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RISKY BUSINESS: DIRECTORS MAKING BUSINESS JUDGMENTS IN WASHINGTON STATE

Adam J. Richins

Abstract: Section 23B.08.300 of the Revised Code of Washington (RCW) defines the general standards of conduct for directors in discharging corporate duties. The Washington State Legislature developed these standards to govern the manner in which directors perform their duties, rather than to impose liability on directors for negligent business decisions under the business judgment rule. Indeed, the business judgment rule, as defined by leading corporate-law jurisdictions and the American Bar Association, generally protects directors from liability associated with negligent business decisions so long as the director makes decisions in good faith, on an informed basis, without self-interest, and in accordance with the director's belief of what is best for the corporation. Nevertheless, the Washington State Supreme Court has suggested in dicta that the ordinary due-care standard of conduct included in RCW 23B.08.300 is an element of the business judgment rule standard of liability. Under the court's interpretation of the business judgment rule, the quality or substance of a director's business decision will not be protected from liability unless an ordinarily prudent person would have made the same decision under like circumstances. This Comment first argues that the standards of conduct set forth in RCW 23B.08.300 are separate and distinct from the business judgment rule standard of liability, and should not impose liability on directors for unfavorable business decisions. Second, this Comment proposes a legal framework for applying the business judgment rule in Washington state that is consistent with court precedent and the legislative intent underlying RCW 23B.08.300. Finally, this Comment proposes that Washington state courts adopt section 8.31 of the Model Business Corporations Act to provide the judiciary, directors, and the corporate bar with additional guidance in applying the business judgment rule.

State statutes generally provide that the business and affairs of a corporation must be managed under the direction of a board of directors.¹ Directors commonly authorize major corporate actions, counsel officers, oversee auditing procedures, and supervise ongoing investments of the corporation.² Although directorial management does not require directors to engage in the daily handling of a company's business,³ they may be responsible for making business judgments as

1. See, e.g., DEL. CODE ANN. tit. 8, § 141 (2004) (stating that the business and affairs of a corporation in Delaware must be managed by or under the direction of a board of directors); N.Y. BUS. CORP. LAW § 701 (McKinney 2005) (same); WASH. REV. CODE § 23B.08.010 (2004) (same).

2. See PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3.02 (1994) [hereinafter CORPORATE GOVERNANCE].

3. See, e.g., Francis v. United Jersey Bank, 432 A.2d 814, 822 (N.J. 1981) ("Directorial management does not require a detailed inspection of day-to-day activities, but rather a general monitoring of corporate affairs and policies.").

part of their directorial functions.⁴

The pace and complexity of the modern business world places directors in an environment of risk.⁵ Business imperatives often call for quick decisions based on imperfect information.⁶ Even the most rational decision at the time may seem like a “wild hunch” when a court reviews it years later in the light of perfect knowledge.⁷ Courts recognize that the standard they use to review a director’s decision should reflect this imperfect business environment.⁸ In addition, courts have acknowledged that directors are usually more qualified to make business decisions than judges.⁹ As a result, courts typically give substantial deference to directors’ business decisions.¹⁰ The business judgment rule embodies this deference.¹¹

The business judgment rule is a common-law standard of judicial review designed to protect directors from the inherent risks of their position.¹² In general, the rule shields a director from liability for a business decision when the director: (1) acts in good faith; (2) is not self-interested; (3) becomes informed, prior to making a decision, to the extent the director reasonably believes appropriate under the circumstances; and (4) having become informed, acts according to his or her reasonable belief¹³ of what is best for a corporation at the time.¹⁴

4. See WILLIAM E. KNEPPER & DAN A. BAILEY, *LIABILITY OF CORPORATE OFFICERS AND DIRECTORS* § 2.01 (7th ed. 2004).

5. See JENNIFER L. BERGER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 1037, at 42 (perm. ed., rev. vol. 2002).

6. See *id.* at 44.

7. See, e.g., *Joy v. North*, 692 F.2d 880, 886 (2d Cir. 1982) (“[A director’s] function is to encounter risks and to confront uncertainty, and a reasoned decision at the time made may seem a wild hunch viewed years later against a background of perfect knowledge.”).

8. See KNEPPER & BAILEY, *supra* note 4, § 2.02.

9. See, e.g., *Int’l Ins. Co. v. Johns*, 874 F.2d 1447, 1458 n.20 (11th Cir. 1989) (“The business judgment rule is a policy of judicial restraint born of the recognition that directors are, in most cases, more qualified to make business decisions than are judges.”).

10. E. Norman Veasey, *New Insights Into Judicial Deference to Directors’ Business Decisions: Should We Trust the Courts?*, 39 *BUS. LAW.* 1461, 1463 (1984).

11. *Miller v. Am. Tel. & Tel. Co.*, 507 F.2d 759, 762 (3d Cir. 1974).

12. See *MODEL BUS. CORP. ACT* § 8.31 annot. at 8-55 (2002); *CORPORATE GOVERNANCE*, *supra* note 2, § 4.01(c) cmt. b.

13. The comments for § 8.31 of the Model Business Corporation Act (MBCA) state that the term “reasonable belief” calls for a subjective belief, except in the “rare case where a decision respecting the corporation’s best interests is so removed from the realm of reason (e.g. corporate waste) . . . as to fall outside permissible bounds of sound discretion.” *MODEL BUS. CORP. ACT* § 8.31 annot. at 8-63 to -64 (emphasis added).

Importantly, the rule applies only where directors make conscious business decisions.¹⁵ The rule does not shield directors in cases of “omission,” where an injury to a corporation or its shareholders resulted from a director’s inattentiveness rather than a decision to take or not to take action.¹⁶

Washington courts have applied the business judgment rule for over thirty years,¹⁷ but have not interpreted the rule consistently.¹⁸ Many inconsistencies in application originate from ambiguities within section 23B.08.300 of the Revised Code of Washington (RCW).¹⁹ RCW 23B.08.300 defines the general standards of conduct for directors in discharging corporate duties.²⁰ The statute is ambiguous because it does not clearly spell out whether liability will result from a violation of its standards of director conduct.²¹ The statute is also ambiguous because it does not indicate whether it applies to directors’ decisions in addition to general oversight duties.²² These ambiguities raise the question of whether the legislature intended to modify Washington’s common-law application of the business judgment rule.²³ However, the statute’s

14. *Id.* § 8.31 (“A director shall not be liable to the corporation or its shareholders for any decision to take or not to take action . . . unless the party asserting liability in a proceeding establishes that: . . . (2) the challenged conduct consisted or was the result of: (i) action not in good faith; or (ii) a decision (A) which the director did not reasonably believe to be in the best interests of the corporation, or (B) as to which the director was not informed to an extent the director reasonably believed appropriate in the circumstances.”); CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c) (“A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer: (1) is not interested . . . in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.”).

15. CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c) cmt. c. The business judgment rule also applies when a director makes a decision not to act. *Id.*

16. *See id.*; *In re* The Walt Disney Co. Derivative Litig., No. Civ.A. 15452, 2005 WL 1875804, at *32 (Del. Ch. Aug. 9, 2005).

17. *See* Riss v. Angel, 131 Wash. 2d 612, 631–33, 934 P.2d 669, 680–81 (1997); Nursing Home Bldg. Corp. v. DeHart, 13 Wash. App. 489, 498–99, 535 P.2d 137, 143–44 (1975).

18. *See infra* Part II.

19. *See* WASH. REV. CODE § 23B.08.300 (2004).

20. *See id.*

21. *See id.* § 23B.08.300(4).

22. *See id.* § 23B.08.300(1).

23. *See* R. Franklin Balotti & Joseph Hinsey IV, *Director Care, Conduct, and Liability: The Model Business Corporation Act Solution*, 56 BUS. LAW. 35, 40 (2000) (discussing how similar text in a 1974 Amendment to the MBCA raised questions regarding whether the American Bar Association (ABA) intended to preempt common-law application of the business judgment rule).

legislative history shows that the legislature intended RCW 23B.08.300 to be separate and distinct from the business judgment rule, and not to introduce a new source of liability for a director's business decision.²⁴ Nonetheless, in two separate cases, the Washington State Supreme Court has suggested that RCW 23B.08.300 is part of the business judgment rule.²⁵

This Comment argues that Washington courts should not incorporate RCW 23B.08.300's ordinarily prudent person standard into the business judgment rule's standard of liability. Instead, courts should recognize the business judgment rule as a limitation on director liability that is distinct from RCW 23B.08.300's standard of conduct, in accord with the statute's legislative history and lower court precedent. Part I of this Comment defines the business judgment rule as commonly recognized in leading corporate-law jurisdictions throughout the United States. Part II analyzes RCW 23B.08.300 and its extensive legislative history. Part III evaluates Washington state's common-law development of the business judgment rule. Part IV posits two arguments regarding interpretation and application of the business judgment rule in Washington. Part IV.A argues that the standards of conduct contained in RCW 23B.08.300 do not establish the standard for liability under which business judgments are reviewed. Part IV.B outlines how Washington state courts should apply the business judgment rule. Finally, Part V concludes that courts should incorporate section 8.31 of the Model Business Corporation Act (MBCA) into Washington's business judgment rule to provide the judiciary, directors, and the corporate bar with additional guidance in applying the rule.

I. THE BUSINESS JUDGMENT RULE IS A COMMON-LAW STANDARD OF LIABILITY

Directors owe a fiduciary duty to corporations and their shareholders.²⁶ This fiduciary duty is commonly evaluated using two standards of conduct: the duty of loyalty and the duty of care.²⁷ Courts

24. See SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041-44 (Wash. 1989).

25. See *Riss v. Angel*, 131 Wash. 2d 612, 632, 934 P.2d 669, 681 (1997); *In re Spokane Concrete Prods., Inc.*, 126 Wash. 2d 269, 279, 892 P.2d 98, 104 (1995).

