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## To Incorporate or Not to Incorporate - That is the Question: How *State v. Custard* Clarified Corporate Governance in North Carolina

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## NOTE

# TO INCORPORATE OR NOT TO INCORPORATE - THAT IS THE QUESTION: HOW *STATE V.* *CUSTARD* CLARIFIED CORPORATE GOVERNANCE IN NORTH CAROLINA

LAUREN J. ALLEN\*

### INTRODUCTION

As the business arena in North Carolina is rapidly evolving in numerous forms, shapes, and sizes, it is much more important to make sure the laws are precise and clear for those who decide to start a business entity in North Carolina. Venturing into the business sector can be a scary situation and there are many risks involved if not done correctly. The economic crisis that began in 2008 has impacted the entire nation and is a reflection of those that made extremely poor business decisions. If you are a business lawyer in North Carolina, then you understand the importance of keeping a copy of *Robinson on North Carolina Corporation Law (Robinson)* with you at all times, and to cherish it during your years as a practicing attorney like you would your Bible or any other sacred literature.<sup>1</sup> *Robinson is a “treatise that occupies a prominent shelf in every North Carolina business lawyer’s library.”*<sup>2</sup>

After a thorough and lengthy reading of Judge Tennille’s opinion for *State ex rel. Comm’r Ins. v. Custard*, you would do yourself an injustice not to include this highly informative piece with your “Corporation Bible.”<sup>3</sup> The North Carolina Business Court Judge detailed the importance of corporate governance in this complex business case

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\* B.A., North Carolina State University, Communication Media with a minor in Journalism, 2006; J.D. (cand.) North Carolina Central University School of Law, 2012. I would like to dedicate this casenote to my father, Douglas A. Allen, and in loving memory of my mother, Cheryl H. Allen.

1. John Buford, *Business Court Blockbuster: If You Only Read One Corporate Governance Case This Year, Make It This One*, North Carolina Business Litigation Report (March 21, 2010), <http://www.ncbusinesslitigationreport.com/tags/business-judgment-rule/> and RUSSELL M. ROBINSON, II, *ROBINSON ON NORTH CAROLINA CORPORATION LAW* (Matthew Bender, 7th ed. 2009).

2. Buford, *supra* note 1.

3. *State ex rel. Comm’r Ins. v. Custard*, 2010 NCBC 6 ¶¶ 1-70 (N.C. Super. Ct. Mar. 19, 2010).

and finally answered some legal issues that were of first impression in North Carolina.

For many years, the majority of states, including North Carolina, have looked to the premier Delaware business courts for guidance in their judicial interpretation of challenging business issues.<sup>4</sup> Delaware became the leading authority due to its favorable laws for incorporation, which lured an astonishing number of businesses to incorporate there. This has given the Delaware courts an advantage over the other state courts by allowing them more opportunities to handle legal issues that arise in business law. *Custard* examines some of these difficult legal issues left unanswered by *Robinson* which include: (1) what does a breach of a fiduciary duty by a director or officer look like; (2) is there a difference in determining directors' duties based on particular industries; (3) what standard is applied for the business judgment rule; (4) is the gross negligence standard used in North Carolina corporation law; and (5) is good faith a separate duty or an element of a duty of loyalty or a duty of care?<sup>5</sup> While Delaware corporate law has and will remain as one of the best sources of authority to refer to when establishing the law in North Carolina, *Custard* sets precedence for those that decide to incorporate in North Carolina. Judge Tennille's interpretation of the North Carolina General Statutes in *Custard* provides a clearer representation of North Carolina corporation law. Finally, *Custard* pushed North Carolina corporation law out from behind the shadows of the Delaware decisions.

This is an informative note which considers the significance of looking at decisions of corporate governance in North Carolina rather than strictly focusing on Delaware decisions. Prior case law has left business lawyers in North Carolina with no other choice but to rely on the outcomes in Delaware law. At some point, we have to look upon our North Carolina cases, precedence, and authoritative sources to make our law clear for those who decide to incorporate in North Carolina. This note focuses on the importance of the North Carolina Business Court and the implications of *Robinson* prior to this decision. Next, it clarifies and expands on some unanswered questions from *Robinson* on the fiduciary duties of officers and directors in a corporation. The *Custard* decision declares that different industries determine different directors' duties, the business judgment rule is a gross negligence standard, and good faith is not a separate duty but rather an element of a duty of loyalty or a duty of care. Finally, this note will show how Judge Tennille's decision in *Custard* enhances the judicial

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4. *Id.* ¶ 48.

