THE FIDUCIARY DUTY OF DIRECTORS AND OFFICERS UNDER THE LOUISIANA BUSINESS CORPORATION ACT OF 2014

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I. INTRODUCTION

The principal purpose of this article is to assist Louisiana lawyers and judges in gaining familiarity with changes made in existing Louisiana law relating to the fiduciary duty of directors and officers by the Business Corporation Act, recently adopted in Act No. 328 of 2014 (BCA).

A. ORIGIN OF BCA

Representative Foil introduced the BCA into the 2014 Regular Session of the legislature as HB 319 on the recommendation of the Louisiana State Law Institute (LSLI) in response to House Concurrent Resolution No. 146 of the 2008 Regular Session. The legislative resolution requested that the LSLI "study and make recommendations on the revision . . . of the laws of the state relative to corporations" and to include consideration of the adoption of the Model Business Corporation Act.[1]

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The LSLI responded to the legislature's request by appointing a new Corporations Committee (Committee) in 2008 that included lawyers from around the state and representatives of the Secretary of State's office, with Professor Glenn G. Morris of the LSU Law School as reporter. The Committee's mission was either to amend the existing Louisiana Business Corporation Law, R.S. 12:1-178 (LBCL), or draft a new statute to replace it. The Committee opted to draft a new statute based on the Model Business Corporation Act. The version used in drafting the BCA is the Revised Model Business Corporation Act Annotated (2010), as subsequently amended (Model Act).

The Committee on Corporate Laws of the Section of Business Law of the American Bar Association (ABA Committee) drafted, and has continuously updated, the original Model Business Corporation Act, which was first published in 1950. Thirty states have adopted the Model Act in whole or in part.[2] As such it represents a broad national consensus on the most appropriate provisions to be included in a contemporary state business corporation statute (with apologies to Delaware, whose unique body of corporate law and court system have been chosen by a majority of the nation's public companies as their governing regime). Moreover, the body of national case law interpreting the Model Act, as well as the detailed Official Comments that accompany it, is a common resource for lawyers and judges in every state that has adopted it.

The Committee reviewed the Model Act on a line-by-line basis and modified many of its provisions in the BCA to retain certain LBCL rules, conform Model Act language with Louisiana

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1. H. Con. Res. 146, 2008 Leg., Reg. Sess. (La. 2008), *available at* http://www.legis.la.gov/legis/ViewDocument.aspx?d=499238. The BCA was originally introduced into the 2013 Regular Session of the Louisiana Legislature as House Bill No. 408. H.R. 408, 2013 Leg., Reg. Sess. (La. 2013), *available at* http://www.legis.la.gov/legis/ViewDocument.aspx?d=847384. Although it passed the 2013 House of Representatives unanimously and encountered no opposition in the Senate, it was tabled in the Senate shortly before adjournment in deference to other pressing business.

2. Alabama, Arizona, Arkansas, Connecticut, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kentucky, Maine, Massachusetts, Mississippi, Montana, Nebraska, New Hampshire, North Carolina, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

terminology and civil procedure, create new Louisiana approaches to certain issues, and include Louisiana revision comments that explain departures from the Model Act and the reasons for them. One of the objectives of this article is to address differences between the BCA and the Model Act, as well as differences between the BCA and the LBCL, insofar as each relates to the fiduciary duty of directors and officers.

B. LEGISLATIVE HISTORY OF LBCL

Because of Louisiana's unique legal heritage, one might suppose the LBCL embodies at least some civilian principles relating to the fiduciary duty of directors and officers that are arguably inconsistent in origin, spirit, or terminology with the Model Act. Nothing could be further from the truth. Louisiana Acts 1968, No. 105 enacted the LBCL. Lawmakers consciously drafted it as reform legislation intended to modernize the corporation law of Louisiana and bring it into harmony with the best-recognized practices around the country. More particularly, a statewide committee of practicing lawyers and public officials drafted the LBCL. The committee worked on the project for five years before the bill that became Act No. 105 was introduced into the Legislature.[3]

As a basis for its first draft, the 1968 Louisiana revision committee studied the corporation laws of many states, including Delaware, New York, North Carolina, Arkansas, and Texas.[4] The Louisiana committee attempted in its drafting to bring "Louisiana concepts and terminology into greater conformity with that [sic] of other states."[5]

The 1968 committee asserted that, "The new legislation gives to Louisiana the most modern and forward-looking corporation laws in the United States."[6] The committee noted that the LBCL "combines what were considered the best features

3. *See, e.g.*, Levy v. Billeaud, 443 So. 2d 539, 542 (La. 1983); Eberhard P. Deutsch, *Introduction to 1968 Revision*, *in* 5 WEST'S LOUISIANA STATUTES ANNOTATED: REVISED STATUTES xix (2010).

4. *See, e.g.*, PROPOSED REVISION OF THE LOUISIANA CORPORATION LAWS AND RELATED STATUTORY PROVISIONS (ON THE RECOMMENDATION OF THE LOUISIANA STATE BAR ASSOCIATION) vii (1966). While the Louisiana committee was at work, Delaware adopted in 1967 a thoroughly modernized version of its Delaware General Corporation Law, still in effect as since amended (DGCL).

5. *Id.*

6. Deutsch, *supra* note 3, at xix.

of the superseded law [*i.e.*, Louisiana Acts 1928, No. 250 (hereinafter, '1928 Statute')] and of other corporation laws throughout the country."[7] The LBCL definitions of stated capital, insolvency, and net assets, as well as its *ultra vires* section, were all taken from the Model Act as it then stood.[8]

The 1928 Statute on which the LBCL was partly based ("the best features of the superseded law") has an intimate relationship with the Model Act as well as with the LBCL. A distinguished committee of the Louisiana Bar Association (as it then was) appointed at its 1927 meeting, working with a similarly distinguished committee of the New Orleans Bar Association, drafted the 1928 statute.[9]

At the time these 1927 committees were appointed, the Commissioners on Uniform State Laws (Commissioners) had just tentatively approved a draft of the then-proposed Uniform Business Corporation Act (UBCA)—ultimately promulgated in 1928. The 1927 Louisiana committees used that draft as the basis for their work.[10] The Louisiana committees "also carefully studied and used the modern corporation acts of other states in connection with their work of phrasing and adapting the uniform act to local law and conditions."[11]

The draft of the UBCA, approved in August 1927 by the Commissioners, was the most advanced corporation statute in the country.[12] Moreover, it is the ancestor of the Model Act as well as the LBCL, by the following path. In 1943, the Commissioners on Uniform State Laws withdrew the 1928 UBCA as a uniform statute and renamed it the Model Business Corporation Act.[13] In 1958, the Commissioners withdrew it altogether.[14] Meanwhile, the ABA Committee drew upon the UBCA in drafting its own Model Business Corporation Act, which it published in 1950 and which the committee has since revised on a regular basis.

7. Deutsch, *supra* note 3, at xix.

8. *See, e.g.*, René H. Himel, Jr., *Major Changes Made by the New Business Corporation Law*, 16 LA. B. J. 123, 126 (1968).

9. *See, e.g.*, Charles E. Dunbar & Eugene A. Nabors, *The Louisiana Business Corporations Law*, *in* 5 WEST'S LOUISIANA STATUTES ANNOTATED: REVISED STATUTES xxxi, xxxii (1951).

10. *Id.* at xxxiii.

11. *Id.*

12. *Id.* at xxxiii n.12.

13. *See* 1 MODEL BUS. CORP. ACT ANN. xii (2013).

14. *Id.*

As indicated, the origins of the LBCL and the Model Act are inextricably intertwined. Both were originally conceived as systematic reform legislation designed to modernize corporate statute law based on a survey of the best models and ideas available at the time from around the country. The LBCL and the Model Act sections relating to the fiduciary duty of directors and officers thus share a common heritage in which there is no admixture of Louisiana civilian components.

Perhaps the greatest irony of all is that, as we shall see, Louisiana is responsible for originating the American business judgment rule (Business Judgment Rule), widely regarded today as the cornerstone of corporate fiduciary law.[15] Far from being a backwater distant from leading eastern centers of commerce, Louisiana was in its earliest days a pioneer of corporate law whose signal contribution remains today a central component of the Model Act provisions governing the fiduciary duty of directors and officers.

II. BACKGROUND

Justice Oliver Wendell Holmes once famously observed, "Upon this point a page of history is worth a volume of logic."[16] The fiduciary duty of corporate directors and officers is a subject to which the justice's observation is particularly relevant.

In the broadest terms, American law governing the fiduciary duty of directors and officers has evolved over the past two centuries from a principles-based system toward a rules-based system. This is chiefly because the origin of this branch of law is found not in statutes but rather in cases decided by the English Court of Chancery. A body of commercial law based entirely upon cases generally lacks predictability, which stimulates interest in codifying the rules.

The Model Act represents the most ambitious American effort so far to replace the fundamental case law principles of a fiduciary's duties of care and loyalty with bright-line rules designed to bring greater precision and predictability to the resolution of issues upon which a substantial part of the nation's commerce depends.

15. *See, e.g.*, 1 STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE OFFICERS 26 (6th ed. 2009).

16. N.Y. Trust Co. v. Eisner, 256 U.S. 345, 349 (1921).

A. ORIGIN OF DIRECTORS' FIDUCIARY DUTY

The fiduciary duty of corporate directors consists of two components—the duty of loyalty and the duty of care.[17]

1. DUTY OF LOYALTY

It is perhaps poetic justice that the genesis of the corporate director's fiduciary duty of loyalty lies in the notorious South Sea Company bubble, Europe's first great stock market swindle featuring insider trading, market rumors, leveraged share purchases, and crooked judges, which in 1720 bankrupted wealthy English businessmen, as well as widows and orphans, and sent even judges to jail.[18]

In the wake of the South Sea bubble, which had been aggravated by speculation on the part of trustees, Lord Chancellor King laid down in *Keech v. Sandford*,[19] as a new departure in English law, the rule that a trustee owes a strict and absolute duty of loyalty not to act in a conflict of interest with his beneficiary and, if he violates that duty, any transaction with his beneficiary is voidable at the option of the latter or, alternatively, subject to a constructive trust in favor of the beneficiary. *Keech* is generally considered the original statement in the Anglo-American world of a trustee's duty of fidelity.[20]

The rule in *Keech*, formulated for trustees, always sat uneasily on corporations because the law charges corporate directors, unlike trustees, with responsibility for managing risk-oriented businesses.[21] Moreover, corporate shareholders, unlike trust beneficiaries, hold the exclusive power to elect directors annually and to authorize or block at will a merger, liquidation, or sale of substantially all the assets of a corporation.[22] Shareholders therefore arguably do not need the same level of protection from faithless fiduciaries as do trust beneficiaries.

17. *See, e.g.*, 1 RADIN, *supra* note 15, at 1.

18. *See* Joshua Getzler, *"As if." Accountability and Counterfactual Trust*, 91 B.U. L. REV. 973, 982-84 (2011).

19. (1726) 25 Eng. Rep. 223 (Ch.) 223-24 (U.K.).

20. *See generally* Leonard I. Rotman, *Fiduciary Law's "Holy Grail": Reconciling Theory and Practice in Fiduciary Jurisprudence*, 91 B.U. L. REV. 921, 922, 942-43 (2011); Getzler, *supra* note 18, at 983-84.

21. *See*, *e.g.*, 1 RADIN, *supra* note 15, at 796-98.

22. *See, e.g.*, Louisiana Business Corporation Law, LA. REV. STAT. ANN. §§ 12:73(A), 12:112(C)(2), 12:121(B), 12:142(A) (2010).

And finally, many corporate directors are also major shareholders. Their role as shareholders blurs the principal-agent relationship between beneficiaries and trustees, a relationship whose balance wheel is, moreover, set not by the beneficiary but by an independent third party, the settlor.

Because of the inherent division of corporate authority between directors and shareholders, a strict rule that all contracts between a corporation and one of its directors are voidable at the option of the corporation, may cause more mischief than it avoids. And, indeed, courts have struggled ever since *Keech* to apply its rule in a corporate setting.[23] It has long been recognized that many contracts between directors and their corporations are highly beneficial to the latter and deserve the same legal protection accorded corporate contracts with unrelated persons.[24]

Against this background we will review, in Part III(D) below, how the BCA will apply the director's duty of loyalty to a conflicting interest transaction with his Louisiana corporation.

2. DUTY OF CARE

The second fundamental landmark in the English formulation of the fiduciary duty of directors was Lord Chancellor Hardwicke's decision in *Charitable Corporation v. Sutton*,[25] in which he held a group of directors personally liable in damages for losses suffered by their corporation as a result of their gross negligence. The court stated the rule: "By accepting a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence."[26]

A director's duty of "fidelity" as mentioned in *Sutton* had, of course, previously been established in *Keech v. Sandford*.[27] But Lord Chancellor Hardwicke's formulation in *Sutton* of what is now known as the duty of care has been far more troublesome to subsequent courts. The chancellor said that duty called for a director to exercise "reasonable diligence."[28] The practical

23. *See, e.g.*, 1 RADIN, *supra* note 15, at 796-98.
24. *Id.*
25. (1742) 2 Atk. 400, 26 Eng. Rep. 642 (Ch.).
26. *Id.* at 645.
27. Keech v. Sandford, (1726) 25 Eng. Rep. 223 (Ch.) 223-24.
28. Charitable Corp. v. Sutton, (1742) 2 Atk. 400, 26 Eng. Rep. 642 (Ch.).

question is, how much diligence is it reasonable to expect a director to exercise—the diligence of a surgeon or that of a plumber?

The question is fundamental, because under the *Sutton* formulation a corporate director who underestimates the extent of his duty of "reasonable diligence" is in peril of liability for damages to make good corporate losses attributable to his mistake concerning the extent of his duty.

