



House of Representatives

General Assembly

File No. 462

February Session, 2000

Substitute House Bill No. 5612

House of Representatives, April 6, 2000

The Committee on Judiciary reported through REP. LAWLOR of the 99th Dist., Chairperson of the Committee on the part of the House, that the substitute bill ought to pass.

An Act Concerning Standards Of Conduct And Liability For Corporate Directors, Disclosure Of Insurance Policy Limits, Decisions Of The Claims Commissioner And The Admissibility Of Evidence Of The Failure To Wear A Seat Belt.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. Section 33-756 of the general statutes is repealed and the
2 following is substituted in lieu thereof:

3 [(a) A director shall discharge his duties as a director, including his
4 duties as a member of a committee]

5 (a) Each member of the board of directors, when discharging the
6 duties of a director, shall act: (1) In good faith; (2) with [the care an
7 ordinarily prudent person in a like position would exercise under
8 similar circumstances] due care; and (3) in a manner [he] the director
9 reasonably believes to be in the best interests of the corporation.

10 (b) The members of the board of directors or a committee of the

11 board, when becoming informed in connection with their decision-
12 making function or devoting attention to their oversight function, shall
13 discharge their duties with the due care that a person in a like position
14 would reasonably believe appropriate under similar circumstances.

15 (c) In discharging board or committee duties, a director, who does
16 not have knowledge, or reason to know, that makes reliance
17 unwarranted, is entitled to rely on the performance by any of the
18 persons specified in subdivision (1) or (3) of subsection (e) of this
19 section to whom the board may have delegated, formally or informally
20 by course of conduct, the authority or duty to perform one or more of
21 the board's functions that are delegable under applicable law,
22 provided the director reasonably believes such reliance is in the best
23 interests of the corporation.

24 [(b)] (d) In discharging [his] board or committee duties a director,
25 who does not have knowledge that makes reliance unwarranted, is
26 entitled to rely on information, opinions, reports or statements,
27 including financial statements and other financial data, [if] prepared or
28 presented by [: (1) One or more officers or employees of the
29 corporation whom the director reasonably believes to be reliable and
30 competent in the matters presented; (2) legal counsel, public
31 accountants or other persons as to matters the director reasonably
32 believes are within the person's professional or expert competence; or
33 (3) a committee of the board of directors of which he is not a member if
34 the director reasonably believes the committee merits confidence] any
35 of the persons specified in subsection (e) of this section.

36 (e) A director is entitled to rely, in accordance with subsection (c) or
37 (d) of this section, on: (1) One or more officers or employees of the
38 corporation whom the director reasonably believes to be reliable and
39 competent in the functions performed or the information, opinions,
40 reports or statements provided; (2) legal counsel, public accountants or
41 other persons retained by the corporation as to matters involving skills

42 or expertise the director reasonably believes are matters (A) within the
43 particular person's professional or expert competence, or (B) as to
44 which the particular person merits confidence; or (3) a committee of
45 the board of directors of which the director is not a member if the
46 director reasonably believes the committee merits confidence.

47 [(c) A director is not acting in good faith if he has knowledge
48 concerning the matter in question that makes reliance otherwise
49 permitted by subsection (b) of this section unwarranted.]

50 [(d)] (f) For purposes of sections 33-817, 33-830, 33-831, 33-841 and
51 33-844, a director of a corporation which has a class of voting stock
52 registered pursuant to Section 12 of the Securities Exchange Act of
53 1934, as the same has been or hereafter may be amended from time to
54 time, in addition to complying with the provisions of subsections (a) to
55 [(c)] (e), inclusive, of this section, shall consider, in determining what
56 [he] the director reasonably believes to be in the best interests of the
57 corporation, (1) the long-term as well as the short-term interests of the
58 corporation, (2) the interests of the shareholders, long-term as well as
59 short-term, including the possibility that those interests may be best
60 served by the continued independence of the corporation, (3) the
61 interests of the corporation's employees, customers, creditors and
62 suppliers, and (4) community and societal considerations including
63 those of any community in which any office or other facility of the
64 corporation is located. A director may also in [his] the director's
65 discretion consider any other factors [he] the director reasonably
66 considers appropriate in determining what [he] the director reasonably
67 believes to be in the best interests of the corporation.