5. *Id.* ¶ 58.

interpretation that is already found in *Robinson* and provides case authority that will assist similarly situated lawyers in the future.

#### THE CASE

On March 31, 2006, the plaintiff, James E. Long, filed in the North Carolina Superior Court in the Tenth Judicial District of Wake County, but was subsequently transferred to the North Carolina Business Court where Judge Tennille presided over the case due to its complex business issues.<sup>6</sup> *Robinson on North Carolina Corporation Law* states:

The equally important purposes of the Business Court are, first, to establish an expert forum that can expeditiously resolve complex corporate and other business disputes and, second, by requiring a written opinion in every case, to create a larger body of case law that will result in greater certainty and predictability for business decision making.<sup>7</sup>

The plaintiff, James E. Long (Mr. Long), was the North Carolina Commissioner of Insurance and the liquidator of Commercial Casualty Insurance Company (CCIC) of North Carolina.<sup>8</sup> Prior to this suit, CCIC was forced into liquidation after becoming insolvent as a result of poor decisions and was over sought by Mr. Long of the North Carolina Department of Insurance (NCDOI).<sup>9</sup> CCIC was a property and liability insurance company that originally formed in Georgia, but re-domesticated to North Carolina on December 21, 2001.<sup>10</sup> The defendants, collectively as “individual Defendants,” were Richard and Wendy Custard, Nimocks Haigh, and Delta Insurance Services, Inc.<sup>11</sup> Mr. and Mrs. Custard, along with Mr. Haigh were members of the board of directors and officers at CCIC.<sup>12</sup> Delta owned the outstanding stock in CCIC and the above named defendants were also board members, officers, and shareholders of Delta.<sup>13</sup> “The Custards also owned and controlled Custard Insurance Adjusters (CIA), a company that adjusted property and casualty insurance claims for companies nationwide” which included a majority of CCIC’s claims.<sup>14</sup>

During Mr. Long’s investigation, he found that the individual Defendants “directed the business of CCIC in such a way as to promote the best interests of CIA and in disregard of the interests of CCIC

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6. *Id.* ¶ 6.

7. ROBINSON, *supra* note 1, § 1.04[2].

8. *Custard*, 2010 NCBC 6 ¶ 10.

9. *Id.*

10. *Id.*

11. *Id.* ¶¶ 25-8.

12. *Id.*

13. *Id.* ¶ 23.

14. *Id.*

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shareholders and policyholders.”<sup>15</sup> Mr. Long brought this suit on behalf of the creditors and policyholders of CCIC to recover money judgments from a loan of funds, termination payments, and a breach of fiduciary duties by the individual Defendants in their capacity as directors/officers at CCIC.<sup>16</sup> NCDOI based its theory of liability on the fact that the individual Defendants showed bad faith or a lack of good faith when they filed CCIC’s monthly reports with NCDOI and when they continued to sell a high volume of artisan insurance policies even though there was evidence of extreme losses on these policies.<sup>17</sup>

The only prior history was the opinion by Judge Tennille on the individual Defendants’ motion to dismiss for failure to state a claim on August 8, 2007.<sup>18</sup> On July 15, 2009, the individual Defendants filed a motion for summary judgment which this opinion is in response of that motion.<sup>19</sup> Judge Tennille granted the individual Defendants’ motion for summary judgment in regards to the claims for breach of fiduciary duties as the final outcome for *Custard*.<sup>20</sup>

