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S.B. 174: Ohio Defines a New Standard of Care for Corporate Directors

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S.B. 174: OHIO DEFINES A NEW STANDARD OF CARE FOR CORPORATE DIRECTORS

INTRODUCTION

A definition of a corporate director's legal duty and corresponding potential for personal liability involves a delicate balance. Such a definition should insure that the corporation's directors will adequately represent the shareholders' interests, yet it must not so rigidly impose liability on the directors that talented individuals will be discouraged from becoming directors.[1] At the same time, some certainty in the application of a standard may be as important for directors as a lack of rigidity.[2] The Ohio legislature has used The Model Business Corporations Act[3] as its source in an effort to achieve this balance through Senate Bill 174.[4]

S.B. 174 creates a statutory standard of care for directors of business corporations and for trustees of nonprofit corporations.[5] This statutory standard of care has expanded[6] upon the standard of care already present in Ohio case law.[7]

Although directors and trustees of corporations already had the authority to create a committee or committees of directors or trustees,[8] S.B. 174 extends to these committees of directors and committees of trustees the privilege of holding meetings via electronic communications equipment.[9] This privilege has already been granted the full board of directors[10] and board trustees.[11] In addition, the bill recognizes that much of the day-to-day authority for running the corpora-

1. Miller, *The Fiduciary Duties of a Corporate Director*, 4 U. BALT. L. REV. 259 (1975) [hereinafter cited as Miller].

2. Conard, *A Behavioral Analysis of Directors' Liability for Negligence*, 1972 DUKE L.J. 895.

3. ABA-ALI MODEL BUS. CORP. ACT (1971).

4. Amended Senate Bill No. 174: Remarks by Frank R. Morris, Columbus, Ohio, Witness for the Ohio State Bar Association Before the House Judiciary Committee, February 12, 1980, 1 [hereinafter cited as Morris] (on file with the University of Dayton Law Review).

5. *Id.* at 1. *See* notes 20 and 28 *infra*.

6. Morris, *supra* note 4, at 1.

7. Goff v. Emde, 32 Ohio App. 216, 167 N.E. 699 (1928).

8. *See* OHIO REV. CODE ANN. § 1701.63 (Page 1978) (regarding committees of directors for business corporations). *See Id.* § 1702.33 (regarding committees of trustees for nonprofit corporations).

9. Morris, *supra* note 4, at 2.

10. OHIO REV. CODE ANN. § 1701.61(B) (Page 1979).

11. *Id.* § 1702.31(B).

tion has been delegated by the directors or trustees to the officers and employees of the corporation.[12]

The bill also contains a new provision that allows contracts between an interested trustee and the nonprofit corporation he serves.[13] This addition to Ohio law regarding nonprofit corporations parallels an already existing provision regarding business corporations.[14]

SECTIONS OF OHIO LAW AFFECTED

S.B. 174 amends two sections of Ohio law regarding business corporations and two sections regarding nonprofit corporations. It also adds a new section to Ohio law regarding nonprofit corporations.

Sections 1701.59[15] and 1701.63[16] are the amended sections regarding business corporations. In section 1701.59 (A),[17] the phrase "or under the direction of" has been added to the definition of a director's authority. The addition of this phrase acknowledges that many of the day-to-day decisions in managing a corporation are made by its officers and employees.[18]

The bill has discarded the language of the former section 1701.59 (B)[19] and replaced it with a greatly expanded section (B).[20] This new

