

## Recent New Jersey Enactments on Corporate Governance

by Brett R. Harris

On the final day of Governor Chris Christie's term of office,<sup>1</sup> a series of laws were passed intending to modernize provisions of the New Jersey Business Corporation Act (BCA) and make the state more hospitable to corporations from a legislative perspective. The package was comprised of six bills that were developed based on recommendations by the New Jersey Corporate and Business Law Study Commission to update the BCA and generally benefit corporate boards.

By way of background, the commission was created in 1989 by the New Jersey Legislature<sup>2</sup> as a legislative commission responsible for studying and reviewing all aspects of statutes, legislation and decisions of New Jersey courts, as well as other states' relation to business entities and nonprofit corporations. Patrick J. Diegnan Jr., previously a state assemblyman and now a state senator, sits on the commission and sponsored the six bills that comprised the corporate reforms. The bills had all been introduced in previous legislative terms, one as early as 2010, but they languished for a number of years without activity, despite there being no apparent opposition to them. During 2017, Senator Diegnan continued to promote them as measures to streamline the state's corporate laws, making it easier for those already in the state to continue conducting activities and expand operations, and to attract new companies.

The state's business advocacy groups and transactional attorneys have long noted the lag in business incorporation activities in New Jersey as other jurisdictions have enacted more business-friendly corporate governance laws. Delaware touts itself as the preeminent jurisdiction for incorporation, which it attributes in part to its statute, the Delaware General Corporation Law, described on its website as "the most advanced and flexible business formation statute in the nation."<sup>3</sup> According to the website of the Delaware Division of Corporations, "More than two thirds of the Fortune 500 continue to call Delaware their corporate home, along with four out of every five new companies that go public in the United States."<sup>4</sup>

The New Jersey State Bar Association supported the package of corporate governance bills sponsored by Senator Diegnan "as amendments to New Jersey corporate law that will update current law."<sup>5</sup> The bar association also referred to several of the bills as "important measures to update the state's corporate governance laws and ease the burden on corporations to act in accordance with them."<sup>6</sup>

The New Jersey Business & Industry Association (NJBIA) also supported the bills while they were pending before the New Jersey Legislature: "This legislation would make New Jersey more business friendly and more competitive with states such as Delaware, Pennsylvania and New York, which have already incorporated changes regarding shareholder matters into their laws," said Mary Beaumont, NJBIA's vice president for health and legal affairs. She was quoted in several statements issued by the NJBIA in 2017 encouraging legislators to support the bills the association lauded as pro-business revisions to laws governing New Jersey corporations.

In the lame duck days of the 2016-2017 legislative term, the time was apparently finally right for some corporate governance reforms; thus, six new laws amending the BCA were enacted, as follows:

### **P.L.2017, c.299:<sup>7</sup> *An act concerning corporation proxy solicitation materials and supplementing Chapter 5 of Title 14A of the New Jersey Statutes***

This law allows certain materials to be included in a corporation's proxy solicitation materials. Specifically, it enables a corporation to establish in its bylaws procedures or conditions under which materials related to shareholder-nominated individuals will be included in the corporation's proxy solicitation materials. Codified as a new section of Chapter 5 of the BCA (Shareholders' Meetings and Elections; Rights and Liabilities of Shareholders in Certain Cases), Section 31<sup>8</sup> is entitled "Establishment of procedures, conditions relative to certain proxy solicitation materials."

The new section provides a non-exhaustive list of procedures or conditions that may apply to the inclusion of materials in a corporation's proxy solicitation materials for an upcoming election of directors. Six examples are set forth, including a condition requiring a minimum level of beneficial ownership of shares of the corporation's stock by the nominating shareholder, a provision limiting the number of shareholder-nominated directors for a particular shareholder meeting when directors will be elected, and a provision requiring that the nominating shareholder indemnify the corporation in respect of losses arising as a result of false or misleading statements submitted in connection with the nomination.

