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Recent Developments Concerning the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule

Patricia A. Daniel

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Recent Developments Concerning the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule*

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I. INTRODUCTION

The judiciary faces a difficult task in attempting to define the proper standards of conduct for corporate directors and officers. Although courts have enunciated various standards, the prevailing theme has been that corporate directors and officers are fiduciaries who have a "distinct legal relationship" with the corporation and its shareholders.[1] As fiduciaries, directors and officers must conform to the duty of care[2] and the duty of loyalty.[3] The business judgment rule, which creates a presumption of propriety for directors' and officers' substantive business decisions, developed concur-

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* This Special Project Note is cited as "*Recent Developments* (Special Project)" throughout the Special Project.

1. *See supra An Historical Perspective* (Special Project) notes 2-5 and accompanying text.
2. *See id.* notes 9-49 and accompanying text.
3. *See id.* notes 115-40 and accompanying text.

rently with these duties.[4]

Several recent court decisions concerning corporate director and officer liability appear to have placed a greater duty on directors and officers to investigate, inquire, and more actively participate in corporate governance.[5] In contrast, two recent state statutory amendments have lessened the fiduciary burden on directors and officers.[6] Meanwhile, the business judgment rule remains a significant limitation on courts' ability to question the substantive business decisions made by directors and officers.[7] These developments have evoked differing philosophical responses, the two most notable of which are the neoclassical model[8] and the monitoring model.[9]

This Special Project Note will discuss recent developments in three distinct areas of corporate law and will illustrate that many of the developments hailed as expressing a pervasive dissatisfaction with corporate governance[10] actually are not significant deviations from the current law, but merely are clarifications of existing law.[11] Part II of this Special Project Note will examine recent Delaware state court decisions and will evaluate their potential impact on corporate law. Part III will analyze three recent cases decided in jurisdictions outside Delaware and will compare them to Delaware law. Finally, Part IV will discuss two recent state statutory amendments that drastically affect the traditional law governing director and officer liability by effectively eliminating corporate directors' and officers' duty of care.

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4. *See id.* notes 50-79 and accompanying text.

5. *See, e.g.,* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

6. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1986); IND. CODE ANN. § 23-1-35-1(e) (Burns Supp. 1986).

7. *See, e.g.,* Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

8. *See* Burgman & Cox, *Corporate Directors, Corporate Realities, and the Deliberative Process: An Analysis of the* Trans Union *Case*," 11 J. CORP. L. 311, 342 (1986). The neoclassical model theorizes that the monitoring devices present in the United States' economic system and in the corporate structure itself negate any need for a legal monitoring system. *See id.* at 313, 342-43; *see also* Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259 (1982) (discussing the proposals for change in corporate governance and concluding that those who advocate change fail to understand the economics of the corporate system).

9. The monitoring model calls for a more active board of directors and places a legal obligation on directors to "engage in a deliberative process with reasonably complete information." Burgman & Cox, *supra* note 8, at 342.

10. This perceived dissatisfaction is the basis for the ALI's proposed Principles of Corporate Governance. *See infra ALI Proposals* (Special Project) notes 9-15 and accompanying text.

11. *See infra* notes 76-86 and accompanying text.

II. Recent Delaware Case Law

A. Introduction

Recent Delaware state court decisions do not significantly change traditional corporate law; instead, these decisions clarify and explain the current standards of conduct for directors and officers. First, *Zapata Corp. v. Maldonado*[12] creates a two-step test for analyzing a board's motion to dismiss a properly filed shareholder derivative suit.[13] The *Zapata* test modifies the traditional application of the business judgment rule.[14] *Aronson v. Lewis*,[15] however, mitigates the impact of *Zapata* by limiting the application of its two-step test.[16] Second, *Smith v. Van Gorkom*[17] reaffirms a gross negligence standard for directors and officers under the duty of care, yet limits application of the business judgment rule.[18] Subsequent cases, however, have continued to apply a highly deferential standard of review for directors' and officers' actions.[19] Finally, *Weinberger v. UOP, Inc.*[20] employs a traditional duty of loyalty analysis, which places the burden of proving the essential fairness of a given transaction on the director who has an interest on both sides of the transaction.[21]

B. Zapata Corp. v. Maldonado *and* Aronson v. Lewis

One situation that requires courts to examine directors' actions closely is the shareholder derivative suit.[22] Directors often are

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12. 430 A.2d 779 (Del. 1981).

13. For a full discussion of *Zapata*, see *infra* notes 22-35 and accompanying text.

14. *See, e.g.*, Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979); *see also infra* notes 30-34 and accompanying text.

15. 473 A.2d 805 (Del. 1984).

16. For a full discussion of *Aronson*, see *infra* notes 36-47 and accompanying text.

17. 488 A.2d 858 (Del. 1985).

18. For a full discussion of *Van Gorkom*, see *infra* notes 48-86 and accompanying text.

19. For a discussion of the Delaware cases decided since *Van Gorkom*, see *infra* notes 87-114 and accompanying text.

20. 457 A.2d 701 (Del. 1983).

21. For a full discussion of *Weinberger*, see *infra* notes 115-35 and accompanying text.

22. *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984); Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981); *see also* Block & Prussin, *Termination of Derivative Suits Against Directors on Business Judgment Grounds: From* Zapata *to* Aronson, 39 Bus. Law. 1503 (1984). A derivative action is a suit brought by a sbareholder to enforce a right properly belonging to the corporation when, for some reason, the corporation itself fails to bring the

named as defendants in shareholder derivative suits. Therefore, to ensure that a board is acting in the best interests of the shareholders and the corporation, a court must scrutinize carefully a board's motives in voting to dismiss a derivative action against a director.

Zapata Corp. v. Maldonado[23] addressed the inherent conflicts of interest stemming from a shareholder derivative suit by creating a two-step test to evaluate a board's decision to dismiss a derivative suit against a director. In *Zapata* a shareholder, William Maldonado, brought a derivative suit alleging that Zapata's directors breached their fiduciary duties to the corporation and its shareholders. Mr. Maldonado, however, filed the suit without first demanding that the board pursue the corporation's cause of action.[24] Mr. Maldonado argued that demand should have been "excused," alleging that a demand would have been futile because the directors were not sufficiently independent.[25] Meanwhile, Zapata's board created a special litigation committee composed of disinterested directors to determine whether to pursue the action.[26] The committee decided to dismiss the suit; Zapata's subsequent motion to dismiss was granted by the trial court and Mr. Maldonado appealed.[27]

On appeal the Delaware Supreme Court considered whether a special litigation committee has the power to dismiss a derivative

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action. Subsequently, the corporation's board of directors may form a committee of disinterested directors—a "special litigation committee"—to determine whether to pursue or dismiss the shareholder's derivative action. *See infra* note 26 and accompanying text.

23. 430 A.2d 779 (Del. 1981).

24. *Id.* at 780. Zapata's board of directors created a stock option plan for certain directors and officers, granting them the right to purchase the corporation's common stock at $12.15 per share. Zapata also planned a self-tender offer calculated to increase the market price of its stock from $18-19 per share to the price offered, $25 per share. The directors' capital gains were to be measured by the difference between the option price and the fair market value of the stock on the option's exercise date. In order to minimize their individual federal income tax liability, the directors wanted to exercise their options before the announcement of the proposed self-tender offer and the accompanying jump in price. Thus, they accelerated the date upon which they could exercise their options, an action that Mr. Maldonado alleged was a breach of the directors' fiduciary duty owed to Zapata and its shareholders. *See* Maldonado v. Flynn, 413 A.2d 1251, 1254-55 (Del. Ch. 1980), *rev'd sub nom.* Zapata v. Maldonado, 430 A.2d 779 (Del. 1981).

25. For a discussion of demand-refused and demand-excused cases, see *infra* note 33.

26. *Zapata*, 430 A.2d at 781. Courts have recognized that special litigation committees composed of independent directors have the authority to investigate the merits of shareholder derivative suits on behalf of directors who have some interest in the outcome of an action. *See, e.g.*, Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979). The business judgment rule traditionally has afforded protection to decisions by these special litigation committees.

27. *Zapata*, 430 A.2d at 781.

action[28] and concluded that the board of directors possesses that power and may delegate that power to a committee of the board. The significance of *Zapata*, however, is its limitation on the traditional protection afforded by the business judgment rule to a committee decision to dismiss derivative litigation in "demand-excused" situations. The court's analysis of the judicial deferrence required by the business judgment rule included a two-step test to assess the integrity of the board's motion to dismiss.[29] The court sought to balance the board's desire to protect the corporation from meritless claims and costly litigation with the shareholders' need for protection against improperly motivated dismissals of worthwhile shareholder suits. Consequently, the court modified its application of the business judgment rule to avoid either of these extremes.

Zapata's two-step test requires that a court (1) examine the good faith and independence of a board's or committee's decision to dismiss a suit,[30] and (2) apply its own business judgment to determine whether the suit should be dismissed.[31] Requiring a court to exercise its own business judgment is a significant limitation on the traditionally deferential business judgment rule that has been applied to corporate decisions.[32] This limitation, however, is restricted to the context of "demand-excused" cases.[33] In a "de-

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28. *Id.*

29. *Id.* at 788. The court stated:

First, the Court should inquire into the independence and good faith of the committee and the bases supporting its conclusions . . . .

The second step provides, we believe, the essential key in striking the balance between legitimate corporate claims as expressed in a derivative stockholder suit and a corporation's hest interests as expressed by an independent investigating committee. The Court should determine, applying its own independent business judgment, whether the motion should be granted.

