Chapter 1

Director and Officer Liability

1-1 INTRODUCTION

The role of a director or officer of a corporation is generally that of a fiduciary. Directors, when elected to office, are held to be trustees of the entire body of corporate owners.

1-2 FIDUCIARY DUTIES OF A DIRECTOR OR OFFICER

1-2:1 General Obligations of Directors and Officers

A director or officer may not compromise his loyalty and fiduciary duty to his company.[1] The scope of loyalty owed by directors to shareholders is described as becoming trustees of the entire body of corporate owners. They owe loyalty to both majority and minority stockholders. "To disregard the rights of either group, or of the corporation as such—even for a moment—is a violation of their fiduciary obligation."[2]

The fiduciary duties of a director or officer also extend beyond the boundaries of the corporation and shareholders. For instance, when a corporation becomes insolvent, directors' and officers'

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1. Black's Law Dictionary defines "fiduciary duty" as "a duty of utmost good faith, trust, confidence, and candor owed by a fiduciary (such as a lawyer or corporate officer) to the beneficiary (such as a lawyer's client or a shareholder)[.]" Black's Law Dictionary 639 (11th Ed. 2019).

2. *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 90-91 (App. Div. 1956); *see also Casey v. Brennan*, 344 N.J. Super. 83, 108 (App. Div. 2001) ("In light of their status as fiduciaries, our law demands of directors utmost fidelity in dealing with a corporation and its stockholders.").

fiduciary duties extend to the corporation's creditors with regard to the corporation's assets.[3]

A director can breach his duties not only by intentional acts, but also through mere negligence.[4] Indeed, a director must possess a basic understanding of the business of the corporation.[5] Inherent in this requirement is that a director should become familiar with the fundamentals of the business in which the corporation is engaged. Directors, by virtue of the requirement that they exercise ordinary care in dealing with the affairs of the corporation, cannot raise as a defense a lack of that knowledge which is needed to exercise the requisite degree of care.[6] The New Jersey Supreme Court has held that it is the duty of directors who do not have sufficient business experience to qualify themselves to perform their requisite duties to either "acquire the knowledge by inquiry, or refuse to act."[7]

Aside from merely obtaining knowledge of the affairs of the corporation, directors also have a continuing obligation to remain informed about the activities of the corporation.[8] Directors may not look the other way when misconduct arises and then "claim that because they did not see the misconduct, they did not have a duty to look."[9] Although our courts have not indicated that

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3. *See Francis v. United Jersey Bank*, 87 N.J. 15, 36-37 (1981); *see also In re Thomas*, 255 B.R. 648, 654-55 (D.N.J. 2000) (citing *Francis v. United Jersey Bank* for the proposition that if a corporation becomes insolvent, its directors and officers owe a fiduciary duty to creditors as to the corporation's assets. The district court also noted that a fiduciary duty is also imposed in such a case on a corporation's shareholders as to corporate assets that come into their possession. Breach of that duty can result in a debt which is nondischargeable under 11 U.S.C. § 523(a)(4).); *Jurista v. Amerinox Processing, Inc.*, 492 B.R. 707, 759-60 (Bankr. D.N.J. 2013).

4. *See* N.J.S.A. 14A:6-14(1) ("Directors and members of any committee designated by the board shall discharge their duties in good faith and with that degree of diligence, care and skill which ordinarily prudent people would exercise under similar circumstances in like positions."). Relying on this statute, the N.J. Supreme Court in *Francis v. United Jersey Bank*, 87 N.J. 15 (1981), held a former director negligent in not noticing and trying to prevent misappropriation of funds held by a corporation in an implied trust.

5. *Francis v. United Jersey Bank*, 87 N.J. 15, 31 (1981).

6. *Francis v. United Jersey Bank*, 87 N.J. 15, 31 (1981); *see also Ross v. Celtron International, Inc.*, 494 F. Supp. 2d 288, 304 (D.N.J. 2007).

7. *Francis v. United Jersey Bank*, 87 N.J. 15, 31 (1981) (internal citation omitted).

8. *Francis v. United Jersey Bank*, 87 N.J. 15, 31 (1981); *see also In re PSE&G Shareholder Litig.*, 315 N.J. Super. 323, 328 (Ch. Div. 1998), *aff'd*, 173 N.J. 258 (2002) (holding that for directors of a corporation making a business decision to be protected by the business judgment rule, discussed in § 1-2:4, they must have become fully informed and acted in "good faith and in the honest belief that their actions are in the corporation's best interest.") (internal citation omitted).

9. *Francis v. United Jersey Bank*, 87 N.J. 15, 31 (1981).

directors and managers must supervise in detail the day-to-day activities of a corporation, it is evident that directors and managers generally must monitor corporate affairs and policies.[10]

Directors cannot use "their role in the corporation for personal advantage to the detriment of shareholders."[11] Furthermore, directors and officers cannot manipulate a corporation's affairs with the primary intent of securing control or affecting control of the corporation, or excluding others from such control.[12] The U.S. Supreme Court has stated with regard to the issue of such usurpation that someone in a fiduciary position "cannot serve himself first and his cestuis second."[13] The Court cautioned that "[h]e cannot manipulate the affairs of his corporation to their detriment and in disregard of the standard of common decency and honesty."[14] In addition, the Court noted that "[h]e cannot use his power for his own personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitations that it may not be exercised for the aggrandizement, preference or advantage of the fiduciary to the exclusion or detriment of the cestuis."[15]

1-2:2 Reliance on Reports and Records by Third Parties

Francis v. United Jersey Bank is a benchmark case for the proposition that a director must exercise reasonable care in executing his affairs on behalf of a corporation.[16] But, in addition to the basic duties of a director to become and remain informed

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10. *Francis v. United Jersey Bank*, 87 N.J. 15, 32 (1981).

11. *Francis v. United Jersey Bank*, 87 N.J. 15, 36 (1981); *Maul v. Kirkman*, 270 N.J. Super. 596, 617 (App. Div. 1994); *see also Berkowitz v. Power-Mate Corp.*, 135 N.J. Super. 36, 45 (Ch. Div. 1975).

12. *Fitzgerald v. National Rifle Association of Am.*, 383 F. Supp. 162, 165 (D.N.J. 1974). *Pepper v. Litton*, 308 U.S. 295, 311 (1939).

13. *Pepper v. Litton*, 308 U.S. 295, 311 (1939).

14. *Pepper v. Litton*, 308 U.S. 295, 311 (1939).

15. *Pepper v. Litton*, 308 U.S. 295 (1939); *see also Fitzgerald v. National Rifle Association of Am.*, 383 F. Supp. 162, 165-66 (D.N.J. 1974).

16. In *Francis*, the bankruptcy trustee of a corporation brought an action to recover funds paid by the corporation to its principal stockholder for the benefit of her estate and members of her family. In suing the estate of the principal stockholder and director, the trustee established to the Court's satisfaction that the decedent was negligent in not noticing and attempting to prevent the misappropriation of funds held by the corporation.

about the affairs of the corporation, there is a correlative rule affording some protection to directors and officers. Directors acting in good faith when relying upon the opinions of counsel for the corporation, or upon written reports concerning financial data about the corporation, generally are immune from liability resulting from these opinions, reports, or both.[17]

Pursuant to statute, directors generally will not be liable for their reliance on records or reports by third parties if, while acting in good faith, they rely upon: (1) the opinion of counsel for the corporation; (2) written reports setting forth financial data concerning the corporation prepared by an independent public accountant, certified public accountant, or firm of such accountant; (3) financial statements, books of account or reports of the corporation represented to them to be correct by the president, the officer of the corporation having charge of its books of account, or the person presiding at a meeting of the board; or (4) written reports of committees of the board.[18]

The review by a director of financial statements or opinions of counsel may, however, give rise to the duty to further inquire into matters revealed by those materials.[19] If, for instance, a director discovers an illegal activity being conducted by the corporation, the director has an affirmative duty to object to the activity, and if the corporation fails to correct its illegal conduct, the director even may have a duty to resign from office.[20] A director who uncovers misconduct or should have knowledge of alleged misconduct will be held liable if he fails to act.[21]

The duty of a director who discovers a corporation's illegal activities may call for more than mere objection and resignation. A director may be in a position in which he is required and obligated to seek the advice of counsel.[22] Indeed, a director may be obligated to obtain legal advice concerning the propriety of

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The Court further found that her negligence was the proximate cause of the trustee's losses. *Francis v. United Jersey Bank*, 87 N.J. 15 (1981).

17. *Francis v. United Jersey Bank*, 87 N.J. 15, 33 (1981).
18. N.J.S.A. 14A:6-14(2).
19. *Francis v. United Jersey Bank*, 87 N.J. 15, 33 (1981).
20. *Francis v. United Jersey Bank*, 87 N.J. 15, 33 (1981).
21. *Brenner v. Berkowitz*, 134 N.J. 488, 510 (1993).
22. *Francis v. United Jersey Bank*, 87 N.J. 15, 33 (1981).

his own conduct, the conduct of other officers or directors, or the conduct of the corporation itself.[23] Furthermore, the duty of a director who discovers improper activities by his peers may require more than mere consultation with outside counsel, and may require the director to take other reasonable means to prevent the illegal conduct being permitted by co-directors.[24]

Similarly, New York courts have held that corporate officers may rely on opinions and reports generated by competent employees or consultants. In *Kimmell v. Schaefer*,[25] a negligent misrepresentation action was brought against the chief financial officer/chairman of a corporation developing a limited partnership. The court stated that pursuant to New York's statute,[26] corporate officers and directors may rely on information and opinions provided by corporate employees; however, such reliance will be justified only when the officer or director believes those employees are reliable and competent with respect to the matters presented.[27] Because the defendant had little or no personal dealings with the staff that rendered information and opinions to him and because he failed to make any inquiry into the basis or methodology of the projections at issue, the defendant was liable for negligent misrepresentation.[28] A similar conclusion might well be reached in New Jersey based upon the holding of *Francis*.

1-2:3 Shareholders' Recourse

A corporate director not only owes a fiduciary duty to the corporation, but also to its shareholders. Shareholders have a right to expect that directors will exercise reasonable supervision and control over the policies and practices of a corporation.[29] In an action against a director for breach of fiduciary duty, a plaintiff must establish a breach of duty by the director and that performance of the director's duty would have avoided the company's loss.[30]

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23. *Francis v. United Jersey Bank*, 87 N.J. 15, 33 (1981).
24. *Francis v. United Jersey Bank*, 87 N.J. 15, 34 (1981).
25. *Kimmell v. Schaefer*, 652 N.Y.S.2d 715 (N.Y. 1996).
26. N.Y. Bus. Corp. Law §§ 715, 717.
27. *Kimmell v. Schaefer*, 652 N.Y.S.2d 715, 720 (N.Y. 1996).
28. *Kimmell v. Schaefer*, 652 N.Y.S.2d 715, 720 (N.Y. 1996).
29. *Francis v. United Jersey Bank*, 87 N.J. 15, 36 (1981).
30. *Francis v. United Jersey Bank*, 87 N.J. 15, 36 (1981).

On the other hand, a director may possibly absolve himself of liability by informing other directors of the impropriety in voting for an improper cause of action.[31]

1-2:4 The Business Judgment Rule

The business judgment rule protects a director's actions from being questioned by a court in the absence of a showing of fraud, self-dealing or unconscionable conduct, as long as he acts reasonably and in good faith in carrying out his fiduciary duties to the corporation.[32] The rule acts to promote and protect the full and free exercise of the power of management given to directors.[33] The rule presumes that disinterested directors of a company act "on an informed basis, in good faith and in the honest belief that their actions are in the corporation's best interest."[34]

The rule is a rebuttable presumption, and the burden of proof shifts to the defendant to show the intrinsic fairness of the transaction at issue,[35] but only upon a showing by the plaintiff

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31. *Francis v. United Jersey Bank*, 87 N.J. 15, 40 (1981) (citing N.J.S.A. 14A:6-12).

32. *Alloco v. Ocean Beach & Bay Club*, 456 N.J. Super. 124, 135 (App. Div. 2018); *Papalexiou v. Tower West Condominium*, 167 N.J. Super. 516, 527 (Ch. Div. 1979); *Daloisio v. Peninsula Land Co*., 43 N.J. Super. 79, 93 (App. Div. 1956). There is understandable confusion regarding the true meaning of the business judgment rule. Many practitioners perceive the rule to hold directors and officers to a duty requiring the exercise of reasonable business judgment as the title states. As indicated herein, the case law is to the contrary. "Bad judgment without bad faith does not ordinarily make officers individually liable." *Maul v. Kirkman*, 270 N.J. Super. 596, 614 (App. Div. 1994) (citing 3A William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Private Corporations § 1038, at 45 (perm. ed. rev. vol. 1986)). *See also Verna v. Links at Valleybrook Neighborhood Ass'n*, 371 N.J. Super. 77, 93 (App. Div. 2004) (affirming *Papalexiou*); *Jurista v. Amerinox Processing, Inc.*, 492 B.R. 707, 761-62 (Bankr. D.N.J. 2013). The *Jurista* court noted that in order to show a director acted in bad faith, the plaintiff must show that the director "(1) intentionally acted with a purpose other than that of advancing the best interests of the corporation, (2) acted with the intent to violate applicable positive law, or (3) intentionally failed to act in the face of a known duty to act, thereby demonstrating a conscious disregard for his duties." The *Jurista* court concluded that the business judgment rule will not protect a director if such bad faith is shown.

