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CORPORATIONS, PARTNERSHIPS, AND ASSOCIATIONS

Corporate Officers and Directors: Provide Standard of Care and Amend Law on Indemnification

CODE SECTIONS:	O.C.G.A. §§ 14-2-152.1 (new), 14-2-156 (amended), 14-2-171 (amended), 14-3-113.1 (new), 14-3-131 (amended), 46-8-51 (new), 46-8-55 (new)
BILL NUMBER:	HB 209
ACT NUMBER:	657
SUMMARY:	HB 209 establishes a standard of care for corporate directors and officers in the performance of their duties; permits indemnification in certain instances for directors, officers, agents, and employees who are made a party to or threatened with litigation arising out of their activities for the corporation; permits inclusion in the articles of incorporation of a provision eliminating or limiting the personal liability of a director to the corporation or to the shareholder; and makes similar provisions for nonprofit organizations, railroad companies, and business corporations.
EFFECTIVE DATE:	July 1, 1987

History

Georgia joins a number of other states in limiting liability of directors, officers, employees, and agents.¹ The General Assembly passed the bill in an effort to attract new businesses to Georgia to create jobs and prevent established businesses from leaving the state.²

Corporations face two major problems in the area of director liability: (1) the rising cost and unavailability of Director and Officer (D & O) insurance,³ and (2) the need to attract and maintain competent outside

1. See, e.g., DEL. CODE ANN. tit. 8, § 145 (1983 & Supp. 1986); FLA. STAT. ANN. § 607.014 (Supp. 1987); N.Y. BUS. CORP. LAW § 722 (McKinney 1986).

2. Telephone interview with Representative Pete Robinson, House District No. 96 (May 20, 1987) [hereinafter Robinson Interview].

3. Crossen, *Companies Ask Holders to Limit Boards' Liability*, Wall St. J., Oct. 7, 1986, at 35, col. 3.

directors.⁴

According to a national survey by Peat, Marwick, Mitchell & Co., D & O insurance premiums rose more than 300 percent at renewal for approximately one-third of the sample group, with an increase in premiums of less than 300 percent for forty-six percent of those surveyed. The deductible rose 300 percent or more for sixteen percent of the sample.⁵ Control Data, a major computer firm, gave up its D & O insurance last year after being faced with a substantially higher premium for only one-fifth of its previous liability coverage. When Control Data suspended the policy, three directors resigned and three retired.⁶

Eight percent of the respondents to the Peat Marwick survey reported situations in which board candidates declined invitations for board membership due to "the perception of D & O liability [being] a problem."⁷ Because of this problem, a trend has developed of using more company insiders instead of outsiders for board membership, thus making the boards less independent.⁸

A recent Delaware case demonstrates the increasing liability of directors. In *Smith v. Van Gorkom*,⁹ the Delaware Supreme Court held directors personally liable for breach of their fiduciary duty of care to the stockholders in a cash-out merger of a corporation into a new corporation. The directors were grossly negligent because their approval was not the result of an informed business judgment.¹⁰

HB 209, which had the support of the state's business community,¹¹ the State Bar of Georgia,¹² and various charitable groups,¹³ underwent several revisions in the legislative process. Although similar bills were introduced in the House and Senate, the House bill was the one finally acted on by the lawmakers.¹⁴ The original House bill included only the indemnification provision for profit and nonprofit corporations and the provision for amending the bylaws of profit corporations in order to limit director lia-

4. Bawm, *The Job Nobody Wants: Outside Directors Find That the Risks and Hassles Just Aren't Worth It*, Bus. Wk., Sept. 8, 1986, at 56-57.

5. Peat, Marwick, Mitchell & Co., *D & O Directors' and Officers' Liability: A Crisis in the Making*, at 6 (1987) [hereinafter Peat Marwick Report]. In 1987, Peat, Marwick, Mitchell & Co. merged with another accounting firm. The new name is Peat Marwick Main & Co.

6. Bawm, *supra* note 4, at 57.

7. Peat Marwick Report, *supra* note 5, at 7.

8. Bawm, *supra* note 4, at 56.

9. 488 A.2d 858 (Del. 1985).

10. *Id.* at 874.

11. Robinson Interview, *supra* note 2.

12. Telephone interview with George Hibbs, Assistant General Counsel, State Bar of Georgia (May 28, 1987) [hereinafter Hibbs Interview].

13. Telephone interview with Senator Edward Hine, Jr., Senate District No. 52, (May 27, 1987).

14. Hibbs Interview, *supra* note 12.

bility.¹⁵ The Senate Judiciary Committee revised the bill, adding a provision that allows nonprofit corporations to limit director liability in their bylaws and adding an indemnification provision for railroad companies.¹⁶ The bill's final version included these provisions as well as a new standard of care provision for profit and nonprofit corporations and railroad companies.¹⁷

HB 209

The Act establishes a standard of care for corporate directors¹⁸ and officers.¹⁹ Corporate directors and officers must carry out their duties in good faith and "[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances."²⁰