B. BUSINESS JUDGMENT RULE

1. DESCRIPTION OF MODERN RULE

The Business Judgment Rule is a standard of judicial review applied to director conduct when it is drawn into question in a shareholder's derivative suit. The rule takes the form of a rebuttable presumption that, in making an affirmative business decision, directors acted on an informed basis, in good faith, without a conflict of interest, and in the honest belief that the action taken was in the best interests of the corporation.[29]

The rule operates in practice as follows. In a derivative proceeding against directors for alleged breach of fiduciary duty, a court will not review the merits of an affirmative business decision by the board challenged by the plaintiff that resulted in financial loss to the corporation unless, as a preliminary matter, the plaintiff is able to rebut the presumption created by the Business Judgment Rule in favor of the directors by pleading with particularity facts establishing that, with respect to the challenged decision, the directors: (a) acted under a conflict of interest, (b) did not act on an informed basis, (c) did not act in good faith, or (d) did not act in an honest belief that the action taken was in the best interests of the corporation.[30]

Importantly, a derivative plaintiff cannot overcome the pro-director presumption of the Business Judgment Rule by pleading only that the directors' challenged business decision resulting in corporate loss was ill-advised, unintelligent, or risky.[31] The presumption can be overcome only if the plaintiff alleges facts that, if proven, establish that the *process* by which the directors

29. *See, e.g.*, 1 RADIN, *supra* note 15, at 11.
30. *See generally id.* at 53-62.
31. *See id.* at 44.

reached their decision was flawed in one or more of the four ways described above.[32]

If, but only if, the facts pled by the plaintiff would be sufficient to rebut the pro-director presumption of the Business Judgment Rule, will a court allow discovery sufficient to establish on motion practice the possibility that, at a trial on the merits, the plaintiff can prove those facts.[33]

If the plaintiff is unable to meet this burden, the rule requires the court to dismiss the case with prejudice, which automatically means the directors cannot be held liable in damages for losses suffered by the corporation as a result of their challenged business decision.[34]

If, *per contra*, the plaintiff does meet this burden, the court would normally proceed to a trial on the merits. Unless previously resolved on motion practice, the first issue at trial is whether the presumption of the Business Judgment Rule in favor of the directors has been overcome, and on that question the plaintiff has the burden of proof.[35] If the plaintiff prevails on that issue, the burden shifts to the defendant directors to prove the entire fairness to the corporation of the challenged transaction.[36]

The Business Judgment Rule does not apply to an omission by directors to act, unless the omission was "the result of a conscious decision not to act."[37] That is, the Business Judgment Rule does not protect a failure of directors to exercise oversight.

32. 1 RADIN, *supra* note 15, at 45, 57.

33. The availability of discovery at this stage of a derivative proceeding is not outcome determinative because every corporation statute includes a provision corresponding to LBCL § 103(D) and DGCL § 220, which authorizes a shareholder, subject to modest limitations, to inspect corporate records at any time for the purpose, *inter alia*, of documenting suspected director malfeasance. The Delaware courts have actively encouraged litigants to avail themselves of inspection rights before filing a derivative suit, in order to improve the particularization of allegations of wrongdoing in the petition, thereby reducing the need for expedited discovery at the motion stage in most cases. *See*, *e.g.*, White v. Panic, 783 A.2d 543, 556-57 & n.54 (Del. 2001). BCA § 1-1602(C) preserves the right under existing LBCL § 103(D) of holders of 5% or more of a corporation's stock to inspect any and all corporate records. *See* Louisiana Business Corporation Act, No. 328, § 1-1602 cmts. (a), (d) (May 30, 2014), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

34. *See, e.g.*, 1 RADIN, *supra* note 15, at 58-59.

35. *Id.* at 62-64.

36. *Id.* at 62.

37. *Id.* at 87.

It applies only to affirmative business decisions.

2. ORIGIN AND DEVELOPMENT OF BUSINESS JUDGMENT RULE

In *Charitable Corporation v. Sutton*, cited above, the court held the defendant directors personally liable in damages for corporate losses attributable to their grossly negligent omission to monitor procedures by which the corporation made loans. In the course of his decision the chancellor offered the following dictum:

> For it is by no means just in a judge after bad consequences have arisen from such executions of their [the directors'] power to say that they foresaw at the time what must necessarily happen; and therefore were guilty of a breach of trust.[38]

This dictum is generally regarded as the first statement in Anglo-American jurisprudence of the Business Judgment Rule.[39] It is not, however, a statement of the rule as it stands today. Indeed, the *Sutton* decision amounts to little more than a statement of the general proposition that directors cannot be held liable in damages for unforeseen consequences of their business decisions, provided they have not failed in their duty of "reasonable diligence" with respect to the decision in question.[40]

Louisiana has the honor of being the first American state to adopt the Business Judgment Rule, which occurred in *Percy v. Millaudon*.[41] *Percy* was a derivative suit by shareholders of the failed Planters Bank in New Orleans against three of its directors for $451,000 in damages (over $10 million today) for permitting the cashier of the bank to discount notes fraudulently without the approval of the directors, as required by the bank's rules. There was no evidence that the defendant directors had knowledge of the fraudulent acts.

The *Percy* court reversed the judgment of the trial court

38. Charitable Corp. v. Sutton, (1742) 2 Atk. 400, 405, 26 Eng. Rep. 642, 644 (Ch.).

39. *See, e.g.*, 1 RADIN, *supra* note 15, at 26; Mark J. Loewenstein, *Shareholder Derivative Litigation and Corporate Governance*, 24 DEL. J. CORP. L. 1, 1 n.1 (1999).

40. Charitable Corporation v. Sutton, (1742) 2 Atk. 400, 406, 26 Eng. Rep. 642, 645 (Ch.).

41. 8 Mart. (n.s.) 68, 77-78 (La. 1829); *see, e.g.*, 1 RADIN, *supra* note 15, at 26 (citing *Percy* as the earliest American case on the subject). No less an authority than the United States Supreme Court referred to *Percy* as early as 1891 as "a leading case for more than sixty years." Briggs v. Spaulding, 141 U.S. 132, 147 (1891).

against the defendant directors and, after rejecting the contrary authority of the distinguished 18th-century French commentator Pothier, announced the rule of the case as follows:

> The only correct mode of ascertaining whether there was fault in an agent, is by enquiring [sic] whether he neglected *the exercise of that diligence and care, which was necessary to a successful discharge of the duty imposed on him*. . . . There are many things which, in their management, require the utmost diligence, and most scrupulous attention . . . . There are others, where the duties imposed are presumed to call for nothing more than ordinary care and attention, and where the exercise of that degree of care suffices.
>
> The directors of banks from the nature of their undertaking, fall within the class last mentioned, while in the discharge of their ordinary duties. . . . If nothing has come to their knowledge, to awaken suspicion of the fidelity of the president and cashier, ordinary attention to the affairs of the institution is sufficient. If they become acquainted with any fact calculated to put *prudent men* on their guard, a degree of care commensurate with the evil to be avoided is required, and a want of that care certainly makes them responsible.
>
> . . . [W]hen the person who is appointed [a director], has the qualifications necessary for the discharge of the *ordinary duties* of the trust imposed, we are of opinion that on the occurrence of difficulties, in the exercise of it, which offer only a choice of measures, *the adoption of a course from which loss ensues cannot make the agent responsible, if the error was one into which a prudent man might have fallen*. . . . The test of responsibility therefore should be, not the certainty of wisdom in others, but the possession of ordinary knowledge; and by shewing [sic] that the error of the agent *is of so gross a kind*, that a man of common sense, and ordinary attention, would not have fallen into it.[42]

The *Percy* decision is sometimes described as the "prudent man" rule because of the standard chosen by the court to articulate the level of "reasonable diligence" required of a director to avoid personal liability for corporate losses resulting from his

42. Percy v. Millaudon, 8 Mart. (n.s.) 68, 74-75, 77-78 (La. 1829) (emphasis added).

business decisions.[43]

Percy represented a substantial advance on *Sutton* by clarifying the minimum diligence sufficient to preclude directorial liability for corporate losses by reason of a breach of the duty of care. That is, the *Percy* court referred to a director's duty of "diligence and care" and defined the standard of liability as a failure to exercise the level of care a "man of common sense, and ordinary attention" would employ in making a "choice of measures" in a difficult situation, expressly rejecting a standard of "the utmost diligence, and most scrupulous attention . . . ."[44]

On the other hand, the *Percy* case did not offer a judicial procedure for determining, short of a full trial on the merits, whether a directorial decision resulting in corporate losses alleged in a derivative suit to have been caused by the directors' gross negligence was, or was not, culpable under the prudent man standard. That is, how does one balance the shareholders' need for a judicial procedure to redress wrongful acts by faithless or grossly negligent directors with the directors' need for a judicial procedure that enables them to fend off groundless shareholder suits seeking to impose personal liability on them for every corporate loss that results from their business decisions?

Between 1829 and the advent of the Model Act, the answer given to that question is found not in corporate statutes but rather in cases decided by the courts based on the duties of loyalty and care explicated in *Keech*, *Sutton*, and *Percy*. The first general corporation statute anywhere in the United States was not enacted until 1837, several years after the *Percy* decision.[45] Moreover, general corporation statutes enacted before 1928 rarely, if ever, addressed the fiduciary duty of directors.

Delaware law relating to the fiduciary duty of directors and derivative shareholder suits to enforce that duty, which governs over half of the Fortune 500 companies, has been developed entirely by the courts.[46] Indeed, even today there are few provisions in the Delaware General Corporation Law relating to

43. Percy v. Millaudon, 8 Mart. (n.s.) 68, 74-75 (La. 1829).

44. *Id.* at 74-78.

45. *See* David McBride, *General Corporation Laws: History and Economics*, 74 LAW & CONTEMP. PROBS. 1, 3 (2011).

46. *See, e.g.*, Randy J. Holland, *Delaware Directors' Fiduciary Duties: The Focus on Loyalty*, 11 U. PA. J. BUS. L. 675, 680-83 (2009).

the fiduciary duty of directors, and those few are confined chiefly to elective provisions relating to exculpation, renunciation of corporate opportunity, ratification of interested director transactions, and indemnification.

The requirement that a shareholder must make written demand on a corporation to take action against one of its directors before filing a derivative suit, the circumstances under which such a demand may be excused because a majority of the directors are implicated in the alleged wrongdoing specified in the demand, the appointment of special litigation committees to evaluate a shareholder demand, and the various burdens of proof in derivative litigation, were all developed by courts on a case-by-case basis as occasion arose.

C. THE LOUISIANA EXPERIENCE

Percy v. Millaudon has been cited by the Louisiana Supreme Court only twice since 1844 and has therefore not played a significant role in the subsequent development of Louisiana law relating to the duty of care.[47] The author is not aware, however, of any reported Louisiana decision prior to 1928 questioning *Percy*'s prudent man rule or its gross negligence standard for determining the personal liability in damages of directors for corporate losses resulting from their business decisions.

With respect to derivative shareholder claims generally, the Louisiana Supreme Court stated as early as 1902 that absent willful abuse of directorial discretion, bad faith, or breach of a known duty, the management of a corporation rests with its directors and not with individual shareholders.[48] The *Watkins* court overruled the corporation's exceptions to a derivative suit, however, on the ground that the petition stated a cause of action for such a level of gross mismanagement, waste, misuse, and misapplication of the property of the corporation as to constitute a fraud in law. The court was at pains, nevertheless, to make clear that:

> The reluctance of courts to interfere at the instance of a stockholder, or of a minority of the stockholders, with the affairs of a private corporation, is very pronounced; but their

47. Allen v. Cochran, 107 So. 292, 293 (La. 1926); Orlando v. Nix, 129 So. 810, 811 (La. 1930).

48. Watkins v. N. Am. Land & Timber Co., 31 So. 683, 686-87 (La. 1902).

> right and their duty so to interfere in proper case is indubitable, and the question recurring in every case is whether the particular case is a proper one for interference.[49]

Somewhat later, in *Levert v. Shirley Planting Co.*, the supreme court held that a derivative suit cannot be maintained by a shareholder on behalf of a corporation against *a third person* unless the plaintiff shareholder has first made a demand on the board to take appropriate action.[50] Dicta in the 1926 decision in *Orlando v. Nix* reiterated the necessity of prior demand on the board as an indispensable condition to a shareholder's right to maintain a derivative suit against the corporation's *directors and officers* for breach of their fiduciary duty to the corporation.[51]

The corporation statute in effect in Louisiana before 1928 was Act 267 of 1914.[52] In common with most such statutes of its era, it contained no provision that addressed the fiduciary duty of directors. Indeed, the Model Act did not include such a provision until 1974.[53] The 1927 draft of the UBCA, however, did contain a provision (§ 33), which was carried over almost *verbatim* as § 36 of the 1928 Statute, reading as follows:

> Officers and directors shall be deemed to stand in a fiduciary relation to the corporation, and shall discharge the duties of their respective positions in good faith, and with that diligence, care, judgment and skill which ordinarily prudent men would exercise under similar circumstances in like positions.[54]

The UBCA draftsmen noted they included this section because of "a conflict . . . in the decisions as to whether directors should use that degree of care that the ordinarily prudent man would use in his own business . . . or that amount of care which an ordinarily prudent director would use."[55] In either case, this standard echoes the rule in *Percy v. Millaudon* that "the adoption

49. Watkins v. N. Am. Land & Timber Co., 31 So. 683, 686 (La. 1902).

50. 66 So. 301, 302 (La. 1914).

51. Orlando v. Nix, 129 So. 810, 811 (La. 1930).

52. Act of July 9, 1914, No. 267, 1914 La. Acts 521; s*ee, e.g.*, Dunbar & Nabors, *supra* note 9, at xxxii.

53. *See* 7 GLENN MORRIS & WENDELL HOLMES, LOUISIANA CIVIL LAW TREATISE: BUSINESS ORGANIZATIONS § 22.02, at 548 n.2 (1999).

54. Act of July 18, 1928, No. 250, § 36, 1928 La. Acts 409, 436.

55. 9 GEORGE GLEASON BOGERT, UNIFORM LAWS ANNOTATED § 33, at 127-28 (Harry Noyes Greene ed., 1942).

of a course from which loss ensues cannot make the agent responsible, if the error was one into which a prudent man might have fallen."[56]

The 1968 draftsmen carried over § 36 of the 1928 Statute, quoted above, *verbatim* into the LBCL as § 91, except for a slight rewording to say officers and directors stood in a fiduciary relation not only to the corporation but also to "its shareholders."[57]

Neither § 36 of the 1928 Statute nor the 1968 version of LBCL § 91 expressly stated that the standard of care required of a director to avoid personal liability for a breach of duty was gross negligence. However, cases decided under those statutes applied gross negligence as the standard of liability.[58]

In practice, few American cases before 1985 imposed personal liability in damages on directors for a breach of their duty of care, regardless of the legal standard applied by the court.[59] Against that background, the Delaware Supreme Court's decision in *Smith v. Van Gorkom*,[60] struck the corporate world like a thunderbolt. The court held a blue-ribbon board of unconflicted directors personally liable in damages for breach of their duty of care in voting to sell their public company for a price representing a premium over the current market without first engaging in a sufficiently deliberative process.[61]

The fallout from *Van Gorkom*, discussed in greater detail in Part III(B)(1) below, led to Louisiana's enactment of R.S. 12:24(C)(4) in 1987, authorizing corporations to amend their articles of incorporation to relieve the directors of personal liability in damages for any breach of their duty of care.[62] Although R.S. 12:24(C)(4) was not self-executing, every Louisiana corporation was free after 1987 to eliminate by charter amendment all potential directorial liability in damages for any breach of the duty of care, whether determined under a gross

56. Percy v. Millaudon, 8 Mart. (n.s.) 68, 77-78 (La. 1829).

57. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:91(A) (2010).