26. See, e.g., *Pepper v. Litton*, 308 U.S. 295, 306 (1939) (establishing that directors serve as fiduciaries with "powers in trust").

27. See Melvin A. Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 *FORDHAM L. REV.* 437, 438 (1993).

can impose liability on directors if they fail to perform a corporate duty in accordance with these standards of conduct.²⁸ However, when the corporate duty involves a business decision, courts commonly review such decision-making under the business judgment rule.²⁹ The business judgment rule operates to insulate directors from personal liability associated with business decisions.³⁰

A. *Corporate Law Differentiates Between Standards of Conduct and Standards of Liability*

In order to understand judicial review of a director's action, it is necessary to distinguish between standards of conduct and standards of liability.³¹ In general, a standard of conduct sets forth the manner in which an actor should perform a given activity.³² A standard of liability,³³ in contrast, establishes the test a court should apply when it reviews an actor's conduct to determine whether to impose liability.³⁴ In most areas of law, these two standards converge.³⁵ For instance, the standard of conduct governing automobile drivers demands that they drive with requisite care.³⁶ The standard of liability in a claim against a driver is whether the driver drove carefully.³⁷

In the corporate context, however, standards of conduct differ from standards of liability.³⁸ Standards of conduct are primarily intended for

28. See MODEL BUS. CORP. ACT § 8.30 annot. at 8-39 (2002).

29. See, e.g., *Kaplan v. Centex*, 284 A.2d 119, 124 (Del. Ch. 1971) (“Application of the [business judgment] rule . . . depends upon a showing that informed directors did, in fact, make a business judgment authorizing the transaction under review.”); see also CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c) (indicating that the business judgment rule applies only if a director makes a “business judgment”).

30. See, e.g., *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989) (“[T]he business judgment rule . . . protect[s] the directors and the decisions they make.”).

31. See MODEL BUS. CORP. ACT § 8.31 annot. at 8-58 (differentiating between standards of conduct and standards of liability in its discussion of the judicial review of director actions).

32. See Eisenberg, *supra* note 27, at 437.

33. The terms “standard of liability” and “standard of review” are used interchangeably in the corporate context. See, e.g., MODEL BUS. CORP. ACT § 8.31 annot. at 8-58 (referring to Eisenberg’s article, *supra* note 27, as an analysis of how and why standards of conduct and standards of liability diverge in corporate law, even though Eisenberg actually used the term standard of review).

34. See Eisenberg, *supra* note 27, at 437.

35. See *id.*

36. See *id.*

37. See *id.*

38. See MODEL BUS. CORP. ACT § 8.31 annot. at 8-58.

the actor.³⁹ They are legal rules intended to guide a director's behavior.⁴⁰ A director who actively conforms to a standard of conduct can be sure of a safe harbor from liability.⁴¹ Failure to comply with a standard of conduct, on the other hand, does not necessarily lead to liability.⁴² The duty of care and the duty of loyalty are the two most notable concepts of corporate law that involve standards of conduct.⁴³

In contrast, standards of liability are directed primarily to the judge.⁴⁴ If a judge determines that a director failed a particular standard of liability, liability is generally axiomatic.⁴⁵ The business judgment rule is a standard of liability.⁴⁶

B. Director Duties Are Commonly Governed by Two Standards of Conduct: The Duty of Loyalty and the Duty of Due Care

Directors are fiduciaries who hold positions of trust and confidence.⁴⁷ A corporate director can be liable to a corporation if he or she does not exercise care to avoid harm to the corporation.⁴⁸ Directors must also typically avoid conflicts of interest, and must place a corporation's well-being ahead of their own.⁴⁹ The primary objective of a director is to enhance corporate profit and shareholder gains by any legal means necessary.⁵⁰

The duty of loyalty is the standard of conduct that applies to directors to ensure that their self-interest will not interfere with the corporation's best interests.⁵¹ This standard of conduct requires directors to

39. See Eisenberg, *supra* note 27, at 465–66.

40. See *id.* at 464.

41. MODEL BUS. CORP. ACT § 8.31 annot. at 8-54.

42. *Id.*

43. Eisenberg, *supra* note 27, at 438.

44. See *id.* at 466.

45. See *id.* at 437, 466.

46. See *id.* at 438.

47. See, e.g., KNEPPER & BAILEY, *supra* note 4, § 4.01 (stating that directors “must absolutely refrain from doing any act that breaches their obligation of trust and, in addition, must affirmatively defend and protect the interests entrusted to them”).

48. See, e.g., Francis v. United Jersey Bank, 432 A.2d 814, 829 (N.J. 1981) (ruling that a director had a duty to prevent her sons from harming the corporation).

49. See MODEL BUS. CORP. ACT § 8.61 (2002); see also Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (indicating that the obligations of a director do “not tolerate faithlessness or self-dealing”).

50. See CORPORATE GOVERNANCE, *supra* note 2, § 2.01(a).

51. See Eisenberg, *supra* note 27, at 450.

demonstrate the utmost good faith in pursuing the interests of their companies, and to exert all reasonable and lawful efforts to avoid injury to the company.⁵² Any conduct implicating an interest that is adverse to the corporation will come under close scrutiny, and potentially lead to liability, unless the conduct is shown to be “fair” to the corporation.⁵³

The duty of care standard of conduct addresses the attentiveness and prudence of directors in performing several distinct functions.⁵⁴ Although the exact standard of conduct varies depending on the jurisdiction, the duty of care standard generally requires that directors perform their functions in good faith, in a manner that they reasonably believe to be in the best interests of the corporation, and with care that an ordinarily prudent person would be expected to exercise under similar circumstances.⁵⁵ Notably, directors are not necessarily liable if their business decisions conflict with the duty of care standard.⁵⁶

C. The Business Judgment Rule Is a Standard of Liability that Insulates Directors from Liability Based on Their Business Decisions

The business judgment rule is a procedural barrier that protects a director’s decision unless there is evidence of: (1) bad faith; (2) self-interest in the transaction; (3) gross negligence in becoming informed; or (4) lack of subjective belief that the decision was in the best interest of the corporation.⁵⁷ In determining director liability, courts generally will not second-guess the quality of directors’ business decisions, but instead will focus on the procedures followed in reaching those decisions.⁵⁸

52. See KNEPPER & BAILEY, *supra* note 4, § 4.01.

53. See MODEL BUS. CORP. ACT §§ 8.60–63; *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

54. See MODEL BUS. CORP. ACT § 8.30; CORPORATE GOVERNANCE, *supra* note 2, § 4.01(a).

55. See MODEL BUS. CORP. ACT § 8.30; CORPORATE GOVERNANCE, *supra* note 2, § 4.01(a).

56. See MODEL BUS. CORP. ACT § 8.31 annot. at 8-54 (“[T]he fact that a director’s performance fails [to meet the duty of care standards] does not automatically establish personal liability for damages . . .”).

57. See *id.* § 8.31; *Smith v. Van Gorkom*, 488 A.2d 858, 872–73 (Del. 1985); CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c).

58. See, e.g., *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) (“Courts do not measure, weigh or quantify directors’ judgments. . . . Due care in the decision-making context is *process* due care only.”) (emphasis in original); see also *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (“[W]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through ‘stupid’ to ‘egregious’ or ‘irrational’, provides no ground for director liability, so long as the court determines that the process

Furthermore, adequately informed directors will rarely be liable for honest mistakes, even if the director's decision constituted negligence.⁵⁹

1. *The Business Judgment Rule Is a Procedural Barrier that Applies to Director Decisions*

The business judgment rule establishes certain procedural barriers for plaintiffs.⁶⁰ Specifically, the initial burden of pleading and the ultimate burden of persuasion are placed on the challenger to prove the inapplicability of the business judgment rule.⁶¹ This burden is particularly demanding because courts presume that a director's decision-making satisfied all applicable legal requirements.⁶² Put another way, a plaintiff attempting to impose liability on a director for an unwise business decision must rebut a "presumption of regularity" in favor of the director.⁶³

The business judgment rule is a common-law standard of liability that applies to a director's conscious decision to take or not take action, as opposed to situations where a director is passive in his or her duties.⁶⁴ Courts do not use the business judgment rule to evaluate the majority of everyday director functions, such as the duties of oversight or inquiry.⁶⁵ Instead, the rule offers directors protection from personal liability arising from conscious business decisions.⁶⁶ Most business judgment cases deal with risky economic decisions, although the rule extends to such matters as compensation and the removal of personnel.⁶⁷

employed was either rational or employed in a *good faith* effort to advance corporate interests.") (emphasis in original).

59. See BERGER ET AL., *supra* note 5, § 1031 ("[T]he business judgment rule . . . generally insulates [directors] from negligence liability.").

60. See MODEL BUS. CORP. ACT § 8.31 annot. at 8-55; see also Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("The burden is on the party challenging the decision to establish facts rebutting the presumption [of regularity].").

61. See MODEL BUS. CORP. ACT § 8.31 annot. at 8-55.

62. See *id.*

63. See *id.*

64. CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c) cmt. c.

65. *Id.*

66. MODEL BUS. CORP. ACT § 8.31, annot. at 8-55 (stating that the business judgment rule "shield[s] the director's decision-making from liability").

67. CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c) cmt. b.

2. *The Business Judgment Rule Does Not Apply if a Director Fails to Comply with the Duty of Loyalty Standard of Conduct*

When a person challenging a business decision shows that a director had self-interest in the decision at issue, the burden of proof shifts to the director and the business judgment rule no longer applies.⁶⁸ Directors thus cannot appear on both sides of a transaction and expect protection from the rule.⁶⁹ Rather, in such cases, directors must show that their decisions brought forth “fair” results.⁷⁰

Some jurisdictions have developed so-called safe harbor provisions in their duty of loyalty statutes that allow business decisions to be protected even in conflict-of-interest cases.⁷¹ These provisions, which are typically based on sections 8.61 through 8.63 of the MBCA, provide insulation for a director’s conflict-of-interest transaction⁷² if: (1) the transaction is approved by a majority of the board’s disinterested directors⁷³ or its qualified shareholders; and (2) the conflicted director gave full disclosure of all material facts to the corporation.⁷⁴ Thus, a director’s business decision may be protected even though the business judgment rule does not apply.⁷⁵

3. *The Business Judgment Rule Typically Protects Directors Even When They Fail to Comply with the Ordinary Duty of Care Standard of Conduct*

Courts separate review of a business decision under the business

68. See MODEL BUS. CORP. ACT § 8.31(a)(1) & annot. at 8-59 to -60.

69. See CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c)(1); see also Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (“From the standpoint of interest, this means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing . . .”).

70. See, e.g., Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 371 (Del. 1993) (stating that a director’s breach of the duty of loyalty “rebut[s] the presumption that the directors have acted in the best interests of the shareholders, and requires the directors to prove that the transaction was entirely fair”).

71. See, e.g., WASH. REV. CODE §§ 23B.08.700–.730 (2004) (establishing a safe harbor for conflict-of-interest transactions made by directors in Washington state).

72. See MODEL BUS. CORP. ACT § 8.60 (defining a director’s conflict of interest).

73. Approval by the majority of a duly empowered committee of the board is also allowed. MODEL BUS. CORP. ACT § 8.62(a).

74. See, e.g., WASH. REV. CODE §§ 23B.08.700–.730 (mirroring MODEL BUS. CORP. ACT §§ 8.61–.63).

75. See MODEL BUS. CORP. ACT § 8.31(a)(1).

judgment rule into two distinct parts.⁷⁶ The first part deals with the director's decision-making process.⁷⁷ The court reviews the decision-making process to determine whether the director became adequately informed before making a decision.⁷⁸ The second part focuses on the director's actual decision.⁷⁹ Under the second part, courts review the substance or quality of a decision to determine liability.⁸⁰

The business judgment rule often shields directors even when they do not exercise ordinary due care in *becoming informed*.⁸¹ Although directors are expected to exercise some level of care in informing themselves of all material information prior to making the decision,⁸² the due care standard is not that of an ordinarily prudent person.⁸³ Rather, the standard of liability commonly used under the business judgment rule to review the director's effort in becoming informed is "gross negligence."⁸⁴ The term "gross negligence" is not part of the MBCA.⁸⁵ Nonetheless, the American Bar Association (ABA) has developed a similar standard, which respects a director's decision-making process unless the "preparation to make an informed judgment is so unreasonable as to fall outside the permissible bounds of sound discretion."⁸⁶ Thus, a director may fail to comply with the ordinarily prudent person standard of conduct when becoming informed, but still avoid liability under the business judgment rule.⁸⁷

The business judgment rule also often protects directors even when

76. See MODEL BUS. CORP. ACT § 8.31(a)(2)(ii)(A)-(B); CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c)(2)-(3).

77. See MODEL BUS. CORP. ACT § 8.31(a)(2)(ii)(B).

78. See *id.*

79. See *id.* § 8.31(a)(2)(ii)(A).

80. See *id.*

81. See *id.* § 8.31 annot. at 8-63 to -64.

82. See *id.* § 8.31(a)(2)(ii)(B); CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c)(2); *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).

83. MODEL BUS. CORP. ACT § 8.31 annot. at 8-61 ("An 'ordinarily prudent person' might do more to become better informed, but if a director believes, in good faith, that the director can make a sufficiently informed business judgment, the director will be protected so long as that belief is within the bounds of reason.")

84. See, e.g., *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (holding that director liability is predicated upon concepts of gross negligence under the business judgment rule). Gross negligence is a "high standard" that requires proof of reckless indifference. See *KNEPPER & BAILEY*, *supra* note 4, § 2.07.

85. See MODEL BUS. CORP. ACT §§ 8.30-31.

86. *Id.* § 8.31 annot. at 8-64.

87. See *id.*

they are grossly negligent in *making an actual decision*.⁸⁸ That is, the gross negligence standard associated with becoming informed is usually not the standard courts use to review the substance or quality of an actual directorial decision under the business judgment rule.⁸⁹ Indeed, the standard of conduct required in this context is even less demanding.⁹⁰ Many leading corporate courts have indicated that the business judgment rule protects an imprudent decision so long as the decision was informed.⁹¹ Similarly, the MBCA suggests that a director must only subjectively believe that the actual decision is in the best interests of the corporation.⁹² The MBCA requires that courts apply an objective belief standard only in “rare cases” when a decision is “so removed from the realm of reason . . . as to fall outside the permissible bounds of sound discretion.”⁹³

In sum, the business judgment rule is a judicial standard of liability that generally protects disinterested directors from claims of negligent decision-making. Whether a director complied with a jurisdiction’s ordinary due-care standard of conduct is not dispositive when a plaintiff attempts to impose liability on that director for a business decision. A director may avoid liability even if he or she is negligent in becoming informed or makes a decision that is substantively imprudent. The business judgment rule only fails to shield a director from liability when a decision is made: (1) in bad faith; (2) with self-interest; (3) after acting with gross negligence in becoming informed; or (4) where the director did not reasonably believe the challenged decision to be in the best interests of the corporation.

II. THE WASHINGTON STATE LEGISLATURE HAS ADDRESSED THE BUSINESS JUDGMENT RULE

In the span of nine years, the Washington State Legislature enacted two statutes that define the general standards of conduct for directors.⁹⁴

88. See KNEPPER & BAILEY, *supra* note 4, § 2.07.

89. *See id.*

90. *See id.*

91. *See id.*

92. *See* MODEL BUS. CORP. ACT § 8.31 annot. at 8-63 to -64.

93. *See id.* § 8.31 annot. at 8-64.

94. *See* Business Corporation Act, ch. 165, § 97, 1989 Wash. Sess. Laws 640, 688–89 (codified at WASH. REV. CODE § 23B.08.300 (1990)); Act of March 10, 1980, ch. 99, § 5, 1980 Wash. Sess. Laws 307, 314 (codified at WASH. REV. CODE § 23A.08.343 (1981) (repealed 1989)).

The first statute, RCW 23A.08.343, did not address the business judgment rule.⁹⁵ The Legislature's silence on the business judgment rule ended ten years later when it replaced RCW 23A.08.343 with RCW 23B.08.300.⁹⁶ RCW 23B.08.300 includes extensive legislative comments that: (1) discuss whether RCW 23B.08.300 can be used to impose liability on directors; (2) explain the interplay between RCW 23B.08.300 and the business judgment rule; and (3) set forth guidelines in applying both.⁹⁷ These comments are significant because on its face RCW 23B.08.300 presents ambiguities, and courts may review legislative history to interpret ambiguous statutes.⁹⁸

A. The Washington Legislature Enacted RCW 23A.08.343 to Clarify Director Responsibilities, but Did Not Address the Business Judgment Rule

In 1979, the Washington State Bar Association directed its Section on Corporation, Business, and Banking Law to review the Washington Business Corporation Act (RCW Title 23A) for possible changes in light of revisions made to the MBCA in 1974.⁹⁹ This review resulted in the Legislature's enactment of RCW 23A.08.343 in 1980,¹⁰⁰ which reflected the ABA's 1974 Amendment to section 35 of the MBCA.¹⁰¹ RCW 23A.08.343 provided that:

A director shall perform the duties of a director, including the duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.¹⁰²

95. See WASH. REV. CODE § 23A.08.343 (1981) (repealed 1989); see also FORTY-SIXTH LEGISLATURE OF WASH. STATE, FINAL LEGISLATIVE REPORT 67 (1980).

96. See SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041-44 (Wash. 1989).

97. See *id.*

98. See *Dep't of Transp. v. State Employees' Ins. Bd.*, 97 Wash. 2d 454, 458-59, 645 P.2d 1076, 1078 (1982) (stating that courts may review legislative history if the legislature's intent is not clear from the face of the statute).

99. See FORTY-SIXTH LEGISLATURE OF WASH. STATE, *supra* note 95, at 67.

100. Act of March 10, 1980, ch. 99, § 5, 1980 Wash. Sess. Laws at 314.

101. Compare WASH. REV. CODE § 23A.08.343 (1981) (repealed 1989), with MODEL BUS. CORP. ACT § 35 (Supp. 1979).

102. WASH. REV. CODE § 23A.08.343.

This broad and ambiguous text prompted three principle issues amongst scholars, practitioners, and commentators.¹⁰³ First, the statute did not indicate whether it represented a standard of liability or a standard of conduct.¹⁰⁴ Second, the statute failed to specify whether it applied to director decisions, thus leaving unanswered the question of whether it preempted Washington state's common-law development of the business judgment rule.¹⁰⁵ Finally, RCW 23A.08.343 did not define the "ordinarily prudent person" standard and its relationship, if any, with the law of torts established in the Restatement (Second) of Torts.¹⁰⁶

The brief legislative history accompanying RCW 23A.08.343 did little to clarify these issues.¹⁰⁷ This history discussed the baseline authority of directors to oversee and direct corporation actions, but remained silent on how the statute affected common-law concepts of corporate governance.¹⁰⁸ Most significantly, the legislative history failed to mention the business judgment rule.¹⁰⁹ This silence left the courts with little guidance in applying RCW 23A.08.343 in the context of a director's business decision.¹¹⁰

B. The Legislature Subsequently Enacted RCW 23B.08.300 with Extensive Legislative Comments that Offer Substantive Procedural Guidelines for Applying the Business Judgment Rule

In 1989, the Washington State Legislature substantially revised the Washington Business Corporation Act to incorporate provisions of the Revised Model Business Corporations Act (RMBCA).¹¹¹ According to the Legislature, the RMBCA contained "significant improvements" over the past version in organization, language, and concepts.¹¹² As part of these revisions, the Legislature replaced RCW 23A.08.343 with RCW

103. See Balotti & Hinsey, *supra* note 23, at 40 (discussing the confusion that developed amongst corporate scholars when the ABA released the 1974 Amendment to section 35 of the MBCA, which contained text identical to RCW 23A.08.343).