Id. at 788-89 (footnotes omitted).

30. *Id.*

31. *Id.* at 789.

32. *See* Block & Prussin, *supra* noto 22, at 1505. For a discussion of the business judgment rule and its application, see *supra An Historical Perspective* (Special Project) notes 50-79 and accompanying text.

33. *Zapata*, 430 A.2d at 783. The court clearly distinguished between "demand-excused" and "demand-refused" cases. In a demand-excused case a shareholder may sue without first demanding that the hoard bring the action. A shareholder may bring an action without prior demand if the directors are so interested in the action that their decision on whether to pursue the action likely would be a "tainted" decision. Typically, demand is excused if all or a majority of the directors participated in the questioned transaction or are defendants in the action. *Id.* at 784. When a board decides not to pursue an action after a shareholder has made a demand, the shareholder's subsequent suit is deemed demand-refused. Courts assume that the directors possess the requisite impartiality to assess fairly the

mand-refused" case a board's decision not to pursue an action still is entitled to the protection of the business judgement rule unless the stockholder can show that the decision was "wrongful."[34]

Several commentators view *Zapata* as a significant limitation on the great deference traditionally afforded directors' business decisions;[35] *Zapata*'s two-step test, however, is limited by *Aronson v. Lewis*.[36] In this subsequent Delaware case, Harry Lewis brought a shareholder derivative suit challenging the validity of certain transactions betweeen Meyers Parking System, Inc. and Leo Fink, one of its directors.[37] Mr. Lewis also named as defendants the entire board that approved the challenged transactions between Mr. Fink and the corporation. Mr. Fink, who owned forty-seven percent of Meyers' outstanding shares, had a lucrative employment contract with Meyers.[38] Mr. Lewis asserted that Mr. Fink dominated the board of directors through his stock ownership interest and his alleged selection of all the Meyers directors. Mr. Lewis claimed that the employment contract and other transactions[39] be-

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merits of pursuing a derivative suit if demand is not excused. Thus, a decision by disinterested directors to dismiss a suit is afforded the same business judgment rule protection that any other business decision would receive. *See id.* at 783-85.

34. *Id.* at 783. In McKee v. Rogers, 18 Del. Ch. 81, 156 A. 191 (1931), the court held that a shareholder may not "invade the discretionary field" of the directors when they have decided not to pursue a claim on behalf of the corporation. *Id.* at 85-86, 156 A. at 193. The *Zapata* court asserted that application of the business judgment rule in demand-refused situations would not harm the shareholders hecause "[b]oard members, owing a well-established fiduciary duty to the corporation, will not be allowed to cause a derivative suit to be dismissed when it would be a breach of their fiduciary duty." *Zapata*, 430 A.2d at 783.

35. *See, e.g.*, Block & Prussin, *supra* note 22, at 1504-05. According to the authors, *Zapata* exemplifies the "structural bias" viewpoint, which calls for strict criteria in determining the disinterestedness of directors. A "structural bias" favors interested directors because disinterested directors sympathize with their colleagues. *Id. But see* Cox, *Searching for the Corporation's Voice in Derivative Suit Litigation: A Critique of* Zapata *and the ALI Project*, 1982 DUKE L. J. 959. Although Professor Cox applauds the court's refusal to apply the business judgment rule, he sees the two-step test as an "illusory improvement" because of the lenient standards for a showing of good faith by the directors. Cox, *supra*, at 975, 983. The "structural bias" view is reflected more clearly in Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709 (Iowa 1983). *See infra* notes 144-58 and accompanying text.

36. 473 A.2d 805 (Del. 1984).

37. *Id.* at 808.

38. Mr. Fink's five-year employment contract, which contained terms for automatic renewal, provided for an annual salary of $150,000 plus a bonus of five percent of Meyers' pre-tax profits over $2,400,000. Mr. Fink could terminate the contract at any time, but Meyers had to give six months notice to terminate. Upon termination of the contract, Mr. Fink would become a consultant for Meyers and would receive $150,000 per year for the first three years, $125,000 per year for the next three years, and $100,000 per year thereafter. The contract further provided that Mr. Fink's inability to perform any services would not affect his compensation. *Id.* at 808-09.

39. In addition to the employment contract, Meyers made several interest-free loans

tween Meyers and Mr. Fink had no valid business purpose and were a waste of corporate assets because the amounts paid were excessive and hecause Mr. Fink performed little service to the corporation.[40] Because of Mr. Fink's alleged domination of the board, Mr. Lewis failed to make a demand on Meyers' directors to bring the derivative action, deeming such a demand to be futile.[41] The trial court denied the defendant-directors' subsequent motion to dismiss for failure to make a demand and held that the failure was excused because the directors could not have considered the demand impartially.[42] The directors appealed and the Delaware Supreme Court was presented an opportunity to apply *Zapata's* two-step test to determine whether the action should proceed. The court, however, refused to apply the *Zapata* test, concluding that Mr. Lewis had not shown that a demand would have been futile.[43]

Aronson was not a demand-excused case because demand was not futile. The court stated that it must determine whether the plaintiff alleged facts creating a reasonable doubt that "(1) the directors are disinterested and independent, and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[44] In assessing these factors, the threat of personal liability for approving an allegedly wrongful transaction was not sufficient to make a director "interested" for the purpose of determining whether the decision not to pursue the action was a tainted one.[45] *Aronson* excuses demand only when directors making the decision to terminate are "under an influence which sterilizes their discretion," and holds that mere approval—absent evidence of a breach of fiduciary duty or other evidence of a lack of indepen-

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to Mr. Fink. *Id.* at 809.

40. *Id.*

41. *Id.* According to Mr. Lewis, the following factors made demand futile: (1) all directors were named as defendants and had participated in, approved or acquiesed in, and were personally liahle for the alleged wrongdoings (*i.e.*, they approved the challenged transactions); (2) Mr. Fink selected each director and, thus, controlled all the board's actions; and (3) pursuing this claim would require the defendant-directors to sue themselves, "thereby placing the conduct of this action in hostile hands and preventing its effective prosecution." *Id.*

42. *Id.* at 809-10.

43. *Id.* at 816. The *Aronson* court stated:

> We conclude that in the demand-futile [demand-excused] context a plaintiff charging domination and control of one or more directors must allege particularized facts manifesting "a direction of corporate conduct in such a way as to comport with the wishes or interests of the corporation (or persons) doing the controlling."

Id. (quoting Kaplan v. Centex Corp., 284 A.2d 119, 123 (Del. Ch. 1971)).

44. *Aronson*, 473 A.2d at 814.

45. *Id.* at 815.

dence or disinterestedness—is insufficient to prevent a director from exercising a valid business judgment. The court held that Mr. Lewis' allegations—Mr. Fink's domination of the board based on his ownership of forty-seven percent of Meyers' outstanding stock, Mr. Fink's personal selection of each director, and Mr. Fink's lucrative contract—were not sufficient to support a demand-futility claim. Given the apparent sufficiency of these allegations, *Aronson* makes proving demand-futility very difficult.[46]

Aronson greatly limits the application of *Zapata*'s two-step test by classifying very few cases as demand-excused. Even if the directors are named as defendants in the action, demand will not be excused unless self-dealing is clearly shown.[47] If demand is not excused, a shareholder must make a demand on the board of directors to pursue any claim. In this situation, the business judgment rule will protect a board's refusal as if the *Zapata* test did not exist. Despite *Aronson, Zapata*'s two-step test still limits the protection afforded directors under the business judgment rule in proper demand-excused cases.

C. Smith v. Van Gorkom: *the* Trans Union *Case*

Smith v. Van Gorkom[48] (the *Trans Union* case) is perhaps the most important recent case concerning the duty of care and the business judgment rule. In *Trans Union* the Delaware Supreme Court refused to apply the business judgment rule to the Trans Union directors' decision because their actions did not constitute a valid business decision. The widespread reactions to and criticisms of the court's holding evince its significance to corporate governance.[49]

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46. *See* Block & Prussin, *supra* note 22, at 1505-06. Dennis Block and Adam Prussin, attorneys with Weil, Gotshal & Manges in New York, NY, note that:

> *Aronson* makes it clear that demand will almost always be required unless a majority of the Board is so directly self-interested in the challenged transaction that there is serious doubt that the business judgment rule would protect that transaction. Self-interest, for these purposes, is defined in terms of direct financial interest in the challenged transaction: the fact that a majority of directors voted to approve the transaction . . . does *not* constitute the requisite self-interest and will not excuse demand.

Id. at 1506.

47. *See id.*

48. 488 A.2d 858 (Del. 1985).

49. *See, e.g.*, Burgman & Cox, *supra* note 8; Chittur, *The Corporate Director's Standard of Care: Past, Present, and Future*, 10 DEL. J. CORP. L. 505 (1985); Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437 (1985); Manning, *Reflections and Practical Tips on Life in the Boardroom after* Van Gorkom, 41 BUS. LAW. 1 (1985); Veasey & Seitz, *The Business Judgment Rule in the Revised Model Act, the* Trans

The facts in *Trans Union* are crucial to assessing the decision's impact on the duty of care and the business judgment rule. Trans Union, a publicly traded holding company, sought to generate sufficient income to offset its substantial investment tax credits.[50] A report presented to the board of directors at its July 1980 meeting detailed four possible means of generating income. Sale of the company, however, was not one of the alternatives listed.[51] At a senior management meeting a leveraged buy-out by management was discussed briefly. Buy-out figures of between fifty and sixty dollars per share were discussed, but no definite price was set.[52] Fearing a potential conflict of interest, Jerome Van Gorkom, chairman of Trans Union, vetoed the suggestion of a leveraged buy-out by management.