12. Morris, *supra* note 4, at 1. *See also* notes 17 and 26 *infra*.
13. Morris, *supra* note 4, at 3. *See* note 32 *infra*.
14. OHIO REV. CODE ANN. § 1701.60 (Page 1979).
15. *Id.* § 1701.59 (Page Supp. 1980).
16. *Id.* § 1701.63.
17. The previous § 1701.59(A) had provided: "(A) Except where the law, the articles, or the regulations require action to be authorized or taken by shareholders, all of the authority of a corporation shall be exercised by its directors. For their own government the directors may adopt bylaws not inconsistent with the articles or the regulations." *Id.* § 1701.59(A) (Page 1979). The amended § 1701.59(A) states: "(A) Except where the law, the articles, or the regulations require action to be authorized or taken by shareholders, all of the authority of a corporation shall be exercised by *or under the direction of* its directors. For their own government, the directors may adopt bylaws *that are* not inconsistent with the articles or the regulations." *Id.* § 1701.59(A) (Page Supp. 1980) (emphasis added).
18. Morris, *supra* note 4, at 1.
19. The former § 1701.59(B) stated:
(B) In discharging his duties, a director may, when acting in good faith, rely upon the books and records of the corporation, upon reports made to the corporation by an officer or employee or by any other person selected for the purpose with reasonable care by the corporation, and upon financial statements or written reports prepared by an officer or employee of the corporation in charge of its accounts or certified by a public accountant or firm of public accountants.
Id § 1701.59(B) (Page 1978).
20. The new § 1701.59(B) states:
(B) A director shall perform his duties as a director, including his duties as a member of any committee of the directors upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would

section 1701.59 (B) contains a standard of care for corporate directors. The bill has also added a subsection (C)[21] to section 1701.59 that indemnifies the corporate directors from personal liability when the standard of care in section 1701.59 (B) has been met.

The bill makes some minor stylistic changes in sections 1701.63 (A)[22] and (B).[23] But the significant change in section 1701.63 has been the addition of a new subsection (E)[24] that allows committee meetings of directors to be held via electronic communications equipment.

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use under similar circumstances. In performing his duties, a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, that are prepared or presented by:
(1) One or more directors, officers, or employees of the corporation whom the director reasonably believes are reliable and competent in the matters prepared or presented;
(2) Counsel, public accountants, or other persons as to matters that the directors reasonably believes are within the person's professional or expert competence;
(3) A committee of the directors upon which he does not serve, duly established in accordance with a provision of the articles or the regulations, as to matters within its designated authority, which committee the director reasonably believes to merit confidence.

Id. § 1701.59(B) (Page Supp. 1980).

21. The new § 1701.59(C) provides:
(C) For purposes of division (B) of this section, a director shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would cause reliance on information, opinions, reports, or statements that are prepared or presented by the persons described in divisions (B)(1) to (3) of this section, to be unwarranted. A person who, as a director of a corporation, performs his duties in accordance with division (B) of this section shall have no liability because he is or has been a director of the corporation.

Id. § 1701.59(C).

22. Section 1701.63(A) has been changed from:
(A) The regulations may provide for the creation by the directors of an executive committee or any other committee of the directors, to consist of not less than three directors, and may authorize the delegation to any such committee of any of the authority of the directors, however conferred, other than that of filling vacancies among the directors or in any committee of the directors.

now to read:
(A) The regulations may provide for the creation by the directors of an executive committee or any other committee of the directors, to consist of not less than three directors, and may authorize the delegation to any such committee of any of the authority of the directors, however conferred, other than *the authority* of filing vacancies among the directors or in any committee of the directors.

Id. § 1701.63(A) (emphasis added).

23. Section 1701.63(B) has been changed from: "The directors may appoint one or more directors as alternate members of any such committee, who may take the place of any absent member or members at any meeting of such committee" now to read: "(B) The directors may appoint one or more directors as alternate members of any such committee, who may take the place of any absent member or members at any meeting of *the particular* committee." *Id.* § 1701.63(B) (emphasis added).

24. The new provision contained in S.B. 174 states:
(E) Unless participation by members of any such committee at a meeting by means

This bill also changes Ohio law regarding nonprofit corporations. Subsection 1702.30 (A)[25] has been amended with the phrase "or under the direction of"[26] to reflect the same recognition of trustees' delegation of day-to-day authority that had prompted the change in subsection 1701.59 (A). Similarly, subsection 1702.30 (B)[27] has been completely changed[28] so it now contains a standard of care for trustees of a nonprofit corporation. Trustees of nonprofit corporations are now indemnified from personal liability by the addition of subsection 1702.30 (C),[29] as long as they meet the standard of care outlined in 1702.30 (B).

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of communications equipment is prohibited by the articles, the regulations, or any order of the directors, meetings of the particular committee may be held through any communications equipment if all persons participating can hear each other. Participation in a meeting pursuant to this division constitutes presence at the meeting.