104. See WASH. REV. CODE § 23A.08.343.

105. See *id.*

106. See *id.* § 23A.08.343; RESTATEMENT (SECOND) OF TORTS § 283 cmt. c (1965) (discussing the "ordinarily prudent man" standard).

107. See FORTY-SIXTH LEGISLATURE OF WASH. STATE, *supra* note 95, at 67 (1980).

108. See *id.*

109. See *id.*

110. See *id.*

111. FIFTY-FIRST LEGISLATURE OF WASH. STATE, FINAL LEGISLATIVE REPORT 249 (1989).

112. *Id.*

23B.08.300, entitled “General Standards for Directors.”¹¹³ The statute provides in relevant part that:

(1) A director shall discharge the duties of a director, including duties as member of a committee: (a) In good faith; (b) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (c) In a manner the director reasonably believes to be in the best interests of the corporation. . . . (4) A director is not liable for any action taken as a director, or any failure to take any action, if the director performed the duties of the director’s office in compliance with this section.¹¹⁴

The Legislature did not introduce any significant changes to the text of RCW 23A.08.343 when it enacted RCW 23B.08.300.¹¹⁵ The only notable change was the addition of subsection (4).¹¹⁶ Subsection (4) states that a director is not liable for a directorial action that complies with RCW 23B.08.300, but does not address whether courts should impose liability on directors who violate the statute.¹¹⁷ Thus, the Legislature failed to answer previous questions regarding whether RCW 23A.08.343 constituted a standard of liability or a standard of conduct.¹¹⁸ Likewise, the Legislature did not indicate in the text of RCW 23B.08.300 whether it governed directorial decisions.¹¹⁹ On its face, the statute continued to introduce ambiguities.¹²⁰

The legislative history of RCW 23B.08.300, however, presented Washington courts with several new considerations concerning the business judgment rule.¹²¹ First, the Legislature expressly discussed whether RCW 23B.08.300 could impose liability on directors.¹²² The

113. Business Corporation Act, ch. 165, § 97, 1989 Wash. Sess. Laws 640, 688–89.

114. WASH. REV. CODE § 23B.08.300 (2004).

115. Compare WASH. REV. CODE § 23B.08.300 (1990), with WASH. REV. CODE § 23A.08.343 (1981).

116. Compare WASH. REV. CODE § 23B.08.300 (1990), with WASH. REV. CODE § 23A.08.343 (1981) (repealed 1989).

117. See WASH. REV. CODE § 23B.08.300 (1990).

118. See *id.*

119. See *id.*

120. See *id.*

121. See SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041–44 (Wash. 1989). This legislative history is indistinguishable from that included in the RMBCA. Compare REV. MODEL BUS. CORP. ACT. § 8.30 annot. at 220–25 (1984), with SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041–44 (Wash. 1989).

122. SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041–42 (Wash. 1989).

Legislature provided that RCW 23B.08.300 was a “standard of conduct” for directors that should not be used to review the “correctness of the director’s decisions.”¹²³ It further discussed the unreasonableness of “reexamin[ing] [director] decisions with the benefit of hindsight.”¹²⁴ The Legislature concluded its discussion on liability by noting that “a director is not liable for injury or damage caused by a director’s decision, no matter how unwise or mistaken it may turn out to be, if in performing the director’s duties the director met the requirements of [RCW 23B.08.300].”¹²⁵

Second, the Legislature explained the interplay between RCW 23B.08.300 and state common law regarding development of the business judgment rule.¹²⁶ The Legislature acknowledged the similarities between RCW 23B.08.300’s text and the business judgment rule.¹²⁷ However, the Legislature stated that despite the similarities, they did not intend to codify the business judgment rule.¹²⁸

The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts in Washington and elsewhere. . . . In view of that continuing judicial development, Proposed section [RCW 23B.08.300] does not try to codify the business judgment rule or delineate the differences, if any, between that rule and the standards of director conduct set forth in this section.¹²⁹

Finally, the Legislature established some procedural guidelines for applying RCW 23B.08.300 and the business judgment rule.¹³⁰ More pointedly, the comments indicate when courts should apply RCW 23B.08.300 and the business judgment rule in reviewing a business decision, and how a trier of fact should use each standard to determine director liability:

If compliance with the standard of conduct set forth in Proposed section [23B.08.300] is established, there is no need to consider possible application of the business judgment rule. The possible

123. *Id.*

124. *Id.* at 3042.

125. *Id.*

126. *Id.*

127. *See id.*

128. *Id.*

129. *Id.*

130. *Id.* at 3044.

application of the business judgment rule need only be considered if compliance with the standard of conduct set forth in Proposed section [23B.08.300] is not established.¹³¹

RCW 23B.08.300's legislative comments are significant because Washington courts have long turned to legislative history to interpret ambiguous statutes.¹³² This rule of statutory construction continues to govern the review of statutes today.¹³³ A court's primary objective in examining a statute is to determine whether it can ascertain the plain meaning from the statute on its face.¹³⁴ If the plain meaning is ambiguous—that is, susceptible to two or more reasonable meanings¹³⁵—courts may examine other statutory provisions in the act to assist in determining the legislative intent.¹³⁶ If the statute remains ambiguous after such review, it is appropriate to resort to construction aides, including legislative history.¹³⁷

In sum, the Washington State Legislature answered many significant questions when it enacted RCW 23B.08.300 with extensive legislative comments. Specifically, the Legislature established the extent to which the statute imposes liability on directors, set forth the statute's interplay with the business judgment rule, and provided guidance in applying both the statute and the business judgment rule. This legislative history is important because Washington courts can utilize the comments to interpret ambiguous statutes.

III. WASHINGTON COURTS HAVE INCONSISTENTLY APPLIED THE BUSINESS JUDGMENT RULE

Washington courts have struggled with establishing a consistent application of the business judgment rule.¹³⁸ Although lower courts

131. *Id.*

132. *See, e.g.,* Dep't of Transp. v. State Employees' Ins. Bd., 97 Wash. 2d 454, 458–59, 645 P.2d 1076, 1078–79 (1982) (indicating that legislative history may be reviewed to determine legislative intent when faced with an ambiguous statute).

133. *See, e.g.,* Dep't of Ecology v. Campbell & Gwinn, L.L.C., 146 Wash. 2d 1, 9–10, 43 P.3d 4, 9 (2002) (providing the same rule of statutory construction established twenty years earlier by the *State Employees' Ins. Bd.* court).

134. *Id.*

135. *Vashon Island Comm. for Self-Gov't v. State Boundary Review Bd. for King County*, 127 Wash. 2d 759, 771, 903 P.2d 953, 959 (1995).

136. *See* *Burton v. Lehman*, 153 Wash. 2d 416, 423, 103 P.3d 1230, 1234 (2005).

137. *Campbell & Gwinn*, 146 Wash. 2d at 12, 43 P.3d at 11.

138. *See* *Shinn v. Thrust IV, Inc.*, 56 Wash. App. 827, 833, 786 P.2d 285, 289 (1990) (indicating

resolved some inconsistencies during the first fifteen years of the rule's application,¹³⁹ the Washington State Supreme Court has twice, in dicta, reintroduced confusion into this area of law.¹⁴⁰ As a result, the application of Washington state's business judgment rule remains unclear.¹⁴¹

A. Lower Courts in Washington Have Struggled to Consistently Apply the Business Judgment Rule

Washington courts first discussed the business judgment rule in *Nursing Home Building Corp. v. DeHart*.¹⁴² In this case, the plaintiff corporation alleged that the defendants had fraudulently misappropriated corporate assets, including management fees, leased automobiles, and miscellaneous fringe benefits.¹⁴³ The plaintiff attacked such expenditures as a waste of corporate assets.¹⁴⁴

The *Nursing Home* court relied on the business judgment rule in ruling against liability.¹⁴⁵ The court employed a statement from William Fletcher's treatise on corporate law to define the business judgment rule.¹⁴⁶ This statement indicated that directors should be given "wide latitude" in making decisions and should not be held liable for mistakes of judgment if they acted with honesty and good faith.¹⁴⁷ It further supported judicial restraint even when a director's actual decision involved a gross error in judgment.¹⁴⁸ Thus, because the defendants acted without a corrupt motive and in good faith, the court held that they were immune from liability under the business judgment rule.¹⁴⁹ The *Nursing Home* court established that there could be instances in which directors might be completely incompetent in becoming informed about

that application of the business judgment rule is uncertain in Washington state).

139. See *infra* Part III.A–B.

140. See *Riss v. Angel*, 131 Wash. 2d 612, 631, 934 P.2d 669, 680 (1997); *In re Spokane Concrete Prods., Inc.*, 126 Wash. 2d 269, 279, 892 P.2d 98, 104 (1995).

