize that their indigestion is a long way from being over.

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**Just the Right Size: Benefits (and Potential Pitfalls) of Limited Assistance Representation**  
**by Christopher T. Saccardi**  
**Practice Tips**

Every day in Massachusetts state courts, people take on the burden of representing themselves in civil cases. While there are a number of reasons for this, the principal factor is obvious: lawyers are expensive, and many individuals simply can't afford them.

There are no easy solutions to this problem, but Limited Assistance Representation (LAR), which was introduced in Massachusetts in 2009 and has been expanding through the trial courts, can help. It allows litigants to retain counsel for an essential phase of litigation, or for a crucial hearing, at a cost that is much less than what an attorney might charge to represent the client for a full case. LAR also allows an attorney to offer pro bono services for a particular litigation event without having to commit to taking on an entire case.

While this article draws primarily on procedures and experience with LAR in Housing Court to introduce practitioners to LAR, highlight its benefits, and identify key issues and potential pitfalls, the rules are very similar in the other courts in which LAR is now available to civil litigants—the District Court, the Boston Municipal Court, Probate and Family Court, and the Superior Court.

Under LAR, attorneys are permitted to represent clients on a limited basis after registering with the appropriate court and watching a short video or attending a training on the mechanics of LAR. The duration of the representation can vary by agreement reached between counsel and client. Representations can be as short as a single hearing or discrete task, or they can cover a longer period of time, such as assisting through the completion of discovery or even preparing for and conducting a trial.

For example, common parts of a Housing Court case that are particularly conducive to LAR are: answering or drafting discovery requests; drafting and filing motions; appearing to argue a motion, such as a motion to vacate a default judgment or to issue an execution; conducting a mediation with a Housing Specialist; or trying a summary process (eviction) case.

The mechanics of appearing and withdrawing under LAR vary slightly from court to court, but generally follow the same basic parameters throughout the Commonwealth: attorney and client must sign an agreement that details the specific nature of the representation and the tasks and period of time to be included. The attorney will then complete a set of LAR appearance and withdrawal forms that can be obtained from the appropriate court (or [online](#)) and which must be signed by both the client and the attorney. The withdrawal is filed as soon as the representation ends; in the case of LAR for a discrete hearing, it is not unusual to file the limited appearance form at the beginning of the hearing and to file the withdrawal in open court immediately following the conclusion of the hearing.

While LAR can be a convenient tool for both attorney and client, it does present some unique challenges that are important for practitioners to keep in mind. Litigants can risk disjointed or

incomplete counsel from an LAR attorney who focuses narrowly on the specific task at hand without considering the overall litigation strategy. Or, a client who engages an attorney only to draft a motion could be ill-served, even if the motion is excellent, if the LAR agreement does not provide for properly preparing the client to argue that motion. It is therefore important for both attorney and client to carefully consider the appropriate duration of the representation and the way in which the included tasks will be defined. A failure to do this can lead to awkward situations, as a judge will occasionally not allow the LAR withdrawal if he or she feels that an additional task should be completed by the attorney. For example, a judge will sometimes ask the LAR attorney to postpone the withdrawal after a hearing in order to receive a copy of the decision and explain it to the client.

Another challenge can result if it is unclear to opposing counsel when exactly an LAR attorney has entered and, more importantly, has exited the case. Not knowing whether the adverse party is represented or is pro se can hamper the ability of opposing counsel to negotiate a resolution or simply to communicate about procedural issues. Timely providing copies of the limited appearance and withdrawal to opposing counsel is therefore critically important.

[Housing Court Standing Order 1-10](#), which governs LAR in the Housing Court, contains several requirements counsel must follow to help avoid those potential pitfalls. For example, the signature block of any document filed by an LAR attorney must indicate that it is filed under a LAR representation; a failure to do this could convert the engagement from limited to full representation. The Standing Order also requires opposing counsel to serve documents related to matters within the scope of the limited representation on both the LAR counsel and the party. Similar rules apply in other courts. *See, e.g.,* [BMC Standing Order 1-10](#), [District Court Standing Order 1-11](#), [Superior Court Standing Order 2-17](#), and a [memo](#) and [FAQ](#) regarding LAR in Probate and Family Court. The [LAR page](#) on the Massachusetts state website provides a good summary of the various LAR rules, along with links to FAQs, standing orders, and court forms.

