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COMMENTARY

HB 209: A Prudent Change in Georgia Law

HB 209 as enacted by the General Assembly makes major changes in the liabilities of directors as well as changing the legal standards governing conduct by officers and directors. In addition, the rules regarding indemnification are significantly broadened. The General Assembly has shown a concern for the problems of publicly held corporations which is not unique among state legislatures. Similar legislation has recently been enacted in Delaware as well as several other states. Although the legislative changes might be criticized as lowering the standards that apply to directors' conduct, such criticism is unrealistic. Most large corporations are free to reincorporate in any of the fifty states. If Georgia law is substantially less favorable than that of other jurisdictions, it will not lead to a higher standard of care among directors; it will merely compel Georgia corporations to reincorporate elsewhere.

Section 1 of the Act creates a new O.C.G.A. § 14-2-152.1 in place of the former Code section 14-2-152. The standard of liability remains the same for both officers and directors, but the amendment permits officers and directors expanded reliance on certain kinds of information and reports to justify their conduct. The former statutory language permitted reliance on "financial information." The amendment permits reliance on information, opinions, reports, or statements, including financial statements and other financial data. The former statutory language permitted reliance on information represented to be correct by the president or officer of the corporation having charge of its books of account, or stated in a report by a certified public accountant. The amendment extends the category of persons upon whom directors may rely to (1) officers or employees whom the director believes reliable and competent, (2) legal counsel, public accountants, investment bankers, or other persons as to matters the director believes are within the person's professional or expert competence, and (3) committees of the board of directors. The amended section treats directors and officers separately, though the standard for liability is nearly the same.[1]

Section 2 amends Code section 14-2-156. Subsection (b) is broadened by omitting the words "for negligence or misconduct in the performance of his duty." This change seems relatively minor since under Code section

1. Section 4 enacts substantially the same changes for nonprofit corporations, creating a new O.C.G.A. § 14-3-113.1. Section 7 enacts substantially the same changes for railroad corporations by adding a new O.C.G.A. § 46-8-55.

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14-2-156(b) a person adjudged liable to the corporation may be indemnified only upon a finding that the person is fairly and reasonably entitled to indemnity. The amendment expands the category from those adjudged liable only for negligence or misconduct to those adjudged liable in any way to the corporation. It would seem that negligence or misconduct would have covered everything, but evidently the legislature believed it was necessary to eliminate this language.

Code section 14-2-156(f) is amended to make clear that no indemnification may be provided if the new standard of conduct in Code section 14-2-171 is violated. The amendment appears to be more stringent than prior law. Code section 14-2-156(h) is amended to simplify the process of sending certain reports relating to indemnification to the shareholders. The new standard is that specified in Code section 14-2-113. If the corporation has more than 500 shareholders entitled to vote, it may utilize a class of mail other than first class if the notice is mailed with adequate postage prepaid, not less than thirty days before the date of meeting.

A new subsection (j) is added which provides that the indemnification and advancement of expenses provided or granted pursuant to Code section 14-2-156 inures to the benefit of the heirs, executors, and administrators of those entitled to be indemnified. This new subsection simply moves nearly identical language from former Code section 14-2-156(f), but the amendment is slightly broader in effect because it now clearly includes rights as to both indemnification and advancement of expenses.[2]

Section 3 contains the most far-reaching change.[3] It permits the articles of incorporation to contain a provision eliminating or limiting the personal liability of a director to the corporation or its shareholders for breach of duty of care or other duty as a director. However, certain kinds of liability may not be eliminated. These are liability for (1) appropriation of business opportunity of the corporation, (2) acts or omissions in good faith not involving intentional misconduct or a knowing violation of law, (3) violating the specific rules in Code section 14-2-156, and (4) transactions from which the director derives an improper personal benefit.

In addition, the provision in the articles of incorporation cannot eliminate liability for acts or omissions prior to the date when the provision becomes effective.[4] Thus, the new standard of liability for directors is essentially good faith, and a director will not be liable for mere negligence. The new standard applies, however, only if it is in the articles of incorporation, so that, if the shareholders disapprove of the concept, they can simply vote against any proposal to limit directors' liability.

One of the advantages of this new rule is that it will be easier to find

2. Section 6 makes substantially the same changes for railroad companies by adopting a new O.C.G.A. § 46-8-51.

3. Substantially the same changes also apply to railroad corporations.

4. Section 8 of HB 209 repeals all laws and parts of laws in conflict with the Act.

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outside directors. At present many individuals are reluctant to serve as directors because of the risk of personal liability. The other consequence is that the cost of directors' liability insurance should decrease.

The fundamental question remains as to whether the modification of the negligence standard for directors is wise public policy. The easiest answer is to point out that the State of Delaware has enacted a similar statute so that the only practical effect of Georgia adhering to the older standard is to encourage Georgia corporations to reincorporate in Delaware. Many other jurisdictions are following Georgia's example, so that it seems quite unwise to retain the old standard. For those who believe in stricter regulation of large corporations, the better course would be some sort of federal statute applicable to the directors of all large, publicly held corporations. Most of the proposals for such regulation have received little support in the Congress; therefore, such a solution is not likely in the near future.

Is the negligence standard for directors an appropriate one? Many commentators think it is not. The abstract question, however, is not entirely helpful. One might easily admit that a negligence standard is appropriate, but despair of a court ever being able to enforce it in a sensible manner. The experience of the last fifty years of decided cases is that a director has almost no chance of being adjudged negligent. The few exceptions are so startling that it is not surprising that businessmen find them worrisome.

The most frequently cited case imposing liability on directors for negligence is a Delaware decision, and the fact that it is a recent decision enhances its impact. In *Smith v. Van Gorkom*,[5] the Delaware Supreme Court found that the negligence standard had been violated when a merger agreement was approved because directors had not seen the full text of the agreement in advance and relied on oral summaries of it from officers. When the ratification meeting took place, the directors were not told of its purpose in advance. The merger agreement that was approved by the directors was then executed at a social event later that evening. The major criticism of the court's reasoning is that the court was second guessing the directors' judgment, especially as to whether or not an expeditious decision was necessary. The major impact of the decision is not that better decisions will be made in the future, but rather that the format of decision making will be changed to a very ponderous one in which voluminous data is gathered, which will then be presented to the directors for their decision, after due deliberation. This may well be to the detriment of most shareholders rather than to their advantage.

The other argument to consider is the cost of litigation and directors' and officers' liability insurance as well as the existing rules on indemnification. Even if we assume that the negligence standard is wise, the cost of

5. 488 A.2d 858 (Del. 1985).

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litigation is so high that a rational shareholder may well prefer to change it. Indeed, as a practical matter, since many corporations pay the cost of liability insurance for their directors and officers, successful shareholder litigation will not benefit the shareholders in any real sense. Further, even if a director or officer is adjudged negligent, his attorney's fees as well as any judgment awarded to the corporation may well be borne by the corporate entity under an indemnification bylaw. Therefore, the recent changes in Georgia law seem quite prudent indeed.

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