Mr. Van Gorkom approached Jay Pritzker, a takeover specialist, with a proposed sale price and financing structure on September 13, 1980.[53] Two days later, Mr. Pritzker informed Mr. Van Gorkom of his interest in the cash-out merger proposal at fifty-five dollars per share. Mr. Pritzker and Mr. Van Gorkom met on September 18, at which time Mr. Pritzker informed Mr. Van Gorkom that the board must act on his proposal within three days.[54] On September 19 Mr. Van Gorkom called meetings for the following day for both senior management and the board of directors.[55] Mr. Van Gorkom disclosed Mr. Pritzker's offer to senior management but did not furnish them with a copy of the merger agreement. Despite senior management's negative reaction to the proposed merger,[56] Mr. Van Gorkom presented the proposal to Trans Union's board of directors the same day.[57] The board received cop-

Union *Case, and the ALI Project—A Strange Porridge*, 63 Tex. L. Rev. 1483 (1985).

50. *Van Gorkom*, 488 A.2d at 864-65.

51. The following four options were presented to the board: "(1) stock purchase; (2) dividend increases; (3) a major acquisition program; and (4) combinations of the above." *Id.* at 865.

52. *Id.*

53. *Id.* at 866. Mr. Pritzker was also a social acquaintance of Mr. Van Gorkom. The proposals presented to Mr. Pritzker were assembled by Mr. Van Gorkom without consulting senior management. *Id.* Mr. Van Gorkom obtained the aid of Carl Peterson, Trans Union's Controller, to determine the feasibility of selling the company at $55 per share and directed Mr. Peterson not to tell anyone else of his actions. *Id.*

54. *Id.* at 867.

55. *Id.*

56. *Id.* at 867-68. Mr. Peterson and Bruce Chelberg, president of Trans Union, were the only supporters of Mr. Van Gorkom's proposal. Donald Romans, the chief financial officer, criticized the price as being too low and argued that the proposal already was more of an "agreed merger" than it was an offer. *Id.*

57. *Id.* The board of directors consisted of five outside directors and five inside direc-

ies of the merger agreement too late to study the transaction before the meeting.[58] Mr. Van Gorkom did not disclose that fifty-five dollars per share was near the bottom of the range of fair prices for the company or that he proposed this price. The board was left to assume that the price had been set only after negotiation. After two hours, the board approved the merger proposal without ever reading it.[59] Mr. Van Gorkom executed the agreement that night at a social function. When the merger was announced on September 22, many of Trans Union's officers threatened to resign. Thereafter, Mr. Van Gorkom met with Mr. Pritzker, who agreed to modify the proposal if Mr. Van Gorkom could persuade dissident officers to continue working for Trans Union for at least six months after completion of the merger.[60] The board approved the amendments sight unseen on October 8;[61] the shareholders ratified the merger at their meeting in January 1981.[62]

The lower court held that the business judgment rule protected the directors' actions and found no liability on their part.[63]

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tors. Four of the five outside directors were corporate chief executive officers, and one was the former dean of the University of Chicago Business School. Although none of the outside directors were investment bankers or financial analysts, they were professional businessmen with 53 years cumulative experience as directors of Trans Union. *Id.* at 894 (McNeilly, J., dissenting).

58. *Id.* at 868. The proposal provided that Mr. Pritzker would pay $55 cash for all outstanding shares of Trans Union; that Trans Union could receive competing offers for 90 days, but could not solicit them actively; that the offer was to be accepted by September 21 (the next day); that competing bidders could be given published, but not proprietary, information; that Mr. Pritzker's obtaining financing by October 10 was a condition of the agreement; and that if the financing condition was met by Mr. Pritzker or waived by Trans Union, Trans Union was obligated to sell Mr. Pritzker one million newly issued shares of treasury stock for $38 per share. *Id.*

59. *Id.* at 869. The court felt that the board based its approval of the merger solely on Mr. Van Gorkom's presentation, statements by Mr. Chelberg and Mr. Romans as to fair price, James Brennan's legal advice, and the board's general knowledge about the history of Trans Union stock. Mr. Brennan, retained by Mr. Van Gorkom, informed the board that failure to accept the offer might result in a lawsuit and that Delaware law did not require the board to seek a fairness opinion before approving the transaction.

60. *Id.*

61. *Id.* Mr. Van Gorkom did not present accurately the amendments to the board. Mr. Van Gorkom represented that the amended agreement would allow Trans Union to openly solicit other offers. The actual amendment, however, was more restrictive. A more favorable offer was no longer sufficient cause for Trans Union's withdrawal from the merger agreement. Trans Union could abandon the agreement only if it completed a merger or entered into a merger agreement before February 10, 1981. *Id.* at 882. Although the purpose of the meeting was "to amend the Merger Agreement, in a manner agreeable to Pritzker, to permit Trans Union to conduct a 'market test,' " these amendments were not codified until after the board had voted to approve them. *Id.*

62. *Id.* at 870.

63. The opinion of the Court of Chancery is an unreported letter opinion.

The Delaware Supreme Court acknowledged the role of the business judgment rule in corporate governance, but refused to apply the rule, finding that the directors had failed to reach an informed business judgment.[64] The court stated that the business judgment rule is not applicable until there has been a showing that the board reached an informed business decision.[65] The court did not focus on the board's ultimate substantive decision; rather, the court scrutinized the process by which the directors reached their decision and concluded that their gross negligence during this process prevented them from making a valid business judgment. The court imposed on the board a duty to inquire and obtain "all information that was reasonably available to them."[66] The court did not deviate from the gross negligence standard usually applied in duty of care cases; rather, it found that the directors were grossly negligent because they "failed to act with informed reasonable deliberation."[67] The business judgment rule did not apply because the directors never made an informed business judgment. The *Trans Union* court's concentration on a process-oriented approach permits courts to assess the amount of care exercised by a board of directors in reaching its decision. *Trans Union* directs a court's attention to the directors' decisionmaking process and clarifies the existing gross negligence standard.

The court also examined whether later actions by the board or shareholders cured the directors' negligence. The court found the board's subsequent conduct in "approving" amendments based solely on Mr. Van Gorkom's representations to be grossly negligent.[68] Likewise, the shareholders' subsequent ratification of the

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64. *Van Gorkom*, 488 A.2d at 871-72.

65. The court summarized its reasons for not applying the business judgment rule as follows:

> The directors (1) did not adequately inform themselves as to Van Gorkom's role in forcing the "sale" of the Company and in establishing the per share purchase price; (2) were uninformed as to the intrinsic value of the Company; and (3) given these circumstances, at a minimum, were grossly negligent in approving the "sale" of the Company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency.

Id. at 874.

66. *Id.* at 877.

67. *Id.* at 881.

68. *Id.* at 882-83. The court also found fault with Mr. Van Gorkom's handling of an offer made by Kohlberg, Kravis, Roberts & Co. (KKR) subsequent to the board's approval of the merger agreement with Mr. Pritzker. Mr. Van Gorkom received a formal letter from KKR on December 2 offering to purchase 100% of Trans Union's assets and assume its liabilities for up to $60 per share. Mr. Van Gorkom felt the financing condition in the offer prevented it from being a firm offer and refused to issue a press release announcing KKR's

merger agreement did not cure the directors' earlier errors.[69] Before shareholder ratification can cure a wrongful transaction, the shareholders must be fully informed of "all facts germane to the transaction at issue in an atmosphere of complete candor."[70] The court held that Trans Union's proxy materials did not fully inform the shareholders; therefore, the shareholders' ratification of the merger agreement did not validate it.[71]

The majority and dissenting opinions in *Trans Union* have been interpreted in several ways. By imposing on directors a more stringent duty to inquire and investigate, the majority may have adopted the "monitoring approach" embraced in the American Law Institute's Principles of Corporate Governance.[72] In contrast, both dissenting opinions felt that the court erred in not applying the business judgment rule. The dissents, therefore, arguably exemplify a more deferential view, similar to the "neoclassical model" of corporate governance.[73] Justice McNeilly, however, claimed that he dissented merely because he disagreed with the majority's evidentiary conclusions.[74] Justice McNeilly felt that the majority focused on negative aspects of the transaction and ig-

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offer. KKR withdrew the offer within hours, allegedly because one of the purchasers withdrew from the group. Mr. Van Gorkom did not inform the board of KKR's proposal at its meeting later that afternoon. *Id.* at 884-85.

69. "The parties tacitly agreed that a discovered failure of the Board to reach an informed business judgment in approving the merger constituted a voidable, rather than a void, act." *Id.* at 889. The directors argued that because the transaction was voidable, subsequent ratification by the shareholders would validate the agreement between Mr. Pritzker and Trans Union. The court rejected this argument.

70. *Id.* at 890.

71. The court relied on the following deficiencies in the proxy materials: (1) the board's lack of information regarding the value of the corporation was not disclosed; (2) the failure to assess the premium offered was not disclosed; (3) the account of events preceeding the September 20 meeting was not complete; and (4) the supplemental proxy statement contained information that was available for inclusion in the original proxy statement, but that was not revealed in the original proxy statement. *Id.* at 890-92.