58. *See, e.g.*, La. World Exposition v. Fed. Ins. Co., 864 F.2d 1147, 1152 (5th Cir. 1989); Pool v. Pool, 16 So. 2d 132, 135 (La. Ct. App. 1943).

59. *See, e.g.*, 7 MORRIS & HOLMES, *supra* note 53, § 22.02, at 549.

60. 488 A.2d 858 (Del. 1985).

61. *Id.* at 874-81, 893.

62. Act of July 3, 1987, No. 261, § 24, 1987 La. Acts 674, 674-75.

negligence or a simple negligence standard.

Louisiana's version of *Van Gorkom* came in the notorious decision of the first circuit in *Theriot v. Bourg*, in which the court of appeals affirmed a trial court judgment for over $5 million in damages against directors of a close corporation for corporate losses resulting from a breach of their duty of care, holding that the applicable standard of liability was simple, rather than gross, negligence.[63] The tragedy of this decision is that if the family company involved had simply amended its charter in 1987, as permitted by R.S. 12:24(C)(4), to eliminate personal directorial liability for breach of the duty of care, the court would have dismissed the derivative claim in *Theriot*.

Ignoring 168 years of Louisiana precedent beginning with *Percy v. Millaudon* (directorial liability can result only where "the error . . . is of so gross a kind, that a man of common sense, and ordinary attention, would not have fallen into it"), the *Theriot* court held:

> The appellants assert that this language [from *Pool v. Pool*] mandates the use of a gross negligence standard. We disagree. . . .
>
> [W]e have thoroughly searched the jurisprudence for Louisiana cases which require gross negligence under LSA-R.S. 12:91 and found none. The appellants have referred us to no such Louisiana cases.[64]

The *Theriot* decision shocked the Louisiana corporate bar.[65] The legislature reacted promptly, overruling *Theriot* by name in Act No. 1253 of 1999.[66] That statute amended R.S. 12:91(A) to provide that "a director . . . shall not be held personally liable to the corporation. . . for monetary damages unless the director. . . acted in a grossly negligent manner"; gross negligence was defined for good measure in R.S. 12:91(B) to mean "a reckless disregard of or a carelessness amounting to indifference to the best interests of the corporation . . . ."[67]

63. 96-0466, p. 9-11 (La. App. 1 Cir. 2/14/97); 691 So. 2d 213, 221-22.

64. *Id.* at 222.

65. *See* Thomas M. McEachin, Note, Theriot v. Bourg*: The Demise of the Business Judgment Rule in Louisiana?*, 59 LA. L. REV. 375 (1998).

66. Act of July 12, 1999, No. 1253, 1999 La. Acts 3301.

67. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:91 (2010).

Act No. 1253 of 1999 thus restored the Louisiana standard of liability in damages for a directorial breach of the duty of care—at least for corporations that had not exculpated their directors entirely from care liability by charter amendment under R.S. 12:24(C)(4)—to gross negligence, where it had begun in 1829.

In addition, as we shall see in Part III(A) below, Act No. 1253 of 1999 moved Louisiana a considerable distance away from the traditional principles-based regime of fiduciary liability typified by *Percy v. Millaudon* and toward a rules-based regime of which the BCA and the Model Act are the most highly articulated version.

III. BCA COMPARED WITH LBCL AND MODEL ACT

A. STANDARD OF CONDUCT VERSUS STANDARD OF LIABILITY UNDER LBCL AND BCA

Like the LBCL, the BCA distinguishes between the standard of *conduct* required of a director and the standard for imposing personal *liability* in damages on the director by reason of failure to meet that standard of conduct.[68] That is, the operative principle under both statutes is first to impose a broad required standard of conduct and then to provide that only certain failures, but not all failures, by a director to meet that standard will result in personal liability in damages.[69]

And, as discussed in Part III(B) below, both the LBCL and the BCA authorize the exculpation of directors from personal liability in damages for certain breaches of the standard of conduct that would, but for exculpation, expose them to personal liability. Exculpation therefore further widens the gap between the more demanding standard of conduct imposed by both statutes, on the one hand, and the less demanding standard whose violation can result in personal liability in damages, on the other hand.

An understated principle of both the LBCL and the BCA is that where a board's affirmative business judgment fails to satisfy the required standard of conduct, that failure is a

68. Louisiana Business Corporation Act, No. 328, §§ 1-830, -831 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-830, -831), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

69. *See, e.g.*, 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. ¶ 1, at 8-231 (2013).

sufficient basis for a court to enjoin the implementation of it, even though the failure is not sufficient to impose personal liability in damages on the individual directors.[70] In practice, the risk of injunctive relief against board action that fails to satisfy the standard of conduct is the principal mechanism that enforces the standard in cases where the directors know they cannot be held personally liable for their failure to meet it.

1. LBCL

Subsection (A) of R.S. 12:91 as amended in 1999 first imposes a general standard of conduct requiring directors to "discharge the duties of their . . . [office] in good faith, and with [the] diligence, care, judgment, and skill which ordinary prudent men would exercise under similar circumstances in like positions . . . ."[71]

R.S. 12:91 then narrows that general standard of conduct—but only with respect to an affirmative business judgment, as distinguished from a failure of oversight—by stating in subsection (C) that a director who makes a business judgment in good faith meets the subsection (A) standard of conduct if he: (a) "[d]oes not have conflict of interest with respect to the subject of the business judgment", (b) is informed with respect to that subject to the extent he reasonably believes appropriate, and (c) rationally believes "the business judgment is in the best interests of the corporation and its shareholders."[72]

Subsection (C) thus offers a species of safe harbor under subsection (A)'s general standard of conduct.[73] If the three conditions of the safe harbor are met with respect to a particular business judgment, the standard of conduct has been satisfied without further judicial inquiry into the issues of diligence or prudence, and no directorial liability can result.

After specifying the standard of *conduct* quoted above, subsection (A) distinguishes it from the less demanding standard of *liability* by providing that "a director . . . shall not be held

70. *See, e.g.*, 2 MODEL BUS. CORP. ACT ANN. § 8.30 official cmt. ¶ 4, at 8-195 (2013); 1 MODEL BUS. CORP. ACT ANN. § 2.02 official cmt. 3.I. ¶ 2, at 2-17 to 2-18 (2013).

71. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:91(A) (2010).

72. *Id.* § 12:91(C).

73. *Id.*

personally liable to the corporation . . . for monetary damages unless the director . . . acted in a grossly negligent manner as defined in Subsection (B) of this Section . . . ."[74]

In other words, even if a director's conduct with regard to a challenged matter—whether an affirmative business judgment or a failure of oversight—does not meet the "ordinary prudent man" standard of conduct, the last quoted portion of subsection (A) says the director nevertheless cannot be held liable in damages for failure to meet that standard, unless he acted in a grossly negligent manner.[75] By this means, § A establishes a less demanding standard for personal liability than it does for conduct.

Just as subsection (C) of § 91 narrows the standard of *conduct* (i.e., under § 91(C), the conduct standard is met as to a business judgment if: (a) no conflict, (b) informed, and (c) rational belief), subsection (B) of § 91 narrows the standard of *liability* by defining the term "gross negligence" indispensable to a finding of liability in damages as "a reckless disregard of or a carelessness amounting to indifference to the best interests of the corporation . . . ."[76] Thus, a director cannot be held personally liable in damages unless his alleged grossly negligent conduct rose to the level of reckless disregard, etc.

Finally, subsection (E) of § 91 implements the Business Judgment Rule by imposing on the derivative plaintiff the burden of proving an alleged breach of directorial duty and, in a damage suit, that the breach was the legal cause of the damage suffered by the corporation.[77]

2. BCA

The BCA (and the Model Act) drafting approach differs from that of R.S. 12:91 by separating the standards of conduct and liability into different sections of the statute, rather than including them in a single section.[78] The BCA standard of *conduct* is specified in § 1-830 (and, for public corporations only, §

74. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:91(A) (2010).

75. *Id.*

76. *Id.* § 12:91(B)-(C).

77. *Id.* § 12:91(E).

78. *See generally* Louisiana Business Corporation Act, No. 328, §§ 1-830, -831 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-830, -831), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

1-801(c) in addition), while the standard of *liability* is delineated in §§ 1-831 and 1-832.[79] The standard of conduct under § 1-830 will be dealt with in this Part III(A)(2), while the standard of liability will be covered in Parts III(B)-(D) below.

Section 1-830(A) imposes the familiar conduct standards of (a) good faith and (b) reasonable belief that directorial action taken is in the best interests of the corporation.[80]

Section 1-830(B) modifies the traditional prudent man rule by providing that "when becoming informed," in connection with either decision-making or oversight, directors "shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances," as compared with the corresponding formulation in R.S. 12:91 that directors shall discharge their duties "with that diligence, care, judgment, and skill which ordinary prudent men would exercise [rather than 'believe appropriate'] under similar circumstances in like positions."[81] "Diligence," "judgment," and "skill" have been intentionally omitted from § 1-830(B), and the obligation to become informed has been added.[82]

The third paragraph of the extensive Model Act § 8.30 Official Comment makes clear that § 1-830(B) is intended to suppress the traditional prudence standard in favor of encouraging the risk-taking typical of entrepreneurial board activity.[83] The comment also clarifies (second paragraph) that deficient performance by one or more directors is moot, provided acceptable conduct by other directors was sufficient to discharge the board's duty in question.[84]

Section 1-830(C) adds an important new component to a director's standard of care by requiring that a director disclose to other board or committee members information not known to

79. Louisiana Business Corporation Act, No. 328, §§ 1-830, -831 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-830, -831), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

80. Louisiana Business Corporation Act, No. 328, § 1-830(A) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-830(A)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

81. *Id.* § 1-830(B) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-830(B)).

82. *Id.*

83. 2 MODEL BUS. CORP. ACT ANN. § 8.30 official cmt., at 8-194 (2013).

84. *Id.* at 8-193 to 8-194.

them but known by the disclosing director to be material to the discharge of their duties (subject to a confidentiality carve out to protect the nondisclosure of confidential information).[85]

Sections 1-830(D)-(E) modify the approach of R.S. 12:92(E), which authorizes a director to rely on opinions and information presented by employees and by experts who have been selected with reasonable care, by clarifying that a director may so rely only if he "does not have knowledge that makes reliance unwarranted."[86]

For public corporations only, § 1-801(C) provides that a board's oversight responsibilities include attention to eight specified subjects, including business plans, major risks, the compensation of senior officers, legal compliance and ethical conduct, financial statements, and internal controls.[87]

B. EXCULPATION OF DIRECTORS FROM PERSONAL LIABILITY

1. ORIGIN OF EXCULPATION

R.S. 12:24(C)(4) has, like DGCL § 102(b)(7), authorized Louisiana corporations since 1987 to include in their charters a provision eliminating personal liability of directors or officers to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director or officer, except that such provisions may not limit the liability of a director or officer for:

a. breach of the duty of loyalty to the corporation or its shareholders,

b. acts or omissions not in good faith or that involved intentional misconduct or a knowing violation of law,

c. voting knowingly, or without the exercise of reasonable care and inquiry, in favor of a distribution assets to shareholders in violation of the LBCL, or

d. any transaction from which the director or officer received

85. Louisiana Business Corporation Act, No. 328, § 1-830(C) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-830(C)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

86. Louisiana Business Corporation Act, No. 328, § 1-830(E) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-830(E)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

87. *Id.* § 1-801(C) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-801(C)).

an improper personal benefit.[88]

Corporation statutes authorizing these so-called exculpation clauses in charters owe their origin to the decision in *Smith v. Van Gorkom*, discussed in Part II(C) above, in which the Delaware Supreme Court held a blue-ribbon board of unconflicted directors personally liable in damages for what the court found to be their gross negligence in voting without the exercise of due care to sell their public company, even though the sale price represented a premium over the trading market.[89]

The ensuing collapse in the directors and officers insurance market and reluctance of able individuals to agree to serve on public company boards led the Delaware legislature to enact DGCL § 102(b)(7), authorizing corporations to relieve their directors prospectively by charter amendment from personal liability in damages to the corporation for any breach of their fiduciary duty not involving disloyalty or intentional wrongdoing.[90] Louisiana followed suit in 1987 with La. R.S. 12:24(C)(4), modeled on DGCL § 102(b)(7).[91]

2. OVERVIEW OF LBCL VERSUS BCA EXCULPATION

In general terms, the effect of R.S. 12:24(C)(4) is to authorize the exculpation of directors and officers from personal liability in damages for a breach of their duty of *care*. Exculpation means not that personal liability accrues and is then expunged, but rather that no personal liability arises in the first place from a breach of the duty of care. Importantly, directors and officers are not entitled to the protection authorized by this statute unless affirmative steps have been taken by the corporation to include an exculpation clause in its corporate charter.

The BCA authorizes a similar but not identical exculpation of directors and officers. The formulation in § 1-832 of the limits on permitted exculpation differs, however, from that specified in R.S. 12:24(C)(4) in three respects, as described below.

88. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:24(C)(4) (2010).

89. Smith v. Van Gorkom, 488 A.2d 858, 874-81, 893 (Del. 1985).

90. *See* 1 RADIN, *supra* note 15, at 692; Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 102(b)(7) (2011).

91. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:24(C)(4) (2010).

3. AUTOMATIC EXCULPATION UNDER BCA VERSUS ELECTIVE EXCULPATION UNDER LBCL

BCA § 1-832, which is not found in the Model Act, automatically exculpates directors from liability to the corporation or its shareholders for monetary damages by reason of, generally speaking, a breach of their fiduciary duty of care as distinguished from their duty of loyalty, unless the charter limits or rejects such director protection.[92]

As indicated above, R.S. 12:24(C)(4), like DGCL § 102(b)(7), takes the different approach of authorizing the *elective* inclusion in a corporate charter of a clause exculpating directors from monetary liability for breach of the duty of care but does not afford *automatic* exculpatory protection, as does BCA § 1-832, if the charter does not contain such a clause.[93] Model Act § 2.02(b)(4) is conceptually similar to R.S. 12:24(C)(4) and, like existing law but unlike BCA § 1-832, withholds exculpatory protection unless an appropriate clause is included in the charter.[94]

Moreover, exculpation where available under the BCA (whether by default under § 1-832 or pursuant to an express clause in the corporate charter) is, as under the Model Act, self-executing unless affirmatively challenged by the plaintiff in a derivative suit.[95] In other words, under the BCA exculpation is not an affirmative defense as to which the defendant bears the burden of proof. Existing law does not deal with the burden of proof issue.

