The Duty of Care, Exculpation and Indemnification under the New Jersey Revised Uniform Limited Liability Company Act—A Continuing Evolution

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Perhaps more than any other provisions of the New Jersey Revised Uniform Limited Liability Company Act (NJ RULLCA), those which impose ‘default’ fiduciary duties of loyalty and care on members and managers are likely to have the most significant and far-reaching impact on the governance and operation of limited liability companies (LLCs). During the past few years the Delaware Chancery Court has made various pronouncements concerning both the existence and extent of fiduciary duties in the context of alternative business entities such as limited partnerships and limited liability companies,1 and in 2012 the Delaware Limited Liability Company Act was amended to confirm the application of default fiduciary duties in the context of Delaware LLCs.2 NJ RULLCA leaves no doubt regarding the imposition of these duties for New Jersey LLCs, and carefully proscribes the extent to which they may be modified.

A clear understanding of the nature of the limited liability company as a legal entity, as well as the structure of the act and the impact of its default rules (including those relating to the imposition of fiduciary duties), is a necessary starting point for this analysis.

When LLCs first arrived on the scene in the early 1990s (New Jersey’s first enabling legislation was enacted in 1994), they were hailed as the perfect combination of the business corporation and the partnership. When, in 1997, the IRS added the tax classification flexibility afforded by the so-called ‘check-the-box’ regulations, the LLC was practically nirvana to business lawyers and clients alike. The extraordinary versatility of the LLC as a vehicle for structuring economic and legal relationships was truly novel. However, many important issues concerning governance and operation of LLCs (including the extent to which fiduciary duties apply to these entities) were not addressed in the first generation of enabling legislation that proliferated across the country. New Jersey’s initial LLC law was no exception.

As LLCs have now been around for a whopping 20 years, and far outpace corporations as the entity of choice for most new business formations, many recognized the need to update the statutory ground rules under which these entities operated. The National Conference of Commissioners on Uniform State Laws (NCCUSL) approved the Revised Uniform Limited Liability Company Act (ULLCA) in July 2006. According to the Uniform Law Commission website, some version of the ULLCA is now enacted in 10 jurisdictions (including the District of Columbia), and enactment is pending in one additional jurisdiction (South Carolina). NJ RULLCA was passed in New Jersey on Sept. 18, 2012, and was initially effective on March 18, 2013, for all LLCs formed after that date (or which affirmatively opted to be governed by the act). On March 1, 2014, the prior LLC statute was repealed, leaving the act as the sole statutory authority now governing all New Jersey LLCs.

Limited liability companies are generally regarded as ‘contractarian’ in nature. There is a strong legislative policy in favor of the private ordering of relationships between and among the members, managers and other potential stakeholders of the entity. The statute itself provides that it is to be “liberally construed to give the maximum effect to the principle of freedom of contract and to the enforceability of operating agreements.”

NJ RULLCA prescribes a series of default rules that apply only in the absence of a contrary agreement of the parties. While there are a limited number of restrictions on the parties’ ability to vary these default rules by agreement (some of which apply to modification or elimination of fiduciary duties), the parties generally have substantial latitude to conceive and implement their own rules to govern their relationships. From a drafting perspective, the parties can choose to stay silent on an issue, in which case the default rule will automatically apply, or they may modify the default rule by agreement, in which case the contract will be enforced unless the particular modification in question runs afoul of one of the few explicit restrictions of NJ RULLCA. Practitioners should understand the act’s structure and default rules, as well as the manner and extent to which those rules may be modified by the parties’ agreement, in order to avoid unintended consequences.

The remainder of this article addresses the duty of care members and managers owe to each other and to the company under the act. Following an overview of the default rules is
a discussion of the interplay between the duty of care and the tools available to limit liability for breach of that duty through exculpation (which limits the liability of a breaching party to the members and the company) and indemnification (which protects the breaching party from liability to third parties). Following that analysis is a series of practice points. The article concludes with suggested operating agreement clauses that address these issues in each of the manager-managed and member-managed contexts.

