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BUSINESS LAW: EXCULPATORY PROVISIONS UNDER FIDUCIARY DUTIES

Summary

Former directors of Lewis & Clark LTC Risk Retention Group, Inc. filed a writ of mandamus in the Nevada Supreme Court, seeking (1) direction concerning the district court's application of *Shoen v. SAC Holding Corp.*² and (2) relief from that court's judgment. The directors asserted that gross negligence does not support a viable claim for personal liability under the NRS 78.138. The Commissioner of Insurance for the State of Nevada maintained that gross negligence is an appropriate claim against directors under *Shoen*. The Court elected to consider the director's petition for a writ of mandamus, clarified the language in *Shoen*, and held that NRS 78.138 provides the exclusive mechanism to hold directors and officers individually liable for damages in Nevada. The statute says that "knowing violations of law" require a knowledge of wrongfulness. Therefore, gross negligence allegations do not state an actionable claim under NRS 78.138.

Background

The Nevada Division of Insurance filed a receivership action related to Lewis & Clark in 2012, and the district court ordered a liquidation of Lewis & Clark. The court appointed the Commissioner of Insurance for the State of Nevada as receiver. The liquidation order granted the receiver power to prosecute any action that may exist on behalf of the policyholders, members, or shareholders of Lewis & Clark against any officer of Lewis & Clark or any other person. The Commissioner then filed a complaint against the directors, alleging claims of (1) gross negligence and (2) deepening insolvency. To substantiate these claims, the Commissioner asserted that the directors (1) failed to properly inform themselves and take corrective action and (2) that their inaction led to Lewis & Clark's initial insolvency and its increased insolvency.

The directors filed a Nevada Rules of Civil Procedure (NRCP) 12(b)(6) motion, asserting that the Commissioner failed to state a viable claim. When the district court denied that motion, the directors filed a NRCP 12(c) motion for judgment on the pleadings, arguing that gross negligence cannot support a claim for personal liability against directors under NRS 78.138. The district court denied that motion and, after the directors' motion for reconsideration, ruled that the Commissioner stated a claim for breach of fiduciary duty of care under *Shoen*, as well as a claim for deepening insolvency.³ Following that ruling, the directors petitioned the Nevada Supreme Court for a writ of mandamus directing the district court to apply the plain meaning of NRS 78.138 and to grant the motion for judgment on the pleadings.

¹ By Dylan J. Lawter

² *Shoen v. SAC Holding Corp.*, 122 Nev. 621, 640, 137 P.3d 1171, 1184 (2006).

³ The district court held that the deepening insolvency claim could only exist as a collateral cause of action, so the Court did not address the validity of this claim.

Discussion

The Court elected to consider the petition for a writ of mandamus

The Court generally declines to entertain writ petitions challenging a denial for judgment on the pleadings. But when an important issue of law needs clarification, the Court will grant the petition. Because this writ petition presented a purely legal question—in regard to the district court’s reliance upon the dicta in *Shoen*—the Court decided to clarify the law governing actions against directors or officers for breaches of fiduciary duties.

NRS 78.138 provides the sole mechanism to hold directors and officers individually liable for damages in Nevada

The Court quotes NRS 78.138(3), which provides that a director is not individually liable for damages except under circumstances described in subsection 7. That subsection requires a two-step analysis to determine a director’s individual liability: (1) the presumptions of the business rule must be rebutted and (2) the director’s act or failure to act must constitute “a breach of his or her fiduciary duties,” and that breach must involve “intentional misconduct, fraud, or a knowing violation of law.”⁴ The district court relied upon the Nevada Supreme Court’s decision in *Shoen* to show that gross negligence is the baseline for holding directors personally liable in breach-of-the-fiduciary-duty-of-care claims. The Court rejected this characterization of *Shoen* and held that a bifurcated approach for duty-of-care or duty-of-loyalty claims does not exist, but the plain meaning of NRS 78.138 provides the only path to hold directors individually liable for damages arising from official conduct.

The Commissioner failed to plead a cause of action pursuant to NRS 78.138 because allegations of gross negligence do not state a breach of the fiduciary duty of care involving a “knowing violation of law”

The Court then turned to the Commissioner’s allegations against the former directors. According to the language in NRS 78.138(7), the Commissioner must allege facts that, when taken as true, constitute a breach of the fiduciary duty involving “intentional misconduct, fraud, or a knowing violation of law.”⁵ The Court then considered what a “knowing violation of law” means in the context of exculpatory provisions for directors and officers. The Court cited the Tenth Circuit Court of Appeals, which adopted an expansive definition of “intentional” and “knowing,” requiring the director to have a knowledge of wrongfulness.⁶ Because the Commissioner’s complaint focused solely on gross negligence, and not the higher standard of knowledge of wrongdoing, the directors became entitled to judgment as a matter of law.

Conclusion

The Nevada Supreme Court held that the Commissioner failed to plead sufficiently that the directors knew their conduct was wrongful, as required by NRS 78.138. The Court granted the

⁴ NEV. REV. STAT. § 78.138(7)(b)(1)-(2) (2017).

⁵ *Id.*

⁶ *In re ZAGG, Inc. S’holder Derivative Action*, 826 F.3d 1222, 1232–33 (10th Cir. 2016).

directors' petition and issued a writ of mandamus to instruct the district court to enter a new order granting the motion for judgment on the pleadings. Alternatively, the district court may grant the Commissioner leave to amend the complaint, according to its discretion.