4. EXCULPATION FOR FAILURE OF OVERSIGHT UNDER BCA COMPARED WITH LBCL

R.S. 12:24(C)(4) does not take a position on the issue, raised

92. Louisiana Business Corporation Act, No. 328, § 1-832 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-832), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

93. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:24(C)(4) (2010).

94. *Id.*; 1 MODEL BUS. CORP. ACT ANN. § 2.02(b)(4), at 2-12 (2013).

95. *See* Louisiana Business Corporation Act, No. 328, § 1-831(A)(1) & cmt. (b) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-831(A)(1)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 1, at 8-236 (2013).

in *Stone v. Ritter*,[96] whether breach of a director's duty of oversight is a non-exculpable breach of the duty of loyalty. R.S. 12:91(B), however, leaves open the possibility that a director can be held liable for "carelessness amounting to indifference to the best interests of the corporation or the shareholders[,]" i.e., for a breach of the duty of oversight.[97]

The duty of oversight is a directorial duty to take action under circumstances that arouse suspicion of possible wrongdoing by corporate officers or employees. As Lord Chancellor Hardwicke stated in *Charitable Corporation v. Sutton* back in 1742, directors "may be guilty of acts of commission or omission, of mal-feasance or non-feasance."[98] More recently, Chancellor Allen suggested in *In re Caremark International, Inc. Derivative Litigation* that while directorial liability in damages for a breach of the duty of oversight—i.e., an omission to act, or non-feasance—would be rare, sufficiently egregious circumstances might "establish the lack of good faith that is a necessary condition to liability."[99]

Unlike the charter exculpation clause permitted by Model Act § 2.02(b)(4), BCA § 1-832 precludes exculpation for *any* breach of the duty of loyalty but specifies that the duty of loyalty does not include "any duty to act with any degree of care."[100] In other words, § 1-832(C) provides automatic exculpation from liability in damages for a breach of the duty of oversight, except to the extent exculpation is expressly limited in the charter.[101] Where exculpation is available, the effect of § 1-832(C) is to moot § 1-831(A)(2)(d), insofar as the latter implies that a breach of the duty of oversight can be an alternative basis for directorial liability in damages.[102]

Section 1-832 is therefore more favorable to directors than current law by expressly exculpating directors from potential oversight liability. On the other hand, § 1-832 is less favorable to

96. 911 A.2d 362 (Del. 2006).

97. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:91(B) (2010).

98. (1742) 2 Atk. 400, 405, 26 Eng. Rep. 642, 644 (Ch.).

99. 698 A.2d 959, 971 (Del. Ch. 1996).

100. *See* Louisiana Business Corporation Act, No. 328, § 1-832 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-832), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

101. *See id.* § 1-832 cmt. (d).

102. *See id.* § 1-831 cmt. (b).

directors than Model Act § 2.02(b)(4), and identical with R.S. 12:24(C)(4), in prohibiting exculpation for any breach of the duty of loyalty.[103]

5. EXCULPATION FOR "INTENTIONAL" AND "KNOWING" CONDUCT UNDER BCA COMPARED WITH LBCL

R.S. 12:24(C)(4) contains a carve out that bars exculpation for acts or omissions involving intentional misconduct or a knowing violation of law.[104] BCA § 1-832, on the other hand, does not expressly bar exculpation for these two categories of conduct but does bar exculpation for: (a) intentional infliction of harm on the corporation or its shareholders, or (b) an intentional violation of criminal law.[105]

Both R.S. 12:24(C)(4)(a) and BCA § 1-832(A)(1) bar exculpation for any breach of the duty of loyalty *eo nomine*, so any act or omission constituting a breach of that duty is non-exculpable under both existing law and the BCA, even if the act or omission were otherwise facially exculpable under the "intentional" and "knowing" carve outs that vary between the two statutes.[106]

In one respect, however, new § 1-832 offers less protection than does the corresponding Model Act § 2.02(b)(4). The Model Act section authorizes exculpation *even for a breach of the duty of loyalty*, except to the extent the defendant director received a financial benefit to which he was not entitled.[107] BCA § 1-832 rejects the Model Act standard and retains the existing prohibition against exculpation of *any* breach of the duty of

103. In the duty of loyalty context, Model Act § 2.02(b)(4) bars exculpation by charter clause from liability for a loyalty breach only where a director received a financial benefit to which he was not entitled, as explained in the next topic.

104. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:24(C)(4) (2010).

105. Louisiana Business Corporation Act, No. 328, § 1-832(A) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-832(A)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

106. Louisiana Business Corporation Act, No. 328, § 1-832 cmt. (c) (May 30, 2014), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; *id.* § 1-831(A)(1) & cmt. (b) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-831(A)(1)).

107. Louisiana Business Corporation Act, No. 328, § 1-832 cmt. (c) (May 30, 2014), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; *id.* § 1-831(A)(1) & cmt. (b) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-831(A)(1)).

loyalty, even if as a result of the breach the defendant director did not receive a financial benefit to which he was not entitled.[108]

A director is nevertheless marginally better off under the BCA, as respects exculpation for "intentional" and "knowing" acts, in that a charter clause granting (or, in a post-2014 charter, not withholding) maximum exculpation would under BCA § 1-832 protect him from liability *even* for intentional misconduct or a knowing violation of law—providing that the misconduct or violation was not: (a) intended to inflict harm on the corporation or its shareholders, (b) an intentional violation of criminal law, or (c) a breach of the duty of loyalty. For example, a knowing violation of a non-criminal law could not be exculpated under R.S. 12:24(C)(4)(b) but would be exculpable under BCA § 1-832(A), so long as the violation was not intended to inflict harm on the corporation or its shareholders.[109]

Theoretically, exculpation under the BCA would be available even if the director did not reasonably believe his challenged conduct was in the best interests of the corporation, which is requisite to permissible indemnification under BCA § 1-851 but not to exculpation under § 1-832. If, however, a director's nonexculpable duty of loyalty is deemed to include the duty of good faith (i.e., the duty not to authorize a transaction known to constitute a violation of applicable positive law or for some purpose other than a genuine attempt to advance corporate welfare), the scope of conduct involving a knowing violation of a noncriminal law that is nevertheless exculpable under BCA § 1-832, but not under existing law, would likely be narrow.[110]

6. IS A CHARTER AMENDMENT NECESSARY TO EXTEND BROADER BCA EXCULPATION PROTECTION TO DIRECTORS OF EXISTING CORPORATIONS?

The BCA applies to all existing Louisiana corporations effective January 1, 2015.[111] The marginally greater exculpation

108. *Id.* § 1-832 & cmt. (c) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-832).

109. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:24(C)(4)(b) (2010); Louisiana Business Corporation Act, No. 328, § 1-832(A) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-832(A)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

110. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 1.A., at 8-240 (2013).

111. Louisiana Business Corporation Act, No. 328, §§ 5, 7, 1-1701 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-1701), *available at*

protection afforded directors under the BCA as compared with the LBCL is probably not sufficiently material to justify a charter amendment by existing corporations solely for the purpose of expanding the existing scope of exculpation to match that permitted by the BCA. If the corporation were to make other unrelated charter amendments, however, the conservative approach for those seeking maximum protection for directors would be to expressly expand an existing charter exculpation clause to the maximum limits permitted by the BCA.

The effect of such a charter amendment would be to lock in the elimination of potential director liability in damages for any post-amendment (a) breach of the duty of oversight, (b) knowing violation of a non-criminal law, (c) knowing but unintentional violation of a criminal law, or (d) intentional misconduct not intended to inflict harm on the corporation or its shareholders, so long as the act or omission did not involve a breach of the duty of loyalty.

The other side of the coin is that corporations preferring that their directors be personally liable in damages for a breach of the duty of oversight, or of the duty of care generally, are free under BCA § 1-832 to specify in their charters that the exculpatory protection afforded by that section shall not apply.[112]

Exculpation, where available, protects directors only from personal liability for damages by reason of certain breaches of fiduciary duty. It does not insulate a proposed transaction authorized by a board from a derivative shareholder proceeding seeking injunctive relief on the ground of a directorial breach of the duty of care.[113]

7. APPLICABILITY OF BCA TO EXISTING ACTS OR OMISSIONS BY DIRECTORS AND OFFICERS

Section 5 of Act No. 328 repeals the LBCL, effective January 1, 2015. The repeal does not, however, affect its operation before its repeal or any action taken or liability incurred under, or

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http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

112. Louisiana Business Corporation Act, No. 328, § 1-832(A) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-832(A)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

113. *See, e.g.*, 1 MODEL BUS. CORP. ACT ANN. § 2.02 official cmt. 3.I. ¶ 2, at 2-17 to 2-18 (2013); 2 MODEL BUS. CORP. ACT ANN. § 8.30 official cmt. ¶ 4, at 8-195 (2013).

violation of it before its repeal.[114]

For that reason, acts or omissions by directors and officers of a Louisiana corporation that occurred prior to January 1, 2015, will continue to be governed by the LBCL. Accordingly, the broader scope of exculpation for directors under the BCA will apply only with respect to acts or omissions that occurred after 2014.

C. PREREQUISITES UNDER BCA TO SHAREHOLDER DERIVATIVE PROCEEDING AGAINST ONE OR MORE DIRECTORS

As indicated in Part III(B) above, the BCA affords slightly broader exculpation protection to directors from personal liability in damages than does R.S. 12:24(C)(4).

The changes made by the BCA with regard to shareholder derivative suits, however, afford substantially greater protection to directors than does the LBCL and provide much more precise procedural rules governing such suits.

1. NATURE OF DERIVATIVE PROCEEDING

The derivative proceeding, defined in § 1-740(1) as "a civil suit in the right of a domestic corporation," arises in the following way.[115]

The general rule is that only a corporation, and not its shareholders individually, has the right to enforce a claim by the corporation against another person.[116] Where a corporation has a possible claim against one of its own directors or officers for breach of fiduciary duty to the corporation, however, a potential conflict arises between the interests of the corporation in pursuing the claim and the interests of prospective defendants who may control the corporation in suppressing the claim. The derivative shareholder suit (i.e., a shareholder's suit on behalf of the corporation derived from it by virtue of the shareholder's ownership interest) is a longstanding exception to the general

114. *See* Louisiana Business Corporation Act, No. 328, § 1-1703 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-1703), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

115. *See* Louisiana Business Corporation Act, No. 328, § 1-740(1) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-740(1)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

116. *See, e.g.*, 8 MORRIS & HOLMES, *supra* note 53, § 34.01.

rule that a corporation's board of directors has exclusive authority to determine whether to assert a claim by the corporation against another.

2. SHAREHOLDER DEMAND ON CORPORATION PRIOR TO FILING DERIVATIVE SUIT NO LONGER EXCUSED UNDER BCA

Under existing law, a shareholder may file a derivative suit against corporate directors without making prior demand on the board, provided the majority of the board are named as defendants.[117] This rule effectively deprives the board of control over much derivative litigation and subsists despite the Louisiana Supreme Court's having held as early as 1930 that a shareholder is not procedurally entitled to maintain a derivative proceeding against directors "until an ineffectual demand has been made on the corporation to institute the suit."[118]

BCA § 1-742, *per contra*, requires that written shareholder demand "upon the corporation to take suitable action" be made on the board in every case at least ninety days before any shareholder derivative proceeding is filed (unless irreparable injury will result from the delay), regardless of whether the proceeding names as defendants only a single director, the entire board, or a third person.[119]

There is no longer a category of derivative proceedings in which prior demand on the board is excused. The BCA eliminates the risk that such a proceeding can be filed by a shareholder acting on his own without the board's first having an opportunity to conduct an inquiry into the allegations prior to its filing. The demand must "be sufficiently specific to apprise the corporation of the action sought to be taken and the grounds for that action so that the demand can be evaluated."[120] This universal demand rule gives corporate boards a greater procedural advantage than existing law.

Once demand has been made, § 1-744 authorizes the

117. *See, e.g.*, Louisiana Business Corporation Act, No. 328, § 1-742 rev. cmt. (May 30, 2014), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

118. Orlando v. Nix, 129 So. 810, 811 (La. 1930).

119. Louisiana Business Corporation Act, No. 328, § 1-742 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-742), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

120. *See* 2 MODEL BUS. CORP. ACT ANN. § 7.42 official cmt. 1, at 7-345 (2013).

corporation to either appoint a committee of qualified (i.e., disinterested) directors or petition the court to appoint a panel, in either case to conduct an inquiry into the allegations made in the demand.[121] There is, however, no obligation on the part of the corporation to respond to the demand.[122]

3. SHAREHOLDER DEMAND ACCEPTED, REJECTED, OR NOT INVESTIGATED BY CORPORATION WITHIN NINETY-DAY PERIOD

a. Board Accepts Demand

If a board committee (the usual delegated body) determines within the ninety-day period that the demand has merit, and as a result the corporation elects to institute a direct suit based on the demand against one or more of its directors or officers (or against a third person, as the case may be), the shareholder's right to file a derivative proceeding based on his demand terminates (unless it can be shown the corporation will not adequately pursue the matter).[123]

b. Board Rejects Demand

If, *per contra*, a board committee determines within the ninety-day period that the maintenance of a proceeding based on the demand is not in the best interests of the corporation and the corporation so notifies the demanding shareholder, which it is authorized by § 1-742(2) to do, the shareholder is thereupon entitled under § 1-741 to file a derivative proceeding based on the

121. Louisiana Business Corporation Act, No. 328, § 1-744 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-744), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

122. *See* 2 MODEL BUS. CORP. ACT ANN. § 7.42 official cmt. 4, at 7-347 (2013). However, where a shareholder demand is deemed by the board to be colorable, particularly if it asserts a majority of the board is conflicted with respect to the subject of the demand, the common practice is for the board to appoint a special litigation committee of disinterested directors authorized to investigate and evaluate, with the assistance of special legal counsel compensated by the corporation, the merits of the demand and to decide whether taking the action demanded is in the best interests of the corporation. Counsel for such a committee typically reviews relevant documents, performs any necessary legal research and, where appropriate, interviews prospective witnesses before drafting a comprehensive written report for the committee evaluating the merits of the demand and offering recommendations as to its disposition. *See, e.g.*, Atkins v. Hibernia Corp., 182 F.3d 320, 324 (5th Cir. 1999).