The Duty of Care under the Act and its Antecedents

Under NJRULLCA, the default duties of loyalty and care apply to members in member-managed limited liability companies, and to managers in manager-managed limited liability companies. Because NJRULLCA subjects parties to fiduciary duties on the basis of their role within the LLC itself, clear drafting and role definition is critical. An operating agreement should never be ambiguous regarding whether it is member-managed or manager-managed. Likewise, there should be no confusion regarding which parties are members and which are managers, or in which capacity they are acting in any particular circumstance. Use of the title ‘managing member’ (which was a recognized status under the prior law) should be scrupulously avoided.

The default duty of care owed by the members to one another and the company in a member-managed LLC, and by the manager to the members and the company in a manager-managed LLC, is to “refrain from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law” in the conduct and winding up of the company’s activities. The operating agreement may alter, but not eliminate, the duty of care. However, no alteration is permissible that in effect “authorize[s] intentional misconduct or knowing violation of law.”

Assuming a contractual limitation on the duty does not violate the proscription against authorizing intentional misconduct or a knowing violation of law, any modification of the duty nonetheless remains subject to judicial review on grounds that the limitation is “manifestly unreasonable.” If a court determines that either: 1) the limiting term itself is unreasonable, or 2) the limiting term is an unreasonable means to achieve the provision’s objective (in either instance, viewed from the perspective of the parties at the time the limitation became a part of the operating agreement), the limitation may be invalidated. Importantly, nothing in the act prevents parties from agreeing to a modification of the duty of care to impose a standard of care greater than that imposed by the act. As suggested below, a ‘raise’ on the duty of care may more closely match the expectations and objectives of the parties than the default standard.

Because fiduciary duty law has varied origins, a comparison of the default duty of care applicable to LLCs to its analogs in the context of corporations and partnerships is worthwhile. In the New Jersey Business Corporation Act (NJBCA), the duty of care owed by directors of a business corporation to the corporation and its shareholders is comparatively much higher than that owed by members or managers under NJRULLCA. The NJBCA requires directors to “discharge their duties in good faith and with that degree of diligence, care, and skill which ordinarily prudent people would exercise under similar circumstances in like positions.” This standard, based upon the Model Business Corporation Act, assumes a dichotomy between corporate control (directors) and ownership (shareholders). In this context, directors are viewed as trustees of corporate assets, and are required to “acquire at least a rudimentary understanding of the business of the corporation...[and they] are under a continuing obligation to keep informed about the activities of the corporation.”

A comparison of the default standard under NJRULLCA to that which is owed by a partner to the other partners and the partnership under the New Jersey Uniform Partnership Act (NJUPA) yields a different result. Under the NJUPA, “[a] partner’s duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.” This standard is remarkably similar to the default duty of care under NJRULLCA. It also reveals a legislative bias to the ‘partnership’ model, rather than the corporate model of business governance. Other examples of this bias include transferability restrictions, creditor remedies, and events of disassociation and dissolution.

Although it may be surprising to some, more than a partner’s ordinary negligence is required for misconduct to be actionable. Courts interpreting the NJUPA have set parameters on various actions that may be considered “gross negligence.” These interpretations confirm the default standard of care is, in fact, quite low.

No express duty of care was articulated under New Jersey’s prior LLC law (the predecessor act). However, members and managers were relieved of personal liability “for failure to perform in accordance with, or to comply with the terms and conditions of, the operating agreement or for any other reason unless such failure to perform or to comply or such other reason constitutes gross negligence or willful misconduct by the member.” This exculpation, while not an explicit imposition of the duty of care, at least implied a minimum stan-
dard of conduct, the breach of which potentially would result in the imposition of liability.