In sum, LAR can be a valuable tool, especially in courts that serve a large population of unrepresented parties. It can be used on a pro bono basis or for paying clients, and can be a helpful way to provide assistance to a party with a critical piece of litigation at considerably lower cost than full representation. Judges are generally appreciative of LAR attorneys because they understand that often the alternative is no representation at all. So long as counsel give careful consideration to how they delineate the duration of the representation and are familiar with the applicable rules, LAR can be a useful part of any practice.

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## **Director Liability Under the Massachusetts Wage Act: The Supreme Judicial Court Clarifies the Law but Traps May Remain for the Unwary**

**By Mark D. Finsterwald**

### **Case Focus**

In *Segal v. Genitrix*, [478 Mass. 551](#) (2017), the Supreme Judicial Court (“SJC”) addressed whether members of a company’s board of directors may be personally liable under the Massachusetts Wage Act, [G.L. c. 149, §§ 148, 150](#), for the company’s failure to pay wages to employees. In *Segal*, the SJC interpreted, for the first time, language in the Wage Act defining “employer” in the context of directors. The SJC held that the Wage Act does not impose liability on directors acting only in their capacity as directors. Even so, the Court did not fully insulate directors from Wage Act liability. There remains a possibility that directors could, perhaps unwittingly, become subject to personal liability in the event a company fails to pay wages.

### **The Wage Act**

The Wage Act enables employees to sue employers who do not pay earned wages, with mandatory awards of treble damages and attorney’s fees for successful claims. Liability is not limited to the business entity, as the Wage Act defines “employer” to include “the president and treasurer of a corporation and any officers or agents having the management of such corporation.” This definition does not mention directors. Nor does it explain how to assess whether a person is an “agent[] having the management of such corporation.” [G.L. c. 149, § 148](#).

### **Facts and Procedural History**

Plaintiff Andrew Segal was the president of Genitrix, LLC, a biotechnology startup that he cofounded with defendant H. Fisk Johnson, III. Johnson was also an investor in Genitrix, and he appointed his representative, defendant Stephen Rose, to the company’s board of directors. Johnson funded Genitrix through a company called Fisk, which Johnson and Rose co-owned. Segal, as president, managed all of Genitrix’s day-to-day operations, including payroll.

In 2006, Genitrix began to have difficulty making payroll. Starting in 2007, Segal stopped taking salary to enable the company to meet its other financial commitments. Rose later declined to direct Fisk to invest enough money in Genitrix to pay Segal. In early 2009, Segal initiated Wage Act litigation against Johnson and Rose.

At trial, the judge instructed the jury that “a person qualifies as an ‘agent having the management of such corporation’ if he ... controls, directs, and participates to a substantial degree in formulating and determining policy of the corporation or LLC.” The judge did not instruct the jury that the defendants needed to have been appointed as agents. Nor did the judge instruct the jury that defendants needed to have assumed responsibilities functionally equivalent to those of a president or treasurer. The jury found both defendants liable for Segal’s unpaid salary. Johnson and Rose moved for judgment notwithstanding the verdict, the trial court denied the motion, and Johnson and Rose appealed.



## The SJC's Analysis

At the outset, the Court stated that it viewed as significant the Legislature's omission of directors from the Wage Act's definition of "employer." *Segal*, 478 Mass. at 558. Parsing the statutory language, the SJC dismissed the possibility that either defendant could be liable as president, treasurer, or any other officer, because neither of them held an office at Genitrix. Johnson and Rose could be liable only if they were "agents having the management" of the company. The Court explained that this language establishes "two important requirements: the defendant must both be an agent and have the management of the company." *Id.* at 559. The Court differentiated between having some management responsibility and "having the management" of the company. "Having the management" means assuming responsibility similar to that performed by a corporation's president or treasurer, the Court reasoned, "particularly in regard to the control of finances or payment of wages."

As to agency, common law agency principles—set forth in the Restatement (Second) of Agency—counsel that directors are not typically considered agents. Restatement (Second) of Agency § 14C (1958). The SJC observed that "[a] board generally acts collectively, not individually." *Segal*, 478 Mass. at 561. Such collective action does not confer individual agency authority on directors. Nevertheless, the Court explained that individual directors still could be "considered agents of the corporation if they are empowered to act as such, but any agency relationship stems from their appointment as an agent, not from their position as a director...." *Id.* at 563. An agency appointment could result from a board resolution, but also could "arise from either express or implied consent." The Court gave as an example a scenario in which "a particular board member had been empowered to act individually as the functional equivalent of the president or treasurer of the corporation." Genitrix, however, made no such appointment with respect to either defendant, instead delegating executive management authority (including dominion over wages) to Segal. Segal signed the checks, oversaw the payroll, and suspended the payment of his salary. Defendants had no such authority.