68 [(e) A director is not liable for any action taken as a director, or any
69 failure to take any action, if he performed the duties of his office in
70 compliance with this section.]

71 Sec. 2. (NEW) (a) If the party asserting liability in a proceeding
72 establishes a director's fiduciary relationship, the director shall not be

73 liable to the corporation or its shareholders for any decision to take or
74 not to take action, or any failure to take any action, as a director, if the
75 director establishes by clear and convincing evidence that: (1) Any
76 provision in the certificate of incorporation authorized by subdivision
77 (4) of subsection (b) of section 33-636 of the general statutes or the
78 protection afforded by section 33-782 of the general statutes for action
79 taken in compliance with section 33-783 or 33-784 of the general
80 statutes, to the extent interposed as a defense in the proceeding by the
81 director, precludes liability; and (2) the challenged conduct did not
82 consist of or was not the result of: (A) Action not taken with due care;
83 or (B) a decision (i) which the director did not reasonably believe to be
84 in the best interests of the corporation, or (ii) as to which the director
85 was not informed to an extent the director reasonably believed
86 appropriate in the circumstances; or (C) a lack of objectivity due to the
87 director's familial, financial or business relationship with, or a lack of
88 independence due to the director's domination or control by, another
89 person having a material interest in the challenged conduct (i) which
90 relationship or which domination or control could reasonably be
91 expected to have affected the director's judgment respecting the
92 challenged conduct in a manner adverse to the corporation or conduct
93 which was in the director's own financial interest, and (ii) after a
94 reasonable expectation to such effect has been established, the director
95 shall not have established that the challenged conduct was reasonably
96 believed by the director to be in the best interests of the corporation; or
97 (D) a sustained failure of the director to devote attention to ongoing
98 oversight of the business and affairs of the corporation, or a failure to
99 devote timely attention, by making or causing to be made appropriate
100 inquiry, when particular facts and circumstances of significant concern
101 materialize that would alert a reasonably attentive director to the need
102 therefor; or (E) receipt of a financial benefit to which the director was
103 not entitled or any other breach of the director's duties to deal fairly
104 with the corporation and its shareholders that is actionable under
105 applicable law.

106 (b) When a party is seeking to hold the director liable: (1) For money
107 damages, the director shall also have the burden of establishing that
108 (A) no harm to the corporation or its shareholders has been suffered, or
109 (B) the harm suffered was not proximately caused by the director's
110 challenged conduct; or (2) for other money payment under a legal
111 remedy, such as compensation for the unauthorized use of corporate
112 assets, the party shall also have whatever burden of persuasion may be
113 called for to establish that the payment sought is appropriate in the
114 circumstances; or (3) for other money payment under an equitable
115 remedy, such as profit recovery by or disgorgement to the corporation,
116 the party shall also have whatever burden of persuasion may be called
117 for to establish that the equitable remedy sought is appropriate in the
118 circumstances.

119 (c) Nothing contained in this section, sections 33-756 and 33-757 of
120 the general statutes, as amended by this act, and section 4 of this act
121 shall: (1) In any instance where fairness is at issue, alter the burden of
122 proving the fact or lack of fairness otherwise applicable, (2) alter the
123 fact or lack of liability of a director under another section of chapter
124 601 of the general statutes, such as the provisions governing the
125 consequences of an unlawful distribution under section 33-757 of the
126 general statutes, as amended by this act, or a transactional interest
127 under section 33-782 of the general statutes, or (3) affect any rights to
128 which the corporation or a shareholder may be entitled under another
129 statute of this state or the United States.