## BACKGROUND

“For more than 30 years, *Robinson on North Carolina Corporation Law* has been the authoritative reference on corporation law in North Carolina.”<sup>21</sup> According to LexisNexis, “it provides complete coverage of significant case law developments, placing a special emphasis on corporate control and governance.”<sup>22</sup> Russell M. Robinson, II is the author of this significant treatise and is a well-known, leading authority on North Carolina business corporation law.<sup>23</sup> In referring to *Robinson* in this section of the note, the implications and results derive from *Robinson* prior to the 2010 *Custard* decision.<sup>24</sup>

Before the March 19, 2010 opinion, *Robinson* could only rely on the August 8, 2007 *Custard* opinion for Defendants’ motion to dismiss for failure to state a claim for its implications of statutes of limitations in regards to the breaches of duty of care and loyalty.<sup>25</sup> In regards to this

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15. *Id.* ¶ 9.

16. *Id.* ¶ 20.

17. *Id.* ¶ 10.

18. *State ex rel. Comm’r Ins. v. Custard*, 2007 NCBC 26 ¶¶ 1-35 (N.C. Super. Ct. Aug. 8, 2007).

19. *Custard*, 2010 NCBC 6 ¶ 3.

20. *Id.* ¶ 178.

21. *Robinson on North Carolina Corporation Law*, LEXISNEXIS.COM, <http://www.lexisnexis.com/store/catalog/booktemplate/productdetail.jsp?pageName=relatedProducts&catId=&prodId=7236#> (last visited April 6, 2011).

22. *Id.*

23. *Id.*

24. ROBINSON, *supra* note 1.

25. *Id.* § 17.07[1].

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implication, *Robinson* explained, “the prevailing view holds that the applicable period of limitations is determined by the nature of the wrong complained of, not by the nature of the suit as being derivative or the general nature of the directors’ duties as being fiduciary.”<sup>26</sup> This view derived from the prior case law of *Custard*, in “applying three-year period in action under insurance statute against directors of insurance company for breach of fiduciary duty of loyalty.”<sup>27</sup> However, as a result of the Court’s denial of Defendants’ motion to dismiss Plaintiff’s prior case law claims in *Custard*, this present case arose to answer those claims.<sup>28</sup> Judge Tennille pointed out that *Robinson* left four unanswered questions “about fiduciary duties of officers and directors” in North Carolina which include whether there is “a separate duty of good faith under North Carolina law,” whether different directors can “be held to different standards of care,” whether “directors in different kinds of companies [could] be held to different standards of care,” and whether “the standard of review under the duty of care [is] ‘negligence’ or ‘gross negligence’”<sup>29</sup> According to N.C. Gen. Stat. § 55-8-30(a), “a director shall discharge his duties as a director, including his duties as a member of a committee: (1) [i]n good faith; (2) [w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) [i]n a manner he reasonably believes to be in the best interests of the corporation.”<sup>30</sup> Thus, this applicable statute for the general standards for directors imposes a duty of good faith, care, and loyalty.<sup>31</sup>

Prior to the 2010 *Custard* decision, it was unclear whether or not there was a separate duty of good faith under North Carolina law.<sup>32</sup> In referring to N.C. Gen. Stat. § 55-8-30(a)(1), *Robinson* states, “[t]he requirement of good faith is listed separately in the statute and has occasionally been cited as a separate duty apart from the duties of due care and loyalty. . . .”<sup>33</sup> While there are several notable cases used throughout *Robinson* to express opinions of differing views when it comes to the “duty of good faith” as a separate duty from the duty of care or loyalty, these cases are based on Delaware law.<sup>34</sup> Thus, *Robinson* concluded that “the North Carolina courts have not yet de-

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26. *Id.*

27. *Id.* (quoting *State v. Custard*, 2007 NCBC 26, n.6).

28. *State ex rel. Comm’r Ins. v. Custard*, 2010 NCBC 6 ¶¶ 1-70 (N.C. Super. Ct. March 19, 2010).

29. *Id.* ¶ 58 n.16 (quoting *ROBINSON*, *supra* note 1, § 14.03[1]).

30. N.C. GEN. STAT. § 55-8-30(a) (2010).

31. *ROBINSON*, *supra* note 1, § 14.02, *see id.*

32. *Custard*, 2010 NCBC 6 ¶ 31.