123. *See* 2 MODEL BUS. CORP. ACT ANN. § 7.42 official cmt. 4, at 7-345 (2013).

rejected demand immediately.[124]

In such cases, § 1-744(C) requires that the derivative petition allege with particularity facts establishing that either (a) a majority of the board did not consist of qualified (i.e., disinterested) directors (as defined in § 1-143), or (b) the corporation either did not conduct a reasonable inquiry or did not conduct it by means of qualified directors, or did not act in good faith in rejecting the demand.[125]

(i). Burden of Proof of Proper Rejection

If the plaintiff believes a majority of the board did not consist of qualified directors, his petition would normally so allege. Regardless of whether the corporation contests or concedes that allegation, however, it would typically respond with a motion for summary judgment,[126] alleging that it made the determination in good faith based upon conclusions reached by a committee of qualified directors after conducting a reasonable inquiry. In addition, if the corporation contests the plaintiff's allegation that a majority of its board did not consist of qualified directors, it would also so assert in its motion.

If the corporation concedes, or the plaintiff alleges and proves, a majority of the board did not consist of qualified directors, the effect under § 1-744(D) is to shift to the corporation the burden of proving the sufficiency of its determination to reject the demand (i.e., reasonable inquiry by qualified directors and

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124. Louisiana Business Corporation Act, No. 328, §§ 1-741, -742(2) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-741, -742(2)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

125. In addition, BCA §§ 1-741 and 742.1 require that the petition: (i) allege the plaintiff was a shareholder at the time the act or omission complained of occurred, (ii) allege the plaintiff will fairly and adequately represent the interests of the corporation in enforcing its right in the derivative proceeding, (iii) join as defendants the corporation and the obligor on the corporate obligation sought to be enforced, and (iv) include a prayer for judgment in favor of the corporation, rather than the plaintiff. Louisiana Business Corporation Act, No. 328, §§ 1-741, -742.1 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-741, -742.1), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786. Subsection 1-741(A) and § 742.1 of the BCA replace existing Articles 591 through 616 of the Louisiana Code of Civil Procedure, insofar as they relate to derivative proceedings. *See id.* § 4. These amendments have the effect of eliminating the distinction drawn by the Louisiana Code of Civil Procedure between those derivative suits treated as class actions and those that require the joinder of all shareholders as parties to the suit. *See id.* § 1-742.1 cmt. (b).

126. *See* LA. CODE CIV. PROC. ANN. art. 966(A)(1) (2005).

good faith rejection).[127] If, *per contra*, the plaintiff fails to allege that a majority of the board did not consist of qualified directors, or the plaintiff so alleges but fails to prove it, the effect under § 1-744(D) is to shift to the plaintiff the burden of proving the insufficiency of the corporation's determination to reject the shareholder's demand.[128]

(ii). Court Determines Corporation Properly Rejected Demand

If the court accepts the sufficiency of the corporation's determination to reject the shareholder's demand under the foregoing rules of proof, § 1-744(A) requires the court to dismiss the proceeding on the corporation's motion, without reviewing the reasonableness of its determination to reject the demand.[129] Section 1-746(2) authorizes a dismissing court to order the plaintiff to pay the defendants' litigation expenses if it finds the proceeding was commenced or maintained without reasonable cause or for an improper purpose.[130] The BCA does not, however, as did Code of Civil Procedure articles 595(B) and 611, authorize the court to require a plaintiff in a derivative proceeding to furnish advance security for the defendants' court costs.[131]

(iii). Court Determines Corporation Did Not Properly Reject Demand

If, *per contra*, the sufficiency of the corporation's determination to reject the demand is not established under the foregoing rules of proof, § 1-741(B) entitles the shareholder to maintain his derivative proceeding.[132]

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127. Louisiana Business Corporation Act, No. 328, § 1-744(D) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-744(D)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

128. Louisiana Business Corporation Act, No. 328, § 1-744(D) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-744(D)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

129. *See* 2 MODEL BUS. CORP. ACT ANN. § 7.44 official cmt. 2 ¶ 9, at 7-361 (2013).

130. Louisiana Business Corporation Act, No. 328, § 1-746(2) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-746(2)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

131. *See id.* § 1-742 (to be codified as amended at LA. REV. STAT. ANN. § 12:1-742); LA. CODE CIV. PROC. ANN. arts. 595(B), 611 (2011).

132. *See* Louisiana Business Corporation Act, No. 328, § 1-741 rev. cmt. (May 30, 2014), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

c. Corporation Ignores Demand

If the corporation elects to ignore a shareholder's demand, § 1-742.1 authorizes a plaintiff to file a derivative petition after the expiration of the statutory ninety-day delay.[133] In such a case, § 1-744(C) (by negative implication) excuses the plaintiff from the requirement of alleging either that a majority of the corporation's board of directors was not qualified or that the corporation did not make a sufficient determination to reject his demand.[134]

4. DERIVATIVE PROCEEDING FILED BY SHAREHOLDER BEFORE CORPORATION'S RESPONSE TO SHAREHOLDER DEMAND

In two situations the pleading requirements described above permit a derivative proceeding to be filed before the corporation has responded to a shareholder's written demand.

a. Shareholder Alleges Irreparable Injury

The first situation is where, prior to the expiration of the statutory ninety-day delay period, the shareholder files a derivative proceeding alleging under §§ 1-742 and 1-742.1 that irreparable injury to the corporation would result from awaiting its response to his demand.[135] The standard to be applied by the court to the corporation's motion to dismiss such a proceeding is the same as that governing the entry of a preliminary injunction.[136] That is, unless the plaintiff sustains the burden of proving entitlement to a preliminary injunction with reference to his allegation of irreparable injury (assuming he had sought that remedy), the court should dismiss or stay his suit pending the earlier of the corporation's response to the demand or the expiration of the original ninety-day delay.

For example, a shareholder seeking to enjoin a proposed merger on the ground of an alleged breach by the board of its duty of care in authorizing the transaction would file a derivative

133. Louisiana Business Corporation Act, No. 328, §§ 1-742, -742.1 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-742, -742.1), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

134. *Id.* § 1-744(C) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-744(C)).

135. Louisiana Business Corporation Act, No. 328, §§ 1-742, -742.1 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-742, -742.1), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

136. *See* 2 MODEL BUS. CORP. ACT ANN. § 7.42 official cmt. 3, at 7-346 (2013).

proceeding immediately after making demand, alleging under §1-742 that "irreparable injury to the corporation would result by waiting for the expiration of the ninety-day period" following the making of the demand.[137]

b. Corporation Does Not Respond to Demand within Ninety Days

The second situation where a derivative proceeding may be filed in advance of the corporation's response to a demand that it has not chosen to ignore would occur where the corporation has commenced an inquiry into the demand within the statutory ninety-day delay period but has not notified the shareholder of its response prior to the expiration of that period.[138] If the demanding shareholder files a derivative proceeding based on the demand after expiration of the ninety-day delay, § 1-743 authorizes the court to stay the proceeding for such period as the court deems appropriate to permit the corporation to complete its inquiry and respond to the demand.[139]

5. CORPORATION SEEKS STAY

a. Court Grants Stay

Where, in either of the situations described above, the court stays the proceeding and the corporation thereafter rejects the demand within the stay period, the shareholder must either acquiesce in the rejection or amend his petition to include one of the allegations required by § 1-744(C). For instance, either (a) "a majority of the board did not consist of qualified directors," or (b)

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137. Louisiana Business Corporation Act, No. 328, § 1-742 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-742), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786. The exculpation of directors from money damages liability for a breach of the duty of care found in BCA § 1-832 does not eliminate such a breach as a viable basis for injunctive action. *See* 1 MODEL BUS. CORP. ACT ANN. § 2.02 official cmt. 3.I. ¶ 2, at 2-17 to 2-18 (2013) (noting that exculpation "is applicable only to money damages and not to equitable relief").

138. Louisiana Business Corporation Act, No. 328, §§ 1-741(B), -742(2) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-741(B), -742(2)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

139. Louisiana Business Corporation Act, No. 328, § 1-743 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-743), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786. It would not be uncommon for a court to extend the period. *See* 2 MODEL BUS. CORP. ACT ANN. § 7.42 official cmt. 3, at 7-346 to 7-347 (2013).

the corporation either did not conduct a reasonable inquiry, did not do so through qualified directors, or did not act in good faith in determining to reject the demand.[140] Subsequent steps in the litigation would track those described above in Part III(C)(3)(b) in a case where the corporation has notified a shareholder of its rejection of his demand within ninety days after its receipt.

b. Court Does Not Grant Stay

In the alternative, if the court finds further delay of a derivative petition will cause irreparable corporate injury, or declines to stay a proceeding filed after the expiration of ninety days but prior to the plaintiff's receipt of a demand response, the plaintiff is entitled under § 1-741(B) to continue his derivative proceeding without further delay.[141]

D. ADJUDICATING DIRECTOR LIABILITY IN A VIABLE SHAREHOLDER DERIVATIVE PROCEEDING

1. BURDEN OF PROOF UNDER BCA

a. Preliminary Pleading Requirements

The pleading requirements prescribed by BCA Subpart 7(D), as outlined in Part III(C) above, do not require a derivative petition to particularize wrongdoing by defendant directors that has allegedly caused the corporation monetary harm for which the defendants should be held personally liable in damages.[142]

That is, §§ 1-740 through 1-744 affirmatively require only that a shareholder demand be made prior to the filing of a derivative proceeding, and that any post-demand derivative

140. Louisiana Business Corporation Act, No. 328, § 1-744(C) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-744(C)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

141. Louisiana Business Corporation Act, No. 328, § 1-741(B) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-741(B)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786. Although the rules outlined above confer substantial power on the board to control derivative proceedings, those rules do not apply to a suit filed as a class action, but not as a derivative proceeding. Most recent shareholder suits seeking to enjoin a merger by a target public company on the ground of alleged breach of fiduciary duty by the entire board, for example, have been brought as non-derivative class actions, which are not subject to the rules outlined above governing derivative proceedings.

142. Louisiana Business Corporation Act, No. 328, § 1-742.1 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-742.1), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

petition be verified and contain specified allegations concerning the plaintiff's stock ownership, fair and adequate representation, joinder of parties, timeliness, and improper corporate rejection or disregard of the demand, including a prayer for judgment in favor of the corporation.[143]

Once those requirements have been met, the claims asserted in the demand might be disposed of summarily in any of three ways: (a) the corporation rejects the demand and no derivative proceeding based on it is thereafter filed, (b) the court dismisses the derivative petition under § 1-744 on the ground that the corporation properly rejected the demand, or (c) the derivative petition becomes moot because the corporation elected either to file its own direct petition based on the demand or to assume control of the plaintiff's proceeding.

b. When is Plaintiff's Derivative Proceeding Viable?

If the claims in the shareholder's demand are not disposed of summarily in one of these three ways, the plaintiff would be entitled to continue the derivative proceeding if either: (a) the court rules that irreparable injury would result from a delay; (b) the corporation timely rejects the demand and the court rules the rejection was inappropriate on the ground that the corporation either did not conduct a reasonable inquiry or did not make its determination in good faith or its determination was not made exclusively by qualified directors; or (c) the derivative proceeding is filed after expiration of the ninety-day delay following the plaintiff's demand and either the corporation does not move for, or the court declines to grant, a motion to stay.

c. Summary of Substantive Pleading and Proof Requirements for Plaintiff

The question presented in the instances mentioned in the preceding paragraph is, once it has been established that the derivative proceeding remains viable, what must the plaintiff allege and prove in order to recover damages for the corporation

143. Louisiana Business Corporation Act, No. 328, §§ 1-742(1), -742.1 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-742(1), -742.1), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786. A plaintiff who filed a derivative suit immediately after demand alleging that irreparable corporate injury would result from delay and seeking a preliminary injunction of a proposed corporate transaction would, of course, be required to plead with particularity the facts on which the claim for injunctive relief was based.

from one or more directors by reason of their breach of fiduciary duty? The answer provided by § 1-831 is that the plaintiff must amend his petition to allege and must then prove:

(i) the defendant director is neither:

(A) exculpated (if claimed by the defendant) by § 1-832 from liability for his challenged conduct, nor

(B) immunized (if claimed by the defendant) from judicial review of an alleged conflicting interest transaction by prior corporate compliance with the statutory "safe harbor" exemption discussed in Part III(D)(3) below, and

(ii) (if, but only if, the defendant concedes, or the plaintiff proves, the defendant's conduct was not exonerated under paragraph (i) above) the defendant either:

(A) did not act in good faith, or

(B) was not appropriately informed before making a challenged business decision or did not reasonably believe that decision was in the best interests of the corporation, or

(C) due to his relationship with a person having a material interest in the challenged decision, the defendant lacked the objectivity necessary to form a reasonable belief that that decision was in the best interests of the corporation, or[144]

(D) failed in his duty of oversight (unless the defendant is already exculpated under paragraph (i)(A) above from potential oversight liability), or

(E) received a financial benefit to which he was not entitled, and

(iii) the corporation was harmed, and

(iv) the harm suffered by the corporation was proximately caused by the director's challenged conduct.[145]

Per contra, a derivative plaintiff seeking a waiver of the

144. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 1.C., at 8-242 to 8-243 (2013). Paragraph (ii)(C) does not cover a "director's conflicting interest transaction," which is separately dealt with in paragraph (i)(B) and §§ 1-860 through 1-870 of the BCA. *See infra* Part III(D)(3).

145. *See* Louisiana Business Corporation Act, No. 328, § 1-831 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-831), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

statutory ninety-day, post-demand delay on the ground that otherwise the corporation would suffer irreparable injury and praying for a preliminary injunction of a proposed transaction, rather than damages, would be obligated to plead and prove only one or more of paragraphs (ii)(A), (ii)(B), (ii)(C), or (ii)(E) above as to a majority of the board of directors.[146]

d. BCA Formulation of Standard of Care

The formulation in § 1-831 of the requirements for establishing potential director liability eliminates, with respect to duty of care claims, the reliance under R.S. 12:91 on a gross negligence standard, which is defined to include "a reckless disregard of[,] or a carelessness amounting to indifference to[,] the best interests of the corporation . . . ."[147] As previously noted, new § 1-830(B) also eliminates the traditional "ordinary prudent men" standard for defining a director's duty of care and replaces it with "the care that a person in a like position would reasonably believe appropriate under similar circumstances."[148]

The objectively based care standard under § 1-830(B) offers directors greater latitude than existing law in making risk-taking decisions and is intended to discourage a result-oriented analysis of either director personal liability or the availability of injunctive relief with respect to a proposed transaction. It is not, however, intended to codify the Business Judgment Rule.[149]

The BCA focuses the derivative plaintiff's pleading requirements on the *process* by which challenged board decisions were made, rather than on the *prudence* of those decisions.

146. Such a suit must be filed, if at all, prior to any shareholder meeting vote to approve the proposed transaction. *See* Louisiana Business Corporation Act, No. 328, § 1-1340(A) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-1340(A)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=91 2786.

147. *See* Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:91(B) (2010).