Id. § 1701.63(E).

25. Section 1702.30(A) had been: "(A) Except where the law, the articles, or the regulations require that action be otherwise authorized or taken, all of the authority of a corporation shall be exercised by its trustees. For their own government [sic] the trustees may adopt bylaws not inconsistent with the articles or the regulations." *Id.* § 1702.30(A) (Page 1978).

26. The amended § 1702.30(A) provides: "(A) Except where the law, the articles, or the regulations require that action be otherwise authorized or taken, all of the authority of a corporation shall be exercised by *or under the direction of* its trustees. For their own government, the trustees may adopt bylaws *that are* not inconsistent with the articles or the regulations." *Id.* § 1702.30(A) (Page Supp. 1980) (emphasis added).

27. The previous § 1702.30(B) had been:

(B) In discharging his duties, a trustee may, when acting in good faith, rely upon the books and records of the corporation, upon reports made to the corporation by an officer or employee or by any other person selected for the purpose with reasonable care by the corporation and upon financial statements or written reports prepared by an officer or employee of the corporation in charge of its accounts or certified by a public accountant or firm of public accountants.

Id. § 1702.30(B) (Page 1978).

28. The amended § 1702.30(B) provides:

(B) A trustee shall perform his duties as a trustee, including his duties as a member of any committee of the trustees upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would use under similar circumstances. In performing his duties, a trustee is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, that are prepared or presented by: . . . .

Id. (Page Supp. 1980).

29. The new § 1702.30(C) states:

(C) For purposes of division (B) of this section, a trustee shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would cause reliance on information, opinions, reports, or statements that are prepared or presented by the persons described in divisions (B)(1) to (3) of this section, to be unwarranted. A person who, as a trustee of a corporation, performs

A minor stylistic change has been made in subsection 1702.33 (C).[30] The addition of a new subsection (E)[31] to 1702.33 allows committees of trustees to conduct meetings via electronic communications equipment.

This bill adds a new section, 1702.301,[32] to Ohio law regarding

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his duties in accordance with division (B) of this section shall have no liability because he is or has been a trustee of the corporation.

Id. § 1702.30(C).

30. The previous § 1702.33(B) had been: "(C) The trustees may appoint one or more trustees as alternate members of any such committee, who may may [sic] take the place of any absent member or members at any meeting of such committee." *Id.* § 1702.33(B) (Page 1978). It has been changed to: "(C) The trustees may appoint one or more trustees as alternate members of any such committee, who may take the place of any absent member or members at any meeting of *the particular* committee." *Id.* (Page Supp. 1980) (emphasis added).

31. The new § 1702.33(E) states:

(E) Unless participation by members of any such committee at a meeting by means of communications equipment is prohibited by the articles, the regulations, or an order of the trustees, meetings of the particular committee may be held through any communications equipment if all persons participating can hear each other. Participation in a meeting pursuant to this division constitutes presence at the meeting.

OHIO REV. CODE ANN. § 1702.33(E) (Page Supp. 1980).

32. The complete text of § 1702.301 is:

(A) Unless otherwise provided in the articles or the regulations:

(1) No contract or transaction is void or voidable with respect to a corporation because the contract or transaction is between the corporation and one or more of the corporation's trustees or officers, or between the corporation and any other person in which one or more of the corporation's trustees or officers are directors, trustees, or officers, or in which one or more of the corporation's trustees or officers have a financial or personal interest; or because one or more interested trustees or officers participate in or vote at the meeting of the trustees or a committee of the trustees that authorizes the contract or transaction, if any of the following apply:

(a) The material facts as to his or their relationship or interest and as to the contract or transaction are disclosed or are known to the trustees or the committee, and the trustees or committee, in good faith reasonably justified by the material facts, authorize the contract or transaction by the affirmative vote of a majority of the disinterested trustees, even though the disinterested trustees constitute less than a quorum;

(b) The material facts as to his or their relationship or interest and as to the contract or transaction are disclosed or are known to the members entitled to vote on the contract or transaction and the contract or transaction is specifically approved at a meeting of the members held for the purpose of voting on the contract or transaction, by the affirmative vote of a majority of the voting members of the corporation who are not interested in the contract or transaction;

(c) The contract or transaction is fair as to the corporation as of the time it is authorized or approved by the trustees, a committee of the trustees, or the members.

