The Business Judgment Rule in Overview

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Some people are fortunate since they have never heard of the business judgment rule. Less fortunate are people who sense the general purport of the business judgment rule to be that courts do not hold corporate directors liable for bad business judgments and who have then thought no more about it. Not at all fortunate are the members of this morning's audience who are consigned to sit through the upcoming vivisection of the rule. Least fortunate are we on this platform who have been assigned to explicate the anatomy of the modern business judgment rule, diagnose its problems, and prescribe remedies.

The unhappy fact is that while hard working businessmen, lawyers, and other sensible people have been quietly going about their business, a jurisprudential fire has broken out deep in the hold of American corporate jurisprudence in the container marked "business judgment rule." Current debate about the rule has the quality of a febrile theological controversy that is ultimately resolved only by Chalcedon or Nicaea and is followed by banishment, as heretics, of all who hold views at variance with the currently accepted dogma. As it happens, that sort of doctrinal hammering is under way at this very time with regard to the business judgment rule in two different conventicles. One synod consists of the custodial solons of the Committee on Corporate Laws (CCL), the drafters of the American Bar Association's Model Business Corporation Act (MBCA). The other is made up of the high priests of the American Law Institute (ALI). Professor Hamilton, a prelate of cardinal rank from the CCL order, and Professor Goldschmid, of equal station within the ALI, are with us today on the platform.

We all learn in first year physics that when a substance is put under pressure, its temperature rises. The business judgment rule has been put under pressure by the current undertaking of the CCL to update the entire MBCA and by the current Corporate Governance Project of the ALI, and the temperature has risen. Debate about the business judgment rule would have escalated in recent years anyway. One cause lies, sadly, in the eroding public regard for the nation's institutional structures which has occurred during the last ten or fifteen years; since Watergate and the revelations of political bribery overseas by United States corporations, pressure for closer scrutiny of the corporate boardroom has increased.

The second cause of the heated debate concerning the business judgement rule is the frequent conversion of the rule from a protective shield into an aggressive sword. The following hypothetical illustrates this phenomenon. Suppose a shareholder (or in reality a lawyer from the plaintiffs' bar) brings a derivative action on behalf of the corporation. A committee of disinterested directors, perhaps supplemented by other outside persons, subsequently looks into the matter and resolves that in its business

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judgment the claim on behalf of the company is not warranted and should be dropped. The adopted resolution is presented to the court, and it is argued that the resolution is determinative against the plaintiff since the business judgment rule precludes a judicial examination of the merits of the decision reached by the committee of disinterested directors. The committee's argument thus transforms the rule from a defensive weapon to an offensive weapon. In a stream of recent cases, mainly in Delaware and New York, courts have been struggling with this scenario, and variations of it, in an effort to define the scope of judicial willingness to be guided by the determinations made by these special litigation committees.[1] In so doing, these courts are hammering and retempering the business judgment rule on the anvil of the common law. The wave of cases in this area has contributed significantly to the recent wake of law review commentary on the business judgment rule in which we are currently awash.

As the opening speaker, I will seek to provide the audience with a general acquaintance of the business judgment rule and its quirks, and to provide a sense of what the shouting relating to the business judgment rule is all about. I will do this to the extent that some fifteen years of experience as a member of several corporate boards, many more years of practice as counsel to boards and committees of boards, and a number of years of law teaching enables me to divine what the shouting is all about.

I do not contemplate that anything I say here will alter the views of any of my colleagues on this panel, as each of them is an outstanding scholar who has worked his way carefully to his own position of doctrinal salvation. While I shall make no effort to conceal my own views in these matters, some of which are strongly held, neither shall I proselytize those in the audience to share my own viewpoints, though, of course, that would always be welcome.

One introductory observation is important. Throughout the course of these remarks, I will try to describe, in summary form, the separate issues that make up the present tangle and state the positions of various participants in the doctrinal free-for-all. It is a mark of the present confused situation, however, that I can confidently predict that none of my colleagues on this platform will agree that I have stated the issues correctly, and each will assert, probably correctly, that I have failed to capture or portray his own thoughtful position accurately. I therefore wish to make explicit that, when in these remarks I state that regarding a particular issue some persons take a position, P, I do not thereby mean to imply that any member of this panel takes position P. The panel members are quite able to speak for themselves about their own views, and they will doubtlessly do so.

