

September 17, 2024

## **BUSINESS JUDGMENT RULE: APPLICATION TO NORTH CAROLINA CORPORATIONS**

Under North Carolina law, directors of a corporation owe fiduciary duties to the corporation. The North Carolina Business Corporation Act, found in Chapter 55 of Article 8 of the North Carolina General Statutes, imposes on directors the fiduciary duties of good faith, loyalty, and care. These fiduciary duties ensure that the directors are acting in the best interest of the corporation. Directors have an obligation to ensure that the decisions they make are prudent and based on a reasonable business basis. When shareholders question whether a director has breached their fiduciary duty of care, the business judgment rule comes into effect. The business judgment rule can protect directors when shareholders initiate litigation based on a perceived breach of the duty of care. Therefore, it is essential for every director to be aware of their fiduciary duties and the implications of the business judgment rule in North Carolina.

### **What is the Business Judgment Rule?**

The business judgment rule is a presumption that protects directors from being held liable for their business decisions when the directors act in accordance with their fiduciary duty of care. Section 55-8-30 of the North Carolina Business Corporation Act codifies the business judgment rule. The rule can be used as a defense to a shareholder's claim that a director breached his fiduciary duty of care owed to the corporation. The Act provides that a director is allowed to rely on information and reports that are provided by legal counsel, employees of the corporation, or committee of the board of disinterested directors if the director reasonably believes them to be reliable and competent.

The rule is further explained in the treatise Robinson on North Carolina Corporation Law, which states that the court will not hold directors liable or invalidate a business decision made by the directors when the decision was within the scope of their authority and made with reasonable care. Therefore, even when a director's decision causes loss or harm to the corporation, they may be shielded from liability by this rule when the decisions are made based on good faith and a reasonable basis. This allows directors to make good faith decisions without the fear of possibly being held liable if that decision turns out to be harmful.

For a challenging party to overcome this presumption, they must show that there was no informed basis for the decision, the directors acted in bad faith, or the directors did not believe that they were acting in the best interest of the corporation. This is an extremely high burden of proof for a challenger to bring, causing the rule to offer great protection to directors of corporations.

## When does the Business Judgment Rule apply?

The business judgment rule will apply in all cases brought by shareholders on behalf of the corporation that questions a decision of the board of directors. The rule will protect the directors from liability when they are made with good faith intent and reasonable care. The court will be precluded from unreasonably reviewing or interfering in the decisions of the directors.

However, there are cases when the business judgment rule does not apply, including cases where there is wrongdoing such as fraud, self-dealing, or gross negligence. The business judgment rule can be rebutted and does not protect directors when they have violated their fiduciary duties, which can be a complex legal issue.

## JAH Can Help

The experienced corporate attorneys at Johnston Allison Hord can help you navigate the complexities of director liability and the application of the business judgment rule. Our team offers expert guidance on maintaining proper corporate formalities and protecting your corporation. [Click here to contact a member of our Corporate Practice Group](#) if you need assistance.

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