



# New Jersey Corporation Advancement of Legal Expenses to Corporate Agents

## Client Advisories

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Directors, officers, employees and agents of a corporation ("corporate agents") may be parties in legal proceedings where the corporation's attorney may not be able to represent them. In such cases, they must retain and pay their own attorneys.

The New Jersey Business Corporation Act (the "Act") provides for indemnification of corporate agents for the reasonable costs, disbursements and counsel fees they incur in such proceedings, and for their liabilities, which include settlements, judgments, fines and penalties. The Act broadly defines a "proceeding" as any pending, threatened or completed civil, criminal, administrative or arbitral action, suit or proceeding, any appeal, and any inquiry or investigation which could lead to such action, suit or proceeding.

The Act provides that if a corporate agent wins a proceeding, the corporation is required to indemnify him for his expenses (theoretically, the corporate agent would have no liabilities if he wins the proceeding). If a corporate agent fails to win a proceeding, the corporation has the discretion to indemnify a corporate agent for his expenses and/or liabilities, depending on the nature of the proceeding, if he acted in good faith and in a manner he believed to be in, or not opposed to, the best interests of the corporation. However, a corporate agent is never entitled to indemnification if it is determined in court that the corporate agent's acts or omissions were not in good faith or involved a knowing violation of law, were in breach of his duty of loyalty to the corporation or its shareholders, or resulted in the corporate agent's receipt of an improper personal benefit.

The Act allows a corporation to advance reasonable expenses incurred by a corporate agent in a proceeding. The rationale is that a corporate agent is required to personally pay such expenses and may not be indemnified for such expenses until the final disposition of the proceeding, which may be months or years later. Note that the right to indemnification is separate and distinct from the right to advancement of expenses. That is, even if it is likely that the corporation will be required to indemnify a corporate agent for such expenses, that alone does not require the corporation to advance such expenses to a corporate agent.

Historically, a corporation's board of directors has the responsibility for making the determination whether to advance expenses to a corporate agent. As a result of a recent amendment to the Act, a board may now delegate this responsibility to others in the corporation and/or to establish a procedure for determining whether to advance such expenses.

The board has many options. It may (1) retain the right to make such determinations, (2) create a committee of the board to make such determinations, (3) allow senior management to make such determinations, (4) provide that independent counsel make such determinations, or (5) adopt a policy on how to make such determinations. The board may also split the responsibility based on the type of corporate agent. For example, the board can reserve the right to make such determinations for directors and senior management, and allow others, such as senior management, to make such determinations for lower management and employees. It may also split the responsibility to make such determinations based on the type of proceeding or the amount of the advancement. If the certificate of incorporation or bylaws do not specify who makes the determination, then it remains a board determination, but the board may delegate the determination on a case-by-case basis to a committee, senior management, independent counsel, or even to the shareholders.

The amendment to the Act did not, however, change the requirement that the corporation receive an undertaking by, or on behalf of, the corporate agent to repay the amount of any advancement of expenses if it is ultimately determined that the corporate agent is not entitled to indemnification. In other words, if the corporate agent is not entitled to indemnification, he was not entitled to an advance and he must repay the advanced expenses to the corporation. Therefore, in determining whether to advance such expenses to a corporate agent, the decision-maker for the corporation must take into account the financial ability of the corporate agent to repay such expenses in the event it is determined that he is not entitled to indemnification. If the corporate agent does not or will not have the ability to repay the advanced expenses, then the corporation may determine not to advance such expenses.

In light of this new flexibility in the Act, a corporation should review and, if desired, revise the advancement of expenses provisions in its certificate of incorporation, bylaws, employment agreements, employee handbooks and other documents.

For further information about indemnification and advancement of expenses, please contact **Gianfranco A. Pietrafesa**, a member of Archer's **Corporate Department**, or the attorney in the firm with whom you regularly conduct business.

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