72. *See* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (Tent. Draft No. 4, Apr. 12, 1985). This view favors greater examination of directors' and officers' actions. *See infra ALI Proposals* (Special Project) notes 49-77 and accompanying text (discussing the Principles of Corporate Governance).

73. For a discussion of these two views, see *supra* notes 8-9.

74. Justice McNeilly stated as follows:

> I have no quarrel with the majority's analysis of the business judgment rule. It is the application of that rule to these facts which is wrong. An overview of the entire record, rather than the limited view of bits and pieces which the majority has exploded like popcorn, convinces me that the directors made an informed business judgment which was buttressed by their test of the market.

Van Gorkom, 488 A.2d at 897 (McNeilly, J., dissenting).

nored any evidence of due care on the part of the directors.[75] Justice McNeilly's dissent illustrates that *Trans Union's* facts are subject to several interpretations. The majority and dissenting opinions, therefore, do not necessarily espouse opposite views on the role of the business judgment rule.

Various commentators have noted that the Delaware Supreme Court's decision in *Trans Union* can be interpreted to lead to at least four different results.[76] First, *Trans Union* may represent an adoption of the monitoring model set forth in the ALI's Principles of Corporate Governance,[77] in which case the court simply reacted to its dissatisfaction with the great discretion afforded directors and officers under the business judgment rule.[78] According to this view, *Trans Union*'s retention of the gross negligence standard and its emphasis on the process by which directors reached a decision are consistent with current Delaware law.[79] Second, *Trans Union* may be a significant change in Delaware law and an end to Delaware's "race to the bottom."[80] Third, the Delaware Supreme Court may have erred in refusing to apply the business judgment rule to

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75. Justice McNeilly cited, as factors to be considered, the collective experience of the board, *see supra* note 57, the board's reservation of the rigbt to accept a better offer, an outside study of Trans Union conducted by the Boston Consulting Group, and the adequacy of the proxy statement in informing the sbareholders of the proposed transaction. *Id.* at 894-96 (McNeilly, J., dissenting). Justice McNeilly further argued that the board's experience, combined with tbeir business backgrounds, contradicted the majority's conclusion that tbe board's hasty decision was one made witbout due care:

> Directors of this caliber are not ordinarily taken by a "fast sbuffle." I submit they were not taken into this multi-million dollar corporate transaction without being fully informed and aware of the state of the art as it pertained to the entire corporate panoroma of Trans Union.... These men knew Trans Union like the back of their hands and were more than well qualified to make on the spot informed business judgments concerning the affairs of Trans Union including a 100% sale of the corporation.

Id. at 894-95 (McNeilly, J., dissenting).

76. *See, e.g.,* Burgman & Cox, *supra* note 8; Fischel, *supra* note 49; Manning, *supra* note 49. Dierdre Burgman, an attorney with Cahill, Gordon & Reindel in New York, NY, and Professor Cox recognize the following two interpretations of *Trans Union*:

> There are two ways of viewing *Trans Union.* One view concludes, as have some commentators, that the Delaware Supreme Court is out of touch with how corporate business is conducted. The other view assumes that the Delaware Supreme Court does understand "corporate realities" and is attempting to mold the law both to reflect and reform these realities.

Burgman & Cox, *supra* note 8, at 313.

77. *See infra ALI Proposals* (Special Project) notes 49-77 and accompanying text.

78. *See, e.g.,* Burgman & Cox, *supra* note 8, at 313.

79. *See id.* at 328.

80. *See* Chittur, *supra* note 49, at 527. In general, Delaware law has placed minimal standards on corporate directors and has made incorporating in Delaware a simple procedure. This leniency has made Delaware a leader among the states in the "race to the bottom" of corporate law.

the directors' actions.[81] Consequently, directors will be less likely to take risks to further the interests of their corporations, fearing potential liability for mistaken business judgments.[82] Finally, *Trans Union* may be insignificant regardless of whether it changes Delaware law, and its requirements may have little substantive effect, because directors can prove that they exercised due care in reaching their business decisions by paying an expert to evaluate the "fair" value of a corporation[83] and by creating a voluminous paper record of all deliberations.[84]

Despite these various responses, *Trans Union* does not forsake completely the traditional standards for the duty of care and the business judgment rule.[85] The business judgment rule still applies in all cases except those in which a court determines that the directors were grossly negligent in fulfilling their duty of care. With the proper precautions, a board can easily demonstrate that it was not grossly negligent. Thus, the *Van Gorkom* court appears to be clarifying existing standards rather than creating new ones.[86]

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81. *See, e.g.,* Fischel, *supra* note 49, at 1438; *see also id.* at 1455 (referring to *Trans Union* as "one of the worst decisions in the history of corporate law"). Professor Fischel states that the expenses of ohtaining an expert's evaluation of each contemplated transaction and the loss of revenue resulting from directors' fear of risky or aggressive agreements are costs that will affect the corporate shareholders more than anyone else. *Id.* at 1453.

82. *See id.* at 1453.

83. *See id.*

84. *See* Manning, *supra* note 49, at 9-13. Bayless Manning, an attorney with Paul, Weiss, Rifkind, Wharton & Garrison in New York, NY, helieves that directors can comply with the *Van Gorkom* court's requirements hy making copies of all documents and keeping a written record of all steps in a given transaction, including the minutes of all meetings.

85. *See* Comment, *Mining the Safe Harbor?: The Business Judgment Rule after* Trans Union, 10 DEL. J. CORP. L. 545 (1985).

> The *Trans Union* decision did not hreak new ground or introduce radical theories. Rather, it followed the basic standards for the application of the husiness judgment rule established in *Aronson v. Lewis;* namely, that the defense afforded by the rule will be lost if the directors do not act to inform themselves properly prior to making business decisions.

Id. at 567 (footnotes omitted).

86. *See* Prickett, *An Explanation of* Trans Union *to 'Henny-Penny' and Her Friends,* 10 DEL. J. CORP. L. 451 (1985). William Prickett, an attorney with Prickett, Jones, Elliot, Kristel & Schnee in Delaware and the attorney for the plaintiff in *Van Gorkom,* states:

> First, the court could not in the light of pre-existing Delaware law decide the *Trans Union* appeal in any other way, faced with the truly horrendous factual record. Second, the *Trans Union* opinion does not modify or change existing Delaware law in any dramatic way: on the contrary, *Trans Union* simply reaffirms and applies well known legal principles long since plainly stated in familiar Delaware cases. Third, *Trans Union* was not only correctly decided, but is sound precedent reaffirming the basic obligation of due care owed by corporate directors to stockholders.

Id. at 452.

D. *Since* Trans Union

Three subsequent Delaware cases illustrate the effect of *Trans Union* on Delaware corporation law. First, *Unocal v. Mesa Petroleum Co.*[87] applied the business judgment rule to directors' actions, even in the presence of allegations of self-interest. The *Unocal* court, however, required directors to show the reasonableness of their actions before applying the rule in a takeover context.[88] Second, *Moran v. Household International, Inc.*[89] reaffirmed and applied *Unocal's* "reasonableness" test. Finally, *Revlon v. McAndrews & Forbes Holdings, Inc.*[90] refused to apply the business judgment rule and imposed liability on directors who breached their duty of care in creating a lock-up option to avoid a hostile takeover.

Unocal concerned the attempted takeover of Unocal Corporation by Mesa,[91] who owned thirteen percent of Unocal's stock. Mesa presented Unocal with a front-loaded, two-tiered tender offer[92] that Unocal's board of directors[93] rejected as "grossly inadequate."[94] The Unocal board then made a self-tender offer for forty-nine percent of its outstanding shares to all shareholders except Mesa. Mesa brought an action challenging the validity of the self-tender offer.

The *Unocal* court's analysis focused on two questions: (1) whether the board had the authority to oppose the takeover threat; and (2) whether the business judgment rule protected the board's action.[95] The court found that the board had a duty to protect Unocal's shareholders and, therefore, had the authority to oppose

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87. 493 A.2d 946 (Del. 1985).

88. *See infra* notes 91-99 and accompanying text.

89. 500 A.2d 1346 (Del. 1985).

90. 506 A.2d 173 (Del. 1986).

91. "Mesa" was composed of Mesa Petroleum Co., Mesa Asset Co., Mesa Partners II, and Mesa Eastern, Inc.

92. Mesa offered to purchase approximately 37% of the outstanding shares of Unocal at $54 per share. The remaining publicly held shares would be eliminated in exchange for subordinate securities purportedly worth $54 per share. *Unocal,* 493 A.2d at 949.