33. *ROBINSON*, *supra* note 1, § 14.02 (citing § 55-8-30(a)).

34. *Id.* (citing *In re Caremark Int’l*, 698 A.2d 959, 970 (Del. Ch. 1996), *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), *Brehm v. Eisner*, 906 A.2d 27, 67 (Del. 2006)).

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fined whether and to what extent a director may be held liable under the duty of good faith for conduct that may not precisely constitute disloyalty or lack of due care.”<sup>35</sup>

Prior to the 2010 *Custard* decision, *Robinson* could not answer whether or not different directors in the same company or directors in different kinds of companies could be held to different standards of care under North Carolina law.<sup>36</sup> These two issues were paired together because they have very similar reasonings in their decisions and authority found prior to Judge Tennille’s opinion. In referring to the N.C. Gen. Stat. § 55-8-30(a)(2), “this formulation of the standard of care in terms of a “prudent person” acting under “similar circumstances” raises the question whether the test is a fixed standard of prudence applicable to all directors and all corporations alike or whether it may be higher for some corporations and directors than for others.”<sup>37</sup> Some courts throughout the United States have the view that when it comes to different directors in the same company, the standard of care will vary based on that individual director’s experience and reputation.<sup>38</sup> *Robinson* goes on to state that even though certain directors will have differing duties and may even discharge their duties to outside advisors, directors as a whole are “under a “duty of reasonable inquiry” to inform themselves as to the condition of the corporation and the conduct of its affairs; it is no excuse for them to say that they had no knowledge of the mismanagement or fraud that reasonable attention to those affairs would have disclosed.”<sup>39</sup> Many of the earlier decisions in North Carolina stem on a bank director’s liability “who might be held to higher standards of conduct and broader liabilities than directors of ordinary corporations.”<sup>40</sup> It is important to note that these bank director decisions that *Robinson* refers to occurred some one hundred years ago.<sup>41</sup> This just goes to show the lack of relevant case authority in North Carolina business law. “The North Carolina Supreme Court has indicated that there may be differences between the responsibilities of a bank director and a director of an ordinary corporation, which view seems supported by the words “like position” in the statute.”<sup>42</sup> Thus, in referring to N.C. Gen. Stat. § 55-8-30(a)(2), *Robinson* concluded, “it is arguable, however, that the ‘like position’ phrase refers only to the

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35. ROBINSON, *supra* note 1, §14.02.

36. *Custard*, 2010 NCBC 6 ¶ 58.

37. ROBINSON, *supra* note 1, § 14.03[1].

38. *Id.*

39. *Id.* § 14.03[2].

40. *Id.* § 14.03[1].

41. *Id.*

42. *Id.*

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different duties of officers and directors, not to the different duties of directors of different types of corporations.”<sup>43</sup>

Prior to the 2010 *Custard* decision, *Robinson* could not answer whether the standard of review under the duty of care was ordinary negligence or gross negligence under North Carolina law.<sup>44</sup> Instead, *Robinson* relied on more Delaware decisions, like *Smith v. Van Gorkom*, that pronounced that the applicable standard is “gross negligence.”<sup>45</sup> The Delaware courts reasoning on how to determine whether the standard of review was gross negligence, depended on the directors having an informed, rational basis for the operation of the company like specific decisions or general monitoring.<sup>46</sup> However, there is one footnote referencing the North Carolina case of *First Union Corp. v. Suntrust Banks, Inc.*, which found that “the duty to act on a fully informed basis is often stated as the prime duty of due care,” but does not make any other distinctions in relation to gross negligence.<sup>47</sup>

Courts in other jurisdictions have drawn a distinction between (a) the duty of care in making a specific decision, such as approving a transaction, for which the protection of the business judgment rule may be available, and (b) the duty of care in the directors’ general supervisory or oversight performance, such as monitoring compliance with a policy or legal requirements, for which the protection of the business judgment rule may not be available.<sup>48</sup>

“The North Carolina courts have not explicitly noted that distinction, but the North Carolina decisions. . .clearly impose a duty of care on the directors in monitoring the ongoing operation of the corporation as well as in making decisions on particular matters.”<sup>49</sup> Thus, *Robinson* infers that even though there are no North Carolina decisions directly on point, “it appears likely from the language and background of the North Carolina decisions that the North Carolina courts under the Business Corporation Act would apply a standard of reasonable care under the circumstances, rather than a lower ‘gross negligence’ standard.”<sup>50</sup>

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43. *Id.* (referencing n.7).