33. *Maul v. Kirkman*, 270 N.J. Super. 596, 614 (App. Div. 1994); *see also Jurista v. Amerinox Processing, Inc.*, 492 B.R. 707, 759 (Bankr. D.N.J. 2013).

34. *In re PSE&G Shareholder Litig*., 315 N.J. Super. 323, 327 (Ch. Div. 1998), *aff'd*, 173 N.J. 258 (2002) (citing *Grobow v. Perot*, 539 A.2d 180, 187 (Del. Supr. 1988)); *Brehm v. Eisner*, 746 A.2d 244, 264 n. 66 (Del. 2000)); *Alloco v. Ocean Beach & Bay Club*, 456 N.J. Super. 124, 135 (App. Div. 2018).

35. *Maul v. Kirkman*, 270 N.J. Super. 596, 614 (App. Div. 1994); *Alloco v. Ocean Beach & Bay Club*, 456 N.J. Super. 124, 136 (App. Div. 2018) (affirming order applying business judgment rule to grant summary judgment where the "evidence proffered by plaintiffs was insufficient to rebut the presumption of validity and carry their initial burden of showing the Board's actions were fraudulent, self-dealing, or unconscionable.").

of self-dealing or "other disabling factor."[36] The rationale behind this rule is to encourage qualified persons to serve as directors and to motivate them to take entrepreneurial risks.[37] Similarly, although a shareholder may recover derivatively on behalf of the corporation for losses sustained by the corporation caused by acts of a breaching director, a shareholder may not recover derivatively if the losses arise from a director's legitimate and good faith business judgment.[38]

Delaware and New York, two beacon states when analyzing corporate law, are substantially similar to New Jersey. In *Shamrock Holdings, Inc. v. Polaroid Corp.*,[39] an action attacking the validity of an employee stock ownership plan, the Delaware Chancery Court found that it was well settled that directors are responsible for managing the business affairs of a corporation, and in exercising such responsibilities they are charged with a fiduciary duty to the corporation and its shareholders.[40] The *Shamrock Holdings* court further stated that when the business judgment rule is properly invoked, directors' decisions will be upheld absent an abuse of discretion. However, the protection of the business judgment rule will not be given to directors who fail to inform themselves prior to making a business decision of all material information reasonably available.[41]

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36. *Maul v. Kirkman*, 270 N.J. Super. 596, 614 (App. Div. 1994) (citing 3A William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Private Corporations § 1039, at 58 (perm. ed. rev. vol. 1986)).

37. *In re PSE&G Shareholder Litig.*, 315 N.J. Super. 323, 328 (Ch. Div. 1998), *aff'd*, 173 N.J. 258 (2002).

38. *68th St. Apts., Inc. v. Lauricella*, 142 N.J. Super. 546, 557 (Law Div. 1976) (citations omitted), *aff'd*, 150 N.J. Super. 47 (App. Div. 1977); *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 93 (App. Div. 1956) (citing *Ellerman v. Chicago Junction Railways, Etc., Co.*, 49 N.J. Eq. 217, 232 (Ch. 1891)); *Bentley v. Colgate*, 10 N.J. Misc. 1222, 1224 (Sup. Ct. 1932).

39. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257 (Del. Ch. 1989).

40. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 269 (Del. Ch. 1989).

41. *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 269 (Del. Ch. 1989) (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds, Brehm v. Eisner*, 746 A.2d 244 (Del. 2000)). The *Brehm* Court followed the proposition from *Aronson* that directors must consider all material information reasonably available to them when making business decisions and also stated in *dicta* that directors are responsible for considering *only* material facts that are reasonably available, and not those facts that are immaterial or out of the directors' reasonable reach. *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000). *See also In re WeWork Litig.*, 250 A.3d 901 (Del. Ch. 2020) (holding that a temporary committee of the board of directors, created in response to the filing of a lawsuit against the corporation's new controlling stockholders was not permitted to terminate a lawsuit, which an earlier committee of the board filed on behalf of the corporation with the support of the

In *Gagliardi v. TriFoods International, Inc.*,[42] plaintiff shareholders asserted that the defendant directors and certain major shareholders were liable to the corporation and to the plaintiffs individually based upon a host of theories, including mismanagement. The court stated with respect to the allegations of negligent mismanagement that unless there are facts showing self-dealing or improper motive, "a corporate officer or director is not legally responsible to the corporation for losses that may be suffered as a result of a decision that an officer made or that directors authorized in good faith."[43]

The actions of a corporation's directors must meet the test of reasonableness, too.[44] At least one Delaware court has found that decisions by the corporation or its directors may be so egregious that liability for losses arising from such decisions may be actionable even in the absence of conflict of interest or improper motivation on the part of the directors.[45] However, generally, a claimant will not be able to sustain a cause of action alleging loss resulting from a lawful and good faith transaction by the corporation or the directors.[46]

In *Kamin v. American Express Co.*,[47] the New York trial court stated that the question of whether or not a dividend is to be declared or a distribution of some kind should be made is

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corporation's management and its outside counsel to enforce the corporation's contractual rights, because it erroneously concluded that special members were no longer sufficiently disinterested to maintain the action due to personal interests in the subject tender offer, and temporary committee's comparison of benefits and harms of the litigation was flawed).

42. *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049 (Del. Ch. 1996).

43. *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1051 (Del. Ch. 1996) (other citations omitted). *See also In re Citigroup Inc. Shareholder Derivative Litig.*, 964 A.2d 106, 130 N. 72 (Del. Ch. 2009); *In re Intel Corp. Derivative Litig.*, 621 F. Supp. 2d 165, 174 (D. Del. 2009) (citing *In re Caremark Int'l*, 698 A.2d 959, 967 (Del. Ch. 1996) and *In re Citigroup, Inc. Shareholder Derivative Litig.* for the proposition that "liability for such a failure to oversee requires a showing that the directors knew that they were not discharging their fiduciary obligations or that they demonstrated a *conscious* disregard for their duties.") (emphasis in original).

44. *Papalexiou v. Tower West Condominium*, 167 N.J. Super. 516, 526 (Ch. Div. 1979).

45. *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996) (stating that it was aware of only one "dubious" holding in Delaware, *Gimbel v. Signal Companies, Inc.*, 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974), where equitable relief was granted in the absence of conflict or improper motivation).

46. *Gimbel v. Signal Companies, Inc.*, 316 A.2d 599, 620 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).

47. *Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807 (N.Y. Sup. Ct.), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1st Dept. 1976).

exclusively a matter for directors and well within their exercise of business judgment.[48] The court further noted that it will not interfere with directors' exercise of business judgment unless it appears that the directors have acted or are about to act in bad faith and for a dishonest purpose.[49] Thus the court found that there is not a cognizable cause of action when a complaint merely alleges that "some course of action other than that pursued by the Board of Directors would have been more advantageous."[50] The court stated that "[t]he directors' room rather than the courtroom is the appropriate forum for thrashing out purely business questions which will have an impact on profits, market prices, competitive situations, or tax advantages."[51]

The notion that the declaration of a dividend is a matter of business judgment for the board of directors is acknowledged by courts in New Jersey as well.[52] The business judgment rule will not protect the conduct of corporate officers alleged to have acted in bad faith in furtherance of a fraudulent scheme and in their own self-interest in declaring a sizable dividend to themselves at a time when the corporation was otherwise insolvent.[53]

1-3 USURPING CORPORATE OPPORTUNITIES

A director may not purchase for himself property that he has the duty to purchase for the corporation.[54] That directors may not

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48. *Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807, 812 (N.Y. Sup. Ct.), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1st Dept. 1976). In *Kamin*, two minority stockholders sought to declare that a dividend-in-kind issued by the directors was a waste of corporate assets. The directors defended their actions as being based on sound business judgment.

49. *Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807, 810, 812 (N.Y. Sup. Ct.), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1st Dept. 1976) (citing *Liebman v. Auto Strop Co.*, 241 N.Y. 427, 433-34 (1926)).

50. *Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807, 810 (N.Y. Sup. Ct.), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1st Dep't. 1976).

51. *Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807, 812-13 (N.Y. Sup. Ct.), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1st Dept. 1976).

52. *See Maul v. Kirkman*, 270 N.J. Super. 596, 615 (App. Div. 1994); *see also In re Arens' Trust*, 41 N.J. 364, 375 (1964), *abrogated on other grounds, Matter of Estate of Dawson*, 136 N.J. 1 (1994); *Casson v. Bosman*, 137 N.J. Eq. 532, 535 (Err. & App. 1946); *L.L. Constantin & Co. v. R.P Holding Corp.*, 56 N.J. Super. 411, 423 (Ch. Div. 1959); *Seidman v. Clifton Sav. Bank, S.L.A.*, 205 N.J. 150, 175 (2011) (citing with approval *In re Arens' Trust*, 41 N.J. 364, 375 (1964) (improperly cited as "*In re Trust of Arens*") for proposition that "declaration of any kind of dividend is committed to business judgment of corporate directors").

53. *Jurista v. Amerinox Processing, Inc.*, 492 B.R. 707, 762 (Bankr. D.N.J. 2013).

54. *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 92 (App. Div. 1956). As explained by the U.S. Court of Appeals for the Third Circuit in *VFB, LLC v. Campbell Soup Co.*,

compete with the corporation is a "fundamental proposition." Directors cannot hide behind the excuse that the company was unable to take advantage of a corporate opportunity because of the lack of funds when it was the directors' own lack of diligence that caused the corporation's inability to take on the corporate opportunity.[55]

It is clear that directors may not forgo a legitimate corporate opportunity, or give a company's valuable property rights away, for directors' personal gain.[56] Indeed, directors must forgo entering into a contract that would serve their personal interests if doing so would be adverse to the interests of the corporation.[57]

Our courts have found that New Jersey subscribes to the Delaware view of usurpation of corporate opportunity:

> [I]f there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, and is, from its nature, in the line of the corporation's business and is a practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself. And, if in such circumstances, the interests of the corporation are betrayed, the corporation may elect to claim all of the benefits of the transaction for itself, and the law will impress a trust in favor of the corporation

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482 F.3d 624, 634-35 (3d Cir. 2007), corporate directors must act in their shareholders' best interests and not enrich themselves at their expense (citing *Cede & Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994) and *AYR Composition, Inc. v. Rosenberg*, 261 N.J. Super. 495, 619 A.2d 592, 595 (App. Div. 1993)). The law enforces this duty of loyalty by subjecting certain actions to unusual scrutiny. When a director acts while under an incentive to disregard the corporation's interests, she must show her "utmost good faith and the most scrupulous inherent fairness of the bargain." *VFB LLC v. Campbell Soup Co.*, 482 F.3d 624, 635 (3d Cir. 2007) (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983).

55. *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 93 (App. Div. 1956).

56. *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 92 (App. Div. 1956).

57. *See Valle v. N. Jersey Automobile Club*, 141 N.J. Super. 568, 573-74 (App. Div. 1976), *aff'd*, 74 N.J. 109 (1977).

> upon the property, interests and profits so acquired . . . .[58]

The Delaware Supreme Court further elaborated on this doctrine in *Broz v. Cellular Information Systems, Inc.*[59] In that case, Broz, the defendant, was the president and sole stockholder of RFBC, while also a member of the board of directors of plaintiff CIS. Broz purchased a cellular telephone service license for the benefit of RFBC. CIS brought action against Broz and RFBC for equitable relief.

Although CIS would have been unable to purchase the license at issue without the approval of its creditors, the Delaware Court of Chancery determined that the purchase of the cellular license for RFBC by Broz constituted an impermissible usurpation of a corporate opportunity properly belonging to CIS, and thus Broz breached his fiduciary duty to CIS and its shareholders.[60]

The Delaware Supreme Court found that a director or officer may take a corporate opportunity if: (1) the opportunity is presented to the director or officer in his individual and not his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity.[61]

In a more general discussion on liability for usurping a corporate opportunity, the *Broz* Court stated:

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58. *Valle v. N. Jersey Automobile Club*, 141 N.J. Super. 568, 573-74 (App. Div. 1976), *aff'd*, 74 N.J. 109 (1977) (citing *Guth v. Loft, Inc.*, 23 Del. Ch. 255, 272 (1939)). The *Valle* decision shows that the same standards apply for depriving a corporation of a legitimate business opportunity whether the corporation is for profit or nonprofit.

59. *Broz v. Cellular Info. Systems Inc.*, 673 A.2d 148 (Del. 1996).

60. *Broz v. Cellular Info. Systems Inc.*, 673 A.2d 148, 151 (Del. 1996).