93. Eight of Unocal's thirteen directors were outside directors. The remaining five were officers. *Id.* at 950.

94. *Id.* At the Unocal board of directors meeting, the board received detailed presentations regarding the valuation of Unocal, whose value was determined to be in excess of $60 per share. Unocal's legal counsel presented various defensive strategies available to the corporation, one of which was a defensive self-tender offer for $70 to $75 per sbare. Unocal's outside directors met with Unocal's financial advisors and agreed to reject Mesa's offer. *Id.*

95. *Id.* at 953.

the takeover attempt with a selective self-tender offer. The court, however, recognized that it should not apply the business judgement rule unquestioningly because of the inherent conflicts of interest for directors opposing the hostile takeover attempt. The court stated that before it would apply the business judgment rule, the "directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership."[96] Directors may satisfy this burden through a showing of good faith and reasonable investigation.[97] The reasonableness of both the directors' apprehensions and their reactions to the threat posed are important tests of a board's good faith.[98] The *Unocal* court concluded that the business judgment rule protected the directors' decisions from judicial second-guessing unless Mesa could show that the directors were motivated by self-interest, fraud, or bad faith.[99]

Unlike *Unocal, Moran* concerned a defensive maneuver prior to any takeover attempt. Acting through its board of directors, Household International, Inc. adopted a "Rights Plan"[100] providing each common stockholder with a preferred stock purchase option. The board adopted this plan not in response to a hostile tender offer, but rather to prevent future takeover attempts.[101] The court found that the board had the authority to adopt such a plan and that the business judgment rule protected the directors' actions even though the plan was not in response to a tender offer.[102] The court reaffirmed *Unocal*'s "reasonableness" test for determining a board's good faith as a prerequisite to applying the business

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96. *Id.* at 955. Whereas *Unocal* placed the initial burden on the directors, Hanson Trust PLC v. ML SCM Acquisitions, Inc., 781 F.2d 264 (2d Cir. 1986), placed the initial burden on the plaintiff. *See infra* notes 176-96 and accompanying text.

97. *Unocal*, 493 A.2d at 955.

98. *Id.* Approval of the action by a majority of outside directors also is evidence of the board's good faith.

99. *Id.* at 958.

100. The Rights Plan, commonly referred to as a "poison pill," provided that stockholders receive one Right per share of common stock upon the occurrence of one of two triggering events. If a bidder announced a tender offer for 30% of Household's stock, the Rights were issued and were exercisable immediately to purchase 1/100 share of a new preferred stock for $100. They also were redeemable for 50 cents per Right. Thus, upon a merger the Right holder could purchase $100 of Household common stock for $50. In addition, if anyone acquired 20% of Household's shares, the Rights were issued, became nonredeemable, and became exercisable to purchase 1/100 share of preferred stock. If the Right was not exercised and a merger later occurred, the holder could exercise each Right to purchase $200 of common stock of the tender offeror for $100. *Moran*, 500 A.2d at 1349.

101. *Id.*

102. *Id.* at 1355-56.

judgment rule.

Revlon concerned a board of directors' defensive reaction to an actual tender offer. Pantry Pride, Inc. announced a hostile tender offer for Revlon, Inc. that Revlon's board considered grossly inadequate.[103] The Revlon board advised the stockholders to reject the offer and instituted its own tender offer for up to ten million shares in exchange for notes and preferred stock.[104] While Pantry Pride continued to make offers for Revlon's shares, Revlon agreed to a leveraged buy-out by Forstmann Little & Co.[105] The buy-out agreement included a lock-up option for Forstmann to purchase certain assets and a cancellation fee to be paid to Forstmann if the transaction was not completed.[106]

The *Revlon* court found that the leveraged buy-out agreement breached the directors' duty of care and, thus, was not protected by the business judgment rule.[107] According to the court, because a board's opposition to a threatened takeover may be motivated by the directors' self-interest, these directors bear the burden of proving the reasonableness of their opposition and of their subsequent actions.[108] Because Forstmann's offer was not significantly different from Pantry Pride's, the board could not reasonably claim that its actions were a response to an offer that would affect Revlon's shareholders adversely. Thus, the directors did not act reasonably to protect the shareholders' interests by entering into an agreement with Forstmann.[109]

Unocal illustrates that Delaware courts still adhere to the business judgment rule. The court's two-element threshold test,[110] which scrutinizes directors' apprehensions over and reactions to

103. Pantry Pride first proposed a friendly acquisition priced between $42 and $43 per share. When Revlon's chairman opposed the transaction, Pantry Pride announced a hostile tender offer at $47.50 per share. Revlon's investment banker advised the corporation that Pantry Pride's offers were grossly inadequate. *Revlon*, 506 A.2d at 176-77.

104. Under the Note Purchase Rights Plan, each shareholder was to receive one Note Purchase Right for each share of common stock. The Right, which entitled the holder to exchange each share of common stock for a $65 principal note, would take effect when anyone acquired 20% of Revlon's shares unless the acquirer purchased all the stock for no less than $65 per share. The Rights were not made available to the acquirer. The Notes issued contained covenants limiting Revlon's ability to incur additional debt. *Id.* at 177.

105. Forstmann Little & Co. is the affiliated limited partnership of Revlon's board of directors.

106. *Revlon*, 506 A.2d at 178.

107. *Id.* at 185.

108. *Id.* at 180 (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (1985)).

109. *Revlon*, 506 A.2d at 184-85.

110. *See* Comment, Unocal Corp. v. Mesa Petroleum Co., 72 VA. L. REV. 851, 866 (1986); *see also supra* text accompanying note 98.

perceived threats, is similar to *Trans Union*'s inquiry into the reasonableness of a board's decisionmaking process.[111] The court emphasized good faith and reasonableness, but exhibited a highly deferential attitude toward directors' actions, especially in light of the discriminatory nature of the self-tender offer and the doubt concerning the directors' motives for opposing Mesa's offer.[112]

Moran followed the *Unocal* analysis closely. *Moran* was an opportunity for the Delaware Supreme Court to apply its *Trans Union* criteria to the self-interest/duty of loyalty area.[113] The court, however, simply reiterated the reasonableness test set forth in *Unocal* and applied the business judgment rule. It appears that placing the initial burden on directors to show the reasonableness of their actions does little to limit the broad discretion afforded directors by the business judgment rule.

The *Revlon* court's refusal to apply the business judgment rule illustrates that the initial burden placed on directors by the *Trans Union* court *is* an actual burden. Both *Unocal* and *Moran* discuss this burden, but both cases find that the directors met the burden despite evidence of self-interest. *Revlon* is proof that the court's decision in *Trans Union* is neither an aberration nor limited to the particular facts of that case.[114]

E. Weinberger v. UOP, Inc.

The Delaware Supreme Court reaffirmed the duty of loyalty requirement for directors and officers in *Weinberger v. UOP, Inc.*[115] The *Weinberger* court held that when a director is involved on both sides of a transaction, the director has the burden of proving the transaction's "essential fairness."[116] The court also created

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111. One commentator states:

> In doctrinal terms, the Delaware Supreme Court's approach raises a new barrier to the directors' invocation of the business judgment rule in tender offer defenses, but the court's application of this new doctrine to the *Unocal* facts suggests that not much has really changed. The court's rhetoric and characterization of the facts reflects the continued permissiveness of the Delaware courts in reviewing the actions of corporate officers.

Comment, *supra* note 110, at 872.

112. *See id.* at 873.

113. *See, e.g.*, Manning, *supra* note 49, at 5.

114. For example, the directors in *Trans Union* read neither the Merger Agreement nor the Amendments before approving them; this may have influenced greatly the court's decision in *Trans Union*. *Revlon* shows that these facts alone were not determinative in the *Trans Union* court's decision.

115. 457 A.2d 701 (Del. 1983).

116. *See id.* at 710.

a new appraisal remedy for plaintiffs[117] and discarded the "business purpose test" set forth in *Singer v. Magnavox, Inc.*[118]

In *Weinberger* Signal Companies, Inc. proposed to acquire control of UOP, Inc. by purchasing UOP's stock at twenty-one dollars per share.[119] UOP's board informed its shareholders that Signal's price was not objectionable based on the fact that UOP's stock had been trading at just under fourteen dollars per share. Signal's offer for over fifty percent of UOP's outstanding shares was successful, thus allowing Signal to elect six directors to UOP's board of thirteen directors. Five of these new directors were directors or employees of Signal.[120] When UOP's president and chief executive officer resigned, Signal replaced him with James Crawford, a senior executive vice-president of a Signal wholly owned subsidiary. Subsequently, Mr. Crawford became a director of both Signal and UOP.

Signal later decided to acquire the remaining outstanding shares of UOP. Signal's executive committee agreed to undertake a cash-out merger for these shares at between twenty and twenty-one dollars per share.[121] Charles Arledge and Andrew Chitiea, each a director of both Signal and UOP, conducted a feasibility study prior to the committee's agreement and determined that a price of up to twenty-four dollars per share would be a good investment for Signal. Mr. Arledge and Mr. Chitiea never disclosed this upper limit to UOP's non-Signal directors.[122] Subsequently, Signal's board adopted a unanimous resolution authorizing the merger, subject to approval by a majority of UOP's outstanding minority shares.[123] UOP's non-Signal directors adopted a resolution to ac-

117. *Id.* at 714.

118. 380 A.2d 969 (Del. 1977). The "business purpose test" requires a director or officer to show, in addition to fairness, that the transaction in question had a valid business purpose.

119. *Weinberger*, 457 A.2d at 704. Signal originally proposed a price of $19 per share. The purchase agreement called for Signal to purchase 1,500,000 shares of UOP's authorized but unissued shares. Signal's purchase was contingent on its success in a tender offer for 4,300,000 publicly held UOP shares at $21 per share. After the acquisition, Signal would possess 50.5% of UOP's outstanding shares. *Id.*

120. *Id.*

121. *See id.* at 705. Mr. Crawford never inquired into the fairness of the price offered by Signal.

122. *Id.* at 705, 707.

123. The resolution set the price at $21 per share and provided that the minority of shares approving the merger must, when added to Signal's 50.5% ownership interest, total at least two-thirds of all UOP shares in order for the merger to be approved. *Id.* at 707. UOP approved the agreement within four business days. *Id.* at 711.

cept Signal's offer on the same day.[124] UOP sent a letter to its shareholders advising them of Signal's offer and urged approval of the merger in its proxy statement.[125] Over fifty-one percent of the total minority shares approved the merger. William Weinberger, one of UOP's minority shareholders, brought an action for recission of the merger or money damages, alleging that the merger failed the business purpose test.