148. Louisiana Business Corporation Act, No. 328, § 1-830(B) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-830(B)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

149. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.30 official cmt., at 8-193 to 8-196 (2013); *id.* § 8.31 official cmt. ¶ 1, at 8-230; *id.* § 8.31 official cmt. 1, at 8-239.

e. Plaintiff's Burden of Proving Harm and Causation Where Damages Are Sought

Assume the plaintiff in a derivative proceeding seeking damages meets his burden of proving the defendant's challenged conduct is not insulated from judicial review by either exculpation, the Business Judgment Rule, or the safe harbor exemption for conflicting interest transactions discussed below in Part III(D)(3). Additionally, paragraph 1-831B(1) requires the plaintiff to prove that (a) the corporation was harmed by the defendant's challenged conduct, and (b) the harm was proximately caused by that conduct.[150] A similar burden is imposed on a derivative plaintiff under R.S. 12:91(E) and Delaware case law, for example, although not by a statute corresponding to paragraph 1-831B(1).[151]

The BCA, LBCL, and Delaware approach described above is to be contrasted with the general American rule that where a challenged director transaction is not protected from judicial review by the Business Judgment Rule, the burden shifts immediately to the defendant to prove its fairness to the corporation.[152]

f. Burden of Proving Affirmative Defense of Safe Harbor Compliance

In the context of a transaction challenged on the basis of a director's conflict of interest, rather than on the basis of a breach of the duty of care, the BCA approach is further refined by §§ 1-860 through 1-862, which offer the corporation an elective safe harbor procedure, described in Part III(D)(4) below, for immunizing such a transaction in advance from judicial review in a derivative proceeding.[153] However, the safe harbor is available only in cases where the challenged transaction has been approved by no fewer than two qualified (i.e., disinterested) directors, which means it is not applicable to a derivative suit against the

150. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. ¶ 5, at 8-233 (2013); *id.* § 8.31 official cmt. 2, at 8-247.

151. *See, e.g.*, 1 RADIN, *supra* note 15, at 795.

152. *See, e.g.*, *id.* at 62; 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 3 ¶ 2, at 8-249 (2013).

153. Louisiana Business Corporation Act, No. 328, §§ 1-860 to -862 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-860 to -862), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

entire board.

If the derivative defendant asserts by motion for summary judgment that the challenged transaction is immunized from judicial review by corporate compliance with the § 1-862 safe harbor procedure, paragraph 1-831(A)(1) places the burden on the plaintiff to rebut that defense.[154] This rule applies regardless of whether the plaintiff seeks injunctive relief or damages. If the safe harbor defense succeeds, the case is over and the court should dismiss it under § 1-861(B).[155]

Paragraph 1-861B(3) shifts the burden to the defendant to prove the fairness of the transaction to the corporation only if the plaintiff seeks equitable relief or, in a damage suit, satisfies his burden of proving both harm to the corporation and proximate causation of that harm by the defendant's challenged conduct.[156] The term "fair to the corporation" is defined by BCA § 1-860(6) and explicated by Model Act § 8.60 Official Comment 6.[157] If the defendant does not satisfy the burden of proving the transaction was fair to the corporation, the court would fashion an appropriate remedy, which could take the form of rescission or damages.

g. Burden of Proving Affirmative Defense That Challenged Transaction Was Not a "Director's Conflicting Interest Transaction"

If, in a derivative proceeding challenging a director's conflicting interest transaction with the corporation, the defendant asserts not that the transaction is protected by the safe harbor defense, but rather that it does not constitute a "director's conflicting interest transaction," the plaintiff whether seeking

154. Louisiana Business Corporation Act, No. 328, §§ 1-831(A)(1), -862 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-831(A)(1), -862), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; *see* 2 MODEL BUS. CORP. ACT ANN. § 8.61 official cmt. 2, at 8-527 (2013) ("If board action under § 8.62(b)(1) is interposed as a defense . . . the plaintiff then bears the burden of overcoming that defense under § 8.31.").

155. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 1 ¶ 1, at 8-236 (2013).

156. *See id.* § 8.61 official cmt. 2 ¶ 5, at 8-528 ("Under section 8.61(b)(3) the interested director has the burden of establishing that the transaction was fair.").

157. *Id.* § 8.60 official cmt. 6, at 8-514 to 8-516; Louisiana Business Corporation Act, No. 328, § 1-860(6) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-860(6)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

injunctive relief or damages has the burden of proving the contrary. This is so because § 1-861(A) provides that "a transaction . . . may not be the subject of any form of relief, or give rise to an award of damages or other sanctions against a director . . . in a proceeding by a shareholder. . . on the ground that the director has an interest . . . if it is not a director's conflicting interest transaction,"[158] a term defined with precision by § 1-860(1).[159]

In other words, a derivative plaintiff has not stated a cause of action against a director based on a challenged conflict of interest transaction unless the plaintiff alleges the transaction was a "director's conflicting interest transaction," as defined by § 860(1), because that allegation is an indispensable element of the claim.[160] Hence, where a derivative petition challenging a transaction fails to allege it was a "director's conflicting interest transaction," the plaintiff has the burden of proof on the defendant's exception of no cause of action.[161]

If the plaintiff does not sustain that burden, the case is over and the court should dismiss the proceeding under § 1-861(A) (unless the plaintiff has alleged viable alternative grounds unrelated to the conflict of interest for challenging the transaction).[162] *Per contra*, if the plaintiff establishes that the challenged transaction was a "director's conflicting interest transaction," the burden shifts to the defendant under paragraph 1-861(B)(3) to prove it was fair to the corporation, with the consequences described in Part III(D)(1)(f) above (unless the defendant has offered the safe harbor defense described in Part III(D)(3)(b) below).[163]

158. Louisiana Business Corporation Act, No. 328, § 1-861(A) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-861(A)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

159. Louisiana Business Corporation Act, No. 328, § 1-860(1) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-860(1)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

160. *Id.*

161. *Id.*

162. *See id.* § 1-861(A) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-861(A)); 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 1 ¶ 1, at 8-236 (2013).

163. Louisiana Business Corporation Act, No. 328, § 1-861(B)(3) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-861(B)(3)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

2. OVERVIEW OF BCA DUTY OF LOYALTY RULES COMPARED WITH LBCL

The BCA is significantly more favorable to directors than the LBCL in duty of loyalty cases challenging conflicting interest transactions. This is not so much because the BCA favors such transactions but because it establishes bright-line rules for defining them and, where the corporation has followed prescribed advance approval procedures, immunizing them from judicial review.

The LBCL does not define directors' conflicting interest transactions and makes no provision, as does the BCA, for detailed presumptions, burdens of proof, and the like for cases where a derivative plaintiff alleges that a director's conflicting interest transaction with the corporation has harmed it. Moreover, R.S. 12:84, which purports to establish procedures for protecting directors' conflict of interest transactions by means of disinterested approval, is unclear and has confused the courts.[164] In particular, R.S. 12:84 does not answer the fundamental question whether prior disinterested approval (or subsequent ratification) of a director's conflicting interest transaction does or does not immunize it from judicial review.

These defects of existing law have a long history. The seminal case of *Keech v. Sandford*[165] laid down a strict rule that even a fair contract made by a trustee with his beneficiary was void at the election of the latter or, alternatively, impressed with a constructive trust in favor of the beneficiary. The common law applied this rule to corporate directors.[166]

By the early 20th century, Delaware courts had begun to question the wisdom of a rule that per se invalidated contracts between corporations and their directors without regard to their fairness.[167] The comprehensive 1967 revision of the DGCL adopted an intermediate rule, substantially identical to R.S. 12:84, that offered a method of validating interested director transactions.[168] The statute has not worked well in practice.[169]

164. *See, e.g.*, 7 MORRIS & HOLMES, *supra* note 53, § 22.03.
165. (1726) 25 Eng. Rep. 223 (Ch.) 223-24 (U.K.).
166. *See, e.g.*, 1 RADIN, *supra* note 15, at 796-97.
167. *See, e.g.*, Eberhardt v. Christiana Window Glass Co., 81 A. 774, 778 (Del. Ch. 1911).
168. Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 144 (2011).

BCA §§ 8.60-8.70, discussed in Part III(D)(3) below, were designed to offer bright-line rules for defining conflicting interest transactions between directors and their corporations and, where appropriate, immunizing them from judicial review. The BCA offers litigants and courts much clearer guidance in analyzing and dealing with director conflict transactions challenged in derivative proceedings than does existing law.

3. DIRECTOR'S CONFLICTING INTEREST TRANSACTION AND THE SAFE HARBOR

The statutory safe-harbor method of preemptively immunizing from judicial review in a derivative suit either a director's conflict of interest transaction or a director's taking advantage of a business opportunity is found in BCA §§ 1-860 through 1-862 and 1-870.[170] The safe harbor requires that the transaction (or disclaimer of an opportunity) be approved by no fewer than two unconflicted directors after full disclosure to the board.[171]

The definitions and elective safe harbor in BCA Subchapter 8F sharply limit in two respects both the plaintiff's options and the potential liability of defendant directors with respect to alleged director conflicting interest transactions.[172]

a. Defense That Challenged Transaction Was Not a "director's conflicting interest transaction"

First, § 1-861(A) provides that unless a corporate transaction constitutes a "director's conflicting interest transaction," as narrowly defined in § 1-860(1), it cannot be the subject of any form of judicial relief or give rise to an award of damages against a director in a derivative suit.[173]

169. *See, e.g.*, 1 RADIN, *supra* note 15 at 796-97.

170. Louisiana Business Corporation Act, No. 328, §§ 1-860 to -862, -870 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-860 to -862, -870), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

171. This "safe-harbor" method is not available as a defense to a derivative suit charging that the entire board acted in breach of its duty of loyalty, for example by approving a change of control merger at an inadequate price in order to gain personal financial advantages, because in such a case there are no unconflicted directors.

172. Louisiana Business Corporation Act, No. 328, subpt. 8(F) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-860 to -863), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

173. *See id.* § 1-861 cmts. (a), (b).

The term "director's conflicting interest transaction" includes only a transaction by the corporation to which a director is a party or as to which, at the time the transaction was effected, the director knew he or a "related person" was a party or had a "material financial interest."[174]

Under § 1-860(5), an *entity* is a "related person" of a director within the definition of a "director's conflicting interest transaction" only if the director is an employee, director, general partner, or fiduciary of the entity or owns a majority interest in its voting power or equity.[175] An *individual* is a "related person" of a director only if that person is a specified family member of, lives in the same home as, or has a relationship with the director that would reasonably be expected to impair the objectivity of the latter's judgment at the time the board approved the "director's conflicting interest transaction" or the transaction was effected, as the case may be.[176]

b. Defense That Safe Harbor Protects the Challenged Transaction

Second, §§ 1-861(B) and -870(A) provide that neither a "director's conflicting interest transaction" nor a director's taking advantage of a business opportunity can be the subject of equitable relief or give rise to an award of damages against a director, if the transaction was approved by the board (or disclaimed, as the case may be) in accordance with the safe harbor requirements of § 1-862.[177]

To put the matter differently, the first inquiry as to every derivative claim alleging that a challenged transaction by the corporation involved a disabling conflict of interest or the taking

174. Sections 1-860 through 862 of the BCA do not, however, protect (a) board decisions relating to indemnification, termination of derivative litigation, or director compensation, or (b) transactions from being questioned on grounds other than conflict of interest, such as lack of good faith or violation of a duty owed by a controlling shareholder. *See* 2 MODEL BUS. CORP. ACT ANN. subch. 8F official cmt. 2, at 8-503 (2013).

175. Louisiana Business Corporation Act, No. 328, § 1-860(5) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-860(5)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

176. Louisiana Business Corporation Act, No. 328, § 1-860(5) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-860(5)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

177. *Id.* §§ 1-861(B), -870(A) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-861(B), -870(A)).

advantage of a business opportunity by any one or more directors is this: did the specified transaction fall within the § 1-860(1) definition of a "director's conflicting interest transaction"?[178]

If the answer is no, the second inquiry is whether the challenged transaction was the taking advantage of a business opportunity by a director that should have first been offered to the corporation. If the answer again is no, and the plaintiff's only basis for challenging the transaction is a director's conflicting interest, the court should dismiss the claim under § 1-861A, even if the transaction involved the entire board.[179]

If, however, the answer to either question is yes, the second inquiry is whether the board approved the transaction in accordance with the safe harbor requirements of § 1-862, which requires approval by no fewer than two qualified directors.[180] If the answer is yes, the court should dismiss the claim under § 1-861(B), notwithstanding that the transaction was a "director's conflicting interest transaction" or the taking advantage by a director of a business opportunity that should have first been offered to the corporation, because in either case the transaction has been immunized from judicial review.[181]

4. METHOD AND EFFECT OF ESTABLISHING SAFE HARBOR DEFENSE IN BCA DUTY OF LOYALTY CASE

The safe harbor requirements of § 1-862 are:

a. the "director's conflicting interest transaction" (or business opportunity) must have been authorized (or disclaimed) by the affirmative vote of a majority of the qualified directors,

b. after deliberating and voting outside the presence of and without the participation of non-qualified directors,

c. following disclosure by the conflicted director of the

178. *Id.* § 1-860(1) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-860(1)).

179. *Id.* § 1-861(A) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-861(A)); *see* 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 1 ¶ 1, at 8-236 to 8-237 (2013).

180. Louisiana Business Corporation Act, No. 328, § 1-862 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-862), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

181. Louisiana Business Corporation Act, No. 328, § 1-861(B) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-861(B)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

existence and nature of his conflicting interest and all facts known to the conflicted director respecting the matter (subject to a confidentiality carve-out for the director) that an unconflicted director would reasonably believe material in deciding whether to proceed with the transaction (or disclaimer, as the case may be).[182]

It bears repeating that the rules described above have a decisive impact on every potential derivative claim of director breach of the duty of loyalty, regardless of whether the corporation elects to avail itself in advance of the elective procedure afforded by § 1-861(B) to immunize a "director's conflicting interest transaction," as defined in § 1-860(1).[183] This is so for three reasons.

First, as previously noted, § 1-861(A) has the effect of eliminating a derivative cause of action for any challenge of a transaction on the ground of conflicting director interest, unless the transaction falls within the precise statutory definition of "director's conflicting interest transaction."[184] If the challenged transaction does not fall within the statutory definition, it is not subject to a derivative challenge. This rule applies regardless of whether the corporation elects to immunize the transaction by complying with the elective safe harbor procedures prescribed by § 1-862.

Second, if a proposed transaction, which has been challenged on the ground that a director has a conflicting interest, falls outside the statutory definition of a "director's conflicting interest transaction," the transaction cannot be enjoined in a shareholder derivative suit even if there is no derivative claim against the directors for damages.

