February 19, 2013

NJ Legislature Passes Three New Laws Amending the NJBCA

The New Jersey legislature recently passed three new pieces of legislation amending the New Jersey Business Corporation Act (the "NJBCA"). The legislation will now be sent to Gov. Chris Christie, who is expected to sign each of the bills. The legislation was drafted by the New Jersey Corporate and Business Law Study Commission, a legislative commission formed to study and review New Jersey corporate law, with the goal of modernizing these laws and making New Jersey a more attractive state within which to incorporate. [1]

The legislation:

- Creates a new section regarding shareholder derivative litigation that, if adopted in the certificate of incorporation, allows independent board members greater flexibility to move to dismiss litigation that they deem is not in the best interests of the corporation and implements fee shifting and other provisions in the context of derivative and shareholder class action proceedings;
- Amends the Shareholders' Protection Act (the "SPA") to make all New Jersey corporations subject to the SPA and to allow certain business transactions to take place that previously would have been prohibited under the SPA, if the requisite approvals are obtained;
- Amends the dissenters' rights section to provide that such section is the exclusive remedy absent fraud or material misrepresentation; and
- Allows remote participation by shareholders in annual or special shareholders' meetings.

Please note that, in response to certain of these amendments, New Jersey corporations may need to take certain actions, in one instance before a statutorily mandated deadline, as noted below.

Summary of Amendments

Shareholder Derivative and Class Actions. This bill repeals former N.J.S.A. § 14A:3-6, governing procedural requirements in connection with shareholder derivative actions, and replaces it in its entirety. This new statute enhances the substantive provisions of the former statute and makes certain provisions applicable to shareholder class actions but only applies if so provided in a company's certificate of incorporation.

The new statute is designed to allow New Jersey corporations a greater ability to move to dismiss shareholder derivative suits. It provides that a derivative proceeding will be dismissed if the court finds that independent directors, shareholders or court-appointed professionals have determined that the derivative proceeding is not in the best interests of the corporation. In addition, the statute requires the shareholder plaintiff to hold the shares of the corporation not only at the time of the act or omission complained of, but also to continue to hold the shares throughout the derivative proceeding.

The statute also makes certain provisions, which formerly applied only in the context of a derivative suit, applicable in class actions brought by a shareholder arising out of breach of duty imposed by New Jersey law. These provisions include a requirement that settlements be approved by a court.

The new statute also includes an important fee-shifting provision. A court may require a plaintiff shareholder to pay the

corporation's expenses in the event the court determines the proceeding was brought without reasonable cause or for an improper purpose.

The prior statute required shareholders with less than $25,000 in holdings to post a bond for potential fee shifting in a derivative suit. For both derivative and shareholder class action proceedings, the value of plaintiffs' shareholdings required to avoid the need to post a bond has been increased from $25,000 to $250,000.

The provisions of new N.J.S.A. § 14A:3-6 apply only if they are expressly made applicable to the corporation by the certificate of incorporation. Accordingly, a corporation seeking to take advantage of this section must submit to its shareholders for approval an amendment making new section 3-6 applicable to the corporation.

Shareholders' Protection Act. This bill amends certain provisions of the New Jersey Shareholders' Protection Act, N.J.S.A. § 14A:10A-1 *et seq.* to make it applicable to all New Jersey corporations and to make it easier in certain circumstances to exempt a board-approved transaction from the SPA.

Previously, the SPA was applicable to New Jersey corporations that had either their principal executive offices or "significant business operations" in New Jersey. Corporations often had difficulty determining the meaning of "significant business operations." The amendments remove this uncertainty by expanding the scope of the SPA to define a "resident domestic corporation" to include all New Jersey corporations. **However, those corporations not previously subject to the SPA (because they do not have either their principal executive offices or "significant business operations" in New Jersey) that will now be covered under the amended definition of "resident domestic corporation" will be able to opt out of the SPA by amending their bylaws within 90 days of the effective date of the amendments.**

The amendments also make it easier for corporations to exempt board-approved transactions from the scope of the SPA. The SPA prohibits a "resident domestic corporation" from engaging in business combinations with a shareholder that beneficially owns 10 percent or more of the resident domestic corporation's outstanding voting stock ("interested shareholder") for a period of five years from the date the interested shareholder crossed that 10 percent ownership threshold (the "stock acquisition date") unless that business combination was approved by the resident domestic corporation's board of directors before that interested shareholder's stock acquisition date. This provision had proved difficult to navigate because a business combination often would not have been contemplated at the time the stock was acquired and often would not occur until years later.

Under the amended SPA, a resident domestic corporation may engage in a business combination if the original stock acquisition was previously approved and the subsequent business combination is approved (which approval can be subsequent to the stock acquisition date) by (1) the board of directors (or a committee thereof consisting solely of persons who are not employees, officers, directors, shareholders, affiliates, or associates of that interested shareholder) and (2) the affirmative vote of the holders of a majority of the voting stock not beneficially owned by such interested shareholder at a meeting called for such purpose.

Finally, the amendments provide that a beneficial holder of 5 percent or more of the voting power of the outstanding voting stock of the resident domestic corporation on the effective date of the amended SPA is exempt from the amended SPA if the resident domestic corporation did not have its principal executive offices or significant business operations located in New Jersey as of that date. The intent of this amendment is to "grandfather" 5 percent shareholders newly subject to the SPA (which holders, in the case of public companies, would be required to report their holdings under the Securities Exchange Act by virtue of this 5 percent ownership) because such shareholders would not have expected the SPA to apply to them.

Dissenters' Rights as Sole Remedy. This bill amends N.J.S.A. § 14A:11-1 to provide that, if a shareholder is entitled to dissent from a corporate action (typically a merger or other acquisition transaction), then that shareholder is prohibited from challenging such corporate action (regardless of whether the shareholder actually exercised the right to dissent) unless the corporate action in question was (1) not effectuated in accordance with the applicable provisions under the NJBCA or the corporation's certificate of incorporation or (2) procured as a result of fraud, material misrepresentation, or other deceptive

means. The intent of this amendment is to prevent shareholders from "double-dipping" and reflects the belief that the dissenters' rights statute is an adequate protection for shareholders who believe they are not being paid fair value for their shares.

Remote Participation in Shareholders' Meetings. This bill amends N.J.S.A. § 14A:5-1 to expressly permit shareholders to participate in a shareholders' meeting by means of remote communication to the extent authorized by the corporation's board of directors. This amendment is designed to reflect the fact that much of modern-day communication takes place electronically. Because of our rapidly changing system of communication, the commission, in drafting the legislation, declined to precisely define what constitutes remote communication. Accordingly, participation by remote communication will be subject to guidelines and procedures adopted by the board, provided that each shareholder can see and hear the proceedings contemporaneously and can vote and participate in the meeting.

Action Items

Management and the boards of directors of New Jersey corporations should consider the following potential action items in response to these amendments:

- Consider the new statute governing shareholder derivative and class actions and determine whether to "opt in" to coverage under that statute. If the decision is made to opt in, the corporation's certificate of incorporation will need to be amended, which will necessitate shareholder approval.
- Consider whether the SPA will now apply to the corporation as a result of the revised definition of "resident domestic corporation" and, if necessary, determine whether to "opt out" of the statute.
- Consider the advisability of permitting participation in shareholders' meetings by means of remote communication, including the feasibility, logistics, and implications of implementation of remote participation. Adopt any bylaw amendments or board resolutions that may be needed to authorize remote participation.

[1] Ronald H. Janis is attorney to the Commission; Ellen S. Knarr is Secretary to the Commission.