130 Sec. 3. Section 33-757 of the general statutes is repealed and the
131 following is substituted in lieu thereof:

132 (a) A director who votes for or assents to a distribution [made in
133 violation of section 33-687 or the certificate of incorporation] in excess
134 of what may be authorized and made pursuant to subsection (a) of
135 section 33-687 is personally liable to the corporation for the amount of
136 the distribution that exceeds what could have been distributed without

137 violating said [section or the certificate of incorporation if it is
138 established that he did not perform his duties in compliance with
139 section 33-756. In any proceeding commenced under this section, a
140 director has all of the defenses ordinarily available to a director]
141 subsection (a) if the party asserting liability establishes that when
142 taking the action the director did not comply with section 33-756, as
143 amended by this act.

144 (b) A director held liable under subsection (a) of this section for an
145 unlawful distribution is entitled to: [contribution: (1) From] (1)
146 Contribution from every other director who could be held liable under
147 subsection (a) of this section for the unlawful distribution; and (2)
148 recoupment from each shareholder [for] of the pro rata portion of the
149 amount of the unlawful distribution the shareholder accepted knowing
150 the distribution was made in violation of subsection (a) of section
151 33-687. [or the certificate of incorporation.]

152 (c) A proceeding [under this section] to enforce the liability of a
153 director under subsection (a) of this section is barred unless it is
154 commenced within two years after the date on which the effect of the
155 distribution was measured under subsection (e) or (g) of section 33-687
156 or as of which the violation of subsection (a) of section 33-687 occurred
157 as the consequence of disregard of a restriction in the certificate of
158 incorporation. A proceeding to enforce contribution or recoupment
159 under subsection (b) of this section is barred unless it is commenced
160 within one year after the liability of the director has been finally
161 adjudicated under subsection (a) of this section.

162 [(d) For purposes of this section, a director shall be deemed to have
163 voted for a distribution if such director was present at the meeting of
164 the board of directors or committee thereof at the time such
165 distribution was authorized and did not vote in dissent therefrom, or if
166 such director consented thereto pursuant to section 33-749.]

167 Sec. 4. (NEW) In an examination of the conduct of a director of a

168 business corporation in such director's capacity as a director, such
169 director shall only be entitled to the protections provided in sections
170 33-756 and 33-757 of the general statutes, as amended by this act, and
171 section 2 of this act when the director is acting in the sole capacity of a
172 director and not when the director is acting in the capacity of an
173 officer.

174 Sec. 5. Section 33-1104 of the general statutes is repealed and the
175 following is substituted in lieu thereof:

176 [(a) A director shall discharge his duties as a director, including his
177 duties as a member of a committee]

178 (a) Each member of the board of directors, when discharging the
179 duties of a director, shall act: (1) In good faith; (2) with [the care an
180 ordinarily prudent person in a like position would exercise under
181 similar circumstances] due care; and (3) in a manner [he] the director
182 reasonably believes to be in the best interests of the corporation.

183 (b) The members of the board of directors or a committee of the
184 board, when becoming informed in connection with their decision-
185 making function or devoting attention to their oversight function, shall
186 discharge their duties with the due care that a person in a like position
187 would reasonably believe appropriate under similar circumstances.

188 (c) In discharging board or committee duties, a director, who does
189 not have knowledge, or reason to know, that makes reliance
190 unwarranted, is entitled to rely on the performance by any of the
191 persons specified in subdivision (1) or (3) of subsection (e) of this
192 section to whom the board may have delegated, formally or informally
193 by course of conduct, the authority or duty to perform one or more of
194 the board's functions that are delegable under applicable law,
195 provided the director reasonably believes such reliance is in the best
196 interests of the corporation.