I. THE BUSINESS JUDGMENT RULE IN THE ROUND

To continue this discussion, one is tempted, practically forced, to provide a general statement of the content of the business judgment rule. It is troublesome that any statement of the rule, however abstract and however finely hewn, will carry its

1. *See, e.g.*, Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1980); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

own radiations of meaning and will lean toward one or another interpretation. The problem is akin to setting out a brief functional definition of "due process." It cannot be done. For the moment, therefore, it must suffice to say that the general idea of the business judgment rule is that when a board of directors has acted with reasonable care and in good faith, its decisions will be regarded as "business judgments," and the directors will not be liable for damages even when a decision proves to be detrimental to the corporation. The following frequently quoted explication of the business judgment rule appears in the *Corporate Director's Guidebook* published by the American Bar Association:

> Recognizing that, consistent with the business corporation's profit orientation, business judgment inevitably involves risk evaluation and assumption, and recognizing that the office of corporate director, as such, does not require full-time commitment to the affairs of the enterprise, the corporate director frequently makes important decisions which may eventually prove to be erroneous. A director exercising his good faith judgment may be protected from liability to his corporation under the Business Judgment Rule. While not part of the statutory framework, this legal concept is well established in the case law of most jurisdictions. When viewing the decision of directors acting in the exercise of free and independent judgment, courts have been extremely reluctant to find that they acted negligently. Recognizing that business decisions may seem unrealistically simply [sic] when viewed with hindsight, and expressing reluctance to substitute their judgment for that of directors, courts have generally refrained from questioning the wisdom of board decisions.[2]

This generalized statement of the business judgment rule is arguably satisfactory, but a more specific understanding of the rule is needed.

II. Elements of the Business Judgment Rule

A. *Loyalty—Conflicting Interests*

In this area of the law, as in others, easy cases are easy to decide. The following hypothetical illustrates this point. If a board of directors were to adopt a resolution to sell a valuable corporate asset to the directors as individuals, and a shareholder were to file suit to enjoin the transaction or impose liability on the directors, no court would hold, and no commentator would contend, that the board's resolution would be entitled to the protection of the business judgment rule. In this scenario the directors' position of conflicting interest is manifest. To uphold the transaction, the shareholders would have to approve it, or (some would say "and") the court would have to be satisfied that the transaction were "fair" to the corporation.[3] The conflicting interest on the part of the deciding directors would taint the transaction and strip the board of the protection that would normally be afforded by the business judgment rule.

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2. Committee on Corporate Laws, Section of Corporation, Banking and Business Law, American Bar Association, *Corporate Director's Guidebook*, 33 Bus. Law. 1591, 1603–04 (1978).

3. *See* Cal. Corp. Code § 310 (West 1977); Del. Code Ann. tit. 8 § 144(a) (1983); N.Y. Bus. Corp. Law § 713 (McKinney 1963 & Supp. 1983–1984); *see also* Lewis v. S. L. & E., Inc., 629 F.2d 764 (2d Cir. 1980) (interested directors must prove transaction was fair and reasonable); Fliegler v. Lawrence, 361 A.2d 218 (Del. 1976) (even if shareholders approve transaction, directors may have to show fairness).

Of course there is much debate and litigation about the kind, amount, and intensity of conflicting interest that is required to shrivel the protective shield of the business judgment rule. An obvious illustration of this debate frequently arises in the context of takeover bids. Some commentators have argued, although no court has held, that if the directors of a target company were to reject a takeover bid, their judgment would not be entitled to the protection of the business judgment rule because they would have had a personal interest in retaining their positions as directors, and, in the case of inside directors, their jobs.[4]

More extreme lines of argument are possible. Some critics of the prevailing system of corporate governance believe that all members of a corporate board function as a conspiratorial huddle with the corporate officers. The proponents of this view believe that whenever a claim or charge is made against any of the officers or directors, each has a conflicting self-interest and a group interest to protect. In these circumstances the remaining directors cannot be disinterested.[5] This position is seldom stated this baldly, but reflections of the basic viewpoint can occasionally be detected in the criticisms of commentators who are fundamentally skeptical of the ability of outside directors to be objective in some situations.