61. *Broz v. Cellular Info. Systems Inc.*, 673 A.2d 148, 155 (Del. 1996) (citing *Guth v. Loft, Inc.*, 5 A.2d 503, 513 (Del. 1939)) (The *Broz* Court found that the facts of the case did not support the conclusion that *Broz* had misappropriated a corporate opportunity.) *See also Science Accessories Corp. v. Summagraphics Corp.*, 425 A.2d 957, 963 (Del. 1980); *Lazard Debt Recovery GP v. Weinstock*, 864 A.2d 955, 966-67 (Del. Ch. 2004). The Delaware Court of Chancery has explained that although the four *Broz* factors are articulated in the conjunctive, the four factors are guidelines to be considered by a reviewing court and that no one factor is dispositive, such that all factors must be taken into account insofar as they are applicable. *See Personal Touch Holding Corp. v. Glaubach*, No. 11199-CB, 2019 WL 937180, at *14 (Del. Ch. Feb. 25, 2019), *judgment entered sub nom. Personal Touch Holding Corp. v. Felix Glaubach, D.D.S.* (Del. Ch. 2019).

> The teaching of *Guth [v. Loft]* and its progeny is that the director or officer must analyze the situation ex ante to determine whether the opportunity is one rightfully belonging to the corporation. If the director or officer believes, based on one of the factors articulated above that the corporation is not entitled to the opportunity, then he may take it for himself. Of course, presenting the opportunity to the board creates a kind of "safe harbor" for the director, which removes the specter of a post hoc judicial determination that the director or officer has improperly usurped a corporate opportunity. Thus, presentation avoids the possibility that an error in the fiduciary's assessment of the situation will create future liability for breach of fiduciary duty.[62]

Both the timing and the circumstances involving a potential corporate opportunity must be assessed in determining whether a director will be liable for his actions.[63] The U.S. Court of Appeals for the Third Circuit has held that when a director is acting in the interest of the corporation's wholly-owned subsidiary, there is no "divided loyalty" or need for extra scrutiny. As the Third Circuit explained in *VFB, LLC v. Campbell Soup Co.*:[64]

> Directors must act in the best interests of a corporation's shareholders, but a wholly-owned subsidiary has only one shareholder: the parent. There is only one substantive interest to be protected, and hence 'no divided loyalty' of the subsidiary's directors and no need for special scrutiny of their actions.

Similarly, Delaware courts have stated that a corporate fiduciary is free to take on a business opportunity for himself

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62. *Broz v. Cellular Info. Systems Inc.*, 673 A.2d 148, 154-55 (Del. 1996). *See also South Canaan Cellular Invs., LLC v. Lackawaxen Telecom, Inc. (In re South Canaan Cellular Invs., LLC)*, 427 B.R. 85 (Bankr. E.D. Pa. 2010), *rev'd on other grounds*, Nos. 10-MC-0057, 10-2122, 2010 U.S. Dist. LEXIS 85420 (E.D. Pa. 2010).

63. *Broz v. Cellular Info. Systems Inc.*, 673 A.2d 148, 154-55 (Del. 1996).

64. *VFB, LLC v. Campbell Soup Co.*, 482 F.3d 624, 634-35 (3d Cir. 2007) (quoting *Bresnick v. Franklin Capital Corp.*, 10 N.J. Super. 234 (App. Div.), *aff'd*, 7 N.J. 184 (1951) (per curiam)).

once his corporation has properly rejected the opportunity or if it has been established that the corporation is not in the position to take on the opportunity, regardless of whether the fiduciary learns of the opportunity through his position.[65] Furthermore, there will be no breach of fiduciary duty when a director or a corporate officer benefits personally from a wholly noncorporate transaction unless he has derived some specialized or unique advantage from his fiduciary position.[66] A director or officer, however, will breach his fiduciary obligations when entering into a sale of the corporation's assets for an inadequate or inequitable price, or by soliciting proxies by means of false and misleading proxy materials.[67]

In New Jersey, because corporate directors must act as fiduciaries and have the utmost fidelity in their dealings with the corporation and its shareholders, directors may not personally enter into a contract that benefits any director and that affects the corporation without the knowledge and consent of the shareholders.[68] Although the personal interests of a director in entering into a contract affecting the corporation will not necessarily render the transaction void *per se*, it will render it voidable at the option of the stockholders.[69] Such transactions on the part of a director will be subject to close scrutiny and must be conducted in absolute good faith.[70]

In addition, a contract or transaction between a corporation and one or more of its directors will be voidable by the corporation unless the one seeking to enforce the contract or transaction can demonstrate by clear and convincing proof that it is fair, honest and reasonable.[71] In other words, the director bears the burden of

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65. *Field v. Allyn*, 457 A.2d 1089, 1099 (Del. Ch.), *aff'd*, 467 A.2d 1274 (Del. 1983).

66. *Field v. Allyn*, 457 A.2d 1089, 1099 (Del. Ch.), *aff'd*, 467 A.2d 1274 (Del. 1983).

67. *Scott v. Multi-Amp Corp.*, 386 F. Supp. 44 (D.N.J. 1974) (citing 15 U.S.C. § 78n).

68. *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 88 (App. Div. 1956) (citing *Hodge v. United States Steel Corp.*, 64 N.J. Eq. 807, 813 (1903)).

69. *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 88 (App. Div. 1956) (citing *Hodge v. United States Steel Corp.*, 64 N.J. Eq. 807, 813 (1903)).

70. *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 88 (App. Div. 1956) (citing *Hill Dredging Corp. v. Risley*, 18 N.J. 501, 537 (1955)).

71. *Scott v. Multi-Amp Corp.*, 386 F. Supp. 44, 68 (D.N.J. 1974) (citing *Abeles v. Adams Engineering Co., Inc.*, 35 N.J. 411, 428-29 (1961)). *See also Hill Dredging Corp. v. Risley*, 18 N.J. 501, 531 (1955) (subjecting transactions between a corporation and its director to "close scrutiny"); *Seidman v. Clifton Sav. Bank, S.L.A.*, 205 N.J. 150, 195 (2011) (citing with

justifying such a transaction if it is taken without prior shareholder approval.[72]

1-4 DIRECTORS' PURCHASES OF CORPORATE STOCK

The board of directors can authorize the sale of stock to one of its members without shareholder approval, provided the certificate of incorporation permits such action.[73] Furthermore, provided it is not contrary to the corporation's certificate of incorporation, directors may sell stock to themselves without shareholder approval even when all directors are purchasing stock.[74] In the latter case, the directors must show by clear and convincing evidence that the transaction was honest, fair and reasonable, absent ratification of the sale by the shareholders.[75] If directors in the latter instance purchase a corporation's stock without having obtained prior shareholder approval or without obtaining subsequent ratification by the shareholders, the directors have the burden of proving that the transaction was effectuated for a valid corporate purpose.[76] If this burden is not met, the transaction may be voidable.[77] Furthermore, the directors may be held jointly and severally liable for any and all losses borne by the corporation as a result of their actions.[78]

1-5 USE OF INSIDER INFORMATION

Directors' use of insider information to obtain personal profit violates the directors' fiduciary obligations to the corporation.[79] The U.S. District Court for the District of New Jersey has found that in the absence of any New Jersey law indicating otherwise,

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approval *Abeles v. Adams Eng'g Co., Inc*., 35 N.J. 411 (1961), and *Hill Dredging Corp. v. Risely*, 18 N.J. 501 (1955)).

72. *Daloisio v. Peninsula Land Co.*, 43 N.J. Super. 79, 88 (App. Div. 1956).

73. *Pappas v. Moss*, 393 F.2d 865, 867 (3d Cir. 1968), *on remand*, 303 F. Supp. 1257 (D.N.J. 1969).

74. *Pappas v. Moss*, 393 F.2d 865, 867 (3d Cir. 1968), *on remand*, 303 F. Supp. 1257 (D.N.J. 1969).

75. *Pappas v. Moss*, 393 F.2d 865, 867-68 (3d Cir. 1968), *on remand*, 303 F. Supp. 1257 (D.N.J. 1969).

76. *Tully v. Mott Supermarkets, Inc.*, 337 F. Supp. 834, 847 (D.N.J. 1972).

77. *Tully v. Mott Supermarkets, Inc.*, 337 F. Supp. 834, 847 (D.N.J. 1972).

78. *Pappas v. Moss*, 303 F. Supp. 1257, 1280 (D.N.J. 1969).

79. *National Westminster Bancorp. N.J. v. Leone*, 702 F. Supp. 1132, 1139 (D.N.J. 1988). *See also In re Cendant Corp. Derivative Action Litig.*, 189 F.R.D. 117, 130 (D.N.J. 1999).

there is a common-law cause of action by the corporation against a corporate director for profits gained by trading on inside information.[80]

1-6 CORPORATE LIABILITY FOR THE ACTS OF A PRINCIPAL

An officer's fraudulent acts will be imputed to the corporation when the officer's conduct is committed in the course of his employment and for the benefit of the corporation.[81] The Third Circuit, in *Lightning Lube, Inc. v. Witco Corp.*,[82] clearly stated that a corporation is responsible for compensatory damages for its officer's wrongdoing. However, the *Lightning Lube* court stated that punitive damages may not be assessed against a corporation for the wrongful acts of its employees unless someone "so high in authority as to be fairly considered executive in character" participated in the wrongful conduct or "specially authorized" or "ratified" it.[83] The official committing, approving or ratifying the wrongful conduct need not be the highest officer in the corporate hierarchy for punitive damages to be assessed against the company, but must be a person of such responsibility as to arouse "the institutional conscience."[84] However, a single tortious act alone would not be sufficient to prove management's knowledge and ratification of a corporate scheme to which the corporation and individual employees would be held liable.[85]

1-7 INDIVIDUAL LIABILITY

An officer who enters into an agreement solely as an agent of the corporation will not be found personally liable for default of the

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80. *National Westminster Bancorp. N.J. v. Leone*, 702 F. Supp. 1132, 1139 (D.N.J. 1988) (citing *In re ORFA Sec. Litig.*, 654 F Supp. 1449 (D.N.J. 1987)).

81. *Commodity Futures Trading Comm'n v. Am. Metals Exchange Corp.*, 775 F. Supp. 767, 778 (D.N.J. 1991), *aff'd in part, vacated in part on other grounds*, 991 F.2d 71 (3d Cir. 1993).

82. *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153 (3d Cir. 1993).

83. *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1192 (3d Cir. 1993) (citing *Winkler v. Hartford Accident and Indemnity Co.*, 66 N.J. Super. 22 (App. Div.), *certif. denied*, 34 N.J. 581 (1961)).

84. *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1192 (3d Cir. 1993) (citing *Doralee Estates, Inc. v. Cities Serv. Oil Co.*, 569 F.2d 716, 722 (2d Cir. 1977)).

85. *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1196 (3d Cir. 1993).

corporate obligation under the agreement.[86] The Third Circuit has found that it is a well-settled rule that a corporation is, for most purposes, an entity distinct from its individual shareholders and that only in exceptional circumstances may the separate corporate entity be disregarded.[87] As such, an officer will not be held liable personally for the wrongful acts of the corporation, unless he acted beyond the scope of his authority or exhibited an intent to be held personally liable.[88] Similarly, officers will not be held personally liable for corporate debts incurred while the corporation's charter is suspended.[89]

New Jersey courts apply the doctrine known as the participation theory when determining a corporate officer's personal liability for his tortious conduct.[90] As explained by the New Jersey Supreme Court in *Saltiel*, participation theory means that "a corporate officer can be held personally liable for a tort committed by the corporation when he is sufficiently involved in the commission of the tort."[91] The court noted that "[a] predicate to liability is a finding that the corporation owed a duty of care to the victim, the duty was delegated to the officer and the officer breached the duty of care by his own conduct."[92] Thus, a corporate officer will be

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86. *Trustees of Local 478 Trucking and Allied Indus. Pension Fund v. Pirozzi*, 198 N.J. Super. 297, 317 (Law Div. 1983), *aff'd*, 198 N.J. Super. 318 (App. Div. 1984).

87. *Gardner v. The Calvert*, 253 F.2d 395, 398 (3d Cir. 1958), *cert. denied sub nom., Sound Steamship Lines, Inc. v. Gardner*, 356 U.S. 960 (1958).

88. *Gardner v. The Calvert*, 253 F.2d 395, 398 (3d Cir. 1958), *cert. denied sub nom., Sound Steamship Lines, Inc. v. Gardner*, 356 U.S. 960 (1958). *See also Zeiger v. Wilf*, 333 N.J. Super 258, 284-86 (App. Div. 2000), *overruled on other grounds, Lombardi v. Masso*, 207 N.J. 517 (2011); *Fields v. Thompson Printing Co., Inc.*, 363 F.3d 259, 274 (3d Cir. 2004).

89. *Asbestos Workers, Local Union No. 32 v. Shaughnessey*, 306 N.J. Super. 1, 5 (App. Div. 1997). In *Shaughnessey*, the court raised a caveat to its decision by stating that if there were an element of fraud, or if there were express reliance upon the individual credit of the individual officers because of knowledge by the parties that the corporation was going to be dissolved, the decision regarding personal liability might be different. *See also Zeiger v. Wilf*, 333 N.J. Super 258, 284-86 (App. Div. 2000), *overruled on other grounds, Lombardi v. Masso*, 207 N.J. 517 (2011). The *Zeiger* court clarified that the act of reinstatement of the corporation's charter ratifies the acts taken by officers during the charter's suspension; once the charter is reinstated, the reinstatement will relate back to the date of the revocation of the charter, and all actions taken by the corporation in the interim will be validated. Thus, there would be no reason to add personal liability to the officers of the corporation. *Zeiger*, 333 N.J. Super. at 269. *See also Fields v. Thompson Printing Co., Inc.*, 363 F.3d 259, 274 (3d Cir. 2004).