197 [(b)] (d) In discharging [his] board or committee duties, a director
198 who does not have knowledge that makes reliance unwarranted, is
199 entitled to rely on information, opinions, reports or statements,
200 including financial statements and other financial data, [if] prepared or
201 presented by [: (1) One or more officers or employees of the
202 corporation whom the director reasonably believes to be reliable and
203 competent in the matters presented; (2) legal counsel, public
204 accountants or other persons as to matters the director reasonably
205 believes are within the person's professional or expert competence; or
206 (3) a committee of the board of directors of which he is not a member if
207 the director reasonably believes the committee merits confidence] any
208 of the persons specified in subsection (e) of this section.

209 (e) A director is entitled to rely, in accordance with subsection (c) or
210 (d) of this section, on: (1) One or more officers or employees of the
211 corporation whom the director reasonably believes to be reliable and
212 competent in the functions performed or the information, opinions,
213 reports or statements provided; (2) legal counsel, public accountants or
214 other persons retained by the corporation as to matters involving skills
215 or expertise the director reasonably believes are matters (A) within the
216 particular person's professional or expert competence, or (B) as to
217 which the particular person merits confidence; or (3) a committee of
218 the board of directors of which the director is not a member if the
219 director reasonably believes the committee merits confidence.

220 [(c) A director is not acting in good faith if he has knowledge
221 concerning the matter in question that makes reliance otherwise
222 permitted by subsection (b) of this section unwarranted.

223 (d) A director is not liable for any action taken as a director, or any
224 failure to take any action, if he performed the duties of his office in
225 compliance with this section.]

226 Sec. 6. (NEW) (a) If the party asserting liability in a proceeding
227 establishes a director's fiduciary relationship, the director shall not be

228 liable to the corporation or its members for any decision to take or not
229 to take action, or any failure to take any action, as a director, if the
230 director establishes by clear and convincing evidence that: (1) Any
231 provision in the certificate of incorporation authorized by subdivision
232 (4) of subsection (b) of section 33-1026 of the general statutes or the
233 protection afforded by section 33-1128 of the general statutes for action
234 taken in compliance with section 33-1129 or 33-1130 of the general
235 statutes, to the extent interposed as a defense in the proceeding by the
236 director, precludes liability; and (2) the challenged conduct did not
237 consist of or was not the result of: (A) Action not taken with due care;
238 or (B) a decision (i) which the director did not reasonably believe to be
239 in the best interests of the corporation, or (ii) as to which the director
240 was not informed to an extent the director reasonably believed
241 appropriate in the circumstances; or (C) a lack of objectivity due to the
242 director's familial, financial or business relationship with, or a lack of
243 independence due to the director's domination or control by, another
244 person having a material interest in the challenged conduct (i) which
245 relationship or which domination or control could reasonably be
246 expected to have affected the director's judgment respecting the
247 challenged conduct in a manner adverse to the corporation or conduct
248 which was in the director's own financial interest, and (ii) after a
249 reasonable expectation to such effect has been established, the director
250 shall not have established that the challenged conduct was reasonably
251 believed by the director to be in the best interests of the corporation; or
252 (D) a sustained failure of the director to devote attention to ongoing
253 oversight of the business and affairs of the corporation, or a failure to
254 devote timely attention, by making or causing to be made appropriate
255 inquiry, when particular facts and circumstances of significant concern
256 materialize that would alert a reasonably attentive director to the need
257 therefor; or (E) receipt of a financial benefit to which the director was
258 not entitled or any other breach of the director's duties to deal fairly
259 with the corporation and its members that is actionable under
260 applicable law.

261 (b) When a party is seeking to hold the director liable: (1) For money
262 damages, the director shall also have the burden of establishing that
263 (A) no harm to the corporation or its members has been suffered, or (B)
264 the harm suffered was not proximately caused by the director's
265 challenged conduct; or (2) for other money payment under a legal
266 remedy, such as compensation for the unauthorized use of corporate
267 assets, the party shall also have whatever burden of persuasion may be
268 called for to establish that the payment sought is appropriate in the
269 circumstances; or (3) for other money payment under an equitable
270 remedy, such as profit recovery by or disgorgement to the corporation,
271 the party shall also have whatever burden of persuasion may be called
272 for to establish that the equitable remedy sought is appropriate in the
273 circumstances.