This attitude of distrust can be detected most importantly in the special litigation committee which is made up of incumbent directors who were not involved in the transaction in question, or made up of new outside directors who were specifically recruited for membership on the board in order to serve as members of this committee. A spectrum of views can be, and is, held by commentators with regard to the objectivity and detachment of special litigation committees. Observers who believe that such outsiders by and large will do their best to call the shots in a fair and unbiased way will seek to extend the full protection of the business judgment rule to the committee's determinations. Those who doubt the objectivity and freedom of action of the outside directors will press the court to attach little or no significance to the committee's conclusions.

As in all conflicting arguments, each commentator's view of the matter is the product of an estimate of humanity, the individual's collective experiences and readings, the clarity of the commentator's perception, and the weight attached to the collateral side effects that would ensue if the commentator's preferred rule were to become the law. The issue of directors' loyalty or self-interest, while not the main source of confusion, contributes to the miasma that swirls around the business judgment rule today.

B. *Duty of Care*

Most of the current controversy surrounding the business judgment rule, and most of the anxiety felt by informed people, revolves around the question of the

4. Brown & Phillips, *The Business Judgment Rule:* Burks v. Lasker *and Other Recent Developments*, 6 J. CORP. LAW 453, 459 (1981); Easterbrook & Fischel, *The Proper Role of a Target Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1198, 1194–1204 (1981); Comment, *The Misapplication of the Business Judgment Rule in Contests for Corporate Control*, 76 NW. L. REV. 980, 1001, 1013 (1982).

5. Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 263 (1981); Johnson, *The Business Judgment Rule: A Review of its Application to the Problem of*

director's duty of care. The issues here are troublesome, multiple, and synergistic. The following hypothetical presents a typical scenario.

A company gets into trouble. Trouble tends to come in bunches. As sales decline, a sinking level of profits and cash flow reveals an increasing number of rocks that had not been noticed earlier by the marketplace: an old product line has been continued too long; initiation of a new product line has ignited an expensive lawsuit which alleges a patent infringement; a decision not to close overseas operations has led to a large loss in foreign currency devaluation; the company's number two finance person has been discovered to be a compulsive horserace bettor and to have embezzled substantial corporate funds; a hardline strike position approved by the board has led to bad labor relations.

What are the responsibilities of the board of directors with regard to these matters and a million others like them? Even if it is assumed that something could have been done by the board to avoid, prevent, or solve these problems, what measure of responsibility should the law impose upon the board or upon individual directors? Setting aside for a moment the question of whether a director might be held liable in a lawsuit for damages, the more basic questions are: What is an intelligent, well motivated, and dedicated director expected to do? Over what range of subjects or topics does the director's responsibility reach? How and with what intensity is the director expected to act? What fraction of the director's time must be devoted to the director's duties? What information sources must a director draw upon? Finally, at whose initiative, and in response to what agenda must the director act?

Existing case law is not threatening. Although courts regularly declare that the director who is not careful is not entitled to the protection of the business judgment rule, courts have been extremely reluctant to decide retrospectively that personal liability should be imposed on a director for failure to perform his duties with sufficient care.[6] It is universally agreed that an outside director who simply ignores directorial responsibilities, does not attend meetings, and fails to do the necessary homework runs a substantial risk that if something goes wrong, the business judgment rule will not be available as a defense. It is also agreed that an outside director is not expected to devote his or her entire working time and energies to performing the functions of director. Between these extremes, however, the criteria are murky. They are usually swept up in some generalized articulation like that contained in section 35 of the MBCA stating that the director shall perform his or her duties "in good faith, in a manner he [or she] reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances."[7]

This language is undeniably vague. What shall be done? Some scholars and lawyers would like to see the standard of a director's duty sharpened in order to

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Illegal Foreign Payments, 6 J. CORP. LAW 481, 499 (1981); Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600, 619–26 (1980). *Contra* Brown & Phillips, *supra* note 4, at 456 (committees can be independent).

6. Recently, in Aronson v. Lewis, 473 A.2d 805 (Del. 1984), the Delaware Supreme Court concluded that "under the business judgment rule director liability is predicated upon concepts of *gross* negligence." *Id.* at 812 (emphasis added).