141. See *infra* Part III.C.

142. 13 Wash. App. 489, 535 P.2d 137 (1975).

143. *Id.* at 498, 535 P.2d at 143.

144. See *id.*

145. *Id.* at 498–500, 535 P.2d at 143–44.

146. *Id.* at 498–99, 535 P.2d at 143–44 (citing WILLIAM FLETCHER, PRIVATE CORPORATIONS § 1039, at 621–25 (perm. ed. 1974)).

147. *Id.* at 499, 535 P.2d at 144 (citing FLETCHER, *supra* note 146, § 1039, at 621–25).

148. *Id.*

149. *Id.* at 499–500, 535 P.2d at 144–45.

a decision, yet retain the affirmative defense of the business judgment rule.¹⁵⁰ Put another way, a director's sole obligation when making a business decision was to act in "good faith."¹⁵¹ The court did not address procedural aspects of the business judgment rule.¹⁵²

Shortly after *Nursing Home*, the Legislature enacted RCW 23A.08.343.¹⁵³ Washington courts first applied the new statute in *Schwarzmann v. Ass'n of Apartment Owners*.¹⁵⁴ That case dealt with a condominium board of directors that refused to perform maintenance work on the plaintiff's unit.¹⁵⁵ The *Schwarzmann* court cited *Nursing Home* and the "good faith" standard with approval.¹⁵⁶ However, the court then stated that RCW 23A.08.343 codified the business judgment rule.¹⁵⁷ This interpretation presented a logical inconsistency because if RCW 23A.08.343 truly codified the business judgment rule, then a director needed to act with more than good faith in order to avoid liability: a showing of ordinary due care would also be required.¹⁵⁸ The court nevertheless relied on *Nursing Home*, ruling that the board members did not breach the duty because they acted in good faith.¹⁵⁹

In *Seafirst Corp. v. Jenkins*,¹⁶⁰ a federal district court, applying Washington law, attempted to resolve the confusion in *Schwarzmann*.¹⁶¹ The plaintiff claimed that the corporation's board failed to implement proper oversight procedures.¹⁶² Despite the fact that the director did not make a definitive business decision, the court applied the business

150. *See id.* at 499, 535 P.2d at 144.

151. *See id.*

152. *See id.*

153. Act of March 13, 1980, ch. 99, § 5, 1980 Wash. Sess. Laws 307, 314 (codified at WASH. REV. CODE § 23A.08.343 (1981) (repealed 1989)).

154. 33 Wash. App. 397, 655 P.2d 1177 (1982).

155. *Id.* at 399-400, 655 P.2d at 1179.

156. *Id.* at 401-02, 655 P.2d at 1180.

157. *Id.* at 402 n.1, 655 P.2d at 1180 n.1.

158. *See* WASH. REV. CODE § 23A.08.343 (stating that a director must perform duties of a director "in good faith . . . and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances") (emphasis added).

159. *See Schwarzmann*, 33 Wash. App. at 403, 655 P.2d at 1181 (holding that there was "no evidence of bad faith or improper motive which would demonstrate that the board members breached a duty owed to the plaintiffs").

160. 644 F. Supp. 1152 (W.D. Wash. 1986).

161. *See id.* at 1158-59.

162. *See id.* at 1158.

judgment rule to review the director's actions.¹⁶³ The court then rejected the notion that the business judgment rule shielded any director decision made in good faith, instead asserting that evidence of ordinary due care was necessary due to RCW 23A.08.343.¹⁶⁴ The court concluded that the determination of whether the directors exercised ordinary care was a question of fact for the jury.¹⁶⁵ In short, the court treated the ordinary-care standard as a standard of liability for directors, and dismissed the defendant's motion for summary judgment.¹⁶⁶

B. The Shinn Court Resolved Some Previous Inconsistencies Associated with the Business Judgment Rule

In *Shinn v. Thrust IV, Inc.*,¹⁶⁷ Division I of the Washington State Court of Appeals faced possible application of the business judgment rule in a case that stemmed from a breach-of-partnership claim.¹⁶⁸ The *Shinn* court first recognized that the scope of Washington's business judgment rule was unclear.¹⁶⁹ Then, after analyzing *Nursing Home, Schwarzmann*, and *Seafirst*, the court indicated that the *Seafirst* court's application of the business judgment rule was most in line with excerpts of Fletcher's treatise that required a director to act both in good faith and with "proper care, skill, and diligence."¹⁷⁰ However, in contrast to the *Seafirst* court's ruling, the court indicated that the duty-of-care standards in RCW 23A.08.343 did not appear to codify the business judgment rule.¹⁷¹ Thus, even though a director was required to exercise some level of care, the court suggested that courts should not use the ordinary due care standard in RCW 23A.08.343 to define that level of care.¹⁷²

163. *See id.* at 1154. Washington courts have since realized that the business judgment rule does not apply to cases where no business decision is made. *See Scott v. Trans-Sys, Inc.*, 148 Wash. 2d 701, 709, 64 P.3d 1, 5 (2003) (stating that the business judgment rule applies to "decision[s] to undertake [a] transaction") (emphasis added); *Senn v. Nw. Underwriters, Inc.*, 74 Wash. App. 408, 414–15, 875 P.2d 637, 640 (1994) (applying a duty of oversight standard of care, instead of the business judgment rule, in its review of a director's inattentiveness).

164. *Seafirst*, 644 F. Supp. at 1159.

165. *Id.*

166. *See id.*

167. 56 Wash. App. 827, 786 P.2d 285 (1990).

168. *Id.* at 833, 786 P.2d at 289.

169. *Id.*

170. *See id.* at 833–35, 786 P.2d at 289–90.

171. *See id.* at 834 n.1, 786 P.2d at 290 n.1.

172. *See id.* at 833–35, 786 P.2d at 290.

The *Shinn* court ultimately avoided ruling on whether the business judgment rule applied to partnerships.¹⁷³ Nonetheless, it provided helpful clarifications regarding the rule's application.¹⁷⁴ Specifically, the court stated that the business judgment rule required a director to exercise proper care, in addition to showing good faith, when making a business decision.¹⁷⁵ Although the court never defined the exact standard of care to be applied,¹⁷⁶ it suggested that the standard did not come from RCW 23A.08.343.¹⁷⁷ In addition, the court continued to cite Fletcher's statement of the business judgment rule with approval, thus accepting the treatise's claim that the rule should protect a director's good faith and informed decision-making even if it represents a gross error in judgment.¹⁷⁸ Therefore, while a director was required to exercise some undefined level of care in becoming informed, courts would apply a less demanding gross-error standard when reviewing the actual decision.¹⁷⁹

C. In Dicta, the Washington State Supreme Court Has Suggested that Compliance with RCW 23B.08.300 Is a Necessary Part of the Business Judgment Rule Standard of Liability

The Washington State Supreme Court first addressed the business judgment rule by way of dicta in *Spokane Concrete Products, Inc. v. U.S. Bank*.¹⁸⁰ There, the court briefly discussed the business judgment rule and the recently enacted RCW 23B.08.300 as they related to the controlling shareholders' decision to commence a leveraged buyout.¹⁸¹ In its discussion of the business judgment rule, the court indicated that it reviewed business decisions under the rule unless there was evidence of "fraud, dishonesty, or incompetence."¹⁸² The court equated incompetence with a directors' failure to exercise proper care.¹⁸³ Then, it

173. *See id.* at 837, 786 P.2d at 291.

174. *See id.* at 833–35, 786 P.2d at 289–90.

175. *Id.* at 834–35, 786 P.2d at 289–90.

176. Note that neither the *Shinn* court, nor any lower court, has addressed procedural guidelines associated with the business judgment rule. *See generally Shinn*, 56 Wash. App. 827, 786 P.2d 285.

177. *See id.* at 834–35, 786 P.2d at 289–90.

178. *See id.*

179. *See id.*

180. 126 Wash. 2d 269, 892 P.2d 98 (1995).

181. *See id.* at 278–80, 892 P.2d at 103–04.

182. *Id.* at 279, 892 P.2d at 104.

183. *See id.*

suggested that (1) the concept of proper care in the context of the business judgment rule was defined in RCW 23B.08.300, and (2) the business judgment rule would only apply if a director complied with the statute.¹⁸⁴ Therefore, a director could not take a risk, whether associated with the *decision-making process* or the *actual decision*, without being exposed to liability, unless he or she complied with RCW 23B.08.300.¹⁸⁵ In essence, the court's dicta seemed to establish that the business judgment rule and RCW 23B.08.300 were one and the same.¹⁸⁶ The court never addressed the statute's extensive legislative history.¹⁸⁷

The court indirectly revisited the business judgment rule two years later in *Riss v. Angel*.¹⁸⁸ In *Riss*, plaintiff lot owners brought suit against a homeowners association for the association's rejection of proposed building plans.¹⁸⁹ In analyzing the liability of each individual homeowner in the association, the court discussed the business judgment rule without ultimately ruling as to whether it applied to homeowners associations.¹⁹⁰ The court focused its analysis on the *Schwarzmann* good-faith standard.¹⁹¹ However, the court concluded its discussion by noting that a director was required to abide by the ordinarily prudent person standards of RCW 23B.08.300 as part of the business judgment rule standard of liability.¹⁹² Again, the court did not discuss the statute's legislative history.¹⁹³ In addition, the court continued to avoid any discussion regarding procedural guidelines associated with the business judgment rule.¹⁹⁴

In the recent case of *Scott v. Trans-System, Inc.*,¹⁹⁵ however, the Washington State Supreme Court, in dicta, appeared to abandon its

184. *See id.* (“[D]irectors may take risks . . . so long as they comply with RCW 23B.08.300(1).” (citing *Nursing Home Bldg. Corp. v. DeHart*, 13 Wash. App. 489, 498, 535 P.2d 137, 143 (1975))).