Moreover, just as a board's collective authority over a corporation does not confer agency authority on an individual director, a board's collective "oversight and control over management, finances, and policy is not oversight and control by individual board members." *Id.* at 565. The Court noted that, since corporate statutes vest all management responsibility in a corporation's board, if board members were to be considered agents and normal board oversight were considered "management," then all directors would be personally liable under the Wage Act. That result would be inconsistent with the plain wording of the statute.

The *Segal* defendants' participation in difficult board decisions that affected the company's finances were not the acts of individual agents, did not involve the type of ordinary decisions left to individual managers, and did not confer Wage Act liability. Accordingly, the SJC determined that the trial court should have allowed defendants' motion for judgment notwithstanding the verdict.

In addition to adjudicating the claim against Johnson and Rose, the SJC also provided guidance for instructing future juries. The Court explained that judges should instruct juries that there are two requirements for a defendant to qualify as an employer under the Wage Act: (1) the

defendant must be an officer or agent; and (2) the defendant must have the management of the company. The Court cautioned that juries should be instructed that directors are not agents simply by being directors, and the collective powers of the board are distinct from the powers of individual directors. As to “having the management,” courts should instruct juries that the Wage Act imposes liability on the president, the treasurer, and other officers or agents who perform management responsibilities similar to a president or treasurer, “particularly in regard to the control of finances or the payment of wages.” *Id.* at 570.

### **Lessons for Directors and Corporate Advisors**

After *Segal*, it is difficult, but not impossible, to establish Wage Act liability on the part of individual directors. Directors should be aware that they still may face personal liability (with attendant mandatory treble damages and fee shifting) if they are found to be agents of the corporation who performed responsibilities similar to that of a president or treasurer. Consequently, boards and their advisors should take precautionary measures to reduce the risk to directors.

Corporate counsel would be wise to include in companies’ governing documents language stating that individual directors are not authorized to speak or act on behalf of the company. Counsel should then advise boards to abide by such language in practice. While it is common for boards to delegate tasks and authority to particular directors or committees, counsel should screen such delegations carefully to ensure that they cannot reasonably be construed as conferring management or agency authority. Counsel also would be wise to monitor initiatives that might not expressly delegate agency authority but could be deemed to do so by implication.

To the extent a board bestows management or agency authority on individual directors or committees of directors, that authority should be limited to discrete issues. More importantly, that authority should not encroach on officer control over finances and wages. For example, individual directors should not have check-writing authority, control over payroll, or authority to approve or deny wage payments.

Overall, counsel should be vigilant in ensuring that boards and board committees, including compensation committees, exercise their oversight function collectively, with such collective action formally recorded. These steps would help directors perform their fiduciary responsibilities with less risk of personal liability under the Wage Act.

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## How to Get an LLC into Federal Court: Tips for Pleading Diversity Jurisdiction Over Unincorporated Entities

By Thomas Sutcliffe

### Practice Tips

For federal diversity jurisdiction under 28 U.S.C. § 1332, a plaintiff, or removing defendant, must establish diversity of citizenship between the parties. Typically, that means that all of the plaintiffs must be citizens of a different state than all of the defendants. And a party wishing to get into federal court is required to plead diversity at the outset of litigation.

Pleading diversity, however, can be a challenge when the other party is an unincorporated entity. A corporation's citizenship is straightforward; it is considered to be a citizen of both the state of incorporation and the state in which its principal place of business is located. The citizenship of other entities, such as LLCs and partnerships, is based upon the citizenship of each of its individual members or partners. See generally [Americold Realty Tr. v. Conagra Foods, Inc.](#), 136 S. Ct. 1012 (2016). A complaint or notice of removal, therefore, must say something about the citizenship of an unincorporated entity's members. Failure to do so can result, at the very least, in a show cause order, especially within the First Circuit, where judges have not hesitated to raise the issue *sua sponte*. See e.g., *N. Beacon 155 Assocs. LLC v. Mesirow Fin. Interim Mgmt. LLC*, No. CV 15-11750-LTS, 2015 WL 13427609, at \*1 (D. Mass. June 29, 2015) (finding that allegation in notice of removal that only pleaded state of organization and principal place of business of LLC parties insufficient); *Fratius v. Vivint Solar Developer LLC*, 1:16-CV-10517 (D. Mass. June 8, 2016) (issuing show cause order *sua sponte* based on similar problem in plaintiff's complaint); see also *D.B. Zwirn Special Opportunities Fund, L.P. v. Mehrotra*, 661 F.3d 124, 125 (1st Cir. 2011) (determining, *sua sponte*, that notice of removal failed to allege jurisdiction over LLC plaintiff).