7. MODEL BUSINESS CORPORATION ACT § 35 (1979).

enhance predictability. Others believe that for the good of shareholders and other investors, the directors' performance criteria should be escalated to put directors' feet in the fire, and thereby force them to pay more attention to the company's business affairs.[8] Some persons, however, see the danger of a heightened standard to be a rich opportunity to bring an infinite variety of lawsuits against a generally solvent class of defendant directors.[9]

A few persons may be motivated by a broad political desire to undermine the institutional decisionmaking mechanism of the modern corporation. On the other hand, many lawyers and executives worry that in today's litigious, blame-pointing environment, a court that is unfamiliar with business realities will, in the context of recession and bankruptcies, decide retrospectively to impose individual liability on the directors because of a company's decline. These observers believe, therefore, that the law should move in the direction of specifying the directors' duties and the intensity with which these duties must be performed, thus providing a safe harbor of protection for directors who have met those criteria.

The MBCA articulation of the business judgment rule includes the element of "good faith." This element is standard and obviously important. Again, however, the term is hardly self-executing. In the eyes of some, a director is acting "in good faith" if his heart is pure. For others, the term "good faith" carries with it a component of diligence, so that a director could not be said to have discharged his duties "in good faith" if he or she did not properly complete the necessary homework, did not attend many meetings of the board, or did not follow up on a rumor that the financial officer had been seen at the races. Within the elastic phrase "good faith" there is a vast latitude for interpretation and a corresponding uncertainty as to the law's expectations of directors.

It is generally conceded that directors may, in the discharge of their duties, rely upon experts and specialists in whom the directors have reason to instill confidence: accountants, lawyers, engineers, and others.[10] That proposition is of considerable help to directors, but the underlying question will not disappear: on what topics, to what extent, to what depth, and in what circumstances is a conscientious board expected to seek out and make use of expert assistance?

Finally, as increasing attention has been brought to bear on the "duty of care" issue, a few analysts have come to question the accepted assumption that traditional formulations in the field of tort law can be imported successfully into the field of directors' responsibilities without change. The attempted transplant encounters at least three difficulties. First, when we say that an automobile driver should drive with reasonable care, we know that the activity being pursued is driving a car. By contrast, no commonly articulated roster of directorial functions exists. We do not know what

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8. Johnson, *supra* note 5, at 509–10; Comment, *supra* note 4, at 1010–14; Note, *supra* note 5, at 626–29.

9. *Cf.* Coffee & Schwartz, *supra* note 5, at 318–20 (The problem is that plaintiffs' attorneys will sue for attorney's fees.). *But see* Kim, *The Demand on Directors Requirement and the Business Judgment Rule in the Shareholder Derivative Suit: An Alternative Framework*, 6 J. CORP. LAW 511, 525–26 (1981) (It is irrelevant that attorneys bring strike suits if the lawsuits serve the best interests of the corporation and society. There are other ways to prevent strike suits.).

10. *See* CAL. CORP. CODE § 309(b) (West 1977); DEL. CODE ANN. tit. 8 § 141(e)(1983); N.Y. BUS. CORP. LAW § 717 (McKinney 1963 & Supp. 1983–1984).

the directors are supposed to do; we know only that they are supposed to do it "with care."

Second, tort law is designed to distribute risk and liability in a situation where someone, according to some standard, has acted improperly. Most of the law of torts deals with acts. In a minority of situations, liability may be imposed for omissions; for example, liability may be imposed for failing to cage a dangerous animal. In the case of a board of directors, discrete acts or omissions may be at issue. Criticism of the board's performance, however, is likely to take the form of a different kind of charge—a failure to take action which might have prevented a corporate loss or mishap. Inaction is not usually a tort.

Third, and most important, though elusive, it is manifestly impossible for any director to attend every meeting, read and grasp in detail every briefing paper, raise every question, pursue every unpleasant rumor, or initiate inquiry into every aspect of the company's operations. A director working at the job full-time could not do those things. A part-time director will do only a fraction of them. Thus, even the most conscientious director will inevitably miss many things. If something goes awry, will a court, a jury, and lawyers, all viewing the situation retrospectively and all acting in their time honored style of piece-by-piece attention, focus only on a single event and ask: "Why did the director not see this particular problem, and why did the director not do something about it?"