(2) Common or interested trustees may be counted in determining the presence of

nonprofit corporations. This new section allows for contracts between an interested trustee and the corporation.

ANALYSIS

A. *Promotes Uniformity of Law among Jurisdictions*

The changes in Ohio corporate law enacted by S.B. 174 were based[33] on The Model Business Corporations Act.[34] These changes may have been prompted by a desire for some uniformity with other states.[35] Certainly, with the increased complexity of corporate structures stretching beyond not merely state boundaries but even national borders, a uniformity of some standards to be imposed on corporate directors and trustees from jursidiction to jurisdiction is both practical and desirable.[36] Uniform standards for corporate directors would help alleviate uncertainty regarding potential liability of directors residing in one state while presiding over a corporation located in another state. Uniform standards would help eliminate conflict of laws problems inherent with a corporation chartered in one state controlling a corporation chartered in another state.

Uniformity of corporate law as a goal in itself assumes that the uniform law will exhibit the same high degree of care in draftsmanship

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a quorum at a meeting of the trustees, or of a committee of the trustees that authorizes the contract or transaction.

(3) The trustees, by the affirmative vote of a majority of those in office, and irrespective of any financial or personal interest of any of the trustees, shall have authority to establish reasonable compensation, which may include pension, disability, and death benefits, for services to the corporation by trustees and officers, or to delegate that authority to establish reasonable compensation to one or more officers or trustees.

Id. § 1702.301(A).

33. Morris, *supra* note 4, at 3.

34. MODEL BUS. CORP. ACT ANN. §§ 41 & 48 (2d ed. 1971).

35. As of 1977, one state had enacted a provision identical with § 41 of the Model Business Corporations Act, concerning directors' conflict of interest contracts; eight states including Ohio, had enacted comparable provisions. MODEL BUS. CORP. ACT ANN. § 41, ¶¶ 3.01-3.02, 309 (2d ed. Supp. 1977). Ohio has here extended this privilege to trustees of a nonprofit corporation. *Id.*

One state had enacted a provision identical in substance with section 48, concerning a director's liability; forty-four states, including Ohio, had enacted comparable provisions. *Id.* § 48 at 367. Twelve states had enacted a provision identical with section 43, concerning committee meetings via communications equipment; fifteen had enacted comparable provisions. *Id.* § 43 at 338.

36. *See generally* Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078 (1968); Conard, *A Behavioral Analysis of Directors' Liability for Negligence*, 1972 DUKE L.J. 895; Eisenberg, *The Model Business Corporation Act and the Model Business Corporation Act Annotated*, 29 BUS. L. 1407 (1974); Farrell & Murphy, *Comments on the Theme: "Why Should Anyone Want to Be a Director?"*, 27 BUS. L. 7 (special issue, Feb. 1972); and Miller, *supra* note 1.

as other unifrom laws.[37] At least one commentator has suggested that The Model Business Corporation Act does not exhibit the same desirability as other uniform codes because of the bias in its drafting.[38] Eisenberg demonstrates that, as promulgated, The Model Business Corporation Act was composed by a committee of practicing attorneys with a corporate clientele.[39] Consequently, the Act reflects this predominance of corporate viewpoint by insulating directors from liability for acts except those of the grossest negligence.[40] Eisenberg identifies three classes of attorneys that should be represented on a drafting committee for a uniform corporation act: (1) academics with a corporations specialization; (2) practicing attorneys with a corporate clientele; and (3) practicing attorneys with a shareholder clientele.[41] This mixture of represented viewpoints would help insure that the various needs of corporate law could be fulfilled more adequately.[42] The directors' authority would not be so limited that the corporation would be powerless to act.[43] Yet directors' liability would not be so great that any experienced business person would be discouraged from becoming a director.[44] The shareholders' interests could also be protected.[45] These results would promote uniformity of corporate law that would benefit shareholders, corporations, and the public rather than be aimed primarily at insulating directors from liability.