44. *State ex rel. Comm’r Ins. v. Custard*, 2010 NCBC 6 ¶ 31 (N.C. Super. Ct. Mar. 19, 2010).

45. *ROBINSON supra* note 1, § 14.03[2] (referencing *Smith v. Van Gorkum*, 488 A.2d 858 (Del. 1985)).

46. *Id.*

47. *Id.* (referencing *First Union Corp. v. SunTrust Banks, Inc.*, 2001 NCBC 9A ¶ 32 (N.C. Super. Ct. Aug. 10, 2001)).

48. *Id.* § 14.03[3] (referencing *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996)).

49. *Id.* § 14.03[2].

50. *Id.*

## ANALYSIS

*Custard* required the North Carolina Business Court to examine an insolvent insurance company's fiduciary principles "that fairly distinguish between director and officer conduct that involves (1) a breach of the duty of loyalty that should be remediable by an award of monetary damages and (2) an exculpable or indemnifiable breach of the duty of care."<sup>51</sup> North Carolina now has official case precedent in dealing with directors' duties in corporation law. The North Carolina Business Court made a decision in favor of the Defendants' motion for summary judgment. After Judge Tennille's thorough assessment of *Custard*, he stated that the Commissioner "failed to establish a breach of fiduciary duty by Defendants" and "to establish evidence of bad faith that would support an award of monetary damages."<sup>52</sup> Judge Tennille came to his final decision after he reflected on a broad timeline of the events that occurred leading up to the insolvency of CCIC and the Commissioner's interference with the company's liquidation. Thus, *Custard* answered, "significant questions concerning the duties of officers and directors and to whom those duties are owed and the standards of review applied by the courts" which is discussed in this section.<sup>53</sup>

The first unanswered question: Is there a separate duty of good faith under North Carolina law?<sup>54</sup> According to Judge Tennille, under North Carolina law, "there is no duty of good faith separate and apart from the duties of care and loyalty."<sup>55</sup> Prior case decisions showed difficulty in determining if good faith was in its own category and if a plaintiff could sue a director after a finding of just bad faith. "The North Carolina courts have not created a separate fiduciary duty of good faith because it is not necessary and would create significant uncertainty under our law."<sup>56</sup> Thus, good faith is not a separate duty which resolves the confusion that existed with North Carolina's prior law.<sup>57</sup>

The second unanswered question: May different directors be held to different standards of care?<sup>58</sup> According to Judge Tennille, under North Carolina law, "different directors may be subject to differing duties, at least based on their knowledge."<sup>59</sup> Each of the defendants

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51. State *ex rel.* Comm'r Ins. v. *Custard*, 2010 NCBC 6 ¶ 2 (N.C. Super. Ct. Mar. 19, 2010).

52. *Id.* ¶ 177.

53. *Id.* ¶ 3.

54. *Id.* ¶ 58 (referencing ROBINSON, *supra* note 1, § 14.03[1]).

55. *Id.* ¶ 51.

56. *Id.*

57. *Id.*

58. *Id.* ¶ 58 (referencing ROBINSON, *supra* note 1 § 14.03[1]).

59. *Id.* ¶ 92 (referencing footnote 25 in Judge Tennille's opinion).