The institutional fact is that the work of a director is an ongoing process—a continuing generalized surveillance, monitoring, and probing. In reality, it is that *process* which the director should carry on with "due care." Tort law offers no parallel or analogy for this situation. We would all find it ludicrous to suggest that tort law should provide that an automobile driver not be found liable for a particular accident because he has previously been careful in the general process of driving. However surprising this type of proposition is, ultimately it may be required to deal rationally with the problem of the directors' duty of care. Among the factors that compound the confusion surrounding the business judgment rule is a semi-awareness on the part of many persons that underlying the "due care" issue is a substantial intellectual puzzle that remains unsolved.

C. *Rational Business Purpose*

A particularly sore point in the current debate about the business judgment rule is whether the protection of the rule should be available only if the judgment reached by the directors was "in furtherance of a rational business purpose," or was "rationally in furtherance of a reasonable business purpose," or some similar, general concept. The classic case law position has been that the rule does not protect the directors if they commit an act of corporate "waste." No one denies that proposition. However, there is not much consensus as to what constitutes "waste." Efforts to develop a functional vocabulary to identify "waste" have been as unsuccessful as corresponding efforts to give operational meaning to the concept of "obscenity."

It has been argued that if a corporate transaction does not have a "rational business purpose" it must therefore be "waste," and the business judgment rule

must be made inapplicable. In the eyes of many viewers, however, this approach is a certain avenue to disaster, for it will invite—nay, force—courts to delve into individual business transactions and engage in exactly the kind of business judgment second-guessing that the business judgment rule is designed to eliminate. Everyone, including the courts, agrees that courts are not equipped to make these kinds of judgments.

Proponents of the idea that directors must demonstrate a "rational business purpose" before they may invoke the business judgment rule argue that they are merely seeking to exclude deranged, "off-the-wall," or "wildly irresponsible" actions by the board of directors, actions for which the directors ought to be held liable. Opponents of the proposed change point out that the language proposed does not at all read that way, and that a court cannot know whether a business decision was in fact "off-the-wall." Suppose, however, that it does appear in hindsight that a business decision was deranged or "off-the-wall." Many inventions, industrial innovations, and discoveries, whether ultimately successful or unsuccessful, have been considered "off-the-wall" when first proposed. For that matter, history records dozens of rationally conceived and exquisitely planned corporate projects that proved to be thundering disasters. From a social standpoint, innovation and risk-taking are exactly what boards of directors of most companies (excluding, of course, special categories of financial corporate fiduciaries) should be encouraged to pursue. Precisely because many of the innovative projects proposed by the board will inevitably fail, the business judgment rule is most needed to protect directors from liability. In this broader view of the matter, the whole concept of the "prudent" person is a discordant importation into the field of corporate direction; at a minimum, this concept can survive importation only if it is radically modified.

D. *Some Technical Problems*

Grouped together here for ease of discussion are several disparate items related to the business judgment rule. That they have been captioned "technical" in no way suggests that they are unimportant. Quite the contrary is true.

1. *The Business Judgment Doctrine*

Suppose a court decides, on whatever ground, that the business judgment rule is not available to certain directors in a particular situation. What happens next? That the directors do not have the shield of the rule obviously does not, in itself, mean either that their decision was wrong or that they should be held liable for anything. Nor would anyone seriously suggest that the court should simply insert itself into the role of the board of directors in all respects with regard to the transaction in question. What should the court do? The rhetoric of the cases and the commentators' writings flies off in all directions. In one view of the matter, the unavailability of the business judgment "rule" as a defense does not dilute the continued vigor of the business judgment "doctrine"—the generalized proposition that courts are not disposed to substitute their business judgment for that of the board of directors. (A distinction between the business judgment "rule" and the business judgment "doctrine" is only

occasionally found in the literature, but may prove to be quite a useful analytic tool.) In the main, however, the learned discussions of this topic tend to meander off into esoterica known only to savants of evidence and procedure casebooks—of shifting and springing presumptions of varying specific gravities, of goings forward, of rebuttable presumptions and burdens of proof. Much speculation of this character is further clouded by the uncertainty as to the identity of the direct or indirect objects of the concepts under discussion. For example, if it should be agreed that "the burden of proof" shifts to the defendant directors, still no answer is provided to the question: "Burden of proof as to what and, further, by what measure of burden?" It suffices for our purposes to recognize that unavailability of the business judgment rule is not tantamount to liability of the directors.