Third, a "director's conflicting interest transaction" may be immunized from a conflict challenge by board compliance with the § 1-862 safe harbor, not only before the transaction is effected, but, in the alternative, after it has been effected.[185] The

182. Louisiana Business Corporation Act, No. 328, § 1-862 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-862), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

183. *Id.* §§ 1-860(1), -861(B) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-860(1), -861(B)).

184. *Id.* § 1-861 cmt. (a); 2 MODEL BUS. CORP. ACT ANN. § 8.60 official cmt. 1, at 8-508 (2013); *id.* § 8.61 official cmt. (ii), at 8-525.

185. *See* Louisiana Business Corporation Act, No. 328, § 1-861(B)(1) (May 30,

taking advantage of a business opportunity by a director may be immunized under § 1-870, however, only if it is disclosed to the board before the director becomes obligated.

In the alternative, a "director's conflicting interest transaction" challenged in a derivative proceeding may also be immunized from liability by means of shareholder approval under § 1-863 or by a judicial determination under paragraph 1-861B(3) that the transaction was fair to the corporation at the relevant time.[186]

E. DIRECTOR LIABILITY FOR UNLAWFUL DISTRIBUTIONS TO SHAREHOLDERS

All corporation statutes contain restrictions on non-liquidating distributions (Distributions) of assets by a corporation to its shareholders, whether by way of dividends or redemptions of stock. The original purpose of these restrictions was to protect creditors and holders of preferred stock from an improvident dissipation of corporate assets to their prejudice.[187] The remedy provided in corporation statutes to enforce these restrictions has traditionally been to impose personal liability on directors who vote to make Distributions that are unlawful under the statute.

Historically, early statutory limitations on Distributions typically took the form of (a) a stated capital or earned surplus test, (b) a balance sheet insolvency test, and (c) an equity insolvency test (i.e., no Distribution is permitted if thereafter the corporation cannot pay its debts as they come due in the ordinary course of business.)[188] It has been widely recognized in the last thirty-five years that stated capital/earned surplus tests are an ineffective means of policing improvident Distributions.[189]

2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-861(B)(1)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; 2 MODEL BUS. CORP. ACT ANN. § 8.62 official cmt. 1, at 8-563 to 8-564 (2013).

186. *Id.* §§ 1-861(B)(3), -863 (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-861(B)(3), -863).

187. *See, e.g.*, James J. Hanks, Jr., *Legal Capital and the Model Business Corporation Act: An Essay for Bayless Manning*, 74 LAW & CONTEMP. PROBS. 211, 212-13 (2011).

188. Hanks, *supra* note 187, at 213-14.

189. Stated capital/earned surplus tests limit the sources of legally permissible dividends to statutorily defined balance sheet line items or categories such as "par value," "stated capital," "capital surplus," and "earned surplus". In practice, these tests are easily evaded by revaluing assets upward, by transfers from stated capital or capital surplus to earned surplus, and by inflating the valuation of purchased

R.S. 12:55, -63, and -1L rely in part on the outmoded stated capital/earned surplus test, in addition to balance sheet and equity insolvency tests, for determining the lawfulness of Distributions. The Model Act and BCA § 1-640, *per contra*, entirely eliminate the concepts of stated capital and surplus and rely solely on balance sheet and equity insolvency tests for determining whether a Distribution is lawful.[190] Section 1-640, however—following Model Act § 6.40—authorizes the board to determine the amount of the corporation's assets for purposes of the balance sheet test on "a fair valuation or other method that is reasonable in the circumstances," in preference to generally accepted accounting principles, which are widely understood to govern the balance sheet test under the LBCL.[191]

Section 1-640 in effect permits directors to use a bankruptcy insolvency test for assessing the legality of Distributions by determining the amount of the corporation's assets by reference to their estimated current fair market value, rather than their historical balance sheet cost. Under the BCA balance sheet test, therefore, a Distribution would be lawful if thereafter the reasonably estimated fair market value of the corporation's assets exceeded its liabilities plus the liquidation preference of its preferred stock, even if the Distribution rendered the corporation insolvent by reference to its balance sheet prepared in accordance with generally accepted accounting principles.

The effect upon directors and shareholders of a Distribution that has been determined under the foregoing standards to be unlawful is discussed below separately as to the LBCL, the Model Act, and the BCA.

1. LBCL

R.S. 12:92(D) provides that directors who knowingly, or without the exercise of reasonable care and inquiry, voted in favor of making an unlawful Distribution to shareholders are jointly and severally liable to the corporation or its creditors in an amount equal to the unlawful Distribution, provided suit is

assets. *See, e.g.*, *id.* at 213.

190. *See* 1 MODEL BUS. CORP. ACT ANN. § 6.40 official cmt., at 6-227 (2013); Louisiana Business Corporation Act, No. 328, § 1-640 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-640), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

191. *Id.*

brought within two years after the Distribution.[192] No right of contribution against other directors is provided to those found liable under the statute.

In addition, R.S. 12:93(D) provides that every shareholder who receives an unlawful Distribution of the kind reprobated by R.S. 12:92(D) is similarly liable to the corporation or its creditors up to the amount so received, without proof of culpable conduct or knowledge on the part of the recipient of the illegality of the Distribution, provided suit is brought within two years.[193] R.S. 12:93(E) gives directors who have been held liable under R.S. 12:92(D) for authorizing such an unlawful Distribution a cause and right of action for indemnity against each shareholder for the proportionate part received by the latter but not disgorged.[194]

The net effect of these rules is that shareholders who receive an unlawful Distribution are primarily liable, regardless of fault, to disgorge it, and directors who negligently or intentionally authorized the Distribution are secondarily liable to repay it if the shareholders do not.

2. MODEL ACT

Model Act § 8.33 resembles R.S. 12:92(D) in making directors personally liable, provided suit is brought within two years, for authorizing unlawful Distributions to shareholders if the party asserting liability establishes the directors acted not in good faith, not in a manner they reasonably believed to be in the best interests of the corporation, or not with due care.[195]

Model Act § 8.33 does not, however, make the recipient shareholders directly liable to the corporation and its creditors to disgorge those Distributions, as does R.S. 12:93(D). Further, Model Act § 8.33 does not allow directors who have been held liable for authorizing an unlawful Distribution a right of recoupment of the Distribution from shareholders, unless the shareholder knew at the time of receipt that the Distribution was unlawful.[196]

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192. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:92(D) (2010).

193. *Id.* § 12:93(D).

194. *Id.* § 12:93(E).

195. 2 MODEL BUS. CORP. ACT ANN. § 8.33, at 8-299 to 8-300 (2013).

196. *Id.*; Louisiana Business Corporation Act, No. 328, §§ 1-622, -833 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-622, -833), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; Louisiana Business

3. BCA

a. Comparison with LBCL and Model Act

BCA §§ 1-622 and 1-833 reject portions of Model Act § 8.33 and retain the substance of existing law, as set forth in R.S. 12:92 and 12:93.[197] The new law does, however, adopt the right of contribution against other directors granted by Model Act § 8.33(b)(1) to each director held liable for authorizing an unlawful Distribution.[198]

BCA §§ 1-622 and 1-833 clarify existing law by providing that: (a) a director is liable for authorizing an unlawful Distribution only if the party asserting liability establishes that in so acting the director did not comply with the standard of conduct set forth in § 1-830, and (b) a director or a shareholder, as the case may be, is liable to repay only the portion of an improper Distribution that is unlawful.[199] The new law also clarifies that the two-year limit on suits brought to recover an unlawful Distribution is peremptive, rather than prescriptive.[200]

b. Exculpation and Indemnification for Unlawful Distributions

Importantly, BCA paragraph 1-832(A)(3) provides that a director cannot be exculpated from liability for authorizing a Distribution to shareholders in violation of § 1-833.[201] This means if the party asserting liability establishes that the directors authorized a Distribution without exercising the care a person in a like position would reasonably believe appropriate under similar circumstances, as required by § 1-830(B), the

Corporation Law, LA. REV. STAT. ANN. §§ 12:92, 12:93 (2010).

197. 2 MODEL BUS. CORP. ACT ANN. § 8.33, at 8-299 to 8-300 (2013); Louisiana Business Corporation Act, No. 328, §§ 1-622, -833 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-622, -833), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; Louisiana Business Corporation Law, LA. REV. STAT. ANN. §§ 12:92, 12:93 (2010).

198. 2 MODEL BUS. CORP. ACT ANN. § 8.33(b)(1), at 8-299 (2013); Louisiana Business Corporation Act, No. 328, § 1-833(B) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-833(B)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

199. *See* Louisiana Business Corporation Act, No. 328, § 1-622 cmt. (d) (May 30, 2014), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

200. *See id.* § 1-622 cmt. (e).

201. *Id.* §§ 1-832(A)(3), -833 (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-832(A)(3), -833).

directors would be personally liable notwithstanding the general rule of § 1-832 that directors are not personally liable in damages for a breach of the duty of care.

Moreover, paragraph 1-202(B)(5) prohibits a corporation from including *in its charter* a clause requiring or permitting indemnification of a director for a violation of § 1-833.[202] Notwithstanding the prohibition of such a charter clause, however, paragraph 1-851(A)(1)(a) permits a corporation *dehors* its charter to indemnify a director who (a) conducted himself in good faith and (b) reasonably believed his conduct was in the best interests of the corporation.[203]

Accordingly, if a court determined that a director met the good faith and reasonable belief standards but was nevertheless held liable under § 1-833 for having authorized an unlawful Distribution without exercising the care a person in a like position would reasonably believe appropriate under the circumstances, it appears the corporation would have authority under paragraph 1-851(A)(1) to permissibly indemnify him for expenses (although not for the judgment) incurred in unsuccessfully defending the suit—unless a court read paragraph 1-202(B)(5) as establishing a rule of public policy barring permissible indemnification in any case in which a director is held liable for authorizing a Distribution in violation of § 1-833.

F. DIRECTOR AND OFFICER INDEMNIFICATION

1. BACKGROUND AND OVERVIEW

The modern law relating to indemnification by a corporation of its directors and officers for expenses incurred by them in defending suits against them in their capacity as such finds its origin in the case of *New York Dock Co. v. McCollom*.[204]

In *McCollom*, the New York court declined, in the absence of an authorizing statute, to approve a claim by directors to be indemnified for the expenses of their successful defense of a

202. Louisiana Business Corporation Act, No. 328, §§ 1-202(B), -833 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. §§ 12:1-202(B), -833), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

203. *Id.* § 1-851(A)(1)(a) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-851(A)(1)(a)).

204. 16 N.Y.S.2d 844, 845, 849-50 (N.Y. Sup. Ct. 1939).

derivative shareholder suit.[205] The court reasoned that the directors' defense did not benefit the corporation.[206] The New York Legislature reacted to what was perceived as an unfair and inappropriate result by enacting the first statute authorizing such indemnification in 1941.[207] The ultimate source of most current state director and officer indemnification statutes today is the 1943 Delaware statute, now codified as DGCL § 145.[208] The Delaware statute was incorporated into the original Model Act in 1950.[209] R.S. 12:83 is based on DGCL § 145.[210]

The overall structure of BCA §§ 1-850 and 1-859, which cover corporate indemnification of a director or officer who is a party to a proceeding because he was a director or officer, and advancement to the director or officer of expenses incurred in such a proceeding, is generally similar to that of R.S. 12:83.

That is, the BCA, like R.S. 12:83, provides for: (a) *mandatory* indemnification of a director or officer who is successful in the defense of any proceeding against him, (b) permissible indemnification of a director or officer who conducted himself in good faith and reasonably believed his conduct was in the best interests of the corporation, and (c) *discretionary* advancement of litigation expenses to a director or officer without a prior determination that he met the applicable standard of conduct necessary to establish entitlement to mandatory or permissible indemnification, subject to the advancee's undertaking to repay the advance in the event it is ultimately determined he was not entitled to indemnification for his expenses.

There are, however, significant differences between the LBCL and the BCA that, on a net basis, afford directors and officers more extensive possible protection under the BCA. Indemnification of *directors* is covered in Parts III(F)(2)-(3) below. Indemnification of *officers* is covered in Part III(F)(4) below.

205. *Id.* at 849-50.
206. N.Y. Dock Co. v. McCollum 16 N.Y.S.2d 844, 845, 849-50 (N.Y. Sup. Ct. 1939).
207. *See, e.g.*, GARY LOCKWOOD, LAW OF CORPORATE OFFICERS AND DIRECTORS: INDEMNIFICATION AND INSURANCE § 3:8, at 332 (2d ed. 2014-15).
208. *Id.* § 3:17, at 353.
209. *Id.*
210. *See, e.g.*, Himel, *supra* note 8, at 128.

2. INDEMNIFICATION ADVANTAGES TO DIRECTORS UNDER BCA COMPARED WITH LBCL

a. Expedited Indemnification for Exculpated Claims

BCA paragraph 1-851(A)(2) provides in substance that a director protected by both an exculpation and an indemnification clause in the corporate charter who is made a defendant in a derivative suit that charges a violation only of the duty of care, and not of the duty of loyalty, may be permissibly indemnified after a simple corporate verification that the derivative petition is limited to alleging a duty of care breach, without the necessity of a determination under § 1-855 that the director's challenged conduct met the relevant standard.[211] There is no comparable provision in existing law, which in R.S. 12:83(C) requires that, before indemnification is made in any case, there must be a disinterested determination that the director's conduct met the applicable standard.[212]

b. Availability of Summary Court Proceeding to Determine Indemnification Rights

A second advantage to directors under the BCA is that § 1-854 authorizes a director to apply to the court in which a proceeding has been filed against him for a summary determination, while the suit is pending, alleging that he is entitled to indemnification or advancement of expenses.[213] Existing law makes no express provision for such a summary judicial procedure to determine a director's right to indemnification or advancement prior to the adjudication or settlement of the claim against him.

The court is authorized by § 1-854(A) to determine in such a summary proceeding the director's entitlement to indemnification or advancement either under a charter, bylaw, board resolution,

211. *See* Louisiana Business Corporation Act, No. 328, §§ 1-831 cmt. (b), -851 rev. cmt., -853(A)(1) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-853(A)(1)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 1 ¶ 1, at 8-236 to 8-237 (2013).

212. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:83(C) (2010).