Requiring a party to plead the citizenship of another party's members results in something of a Catch-22. The membership of an LLC or partnership is often not publically available information, meaning a party trying to access federal court may not be able to determine the citizenship of its adversary until discovery. But parties typically cannot conduct discovery unless they can plead some basis for subject matter jurisdiction, leaving plaintiffs and removing defendants in a quandary.

### The Pragmatic Approach Taken by Some Circuits

Some courts, outside the First Circuit, have started to address this dilemma by adopting a more pragmatic approach to pleading citizenship. For example, in [Carolina Cas. Ins. Co. v. Team Equip., Inc.](#), 741 F.3d 1082 (9th Cir. 2014), the Ninth Circuit embraced the "sensible principle that, at [the pleading stage], a party should not be required to plead jurisdiction [against an LLC] affirmatively based on actual knowledge." *Id.* at 1087. Instead, the court held, it is enough for a plaintiff "to allege simply that the defendants were diverse to it," and it is permitted "to plead its allegations on the basis of information and belief." *Id.* Meanwhile, if the unincorporated entity – which presumably knows the citizenship of its own members – has information to the contrary, it is free to provide it and the court can "reevaluate its jurisdiction if contrary information

emerged later.” *Id.* Until then, the court reasoned, the unincorporated entity is not in a position to complain.

The Third Circuit reached a similar conclusion in *Lincoln Ben. Life Co. v. AEI Life, LLC*, 800 F.3d 99 (3d Cir. 2015). In *Lincoln*, the court reasoned that “[d]epriving a party of a federal forum simply because it cannot identify all of the members of an unincorporated association is not a rational screening mechanism,” particularly given that “[t]he membership of an LLC is often not a matter of public record.” *Id.* at 108. As a result, the court forged a compromise aimed at “striking the appropriate balance between facilitating access to the courts and managing the burdens of discovery.” *Id.* Specifically, it held that it was enough for a plaintiff to “alleg[e] that none of the defendant association’s members are citizens of” the same state as the plaintiff. *Id.* at 107. Furthermore, plaintiffs were permitted to make that allegation on information and belief provided they “conduct[ed] a reasonable inquiry into the facts alleged,” such as by consulting publically available sources. *Id.* at 108. “If, after this inquiry,” the court held, “the plaintiff has no reason to believe that any of the association’s members share its state of citizenship, it may allege complete diversity in good faith.” *Id.*

The court in *Lincoln* went on to examine the plaintiff’s complaint and found that – when combined with the plaintiff’s opposition to the defendants’ motion to dismiss – its allegations were sufficient to plead diversity of citizenship. Specifically, the court noted that the plaintiff had alleged that:

1. The LLC defendants had some connection to states where the plaintiff was not a citizen;
2. Plaintiff’s counsel had “conducted a reasonable inquiry to determine the membership of the LLC defendants but found nothing of value;” and
3. Plaintiff’s counsel “found no connection between the LLC defendants” and plaintiff’s home state.

*Id.* at 110.

Based on these allegations, the court concluded that the plaintiff had “alleged complete diversity in good faith.” *Id.* at 111.

#### Applying Carolina and Lincoln in the First Circuit

Can the approach of *Carolina* and *Lincoln* be applied in the First Circuit? Not exactly. In *D.B. Zwirn Special Opportunities Fund, L.P. v. Mehrotra*, 661 F.3d 124 (1st Cir. 2011), the First Circuit held, in a decision that predates *Lincoln*, that citizenship cannot be pleaded in the negative; that is, it is not enough to allege that the plaintiff and defendants are not parties of the same state, as the parties in that case had done. The problem, the court explained, was that even if a party was not a citizen of the same state as its adversary, that did not rule out the possibility that one of the parties was a stateless entity (such as a foreign corporation) in which case diversity jurisdiction would again be lacking. *Id.* at 126-27. As a result, the court required affirmative information regarding the citizenship of the plaintiff-LLC’s members.