274 (c) Nothing contained in this section, sections 33-1104 and 33-1105 of
275 the general statutes, as amended by this act, and section 8 of this act
276 shall: (1) In any instance where fairness is at issue, alter the burden of
277 proving the fact or lack of fairness otherwise applicable, (2) alter the
278 fact or lack of liability of a director under another section of chapter
279 602 of the general statutes, such as the provisions governing the
280 consequences of an unlawful distribution under section 33-1105 of the
281 general statutes, as amended by this act, or a transactional interest
282 under section 33-1128 of the general statutes, or (3) affect any rights to
283 which the corporation or a member may be entitled under another
284 statute of this state or the United States.

285 Sec. 7. Section 33-1105 of the general statutes is repealed and the
286 following is substituted in lieu thereof:

287 (a) A director who votes for or assents to a distribution [made in
288 violation of] in excess of what may be authorized and made pursuant
289 to sections 33-1000 to 33-1290, inclusive, as amended by this act, or the
290 certificate of incorporation is personally liable to the corporation for
291 the amount of the distribution that exceeds what could have been

292 distributed without violating said sections [or the certificate of
293 incorporation if it is established that he did not perform his duties in
294 compliance with section 33-1104. In any proceeding commenced under
295 this section, a director has all of the defenses ordinarily available to a
296 director] if the party asserting liability establishes that when taking the
297 action the director did not comply with section 33-1104, as amended by
298 this act.

299 (b) A director held liable under subsection (a) of this section for an
300 unlawful distribution is entitled to: [contribution: (1) From] (1)
301 Contribution from every other director who could be held liable under
302 subsection (a) of this section for the unlawful distribution; and (2)
303 recoupment from each recipient [for] of the pro rata portion of the
304 amount of the unlawful distribution the recipient accepted knowing
305 the distribution was made in violation of sections 33-1000 to 33-1290,
306 inclusive, as amended by this act, or the certificate of incorporation.

307 (c) A proceeding [under this section] to enforce the liability of a
308 director under subsection (a) of this section is barred unless it is
309 commenced within three years after the date on which the distribution
310 was made. A proceeding to enforce contribution or recoupment under
311 subsection (b) of this section is barred unless it is commenced within
312 one year after the liability of the director has been finally adjudicated
313 under subsection (a) of this section.

314 [(d) For purposes of this section, a director shall be deemed to have
315 voted for a distribution if such director was present at the meeting of
316 the board of directors or committee thereof at the time such
317 distribution was authorized and did not vote in dissent therefrom, or if
318 such director consented thereto pursuant to section 33-1097.]

319 Sec. 8. (NEW) In an examination of the conduct of a director of a
320 nonstock corporation in such director's capacity as a director, such
321 director shall only be entitled to the protections provided in sections
322 33-1104 and 33-1105 of the general statutes, as amended by this act,

323 and section 6 of this act when the director is acting in the sole capacity
324 of a director and not when the director is acting in the capacity of an
325 officer.

326 Sec. 9. (NEW) Any insurance company doing business in this state
327 shall disclose to an injured party making a claim against an insured of
328 such company the amount of the limits of liability coverage including
329 excess or umbrella coverage and a copy of the applicable declarations
330 page and insurance policy not later than fourteen days after receiving a
331 written request therefor from the injured party or the injured party's
332 attorney.

333 Sec. 10. (NEW) Except as provided in subsection (b) of section 4-160
334 of the general statutes, the Claims Commissioner shall hold a hearing
335 and render a decision on a claim not later than four years after the date
336 of the filing of such claim with the Claims Commissioner. If the Claims
337 Commissioner fails to render a decision on a claim within such four-
338 year period, authorization by the Claims Commissioner to sue the state
339 shall be deemed to have been granted to the claimant.