**P.L.2017, c.355:<sup>9</sup> *An act concerning corporate mergers and consolidations and amending N.J.S. 14A:10-3 and N.J.S. 14A:10-4.1***

This law clarifies that a corporation may agree to a 'force the vote' provision for a plan of merger or consolidation, and allows directors to amend a plan of merger or consolidation prior to effectiveness of the plan under certain circumstances. A force the vote provision allows shareholders to vote on a plan of merger or consolidation after approval by the corporation's board of directors, even if the board later determines that the plan is no longer advisable and recommends that the shareholders reject or vote against the plan. Force the vote provisions are used for deal protection purposes in the context of merger and acquisition (M&A) practice. When applied to a target of an acquisition, such a provision can protect a pending transaction by forcing a shareholder vote, even though the board continues to consider other offers.

The law also allows directors to amend a plan of merger or consolidation prior to effectiveness of the plan, as long as the amendment does not alter or change: 1) the consideration to be received by the shareholders; 2) the terms of the certificate of incorporation of the surviving corporation; or 3) any of the terms and conditions of the plan if such change would materially and adversely affect the shareholders of either corporation who have voted or are entitled to vote on the plan, unless the plan of merger or consolidation expressly provides otherwise. If such an amendment is adopted by the board, following the filing of a certificate of merger or consolidation but prior to the time when the merger or consolidation becomes effective, a certificate of amendment of merger or consolidation is to be filed with the Department of the Treasury.<sup>10</sup>

The law was modeled substantially on provisions of the Delaware Business Corporation Law.

**P.L.2017, c.356:<sup>11</sup> *An act concerning corporate bylaws and amending N.J.S. 14A:2-9***

This law clarifies the scope of corporate bylaws and provides that bylaws may include a forum selection clause. Upon its enactment, several new clauses were added to Chapter 2 of the BCA, which addresses formation of corporations. One new clause<sup>12</sup> provides that "the by-laws may contain any provision, not inconsistent with law or the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or power or the rights or power of its shareholders, directors, officers or employees."

Another new clause<sup>13</sup> permits the bylaws to provide that the federal and state courts in New Jersey can be designated as the sole and exclusive forum for the following types of actions or proceedings: derivative actions brought on behalf of the corporation; actions by shareholders asserting a claim of a breach of fiduciary duty owed by a director or officer to the corporation or its shareholders, or a breach of the certificate of incorporation or bylaws; actions brought by shareholders asserting a claim against the corporation or its directors or officers arising under the certificate of incorporation or the BCA; any other state law claim, including a class action asserting a breach of a duty to disclose brought by shareholders against the corporation, its directors or officers; or any other claim brought by shareholders that is governed by the internal affairs or an analogous doctrine. If the bylaws include such a forum selection clause, the bylaws may also provide that shareholders who file an action without complying with the clause will be liable for all reasonable costs incurred in enforcing the requirement, including reasonable attorney's fees.

If a corporation's bylaws do include a forum selection clause, the BCA now provides that the corporation's directors and officers, and former directors and officers, are deemed to have consented to the personal jurisdiction of the forum, provided that the jurisdiction shall apply only to actions asserting claims arising after the date of the adoption of the bylaw provision designating the forum exclusivity.<sup>14</sup>

**P.L.2017, c.362:<sup>15</sup> *An act concerning derivative proceedings and shareholder class actions and amending P.L.2013, c.42***

This law implements a technical change from an ‘opt-in’ to an ‘opt-out’ approach for the applicability of the existing provisions of the BCA on derivative proceedings. Several years ago, the BCA had been significantly updated in respect of derivative actions, which are generally proceedings brought by minority shareholders against the directors or majority shareholders of a corporation alleging failure by management. The 2013 legislation<sup>16</sup> had repealed the prior provision of the BCA, which governed actions by shareholders<sup>17</sup> and added nine new sections to the BCA to address derivative proceedings and shareholder class actions.<sup>18</sup> The 2013 provisions were intended to codify developments in this area of the law since the 1972 amendments to the repealed provision, and were drafted largely based on the Model Business Corporation Act, with substantial additions based on the Massachusetts Business Corporation Law.<sup>19</sup> However, the 2013 legislation stated its provisions would only apply if they were made applicable to a corporation by its certificate of incorporation.<sup>20</sup> “Consequently for those corporations, which through ignorance, disinterest, or purposeful choice, fail to adopt the new statute, the New Jersey Business Corporation Act has no provision dealing with the corporate requirements for derivative and class actions.”<sup>21</sup>