Directors and officers may rely on information, including financial data, if it is prepared or presented by the following: (1) an officer or employee of the corporation whom the directors and officers believe to be reliable and competent on the subject presented,²¹ (2) legal counsel, public accountants, investment bankers, or others whom the directors and officers believe to be professionals or experts in the matter presented,²² and (3) in the case of a director, a board of directors committee of which he is not a member if he believes the committee "merits confidence."²³ The directors or officers are not acting in good faith if they know their reliance on these groups is unwarranted.²⁴ This standard of care applies only to actions occurring on or after July 1, 1987.²⁵

Section 2 of the Act concerns situations in which a corporation may indemnify directors, officers, employees or agents against "threatened, pending, or completed" litigation that arises out of the professional association with the corporation. The corporation may indemnify "against expenses (including attorneys' fees), judgments, fines, and amounts paid in settlement actually and reasonably incurred" in the litigation.²⁶ The corporation shall indemnify against expenses if the person is successful on the merits of the litigation.²⁷ The corporation may pay these costs in advance, but the person must repay if he is not entitled to indemnifica-

15. HB 209, as introduced, 1987 Ga. Gen. Assem.

16. HB 209 (HCS), 1987 Ga. Gen. Assem. .

17. HB 209 (AP), 1987 Ga. Gen. Assem.

18. O.C.G.A. § 14-2-152.1(a) (Supp. 1987).

19. O.C.G.A. § 14-2-152.1(b) (Supp. 1987).

20. O.C.G.A. §§ 14-2-152.1(a)(1)(B), -152.1(b)(1)(B) (Supp. 1987).

21. O.C.G.A. §§ 14-2-152.1(a)(2)(A), -152.1(b)(2)(A) (Supp. 1987).

22. O.C.G.A. §§ 14-2-152.1(a)(2)(B), -152.1(b)(2)(B) (Supp. 1987).

23. O.C.G.A. § 14-2-152.1(a)(2)(C) (Supp. 1987).

24. O.C.G.A. §§ 14-2-152.1(a)(3), -152.1(b)(3) (Supp. 1987).

25. O.C.G.A. § 14-2-152.1(c) (Supp. 1987).

26. O.C.G.A. § 14-2-156(a) (Supp. 1987).

27. O.C.G.A. § 14-2-156(c) (Supp. 1987).

tion.²⁸ The Act entitles a person or his estate to the benefits of indemnification after he ceases to be associated with the corporation.²⁹

If the person performed "in a manner he reasonably believed to be in or not opposed to the best interests of the corporation" and he had no reason to believe his conduct unlawful, he may be indemnified by the corporation; however, no indemnification may be made if the courts find that the person is liable to the corporation.³⁰

Before a corporation may indemnify, it must decide if the person met the proper standard of conduct. The determination may be made by a majority vote of a quorum of disinterested directors, a written opinion from independent legal counsel appointed by a quorum of disinterested directors, or a majority vote of voting shares.³¹ The right of indemnification is not exclusive. The person is entitled to any additional rights given to him by law, resolution, or agreement to which a majority of the shareholders agreed.³²

The articles of incorporation of a corporation may eliminate or limit the director's liability to the corporation and shareholders for money damages for breach of duty owed to the corporation. However, liability may not be eliminated or limited in cases of directors for: (1) misappropriating a business opportunity, (2) acting or failing to act in good faith, (3) engaging in intentional misconduct or a knowing violation of the law, (4) voting for unlawful payment of dividends, distribution of assets, or purchase of shares, (5) commencing business before the corporation received the minimum consideration fixed in the articles of incorporation for shares issued, or (6) obtaining an improper personal benefit.³³

The corporation may carry liability insurance on its directors, officers, employees, or agents even if it does not have the statutory power to indemnify them against the liability.³⁴

The bill sets the standard of care for nonprofit organizations³⁵ and railroad companies.³⁶ It also sets similar limitations on what the articles of incorporation may contain as to limiting and eliminating personal liability of a director of a nonprofit organization to the corporation or its members.³⁷ The bill provides that the same indemnification rights apply

28. O.C.G.A. § 14-2-156(e) (Supp. 1987).

29. O.C.G.A. § 14-2-156(j) (Supp. 1987).

30. O.C.G.A. § 14-2-156(b) (Supp. 1987).

31. O.C.G.A. § 14-2-156(d) (Supp. 1987).

32. O.C.G.A. § 14-2-156(f) (Supp. 1987).

33. O.C.G.A. § 14-2-171(b)(3)(A) (Supp. 1987).

34. O.C.G.A. § 14-2-156(g) (Supp. 1987).

35. O.C.G.A. § 14-3-113.1 (Supp. 1987).

36. O.C.G.A. § 46-8-55 (Supp. 1987).

37. O.C.G.A. § 14-3-131(b)(6) (Supp. 1987). The limitations on voting for unlawful payment of dividends, distribution of assets or purchase of shares, and commencing business before the corporation received the minimum consideration fixed in the articles of incorporation for shares issued, do not apply to nonprofit organizations.

to for-profit corporations,³⁸ nonprofit corporations,³⁹ and railroad companies.⁴⁰

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38. O.C.G.A. § 14-2-156 (Supp. 1987).

39. O.C.G.A. § 14-3-110 (1982) allows nonprofit corporations the same indemnification rights as profit corporations.

40. O.C.G.A. § 46-8-51 (Supp. 1987).