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in *Custard* had certain roles based on their individual expertise in the company and each one of them discharged some aspect of their personal responsibilities to outside experts.<sup>60</sup> In fact, two of the defendants relied on the information received from the other defendant because of his specific role in the company.<sup>61</sup> North Carolina General Statute § 55-8-30(b) states the following:

In discharging his duties a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

- (1) One or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;
- (2) Legal counsel, public accountants, or other persons as to matters the director reasonably believes are within their professional or expert competence; or
- (3) A committee of the board of directors of which he is not a member if the director reasonably believes the committee merits confidence.<sup>62</sup>

Ultimately, the information and reports used from these outside experts had a negative impact on the success of the company.<sup>63</sup> According to N.C. Gen. Stat. § 55-8-30(c), “a director is not entitled to the benefit of subsection (b) if he has actual knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.”<sup>64</sup> The *Custard* decision stated that different directors in the company would be held to different standards of care with respect to their individual knowledge and expertise.<sup>65</sup> The two defendants were entitled to rely on the judgment of the other defendant who in turn would be held to a different standard of care.<sup>66</sup> That one defendant was “Haigh, who was the principal manager of CCIC at the time,” and agreed with an outside expert’s data.<sup>67</sup> Judge Tennille pointed out that “a director cannot rely on a report if she has actual knowledge that it is inaccurate.”<sup>68</sup> However, according to N.C. Gen. Stat. § 55-8-30(b), directors who rely on the professional expertise of officers or outside advisors are given a statutory safe harbor in North Carolina to protect them from potential liabilities.<sup>69</sup> In *Custard*, all of the defendants exercised their duty of care in good faith when they

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60. *Id.* ¶ 88, 99.

61. *Id.* ¶ 91.

62. N.C. GEN. STAT. § 55-8-30(b) (2010) (setting out general standards for directors).

63. *Custard*, 2010 NCBC 6 ¶ 39.

64. § 55-8-30(c) (setting out general standards for directors).

65. *Custard*, 2010 NCBC 6 ¶ 42.

66. *Id.* ¶ 91.

67. *Id.*

68. *Id.* ¶ 92.

69. *Id.* ¶ 88.

relied on the accuracy of the outside information and acted in the best interests of the corporation.<sup>70</sup> Thus, since the one defendant had individual knowledge and expertise, he was held to a different standard of care, but was found to meet that standard since it was done in good faith and believed to be accurate information.<sup>71</sup>

The third unanswered question: May directors of different kinds of companies be held to different standards of care?<sup>72</sup> According to Judge Tennille, under North Carolina law, “directors in different kinds of companies can have different duties.”<sup>73</sup> He went on to distinguish that the earlier decisions referred only to bank directors having a separate and distinct standard of care, but now “conduct by directors of an insurance company may be judged differently from conduct by directors of a textile company depending on the actions in question.”<sup>74</sup> The *Custard* decision made it clear that the standard of care depends on the specific context of the company in question and is always changing.<sup>75</sup> The proper standard of review in this case involved: “(1) the operation of the business and the application of the corporate charter’s exculpatory provisions and (2) the director’s duty to monitor.”<sup>76</sup> Judge Tennille laid out the duties that need to be met in good faith; for example, “officers and directors of insurance companies have a duty to policyholders to act in such a manner as to avoid insolvency that would render the policies written worthless or substantially diminished in value.”<sup>77</sup> If these officers or directors were to intentionally fail to act in accordance of this known duty to avoid insolvency, then they would have demonstrated a conscious disregard for their duties.<sup>78</sup> Obviously, this conduct would entail a lack of good faith or bad faith and “would take the directors outside the protection of the exculpatory provisions of a corporate charter” and the presumption of the business judgment rule that the Court allows.<sup>79</sup> This presumption of the business judgment rule means that “[a]s long as the process employed by the officers and directors was rational and they believed they were advancing the corporation’s business, the Court will not second-guess their business decisions. . . .”<sup>80</sup> Judge Tennille concluded that there was no evidence that the Defendants acted in bad faith “in

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70. *Id.* ¶ 93.

71. *Id.* ¶ 96.

72. *Id.* ¶ 58 n.16 (referencing ROBINSON, *supra* note 1, § 14.03[1]).

73. *Id.* ¶ 69 n. 20.

74. *Id.* ¶ 53.

75. *Id.*

76. *Id.* ¶ 47.

77. *Id.* ¶ 69.

78. *Id.*

79. *Id.*

80. *Id.* ¶ 68.