As suggested below, it is probable that judicial review of contractual limitations on the duty of care will invite much higher scrutiny in manager-managed LLCs than in member-managed LLCs, for the simple reason that manager-managed LLCs more closely resemble the ‘centralized’ management structure of a corporation. More importantly, when advising parties concerning the nature and extent of the duty, it may be worth adopting a version of the duty of care that is akin to that applicable to corporate directors. This is especially true in those LLCs that elect to be governed by a board of managers, believing the individuals serving in that capacity are subject to obligations similar to those applicable to corporate directors. One way to accomplish this is to explicitly reference in the operating agreement that the manager or managers are subject to the standard of care that applies to a corporate director in the state of New Jersey. However, in that case equal care must be taken to include typical ‘business judgment rule’ defenses to liability. In fact, the ‘model’ version of RULLCA, published by NCCUSL in 2006, expressed the duty of care in just that fashion:

Subject to the business judgment rule, the duty of care of a member of a member-managed limited liability company [or of a manager in a manager-managed limited liability company] in the conduct and winding up the company’s activities is to act with the care that a person in a like position would reasonably exercise under similar circumstances and in a manner the member reasonably believes to be in the best interests of the company. In discharging this duty, the member [or manager] may rely in good faith upon opinions, reports, statements, or other information provided by another person that the member [or manager] reasonably believes is a competent and reliable source for the information.19

Exculpation

Exculpation, as a legal concept, relates to the liability of members and managers in a limited liability company to one another and to the LLC itself. In general, the parties are free to excuse, or ‘exculpate’ a manager or member from liability for actions taken in connection with the business and affairs of the company. NJRULLCA does, however, identify the following five specific circumstances under which a member’s or manager’s liability to the company and its members for money damages may not be limited by the operating agreement: 1) a breach of the duty of loyalty; 2) a financial benefit received by the member or manager to which the member or manager is not entitled; 3) except under limited circumstances, liability for improper distributions to members in violation of the act;14 4) intentional infliction of harm on the company or a member; or 5) an intentional violation of criminal law.15 The fourth and fifth identified exceptions (intentional infliction of harm and intentional violation of law) correspond exactly to the lower limit of permissible alteration of the duty of care specified in NJRULLCA.16

Exculpation of members and managers under the act parallels the NJBCA’s provisions governing exculpation of directors and officers. The NJBCA permits a corporation, by charter, to limit the personal liability of directors and officers for breach of any duty owed to the corporation or its shareholders, to the extent it does not provide relief from liability for an act or omission: 1) in breach of such person’s duty of loyalty to the corporation or its shareholders, 2) not in good faith or involving a knowing violation of law, or 3) that results in receipt by such person of an improper personal benefit.17

The first and third of these exceptions relate directly to the duty of loyalty. It is only the second—acts or omissions “not in good faith or involving a knowing violation of law”—that relate to the duty of care. It is important to remember, however, that the duty of care imposed on officers and directors under the NJBCA is much higher than the default duty of care under NJRULLCA. In practical terms, however, an officer or director who is both exculpated and indemnified for all acts other than those for which exculpation and indemnification is expressly prohibited (i.e., actions not in good faith or involving a knowing violation of law), is roughly in the same position as the LLC member or manager functioning under an operating agreement in which the duty of care has been limited to the maximum extent permitted by the act. Furthermore, directors and officers are protected by the proper exercise of their business judgment in the management of the corporation’s business and affairs, an advantage not enjoyed (at least as a matter of law) by members or managers of LLCs.18 The business judgment rule serves as a further mechanism to synthetically insulate corporate agents from liability to the corporation and its shareholders.19

The NJUPA permits a partnership to exculpate partners from the duty of care owed to the partnership and each other, but it may not “unreasonably” reduce the duty of care.20 While the NJUPA provides no useful guidance to distinguish reasonable versus unreasonable restrictions of the duty of care, this standard provides at least some lower limit on the contractual freedom of partnerships to contractually excuse bad behavior.