340 Sec. 11. Subsection (c) of section 14-100a of the general statutes is
341 repealed and the following is substituted in lieu thereof:

342 (c) (1) The operator of and any front seat passenger in a private
343 passenger motor vehicle, as defined in subsection (e) of section 38a-
344 363, fire fighting apparatus or a vanpool vehicle equipped with seat
345 safety belts complying with the provisions of the Code of Federal
346 Regulations, Title 49, Section 571.209, as amended from time to time,
347 shall wear such seat safety belt while the vehicle is being operated on
348 the highways of this state, except that a child under the age of four
349 years shall be restrained as provided in subsection (d) of this section.
350 Each operator of such vehicle shall secure or cause to be secured in a
351 seat safety belt any passenger four years of age or older and under
352 sixteen years of age.

353 (2) The provisions of subdivision (1) of this subsection shall not
354 apply to any person whose physical disability or impairment would
355 prevent restraint in such safety belt, provided such person obtains a
356 written statement from a licensed physician containing reasons for
357 such person's inability to wear such safety belt and including
358 information concerning the nature and extent of such condition. Such
359 person shall carry the statement on his person or in the motor vehicle
360 at all times when it is being operated.

361 (3) As used in this subsection, "private passenger motor vehicle"
362 does not mean an authorized emergency vehicle, other than fire
363 fighting apparatus, responding to an emergency call or a motor vehicle
364 operated (A) by a rural letter carrier of the United States postal service
365 while performing his official duties, or (B) by a person engaged in the
366 delivery of newspapers.

367 (4) Failure to wear a seat safety belt shall not be considered as
368 contributory negligence nor shall such failure be admissible evidence
369 in any civil action, except that, in a product liability claim against a
370 motor vehicle manufacturer, failure to wear a seat safety belt may be
371 admissible evidence on the issues of defective design and causation of
372 personal injury or death.

373 (5) On and after February 1, 1986, any person who violates the
374 provisions of this subsection shall have committed an infraction and
375 shall be fined fifteen dollars. Points may not be assessed against the
376 operator's license of any person convicted of such violation.

377 Sec. 12. This act shall take effect from its passage, except that section
378 10 shall take effect July 1, 2001, and shall be applicable to any claim
379 pending on or filed on or after said date.

JUD Committee Vote: Yea 37 Nay 1 JFS

The following fiscal impact statement and bill analysis are prepared for the benefit of members of the General Assembly, solely for the purpose of information, summarization, and explanation, and do not represent the intent of the General Assembly or either House thereof for any purpose:

OFA Fiscal Note

State Impact: Uncertain

Affected Agencies: Judicial Department, Secretary of State, Department of Insurance, and the Office of the Claims Commissioner

Municipal Impact: None

Explanation

Sections 1 - 8 of the bill make changes in the laws related to the liability of corporate directors. The extent to which passage of the bill will discourage incorporation in the state or encourage state businesses to change incorporation and result in a fiscal impact is uncertain.

Section 9, which requires insurance companies to disclose certain information to injured people making claims against one of their insured, would result in no fiscal impact.

Section 10 requires the Claims Commissioner to hold a hearing within four years after the date a claim is filed. It is not anticipated that this requirement would result in any additional fiscal impact to the agency. It should be noted that there is currently no such statutory time requirement.

Finally, section 11 makes the failure to wear a seat belt admissible evidence in a product liability claim against a motor vehicle

manufacturer. Passage is not anticipated to result in a fiscal impact to the state.

OLR Bill Analysis

sHB 5612

AN ACT CONCERNING STANDARDS OF CONDUCT AND LIABILITY FOR CORPORATE DIRECTORS, DISCLOSURE OF INSURANCE POLICY LIMITS, DECISIONS OF THE CLAIMS COMMISSIONER AND THE ADMISSIBILITY OF EVIDENCE OF THE FAILURE TO WEAR A SEAT BELT.