But the *Carolina/Lincoln* approach still offers some guidance, and Massachusetts courts might be warming to it. In *BRT Mgmt. LLC v. Malden Storage, LLC*, No. CV 17-10005-FDS, 2017 WL 2726689 (D. Mass. June 23, 2017), for example, the court issued a show cause order, and

the plaintiff, citing *Lincoln*, argued that it had searched publically available records but had been unable to determine the citizenship of the LLC defendant. Judge Saylor observed that the approach articulated in *Lincoln* conflicted somewhat with *D.B. Zwirn*, but he nonetheless concluded that *Lincoln*'s "basic reasoning is sound." *Id.* at \*1. He further held that, because *BRT* – like the plaintiff in *Lincoln* – had "consulted all available public information and alleged, in good faith, that there is complete diversity of citizenship," it was entitled to take jurisdictional discovery. *Id.*

*BRT* suggests then that providing some indication of good faith research might go a long way towards overcoming the seemingly high burden set by *D.B. Zwirn*. The decision in *D.B. Zwirn* itself signaled that the court may be open to this kind of a pragmatic approach. Indeed, it is noteworthy that, in *D.B. Zwirn*, the court ordered the plaintiff-LLC to provide information regarding its citizenship, not the defendant who had removed the case to federal court (and who bore the burden of establishing jurisdiction). That suggests that the First Circuit may, in the future, be open to permitting jurisdictional discovery, at least in those instances where the party seeking federal jurisdiction makes an adequate threshold showing.

### Lessons to Be Learned

So what are the lessons that can be gleaned from the case law? A few guidelines seem to emerge:

1. First, a party seeking federal diversity jurisdiction involving an unincorporated entity should research publically available information to the fullest practical extent and describe those efforts in the complaint or notice of removal. Even if that research is inconclusive, it is helpful to establish good faith.
2. Second, if the research reveals no contacts between the unincorporated party and the state of which the party seeking federal jurisdiction is a citizen, the complaint should say so. If there are some contacts, the complaint should explain (if possible) why those contacts are insufficient and/or explain why the unincorporated party's connections to another state are more extensive. The party should also allege, if appropriate, on information and belief, that the parties are not citizens of the same state.
3. Third, the party should try to allege the unincorporated party's state of citizenship, even if it is only an educated guess. That will help avoid the kind of "negative" pleading the First Circuit rejected in *D. B. Zwirn*. Failing that, the complaint should at least try to allege facts ruling out the possibility that the unincorporated party is a "stateless" actor, such as, for example, establishing that the entity is based in the United States (and therefore presumably a citizen of some state).

The rules for establishing diversity jurisdiction over unincorporated parties are at times byzantine and arguably "def[y] logic." *Lincoln*, 800 F.3d at 111 (all judges concurring). But neither the Supreme Court nor Congress has shown any sign of changing those rules, and courts are quick to enforce them. By putting a bit of extra time into alleging diversity jurisdiction over these entities, parties can save themselves considerable trouble in the future and ensure that they remain in the forum of their choosing.

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## **Navigating Rising Water: The Public Waterfront Act**

**By Matthew J. Kiefer and Louise B. Giannakis**

### **Practice Tips**

The Commonwealth of Massachusetts prides itself on being “first in the nation” for many milestones: the first public park (Boston Common), the first college (Harvard) and the first to legalize same-sex marriage. A lesser known “first” was the Commonwealth’s formal recognition of the public trust doctrine, a legal concept dating at least to Justinian. The doctrine, first codified by the Colonial Ordinances of the 1640s, obligates the Commonwealth as trustee to ensure that land subject to tidal action is used for public benefit. The doctrine evolved into [M.G.L. c. 91](#) (“Chapter 91”), the Public Waterfront Act (“Act”). Historically, the Act focused on preserving public access to the water, protecting tidelands for water-dependent uses such as fishing and boating, and encouraging uses and development that animate the waterfront. However, with record-breaking coastal flooding and sea level rise no longer distant threats, climate resilient waterfront development has become a policy imperative in Chapter 91 licensing.