Indemnification

Indemnification concerns the obligation of the limited liability company to pay or reimburse “company agents” for
liabilities and expenses incurred to third parties “in the course of the company agent’s activities on behalf of [the LLC].”21 There are two relevant default rules. The first, which applies solely to expenses (defined as reasonable costs, disbursements and attorney’s fees) requires indemnification of a company agent22 against expenses “to the extent that such company agent has been successful on the merits or otherwise in any proceeding brought against the company agent by reason of the company agent serving as a company agent or serving another enterprise at the request of the limited liability company.”23 NJRULLCA neither expressly mandates nor prohibits advancement of expenses.

The second default rule mandates indemnification of company agents for “any debt, obligation, expense or other liability incurred by the company agent in the course of the company agent’s activities on behalf of the company”24 if, in making the payment or incurring the debt, obligation, expense or other liability, the company agent complied with the duties concerning limitations on distributions in Section 35 of the act,25 and the standards of conduct for members and managers (including fiduciary duties)26 under Section 39 of the act.27 While this provision does not require ‘success on the merits’ as a condition to mandatory indemnification, it does require the agent to comply with the duty of good faith and fair dealing, as well as any applicable duties of loyalty and care.

The act permits the alteration or elimination of an LLC’s default indemnification obligations, subject to the limitation that it may not indemnify a company agent for or in connection with the agent’s: 1) breach of the duty of loyalty, 2) receipt of an improper financial benefit, 3) making a wrongful distribution, 4) intentional infliction of harm on the company or a member, and 5) intentional violation of criminal law.28

The NJBCA informs, in large part, the default indemnification provisions under NJRULLCA, as well as the manner and extent to which those provisions may be permissibly altered or eliminated. This is a significant departure from the predecessor act, which allowed for blanket indemnification of members and managers pursuant to an operating agreement.29 Similar to NJRULLCA, the NJBCA requires indemnification to the extent a corporate agent is successful, on the merits or otherwise, in any action or proceeding: 1) involving the corporate agent by reason of his or her being or having been such corporate agent; or 2) by or in the right of the corporation to procure a judgment in the corporation’s favor that involves the corporate agent by reason of his or her being or having been such corporate agent.30 It further authorizes a corporation to indemnify a corporate agent irrespective of the agent’s success on the merits, so long as the corporate agent “acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation.”31

In contrast to NJRULLCA, the NJBCA expressly permits advancement of expenses subject to the corporation’s receipt of an undertaking to repay the amount if it is ultimately determined that the agent is not entitled to indemnification.32 The right to indemnification afforded to partners under the NJUPA applies to a partner’s actions taken “in the ordinary course of the business of the partnership or for the preservation of its business or property.”33 There are no express limitations on the duty to indemnify.

Practice Points and Sample Provisions

The foregoing discussion illustrates two tensions within the structure of NJRULLCA and governance of LLCs generally. The first is the tension between the corporate and partnership models of business entity governance, one of which (the corporate model) assumes centralized management and control over assets belonging to another, and the other of which (the partnership model) assumes common management and control over assets commonly owned. The second is the tension between imposition of fiduciary duties, which are intended to encourage good stewardship and management practices, and identification of the circumstances in which agents should be excused (through exculpation) or protected (through indemnification) from the consequences of their conduct.

It is important to keep in mind that the default provisions of NJRULLCA more closely follow the partnership model of governance. In a member-managed company in which the equity holders anticipate active participation in the business, these default rules may be appropriate. On the other hand, in a manager-managed entity (whether it is a single manager or board of managers), the default rules may not adequately protect the interests of investors. In that case, altering the duty of care applicable to the manager or managers to one that more closely resembles the duty of care of corporate directors may better reflect the intent and expectations of the parties.