90. *Saltiel v. GSI Consultants, Inc.*, 170 N.J. 297, 303 (2002); *Metuchen Sav. Bank v. Pierini*, 377 N.J. Super. 154, 162 (App. Div. 2005).

91. *Saltiel v. GSI Consultants, Inc.*, 170 N.J. 297, 303 (2002).

92. *Saltiel v. GSI Consultants, Inc.*, 170 N.J. 297, 303 (2002). *See also* 3A Fletcher Cyclopedia of the Law of Private Corporations § 1137 (rev. perm. ed. 1994).

liable if he is sufficiently involved in a tortious act on behalf of the corporation, even if he derived no personal benefit.[93]

In *Allen v. V & A Brothers, Inc*., the New Jersey Supreme Court took a similar approach to the issue of individual liability under the Consumer Fraud Act (CFA).[94] In *Allen*, a case involving CFA claims against both a landscaping corporation and its officers, the Court addressed the "appropriate parameters of individual liability" of corporate officers and employees.[95] Although the only issue before the Court was whether corporate officers could be individually liable for violations of the CFA for acts undertaken through or in conjunction with the corporation, the Court considered the issue in reference to traditional veil-piercing theories and the tort participation theory.[96]

The *Allen* Court cited with approval numerous lower court decisions for the proposition that "individuals may be independently liable for violations of the CFA, notwithstanding the fact that they were acting through a corporation at the time."[97] Although the Supreme Court articulated no specific test for when liability would attach, it explained that "courts focu[s] on the acts of the individual employee or corporate officer to determine whether the specific individual had engaged in conduct prohibited by the CFA."[98] Ultimately, "individual liability for a violation of the CFA will necessarily depend upon an evaluation of both the specific source of the claimed violation that forms the basis for the plaintiff's complaint as well as the particular acts that the individual has undertaken."[99]

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93. *Saltiel v. GSI Consultants, Inc.*, 170 N.J. 297, 303 (2002); *Reliance Ins. Co. v. The Lott Grp., Inc.*, 370 N.J. Super. 563, 580 (2004). *See also Monarch Capital Corp. v. Bath (In re Bath)*, 442 B.R. 377, 394 (Bankr. E.D. Pa. 2010) (applying New Jersey law, holding that to the extent a limited liability company acted through its corporate officer in improperly using funds, the officer is not insulated by the limited liability company's status). *Allen v. V & A Bros., Inc*., 208 N.J. 114, 136 (2011).

94. *Allen v. V & A Bros., Inc*., 208 N.J. 114, 135 (2011) (describing the approach to individual liability under the CFA, N.J.S.A. 56:8-1, *et seq*., as "consistent with the related approach to individual liability . . . identified as the tort participation theory" in *Saltiel*).

95. *Allen v. V & A Bros., Inc*., 208 N.J. 114, 127 (2011).

96. *Allen v. V & A Bros., Inc*., 208 N.J. 114, 127 (2011).

97. *Allen v. V & A Bros., Inc*., 208 N.J. 114, 131-32 (2011) (citing *Gennari v. Weichert Co. Realtors*, 148 N.J. 582, 608-10 (1997)); *see also New Mea Constr. Corp. v. Harper*, 203 N.J. Super. 486, 502-03 (App. Div. 1985); *Hyland v. Aquarian Age 2,000 Inc*., 148 N.J. Super. 186, 193 (Ch. Div. 1977); *Kugler v. Koscot Interplanetary, Inc*., 120 N.J. Super. 216, 255-58 (Ch. Div. 1972).

98. *Allen v. V & A Bros, Inc*., 208 N.J. 114, 132 (2011).

99. *Allen v. V & A Bros, Inc*., 208 N.J. 114, 132 (2011); *see also G&F Graphic Servs. v. Graphic Innovators, Inc.*, 18 F. Supp. 3d 583, 588-89 (D.N.J. 2014) (court denied motion to

When the basis for the CFA claim is a regulatory violation, *Allen* holds that individual liability "rest[s] on the particular regulation in issue and the nature of the actions undertaken by the individual defendant."[100] The determination is "necessarily fact-sensitive" and "often will not lend [itself] to adjudication on a record presented in the form of a summary judgment motion."[101] Explaining the appropriate analysis in such a case, and the distinction between liability of corporate principals and employees, the Supreme Court explained:

> In considering whether there can be individual liability for these regulatory violations, a distinction can be drawn between the principals of a corporation and its employees. The principals may be broadly liable, for they are the ones who set the policies that the employees may be merely carrying out. Therefore, if the principals have adopted a course of conduct in which written contracts are never used, in clear violation of the regulation, there may be little basis on which to extend personal liability to the employee who complies with that corporate policy. However, if the employee unilaterally concludes that an inferior product should be used in place of one specified in a contract and does so without the knowledge of the homeowner, there is little reason to construe the CFA to limit liability to the corporate employer and permit that employee to escape bearing some individual liability. As a result, although the analysis of whether there can be individual liability for regulatory violations is more complex, and although it turns on the particular facts and circumstances of the claim and the regulations, the suggestion that there can be no basis for individual liability is not one we can endorse.[102]

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dismiss CFA claim against company president based on alleged material misrepresentations made by president).

100. *Allen v. V & A Bros, Inc.*, 208 N.J. 114, 134 (2011).

101. *Allen v. V & A Bros, Inc.*, 208 N.J. 114, 135 (2011).

102. *Allen v. V & A Bros, Inc.*, 208 N.J. 114, 134 (2011).

There is an established body of cases holding officers liable for fraud, conversion and other intentional torts.[103] As one court explained, "it is well settled . . . that the officers of a corporation are personally liable to one whose money or property has been misappropriated or converted by them to the uses of the corporation, although they derived no personal benefit therefrom and acted merely as agents of the corporation."[104] In *Robsac Industries, Inc. v. Chartpak*, a corporate officer was found capable of liability for malicious interference with contract, fraudulent misrepresentation and defamation even though liability had also been imposed on the corporation for the same acts.[105] *In Van Dam Egg Co. v. Allendale Farms, Inc.*, the court held that an officer will be liable for his misrepresentations when the officer knows that the information misrepresented is being relied upon by a third party.[106] In *G&F Graphic Services v. Graphic Innovators, Inc.*, the court found a claim of fraud sufficiently pled where the complaint included allegations that the company's president participated in the alleged fraud.[107]

Although most reported cases involve liability for intentional torts, New Jersey courts have acknowledged that an officer or director may be liable for unintentional torts[108] as well as statutory violations. For example, in *Reliance Ins. Co. v. The Lott Group, Inc.*, the court held a financial consultant who assisted a company in improperly diverting funds that had been protected by statute personally liable to the company's surety.[109]

Finally, although not necessarily a tort per se, nonpayment of an employee's wages is yet another basis for a corporate officer's liability. *In Mulford v. Computer Leasing, Inc.*, the court found that an employee may maintain a private cause of action against the

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103. *See, e.g., Saltiel v. GSI Consultants, Inc.*, 170 N.J. 297, 304 (2002) (citing cases); *Charles Bloom & Co. v. Echo Jewelers*, 279 N.J. Super. 372 (App. Div. 1995).

104. *Glenfed Fin. Corp., Commercial Fin. Div. v. Penick Corp.*, 276 N.J. Super. 163, 181 (App. Div. 1994), *certif. denied*, 139 N.J. 442 (1995) (quoting *Hirsch v. Phily*, 4 N.J. 408, 416 (1950)). *See also In re B.S. Livingston & Co., Inc.*, 186 B.R. 841, 867 (D.N.J. 1995).

105. *Robsac Indus., Inc. v. Chartpak*, 204 N.J. Super. 149 (App. Div. 1985).

106. *Van Dam Egg Co. v. Allendale Farms, Inc.*, 199 N.J. Super. 452, 457 (App. Div. 1985).

107. *G&F Graphic Servs. v. Graphic Innovators, Inc.*, 18 F. Supp. 3d 583, 588-89 (D.N.J. 2014).

108. *See Sensale v. Applikon Dyeing & Printing Corp.*, 12 N.J. Super. 171, 175 (App. Div. 1951).

109. *Reliance Ins. Co. v. The Lott Grp., Inc.*, 370 N.J. Super. 563, 581-82, *certif. denied*, 182 N.J. 149 (2004).

employee's corporate employer as well as the corporation's managing officers for nonpayment of wages, and that this remedy is afforded employees in addition to any available penal and administrative sanctions and administrative wage collection proceedings.[110]

For personal liability to attach to a director or officer of a corporation for his tortious conduct, there must be evidence that the director or officer directed the tortious conduct or participated or cooperated in its commission.[111] In *Tannenbaum & Milsak, Inc. v. Mazzola*, for example, the court addressed whether an individual holder of property and shares of a closely held corporation could be held personally liable for commissions arising from a listing agreement signed by him but not all the other owners or shareholders.[112] The court found that the nonsigning defendant was entitled to a dismissal of the claims against him because the plaintiff had failed to present any evidence from which a reasonable fact finder could conclude that he had authorized his codefendant to act for him.[113] As for the signing shareholder's individual liability, the court held that if the plaintiff could establish the existence of a binding contract, the signing shareholder could be individually liable for the commissions.[114]

In making its determination in *Tannenbaum*, the court reviewed its decision in *Kislak Co., Inc. v. Byham*.[115] The court there held that a corporate officer could be held personally responsible for a real estate commission emanating from a signed listing agreement, despite the fact that the property was owned by the corporation. This liability will extend to injured third persons regardless of whether liability also attaches to the corporation.[116] An officer will not be held liable for a

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110. *Mulford v. Computer Leasing, Inc*., 334 N.J. Super. 385, 393-94 (Law Div. 1999) (citing N.J.S.A. 34:11-4.1, *et seq*.); *see also Collins v. ARP Renovations & Maint., LLC*, No. 1:16-cv-04684-RBK-JS, 2018 WL 1293153, at *12 (D.N.J. Mar. 13, 2018).

111. *Trustees of Structural Steel & Ornamental Iron Workers Fund v. Huber*, 136 N.J. Super. 501, 505 (App. Div. 1975), *certif. denied*, 70 N.J. 143 (1976).

112. *Tannenbaum & Milsak, Inc. v. Mazzola*, 309 N.J. Super. 88 (App. Div. 1998).

113. *Tannenbaum & Milsak, Inc. v. Mazzola*, 309 N.J. Super. 88, 94 (App. Div. 1998).

114. *Tannenbaum & Mislak, Inc. v. Mazzola*, 309 N.J. Super. 88, 94, 96 (App. Div. 1998) (in suit against officers to recover moneys allegedly owed, court applies rule that "the actions of an agent bind a principal as against third persons when the agent is vested with apparent authority which the principal knowingly permits the agent to assume, or which the principal holds the agent out to the public as possessing").

115. *Kislak Co., Inc. v. Byham*, 229 N.J. Super. 163, 167-68 (App. Div. 1988).

116. *Robsac Indus., Inc. v. Chartpak*, 204 N.J. Super. 149, 156 (App. Div. 1985).

tort committed by a corporate agent in the course of a contractual agreement unless he had actual knowledge or reasonable cause to believe that the agent was unqualified or incompetent to perform under the contract.[117] If there is actual knowledge or reasonable cause to believe that an agent is unqualified or incompetent, the corporate officer carries the burden of investigating the agent's competency pursuant to the contract.[118]

Furthermore, an officer will not be held personally liable if the officer causes the corporation to breach a contract, as long as that officer believes the breach is in the best interests of the corporation.[119] However, if the officers' actions are contrary to the interests of the corporation, implying a lack of good faith, the officer may be held personally liable.[120]

1-7:1 Limitations on Liability Set Forth in the Certificate of Incorporation

A corporation may set forth in its certificate of incorporation that a director or officer shall not be personally liable, or shall be liable only to the extent therein provided, to the corporation or its shareholders for damages for breach of any duty owed to the corporation or its shareholders.[121] However, such a provision in a certificate of incorporation will not relieve a director or officer of liability for any breach of duty based upon an act or omission: (1) in breach of the person's duty of loyalty to the corporation or its shareholders; (2) not in good faith or involving a knowing violation of law; or (3) resulting in the receipt by such person of an improper personal benefit.[122] An "act or omission in breach of a person's duty of loyalty" means an act or omission that the person knows or believes to be contrary to the best interests of the

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117. *Baran v. Clouse Trucking, Inc.*, 225 N.J. Super. 230, 235 (App. Div.), *certif. denied*, 113 N.J. 353 (1988); *see also Saltiel v. GSI Consultants, Inc.*, 170 N.J. 297, 309 (2002).

118. *Baran v. Clouse Trucking, Inc.*, 225 N.J. Super. 230, 235 (App. Div.), *certif. denied*, 113 N.J. 353 (1988).

119. *Zeiger v. Wilf*, 333 N.J. Super 258, 284-86 (App. Div. 2000), *overruled on other grounds, Lombardi v. Masso*, 207 N.J. 517 (2011).

120. *Zeiger v. Wilf*, 333 N.J. Super 258, 284-86 (App. Div. 2000), *overruled on other grounds, Lombardi v. Masso*, 207 N.J. 517 (2011).