185. *See id.*

186. *See id.*

187. *See id.*

188. 131 Wash. 2d 612, 934 P.2d 669 (1997).

189. *Id.* at 619, 934 P.2d at 674.

190. *Id.* at 631–33, 934 P.2d at 680–81.

191. *Id.* at 631–32, 934 P.2d at 680–81.

192. *See id.* at 633, 934 P.2d at 681 (stating that “a director *must* also act with such care as a reasonably prudent person in a like position would use under similar circumstances”) (emphasis added).

193. *See id.*

194. *See id.*

195. 148 Wash. 2d 701, 64 P.3d 1 (2003).

previous duty-of-care discussion altogether.¹⁹⁶ In an action to dissolve a corporation for oppression of the minority shareholder, the court referred to the previously criticized good-faith standard that was set forth in *Nursing Home*: “Under the ‘business judgment rule,’ corporate management is immunized from liability in a corporate transaction where . . . there is a reasonable basis to indicate that the transaction was made in good faith.”¹⁹⁷ In contrast to *Riss*, there was no discussion of the ordinarily prudent care standard.¹⁹⁸ Rather, the court simply ended the brief discussion of the business judgment rule by noting that courts are reluctant to interfere with business judgments.¹⁹⁹

In sum, Washington courts have not established a consistent application of the business judgment rule. Although the Washington State Supreme Court has not formally ruled on the subject, previous dicta, with the exception of that in *Scott*, suggests a business judgment rule standard of liability that requires adherence to the ordinarily prudent person standard of RCW 23B.08.300. Importantly, this requirement appears to extend to both a director’s process of becoming informed and the quality or substance of a director’s decision. The Court seemingly reached these conclusions without addressing the extensive legislative history of RCW 23B.08.300.

IV. THE STANDARDS OF CONDUCT IN RCW 23B.08.300 ARE NOT ELEMENTS OF THE BUSINESS JUDGMENT RULE

Washington state courts should not incorporate the standards of conduct of RCW 23B.08.300 into the business judgment rule standard of liability. The statute is sufficiently ambiguous to justify reference to its legislative history.²⁰⁰ This history establishes a division between the general standard of conduct for directors in discharging duties set forth in RCW 23B.08.300, and the business judgment rule standard of liability that applies to directors’ decisions.²⁰¹ Specifically, the legislative history

196. *See id.* at 709, 64 P.3d at 5. A recent Washington State Court of Appeals decision discussing the business judgment rule also did not address duty of care standards. *See generally* Northview Terrace Ass’n v. Mueller, 111 Wash. App. 1002, No. 27111-7-II, 2002 WL 598523 (Wash. App. Apr. 5, 2002) (omitting any reference to the duty of care in its discussion of the business judgment rule).

197. *Scott*, 148 Wash. 2d at 709, 64 P.3d at 5.

198. *See id.*

199. *Id.*

200. *See infra* Part IV.A.1.

201. *See infra* Part IV.A.3.

confirms that the Legislature did not intend to modify the business judgment rule previously applied by lower courts in Washington.²⁰² The removal of RCW 23B.08.300 from the business-judgment-rule standard of liability leaves a three-step process for reviewing business judgments.²⁰³ In general, the business judgment rule in Washington should shield directors from liability when the director: (1) makes a conscious business decision; (2) acts in good faith; and (3) becomes competently informed.²⁰⁴

A. The Ambiguity of RCW 23B.08.300 Allows Courts to Review Its Legislative History, Which Separates Ordinary Due Care Standards from the Business Judgment Rule

The legislative history of RCW 23B.08.300 indicates that the statute is not a standard of liability, but instead a standard of conduct that courts should not use to impose liability on a director under the business judgment rule for an unwise business decision.²⁰⁵ It is proper to review the legislative history because there are two basic ambiguities within RCW 23B.08.300(1).²⁰⁶ First, it is unclear whether the provision should be used as a standard of conduct or a standard of liability for directors.²⁰⁷ Second, it is ambiguous whether the statute governs a director's business decision, or alternatively, whether it applies to director duties that do not involve decisions (e.g., duty of oversight).²⁰⁸ Therefore, Washington state courts should examine the legislative history to determine the Legislature's intent.²⁰⁹ This history provides that RCW 23B.08.300 is a standard of conduct separate and distinct from the business judgment

202. See *infra* Part IV.A.3.

203. See *infra* Part IV.B.

204. The MBCA includes a four-step process in reviewing business decisions. See *supra* Part I.C. In addition to becoming adequately informed, the fourth step requires that the director reasonably (the term "rationally" is used by the American Law Institute) believes that the decision was in the best interest of the corporation. MODEL BUS. CORP. ACT § 8.31 (2002). This belief is generally the director's subjective belief, unless the decision reaches the level of absurdity. See *id.* § 8.31 annot. at 8-63 to -64. Washington state courts have not adopted this fourth step. However, this Comment recommends such action in Part V.

205. See SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041-44 (Wash. 1989).

206. See *Dep't of Ecology v. Campbell & Gwinn, L.L.C.*, 146 Wash. 2d 1, 12, 43 P.3d 4, 10 (2002) (stating that if a statute is ambiguous, "it is appropriate to resort to aids to construction, including legislative history").

207. See WASH. REV. CODE § 23B.08.300(4) (2004).

208. See *id.* § 23B.08.300(1).

209. See *Biggs v. Vail*, 119 Wash. 2d 129, 134, 830 P.2d 350, 352-53 (1992).

rule.²¹⁰

1. *RCW 23B.08.300 Is Ambiguous as to Whether It Should Be Used as a Standard for Director Liability*

RCW 23B.08.300 does not indicate whether a director can be liable for failing to meet the statute's standard of ordinary due care. The title of RCW 23B.08.300, "General standards for directors," implies that the statute invokes a standard of conduct, not a standard of liability.²¹¹ However, other sections of RCW 23B.08.300 suggest that the statute imposes liability on directors who do not comply with the section.²¹² For example, RCW 23B.08.300(1) indicates that a director "shall discharge the duties of a director . . . [w]ith the *care an ordinarily prudent person* in a like position would exercise under similar circumstances."²¹³ Concepts of due "care" and the "ordinarily prudent person" stem from tort law.²¹⁴ In tort law, failure to comply with the duty of care by acting as an ordinarily prudent person constitutes negligence.²¹⁵ Individuals are liable for the damage they cause while negligent.²¹⁶ This suggests that violation of the standard in RCW 23B.08.300 will lead to liability.²¹⁷

RCW 23B.08.300(4) introduces additional ambiguity as to whether the statute imposes director liability.²¹⁸ This subsection indicates that "[a] director is *not liable* for any action taken as a director, or any failure to take action, if the director performed the duties of the director's office in compliance with this section."²¹⁹ This implies that a director will be liable if he or she does not comply with the section. However, this

210. See SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041-44 (Wash. 1989).

211. See WASH. REV. CODE § 23B.08.300; see also *supra* Part I.A (discussing the difference between standards of conduct and standards of liability in the corporate context).

212. See WASH. REV. CODE § 23B.08.300(1), (4).

213. *Id.* § 23B.08.300(1)(b) (emphasis added).

214. See RESTATEMENT (SECOND) OF TORTS § 283 cmt. c (1965).

215. *Id.* § 283.

216. *Id.* § 430.

217. See Balotti & Hinsey, *supra* note 23, at 40. The ABA acknowledged and dismissed this misunderstanding in its 1998 amendments to the MBCA. See MODEL BUS. CORP. ACT § 8.31 annot. at 8-54. The ABA noted that "[t]he employment of the concept of 'care,' if considered in the abstract, suggests a tort-law/negligence-based analysis looking toward a finding of fault and damage recovery where the duty of care has not been properly observed and loss has been suffered[, b]ut the Model Act's desired level of director performance . . . does not carry with it the same type of result-oriented liability analysis." *Id.*

218. See WASH. REV. CODE § 23B.08.300(4).

219. *Id.* (emphasis added).

interpretation does not come from the plain meaning of the statute, as it requires a negative inference.²²⁰ Indeed, just because compliance with the statutory standard precludes liability does not mean that a lack of compliance will result in liability.²²¹ Additional requirements besides the lack of compliance may be necessary to impose liability.²²² The result is an ambiguity that brings forth two reasonable meanings. Therefore, the statute's meaning should be determined from the legislative history.²²³

2. *RCW 23B.08.300 Is Ambiguous as to Whether It Applies to Director Decisions*

RCW 23B.08.300(1) does not plainly specify whether it constitutes a standard governing directors' business decisions.²²⁴ Rather, the section simply provides that it applies to a director in the discharge of his or her duties.²²⁵ Neither RCW 23B.08.300, nor any other provision within Title 23B, provides any indication as to what actions constitute the discharge of a directorial duty.²²⁶ In the corporate context, however, the directors' duties and decisions are commonly reviewed separately.²²⁷ For example, the current version of the MBCA provides two distinct provisions related to director actions: one that governs "discharging . . . duties,"²²⁸ and one

220. *See id.*; *see also* Balotti & Hinsey, *supra* note 23, at 40 (stating that the 1974 Amendment to section 35 of the MBCA, which closely resembles RCW 23B.08.300, "seemed to imply by way of negative inference that a director who did not so perform[] his duties could be held liable") (internal quotations omitted).