Irrespective of whether the client chooses to alter or limit any default fiduciary duties imposed by the act, it is equally important to consider the impact of exculpation and indemnification. If an agent is fully exculpated or indemnified for all actions (other than the five specific categories of conduct proscribed in NJRULLCA),34 an alteration of the duty of care (even one that imposes a more exacting standard) may be immaterial. Again, careful consideration must be given to the expectations of the parties, as well as the interplay between the duty itself and exculpation or indemnification of the agent for breach of the duty.
Finally, as counselors and drafters, attorneys must remain mindful of the effect of avoiding a subject completely (and therefore letting the default rules, whatever they may be, govern the outcome), versus addressing the subject with a greater or lesser amount of detail. A good illustration of this arises in the context of advancement of expenses. The default rule in the act neither forbids nor requires advancement of the expenses of defense to a company agent who may be subject to a proceeding. Furthermore, an agent is not entitled to mandatory indemnification for ‘expenses’ unless he or she succeeds on the merits of a claim.38 Unless the operating agreement permits (or requires) advancement of expenses in the identified circumstances, it may be necessary to amend the operating agreement to address the issue when it arises. Depending on the relationship of the members at the time, that may be an inopportune moment to attempt an amendment of the company’s operating agreement. However, at the time of creation of the entity and drafting of the initial organic documents, when all parties see the value of the protection, it may be a simple matter to obtain consensus on the issue.

Following are two sets of sample clauses addressing: 1) alteration of the duty of care, 2) exculpation, and 3) indemnification. The first set may be appropriate for use in a manager-managed structure in which strong investor protection is a priority, while the second set is geared toward a member-managed structure in which personal liability protection is a priority. These provisions illustrate the flexibility and adaptability of the limited liability company to different governance structures, and the tremendous latitude provided by NJRULLCA.

Manager-Managed (Independent Investors)

Duty of Care:
The duty imposed under Section 39(c) of the Act (which applies to the Manager by virtue of Section 39(i)(1) of the Act, is altered as follows:
The Manager, in conducting and winding up the Company’s activities, shall act (i) with the diligence, care, skill and good faith that an ordinarily prudent person in a like position would reasonably exercise under similar circumstances, and (ii) in a manner the Manager reasonably believes to be in the best interests of the Company. In discharging this duty, the Manager may rely in good faith upon opinions, reports, statements, or other information provided by another person that the Manager reasonably believes is a competent and reliable source for the information, including without limitation the following:

(i) An opinion of counsel for the Company;
(ii) A written report concerning the financial condition of the company compiled, prepared, reviewed or audited by the Company’s accountants; and
(iii) Financial statements, books of account or reports of the Company prepared or presented to the Company’s chief financial officer or other Company agent or officer having charge of its books of account.

The Manager is presumed to have met the duty of care articulated above if, in connection with the action, decision or matter in question, the Manager: (i) is disinterested and independent, (ii) exercises due care in investigating the merits and circumstances of the action, decision or matter in question; and (iii) is reasonable.

Exculpation:
The Manager is not liable to the Company or any Member for any loss, damage, claim or expense incurred or suffered by reason of any act or omission performed or omitted (whether or not constituting negligence) by the Manager in good faith and in a manner reasonably believed by the Manager to be in the best interest in, or not opposed to the, the best interests of the Company. The foregoing exculpation does not apply in any of the circumstances for which exculpation is prohibited under Section 11(g) of the Act.

Indemnification for Liabilities and Expenses:
If the Manager, by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was the Manager, or while the Manager is or was serving at the Company’s request as a manager, director, officer, partner, venturer, proprietor, trustee, employee, agent, or similar functionary of the Company or any other business enterprise with which the Company is or was affiliated, is made a party or is threatened to be made a party to or is involved in any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative, arbitrative or investigative, including any appeal or investigation relating to any of the foregoing or any appeal of or with respect to any of the foregoing (collectively, “Covered Proceedings”), the Company shall indemnify the Manager from and against all losses, liabilities, damages, claims, judgments, penalties, fines, settlements and expenses (including without limitation reasonable attorneys’ fees and expenses) actually incurred the Manager in the Covered Proceeding. The foregoing indemnification does not apply to (i) any of the matters for which indemnification is prohibited under Section 11(g) of the NJRULLCA, or (ii) any matter in which it is ultimately determined that the Manager failed to meet the standard of care applicable to the Manager under section _____, above (reference the “Duty of Care” provision).