The Delaware Supreme Court reversed the Chancery Court's decision[126] upholding the validity of the cash-out merger. The court's reversal rested largely on the failure of the directors who served on the boards of both Signal and UOP to disclose the findings of the feasibility study to both boards.[127] The court found the contents of the study to be of material significance to UOP and determined that the failure to share the report with UOP directors constituted a breach of the duty of loyalty[128] by the directors who served on both boards. Instead of invoking *Singer's* business purpose rubric, the *Weinberger* court applied the traditional duty of loyalty test, which requires directors who are on both sides of a transaction to bear the burden of establishing "their utmost good faith and the most scrupulous inherent fairness of the bargain."[129] The court concluded that a director of two corporations owes the same duty of loyalty to both corporations.

Rather than perpetuate the *Singer* analysis, *Weinberger* reaffirmed the essential fairness test for the duty of loyalty. A director must show two distinct elements to prove essential fairness: (1) fair dealing; and (2) fair price.[130] Signal's exclusive use of the feasibility

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124. *Id.* at 711.

125. *Id.* at 708. The proxy statement disclosed neither the feasibility study conducted by Mr. Arledge and Mr. Chitiea nor the failure of UOP's directors to suggest any price other than that offered by Signal.

126. Weinberger v. UOP, Inc., 426 A.2d 1333 (Del. Ch. 1981).

127. The court stated that it was "clear from the record tbat neither Arledge nor Cbitiea shared [the feasibility study] with their fellow directors of UOP. We are satisfied that no one else did either. This conduct hardly meets the fiduciary standards applicable to such a transaction." *Weinberger,* 457 A.2d at 708.

128. For a discussion of tbe duty of loyalty, see *supra An Historical Perspective* (Special Project) notes 115-40 and accompanying text. Simply stated, a director or officer owes an undivided loyalty to the corporation and is bound not to compromise tbat loyalty with self-interest.

129. *Weinberger,* 457 A.2d at 710 (citing Gottlieb v. Heyden Cbem. Corp., 91 A.2d 57 (Del. 1952)).

130. The *Weinberger* court explained the two requirements as follows:

[Fair dealing] embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and bow the approvals of the directors and the stockholders were obtained. The [fair price] aspect of fairness relates

study and its failure to disclose the existence of the report precluded a finding of fair dealing.[131] The court remanded the issue of fair price to the trial court to enable a jury to consider the plaintiff's evidence alleging that the shares were worth twenty-six dollars per share.[132] In determining the plaintiff's damages, the court stated that the trial court should consider all relevant factors, including rescissory damages.[133] This new, liberalized appraisal proceeding will allow a court to use any valuation method "generally considered acceptable in the financial community."[134] The court concluded that this expanded appraisal remedy, coupled with the dual fairness analysis, provides minority shareholders with sufficient protection to obviate the need for *Singer's* additional business purpose test.[135]

F. Conclusion

Despite the claims of some commentators, recent Delaware state court decisions have not drastically altered Delaware corporation law. The familiar duty of care, duty of loyalty, and business judgment rule concepts remain intact. Rather than placing a greater standard of care on directors, *Trans Union* merely defines what constitutes gross negligence. Rather than eliminate the business judgment rule, *Zapata* and cases subsequent to *Trans Union* merely demand that a court not apply the rule automatically without examining the directors' actions. Rather than perpetuate the *Singer* analysis, *Weinberger* reaffirms the essential fairness test for the duty of loyalty. Thus, these recent cases tend to clarify rather than change existing law.

III. CASE LAW OF OTHER JURISDICTIONS

Three recent cases decided outside Delaware illustrate how other state courts either have followed or modified Delaware law.

> to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.

Weinberger, 457 A.2d at 711.

131. *Id.* at 711-12.

132. *Id.* at 712-14. The issue of fair value is important in determining the amount of a plaintiff's recovery.

133. *Id.* at 714.

134. *Id.* at 713; *see also* Note, *Minority Shareholders and Cash-out Mergers: The Delaware Court Offers Plaintiffs Greater Protection and a Procedural Dilemma*, 59 WASH. L. REV. 119, 121 (1983).

135. *Weinberger*, 457 A.2d at 715.

In *Miller v. Register & Tribune Syndicate, Inc.*[136] the Iowa Supreme Court adopted the structural bias approach[137] and refused to give a corporation's defendant-directors the power to confer the authority to dismiss a stockholder derivative suit on a special litigation committee.[138] In contrast, the North Carolina Supreme Court, in *Alford v. Shaw*,[139] held that the business judgment rule protects a special litigation committee's decision to dismiss a derivative suit.[140] In *Hanson Trust PLC v. ML SCM Acquisitions, Inc.*[141] the United States Court of Appeals for the Second Circuit, in a decision contrary to Delaware law,[142] placed the initial burden of proving a director's breach of fiduciary duty in a takeover situation on the plaintiff.[143]

A. Miller v. Register & Tribune Syndicate, Inc.

In *Miller* the Iowa Supreme Court recognized the potential for bias if directors who are defendants in a shareholder derivative suit are permitted to appoint a special litigation committee and confer upon that committee the authority to dismiss the suit.[144] Instead, the court required that the defendant-directors ask the court to appoint a "special panel" to determine whether to pursue the action.[145]

In *Miller* a shareholder brought a derivative suit in federal district court against the directors of Register & Tribune Syndicate, Inc., alleging harm to the corporation from the corporation's sale of its stock at fraudulently low prices.[146] While the action was pending in federal court, the four defendant-directors expanded the board to six members, appointed the two new directors to a

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136. 336 N.W.2d 709 (Iowa 1983).

137. *Id.* at 716-18. For a discussion of the structural bias approach, see *supra* note 35.

138. Thus, the Iowa view rejects Delaware's *Zapata* opinion, which upholds the validity of a special litigation committee appointed by the board of directors. *See supra* notes 23-24 and accompanying text.

139. 318 N.C. 289, 349 S.E.2d 41 (1986).

140. *Id.* The New York Court of Appeals previously adopted this position in Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979). The Delaware Supreme Court, however, rejected application of the traditional business judgment rule to decisions of special litigation committees in Zapata v. Maldonado, 430 A.2d 779 (Del. 1981).

141. 781 F.2d 264 (2d Cir. 1986) (applying New York law).

142. *See* Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); *supra* notes 96-97 and accompanying text.

143. *Hanson*, 781 F.2d at 273.

144. Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709 (Iowa 1983).

145. *Id.* at 718.

146. *Id.* at 710.

special litigation committee, and conferred upon this committee the authority to control the action.[147] Register & Tribune subsequently moved for summary judgment, claiming that the committee had determined that the action was not in the best interests of the corporation.[148] The federal court certified the question to the Iowa Supreme Court and directed the Iowa court to apply Iowa law in deciding whether the defendant-directors of a corporation have the authority to appoint a special litigation committee with the power to conduct a shareholder derivative suit.[149]

The Iowa Supreme Court concluded that under the Iowa Business Corporation Act, a corporation may appoint a special litigation committee and confer upon it the power to conduct a derivative suit if the directors appointing the members of the committee are independent and if the corporation's charter and by-laws authorize the action.[150] The court found that Register & Tribune's charter and by-laws allowed delegation to a special litigation committee,[151] but the court refused to recognize this authority when the directors appointing the committee were defendants in an action.[152] The court found support for this proposition in the ALI's

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147. The board adopted the following resolution:

RESOLVED, that the committee shall:

1. Conduct such investigation of the circumstances surrounding all matters referred to, or wbich may be referred to, in the action *Paul B.W. Miller vs. The Register and Tribune Syndicate, Inc., et al*. . . as the committee deems necessary or desirable to determine whether the corporation or anyone acting on the corporation's behalf shall undertake or continue any litigation against one or more of the present or former Directors. . .

2. Make the determination contemplated in 1 above, in the exercise of the committee's business judgment and in good faith; and

3. Undertake and supervise any action necessary or appropriate to implement any such determination; and further. . .

RESOLVED, tbat the determination made by the Independent Litigation Committee shall be final, shall not be subject to review by the Board of Directors, and shall in all respects be binding on the corporation.

Id. at 711.

148. *Id.*

149. *Id.*

150. *Id.* at 714.

151. *Id.* at 715. The relevant provisions within Register & Tribune's charter and bylaws are as follows: (1) Article IV § 2 of the charter: "The board of directors may also appoint such assistant officers, superintendents, managers, and other agents, as may be authorized by the by-laws or by resolution of the board of directors. . . ."; and (2) Bylaw § 3.3: "The Board of Directors, by resolution, may designate from among its members and such other committees of the Board of Directors, each of which shall have and may exercise such authority of the Board of Directors as the resolution of the Board of Directors may provide." *Id.*

152. The court explained:

Principles of Corporate Governance, which require that independent directors appoint special litigation committees.[153] The court further held that defendant-directors may not appoint a special committee to conduct the action. Instead, the court proposed that these defendant-directors ask the court to appoint a special panel to conduct the litigation.