2. *Character of the Remedy*

Available remedies and timing of the application to the court for a remedy make a difference in the application of the business judgment rule. A court that is sufficiently offended by a transaction to enjoin its future consummation will not necessarily impose personal liability on the directors at a later date after the same transaction has been closed. Likewise, that a court imposes personal liability on the directors does not necessarily mean that the court will use its equitable powers to undo or enjoin the transaction. In circumstances where a court determines that the business judgment rule is not applicable, the character of the remedy sought may prove, explicitly or inexplicitly, to be a dominant element in the outcome.

3. *Cases Not Involving Affirmative Decisions by the Board*

In the literature dealing with the business judgment rule, it is often dogmatically stated that "on the face of it" and "obviously" the only circumstances in which the business judgment rule "can" have an application is a situation in which a go/no-go issue has been brought before the board for decision, and the board has made an affirmative decision on the issue.[11] I have some doubt whether the actual cases, in spite of the language of the opinions, uniformly support that proposition. If, indeed, the business judgment rule provides protection only to a conscious "yes-no" decision on a discrete transaction, then I think one can predict one of two future developments. Either the business judgment rule will have to be changed to delete this requirement, or some *other* supplemental rule will have to be developed to provide protection for boards of directors against charges that inaction on their part constituted a lack of due care. I believe that an important fraction of the debate currently revolving around the business judgment rule is rooted in this element of the matter. It must be admitted, however, that the point has not yet been well articulated or highlighted in the literature.

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11. *See* Block & Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva* Zapata?, 37 BUS. LAW. 27, 33 (1981); Hansen, *The Business Judgment Rule and* Maldonado—*Another Perspective*, 6 CORP. L. REV. 131, 134, 136 (1983) (The business judgment rule will not apply if the directors make no decision whatever to act or not to act.); Comment, *supra* note 4 at 982, 984.

4. *Aftereffects of a Heightened Standard of Liability*

If the standards of liability for directors were escalated, substantial radiating effects would ensue, even if there did not follow, despite common fear, a wave of resignations from boards of directors. For example, what would be the effect of higher standards on directors' indemnification provisions in state statutes, in corporate by-laws, and in contracts? Further, what would be the impact of higher standards on the availability and the cost of directors' and officers' insurance?

III. Some Facts About Modern Boards of Directors

Perhaps some of the puzzles raised by the business judgment rule would prove more tractable if courts, practitioners, corporate executives, boards of directors, and scholars could work on them in a steady-state environment. As is generally known, the American corporate environment is anything but static. A great deal has changed in the last ten years. Some corporations have grown very large when measured by assets and sales. The business activities of many companies have also grown extremely complex and internally diversified, even in companies that are not conglomerates. Further, corporate transactions today move at an unprecedented pace. Multibillion dollar decisions are sometimes required to be made by boards of directors on very short notice—sometimes in a matter of hours and without prior warning. Consider, for instance, the gyrations of Allied-Bendix—Martin Marietta,[12] U.S. Steel—Marathon,[13] or Dupont—Conoco.[14] Corporate managerial activities have been put in a fishbowl by modern disclosure requirements of SEC regulations, Hart-Scott-Rodino rules, and FASB mandates. This fishbowl, and the fish in it, are stared at unblinkingly day after day by the press, by Wall Street analysts, and by troops of lawyers.

Boards of directors of major publicly held companies have been altered dramatically. On the average, two-thirds of these boards are outside directors.[15] In some quarters there is support for the idea of placing the position of chairman of the board in the hands of a nonexecutive director. Audit committees are now virtually universal in public companies.[16] Nominating committees controlled by outside directors are now in the majority among listed companies.[17]

The live persons who inhabit the boardrooms have also changed. The classic pattern was a triple blend of insiders, investment bankers employed by the company,

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12. *See generally A Takeover Triangle has Wall Street Jumping*, Bus. Wk., Sept. 20, 1982, at 36–37; Alexander, *Merger Theater of the Absurd*, Time, Oct. 4, 1981, at 50–51; Anderson, *Bendix Bites the Dust*, Newsweek, Oct. 4, 1982, at 67–68; *Big Bidders*, Time, Sept. 6, 1982, at 53.