SUMMARY:

This bill makes numerous changes in the laws relating to liability of directors of stock and non-stock corporations to their corporations, shareholders, and members.

It establishes a one-year, instead of two-year, statute of limitation for directors found liable for unlawful distributions of corporate profits or assets to sue other liable directors or shareholders who received the unlawful distributions. Under most circumstances the effect is to give liable directors more time to sue because the bill makes the one-year period run from the date the director is found liable instead of from the date the unlawful distribution occurred.

The bill also changes when the statute of limitations begins to run for a corporation to bring a lawsuit against a director for unlawful distributions. This change may increase or decrease the time corporations have to file a lawsuit depending on the circumstances.

The bill requires insurance companies to disclose to injured people making a claim against one of their insured (1) the amount of liability coverage the insured has and (2) a copy of the insurance policy, including its declaration page, within 14 days after receiving a written request from the injured person or his attorney.

The bill requires the claims commissioner to hold a hearing within four years after the date a claim is filed with him. But it exempts medical malpractice claims from this requirement. The bill deems the

commissioner's failure to decide a claim within the four-year period the same as an authorization for the claimant to sue the state. The requirement applies to any claim pending or filed on or after July 1, 2001.

The bill makes the failure to wear a seat belt admissible evidence in a product liability claim against a motor vehicle manufacturer. It is admissible evidence on the issue of defective design and causation of personal injury or death.

EFFECTIVE DATE: Upon passage except the provision dealing with the claims commissioner is effective July 1, 2001.

LAWSUITS AGAINST DIRECTORS FOR IMPROPER DISTRIBUTIONS

By law, a director who votes for, or assents to a distribution in excess of what is authorized is personally liable to the corporation for the excess distribution. But a director can recover proportionally from other liable directors and shareholders who received the unlawful distribution. A distribution can be unlawful either because it violated the corporation's certificate of incorporation or certain statutory standards.

The bill establishes a new rule for calculating when the two-year statute of limitations begins to run for lawsuits alleging a director authorized a distribution in violation of the certificate of incorporation. The period begins to run from the day the directors approve the unlawful distribution instead of from the date the distribution occurs under current statutory rules. Under these rules a distribution occurs (1) in the case of distributions by acquiring the corporation's shares, on the day (a) the corporation transfers the money or other property or incurs the debt or (b) the shareholder ceases to hold the acquired shares, whichever occurs first; (2) in the case of any other distribution of indebtedness, the day the indebtedness is distributed; or (3) in all other cases, on the day the distribution is authorized if payment occurs within 120 days after authorization or the date payment is made if it occurs more than 120 days after it was authorized.

The bill changes the statute of limitations for a liable director to

recover proportionally from other liable directors and from shareholders who received an unlawful distribution. Under current law, the lawsuit must be initiated within two years from the date a distribution occurs. The bill instead gives liable directors one year after their liability for an unlawful distribution has been finally adjudicated.

Finally, the bill eliminates the requirement that a director who was present at a board or committee meeting, but did not vote for a distribution, be deemed to have voted for a distribution if he did not vote against it.

ADDITIONAL BURDENS OF PROOF

The bill specifies that when a person sues a director for money damages, the director has the burden of establishing that neither the corporation nor its shareholders have suffered harm “proximately caused” by the director’s conduct. (It is not clear what affect, if any, this has on the plaintiff’s burden of proof. Normally, this is what the person filing the lawsuit has to allege and prove in order to win.) (In negligence lawsuits, “proximately caused” means conduct that was a substantial factor. Courts might borrow this meaning for this type of lawsuit.)

The bill also specifies that the person seeking to hold the director liable for money payment, other than damages, under some other legal or equitable remedy has whatever burden of persuasion that already exists.

LIMITATION OF DIRECTOR LIABILITY

If a person asserting liability in a proceeding establishes that the director had a fiduciary relationship, the bill limits the director liability if he can prove by clear and convincing evidence certain things.