221. *See* WASH. REV. CODE § 23B.08.300(4) (stating that "[a] director is not liable for any action taken" in accordance with a statute, but not stating that a *director is liable* should he or she fail to comply).

222. *See supra* Part I.A (discussing the common occurrence in corporate law of providing standards of conduct that guide conduct, but do not produce liability).

223. *See* State Dep't of Ecology v. Campbell & Gwinn, L.L.C., 146 Wash. 2d 1, 12, 43 P.3d 4, 10 (2002); *see also supra* Part II.B (explaining when it is proper to review legislative history in Washington state).

224. *See* WASH. REV. CODE § 23B.08.300(1).

225. *See id.*

226. *See id.* § 23B.01.400 (lacking a definition for director duty); *see also* WASH. REV. CODE § 23B.08.010(3) (stating that "[a] corporation may dispense with or limit the authority of its board of directors by describing in its articles of incorporation who will perform some or all of the duties of the board of directors," but not providing any direction regarding business decisions).

227. *See* CORPORATE GOVERNANCE, *supra* note 2, § 4.01(c) cmt. c (providing two examples of cases where duty of oversight does not contain a decision: (1) director's failure to read basic financial information; and (2) not considering the need for a effective audit process).

228. MODEL BUS. CORP. ACT § 8.30(a) (2002) (emphasis added).

that governs “any [director] *decision* to take or not to take action.”²²⁹ Likewise, the American Law Institute (ALI) developed section 4.01(a) of Principles of Corporate Governance: Analysis and Recommendations, which applies to the manner in which a director performs his or her functions, and section 4.01(c), which applies when a director makes a decision associated with those functions.²³⁰ Considering that it is unclear whether or not RCW 23B.08.300 applies to director decisions, it is appropriate to resort to the extensive legislative history to determine the meaning.²³¹

3. *RCW 23B.08.300’s Legislative History Confirms that the Statute Is a Standard of Conduct that Should Not Be Used to Impose Liability on a Director for a Business Decision*

RCW 23B.08.300’s legislative history immediately dismisses the idea of imposing liability on a director who fails to comply with RCW 23B.08.300 when making a business decision.²³² The first sentence of the official comment states that RCW 23B.08.300 defines the general standard of conduct for directors.²³³ This statement supports the argument that RCW 23B.08.300 is not a standard of liability.²³⁴ Rather, RCW 23B.08.300 establishes a safe harbor for directors who conform their actions to the standards.²³⁵ Although the legislative history states that RCW 23B.08.300 “requires a director to perform” his or her duties in accordance with RCW 23B.08.300(1), the Legislature preceded this statement by noting that the statute should not be used to review the substance of a director’s decision.²³⁶

The legislative history addresses the standard of liability that should

229. *Id.* § 8.31(a) (emphasis added).

230. *See* CORPORATE GOVERNANCE, *supra* note 2, § 4.01; *id.*, § 4.01(a)(1)–(2) & cmt. c (indicating that courts review the duty of oversight under § 4.01(c), rather than § 4.01(a), only when a director consciously “*decide[s]* which functions to delegate and what procedures, programs, or other techniques . . . they need to help effectuate the oversight function”) (emphasis added).

231. *See* Dep’t of Ecology v. Campbell & Gwinn, L.L.C., 146 Wash. 2d 1, 12, 43 P.3d 4, 10 (2002); Cockle v. Dep’t of Labor & Indus., 142 Wash. 2d 801, 808, 16 P.3d 583, 586 (2001).

232. *See* SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041 (Wash. 1989).

233. *Id.*

234. *See supra* Part I.A. (explaining the difference between a standard of liability and a standard of conduct in the corporate context).

235. SENATE JOURNAL, S. 51-2, Reg. Sess., at 3042 (Wash. 1989).

236. *See id.* at 3041.

be imposed on directors when they make a business decision.²³⁷ This history emphasizes that the courts must pay deference to director decisions and must avoid reviewing business judgments with the benefit of hindsight.²³⁸ The legislative history states that a director may avoid liability due to an “unwise or mistaken” decision by complying with RCW 23B.08.300, but it does not declare that a director is liable for injury or damages caused by a director’s decision when he or she fails to comply with RCW 23B.08.300.²³⁹ Instead, the comments reveal that courts should use the separate and distinct business judgment rule, which is currently being developed by the courts in Washington state, to determine liability.²⁴⁰ Thus, the only function of the statute when reviewing business decisions is to provide a safe harbor for directors in the event of director compliance.²⁴¹

The Legislature’s desire to set forth a clear division between the business judgment rule and RCW 23B.08.300 extends far beyond its stated exclusion of business decisions from the statute’s scope in the first two paragraphs of the legislative history. Indeed, the legislative history expressly states that the section is not a codification of the business judgment rule.²⁴² The legislative history later cements this division by establishing a specific procedure by which the courts should apply RCW 23B.08.300 and the business judgment rule:

If compliance with the standard of conduct set forth in Proposed section [23B.08.300] is established, there is no need to consider possible application of the business judgment rule. The possible application of the business judgment rule need only be considered if compliance with the standard of conduct set forth in Proposed section [23B.08.300] is not established.²⁴³

Therefore, the ordinarily prudent person standard of conduct is not part of the business judgment rule standard of liability.²⁴⁴ In fact, application of RCW 23B.08.300 occurs before the business judgment

237. *Id.* at 3042.

238. *See id.*

239. *See id.*

240. *See id.*

241. *See id.*

242. *Id.* (stating that “[p]roposed section [23B.08.300] does not try to codify the business judgment rule”).

243. *Id.* at 3044.

244. *See id.* at 3042.

rule standard of liability should be applied.²⁴⁵ If a director complies with RCW 23B.08.300, judicial review of the challenged conduct ends.²⁴⁶ In the event that a director fails to comply with the ordinarily prudent person standard, a court should then apply the business judgment rule to determine liability.²⁴⁷

B. Disentangling RCW 23B.08.300 from the Business Judgment Rule Leaves a Three-Step Process for Reviewing Business Judgments in Washington State

The recommended separation of RCW 23B.08.300 from the business judgment rule standard of liability will resolve the inconsistencies of past Washington state court rulings, and leave a three-step process for reviewing business judgments. In Washington, the business judgment rule will appropriately shield directors from liability when the director: (1) makes a conscious business decision; (2) acts in good faith; and (3) avoids acts of incompetence in becoming informed.²⁴⁸ If a director satisfies these three criteria, Washington courts should not second-guess the merits of a director's decision even when there is an after-the-fact showing of gross error in judgment.²⁴⁹

1. To Be Protected by the Business Judgment Rule in Washington, a Director Must Make a Conscious Business Decision

Application of the business judgment rule hinges on whether a director in fact made a business decision.²⁵⁰ Absent a challenged

245. *Id.* at 3044.

246. *Id.*

247. *Id.*

248. The MBCA includes a four-step process in reviewing business decisions. *See infra* Part I.C. This Comment recommends such action in Part V.

249. *See* *Nursing Home Bldg. Corp. v. DeHart*, 13 Wash. App. 489, 499, 535 P.2d 137, 144 (1975) (“[T]he law will not hold directors liable . . . [e]ven though the errors may be so gross that they may demonstrate the unfitness of the directors to manage the corporate affairs.” (quoting FLETCHER, *supra* note 146, § 1039, at 621–25)) (emphasis added).

250. *Compare Nursing Home*, 13 Wash. App. at 498, 535 P.2d at 143 (applying business judgment rule to review the decision of controlling shareholders to expend corporate assets on management fees, leased automobiles, and miscellaneous fringe benefits), *with* *Senn v. Nw. Underwriters, Inc.*, 74 Wash. App. 408, 416–17, 875 P.2d 637, 641 (1994) (withholding application of the business judgment rule in a case of oversight that did not include a conscious business decision). *See also* *Scott v. Trans-Sys, Inc.*, 148 Wash. 2d 701, 709, 64 P.3d 1, 5 (2002) (“Under the ‘business judgment rule,’ corporate management is immunized from liability in a corporate transaction where . . . the *decision* to undertake the transaction is within the power of the

business decision, courts should apply the general standards of RCW 23B.08.300(1) to review the conduct of the director.²⁵¹ Application of RCW 23B.08.300 occurs when the individual performs directorial duties—such as the duty of oversight or inquiry—that do not include conscious business decisions.²⁵² Directors may not claim protection of the business judgment rule under such circumstances.²⁵³

If a director makes a business decision,²⁵⁴ then he or she satisfies the first step of the analysis and may be eligible for protection under the business judgment rule. It is important to note, however, that evidence of a business decision does not render RCW 23B.08.300 inoperative.²⁵⁵ Washington courts may review a director's decision against the standards of conduct in RCW 23B.08.300 to determine whether a claim should be dismissed.²⁵⁶ That is, if a director's actions are in accordance with the standards of RCW 23B.08.300, then that director's exoneration from liability is automatic.²⁵⁷ If the director's decision conflicts with RCW 23B.08.300, then review continues under the business judgment standard of liability.²⁵⁸

2. *Washington State Courts Should Not Allow Application of the Business Judgment Rule if the Director Did Not Act in Good Faith*

Courts in Washington have stated that directors must act in “good faith” in order for the business judgment rule to apply,²⁵⁹ but have failed to provide a definitive explanation of that term.²⁶⁰ Lack of good faith,

corporation.”) (emphasis added). Washington courts have not yet ruled on whether the business judgment rule applies to situations where the director consciously decided *not to act*. However, most leading corporate law jurisdictions have applied the business judgment rule in cases where the director consciously decided not to act. *See, e.g.,* Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984) (noting that “[a] conscious decision to refrain from acting may . . . be a valid exercise of business judgment and enjoy the protections of the rule”).