The recent enactment changes the applicability by dividing the provisions into two categories: Some provisions will apply by default to corporations unless they affirmatively vary them in their certificate of incorporation, while other provisions will only apply if a corporation opts in by making them applicable in their certificate of incorporation. The following provisions will apply to a corporation unless that corporation chooses to vary the applicability or effect of the provisions in its certificate of incorporation: the conditions for commencing and maintaining a derivative proceeding; the actions that must be taken before a shareholder may commence a derivative proceeding; the conditions for a court to order a stay of a derivative proceeding; the conditions for dismissal of a derivative proceeding; and the requirement for court approval for the discontinuation or settlement of a derivative proceeding or shareholder class action.

There are two provisions of the BCA on derivative proceedings that will only apply if a corporation has expressly made them applicable in the corporation’s

certificate of incorporation: the rules governing how a court should allocate expenses following termination of a derivative proceeding or shareholder class action; and the allowance that a defendant corporation may require the plaintiff to provide security for reasonable expenses related to the derivative proceeding or shareholder class action.

**P.L.2017, c.363:<sup>22</sup> *An act concerning actions of corporate directors and amending N.J.S. 14A:6-7.1***

This law clarifies that corporate directors may approve actions without a meeting, by electronic transmission. The provision of the BCA amended by this law had already provided that any action required or permitted to be taken pursuant to authorization voted at a meeting of the board, or a committee thereof, could be taken without a meeting if, prior to the action, all members of the board or committee consent to the action in writing. The law clarifies that this consent may also be by “electronic transmission,” as defined elsewhere in the BCA as “any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved and reviewed by a recipient, and that may be directly reproduced in paper form by that recipient through an automated process.”<sup>23</sup> The definition was added to the BCA by amendment in 2009<sup>24</sup> to permit certain notices to shareholders to be given electronically, and is a technology-neutral definition.

In recommending this legislation, the commission recognized that the law needed updating to reflect the reality of corporate practice: “The commission believes that, in addition to the historic practice of approving action by written consent, directors already approve action by electronic transmission. In light of changes in technology, the commission believes that it is appropriate to clarify that directors may use electronic transmissions to approve corporate actions.”<sup>25</sup>

**P.L.2017, c.364:<sup>26</sup> *An act concerning corporate books and records and amending N.J.S. 14A:5-28***

This law permits corporations to impose reasonable limitations or conditions on use or distribution of books and records by shareholders. In amending the existing section of the BCA which addresses inspection of corporate records, the type of limitations or conditions are

not set forth explicitly, but insight can be found in the legislative statement accompanying the underlying bill:

Due to significant changes in technology that have occurred and the related ease by which materials may now be used and disseminated, the sponsor has proposed this bill to allow corporations to continue a common practice, which has developed, to condition the receipt of requested materials on, for example, the demanding shareholder agreeing to customary confidentiality obligations. However, the bill is not intended to provide a corporation with a right to deny access to a demanding shareholder of materials which the demanding shareholder is otherwise entitled.<sup>27</sup>

In closing, as a practice pointer, while all of the new public laws took effect immediately upon approval by the governor on Jan. 16, not all of the reforms will automatically benefit corporations. Rather, amendments to corporate governing documents are required to implement several changes. Bylaw revisions are necessary related to the corporation's proxy solicitation materials and forum selection matters, and the certificate of incorporation may need to be amended depending upon the corporation's desire for applicability of certain derivative action provisions (and whether or not they heeded Stuart Pachman's cautionary words<sup>28</sup> and previously amended their certificate of incorporation to address derivative actions). ■