B. Standard of Care for Directors of Corporations

1. Statutory Standard

A major focus of S.B. 174 is the creation of a statutory standard of care for directors of a corporation. While previous Ohio case law had established a standard of care for corporate directors,[46] such a standard had been lacking in Ohio statutes.[47] The newly enacted standard of care contains three basic requirments regarding a director's actions. He must act (1) in good faith; (2) in what he reasonably believes

37. *See* Eisenberg, note 36 *supra*, for a comparison of the drafting history of the Model Business Corporations Act with that of other Model Acts, such as the Uniform Commercial Code and Model Penal Act.

38. Eisenberg, *supra* note 36.

39. *Id.* at 1410.

40. *Id.* at 1427. *See also* Miller, *supra* note 1, at 270.

41. Eisenberg, *supra* note 36, at 1408.

42. *Id.* at 1409.

43. *Id.* at 1422.

44. *Id.*

45. *Id.* at 1421.

46. Goff v. Emde, 32 Ohio App. 216, 167 N.E. 699 (1928); Odd Fellows' Beneficial Ass'n v. Ferguson, 3 Ohio C.C. 84 (1888).

47. Morris, *supra* note 4, at 2.

to be the best interests of the corporation; and (3) as an ordinarily prudent person in a like position.[48]

The first requirement for the corporate director is a duty of good faith.[49] Although a good faith provision had been part of section 1701.59 (B) before it was amended by S.B. 174, that good faith language did not formulate a standard of conduct. Prior to the enactment of S.B. 174, the statute merely specified that "[A] director may, when acting in good faith, rely upon the books and records of the corporation . . . ."[50] Consequently, this good faith provision was limited to qualifying when a director might rely on the books and records supplied by corporate officers, but it did not impose a general standard of conduct. The language of this new provision creates a more general duty of good faith to be applied to all the directors' duties, not merely his reliance on the books and records. The new enactment specifies that "[A] director shall perform his duties as a director . . . in good faith . . . ."[51]

The second requirement is that the director act "in a manner he reasonably believes to be in the best interests of the corporation."[52] Since courts are reluctant to substitute their judgment of what is in the best interests of the corporation for that of the directors,[53] this requirement adds little to the good faith requirement. For example, when one corporation owns an option to purchase the controlling interest in another corporation but refuses to exercise it, a court will be reluctant to substitute its judgment for that of the directors, even when the same party or parties are directors of both corporations.[54] Similarly, when a closely held corporation refuses to declare a dividend, a minority stockholder would have difficulty proving the directors' dividend policy was not in the best interests of the corporation, even when the president of the corporation was also its majority stockholder and controlled the board of directors.[55] Other courts have been reluctant to interfere in the internal affairs of a corporation because the stockholders had sufficient means at their disposal within the corporate structure to

48. *See* note 20 *supra*.
49. *Id.*
50. *See* note 19 *supra*.
51. *See* note 20 *supra*.
52. *Id.*
53. *See* note 78 and accompanying text *infra*.
54. Gottlieb v. Mead, 72 Ohio L.Abs. 353, 137 N.E.2d 178, *aff'd*, 137 N.E.2d 211 (1954).
55. *Id.* at 383, 137 N.E.2d at 209. *See also* Rice v. Wheeling Dollar Savings & Trust Co., 71 Ohio L.Abs. 205, 130 N.E.2d 442 (1954). *See generally* Note, *The Business Judgment Rule and the Declaration of Corporate Dividends: A Reappraisal*, 4 HOFSTRA L. REV. 73 (1975).

have their claims heard.[56] These first two requirements of the new standard of care for corporate directors in Ohio embody the general formulation of the business judgment rule.[57]

The third requirement in the standard of care could potentially lead to closer scrutiny of corporate directors by the courts. Since it requires that a director exercise the care of an "ordinarily prudent person in a like position,"[58] the addition of the modifying phrase "in a like position" may require a professional corporate director level of prudence rather than the prudence of an ordinary man. Although some jurisdictions have interpreted this requirement to be no more than a formulation of the ordinary prudent man standard,[59] some jurisdictions have seen the phrase, "in a like position," to require a higher, professional standard of care.[60] The same three-prong standard of care has been added to the law regarding the conduct of a trustee for a nonprofit corporation.[61]

The bill exempts the director of a business corporation from personal liability for errors in judgment arising out of his role as director,[62] as long as he satisfies the requirements of the standard of care.[63] The same exemption from personal liability for errors in judgment is provided to the trustees of a nonprofit corporation.[64]

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56. Roderick v. Canton Hog Ranch, 46 Ohio App. 475, 189 N.E. 669 (1933). The court identified three procedures a stockholder might and should pursue before seeking court action: 1) request an audit; 2) an investigation by the board of directors; or 3) a full consideration by the board of the charges made. *Id.* at 481, 189 N.E. at 671.

