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Georgia State University Law Review

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CORPORATIONS, PARTNERSHIPS, AND ASSOCIATIONS

Business Corporations: Require Demand in All Shareholder Derivative Actions; Raise the Standard of Care Required for Indemnification of Corporate Directors; Provide that a Director Must be Wholly Successful in an Action in Order to be Entitled to Mandatory Indemnification; Provide that Only Disinterested Directors may Authorize Indemnification; Authorize Contracts to Indemnify or to Advance Funds; Provide that Officers are Held to the Same Standards as Directors Regarding Indemnification; Modify Procedures for Approving Advances for Expenses; Permit Corporations to Merge with Limited Liability Companies and Nonprofit Corporations; Provide for the Survival of Remedies and Rights of a Dissolved Corporation

CODE SECTIONS:	O.C.G.A. §§ 9-11-23, 14-2-140, -202, -843, -850 to -859, -1002, -1103, -1109 (amended), -1410 (new)
BILL NUMBER:	HB 1425
ACT NUMBER:	979
GEORGIA LAWS:	1996 Ga. Laws 1203
SUMMARY:	The Act requires demand on the corporation for a shareholder derivative action. The standard of care required for indemnification of a director is changed from a subjective standard to an objective reasonableness standard. In order to be entitled to mandatory indemnification, a director must be wholly successful in his or her defense of the action. Only disinterested directors may vote to authorize indemnification. A corporation may enter into contracts to indemnify or to advance funds. The Act provides that corporate officers are subject to the same standards as directors regarding indemnification issues. Advances for expenses may be authorized by a majority vote of disinterested directors or, if none are available, by a vote of all the directors or of the disinterested shareholders. The Act permits corporations to merge with limited liability companies and nonprofit corporations, as well as joint-stock

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associations or limited partnerships; either of the merging entities may be the surviving corporation. The Act also provides for the survival of remedies and rights of a dissolved corporation for a period of two years after dissolution.

EFFECTIVE DATE: July 1, 1996

History

The Act is an effort by the Corporate Code Committee of the Corporate and Banking Section of the State Bar of Georgia to incorporate certain aspects of the Model Business Corporation Act (MBCA), which was amended in 1994, into the Georgia Business Corporation Code.[1] In addition, the Act also corrects inconsistencies and oversights that had become apparent in the existing Code.[2]

HB 1425

Shareholder Derivative Actions

The Act amends the Code of Civil Procedure to make it consistent with the Corporate Code.[3] Previously, Code section 9-11-23 allowed a plaintiff in a shareholder derivative action to plead reasons why demand on the corporation should be excused.[4] This was inconsistent with the Corporate Code section 14-2-742, which requires written demand on the corporation in all shareholder derivative actions.[5]

Articles of Incorporation

The Act amends Code section 14-2-202, regarding provisions that may be set forth in the articles of incorporation, to more closely conform to the MBCA.[6] As introduced in the House, the bill would have

1. William J. Carney, Report from the Corporate Code Committee (unpublished documentation) [hereinafter Carney Report] (available in Georgia State University College of Law Library). The bill was sponsored by Representatives Tommy Chambless and Henry Bostick at the request of the Bar. Telephone Interview with Rep. Tommy Chambless, House District No. 163 (Apr. 24, 1996); Telephone Interview with Rep. Henry Bostick, House District No. 165 (May 31, 1996).

2. Carney Report, *supra* note 1.

3. William J. Carney, Summary of Proposed Amendments (unpublished documentation) [hereinafter Carney Summary] (available in Georgia State University College of Law Library); O.C.G.A. § 9-11-23(b) (Supp. 1996).

4. 1989 Ga. Laws 946, § 75, at 1007-08 (formerly found at O.C.G.A. § 9-11-23(b) (1993)).

5. *See* 1988 Ga. Laws 1070, § 1, at 1129 (codified at O.C.G.A. § 14-2-742 (1994)).

6. Carney Summary, *supra* note 3.

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amended Code section 14-2-202(b)(4)(D) to mirror MBCA section 2.02(b)(4)(A) by stating that the articles of incorporation may include a provision limiting director liability, except for liability for "the amount of a financial benefit received by a director to which he is not entitled."[7] The Act incorporates the version proposed by the House Judiciary Committee, which reinstated the previously existing language allowing limitations on director liability in the articles of incorporation, except for "any transaction from which the director received an improper personal benefit."[8] This version mirrors the section of the MBCA regarding authority to indemnify, which provides that a corporation may not indemnify a director charged with "improper personal benefit."[9]

Indemnification

The Act amends Code section 14-2-850 aeding definitions for "disinterested director" and "official capacity," which are concepts utilized in the new indemnification provisions.[10] A disinterested director is one who is not a party to the proceeding and who does not have a relationship to a party to the proceeding that would reasonably be expected to influence his or her judgment in voting on decisions regarding indemnification or advances for expenses.[11]