213. Louisiana Business Corporation Act, No. 328, § 1-854 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-854), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

contract of the corporation, or as a matter of judicial discretion.[214] The court's discretion includes the authority to order indemnification of a director even for amounts paid in settlement of a derivative suit, despite the bar in § 1-851(D)(1) on *permissible* indemnification of derivative settlements.[215] By contrast, Delaware law does not permit a court to order indemnification of a director for amounts paid to settle a derivative suit. DGCL § 145(b) limits a court's indemnification discretion to expenses of a director in a derivative suit.[216]

In addition, § 1-854(B) requires the court to award "fees on fees" to a director who the court has determined is entitled to (a) mandatory indemnification, or (b) either permissible indemnification or an expense advance pursuant to a charter, bylaw, board resolution, or contract.[217]

c. Indemnification Bill of Rights

A third advantage to directors of the BCA over existing law is that § 1-858 provides:

> (i) where the corporation has obligated itself in advance by charter, bylaw, board resolution, or contract to indemnify a director to the fullest extent permitted by law, the obligation to indemnify automatically includes an obligation to advance legal fees unless the corporation otherwise specifically provides,
>
> (ii) a right of indemnification created by a charter, bylaw, or board resolution in effect at the time of a director's allegedly wrongful act or omission cannot thereafter be eliminated or impaired, and such indemnification rights are binding upon any successor by merger of the corporation, and

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214. Louisiana Business Corporation Act, No. 328, § 1-854(A) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-854(A)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

215. *Id.* § 1-851(D)(1) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-851(D)(1)); *see* 2 MODEL BUS. CORP. ACT ANN. § 8.51 official cmt. 4, at 8-421 to 8-423 (2013); *id.* § 8.54 official cmt., at 8-450 to 8-453.

216. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.54 official cmt., at 8-451 (2013); Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 145(b) (2011).

217. Louisiana Business Corporation Act, No. 328, § 1-854(B) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-854(B)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786. "Fees on fees" are legal fees incurred to successfully establish the director's right to indemnification or advancement for his fees in the underlying action.

(iii) nothing in the BCA limits a corporation's discretionary right to pay expenses of a director in connection with his appearing as a witness in a proceeding in which he is not a party.[218]

No comparable provisions appear in existing law.

d. Indemnification in Certain Cases Where Director is Held Liable

A fourth possible advantage to directors of the BCA is that if a court determines a director acted in good faith and in what he reasonably believed were the best interests of the corporation, it may be possible that he can be permissibly indemnified under § 1-851(D) for his expenses in a duty of loyalty derivative proceeding, *even if found by a court to be liable for willful or intentional misconduct in the performance of his duty to the corporation*, provided he was not adjudged liable for receiving a financial benefit to which he was not entitled or for a breach of the duty of loyalty *eo nomine*.[219] The good faith standard requires that a director not have engaged in knowingly illegal conduct that exposes the corporation to harm.[220] The prohibition on a director's receipt of a financial benefit to which he was not entitled is absolute and not subject to a materiality standard.[221]

Per contra, under R.S. 12:83(A)(2) a director cannot be permissibly (as distinguished from judicially) indemnified for expenses in any derivative suit in which he is adjudged liable for willful or intentional misconduct, regardless of other circumstances.[222] Only in unusual circumstances, however, is director conduct likely to satisfy the permissible indemnification

218. Louisiana Business Corporation Act, No. 328, § 1-858 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-858), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

219. *See* 1 MODEL BUS. CORP. ACT ANN. § 2.02 official cmt. 3.I., at 2-17 to 2-19 (2013); 2 MODEL BUS. CORP. ACT ANN. § 8.51 official cmt. 1 ¶¶ 4, 5, at 8-418 (2013); *id.* subch. 8E intro. cmt. 2, at 8-383 to 8-384. *But cf.* Louisiana Business Corporation Act, No. 328, §§ 1-202(B)(5)(a), -856 cmt. (a) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-202(B)(5)(a)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786 (suggesting a public policy against indemnification for any breach of the duty of loyalty, however described).

220. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.31 official cmt. 1.A., at 8-240 to 8-241 (2013).

221. *See id.* § 8.31 official cmt. 1.E., at 8-243.

222. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:83(A)(2) (2010).

standard of § 1-851(D) but not that of R.S. 12:83(A)(2) (i.e., a court found the director liable for willful or intentional misconduct in the performance of his duty to the corporation but he can show he: (a) acted in good faith and in what he reasonably believed were the best interests of the corporation, (b) did not engage in knowingly illegal conduct that exposed the corporation to harm, and (c) did not receive a financial benefit to which he was not entitled).

3. INDEMNIFICATION DISADVANTAGES TO DIRECTORS UNDER BCA COMPARED WITH LBCL

a. No Indemnification for Derivative Suit Settlements

The most significant disadvantage to directors of the BCA, as compared with existing law, is that § 1-851(D) bars indemnification of directors for settlement payments in a derivative suit absent court approval;[223] whereas R.S. 12:83(A)(2) authorizes permissible indemnification for such settlement payments (in addition to incurred legal expenses) up to the estimated cost of litigating the matter to conclusion.[224]

b. No Mandatory Indemnification for Partial Success in Litigation

A second disadvantage to directors of the BCA is that under § 1-852, a director is not entitled to *mandatory* indemnification unless he was *wholly successful*, on the merits or otherwise, in the subject proceeding.[225] Under R.S. 12:83B, as under Delaware law, a director is entitled to mandatory indemnification to the extent successful *in defense of any claim*, *issue, or matter in the proceeding*, even if not successful in the proceeding as a whole.[226] This limitation in § 1-852 does not, however, limit the

223. Louisiana Business Corporation Act, No. 328, § 1-851(D) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-851(D)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

224. The existing authorization for permissible indemnification of settlement costs in a derivative suit found in LBCL § 83(A)(2) is unique to Louisiana. The majority view is that such indemnification is against public policy. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.51 official cmt. 4, at 8-421 to 8-423 (2013). Settlement costs in derivative suits are, however, routinely covered by D&O insurance.

225. Louisiana Business Corporation Act, No. 328, § 1-852 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-852), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

226. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:83(B) (2010); Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 145(c) (2011).

corporation's right of *permissible* indemnification with respect to the expenses of a partially successful defense of any claim, issue, or matter.[227]

c. No Indemnification Dehors the BCA

A third disadvantage to directors of the new law is that under § 1-859, a corporation may provide permissible indemnification or advancement of expenses only as permitted by §§ 1-850 through 1-859. In other words, no indemnification of or advancement to directors is permissible unless expressly authorized by those sections of the statute.[228]

R.S. 12:83(E), *per contra*, provides that indemnification and advancement expressly authorized by other subsections of R.S. 12:83 "shall not be deemed exclusive of any other rights to which the person indemnified. . . is entitled under any bylaw, agreement, [or] authorization of shareholders or directors . . . ."[229] The difference between the LBCL and the BCA is perhaps not as significant as might appear, however, because courts generally take the view that it is against public policy for directors to be indemnified for most types of conduct harmful to the corporation.[230]

d. Advancement Subject to Director's Affirmation of Belief He Has Met Relevant Standard of Conduct

A further minor disadvantage of the BCA to directors is that under paragraph 1-853(A)(1) an advance of litigation expenses may be made to a director only if he provides the corporation, in addition to a written undertaking to repay the advance in the event it is ultimately determined he has not met the relevant standard of conduct, with a written affirmation of his good faith belief either that he has met the relevant standard or that the proceeding involves only duty of care claims from which he has

227. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.52 official cmt. ¶ 2, at 8-431 (2013).

228. The BCA does not, however, limit a corporation's power to indemnify employees and agents who are neither directors nor officers. Louisiana Business Corporation Act, No. 328, § 1-858(F) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-858(F)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

229. Louisiana Business Corporation Law, LA REV. STAT. ANN. § 12:83 (2010).

230. *See* 2 MODEL BUS. CORP. ACT ANN. subch. 8E intro. cmt. 1 ¶ 3, at 8-382 (2013).

been exculpated.[231]

R.S. 12:83(D), on the other hand, conditions a director's entitlement to an advance only upon providing a written undertaking to repay in the event it is ultimately determined he did not meet the applicable standard of conduct.[232] It does not require a written affirmation of belief at the time of advancement that he has met the applicable standard of conduct. BCA § 1-853(B) improves upon R.S. 12:83(D), however, from the standpoint of a director, by providing that the written undertaking need not be secured and may be accepted by the corporation without reference to the financial ability of the director to repay[233]—although as a matter of practice these assumptions have customarily been made under existing law.

4. INDEMNIFICATION OF OFFICERS AS DISTINGUISHED FROM DIRECTORS UNDER BCA COMPARED WITH LBCL

a. Directors and Officers Grouped Together Under LBCL and Delaware Law

As relates to officers, employees, and agents of a corporation other than directors, the indemnification structure of the BCA differs from that of existing law. Under R.S. 12:83(A), as under DGCL § 145, indemnification is authorized for directors, officers, employees, and agents without distinction among those groups.[234]

b. Model Act

Per contra, Model Act Subchapter 8E is focused almost entirely on the indemnification of directors. More particularly, Model Act § 8.58(f) and corresponding BCA § 1-858(F) provide that Subchapter 8E does not limit a corporation's power to indemnify employees and agents who are neither officers nor directors, i.e., the Model Act indemnification rules apply only to

231. Louisiana Business Corporation Act, No. 328, § 1-853(A)(1) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-853(A)(1)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

232. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:83(D) (2010).

233. Louisiana Business Corporation Act, No. 328, § 1-853(B) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-853(B)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

234. Louisiana Business Corporation Law, LA. REV. STAT. ANN. § 12:83(A) (2010); Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 145 (2011).

officers and directors.[235] Further, Model Act § 8.56 (but not BCA § 1-856) establishes a special regime of indemnification for officers who are also directors that distinguishes their conduct as officers from their conduct as directors.[236]

c. BCA

BCA § 1-856 rejects the Model Act distinction between indemnification of directors who are officers and those who are not.[237] All directors, whether officers or not, are subject to the whole of Subchapter 8E *other than* § 1-856.[238] Non-director officers (NDOs) alone are subject to the whole of Subchapter 8E *including* § 1-856.[239]

Like Model Act § 8.56, BCA § 1-856 provides nominally broader indemnification of NDOs than of directors. That is the only function of the section. BCA § 1-856 differs from R.S. 12:83 in treating NDOs differently from directors. The broader entitlement of NDOs under BCA § 1-856 is slightly less generous, however, than Model Act § 8.56. It is limited to permissible indemnification or advancement provided by charter, bylaw, board resolution, or contract for judgments, settlements, and expenses resulting from NDO conduct other than: (a) any breach of the duty of loyalty (not merely those breaches from which the officer received a financial benefit to which he was not entitled, as in Model Act § 8.56), (b) an intentional infliction of harm on the corporation or its shareholders, or (c) an intentional violation of criminal law, subject in all cases to the proviso that indemnification in a derivative proceeding is limited to expenses only.

d. Practical Effect on Officers of BCA Indemnification Regime

The practical effect of BCA § 1-856 appears to be to authorize a corporation to agree in its articles, bylaws, a board resolution,

235. 2 MODEL BUS. CORP. ACT ANN. § 8.58(F), at 8-487 (2013); Louisiana Business Corporation Act, No. 328, § 1-858(F) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-858(F)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

236. 2 MODEL BUS. CORP. ACT ANN. § 8.56, at 8-468 to 8-469 (2013).

237. *See* Louisiana Business Corporation Act, No. 328, § 1-856 cmt. (b) (May 30, 2014), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

238. *Id.* § 1-856 (to be codified as amended at LA. REV. STAT. ANN. § 12:1-856).

239. *Id.*

or a contract to indemnify an NDO under the circumstances described in the preceding paragraph, without the necessity of a determination—which R.S. 12:83 requires in the case of both directors and NDOs, and BCA §§ 1-851 and 1-855 require for directors only—that the NDO (a) conducted himself in good faith, (b) reasonably believed his conduct was in the best interests of the corporation, and (c), in the case of a criminal proceeding, had no reasonable cause to believe his conduct was unlawful.[240] The policy behind allowing more generous permissible indemnification for NDOs than for directors is that the latter have no conflict of interest in determining whether to indemnify an NDO.

BCA § 1-856(C) provides that NDOs, like directors, are entitled to apply to a court in a § 1-854 summary proceeding for indemnification or advancement.[241] In the discretion of the court, judicial relief could include indemnification for settlements in derivative suits despite the prohibition in § 1-856(A)(1) on *permissible* indemnification of derivative settlement costs.[242]

As a practical matter, however, derivative claims against NDOs, as distinguished from claims by third parties such as regulatory agencies, are relatively rare because directors are not subject to a conflict in determining whether to institute suit directly against an NDO or terminate him for conduct they deem inappropriate. The absence of director conflict moots the viability of almost all derivative claims against NDOs. Rights of indemnification and advancement are of practical value to NDOs primarily with respect to *third-party* claims against them by reason of their positions as NDOs or *direct* claims against them by the corporation, rather than with respect to shareholder derivative proceedings.

IV. CONCLUSION

Over the long perspective beginning with the *Keech*, *Sutton*,

240. Louisiana Business Corporation Act, No. 328, § 1-856 (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-856), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786; *see* 2 MODEL BUS. CORP. ACT ANN. § 8.56 official cmt. 1 ¶ 1, at 8-472 (2013).

241. Louisiana Business Corporation Act, No. 328, § 1-856(C) (May 30, 2014) (to be codified as amended at LA. REV. STAT. ANN. § 12:1-856(C)), *available at* http://www.legis.la.gov/Legis/ViewDocument.aspx?d=912786.

242. *See* 2 MODEL BUS. CORP. ACT ANN. § 8.54 official cmt. 3, at 8-450 to 8-451 (2013).

and *Percy* cases and ending with the present, American law governing the fiduciary duty of directors and officers has moved away from a principles-based regime toward a rules-based regime. In Delaware, those rules have been and continue to be developed primarily by the case-law method. Under the Model Act, of which the BCA is an example, the rules are embodied in statutory law.

The challenge under either a case-law method or a statutory scheme is to create procedures that afford shareholders a reasonable opportunity to litigate the alleged breach of fiduciary duty by directors who hold the authority to manage the corporation and the keys to the corporate treasury, while at the same time not impeding the directors' management or imposing liabilities on them that chill their willingness to take business risks on which profits depend.

Over time, the balance has been struck by (a) authorizing the exculpation of directors from personal liability for breach of their duty of care, (b) imposing demand requirements on shareholders before they institute derivative suits, (c) shifting to derivative plaintiffs under the Business Judgment Rule the burden of proof of a directorial breach of duty, (d) immunizing certain interested director transactions from derivative attack, and (e) indemnifying directors for expenses incurred in derivative litigation.

The BCA does a far more precise job of striking this balance than does the LBCL. Some may think the BCA goes too far in favoring the interests of directors, but corporations are always at liberty to incorporate into their charters intermediate governance arrangements that restrict the protections afforded their directors. The BCA rules described above in Part III give Louisiana litigants, lawyers, and judges a default regime that clarifies the fiduciary responsibility of directors and lends greater predictability to the outcome of derivative litigation alleging a breach of that responsibility.