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monitoring business risks” which is required for liability purposes.<sup>81</sup> Thus, the standard of care in CCIC would be different than other companies because the presumption of the business judgment rule is based on the directors of CCIC’s good-faith efforts in fulfilling the necessary duties that an insurance company requires.<sup>82</sup>

The final unanswered question: Is the standard of review under the duty of care “negligence” or “gross negligence?”<sup>83</sup> According to Judge Tennille, under North Carolina law, the standard of review for this case is based on gross negligence because of the type of company involved (insurance company) and the statutes in North Carolina that recognize the risks involved with this type of company.<sup>84</sup> In *Custard*, there was “no showing of a conflict of interest or breach of fiduciary duty of loyalty.”<sup>85</sup> There was no evidence of “reckless indifference, improper motive, personal advantage, or deliberate disregard of corporate interests.”<sup>86</sup> Thus, if there is no showing of bad faith and a self-interest transaction, then the standard of review under the duty of care is gross negligence in order to eliminate the presumption of the business judgment rule.<sup>87</sup> If there is a self-interest transaction, then the standard of review under the duty of care is ordinary negligence in order to eliminate the presumption of the business judgment rule.<sup>88</sup> The Commissioner in *Custard* had the burden to prove the higher standard of review and was unsuccessful in doing so.<sup>89</sup> According to N.C. Gen. Stat. § 55-8-30(d), “a director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.”<sup>90</sup> Further, “[t]he duties of a director weighing a change of control situation shall not be any different, nor the standard of care any higher, than otherwise provided in this section.”<sup>91</sup> The Defendants acted in good faith and there was no proof of a self-interest transaction which offered them the presumption of the business judgment rule and their exculpatory clause in their CCIC charter for their decisions even if they were to be deemed to have mismanaged the company. Thus, the *Custard* decision established that regardless of the negative consequences that occur as a result of bad decisions done in good faith and with no

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81. *Id.* ¶ 82.

82. *Id.* ¶ 59.

83. *Id.* ¶ 58 n. 16 (referencing ROBINSON, *supra* note 1, § 14.03[1]).

84. *Id.* ¶ 68-9.

85. *Id.* ¶ 87.

86. *Id.* ¶ 84.

87. *Id.* ¶ 86.

88. *Id.*

89. *Id.* ¶ 84.

90. N.C. GEN. STAT. § 55-8-30(d) (2010) (setting out general standards for directors).

91. *Id.*

self-interest in a transaction, a plaintiff must meet the gross negligence standard.<sup>92</sup>

#### CONCLUSION

Judge Tennille's opinion in *Custard* answered four significant legal issues that were of first impression in North Carolina corporation law and emphasized the necessary requirements business lawyers must prove in their claims for breaches of fiduciary duties. Under North Carolina law, there is no separate duty of good faith, different directors may be held to different standards of care based on their knowledge, directors in different kinds of companies may be held to different standards of care, and the standard of review under the duty of care is gross negligence only when there is no self-interest transaction.<sup>93</sup> The *Custard* opinion finally produced North Carolina case precedent that North Carolina lawyers can use rather than resorting only to Delaware law, so make sure you keep a copy alongside your *Robinson on North Carolina Corporation Law*. The Court ruled that there was no genuine issue as to any material fact and the motion for summary judgment was granted in favor of the Defendants.<sup>94</sup> In fact, the Court found that "[a]ll the evidence supports a finding that Defendants were trying to run and build up a successful insurance company."<sup>95</sup>

North Carolina courts should follow this case because we must start relying on decisions and explanations that represent North Carolina corporate law rather than the law of Delaware. We have become accustomed to following the business law decisions from the prestigious Delaware Court of Chancery and even at times strictly resorting to Delaware case law. The North Carolina Business Court was established in order to exemplify what North Carolina law does in certain complex business issues and Judge Tennille's opinion in *Custard* has given us an informative and precise interpretation of directors' duties in corporate governance. At a time when economic resilience is crucial, how else will North Carolina attract new business entities to incorporate if we do not clarify North Carolina corporate governance through our own case law?

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92. *Custard*, 2010 NCBC 6 ¶ 84.

93. *Id.* ¶ 51-96.

94. *Id.* ¶ 177-178.

95. *Id.* ¶ 72.