An important provision of the Act is the amendment to Code section 14-2-851 regarding when a corporation may indemnify a party to a proceeding.[12] Prior to the Act, the board of directors was authorized to indemnify a director who "acted in a manner he believed in good faith to be in or not opposed to the best interests of the corporation."[13] The Act differentiates between actions taken in a director's official capacity and other actions.[14] The standard of care is raised for conduct taken by a director in an official capacity by requiring that he or she must have *reasonably* believed that it was in the best interests of the corporation.[15] For all other conduct, the standard is that the director must have *reasonably* believed that it was at least not opposed to the

7. *Compare* HB 1425, as introduced, 1996 Ga. Gen. Assem. *with* MODEL BUSINESS CORP. ACT § 2.02(b)(4)(A) (1994).

8. *Compare* HB 1425 (HCS), 1996 Ga. Gen. Assem. *with* 1988 Ga. Laws 1070, § 1, at 1085 (formerly found at O.C.G.A. § 14-2-202(b)(4)(D) (1994)) *and* O.C.G.A. § 14-2-202(b)(4)(D) (Supp. 1996).

9. MODEL BUSINESS CORP. ACT § 8.51(d)(2) (1994).

10. *See* O.C.G.A. § 14-2-850(3), (6) (Supp. 1996).

11. *Id.* § 14-2-850(3).

12. *Id.* § 14-2-851(a).

13. 1988 Ga. Laws 1070, § 1, at 1143 (formerly found at O.C.G.A. § 14-2-851(a) (1994)).

14. O.C.G.A. § 14-2-851(a)(2)(A), (B) (Supp. 1996).

15. *Id.* § 14-2-851(a)(2)(A).

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best interests of the corporation.[16] In the case of a criminal proceeding, both prior law and the Act provide that the director must have had no reasonable cause to believe the conduct was unlawful.[17]

The Act also amends Code section 14-2-851 to clarify that these standards of care must be satisfied in order for a director to be indemnified for expenses associated with a shareholder derivative action.[18] Although this provision may have been implied under the prior language, the Act makes it explicit.[19] In addition, the Act makes it clear in a new provision that a director may not be indemnified by the corporation in any proceeding regarding his or her receipt of an improper personal benefit.[20]

Prior to the Act, mandatory indemnification was provided whenever a director was successful in an action.[21] The Act amends Code section 14-2-852 to clarify that the director must be "wholly successful" to be entitled to mandatory indemnification.[22] This change addresses the situation in which multiple counts have been filed, the director plea bargains down to one count, and then attempts to obtain mandatory indemnification for a large portion of the expenses.[23]

A corporation may authorize indemnification under the procedural rules set forth in the Act's amendments to Code sections 14-2-855 and -856.[24] If there are two or more disinterested directors, a majority vote of those directors may authorize indemnification.[25] In the alternative, a decision regarding indemnification may be made by special legal counsel selected by two or more disinterested directors; if there are less than two disinterested directors, then the entire board may select the special legal counsel.[26] An indemnification decision may also be made by shareholder vote, but any shares owned or controlled by a director who is not disinterested may not be voted.[27]

The Act amends Code section 14-2-857 to provide that indemnification and advances for expenses of corporate officers are subject only to the same substantive limitations as are imposed on

16. *Id.* § 14-2-851(a)(2)(B).
17. 1988 Ga. Laws 1070, § 1, at 1143 (formerly found at O.C.G.A. § 14-2-851(a) (1994)); O.C.G.A. § 14-2-851(a)(2)(C) (Supp. 1996).
18. O.C.G.A. § 14-2-851(d)(1) (Supp. 1996).
19. Carney Summary, *supra* note 3.
20. O.C.G.A. § 14-2-851(d)(2) (Supp. 1996).
21. 1988 Ga. Laws 1070, § 1, at 1143-44 (formerly found at O.C.G.A. § 14-2-852 (1994)); Carney Summary, *supra* note 3.
22. O.C.G.A. § 14-2-852 (Supp. 1996).
23. Carney Summary, *supra* note 3.
24. O.C.G.A. §§ 14-2-855, -856 (Supp. 1996).
25. *Id.* § 14-2-855(b)(1).
26. *Id.* § 14-2-855(b)(2).
27. *Id.* §§ 14-2-855(b)(3), -856.