251. *See* SENATE JOURNAL, S. 51-2, Reg. Sess., at 3042 (Wash. 1989).

252. *See* Scott, 148 Wash. 2d at 709, 64 P.3d at 5; *see also supra* Part I.C.1.

253. Scott, 148 Wash. 2d at 709, 64 P.3d at 5; *see also supra* Part I.C.1.

254. The decision must be undertaken within the power of the corporation and the authority of management. Scott, 148 Wash. 2d at 709, 64 P.3d at 5.

255. *See* SENATE JOURNAL, S. 51-2, Reg. Sess., at 3044 (Wash. 1989).

256. *See id.*

257. *See id.*

258. *See id.*

259. *See* Shinn v. Thrust IV, Inc., 56 Wash. App. 827, 833–34, 786 P.2d 285, 289 (1990); Seafirst Corp. v. Jenkins, 644 F. Supp. 1152, 1159 (W.D. Wash. 1986).

260. *See, e.g.,* Shinn, 56 Wash. App. at 833–34, 786 P.2d at 289 (excluding any substantive

however, appears to be synonymous with dishonesty.²⁶¹ Whereas older opinions such as *Schwarzmann* and *Nursing Home* used the term “good faith,”²⁶² later cases have noted that a showing of “dishonesty” eliminates any application of the business judgment rule.²⁶³ Regardless of the term used, in order for the business judgment rule to apply, a director must honestly believe at the time of the decision that he or she is acting in the best interests of the corporation.²⁶⁴

When a director’s decision involves a conflict of interest,²⁶⁵ the business judgment rule should no longer afford the director protection because courts cannot presume that the director made the decision in good faith.²⁶⁶ Although the business judgment rule should not be used to protect business decisions made with self-interest, a director may still be afforded protection under Washington law.²⁶⁷ Courts should recognize that RCW 23B.08.710 establishes a safe-harbor provision for directors’ conflict of interest transactions.²⁶⁸ If the particular issue involves a director’s conflicting-interest transaction as defined under RCW 23B.08.700(2), and the director complies with the safe harbor provision of RCW 23B.08.710, then the court should not impose liability on an

discussion of the good faith requirement in a breach-of-partnership claim); *Seafirst*, 644 F. Supp. at 1159 (excluding any substantive discussion of the good faith requirement in a claim of mismanagement against Seafirst Corporation directors).

261. *Compare In re Spokane Concrete Prods., Inc.*, 126 Wash. 2d 269, 279, 892 P.2d 98, 104 (1995) (“Unless there is evidence of fraud, dishonesty, or incompetence . . . courts will generally refuse to substitute their judgment for that of the directors.”), with *Nursing Home Bldg. Corp. v. DeHart*, 13 Wash. App. 489, 499, 535 P.2d 137, 144 (1975) (“[T]he law will not hold directors liable for honest errors, for mistakes of judgment, when they act without corrupt motive and in good faith” (quoting FLETCHER, *supra* note 146, § 1039, at 621–25)).

262. *See Schwarzmann v. Ass’n of Apartment Owners*, 33 Wash. App. 397, 402, 655 P.2d 1177, 1180 (1982); *Nursing Home*, 13 Wash. App. at 499, 535 P.2d at 144.

263. *See Riss v. Angel*, 131 Wash. 2d 612, 632, 934 P.2d 669, 681 (1997) (quoting *Spokane Concrete*, 126 Wash. 2d at 279, 892 P.2d 98 at 104).

264. *See Nursing Home*, 13 Wash. App. at 499, 535 P.2d 137 at 144.

265. *See* WASH. REV. CODE § 23B.08.700(1)–(2) (2004) (providing a definition of what constitutes a director’s conflict of interest).

266. *See Shinn v. Thrust IV, Inc.*, 56 Wash. App. 827, 833–34, 786 P.2d 285, 289–90 (1990), *see also* MODEL BUS. CORP. ACT § 8.31 annot. at 8-55 (2002) (indicating that the business judgment rule presumption does not apply to cases involving self-dealing or other breaches of the duty of loyalty).

267. *See* WASH. REV. CODE § 23B.08.710 (providing a safe harbor for director decisions that involve a conflict of interest).

268. *Id.* Courts should also recognize that RCW 23B.08.320 provides an additional safe harbor for directors. This provision allows corporations to limit the personal liability of a director so long as the corporation does not limit liability of a director for acts of intentional misconduct by a director. *Id.* § 23B.08.320.

interested director due to an unfavorable business decision.²⁶⁹

3. *The Business Judgment Rule Should Not Be Applied if There Is a Showing of Director Incompetence in Becoming Informed About the Decision*

Washington case law provides that the business judgment rule should not be applied if a director displays “incompetence” in becoming informed.²⁷⁰ In dicta, the Washington State Supreme Court has stated that the term “incompetence” is related to the concept of “proper care, skill, and diligence,” but has not yet defined these standards.²⁷¹ Although the Court never substantially elaborated on the meaning of these standards,²⁷² lower courts have suggested that such standards do not apply to the director’s actual decision.²⁷³ On the topic of the director’s actual decision, Washington state appellate courts have consistently enumerated, without reversal, that a director’s error “may be so *gross* that [it] may demonstrate the unfitness of the director[] to manage the corporate affairs.”²⁷⁴ Thus, the common-law standard of incompetence or proper care only applies to the decision-making process, not the reasonableness or quality of a director’s decision. Indeed, gross errors in judgment will be protected so long as the board exercised proper care in

269. *See id.* § 23B.08.700; MODEL BUS. CORP. ACT § 8.31(a)(1).

270. *See Shinn*, 56 Wash. App. at 834, 786 P.2d at 290; *In re Spokane Concrete Prods., Inc.*, 126 Wash. 2d 269, 279, 892 P.2d 98, 104 (1995).

271. *See Spokane Concrete*, 126 Wash. 2d at 279, 892 P.2d at 104 (stating that the business judgment rule does not apply if “there is evidence of fraud, dishonesty, or incompetence (*i.e.*, failure to exercise proper care, skill, and diligence),” but never injecting content into the meaning of these terms).

272. For example, the *Riss* court advised that reasonable care must be taken by the director. *Riss v. Angel*, 131 Wash. 2d 612, 632, 934 P.2d 669, 681 (1997). However, there was no indication whether the standard of reasonable care was subjective or objective. *See id.* Furthermore, the court did not explain what level of culpability was required for a director’s action to be deemed unreasonable (*i.e.*, ordinary negligence, gross negligence, etc.). *See id.*

273. *See Nursing Home Bldg. Corp. v. DeHart*, 13 Wash. App. 489, 499, 535 P.2d 137, 144 (1975) (citing *FLETCHER*, *supra* note 146, § 1039, at 621–25, for the proposition that directors would not be liable for unwise business decisions even if they constituted a gross error in judgment).

274. *See, e.g., Shinn*, 56 Wash. App. at 833–34, 786 P.2d at 290 (stating that the sole good-faith standard of *Nursing Home* was inaccurate, but not considering the substantive gross-error standard). Further, in a recent opinion on the subject, the Washington State Court of Appeals again stated that the business judgment rule applies “even though the errors may be so gross that they may demonstrate the unfitness of the directors to manage the corporate affairs.” *Northview Terrace Ass’n v. Mueller*, No. 271111-7-II, 2002 WL 598523, at *5 n.4 (Wash. App. Apr. 5, 2002).

reaching the decision. The legislative comments of RCW 23B.08.300 support this concept.²⁷⁵ It is also consistent with several leading corporate law jurisdictions.²⁷⁶

V. CONCLUSION

Washington courts should not apply the standards of conduct in RCW 23B.08.300 to determine liability of a director under the business judgment rule because the legislature intended the statute to be separate and distinct from the rule. This assertion is supported by the legislative history of RCW 23B.08.300, which courts should review due to ambiguities in the statute. Separating RCW 23B.08.300 from the business judgment rule leaves a three-step process for reviewing business decisions. Under this framework, the business judgment rule protects a director's good faith business decision—even in the event of a gross error in judgment—so long as the director exercised proper care in becoming informed. Unfortunately, Washington courts have not yet defined concepts such as “good faith,” “proper care,” and “gross error in judgment.” In addition, Washington courts have not established the rule's procedural guidelines. Therefore, this Comment recommends that Washington courts utilize the framework developed by outside authorities on the business judgment rule to provide practitioners, directors, and the judiciary with additional guidance in applying the rule.

Although several outside sources exist that can supplement Washington's law, including persuasive precedent from leading corporate-law jurisdictions like Delaware, Washington courts should consider adopting section 8.31 of the MBCA for three reasons. First, section 8.31 would provide the judiciary with substantive rules and an analytical framework for reviewing the business decisions of directors. Injection of such content into Washington's business judgment rule would provide interested parties with an understanding of how and when the rule applies. Second, section 8.31 would establish an essential fourth step for reviewing business decisions that Washington law currently lacks. Specifically, section 8.31 does not allow directors to avoid liability when they make obviously wasteful decisions just because they became adequately informed. Rather, it permits the imposition of liability in those rare cases when a director's actual decision extends

275. See SENATE JOURNAL, S. 51-2, Reg. Sess., at 3041 (Wash. 1989) (stating that due care standards should not be used to review the quality or substance of a director's business decision).

276. See *supra* Part I.C.3.

beyond a gross error in judgment to a level of absurdity. Finally, Washington courts should utilize section 8.31 because the ABA adopted this section to supplement section 8.30, which is similar to RCW 23B.08.300. Thus, Washington courts can adopt section 8.31 without conflicting with the current law established in RCW 23B.08.300.