Chapter 91 is a comprehensive licensing program, administered by the Massachusetts Department of Environmental Protection (“DEP”), to ensure that proposed waterfront development projects meet public benefit standards with respect to environmental protection, public safety, navigation, preservation of historic maritime industries, and recreational, commercial and industrial activities and uses. Licensing by DEP can be a [complex and lengthy process](#), especially for large-scale urban projects. Although DEP has yet to incorporate formal climate resiliency requirements into its licensing program, a prudent project proponent should include climate resilience as an integral part of a project’s public benefit profile in light of the DEP’s recent licensing decisions, public comments and formal requirements established by other regulatory agencies, such as the Boston Redevelopment Authority (d/b/a Boston Planning and Development Agency or “BPDA”).

**Do the regulatory homework:** Effective representation of a proponent of a waterfront project requires a determination of how the Chapter 91 and associated regulatory standards and policy goals apply to a particular project. *See* Waterways Regulations, [310 CMR 9.00 et seq.](#), Designated Port Area (DPA) Regulations, [301 CMR 25.00 et seq.](#), Municipal Harbor Plan (MHP) Regulations, [301 CMR 23.00 et seq.](#) Early analysis of site-specific factors by a cross-disciplinary team is often required to identify which Chapter 91 requirements are applicable to a particular site — such as whether the site is historically filled or currently flowed tidelands or is nontidal, whether it is above or below the historic low water mark, and whether it serves water-dependent or nonwater-dependent uses. This is critical to developing an effective Chapter 91 permitting path, and should include evaluation of appropriate climate resiliency measures. For example, as sea levels continue to rise, it would be wise to anticipate whether structures currently above the high water mark, and thus exempt from licensing, may become “intertidal” and thus subject to Chapter 91 jurisdiction.

**Review other agencies’ climate change initiatives for guidance:** As climate resiliency becomes a policy imperative for the modern world, federal, state and local agencies are increasingly launching initiatives and establishing requirements to protect communities from the

adverse effects of climate change. In March, 2016, Governor Baker signed [Executive Order 569](#), “Establishing an Integrated Climate Change Strategy for the Commonwealth,” and in early 2018, authorized over \$1.4 billion in capital allocations “to mitigate and adapt to climate change” and “build a more resilient Commonwealth.” These climate resiliency investments include infrastructure repairs and improvements, as well as grants to communities through the Municipal Vulnerability Preparedness Program and the State Hazard Mitigation and Adaptation Plan. In October, 2017, the BPDA formally integrated climate resilience measures into its approval process under [Boston Zoning Code Article 80](#) for Large Project, Planned Development Area and Institutional Master Plan Reviews by requiring a “[Climate Resiliency Checklist Report](#)” that incorporates sea level rise, storm surge, extreme precipitation, extreme heat events, and other considerations. Other Boston initiatives include the recently-approved [Downtown Waterfront Municipal Harbor Plan](#), which encourages a comprehensive, district-wide approach to creating a climate resilient waterfront that overcomes the limitations of a parcel-by-parcel permitting process, and [Climate Ready Boston](#), an ongoing city-wide planning effort to address the effects of climate change. At the federal level, the newly revised [Federal Emergency Management Agency flood hazard maps](#) increase the reach of flood zones and show a stepped-up focus on the topic.

**Consider climate resilience measures in recently approved projects:** Many questions remain on the Chapter 91 licensing implications of many potential climate resiliency measures. Can raised seawalls or berms be licensed if they reduce public pedestrian access? Would a flood protection berm consisting of new fill in flowed tidelands be licensable? Would raising the grade of a project site to anticipate rising sea levels allow for a commensurate increase in building height? What is the scope of responsibility for an individual licensee whose site is located on an area-wide flood zone and whose flood protection activities may not be effective until the entire area is protected?

Regulatory uncertainty notwithstanding, it is clear that adapting to sea level rise is necessary for the long-term viability of a waterfront project. For instance, the developers of Clippership Wharf in East Boston have designed a floodable harbor-walk that can act as a buffer for high seas and are importing significant amounts of new fill to raise parts of the seven-acre site above anticipated flood levels. The developers of a large mixed-use campus at Suffolk Downs in Boston-Revere have proposed a sunken amphitheater with capacity to hold millions of cubic feet of flood water for days to address anticipated flood levels. The developers of the L Street Power Station in South Boston have proposed an elevated floor of the building to accommodate the possible need to raise the ground level while maintaining a reasonable floor to ceiling height.

In short, even in the absence of clear regulatory requirements, waterfront development proponents should incorporate climate resilience measures early in the licensing strategy, not only to extend the project’s design life, but also to facilitate the licensing approval by anticipating the public benefit expectations of the DEP and interests of the waterfront communities.

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