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shareholder indemnification of directors.[28] The Act also includes the provision that a corporate employee or agent may be indemnified and have expenses advanced to the extent consistent with public policy that such may be provided by the corporation's articles of incorporation, bylaws, action of the board of directors, or contract.[29]

The Act amends Code section 14-2-859 to expressly authorize contractual obligations to indemnify and advance expenses.[30] Indemnification commitments do survive a merger, although, unless specifically provided, they do not cover conduct of a director of a predecessor corporation with respect to the predecessor.[31]

Advances for Expenses

The Act amends Code section 14-2-853 regarding advances for expenses by adding a new subsection (c), which provides procedural rules for authorization.[32] Prior to the Act, the statute was silent on this matter; the new subsection is consistent with the approach taken by the Georgia Supreme Court in *Service Corp. International v. H. M. Patterson & Son*.[33] Advances must be authorized by a majority of disinterested directors if there are two or more such directors.[34] If there are less than two disinterested directors, then the entire board is authorized to participate in a vote to approve advances.[35] Authorization may also be made by shareholder vote, but any shares owned or controlled by a director who is not disinterested may not be voted.[36]

Mergers

Prior to the Act, a vote of the shareholders of the surviving corporation was not required for a merger or share exchange when the articles of incorporation of the surviving corporation were not changed and the shareholders remained the same.[37] This requirement was problematic, as it created the need for a shareholder vote in situations where the target corporation owned shares in the surviving corporation

28. *Id.* § 14-2-857; Carney Summary, *supra* note 3.
29. O.C.G.A. §§ 14-2-857(d), -859(e) (Supp. 1996).
30. *Id.* § 14-2-859(a); Carney Summary, *supra* note 3.
31. O.C.G.A. § 14-2-859(b) (Supp. 1996); Carney Summary, *supra* note 3.
32. O.C.G.A. § 14-2-853(c) (Supp. 1996).
33. 263 Ga. 412, 434 S.E.2d 455 (1993); Carney Summary, *supra* note 3.
34. O.C.G.A. § 14-2-853(c)(1)(A) (Supp. 1996).
35. *Id.* § 14-2-853(c)(1)(B).
36. *Id.* § 14-2-853(c)(2).
37. 1988 Ga. Laws 1070, § 1, at 1181 (formerly found at O.C.G.A. § 14-2-1103(h) (1994)).

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that were "canceled" in the merger.[38] The Act amends Code section 14-2-1103 to change the requirement of identical shareholders to a requirement that each previously outstanding share of stock of the surviving corporation be an identical outstanding or reacquired share immediately after the merger.[39]

Prior to the Act, a corporation could merge with a joint stock association or a limited partnership, but the business corporation had to be the surviving entity.[40] The Act amends Code section 14-2-1109 to also permit corporations to merge with limited liability companies and nonprofit corporations, and to allow either party to the merger to be the surviving entity.[41]

Dissolved Corporations

The Act adds Code section 14-2-1410, which provides that the remedies and rights of a dissolved corporation survive for a period of two years after such dissolution.[42] This restores a provision that was inadvertently omitted in the 1988 revisions to the Corporate Code.[43]

Miscellaneous Provisions

The definition of "distribution" is amended to exclude rights to acquire the company's own shares.[44] Prior to the Act, the company's shares were excluded, but the law was silent on the subject of purchase rights.[45] The change was made to address concerns regarding the status of rights plans.[46] Although the rights may have substantial market value when issued, they cannot harm the corporation's creditors.[47]

The Act amends Code section 14-2-843(a) to permit resigning officers to file a copy of their letter of resignation with the Secretary of State.[48] This change was made at the request of the Secretary of State's office.[49]

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38. Carney Report, *supra* note 1.
39. O.C.G.A. § 14-2-1103(h)(2) (Supp. 1996).
40. 1989 Ga. Laws 946, § 51, at 986 (formerly found at O.C.G.A. § 14-2-1109(b) (1994)).
41. O.C.G.A. § 14-2-1109(b) (Supp. 1996).
42. *Id.* § 14-2-1410.
43. Carney Report, *supra* note 1.
44. O.C.G.A. § 14-2-140(6) (Supp. 1996).
45. 1993 Ga. Laws 1231, § 1, at 1233 (formerly found at O.C.G.A. § 14-2-140(6) (Supp. 1995)).
46. Carney Summary, *supra* note 3.
47. *Id.*
48. O.C.G.A. § 14-2-843(a) (Supp. 1996).
49. Carney Report, *supra* note 1.

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Prior to the Act, Code section 14-2-858 provided that a corporation could purchase and maintain insurance against liability on behalf of an individual who "is or was" a director, officer, employee, or other agent, regardless of whether the corporation had power to indemnify that person against liability.[50] The Act amends this Code section to apply only to an individual who "is" a director, officer, employee, or other agent.[51]

The Act amends Code section 14-2-1002 to allow two additional circumstances under which the board of directors may amend the articles of incorporation without a shareholder vote: (1) when deleting the name and address of each incorporator, and (2) when deleting the mailing address of the initial principal corporate office once an annual registration has been filed.[52]

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50. 1988 Ga. Laws 1070, § 1, at 1147 (formerly found at O.C.G.A. § 14-2-858 (1994)).

51. O.C.G.A. § 14-2-858 (Supp. 1996).

52. *Id.* § 14-2-1002(4), (5).

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