Commentators have criticized the court's decision for two reasons. First, the court failed to formulate a clear test to determine when a special panel should be used.[154] The court stated only that a corporation must request a panel when its directors lack sufficient "independence."[155] Defendant-directors clearly lack independence, but the court stated that directors may lack independence even if they are not named in a suit.[156] Thus, future Iowa courts are left to determine, without clear guidance, when directors are not "independent" and, consequently, are not able to appoint a litigation committee.[157] Second, the court failed to establish the level of judicial deference that courts should give to a panel's decision not to pursue a derivative suit.[158]

B. Alford v. Shaw

Although the Iowa Supreme Court was suspicious of special litigation committees and their potential decisions not to pursue shareholder derivative suits,[159] other jurisdictions have continued to apply a traditional business judgment rule analysis to these decisions.[160] For example, in *Alford v. Shaw*[161] the North Carolina

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It is tacitly, if not expressly, conceded by the defendant corporation and the defendant directors in the present case that the board itself could not seek dismissal of the action against the majority of its own members by invoking the business judgment rule. The question which naturally arises is whether, given this circumstance, the board has the power to delegate to a committee the authority to do that which it may not do itself. *Id.* at 716.

153. *Id.* at 717.

154. *See* Comment, Miller v. Register & Tribune Syndicate, *A New Approach to Special Litigation Committees?*, 9 J. CORP. L. 981, 989 (1984).

155. *Miller*, 336 N.W.2d at 718.

156. *Id.* at 718 & n.3.

157. *See id.* (stating that "wherever we have used the term 'independent director' in our discussion . . . we have intended to encompass directors completely free from any dual relationship which prevents an unprejudiced exercise of judgment").

158. *See* Comment, *supra* note 154, at 989.

159. *See* Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709 (Iowa 1983); *supra* notes 144-58 and accompanying text.

160. *See, e.g.*, Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

161. 318 N.C. 289, 349 S.E.2d 41 (1986).

Supreme Court recently held that the business judgment rule protects special litigation committees' decisions.[162]

In *Alford* the All American Assurance Company (AAA) adopted a resolution establishing a special litigation committee empowered to conduct derivative actions.[163] In 1982 minority shareholders brought suit against AAA, alleging that the directors had engaged in unlawful and fraudulent transactions to the detriment of the corporation.[164] The special litigation committee investigated the allegations and recommended that some of the claims be settled and that the remaining claims not be asserted. Pursuant to the committee's recommendation, AAA settled the specified claims, moved for approval of the settlement agreement, and moved for summary judgment on the remaining claims.[165] The district court granted summary judgment, applying the business judgment rule to the committee's decision to dismiss the cliams. The court of appeals reversed and applied the rule established in *Miller v. Register & Tribune Syndicate, Inc.*,[166] which states that defendant-directors cannot confer the authority to conduct a derivative suit on a litigation committee. The North Carolina Supreme Court, however, reversed.

The North Carolina Supreme Court discussed the following conflicting views surrounding judicial deference to special litigation committees' decisions:[167] (1) *Auerbach*'s application of the traditional business judgment rule;[168] (2) *Zapata*'s application of the business judgment rule in demand-refused cases and its applica-

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162. The North Carolina Court of Appeals previously refused to apply the business judgment rule to a special litigation committee's decision to dismiss an action in which the directors allegedly breached their fiduciary duty. Alford v. Shaw, 72 N.C. App. 537, 540, 324 S.E.2d 878, 881 (1985), *rev'd*, 318 N.C. 289, 349 S.E.2d 41 (1986).

163. *Alford*, 318 N.C. at 290, 349 S.E.2d at 42.

164. These allegedly unlawful and fraudulent transactions included:

> [1] failing to exercise an option to purchase shares of AAA stock from Great Commonwealth Life Insurance Company (GCL) and a failure to exercise a "put" to sell shares of AAA stock to American Commonwealth Financial Corporation (ACFC); [2] paying excessive amounts to affiliate companies for administrative expenses; [3] entering into certain allegedly improper reinsurance and co-insurance agreements; [4] redeeming certain 8% debentures held by affiliated companies; [5] releasing American Bank and Trust Company (ABTC), Baton Rouge, Louisiana, from an obligation to purchase an office building; and [6] engaging in other allegedly improper transactions with affiliates, including unsecured loans and joint ownership of airplanes.

Id. at 292, 349 S.E.2d at 44.

165. *Id.* at 292, 349 S.E.2d at 43.

166. *See supra* notes 144-58 and accompanying text.

167. *See Alford*, 318 N.C. at 294-95, 349 S.E.2d at 49-50.

168. *See supra* note 26 and accompanying text.

tion of a two-step test in demand-excused cases;[169] and (3) *Miller*'s view that defendant-directors are not competent to appoint a valid litigation committee.[170] The *Alford* court summarily rejected *Miller*'s view because it was not "in the best interests" of North Carolina's corporate community.[171] The court also rejected *Zapata*'s two-step test, concluding that this two-step analysis was merely an "illusory improvement" because it lacked a clear standard to determine how a court should apply its own business judgment.[172] Instead, the court adopted the *Auerbach* view and applied the business judgment rule to the special litigation committee's decisions. The court limited its inquiry to whether the committee had been composed of independent directors who acted in good faith.[173] The court, however, modified *Auerbach*'s approach and placed the burden of proving disinterestedness and independence on the defendants.[174] Thus, in North Carolina defendant-directors must affirmatively show their independence and good faith; they cannot rely on the plaintiff's failure to show bad faith.[175]

C. Hanson Trust PLC v. ML SCM Acquisitions, Inc.

In *Unocal Corp. v. Mesa Petroleum Co.*[176] the Delaware Supreme Court emphasized that, under Delaware law, defendant-directors acting in a takeover context have the initial burden of showing the reasonableness of their actions. In *Hanson Trust PLC v. ML SCM Acquisitions, Inc.*,[177] however, the United States Court of Appeals for the Second Circuit held that, under New York law, the plaintiff bears this burden.[178]

In *Hanson*, Hanson Trust PLC, a corporation of the United Kingdom, announced a tender offer for the common stock of SCM,

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169. *See supra* notes 23-34 and accompanying text.

170. *See supra* notes 144-58 and accompanying text.

171. *Alford*, 318 N.C. at 295, 349 S.E.2d at 50. The court did not explain why such a view was not "in the best interests" of the state's corporate community.

172. *Id.* at 296-97, 349 S.E.2d at 52.

173. *Id.*

174. *Id.* "We believe that careful application of this modified *Auerbach* rule to determine the disinterested independence and good faith of the committee memhers and the appropriateness and sufficiency of the investigative procedures provides sufficient judicial safeguards." *Id.*

175. *Id.* at 297, 349 S.E.2d at 53.

176. 493 A.2d 946 (Del. 1985); *see supra* notes 91-99 and accompanying text.

177. 781 F.2d 264 (2d Cir. 1986).

178. Nevertheless, the court granted the plaintiff's request for an injunction because the plaintiff met its burden of proving a breach of fiduciary duty.

a New York corporation, on August 21, 1985.[179] The board of SCM met on August 25 to consider alternatives to Hanson's offer. These alternatives included finding a white knight or pursuing a leveraged buy-out. After negotiations, SCM's management reached a leveraged buy-out agreement with Merrill Lynch, Pierce, Fenner & Smith, subject to the approval of SCM's board.[180] Goldman Sachs & Co., SCM's investment banker, informed the board that Merrill Lynch's bid was fair to the shareholders. On September 3 SCM's nine independent directors unanimously approved the agreement; the three inside directors did not participate in the vote. On the same day, Hanson raised its offering price above that offered by Merrill Lynch, conditioned on SCM's refraining from granting any person any type of lock-up device.[181]

On September 6 Merrill Lynch and SCM terminated their original agreement and began negotiations for a new one. A proposal that included a lock-up option for Merrill Lynch to purchase two of SCM's divisions was presented to SCM's board on September 10.[182] Goldman Sachs again advised that the offer was fair, but the board did not discuss the fair value of the two optioned businesses. The nine independent directors unanimously approved the agreement.[183] On September 11 Hanson terminated its latest offer and purchased twenty-five percent of SCM's stock on the open

179. *Hanson*, 781 F.2d at 268. The offer was $60 per share for SCM's common stock. The SCM stock was trading at less than $50 in July 1985. Between August 1 and August 19, however, Hanson purchased 87,000 shares of SCM stock for $54 to $56. The day after the announcement of Hanson's offer, SCM stock closed at 64⅛.

180. *Id.* at 268-69. The agreement called for Merrill Lynch to form ML SCM Acquisitions, Inc., a corporate shell that would make a $70 cash tender offer for up to 10,500,000 SCM shares—approximately 85% of the outstanding shares. *Id.* at 269. The second step in implementing the agreement gave remaining shareholders a choice between exchanging their shares for high-risk, high-yield bonds—junk bonds—valued at $70 per share, or resorting to their appraisal rights as provided by law. SCM management had the right to purchase up to 15% of the newly formed corporation. Merrill Lynch insisted on some assurance that it would profit from its efforts to help SCM defeat Hanson's takeover attempts. Therefore, SCM granted Merrill Lynch a $1.5 million engagement fee and a $9 million break-up fee, wbicb was to be paid if a third party acquired more than one-third of SCM's shares.

181. *Id.* at 270.

182. The terms of the proposal called for a $74 cash tender offer for a minimum of two-thirds, and a maximum of four-fifths, of SCM's common stock. The second step provided that the remaining shares he exchanged for junk bonds. In exchange, SCM agreed to put the $9 million break-up fee in escrow and paid an additional $6 million engagement fee. The most important provision required that SCM grant Merrill Lynch an irrevocable option to purchase SCM's Pigments and Consumer Foods divisions (the lock-up). *Id.* These businesses represented approximately 50% of SCM's sales. *Id.* at 271.