121. N.J.S.A. 14A:2-7(3); N.J.S.A. 14A:6-14(3).

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

corporation or shareholders in connection with a matter in which he has a material conflict of interest.[123]

1-7:2 Liability of Directors in Certain Cases

Directors who vote for or concur in a number of actions will be held jointly and severally liable to the corporation for the benefit of its creditors or shareholders to the extent of any injury suffered as a result of any such action.[124] Corporate actions for which directors will be held jointly and severally liable include:

1. The declaration of any dividend or other distribution of assets to the shareholders contrary to statutory provisions or contrary to any restrictions contained in the certificate of incorporation;
2. The purchase of the shares of the corporation contrary to statutory provisions or contrary to any restrictions contained in the certificate of incorporation;
3. The distribution of assets to shareholders during or after dissolution of the corporation without paying, or adequately providing for, all known debts, obligations and liabilities of the corporation (except that the director shall be liable only to the extent of the value of assets so distributed and to the extent that such debts, obligations and liabilities of the corporation are not thereafter paid, discharged or barred by statute or otherwise);
4. The complete liquidation of the corporation and distribution of all of its assets to its shareholders without dissolving or providing for the dissolution of the corporation and the payment of all fees, taxes, and other expenses incidental thereto (except that the director shall be liable only to the extent of the value of assets so

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

124. N.J.S.A. 14A:6-12(1). This statute, however, appears to contradict the principles of the business judgment rule as discussed in § 1-2:4.

distributed and to the extent that such fees, taxes and other expenses incidental to dissolution are not thereafter paid); and

5. Making any loans to an officer, director or employee of the corporation or of any subsidiary thereof contrary to statutory provisions.[125]

In addition to these actions, if the director, as the responsible party, willfully fails to collect taxes, account for taxes owed, or otherwise willfully attempts to evade or defeat any such tax or tax payments, he will be liable for payment of the amount of taxes evaded, uncollected or not accounted for, in addition to other penalties.[126]

Any director against whom a statutory claim is successfully asserted is entitled to contribution from the other directors who voted for or concurred in the wrongful action.[127] Furthermore, directors against whom a claim is successfully asserted will be entitled to be subrogated to the rights of the corporation against shareholders who received an improper dividend or distribution with knowledge of facts indicating that it was not authorized by statute.[128] In addition, those directors may seek to have the corporation rescind the improper purchase of shares.[129] Directors also may be subrogated to the rights of the corporation against shareholders who receive an improper distribution of assets and against any person receiving an improper loan from the corporation.[130]

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125. N.J.S.A. 14A:6-12(1)(a)-(e).

126. 26 U.S.C. § 6672. Note that this section imposes liability on "the person required to collect" a tax. Thus, this section may impose liability on directors, officers or other employees or designated agents of a corporation. Furthermore, the annotations to Section 6672(b) indicate that board members of tax-exempt organizations may be subject to penalties under this section. However, Section 6672(e) provides for exceptions to this liability for voluntary board members of tax-exempt organizations unless there is no other person who can be held liable for such wrongdoing.

127. N.J.S.A. 14A:6-12(2).

128. N.J.S.A. 14A:6-12(3).

129. N.J.S.A. 14A:6-12(3).

130. N.J.S.A. 14A:6-12(3)(a)-(d).

1-7:3 Presumption of Assent to Actions Taken at Meetings

A director of a corporation who was present at a meeting of its board (or any board committee of which he is a member) at which action was taken on a corporate matter is presumed to have concurred in the action.[131] To avoid this presumption, a dissenting director must either enter his dissent into the minutes of the meeting or file a written dissent with the secretary of the meeting before or promptly thereafter.[132] Directors who are absent from a board or committee meeting also will be presumed to have concurred in the action taken at the meeting unless they file a dissent with the secretary of the corporation within a reasonable time after learning of the action.[133]

1-8 INDEMNIFYING PARTIES

1-8:1 Indemnification of the Corporation

A corporation may sue its officers or directors for indemnification as a result of liability imposed on the corporation. In *Thomas v. Duralite Co., Inc.*,[134] the court, noting that the corporation was a principal that only could be liable for fraud through the conduct of its agents, held that the corporation could sue the directors and officers for indemnification on the premise that the management of the corporate affairs was committed to their charge.[135]

1-8:2 Indemnification of Directors, Officers and Employees

Pursuant to statute, a corporation has the right to indemnify a corporate agent against his expenses and liabilities in connection with any proceeding in which he is involved by reason of acting as a corporate agent. The power to indemnify holds as long as the agent acted in good faith and in a manner reasonably believed to be

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131. N.J.S.A. 14A:6-13.

132. N.J.S.A. 14A:6-13.

133. N.J.S.A. 14A:6-13. A director will not be liable under N.J.S.A. 14A:6-12 if he has discharged his duties to the corporation pursuant to N.J.S.A. 14A:6-14, which discusses directors' good faith reliance on records and reports of employees and consultants.

134. *Thomas v. Duralite Co., Inc.*, 386 F. Supp. 698 (D.N.J. 1974), *aff'd in part, vacated in part on other grounds*, 524 F.2d 577 (3d Cir. 1975).

135. *Thomas v. Duralite Co., Inc.*, 386 F. Supp. 698, 728 (D.N.J. 1974), *aff'd in part, vacated in part on other grounds*, 524 F.2d 577 (3d Cir. 1975).

in, and not opposed to, the best interests of the corporation.[136] A "corporate agent" refers to: (1) any person who is or was a director, officer, employee or agent of the indemnifying corporation, or of any constituent corporation absorbed by the indemnifying corporation in a consolidation or merger; (2) any person who is or was a director, officer, trustee, employee or agent of any enterprise, serving as such at the request of the indemnifying corporation, or of any such constituent corporation; or (3) the legal representative of any such director; officer, trustee, employee or agent.[137] The corporation may indemnify an agent against his liability and expenses with respect to a criminal proceeding as long as the agent had no reasonable cause to believe that his conduct was unlawful.[138]

Pursuant to N.J.S.A. 14A:3-5(2), "the termination of any proceeding by judgment, order, settlement, conviction or upon a plea . . . shall not . . . create a presumption that [the] corporate agent did not meet the applicable standards" governing the agent's ability to be indemnified by the corporation—i.e., (1) the agent having acted in good faith and in a manner reasonably believed to be in or not opposed to the best interests of the corporation or (2) with respect to a criminal proceeding, the agent having had no reasonable cause to believe his or her conduct was unlawful.[139] In *Commerce Bancorp, Inc. v. Interarch, Inc.*, the Appellate Division held that this "anti-presumption" provision precluded a corporation that had voluntarily indemnified an agent upon advice of counsel and after its own due diligence from later suing the agent for restitution after a civil jury verdict found the agent to have acted in bad faith and outside the scope of her agency.[140]

A corporation has the power to indemnify a corporate agent for his expenses in connection with any proceeding against him that is brought by or in the right of the corporation.[141] Such indemnification will be allowed only if the agent acted in good faith and in a manner

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136. N.J.S.A. 14A:3-5(2)(a); *see also Solimine v. Hollander*, 129 N.J. Eq. 264, 273 (Ch. 1941).

137. N.J.S.A. 14A:3-5(1).

138. N.J.S.A. 14A:3-5(2)(b).

139. N.J.S.A. 14A:3-5(2).

140. *Commerce Bancorp, Inc. v. Interarch, Inc.*, 417 N.J. Super. 329 (2010), *certif. denied*, 205 N.J. 519 (2011).

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

reasonably believed to be in, or not opposed to, the best interests of the corporation.[142] Indemnification of expenses will not be allowed when the corporate agent is found to be liable to the corporation, unless the court determines that the corporate agent is fairly and reasonably entitled to indemnification for such expenses.[143] In a proceeding filed by (or in the right of) the corporation, the corporation may indemnify the agent against his expenses to the extent that the agent has been successful in his defense.[144]

A corporation may indemnify an agent in an action brought by the corporation or in its interest only after determining that the indemnification is proper because the agent met the applicable standards of conduct warranting indemnification.[145] If a provision for indemnification is not provided for in the certificate of incorporation or bylaws of the corporation, the determination to indemnify must be made by the board of directors, or a committee of the board, acting by a majority vote of a quorum consisting of directors who were not parties to or otherwise involved in the proceeding.[146] Barring the assembly of a quorum or the majority vote of the disinterested directors, the determination of indemnifying a corporate agent also may be made by independent legal counsel.[147] The shareholders of a corporation also may vote to indemnify an agent as long as permitted by the certificate of incorporation, bylaws or a resolution of the board of directors or shareholders.[148]

A corporation also may advance expenses incurred by an agent prior to the final disposition of a court proceeding.[149] The advance of expenses will be permitted provided that the agent repays the amount if it is determined later that the agent is not entitled to indemnification from the corporation.[150]

A corporation's indemnification and advance of expenses to an agent does not exclude the agent from other rights to which

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

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

144. N.J.S.A. 14A:3-5(4); *see also A.D.M. Corp. v. Thomson*, 707 F.2d 25, 28 (1st Cir.), *cert. denied*, 464 U.S. 938 (1983) (citing New Jersey statutory law on indemnification).

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

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

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

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

149. N.J.S.A. 14A:3-5(6).

150. N.J.S.A. 14A:3-5(6).

the agent may be entitled under a corporation's certificate of incorporation, bylaws, agreement, vote of shareholders, or otherwise.[151] However, indemnification must not be made to or on behalf of a corporate agent if a judgment or other final adjudication adverse to the corporate agent establishes that the agent's acts and omissions: (1) were in breach of his duty of loyalty to the corporation or its shareholders; (2) were not in good faith or involved a knowing violation of law; or (3) resulted in receipt by the corporate agent of an improper personal benefit.[152]

The powers granted by statute may be exercised by the corporation notwithstanding the absence of any similar provision in a certificate of incorporation or bylaws.[153] Despite this provision, in most instances[154] no indemnification or advance of expenses is to be made by a corporation, or ordered by a court, if such action is inconsistent with a provision in a corporate agreement or document that prohibits, limits or conditions the exercise of indemnification powers by the corporation or the rights of indemnification to which a corporate agent may be entitled.[155]

1-9 PIERCING THE CORPORATE VEIL

In New Jersey, a corporation is treated as an entity wholly separate and distinct from the individuals who compose and control it.[156] Absent fraud or injustice, courts generally will not pierce the corporate veil.[157] However, in some instances New Jersey courts will ignore the corporate identity, pierce the corporate veil and hold a corporate principal personally liable.[158] In finding

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

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

153. N.J.S.A. 14A:3-5(10)-(11).

154. Except as required by N.J.S.A. 14A:3-5(4).

155. N.J.S.A. 14A:3-5(10)-(11). *Shotmeyer v. New Jersey Realty Title Ins. Co.*, 195 N.J. 72, 86-87 (2008).

156. *Richard A. Pulaski Constr. Co. v. Air Frame Hangars, Inc.*, 195 N.J. 457, 472-73 (2008) (acknowledging "the fundamental propositions that a corporation is a separate entity from its shareholders, and that a primary reason for incorporation is the insulation of shareholders from the liabilities of the corporate enterprise.").

157. *Shotmeyer v. New Jersey Realty Title Ins. Co.*, 195 N.J. 72, 86-87 (2008); *State of N.J. Dep't of Envtl. Protection v. Ventron Corp.*, 94 N.J. 473, 501 (1983); *see also Canter v. Lakewood of Voorhees*, 420 N.J. Super. 508, 522 (App. Div. 2011); *DeRosa v. Accredited Home Lenders, Inc*., 420 N.J. Super. 438, 463 (App. Div. 2011).

158. *AYR Composition, Inc. v. Rosenberg*, 261 N.J. Super. 495, 506 (App. Div. 1993). *See also State of N.J. Dep't of Envtl. Protection v. Ventron Corp.*, 94 N.J. 473, 500-01 (1983);

individual defendants liable, the plaintiff must prove their individual liability and show the amount of damages chargeable to the individuals.[159] Courts will pierce the corporate veil when a corporation's officers have an opportunity to avoid the negative impact of corporate conduct in areas of public health and safety.[160] Though a corporation and its officers, directors and shareholders generally are treated as separate entities, a court of equity is always concerned with substance over form, and indeed will reach beyond merely the corporate form to achieve justice.[161] The liability sustained by individual defendants will be limited to the amount of damages directly resulting from the effects of their actions.[162]

Veil piercing is an equitable remedy whereby "the protections of corporate formation are lost."[163] As the court in *Verni ex rel. Burstein v. Harry M. Stevens, Inc.* explained, "piercing the corporate veil is not technically a mechanism for imposing 'legal' liability, but for remedying the 'fundamental unfairness [that] will result from a failure to disregard the corporate form.'"[164] The issue of piercing the corporate veil is submitted to the factfinder, unless there is no evidence sufficient to justify disregard of the corporate form.[165]

Two factors must be present to pierce the veil: (1) there must be such unity of interest between the corporation and its owners that separate personalities do not exist, and (2) if the acts complained of are treated as those of the corporation alone, a fraud or injustice will result.[166]

Richard A. Pulaski Constr. Co. v. Air Frame Hangars, Inc., 195 N.J. 457, 472 (2008); *Churchill Downs, Inc. v. Ribis*, 499 F. Supp. 3d 82 (D.N.J. 2020).

