

CORPORATIONS—Directors, Officers, and Agents—Liability and Indemnification—1987 N.J. Sess. Law Serv. 171 (West).

In order to enable a corporation to protect its directors and officers from liability to the corporation or its shareholders, and to clarify when indemnification is available to corporate agents, the New Jersey Legislature amended existing statutes¹ on February 4, 1987 by passing this Act.² The Act provides that a corporation may reduce or even eliminate a director's liability to the corporation or its shareholders by including such a provision in its certificate of incorporation. This protection may also be extended to the officers of the corporation, but the provisions extending protection to the officers expire in two years.

The provision would take effect when a director or officer becomes liable to pay damages to the corporation or its shareholders because of a breach of duty owed to the corporation or its shareholders. It would not apply to equitable relief nor to any liability to outside parties. The provision establishes a standard of conduct, the violation of which would cause the director or officer to be liable. This standard of conduct requires a breach of duty to the corporation or its shareholders, which involves a bad faith violation of law with knowledge, or results in the receipt by a director or officer of an "improper personal benefit."

Identical protection may be provided to the directors and officers of mutual insurers, savings and loan associations, capital stock associations, as well as the managers and officers of savings banks. The appropriate Commissioner, either of Insurance or Banking, must approve the protection and will do so unless he determines that it unreasonably affects the interests of certain third parties. In addition, the directors and officers of banks and capital stock savings banks can be protected.

The Act allows a corporation to indemnify a corporate agent³ for expenses⁴ incurred in a derivative proceeding,⁵ or ex-

¹ N.J. STAT. ANN. §§ 14A:2-7, :3-5, :6-14 (West 1969 & Supp. 1987); N.J. STAT. ANN. §§ 17:9A-3, :9A-8.2; :9A-250 (West 1984 & Supp. 1987); N.J. STAT. ANN. 17B:18-57 (West 1985).

² 1987 N.J. Sess. Law Serv. 171 (West) [hereinafter the Act].

³ A corporate agent is a director, officer, employee, or agent of a corporation. N.J. STAT. ANN. § 14A:3-5(1)(a) (West Supp. 1987).

penses and liabilities⁶ incurred in any other proceeding. However, the proceeding must be one in which the corporate agent is involved because of his position as a corporate agent. In order to receive indemnification, it must be determined that the corporate agent acted in good faith and in the best interests of the corporation. This determination is made by either the board of directors, independent legal counsel, or the shareholders. In addition, the Act provides that when a corporate agent is adjudged to be liable to the corporation in a derivative proceeding, indemnification is permitted only if the court determines that the corporate agent is fairly and reasonably entitled to indemnity despite his liability. Previously, a corporate agent would not be indemnified in a derivative proceeding if he was merely liable for negligence or misconduct.

In addition to voluntary indemnification, the corporation must indemnify a corporate agent for his expenses when the corporate agent is successful in the proceeding or such proceeding is otherwise terminated. There are no limits on the indemnification of a corporate agent when he appears in a proceeding merely as a non-party witness.

According to the prior statute, a corporate agent may receive an advancement of his expenses while the proceeding is still pending. Previously, the procedure governing authorization of advancements was identical to the one used for determining whether the corporate agent had acted in good faith. The present Act, however, provides that the advancement may be made as authorized by the board of directors.

The indemnification and advancement of expenses provided for in the statute does not prohibit indemnification from other sources. However, the Act limits such indemnification if the corporate agent violates a standard of conduct identical to the one used above to determine the liability of a director or officer.

A corporation may obtain insurance for any corporate agent to protect the agent against expenses and liabilities resulting

⁴ Expenses include reasonable costs, disbursements, and counsel fees. *Id.* § 14A:3-5(1)(c).

⁵ A derivative action is one in which "the shareholder sues on behalf of the corporation for harm done to it." R. CLARK, *CORPORATE LAW* 639 (1986).

⁶ Liability includes settlements, judgments, fines, and penalties. N.J. STAT. ANN. § 14A:3-5(1)(d) (West Supp. 1987).

from any of the proceedings discussed above regardless of whether the corporation is required to indemnify the agent. In addition, the Act provides that a corporation may obtain the insurance from an affiliated company, even one organized for the sole purpose of providing such insurance to the corporation.

The corporation may prohibit or limit the indemnification of a corporate agent by a provision in either its certificate of incorporation, by-laws, or resolutions. However, indemnification will be permitted despite the absence of a provision authorizing it. These changes in the indemnification statute are also applicable to banks, savings banks, and capital stock savings banks.

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