183. *Id.*

market.[184] Hanson later purchased over five hundred thousand additional shares of SCM. On October 8 Merrill Lynch announced its intention to exercise its lock-up option to purchase the two divisions.[185] Hanson brought a motion to enjoin the exercise of this lock-up option, but the district court denied tbe motion.[186]

The United States Court of Appeals for the Second Circuit considered whether the business judgment rule protected the SMC directors' decision to approve the lock-up option. The court held that directors enjoy a presumption of propriety in making business decisions and placed the burden of proving a breach of fiduciary duty on the plaintiff.[187] The court, however, reversed the district court and granted the plaintiff's injunction because the plaintiff produced sufficient evidence indicating a breach of fiduciary duty.[188] The court acknowledged that directors must fulfill their duty of care during the decisionmaking process before a court can apply the business judgment rule to their final decision.[189] Thus, the court compared SCM's directors' actions with those of Trans Union's directors.[190] The *Hanson* court, like the *Trans Union* court, questioned the directors' failure to obtain a valuation of their company and their failure to read carefully the various agreements.[191] Once the plaintiff presented prima facie evidence of a breach of the duty of care, the burden shifted to the defendants to justify their actions. Because the plaintiff met this initial burden, the district court erred in not considering evidence on the value of the optioned businesses. The defendants failed to rebut the plaintiff's evidence showing a breach of the duty of care.[192] Therefore, because the plaintiffs presented sufficient evidence to raise questions regarding the propriety of the directors' actions, the court enjoined the lock-up options, fearing that the options might have re-

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184. In Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985), the court held that these transactions did not constitute a *de facto* tender offer.

185. *Id.* Merrill Lynch also withdrew the $9 million break-up fee that had been held in escrow.

186. *See* Hanson Trust PLC v. SCM Corp., 623 F.Supp. 848 (S.D.N.Y. 1985), *rev'd sub. nom* Hanson Trust PLC v. ML SCM Acquisitions, Inc., 781 F.2d 264 (2d Cir. 1986). The district court held that the business judgment rule protected the directors' decision to grant the option.

187. *Hanson*, 781 F.2d at 273.

188. *Id.* at 283.

189. *Id.* at 275.

190. *See supra* note 65 (discussing the Trans Union directors' actions).

191. *Hanson*, 781 F.2d at 276.

192. *Id.* at 281.

sulted in irreparable harm[193] to SCM before the court could reach a decision on the merits.[194]

The majority in *Hanson* held that the plaintiff has the initial burden of showing a director's breach of fiduciary duty. This holding directly contradicts *Unocal* and Delaware corporation law, which place the burden on the defendant-director. The *Hanson* court's analysis, however, is similar to that used in *Trans Union.*[195] The court required that the directors take steps to inform themselves adequately before the business judgment rule would be applied to their ultimate decision. Thus, the plaintiff's burden of rebutting a director's presumption of propriety is not as great. To remove the protection of the business judgment rule and place the burden of justifying their actions on the directors, the plaintiff merely must show that the directors did not avail themselves of information reasonably available.[196]

D. Conclusion

The above cases, like the recent Delaware cases, are not significant deviations from existing corporate law; rather, they merely serve to clarify existing law. *Hanson* and *Alford* appear to favor directors and officers more than Delaware law, thereby providing evidence that Delaware actually may not be leading the "race to the bottom." Conversely, *Miller* appears to approach more closely the structural bias view. Therefore, as in Delaware, the traditional concepts of director and officer liability survive in other jurisdictions, but with a few modifications.

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193. The court stated:

> Once shareholders tender into the SCM-Merrill Lynch $74 offer, the company will essentially become privately held, and Hanson would be virtually precluded from seeking to acquire it, short of the virtually inconceivable possibility of judicial valuation and forced sale. It certainly seems "doubtful that any damage claim against the directors can reasonably be a meaningful alternative."

Id. at 283 (quoting Gimbel v. Signal Co., 316 A.2d 599, 603 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974)).

194. *Hanson*, 781 F.2d at 283.

195. *See supra* notes 64-67 and accompanying text.

196. *Hanson*, 781 F.2d at 277. The dissent expressed its displeasure with the court's holding, stating that "while purporting to apply the business judgment rule, the majority proceeds to engage in extensive explanation of asset valuation of the sort normally reserved to corporate directors." *Id.* at 286 (Kearse, J., dissenting).

IV. Statutory Developments

Although judicial decisions are responsible for much of the reform in corporation law in recent years, legislators also have made several statutory changes. The Revised Model Business Corporation Act[197] and the ALI's Principles of Corporate Governance[198] are attempts to codify and define more clearly the standards of conduct for directors and officers. Likewise, in 1986 significant modifications in some state corporation statutes were instituted in response to the increasing impact of director and officer liability and the apparent lack of D&O liability insurance.[199]

Indiana's revision of its General Corporation Act, which has not been reviewed completely since its establishment in 1929,[200] effectively eliminates the duty of care for directors.[201] The Indiana statute, which became effective in April 1986, states that a director will not be held liable for any action or any failure to take action unless the director is found to have engaged in willful misconduct or to have exhibited recklessness.[202] By adopting a willful misconduct or recklessness standard, the Indiana legislature appears to have extended the gross negligence standard reaffirmed by recent case law[203] and clearly has forsaken the traditional common-law standard of "that degree of care that an ordinarily prudent director or person in a like position would exercise under similar circumstances."[204] Thus, even in the presence of gross negligence,[205]

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197. *See infra Revised Model Act* (Special Project).

198. *See infra ALI Proposals* (Special Project).

199. *See, e.g.*, Del. Code Ann. tit. 8, § 102(b)(7) (Supp. 1986); Ind. Code Ann. § 23-1-35-1(e) (Burns Supp. 1986); *see also* Futter & Gross, *Charter Amendment Offers Way Out of D&O Crisis*, Legal Times, June 9, 1986, at 11; *infra Insurance* (Special Project) (discussing the D&O insurance crisis).

200. *See* Galante, *Developments in Business Association Law*, 19 Ind. L. Rev. 67, 92 (1986).

201. *See* Ind. Code Ann. § 23-1-35-1(e) (Burns Supp. 1986). The Indiana statute provides:

> A director is not liable for any action taken as a director, or any failure to take any action, unless:
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> (1) The director has breached or failed to perform the duties of the director's office in compliance with this section; and
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> (2) The breach or failure to perform constitutes willful misconduct or recklessness.

Id.

202. *See id.; see also* Futter & Gross, *supra* note 199.

203. *See supra* notes 65-67 and accompanying text.

204. *See supra An Historical Perspective* (Special Project) note 12 and accompanying text.

205. The fact situation presented in *Trans Union* is an excellent example of gross negligence.

directors and officers in Indiana will be free from liability.

A new provision in Delaware's General Corporation Act accomplishes the same result through a different approach.[206] The amendment allows a corporation, in its certificate of incorporation, to eliminate or limit liability for a director's breach of the duty of care.[207] The effect of either provision is the same: if a Delaware corporation's shareholders agree to amend the certificate of incorporation to eliminate liability for a director's breach of the duty of care pursuant to the statute, the duty of care effectively is eliminated, thus creating a result similar to that obtained under the Indiana statute.

These statutory amendments attempt to solve the current crisis caused by the increasing liability of corporate directors and officers[208] and the decreasing availability of D&O liability insurance.[209] If the two statutes discussed above are an indication of state legislatures' dissatisfaction with increased director and officer liability, then more statutory amendments with lenient standards may appear.[210] The legislatures' dissatisfaction stems from fear that qualified individuals, unwilling to risk potential liability, will

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206. *See* DEL. CODE ANN. tit. 8, § 102 (b)(7) (Supp. 1986). The Delaware statute provides:

> (b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:
>
> . . .
>
> (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director:
>
> (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this Title; or (iv) for any transaction from which the director derived an improper personal benefit.

Id. Thus, the new provision allows a corporation to eliminate or limit liability for a breach of tbe duty of care, but not for a breach of the duty of loyalty. This result is logical because the general measure of damages for a breach of the duty of loyalty is restitution, which usually is less than the potentially limitless damages awarded for a breach of the duty of care. *See* Futter & Gross, *supra* note 199, at 12.

207. *See* DEL. CODE ANN. tit. 8, § 102 (b)(7) (Supp. 1986).

208. *See* Futter & Gross, *supra* note 199.

209. For a discussion of the current D&O liability insurance crisis, see *infra Insurance* (Special Project) notes 11-19.

210. New York recently enacted an amendment to its corporation statute allowing a corporation, in its charter, to grant directors greater indemnificaiton rights than those formerly permitted by the state's corporation statute. *See infra Indemnification* (Special Project) notes 103-104 and accompanying text.

refuse to serve as directors on corporate boards.[211] Because outside directors are so vital to the functioning of the corporate governance system, it would not be surprising to see more states pass legislation addressing this issue.

PATRICIA A. DANIEL

211. This fear may be a result, in part, of some commentators misreading *Trans Union* and other recent court decisions. *See, e.g.*, Prickett, *supra* note 86 (comparing the reaction to *Trans Union* to Henny-Penny's reaction ("The sky is falling!") to a pea falling on her head).