159. *AYR Composition, Inc. v. Rosenberg*, 261 N.J. Super. 495, 507 (App. Div. 1993). *See Macysyn v. Hensler*, 329 N.J. Super. 476 (App. Div. 2000) (corporate officer not actually involved in corporate business and thus not personally liable).

160. *Macysyn v. Hensler*, 329 N.J. Super. 476, 486-87 (App. Div. 2000).

161. *Hartford Fire Ins. Co. v. Conestoga Title Ins. Co.*, 328 N.J. Super. 456, 459 (App. Div.), *certif. denied*, 165 N.J. 137 (2000) (designation of spouse as sole stock owner did not conceal president's true control of corporation as its alter ego).

162. *AYR Composition, Inc. v. Rosenberg*, 261 N.J. Super. 495, 508 (App. Div. 1993). *Verni ex rel. Burstein v. Harry M. Stevens, Inc.*, 387 N.J. Super. 160, 199 (App. Div. 2006).

163. *Verni ex rel. Burstein v. Harry M. Stevens, Inc.*, 387 N.J. Super. 160, 199 (App. Div. 2006), *certif. denied, Verni v. Harry M. Stevens, Inc.*, 189 N.J. 429 (2007).

164. *Verni ex rel. Burstein v. Harry M. Stevens, Inc.*, 387 N.J. Super. 160, 199 (App. Div. 2006), *certif. denied, Verni v. Harry M. Stevens, Inc.*, 189 N.J. 429 (2007) (citation omitted); *see also Richard A. Pulaski Constr. Co. v. Air Frame Hangars, Inc.*, 195 N.J. 457, 472-73 (2008).

165. *Verni ex rel. Burstein v. Harry M. Stevens, Inc.*, 387 N.J. Super. 160, 199 (App. Div. 2006), *certif. denied, Verni v. Harry M. Stevens, Inc.*, 189 N.J. 429 (2007).

166. *State of N.J. Dep't of Environmental Protection v. Ventron Corp.*, 94 N.J. 473, 501 (1983); *Craig v. Lake Asbestos of Quebec Ltd.*, 843 F.2d 145, 149 (3d Cir. 1988). *See also*

Dominance over the offending corporation also must be shown when seeking to pierce the veil. The Third Circuit, applying New Jersey law, found that corporate dominance may be shown by the following factors: (1) gross undercapitalization; (2) failure to observe corporate formalities; (3) nonpayment of dividends; (4) insolvency of the debtor corporation; (5) siphoning of corporate funds by the dominant shareholder; (6) nonfunctioning of other directors or officers; (7) absence of corporate records; and (8) the fact that the corporation merely is a facade for the operations of the dominant stockholders.[167] Although New Jersey courts appear not to have specifically defined what constitutes "fraud" or "injustice," the U.S. Court of Appeals for the Seventh Circuit best states that fraud or injustice may be found if: (1) a party is unjustly enriched; (2) a parent company causes a subsidiary's liabilities but the subsidiary escapes the liabilities because it is unable to pay; or (3) there is a scheme to place assets into a liability-free company while placing potential or actual liabilities upon an asset-free corporation.[168] However, even in the presence of corporate dominance, liability generally will be imposed only when the parent company has abused the privilege of incorporation by using the subsidiary to perpetuate a fraud or injustice or otherwise to circumvent the law.[169] There must be some wrongdoing or impropriety on the part of the parent corporation or stockholder before the corporate veil will be pierced.[170]

In *Baird Ward Printing Co. v. Great Recipes Public Associations*,[171] the U.S. Court of Appeals for the Sixth Circuit, applying New Jersey law, faced the issue of piercing the corporate veil. There, a corporation was substituted for an individual on a contract with plaintiff. The corporation thereafter declared bankruptcy, and the

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Board of Trustees of Teamsters Local 863 Pension Fund v. Foodtown, Inc., 296 F.3d 164, 171 (3d Cir. 2002); *Verni ex rel. Burstein v. Harry M. Stevens, Inc.*, 387 N.J. Super. 160, 199-200 (App. Div. 2006), *certif. denied, Verni v. Harry M. Stevens, Inc.*, 189 N.J. 429 (2007); *Las Vegas Sands Corp. v. ACE Gaming, LLC*, 713 F. Supp. 2d 427, 446 (D.N.J. 2010).

167. *Craig v. Lake Asbestos of Quebec Ltd.*, 843 F.2d 145, 150 (3d Cir. 1988).

168. *Sea-Land Services, Inc. v. Pepper Source*, 941 F.2d 519, 524 (7th Cir. 1991), *aff'd*, 993 F.2d 1309 (7th Cir. 1993).

169. *State of N.J. Dep't of Environmental Protection v. Ventron Corp.*, 94 N.J. 473, 501 (1983).

170. *Allied Corp. v. Frola*, 701 F. Supp. 1084, 1088-89 (D.N.J. 1988), *superseded by statute on other ground, Bahrle v. Exxon Corp.*, 279 N.J. Super. 5, 36 (App. Div. 1995). *See also Hupp v. Accessory Distribs., Inc.*, 193 N.J. Super. 701, 712 (App. Div. 1984).

171. *Baird Ward Printing Co. v. Great Recipes Pub. Assocs.*, 811 F.2d 305, 307 (6th Cir. 1987).

plaintiff argued that the corporate veil should be pierced. The *Baird* court found that New Jersey courts will not pierce a corporate veil except in cases of fraud or injustice.[172] As such, there could be no fraud when the plaintiff knew that the corporation had been substituted for the individual.[173] The *Baird* court concluded its analysis by noting that "a primary reason for use of the corporate form is to limit the liability of the shareholders," and therefore using the corporate form for that purpose does not constitute fraud.[174]

The party seeking to pierce the corporate veil carries the heavy burden of proving that the parent corporation has abused the privilege of incorporation by using the subsidiary to perpetuate a fraud or injustice.[175] Alternatively, in order to pierce the veil, the party must allege that the subsidiary is a "mere instrumentality of the parent corporation."[176] A court must find the subsidiary to be so dominated by the parent that it has no separate existence but is merely a conduit for the parent.[177]

1-10 SHAREHOLDER DERIVATIVE SUITS

1-10:1 Derivative Suits Defined

On April 1, 2013, the New Jersey legislature enacted nine new sections of the New Jersey Business Corporation Act, N.J.S.A. 14A: 1-1, et seq., which specifically address derivative proceedings and shareholder class actions, and serve to codify much of the case law on this subject.[178] Shareholder derivative actions afford individual shareholders the means to "bring suit against wrongdoers on behalf of the corporation, and it forces those wrongdoers to

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172. *Baird Ward Printing Co. v. Great Recipes Pub. Assocs.*, 811 F.2d 305, 308 (6th Cir. 1987).

173. *Baird Ward Printing Co. v. Great Recipes Pub. Assocs.*, 811 F.2d 305, 308 n.2 (6th Cir. 1987).

174. *Baird Ward Printing Co. v. Great Recipes Pub. Assocs.*, 811 F.2d 305, 308 (6th Cir. 1987).

175. *Goldmann v. Johanna Farms, Inc.*, 26 N.J. Super. 550, 559 (App. Div. 1953).

176. *State of N.J. Dep't of Environmental Protection v. Ventron Corp.*, 94 N.J. 473, 500 (1983). *See also Portfolio Financial Servicing Co. ex rel. Jacom Computer Services, Inc. v. Sharemax.com*, 334 F. Supp. 2d 620, 626 (D.N.J. 2004).

177. *State of N.J. Dep't of Environmental Protection v. Ventron Corp.*, 94 N.J. 473, 501 (1983); *see also Board of Trustees of Teamsters Local 863 Pension Fund v. Foodtown, Inc.*, 296 F.3d 164, 171-172 (3d Cir. 2002); *Ramirez v. STi Prepaid LLC*, 644 F. Supp. 2d 496, 506 (D.N.J. 2009).

178. N.J.S.A. 14A:3-6.1 to 6.9.

compensate the corporation for the injury they have caused."[179] A "shareholder" includes "a beneficial owner whose shares are held in a voting trust or held by a nominee on the beneficial owner's behalf."[180] Derivative claims are those that belong to the corporation and are not to be mistaken with individual claims held by shareholders.[181] Accordingly, a shareholder derivative suit is brought for the benefit of all stockholders who are similarly situated with the individual plaintiff stockholder as well as for the benefit of the corporation itself.[182] By definition, a shareholder derivative claim is one wherein a shareholder asserts a claim that belongs to the corporation.[183]

1-10:2 "Special Injury" Exception to Derivative Suits

The implication behind a derivative suit is that the actions complained of are adverse to the interests of the corporation.[184] Some claims that normally are considered derivative, however, may be brought by a shareholder on an individual basis if a "special injury" exists.[185] A "special injury" will exist when a wrong is suffered by a plaintiff but not suffered by all stockholders generally, or when the wrong involves a contractual right of the stockholder, such as his right to vote.[186]

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179. *In re PSE&G Shareholder Litigation*, 173 N.J. 258, 277 (2002) (citations omitted); *see also Strasenburgh v. Straubmuller*, 146 N.J. 527, 548-49 (1996) *rev'd and remanded on other grounds, Lawson Mardon Wheaton, Inc. v. Smith*, 160 N.J. 383 (1999); *Schulman v. Wolff & Samson, P.C.*, 401 N.J. Super. 467, 479 (App. Div.), *certif. denied*, 196 N.J. 600 (2008).

180. N.J.S.A. 14A:3-6.1.

181. *Strasenburgh v. Straubmuller*, 146 N.J. 527, 552 (1996) (citations omitted), *rev'd and remanded on other grounds, Lawson Mardon Wheaton v. Smith*, 160 N.J. 383 (1999).

182. *Mimnaugh v. Atlantic City Elec. Co.*, 7 N.J. Super. 310, 316 (Ch. Div. 1950).

183. *In re Prudential Ins. Co. Derivative Litig.*, 282 N.J. Super. 256, 274 (Ch. Div. 1995) (citations omitted); *see also* N.J.S.A. 14A:3-6.1 ("Derivative proceeding means a civil suit in the right of a domestic corporation.").

184. *Slutzker v. Rieber*, 132 N.J. Eq. 412, 413 (Ch. 1942).

185. *Strasenburgh v. Straubmuller*, 146 N.J. 527, 550 (1996), *rev'd and remanded on other grounds, Lawson Mardon Wheaton v. Smith*, 160 N.J. 383 (1999); *Weil v. Express Container Corp.*, 360 N.J. Super 599, 611-12 (App. Div.), *certif. denied*, 177 N.J. 574 (2003).

186. *Strasenburgh v. Straubmuller*, 146 N.J. 527, 550 (1996), *rev'd and remanded on other grounds, Lawson Mardon Wheaton v. Smith*, 160 N.J. 383 (1999); *Delray Holding, LLC v. Sofia Design & Dev. at S. Brunswick, LLC*, 439 N.J. Super 502, 513 (App. Div. 2015).

1-10:3 Standing

The New Jersey court rules provide for shareholder derivative suits in New Jersey state courts.[187] Such suits may be brought when the corporation, its managers or directors refuse to enforce rights that may be asserted on behalf of the corporation.[188]

To bring a shareholder derivative suit, the plaintiff must be a shareholder of the corporation "at the time of the act or omission complained of or became a shareholder through transfer by operation of law from one who was a shareholder at that time and remains a shareholder throughout the derivative proceeding."[189] In fact, the relevant statute and case law requires that prior to bringing a derivative suit, a shareholder must demand, in writing, that the board institute proceedings on behalf of the corporation.[190] In addition, a shareholder may not commenced such an action until 90 days have expired since the date of the demand unless the shareholder has earlier been notified that the demand has been rejected by the corporation or unless irreparable injury to the corporation would result from waiting until the expiration of the 90-day period.[191] If a corporation commences an

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187. R. 4:32-3.

188. R. 4:32-3. The sections of the New Jersey Business Corporation Act enacted in 2013 regarding derivative proceedings also provide the conditions for commencing and maintaining a derivative proceeding *See* N.J.S.A. 14A:3-6.2.

189. N.J.S.A. 14A:3-6.1 to 6.9.

190. N.J.S.A. 14A:3-6.3; *see also In re PSE&G Shareholder Litig.*, 315 N.J. Super. 323, 327 (Ch. Div. 1998), *aff'd*, 173 N.J. 258 (2002); *Hirschfeld v. Beckerle*, 405 F. Supp. 3d 601 (D.N.J. 2019), *appeal dismissed*, 19-3511, 2020 WL 2125756 (3d Cir. Jan. 16, 2020).