57. The business judgment rule has been defined as:

> If in the course of management, directors arrive at a decision, within the corporation's powers (*intra vires*) and their authority, for which there is a reasonable basis, and they act in good faith, as the result of their independent discretion and judgment, and uninfluenced by any consideration other than what they honestly believe to be the best interest of the corporation, a court will not interfere with internal management and substitute its judgment for that of the directors to enjoin or set aside the transaction or to surcharge the directors for any resulting loss.

HENN, CORPORATIONS § 242 at 482 (2d ed 1970). *But see*, "The rule that a director is excused from liability for anything but the grossest of negligence is characterized as the 'business judgment' rule." Miller, *supra* note 1, at 270.

58. *See* note 20 *supra*.

59. Graham v. Allis-Chalmers Mfg. Co., 41 Del.Ch. 78, 188 A.2d 125 (S.Ct. 1963). *See also* Note, *Corporations, Fiduciaries, and Conflicts of Interest*, 36 LA. L. REV. 320 (1975).

60. Noe v. Roussel, 299 So.2d 481 (La. App. 4th Cir. 1974); Selheimer v. Manganese Corp. of America, 423 Pa. 563, 224 A.2d 634 (1966). *See generally* Cary and Harris, *Standards of Conduct under Common Law, Present Day Statutes and The Model Act*, 27 BUS. L. 61 (1972); and Miller, note 1 *supra*.

61. *See* note 28 *supra*.

62. *See* note 21 *supra*.

63. *See* note 20 *supra*.

64. *See* note 29 *supra*.

2. Impact of Stautory Standard on Previous Case Law

The standard of care created by S.B. 174 sharpens the definition of a less precise standard already present in Ohio case law.[65] Directors have been required to act in good faith.[66] They have also been required to exercise reasonable care, skill, and diligence in pursuing the best interests of the corporation and its shareholders.[67] Thus, the court in *Goff* defined the standard of care for corporate directors:

> They [the directors] have assumed the duty to properly, intelligently, and honestly conduct all the corporate affairs in such a way and manner as will be for the best interests of the stockholders and all concerned. However this may be, yet the directors are not held as a matter of law to know all its affairs, or all the transactions or business conducted by the corporation, or at all times to know just what its books and papers contain . . . .[68]

Yet the degree of care required has depended upon the nature of the business,[69] and the circumstances of the particular case, including the methods usually used in that type of business.[70]

Historically, the directors of a corporation were responsible for its management and could delegate only ministerial authority to do routine functions to officers or employees of the corporation.[71] This responsibility was frequently seen as a fiduciary duty.[72] But courts exhibited confusion over to whom the fiduciary duty was owed, with some courts finding it owed to the corporation,[73] others to the stockholders.[74]

Liability of directors for mismanagement developed into a theory that a director, as an agent, is liable to the corporation for damages

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65. *See* note 46 *supra*.

66. Goff v. Emde, 32 Ohio App. 216, 167 N.E. 699 (1928).

67. *Id.*; Mason v. Moore, 73 Ohio St. 275, 76 N.E. 932 (1906); Moorehouse v. Crangle, 36 Ohio St. 130 (1880).

68. 32 Ohio App. at 221, 167 N.E. at 700.

69. Glass v. Courtright, 14 Ohio N.P. (n.s.) 273 (1913). The directors of a bank were personally liable to the stockholders for losses due to the directors' negligence.

70. Robison v. Cleveland City Ry. Co., 5 Ohio N.P. 293 (1898). The directors of a new corporation, formed out of the consolidation of two earlier ones, were not liable for an unauthorized issuance of stock certificates, without a showing of fraud on their part.