The right to indemnification conferred in this Section includes the right to be paid or reimbursed by the Company the reasonable expenses incurred by the Manager in the Covered Proceeding [without any prior determination as to the Manager’s ultimate entitlement to indemnification]. However, the Company may only pay such expenses in advance of the final disposition of a Covered Proceeding.
Proceeding if the Company’s receives (i) a written affirmation by the Manager of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification under this Section, and (ii) a written undertaking to repay the Company for any expenses advanced if it is ultimately determined that the Manager is not entitled to indemnification under this Section.

**Member-Managed (Shared Management Responsibility)**

**Duty of Care:**

The Members are subject to the duty of care set forth in Section 39(c) of the Act.

**Exculpation:**

The Members are not liable to the Company or any other Member for any loss, damage, claim or expense incurred or suffered by reason of any act or omission except for actions or omissions for which exculpation is prohibited under Section 11(g) of the Act.

**Indemnification for Liabilities and Expenses:**

If any Member, by reason of the fact that he or she, or a person of whom he or she is the legal representative, is or was a Member, or while a Member is or was serving at the Company’s request as a manager, director, officer, partner, venturer, proprietor, trustee, employee, agent, or similar functionary of the Company or any other business enterprise with which the Company is or was affiliated, is made a party or is threatened to be made a party to or is involved in any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative, arbitrative or investigative, including any appeal or inquiry or investigation relating to any of the foregoing or any appeal of or with respect to any of the foregoing (collectively, “Covered Proceedings”), the Company shall indemnify the Member from and against all losses, liabilities, damages, claims, judgments, penalties, fines, settlements and expenses (including without limitation reasonable attorneys’ fees and expenses) actually incurred the Member in the Covered Proceeding. The foregoing indemnification does not apply to any of the matters for which indemnification is prohibited under Section 11(g) of the Act.

The right to indemnification conferred in this Section includes the right to be paid or reimbursed by the Company the reasonable expenses incurred by the Member in the Covered Proceeding without any prior determination as to the Manager’s ultimate entitlement to indemnification. However, the Company may only pay such expenses in advance of the final disposition of a Covered Proceeding if the Company’s receives (i) a written affirmation by the Member of his or her good faith belief that he or she has met the standard of conduct necessary for indemnification under this Section, and (ii) a written undertaking to repay the Company for any expenses advanced if it is ultimately determined that the Member is not entitled to indemnification under this Section.

**Endnotes**

2. Section 1104, Delaware Limited Liability Company Act (amended 2013).
7. Id. As originally signed into law, the act limited the judicial review standard to just contractual limitations of the duty of loyalty. However, on Jan. 17, 2014, the act was amended to apply the judicial review standard to all provisions of operating agreements that alter fiduciary duties of members and managers, including the duty of care. See N.J.S.A. 42:2C-11(d) (providing the manner in which the operating agreement may restrict, alter or eliminate the fiduciary duties of members or managers).
8. N.J.S.A. 14A:6-14(1). Directors meet this duty if they, acting in good faith, rely upon: (a) an opinion of counsel for the corporation; (b) written reports setting forth financial data concerning the corporation and prepared by an independent public accountant or certified public accountant or firm of such accountants; (c) financial statements, books of account or reports of the corporation represented to them to be correct by the president, the officer of the corporation having charge of its books of account, or the person presiding at a meeting of the board; (d) written reports of committees of the board. N.J.S.A. 14A:6-14(2).
11. See Minard v. Iazzetti, No. 06-645 (MLC), 2007 U.S. Dist. LEXIS 86495, at *3-*4 (D. N.J. Nov. 26, 2007) (determining that partners may have violated duty of care when partnership interests were sold for $8.6 million when it was indicated that such interests’ fair market value was closer to $40.5 million at the time of sale).
14. Under the act, a limited liability company may not make a distribution if, after the distribution: 1) the company may not be able to pay its debts as they become due in the
ordinary course of business; or 2) generally, the company's total assets would be less than the sum of its total liabilities plus the amount that would be needed, following dissolution, wind-up and termination, to satisfy the preferential rights of members whose rights are superior to those receiving the distribution. See N.J.S.A. 42:2C-35(a). Despite this prohibition, a member in a member-managed company may possibly be exculpated from personal liability for a violation of this obligation if the operating agreement “expressly relieves a member of the authority and responsibility to consent to distributions and imposes that authority and responsibility on one or more other members....” N.J.S.A. 42:2C-36(b).