191. N.J.S.A. 14A:3-6.3. It appears that the 90-day period set forth in N.J.S.A. 14A: 3-6.3(2) after which a shareholder may assume a demand has been rejected renders those cases addressing "demand futility" moot. However, these cases may serve to provide some guidance as to the indicia of director self-interest and general wrongdoing. *See In re Cendant Corp. Derivative Action Litig.*, 189 F.R.D. 117, 128-30 (D.N.J. 1999); *see also In re Prudential Ins. Co. Derivative Litig.*, 282 N.J. Super. 256, 275 (Ch. Div. 1995); *In re Johnson & Johnson Derivative Litig.*, 865 F. Supp. 2d 545, 579 (D.N.J. 2011) (dismissing plaintiffs' derivative class action, without prejudice, for failure to satisfy Fed. R. Civ. P. 23.1's heightened pleading standard); *Feuer v. Merck & Co., Inc.*, 455 N.J. Super. 69, 82 (2018) (emphasizing that a shareholder's inquiry under New Jersey statutory law is limited and not broad ranging); *See Johnson v. Glassman*, 401 N.J. Super. 222, 226 (App. Div. 2008). There, as the court explained (under Delaware law):

> [A] controlled director is one who is dominated by another party, whether through close personal or familial relationship or through force of will. A director may also be deemed 'controlled' if he or she is beholden to the allegedly controlling entity, as when the entity has the direct or indirect unilateral power to decide whether the director continues to receive a benefit upon which the director is so dependent or is of such subjective material importance that its threatened loss might create a

investigation into the allegations made in the demand or complaint, a court may stay any derivative proceeding as the court deems appropriate.[192]

If a derivative proceeding is begun after a decision has been made to reject a demand by a shareholder, the resultant complaint must allege with particularity those facts establishing that a majority of the board of directors, or all members of a committee, which in either case determined the matter, was not made up of independent directors at the time the decision was made.[193]

A derivative action may not be maintained if the plaintiff does not appear to represent fairly the interests of the shareholders who are similarly situated to enforce the right of the corporation or association.[194]

It must be noted that a board's decision to reject a shareholder's demand to litigate will not be overturned unless it is found to be wrongful. If the decision by the directors not to litigate is made under a valid exercise of business judgment, the shareholder will not be able to bring a derivative action.[195] N.J.S.A. 14A:3-6.5 sets forth, in detail, the analysis that a court is to undertake in assessing whether directors made a fully informed judgment when rejecting the shareholder's demand and whether the rejection was in the best interests of the corporation.[196]

The statute provides that a derivative proceeding must be dismissed by the court on a motion by the corporation if the court finds one of three possible statutorily approved groupings (all of which include independent directors or a court appointed panel) and "has determined in good faith, after conducting a reasonable

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reason to question whether the director is able to consider the corporate merits of the challenged transaction objectively.

The *Johnson* court further explained, "[I]t is not enough to charge that a director was nominated by or elected at the behest of those controlling the outcome of a corporate election." Rather, "it is the care, attention and sense of individual responsibility to the performance of one's duties, not the method of election, that generally touches on independence." *Johnson v. Glassman*, 401 N.J. Super. 222, 226 (App. Div. 2008).

192. N.J.S.A. 14A:3-6.4.

193. N.J.S.A. 14A:3-6.5(3).

194. R. 4:32-3.

195. N.J.S.A. 14A:3-6.5; *see also In re PSE&G Shareholder Litig.*, 315 N.J. Super. 323 (Ch. Div. 1998), *aff'd*, 173 N.J. 258 (2002).

196. N.J.S.A. 14A:3-6.5; *see also In re PSE&G Shareholder Litig.*, 315 N.J. Super. 323, 328 (Ch. Div. 1998), *aff'd*, 173 N.J. 258 (2002).

inquiry upon which its conclusions are based, that the maintenance of the derivative proceeding is not in the best interest of the corporation."[197] A court may also dismiss a derivative proceeding if a vote is made to terminate the derivative proceeding by "the holders of a majority of the outstanding shares entitled to vote, not including shares owned by or voted under the control of a shareholder or related person who has or had a material beneficial financial interest in the act or omission complained of or other interest therein that would reasonably be expected to exert an influence on that shareholder's or related person's judgment if called upon to vote in the determination."[198] The statute also spells out when a director is considered independent for purposes of evaluating whether a decision to reject a demand was in the best interest of the corporation.[199]

The sections of the New Jersey Business Corporation Act enacted in 2013 regarding derivative proceedings also provide: (1) that a court's approval is required to discontinue or settle a derivative proceeding;[200] (2) what expenses are to be born by the parties upon the termination of a derivative proceeding;[201] and (3) when security must be given for reasonable expenses.[202]

1-10:4 Derivative Versus Class Actions[203]

The difference must be noted between derivative and class action suits. In derivative suits, the alleged wrong is committed against the corporate entity; any recovery will inure to the benefit of the corporation.[204] A "shareholder class action" means "a civil suit by a shareholder against a domestic corporation or its directors or officers which alleges a breach of any duty by the directors or officers or the corporation which is imposed in whole or in part by statutory or common law of the State of New Jersey and seeks

197. N.J.S.A. 14A:3-6.5.

198. N.J.S.A. 14A:3-6.5(1)-(2).

199. N.J.S.A. 14A:3-6.5(7)(a).

200. N.J.S.A. 14A:3-6.6.

201. N.J.S.A. 14A:3-6.7.

202. N.J.S.A. 14A:3-6.8.

203. N.J.S.A. 14A:3-6.1 to 6.9 also applies to shareholder class actions.

204. *Valle v. N. Jersey Automobile Club*, 125 N.J. Super. 302, 307 (Ch. Div. 1973), *modified on other grounds*, 141 N.J. Super. 568 (App. Div. 1976), *aff'd*, 74 N.J. 109 (1977); *see also* N.J.S.A. 14A:3-6.1.

a right, remedy, or damages on behalf of a class of the domestic corporation's shareholders."[205]

1-11 SHAREHOLDER RIGHTS

A corporation is statutorily required to maintain books and records of account and minutes of the proceedings of its shareholders and board and executive committees, and its record of shareholders.[206] In turn, shareholders possess a statutory right to inspect certain corporate records upon the satisfaction of several criteria. Specifically, shareholders who have held their shares for six months, or who own five percent of the corporation's total shares, are entitled, upon a showing of "any proper purpose," to the "minutes of the proceedings of its shareholders" and its "record of shareholders."[207]

The statute further preserves the court's power–rather than directly entitling any shareholder to inspect documents–to grant inspection to shareholders, irrespective of their time or percentage of ownership, for a proper purpose.[208] However, such inspection pertains only to "books and records of account, minutes and record of shareholders of a corporation."[209] The court, in its discretion, may limit or condition such access to the corporation's records, "or award any other relief as the court may deem just and proper."[210]

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205. N.J.S.A. 14A:3-6.1; *see also Valle v. N. Jersey Automobile Club*, 125 N.J. Super. 302, 307 (Ch. Div. 1973), *modified on other grounds*, 141 N.J. Super. 568 (App. Div. 1976), *aff'd*, 74 N.J. 109 (1977) (In a class action, the representative plaintiff claims to have been individually harmed and sues to redress the shareholder's grievance and those of all similarly situated shareholders).

206. N.J.S.A. 14A:5-28(1).

207. N.J.S.A. 14A:5-28(3).

208. N.J.S.A. 14A:5-28(3); *see also Feuer v. Merck & Co., Inc.*, 455 N.J. Super. 69, 77 (App. Div. 2018), *aff'd*, 238 N.J. 27 (2019).

209. N.J.S.A. 14A:5-28(4); *see also Feuer v. Merck & Co., Inc.*, 455 N.J. Super. 69, 77 (App. Div. 2018), *aff'd*, 238 N.J. 27 (2019).

210. N.J.S.A. 14A:5-28(4); *see also Cain v. Merck & Co., Inc.*, 415 N.J. Super. 319, 334-35 (App. Div. 2010) (citations omitted) ("The New Jersey Legislature has expressly recognized the court's power to circumscribe the scope of inspection, stating that '[t]he court may, in its discretion prescribe any limitations or conditions with reference to the inspection, or award any other or further relief as the court may deem just and proper.'"); *see also Feur v. Merck & Co., Inc.*, 455 N.J. Super. 69, 80 (App. Div. 2018), *aff'd*, 238 N.J. 27 (2019) ("The apparent purpose of the sentence was to restrict access and provide other relief to a corporation.").

Thus, the shareholder's statutory right to inspection does not automatically provide her with access to the "books and records of account" of the corporation unless she first obtains judicial relief upon a showing of a "proper purpose."[211] Even then, the shareholder is not necessarily entitled to "any and all records, books, and documents of a corporation" nor to the documents presented during meetings and noted in the minutes.[212] Moreover, although the shareholder's qualified right of inspection extends to the minutes of the board of directors and the executive committee, the shareholder is entitled to examine only those portions of the minutes that specifically address their "proper purpose."[213] The shareholder is not entitled to examine the minutes in order to explore unsubstantiated allegations of general mismanagement.[214]

Accordingly, unsupported allegations of mismanagement do not present a "proper purpose" entitling a shareholder to examine corporate documents.[215] When allowing an inspection for a proper purpose, the court must tailor the inspection to the shareholder's stated purpose.[216] The shareholder has the burden of proving that each category of books and records is essential to the accomplishment of the stockholder's articulated purpose for the inspection.[217]

A shareholder may also have a common law right to examine the books and records of the corporation where the request to inspect was made in good faith and for a purpose germane to the applicants' status as a shareholder.[218] Under New Jersey common law, although a shareholder did not have to prove actual

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211. N.J.S.A. 14A:5-28(4); *see also Feuer v. Merck & Co., Inc.*, 455 N.J. Super. 69, 77 (App. Div. 2018), *aff'd*, 238 N.J. 27 (2019).

212. *See Feuer v. Merck & Co., Inc.*, 455 N.J. Super. 69, 77 (App. Div. 2018), *aff'd*, 238 N.J. 27 (2019) (citing *Pederson v. Arctic Slope Reg'l Corp.*, 33 P.3d 384, 397-99 (Alaska 2014) and Black's Law Dictionary 207, 1504 (9th ed. 2009) (equating "books of account" with "shop books," which are "[r]ecords of original entry maintained in the usual course of a business by a shopkeeper, trader or other business person").

213. *Cain v. Merck & Co., Inc.*, 415 N.J. Super. 319, 323 (App. Div. 2010).

214. *Cain v. Merck & Co., Inc.*, 415 N.J. Super. 319, 323 (App. Div. 2010).

215. *Cain v. Merck & Co., Inc.*, 415 N.J. Super. 319, 334 (App. Div. 2010).

216. *Cain v. Merck & Co., Inc.*, 415 N.J. Super. 319, 334 (App. Div. 2010) (quoting *Security First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 571 (Del. 1997)).

217. *Cain v. Merck & Co., Inc.*, 415 N.J. Super. 319, 334 (App. Div. 2010) (quoting *Security First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 569 (Del. 1997)).

218. *Feuer v. Merck & Co., Inc.*, 455 N.J. Super. 69, 83 (App. Div. 2018), *aff'd*, 238 N.J. 27 (2019) (quoting *Cain v. Merck & Co., Inc.*, 415 N.J. Super. 319, 328 (App. Div. 2010)).

mismanagement before gaining access to the books and records, a shareholder seeking to examine corporate books and records generally came forward with facts to substantiate the concern about mismanagement.[219]

1-12 CRIMINAL LIABILITY OF CORPORATIONS AND PERSONS ACTING, OR UNDER A DUTY TO ACT, ON THEIR BEHALF

A corporation may be convicted of an offense if the conduct constituting the offense is engaged in, authorized, solicited, requested, commanded or recklessly tolerated by either its board of directors or by a high managerial agent acting within the scope of his appointment and on behalf of the corporation.[220] The only exception to this rule is if the offense committed is one defined by a statute that indicates a legislative purpose not to impose criminal liability on corporations.[221]

1-13 CRIMINAL MISCONDUCT BY A CORPORATE OFFICIAL

A director of a corporation will be found guilty of a crime when he knowingly, with the purpose to defraud, concurs in any vote or act instigated by the board of directors of a corporation that has the effect of: (1) making a dividend except in the manner provided by law; (2) dividing, withdrawing, or in any manner paying to any stockholder any part of the capital stock of the corporation except as provided by law; (3) discounting or receiving any note or other evidence of debt in payment of an installment of capital stock actually called in and required to be paid, or with the purpose of providing the means of making such payment; (4) receiving or discounting any note or other evidence of debt with the purpose of enabling any stockholder to withdraw any part of the money paid in by him or his stock; or (5) applying any portion of the funds of

219. *Cain v. Merck & Co., Inc.*, 415 N.J. Super. 319, 333 (App. Div. 2010).

220. N.J.S.A. 2C:2-7(a)(3). Section (b) of this statute defines "high managerial agent" as an officer of a corporation, or any other agent of a corporation, having duties of such responsibility that his conduct may fairly be assumed to represent the policies of the corporation.