71. McMullen, *Committees of the Board of Directors*, 29 BUS. L. 755 (1974).

72. Thomas v. Matthews, 94 Ohio St. 32, 113 N.E. 669 (1916); Nienaber v. Katz, 69 Ohio App. 153, 43 N.E.2d 322 (1942).

73. *In Re* Empress Josephine Toilet Co., 1 Ohio N.P. (n.s.) 20 (1903); Warner & Swasey Co. v. Rusterholz, 41 F. Supp. 498 (D. Minn. 1941).

74. State v. Whitmore, 126 Ohio St. 381, 185 N.E. 547 (1933); Rouse v. Merchants' Nat'l Bank, 46 Ohio St. 493, 22 N.E. 293 (1889); Hatch v. Newark Tel. Co., 34 Ohio App. 361, 170 N.E. 371, *error dismissed*, 122 Ohio St. 611, 174 N.E. 12 (1930).

due to his neglect of duty.[75] Thus, mismanagement of a corporation by a director was categorized as either misfeasance or nonfeasance.[76] Misfeasance was not actionable under the theory that the decision in question had involved an exercise in judgment by the directors,[77] and the courts were unwilling to substitute their judgment of what should have been done for the judgment of the board of directors.[78] On the other hand, a complaint alleging nonfeasance of the director's duty was actionable on the theory that a director's failure to act represented his lack of judgment rather than an exercise of judgment.[79] Similarly, simple negligence by the director was not actionable;[80] the negligence must be so great as to constitute bad faith or fraud.[81]

The new statutory standard of care does change the *Goff* court's standard of "best interests of the stockholders and all concerned" to the narrower "best interests of the corporation."[82] Although this change allows for more precision by eliminating the vague "and all concerned" language and specifying "corporation," perhaps the language has been too narrowly circumscribed. The directors are now required to act only in the best interests of the corporation, while the language of *Goff* could have included the stockholders and even society in general.[83] Thus, the *Goff* court's language of "duty to properly, intelligently, and honestly conduct all the corporate affairs" has been reformulated more precisely in the good faith and reasonable belief clauses of the statute.[84] Finally, the bill goes beyond Ohio's common law standard of care for corporate directors by adding the test of the "ordinarily prudent person in a like position," which courts may interpret to create a higher professional standard for corporate directors.[85]

C. *Directors' Delegation of Authority*

Senate Bill 174 brings Ohio corporate law into closer conformity with the reality of corporate structure by recognizing that directors

75. Minster Loan & Sav. Co. v. Laufersweiler, 67 Ohio App. 375, 36 N.E.2d 895 (1940).

76. Miller, *supra* note 1, at 272.

77. *Id. See also* note 57 *supra.*

78. *See* Lamb v. Lehmann, 110 Ohio St. 59, 143 N.E. 276 (1924). *See also* Miller, *supra* note 1, at 272.

79. *Id.*

80. Goff v. Emde, 32 Ohio App. 216, 167 N.E. 699 (1928).

81. *Id.*

82. *See* note 20 *supra.*

83. The general lack of responsibility or conscience of a corporation towards society is seen as the source of much of the failure by corporations to be concerned with the harmful effects of their products. Stevenson, *Corporations and Social Responsibility in Search of the Corporate Soul*, 42 GEO. WASH. L. REV. 709 (1974).

84. *See* note 20 *supra.*

85. *See* notes 59 and 60 and accompanying text *supra.*

delegate the authority to manage the day-to-day affairs of the corporation to its officers.[86] This recognition of the delegated authority has become an explicit part of the new statute through the addition of the phrase "or under the direction of" to section 1701.59 (A), so the clause now reads, "[A]ll of the authority of a corporation shall be exercise by *or under the direction of* its directors."[87]