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## Endnotes

1. The legislation was signed by Governor Christie on Jan. 16, 2018.
2. P.L.1989, c.163, N.J.S.A. §1:14-12 *et seq.*
3. Response to FAQ: Why do so many companies incorporate in Delaware? <https://corp.delaware.gov/faqs/>. The Delaware Division of Corporation also boasts of the Delaware Court of Chancery, and its state government as being business-friendly and accessible and the division being a model of "state-of-the-art efficiency."
4. FY 2018 Annual Report Statistics Message from the Secretary of State, Jeffrey W. Bullock <https://corp.delaware.gov/stats/>.
5. NJSBA Capital Report dated Jan. 8, 2018.
6. NJSBA Capital Report dated Dec. 11, 2017.
7. Introduced in the 2010-2011 Legislative Session as bill number A-3252, identical bill number S-2495; reintroduced in the 2012-2013 Legislative Session as bill number A-2715, identical bill number S-550; reintroduced in the 2014-2015 Legislative Session as bill number A-2928, identical bill number S-3292 and reintroduced in the 2016-2017 Legislative Session as bill number A-2973, identical bill number S-2239.
8. N.J.S.A §14A:5-31.
9. Introduced in the 2012-2013 Legislative Session as bill number A-3839; reintroduced in the 2014-2015 Legislative Session as bill number A-2482, identical bill number S-3290 and reintroduced in the 2016-2017 Legislative Session as bill number A-2161, identical bill number S-2237.
10. N.J.S.A. §14A:10-4.1(3), the new provision added by this law, refers to filing with the secretary of state. However, the location for business entity filings was transferred from the Department of State to the Department of the Treasury per Executive Reorganization Plan 004-1998, at this time referred to as the Division of Commercial Recoding and now known as the Corporate Filing Unit of the Division of Revenue and Enterprise Services.
11. Introduced in the 2014-2015 Legislative Session as bill number A-2483, identical bill number S-3291 and reintroduced in the 2016-2017 Legislative Session as bill number A-2162, identical bill number S-2234.
12. N.J.S.A. §14A:2-9(4).

13. N.J.S.A. §14A:2-9(5).
14. N.J.S.A. §14A:2-9(5)(b).
15. Introduced in the 2014-2015 Legislative Session as bill number A-3614, identical bill number S-3294 and reintroduced in the 2016-2017 Legislative Session as bill number A-2970, identical bill number S-2236.
16. P.L. 2013, c.42 effective April 1, 2013.
17. N.J.S.A. §14A:3-6.
18. N.J.S.A. §14A:3-6.1 to 3-6.9.
19. See Senate Commerce Committee Statement to Assembly Bill No. 3123, dated Jan. 14, 2013.
20. N.J.S.A. §14A:3-6.9.
21. Stuart L. Pachman, The Derivative Action Statute That Isn't There, *NJSBA Business Law Section Newsletter*, Vol. 37, No. 2 (Sept. 2013).
22. Introduced in the 2014-2015 Legislative Session as bill number A-3612, identical bill number S-3293 and reintroduced in the 2016-2017 Legislative Session as bill number A-2971, identical bill number S-2235.
23. N.J.S.A. §14A:1-8.1.
24. P.L. 2009, c.176 effective Jan. 11, 2010.
25. Assembly Commerce and Economic Development Committee Statement to Assembly No. 2971 dated Nov. 30, 2017.
26. Introduced in the 2014-2015 Legislative Session as bill number A-3615, identical bill number S-3295 and reintroduced in the 2016-2017 Legislative Session as bill number A-2975, identical bill number S-2238.
27. Assembly Commerce and Economic Development Committee Statement to Assembly No. 2975 dated Jan. 12, 2017 and Senate Commerce Committee Statement to Assembly No. 2975 dated June 19, 2017.
28. See Pachman, *supra*.