221. N.J.S.A. 2C:2-7(a)(1). An "agent" is defined in Section (b) of this statute as any director, officer, servant, employee or other person authorized to act on behalf of the corporation.

such corporation, directly or indirectly, to the purchase of shares of its own stock, except in the manner provided by law.[222]

A director or officer of a corporation will also be found guilty if, with the purpose to defraud, he: (1) issues, participates in issuing or concurs in the vote to issue any increase in the corporation's capital stock beyond the amount of the capital stock duly authorized by or pursuant to law; or (2) sells or agrees to sell, or is directly interested in the sale of, any shares of stock of such corporation, or in any agreement to sell the same, unless at the time of such sale or agreement he is the actual owner of such shares. However, a director or officer will not be held liable for similar conduct when he is involved in the sale of stock by or on behalf of an underwriter or dealer in connection with a bona fide public offering of shares of stock of the corporation.[223]

In addition, a person will be guilty of a crime if he purposely or knowingly uses, controls or operates a corporation for the furtherance or promotion of any criminal object.[224] The degree of crime and penalty imposed upon such person depends on the benefit derived from his violation. Currently, if the benefit derived from the violation is $75,000 or more, the crime will be of second degree. If the benefit derived exceeds $1,000 but is less than $75,000, the offender will be guilty of a third degree crime. If the benefit derived is $1,000 or less, the offender will be guilty of a fourth degree crime.[225]

1-14 DIRECTOR CONFLICTS OF INTEREST

Contracts or transactions between corporations and other entities will not be void or voidable solely by reason of a common directorship or common interest.[226] Likewise, such contracts or

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222. N.J.S.A. 2C:21-9(a). There are no reported cases in New Jersey discussing individual liability under this section.

223. N.J.S.A. 2C:21-9(b). There are no reported cases in New Jersey discussing individual liability under this section.

224. N.J.S.A. 2C:21-9(c). The court in *State v. Malik*, 365 N.J. Super. 267 (App. Div. 2003), held that N.J.S.A.'s proscription against corporate misconduct was constitutional in its language and construction and was not limited solely to corporate officers and directors, but applied to an owner of the defendant corporation who had engaged in a kick-back scheme to commit Medicaid fraud.

225. N.J.S.A. 2C:21-9(c).

226. N.J.S.A. 14A:6-8(1).

transactions should not be held invalid solely because such director or directors are present at the meeting of the board or a committee thereof that authorizes or approves the contract or transaction, or solely because their votes are being counted for such a purpose.[227] Those contracts and transactions are voidable, however, unless one of the following is true: (1) the contract or transaction is fair and reasonable to the corporation at the time it is authorized, approved or ratified; (2) the common directorship or interest is disclosed to or known by the board or committee, and the board or committee authorizes, approves, or ratifies the contract or transaction by unanimous written consent, as long as at least one director so consenting is disinterested, or by affirmative vote of a majority of the disinterested directors, even though the disinterested directors are less than a quorum; or (3) the common directorship or interest is disclosed to or known by the shareholders, and they authorize, approve or ratify the contract or transaction.[228]

1-15 RECEIVERS

New Jersey courts have the power to appoint receivers for a corporation when there is gross or fraudulent mismanagement by corporate officers, gross abuse of trust, or general dereliction of duty.[229] "The reason for the appointment of a statutory receiver is to liquidate the corporation; such an appointment may survive the termination of the lawsuit, and continues for whatever time it may take to wind down the affairs of the corporation."[230] As explained by the Appellate Division, "the power of a custodial receiver . . . subject to the court's discretion, is great."[231]

Receivers can be appointed regardless of whether the corporation is solvent.[232] The appointment of a receiver, however, is not a

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227. N.J.S.A. 14A:6-8(1).

228. N.J.S.A. 14A:6-8(1).

229. *Roach v. Margulies*, 42 N.J. Super. 243, 245 (App. Div. 1956). *Ravin, Sarasohn, Cook, Baumgarten, Fisch & Rosen, P.C. v. Lowenstein Sandler, P.C.*, 365 N.J. Super. 241, 249 (App. Div. 2003); *Actives Int'l L.L.C. v. Reitz*, No. BER-C-239-05, 2005 WL 1861939 (Ch. Div. Aug. 9, 2005); *New Jersey Realty Concepts, LLC v. Mavroudis*, 435 N.J. Super. 118, 125 (App. Div. 2014).

230. *Kaufman v. 53 Duncan Investors, L.P.*, 368 N.J. Super. 501, 507 (App. Div. 2004).

231. *Ravin, Sarasohn, Cook, Baumgarten, Fisch & Rosen, P.C. v. Lowenstein Sandler P.C.*, 365 N.J. Super. 241 (App. Div. 2003).

232. *Kaufman v. 53 Duncan Investors, L.P.*, 368 N.J. Super. 501, 507 (App. Div. 2004).

cure-all. Instead, receivers are used as a mechanism that is ancillary or incidental to some other relief sought for the corporation and its shareholders.[233]

N.J.S.A. 14A:14-2 provides courts in New Jersey with the power to appoint and remove receivers when a corporation: (1) has become insolvent; (2) has suspended its ordinary business for lack of funds; or (3) is operating at a loss and in a fashion that is prejudicial to the interests of the creditors or shareholders.[234] The receiver will be vested with title to the corporation's property.[235] A court can discontinue a receivership action when it determines that the cause for a receivership no longer exists.[236] In such an instance, the court will dismiss the receivership proceedings and restore the property to the corporation.[237]

Statutory receivers generally will have the power to do the following on behalf of a corporation: (1) take into possession the property of the corporation; (2) institute and defend legal actions on behalf of the corporation; (3) sell, assign, convey or dispose of the property of the corporation; (4) settle or compromise with any debtor or creditor of the corporation; (5) summon and examine under oath or affirmation any persons concerning any matter pertaining to the receivership of the corporation; (6) take testimony; and (7) continue the business of the corporation.[238]

Statutory receivers will be appointed to protect shareholders and creditors in specific circumstances, such as insolvency.[239] The statutory receiver acquires legal title to corporate assets and has the power to liquidate the assets and dissolve the corporation.[240] Custodial receivers, on the other hand, are appointed to preserve corporate assets for a prescribed time period, for example, during

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233. *Lippmann v. Hydro-Space Technology, Inc.*, 77 N.J. Super. 497, 506 (App. Div. 1962).

234. N.J.S.A. 14A:14-2.

235. N.J.S.A. 14A:14-4.

236. N.J.S.A. 14A:14-19.

237. N.J.S.A. 14A:14-19.

238. N.J.S.A. 14A:14-5.

239. *State v. East Shores, Inc.*, 131 N.J. Super. 300, 309 (Ch. Div. 1974), *judgment aff'd and modified*, 164 N.J. Super 530 (App. Div. 1979).

240. *State v. East Shores, Inc.*, 131 N.J. Super. 300 (Ch. Div. 1974), *judgment aff'd and modified*, 164 N.J. Super 530 (App. Div. 1979); *see also* N.J.S.A. 14A:14-2; 14A:14-4; 14A:14-5.

litigation.[241] Custodial receivers do not acquire legal title and are without power to liquidate and dissolve the corporation.[242]

1-16 FISCAL AGENTS

The appointment of a receiver generally will be avoided when possible, and especially if the relief necessary can be accomplished by less intrusive means.[243] "Short of a showing of . . . fraud, dishonesty or incompetency as would disqualify an officer or director from serving a corporation . . . the court will not interpose a receiver between the stockholders and the directorate to conduct the ordinary business affairs of the corporation."[244] In an effort to avoid hindering the corporate business operations and possibly injuring the corporation's reputation with the public, while at the same time providing some protection to the corporation, a fiscal agent, with circumscribed powers, will be appointed instead of a receiver.[245] The appointment of a fiscal agent is seen as "an ingeniously equitable pendente lite device undoubtedly hopefully contrived to avoid more stringent measures."[246]

1-17 PROVISIONAL DIRECTORS AND CUSTODIANS

A court of equity has the authority to appoint one or more provisional directors to handle the affairs of the corporation.[247] Provisional directors will be appointed if it is determined that it is in the best interests of the corporation and its shareholders, notwithstanding any contrary provision in the corporation's

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241. *State v. East Shores, Inc.*, 131 N.J. Super. 300, 309 (Ch. Div. 1974), *judgment aff'd and modified*, 164 N.J. Super 530 (App. Div. 1979). *Kaufman v. 53 Duncan Investors, L.P.*, 368 N.J. Super. 501, 507 (App. Div. 2004).

242. *State v. East Shores, Inc.*, 131 N.J. Super. 300, 310 (Ch. Div. 1974), *judgment aff'd and modified*, 164 N.J. Super 530 (App. Div. 1979).

243. *Roach v. Margulies*, 42 N.J. Super. 243, 245 (App. Div. 1956). *See also Sarner v. Sarner*, 62 N.J. Super. 41, 59 (App. Div. 1960), *rev'd and remanded*, 38 N.J. 463 (N.J. 1962); *New Jersey Realty Concepts, LLC v. Mavroudis*, 435 N.J. Super. 118, 125 (App. Div. 2014).

244. *Sarner v. Sarner*, 62 N.J. Super. 41, 60 (App. Div. 1960), *rev'd on other grounds*, 38 N.J. 463 (N.J. 1962).

245. *Roach v. Margulies*, 42 N.J. Super. 243, 245 (App. Div. 1956).

246. *Roach v. Margulies*, 42 N.J. Super. 243, 246 (App. Div. 1956); *see also Kassover v. Kassover*, 312 N.J. Super. 96, 100-01 (App. Div. 1998); *New Jersey Realty Concepts, LLC v. Mavroudis*, 435 N.J. Super. 118, 125 (App. Div. 2014).

247. N.J.S.A. 14A:12-7(l); N.J.S.A. 14A:12-7(3).

bylaws, certificate of incorporation, or resolutions adopted by the board of directors or shareholders.[248] Provisional directors will have the rights and powers of duly-elected directors of the corporation until they are removed by order of the court, or by vote or written consent of the majority of shareholders entitled to vote to elect directors, unless otherwise ordered by the court.[249]

In addition to appointing a provisional director, a court may also appoint a custodian for the corporation, notwithstanding any contrary provisions in the corporation's documents, if it is determined that such an appointment is in the best interests of the corporation and its shareholders.[250] The custodian will have the same powers as the board of directors and officers to the extent necessary to manage the affairs of the corporation.[251] The custodian's appointment will remain in effect until removed by order of the court, or by vote or written consent of a majority of the persons entitled to vote as the holders of shares entitled to elect directors, unless otherwise ordered by the court.[252] Thus, an order appointing a provisional director or custodian to handle the affairs of the corporation should specify that such appointment is being made by order of the court, so as to insulate the appointment conflicting provisions in the corporation's documents. The custodian may exercise his powers directly or in conjunction with the corporation's board or officers, at the custodian's discretion or as ordered by the court.[253]

Provisional directors and custodians may be appointed, for example, when the shareholders are so divided that, during a period in which two consecutive annual meetings were or should have been held, they failed to elect successors to directors whose terms had expired or would have expired upon the election and qualification of their successors.[254] They also may be appointed specifically when the directors of the corporation, or the person

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248. N.J.S.A. 14A:12-7(3).
249. N.J.S.A. 14A:12-7(3).
250. N.J.S.A. 14A:12-7(1); N.J.S.A. 14A:12-7(4).
251. N.J.S.A. 14A:12-7(1); N.J.S.A. 14A:12-7(4).
252. N.J.S.A. 14A:12-7(1); N.J.S.A. 14A:12-7(4).
253. N.J.S.A. 14A:12-7(1); N.J.S.A. 14A:12-7(4).
254. N.J.S.A. 14A:12-7(1)(a); *Bostock v. High Tech Elevator Industries, Inc.*, 260 NJ. Super. 432, 441 (App. Div. 1992).

or persons having the management authority on the board, as provided for in the certificate of incorporation, are unable to effect action on one or more substantial matters respecting the management of the corporation's affairs.[255] Furthermore, a provisional director or custodian can be appointed in situations when directors or those in control of a corporation having 25 or fewer shareholders have acted fraudulently or illegally, mismanaged the corporation, or abused their authority or otherwise have acted oppressively or unfairly toward one or more minority shareholders in their capacities as shareholders, directors, officers or employees.[256]

Provisional directors or custodians must not be shareholders or creditors of the corporations (or any subsidiary or affiliate) that they serve.[257] They are obligated to report to the court from time to time concerning the matter(s) complained of, the status of any corporate deadlock, and the status of the corporation's business.[258] Custodians or provisional directors must, if directed, present their recommendations as to the appropriate dispositions of corporate matters at issue.[259] Provisional directors and custodians must be given reasonable compensation for their services, and the corporation must reimburse or directly pay their reasonable costs and expenses incurred in fulfilling their duties.[260]

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255. N.J.S.A. 14A:12-7(1)(b); *Bostock v. High Tech Elevator Industries, Inc.*, 260 NJ. Super. 432, 441 (App. Div. 1992).

256. N.J.S.A. 14A:12-7(1)(c); *Brenner v. Berkowitz*, 134 N.J. 488, 504 (1993); *Hamilton, Johnston, & Co., Inc. v. Johnston*, 256 N.J. Super. 657, 672 (App. Div. 1992), *certif. denied*, 130 N.J. 595 (1992); *Exadaktilos v. Cinnaminson Realty Co., Inc.*, 167 N.J. Super. 141, 150 (Law Div. 1979), *aff'd*, 173 N.J. Super. 559 (App. Div.), *certif. denied*, 85 N.J. 112 (1980).

257. N.J.S.A. 14A:12-7(5).

258. N.J.S.A. 14A:12-7(6).

259. N.J.S.A. 14A:12-7(6).

260. N.J.S.A. 14A:12-7(7).