13. *See generally Are the Oil Takeover Wars just Beginning?*, Bus. Wk., Nov. 16, 1981, at 48–49; Nicholson & Lampert, *Mobil's Marathon Troubles*, Newsweek, Jan. 11, 1982, at 48; Parly, *U.S. Steel to the Rescue*, Newsweek, Nov. 30, 1981, at 79; Taylor, *Clash of the Titans*, Time, Dec. 21, 1981, at 62.

14. *See generally Big Merger Race is off and Running*, U.S. News & World Rep., Aug. 17, 1981, at 9; *Conoco goes in Quest of a 'White Knight,'* Bus. Wk., May 25, 1981, at 50; Marbach & Ipsen, *Conoco Under Seige*, Newsweek, July 6, 1981, at 60; Sheils, *Dupont's Victory*, Newsweek, July 20, 1981, at 52; Smith, *Making of the Megamerger*, Fortune, Sept. 7, 1981, at 58; Taylor & Ungeheier, *And the winner is . . .*, Time, Aug. 17, 1981, at 65.

15. Korn/Ferry International, Board of Directors Eleventh Annual Survey 12 (February 1984).

16. *Id.* at 14 (99.2% of the 1,000 largest United States corporations report that they have audit committees).

17. *Id.* (59.4% of the 1,000 largest United States corporations report that they have nominating committees).

and lawyers who served as general counsel to the company. Today, all three of these groups are unfavored as board members. Many other professions and vocations are represented, and women and persons of minority racial background are commonplace in most boardrooms.[18]

Two antithetical but simultaneous trends can be observed in this regard. Many directors, probably most directors, are added to boards today because of their generalized business backgrounds. Many other directors are added in spite of their lack of such generalized business experience, because they are perceived to have specialized skills or sensitivities which are of relevance to some aspect of the company's operations. Both types of directors have an important contribution to make. Today, an insurance company executive, a filmmaker, a lawyer-politician, a female physicist, the European head of a marketing operation, and a chief executive officer of a United States industrial conglomerate will find themselves working together on a corporate board of a new high-tech company, together with another ten or fifteen directors whose backgrounds are nearly as specialized and diverse.

Thousands of corporations in the United States exist today. Some of these corporations are small family-held companies, some have a wider shareholdership but are not actively traded on the markets, some are unlisted companies whose stock is traded and who file periodic reports with the SEC, and some are listed and traded on the national exchanges. The Fortune 500 list of familiar corporate names constitutes only one percent of the nation's industrial corporations. Today, there is no such thing as a typical corporation.

Finally, as we all now know, the United States' technological, industrial, managerial, and corporate dominance of the world economy has declined, and in some sectors it has declined precipitously. No one—not the unions, not the managements, not the government, not the economists—denies that the nation's major corporate industries cannot afford (as indeed they never could) to ossify as complacent bureaucracies, cautiously doing business in traditional ways. Not since American industrialization first began in the river valleys of Connecticut has there been such a need in this country for innovation, entrepreneurship, and hard work. A significant contribution toward these ends can be expected from new entrants into the business world, new companies, and new young executives. Much of it, however, must come from companies already in place.

The business judgment rule is a legal principle of general application. It must be constructed to work satisfactorily in all the permutations of circumstances implied by contemporary realities. It must also work tomorrow. Therefore, those who design the law must keep in mind that as yesterday did not look like today, so tomorrow will not look like today.

IV. Two Perspectives of the Problem

When Mr. Smith and Ms. Jones, who share a common culture, are in dispute, and the debate does not seem to be getting anywhere, the explanation is usually

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18. *Id.* at 4-5, 13.

found in two factors. First, Mr. Smith's perception of the real problem and Ms. Jones' perception of the real problem differ. Second, the facts that Mr. Smith knows (or thinks he knows) and the facts he projects for tomorrow are not the same as the facts that Ms. Jones knows (or thinks she knows) and the facts she projects for tomorrow. Let us hypothesize a debate in which Mr. Smith and Ms. Jones are at loggerheads with regard to the business judgment rule.

Mr. Smith believes, in a solid American populist way, that concentrated power is a bad thing and that corporate boards of directors and managements have too much power for the good of the rest of the society, and probably too much power for their own good. He believes that while only a minority of directors are scoundrels, most of them are interested primarily in their own advancement, security, and directors' fees. He believes that directors are mainly chosen by the CEO and that while they need not necessarily be his personal cronies, they will not be selected unless they are people who are willing to keep their peace and play along. He believes that most directors tend to be inattentive, or at best casual, in their devotion to their directorial role. Mr. Smith believes that members of the board of directors, often to the detriment of shareholders, make a great deal of money out of corporate transactions or from inside information. Mr. Smith also tends to picture the board's process of work as a series of votes on discrete transactions or proposals.

