

Alert | Securities Litigation



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Nevada Supreme Court Holds That Allegations Of “Gross Negligence” Do Not Plead A Breach Of The Fiduciary Duty Of Care Under Nevada’s Exculpatory Statute (NRS 78.138(7))

The Nevada Supreme Court’s recent decision in *Chur v. Eighth Jud. Dist. Ct.*,¹ is significant for officers and directors of Nevada corporations. *Chur* holds that allegations of “gross negligence” do **not** suffice to plead a breach of the fiduciary duty of care. This decision furthers Nevada’s role as a strong protector of the business judgment rule and director protections thereunder.

Many states have so-called exculpatory statutes limiting the circumstances in which directors may face personal legal liability. In Nevada, that statute is NRS 78.138(7), which protects directors from personal liability unless the conduct alleged involved “intentional misconduct, fraud or a knowing violation of the law.” NRS 78.138(7)(b)(2).

To have standing to sue, a derivative plaintiff is required under NRS 41.520 to plead “with particularity” the reasons why the plaintiff should be excused from making a demand on the company’s board of

¹ *Chur v. Eighth Judicial Dist. Court of Nev.*, Nev. Adv. Op. 7, 2020 Nev. LEXIS 6 (Nev. Feb. 27, 2020). The *Chur* opinion is available for download at: <http://caseinfo.nvsupremecourt.us/document/view.do?csNameID=54795&csIID=54795&deLinkID=759286&onBaseDocumentNumber=20-07840>

directors, a concept referred to as pleading “demand futility.” One way plaintiffs have attempted to plead demand futility is by alleging the directors face personal liability for the decisions made (or not made), and thus cannot be trusted with a decision that could involve suing themselves. Exculpatory provisions like NRS 78.138(7) provide directors with a strong defense to this type of allegation by strictly limiting their personal exposure to suit.

While NRS 78.138(7) is seemingly both plainspoken and quite strict, over time courts have struggled with, and appeared to loosen, the meaning of “intentional misconduct, fraud or a knowing violation of law.” This errant view derived largely from language in *Shoen v. SAC Holding Corp.*, 137 P.3d 1171, 1184 (2006), in which the Nevada Supreme Court said, “the business judgment rule does not protect the *gross negligence* of uninformed directors and officers” in the context of an alleged breach of the duty of care. In *Chur*, the Nevada Supreme Court characterized its prior language as *dicta*, and “disavow[ed] *Shoen* to the extent it implied a bifurcated approach to duty-of-care and duty-of-loyalty claims,” clarifying that alleging a director or officer’s gross negligence is not enough to support either type of claim. 2020 Nev. Lexis at *9–10.

Chur recognized that what supposedly sufficed to plead “intentional” conduct under the exculpatory statute had become impermissibly watered down. This is illustrated by the facts in *Chur*, which involved a receiver suing the former directors of a bankrupt entity, alleging they had “failed to *properly inform*” themselves of the risks that supposedly resulted in the receivership. Relying upon *Shoen*, the trial court denied defendants’ motion for judgment on the pleadings because a trier of fact could consider such conduct (or in *Chur*’s case, non-conduct) to constitute “gross negligence.” Pursuant to a writ of mandate, the Nevada Supreme Court reversed the district court, holding the receiver’s allegations did not suffice under Nevada’s exculpatory statute. The Supreme Court expressly adopted the decision of the Tenth Circuit in *In re ZAGG Inc. S’holder Deriv. Action*, 826 F.3d 1222, 1233 (10th Cir. 2016), which held that “[t]o give [NRS 78.138(7)] a realistic function, it must protect more than just directors . . . who did not know what their actions were; it should protect directors who knew what they did but did not know that it was wrong.”

Chur thus requires that there must be a consciousness of guilt on the part of directors in order for an action to survive Nevada’s exculpatory statute. That, combined with Nevada’s “with particularity” demand futility pleading requirement, makes it a significant case that is consistent with Nevada’s strong support for the business judgment rule, and one that should be recognized and appreciated by directors of Nevada corporations, and those who advise them.

Authors

This GT Alert was prepared by:

- Daniel J. Tyukody | +1 310.586.7723 | tyukodyd@gtlaw.com
- Mark E. Ferrario | +1 702.792.3773 | ferrariom@gtlaw.com
- Michael J. Bonner | +1 702.599.8030 | bonnerm@gtlaw.com
- Kyle A. Ewing | +1 702.792.3773 | ewingk@gtlaw.com

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