15. N.J.S.A. 42:2C-11(g).

16. See supra note 4 and accompanying text.

17. N.J.S.A. 14A:2-7(3).

18. The Supreme Court of New Jersey has articulated a three-part test in determining whether a corporation and its shareholders in order to be protected by the business judgment rule. In In re PSE&G Shareholder Litigation, 801 A.2d 295 (N.J. 2002), the court considered a shareholders’ derivative demand on its board to institute suit against its officers for mismanagement following malfunctions and safety problems that led to shutdowns and regulatory fines at the corporation’s power plants. In the context of a derivative action, a board obtains business judgment protection if it can meet the burden of establishing that it: 1) was disinterested and independent with respect to its decision in question; 2) acted in good faith and with due care in investigating the merits and circumstances of a particular decision; and 3) made a “reasonable” decision on the issue under its consideration Id. at 314-320. With respect to the second prong of this inquiry (good faith and due care), the court noted that a board fails to meet this obligation if its “investigation has been so restricted in scope, so shallow in execution, or otherwise so pro forma or half hearted as to constitute a pretext or sham.” Id. at 315-316 (internal citations omitted). With respect to the reasonableness standard that applies to the third part of the test, the court determined the board satisfied the requirement by relying on the opinion of company counsel not to proceed with litigation against the corporation’s officers, specifically referencing the exculpation provision in the corporation’s certificate of incorporation. Id. at 318-319 (citing Section 14A:2-7(3) of the NJBCA and further noting that the corporation’s charter provided that the corporation’s directors and officers shall not be personally liable to the corporation or its shareholders for breach of “any duty” to the corporation or its shareholders).

19. If a committee, composed of independent and disinterested directors, conducted a proper review of the matters before it, considered a variety of factors and reached, in good faith, a business judgment that the action was not in the best interest of the corporation, the action must be dismissed. The issues become solely independence, good faith, and reasonable investigation. Zapata Corp. v. Maldonado, 430 A.2d 779, 787 (Del. 1981) (internal citations omitted).


22. The act defines “company agent,” in relevant part, as “any person who is or was a member of a member-managed company, a manager of a manager-managed company, an officer, employee or agent of the indemnifying company....” N.J.S.A. 42:2C-38(a)(1).


27. N.J.S.A. 42:2C-38(c).

28. See N.J.S.A. 42:2C-11(g).


31. N.J.S.A. 14A:3-5(2)(a) and (3).

32. N.J.S.A. 14A:3-5(8).

33. N.J.S.A. 42:1A-21(c).

34. See N.J.S.A. 42:2C-11(g).

35. There is some ambiguity in the act concerning indemnification for “expenses.” Under Section 38(b), indemnification is mandatory if the agent “is successful on the merits or otherwise in the defense” of the claim. N.J.S.A. 42:2C-38(b). Indemnification against “any debt, obligation, expense, or other liability” is also mandatory under Section 38(c) of the act, provided the agent did not violate the act’s proscriptions on wrongful distributions or breach an applicable fiduciary duty. The use of the term “expense” could support an argument that indemnification for expenses is mandatory under both provisions.

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