First the director must prove any one of the following three things.

1. He must prove that certain provisions of the certificate of incorporation preclude his liability. These provisions can protect a director from a breach of his duty to a corporation as long as the breach did not: (a) involve a knowing and culpable violation of law; (b) allow the director or his

associate to receive an improper personal economic gain; (c) show a lack of good faith and a conscious disregard for his duties to the corporation under circumstances in which the director was aware that his conduct created an unjustifiable risk of serious injury to the corporation; (d) constitute a sustained and unexcused pattern of inattention amounting to an abdication of his duty to the corporation; or (e) create liability for an unlawful distribution.

Second, the director must prove that the transaction was fair to the corporation.

Third, the director must prove that the transaction in question was approved by either a majority of disinterested directors or a majority of the votes entitled to be cast by shareholders after they were notified that the director had a conflict of interest in the transaction.

After proving any one of these three things, in order to avoid liability, the director must also prove that his action did not consist of or result from:

1. action taken without due care;
2. a decision which either the director did not reasonably believe to be in the corporation's best interests or as to which he was not informed to an extent he reasonably believed appropriate under the circumstances;
3. conduct in his own financial interest or a lack of objectivity due to his family, financial, or business relationships with another person who had a material interest in the challenged conduct. (The relationship could include being dominated and controlled by someone; if so the relationship could reasonably be expected to affect the director's judgment and if so the director has not established that he reasonably believed the challenged conduct was in the corporation's best interests.)
4. the director's sustained failure to devote attention to ongoing oversight of the corporation's business and affairs or to devote attention by appropriate inquiry after facts or circumstances of significant concern materialized that would alert a reasonably

attentive director to the need for appropriate inquiry;

5. the receipt of a financial benefit that he was not entitled to receive; or
6. any other breach of his duties to deal fairly with the corporation and its shareholders that can give rise to a lawsuit.

(It is not clear if the director can prove his action did not consist of or result in any one of these six things or if he has to prove one that is directly related to the allegations in the lawsuit against him.)

The bill eliminates a provision that specifies a director is not liable for taking or failing to take an action if he acted in accordance with the provision establishing the director's duty of care.

LEGAL PROTECTION FOR DIRECTORS

The bill specifies that a director is entitled to the protections the bill and current law provide when he acts solely in the capacity of a director and not in the capacity of an officer.

RELIANCE ON INFORMATION FROM OTHERS

Current law allows corporate directors to rely, under certain circumstances, on the performance, information, opinion, reports, and statements of corporate officers and employees, legal counsel, public accountants, and other experts, and a committee of the board.

The bill limits this in two ways. First, it specifies that the director must reasonably believe the reliance is in the corporation's best interests. Second, it specifies that the legal counsel, public accountants, and others must be retained by the corporation.

It expands a director's authority by allowing him to rely on outside professionals and others retained by the corporation as to matters for which a director believes they merit confidence even though the matters are not within the retained person's professional or expert competence.

LIABILITY UNDER OTHER STATUTES

The bill specifies that it does not change the burden of proving fairness or lack of fairness in any situation where the fairness of a transaction is at issue, nor does it alter a director’s liability under other provisions of the stock corporation statutes. It also specifies that it does not affect any rights that a corporation or shareholder may have under another state or federal law.

BACKGROUND

Claims Commissioner

With a few exceptions the claims commissioner has the authority to hear and decide all claims against the state. By law, the claims commissioner may authorize a suit on any claim against the state he believes presents an issue of law or fact under which the state could be liable if it was a private person. He can approve the payment of claims up to \$7,500 without legislative approval. His recommendations concerning claims exceeding \$7,500 must be presented to the General Assembly which can (1) accept or alter it or (2) reject it and grant or deny the claimant permission to sue the state.

COMMITTEE ACTION

Judiciary Committee

Joint Favorable Substitute

Yea 37 Nay 1