It is fairly obvious, assuming that the basic concept of the corporation and the board of directors is accepted, that persons who hold Mr. Smith's view of life in the corporate boardroom should try to increase the independence and leverage of outside directors. They should find ways to try to force directors into working harder. They should find ways to hold directors personally accountable for the consequences of their business decisions, and they should try generally to bring directors under closer scrutiny by public agencies, individual shareholders, the plaintiffs' bar, and the judiciary.

Ms. Jones has quite a different picture of reality. She sees modern day CEOs dropping like flies. She thinks of today's directors as people who carry many responsibilities in their own businesses and communities and who work long hours, much of it on a volunteer basis. She believes that talented, experienced, and dedicated directors are difficult to identify, attract, and hold. She observes that the dollars received in the form of directors' fees are usually low, often little more than token, and half of that goes for taxes. Ms. Jones sees that directors typically serve on several committees as well as the board, and that they devote in the aggregate a substantial amount of time to the affairs of the company, thereby diluting their attention to their own businesses, communities, and families. Her experience is that directors of major publicly-held companies virtually never engage in transactions related to the company on whose board they sit, and only infrequently trade in the company's stock. To Ms. Jones, major corporations are complex combinations of multiple businesses, and she accepts that it is physically impossible for any outside director to have any more than a generalized familiarity with the various components of any company.

Ms. Jones also sees the process of the boardroom differently. Except, of course, for the ultimate decision to fire and hire the CEO, in Ms. Jones' perspective, the

board seldom "decides" anything. Instead of a series of discrete "decisions," the board of directors performs the continuous monitoring, questioning, probing, and surveillance functions concerning a few recurrent fundamental systemic matters (such as accounting and auditing) and specific individual agenda items only as they are brought to the board's attention.

Persons who share Ms. Jones' general picture of the boardroom also tend to carry two other images in their minds. The first is that business judgments are always fraught with uncertainty, that even in retrospect they cannot usually be clearly perceived as right or wrong, that all decisions are trade-offs on the basis of cost-benefit analyses (frequently with the choice being between the bad and the worse), and that, like batters, one is doing very well to hit .250 and incredibly well if for a sustained period .400 can be hit. Ms. Jones fears that these fundamental truths are unfamiliar to most courts and most juries. Lastly, Ms. Jones perceives shareholder litigation mainly as an exercise that is dubiously motivated and outrageously expensive for the corporation not only in dollars, but in distraction and misallocation of managerial time and attention.

One who holds Ms. Jones' view of the corporate boardroom, in considering the business judgment rule, believes that the key problem at hand is how to attract, hold, and motivate directors of outstanding capacity to devote their time and attention to the interests of the corporation. Ms. Jones does not defend corruption and would not defend any rule that would permit directors to take private advantage of corporate opportunities or shareholders. But Ms. Jones believes that if a director is personally honest, has no interest conflict, and (within the restricted limits of the time and attention which can be allocated to the corporation) has paid attention to corporate activities, then the director should be able to sleep at night without worrying about being pilloried by a plaintiff's lawyer or being subjected to the risk of personal liability after being second-guessed on a business matter years after the fact by a judge or jury with little or no experience in such matters.

Perhaps another jurisprudential difference separates Mr. Smith and Ms. Jones. In the eyes of Mr. Smith, a paramount function of the law should be to allocate blame and to mitigate loss by redress or at least by distribution of the risk. In Ms. Jones' perspective, the primary concern of the law should be to ensure that general procedures and mechanisms are in place which work productively most of the time for the benefit of society as a whole, and which will work in infinite numbers of unforeseeable situations in the future, rather than to focus primarily on looking backward to assess blame for misfortunes of the past.

The controversy that revolves around the business judgment rule today is caricatured by the debate between Mr. Smith and Ms. Jones. What makes it all so difficult and confusing is, of course, that a thoughtful person who has focused on this problem for more than five minutes will find that part of his or her own personality is at one with Mr. Smith and part of it is at one with Ms. Jones.