The directors' delegation of corporate authority to officers and employees includes the right of the directors to rely on books and records received from those officers and employees.[88] While the right to rely on the books and records supplied by corporate officers is not a new addition to the law,[89] this right, in combination with the newly acknowledged delegation of authority, may tend to insulate the directors from having to acquire a real knowledge of the corporate affairs.[90] At least one commentator has urged that large, publicly held corporations must be distinguished from small, closely held corporations in their respective power to delegate authority.[91] The directors of a large, publicly held corporation would have a general right to rely on information supplied by corporate officers and employees under the theory that such directors will not be personally involved in the day-to-day business of the corportion. On the other hand, the directors of a small, closely held corporation have both the opportunity and duty to oversee more closely the day-to-day operations of the corporation.[92] Directors in either case would have a duty to act when they have knowledge of misconduct by the officers or employees of the corporation.[93]

The right to delegate authority to officers and employees of the corporation has also been extended to trustees of a nonprofit corporation.[94]

D. *Private Contracts between a Nonprofit Corporation and Its Trustees and Officers*

Section 1702.301 is an entirely new provision regarding nonprofit corporations.[95] This addition brings Ohio Law regarding nonprofit corporations into conformity with that regarding business corporations by allowing trustees of a nonprofit corporation to enter into private

86. Morris, *supra* note 4, at 2.
87. *See* note 17 *supra*.
88. *Id.*
89. For the language of section (A) prior to amendment of S.B. 174, see *Id.*
90. Miller, *supra* note 1, at 272.
91. *Id.*
92. *Id.*
93. *Id.*
94. *See* note 26 *supra*.
95. *See* note 32 *supra*.

contracts with the corporation just as directors of a business corporation can enter into private contracts with their corporation.[96] A contract is no longer void or voidable simply because it is between a trustee and the corporation,[97] as long as it satisfies any one of the following requirements: 1) the material facts of the relationship and contract are disclosed or known to the other trustees and they have approved it;[98] 2) the material facts of the relationship and contract are known or have been disclosed and the contract has been approved at a meeting held specifically for a vote on it by the disinterested trustees;[99] or 3) the contract is fair to the corporation when approved by the trustees.[100] While the contract must only satisfy any one of these requirements, the third requirement implies that even the interested trustee can vote on his own contract with the corporation, as long as it is "fair" to the corporation.[101] Furthermore, the interested trustee, seeking approval of such a contract, can be counted to make a quorum at a meeting of trustees even though he might not be voting on the contract.[102]

The early rule regarding contracts between a business corporation and an interested director was that such contracts were voidable at the election of the corporation or its stockholders.[103] This rule was usually based on the theory of the director's role as a fiduciary.[104] This theory was liberalized as courts became more and more reluctant to substitute their judgment for that of the corporate directors.[105] The director is now seen to have a dual status as both agent of the corporation and fiduciary of the stockholders.[106] While one state has continued to hold directors to a strict fiduciary standard[107] even after the legislature has passed a bill[108] that allowed contracts between a business corporation

96. *See* note 14 *supra*.
97. For the language of § 1702.301(A)(1), *see* note 32 *supra*.
98. For language of § 1702.301(A)(1)(a), *see* note 32 *supra*.
99. For language of § 1702.301(A)(1)(b), *see* note 32 *supra*.
100. For language of § 1702.301(A)(1)(c), *see* note 32 *supra*.
101. *Id. See also* Note, *Corporations, Fiduciaries, and Conflicts of Interest*, 36 LA. L. REV. 320 (1975).
102. For language of § 1702.301(A)(2), *see* note 32 *supra*.
103. Wardell v. Railroad Co., 103 U.S. 651 (1880).
104. Thomas v. Matthews, 94 Ohio St. 32, 113 N.E. 669 (1916); Nienaber v. Katz, 69 Ohio App. 153, 43 N.E.2d 322 (1942).
105. *See generally* note 57 and accompanying text *supra*.
106. State v. Whitmore, 126 Ohio St. 381, 185 N.E. 547 (1933); Rouse v. Merchants' Nat'l Bank, 46 Ohio St. 493, 22 N.E. 293 (1889); Hatch v. Newark Tel. Co., 34 Ohio App. 361, 170 N.E. 371, *error dismissed*, 122 Ohio St. 611, 174 N.E. 12 (1930).
107. Noe v. Roussel, 299 So.2d 481 (La. App. 4th Cir. 1974). *See generally* Note, *Corporations, Fiduciaries, and Conflicts of Interest*, 36 LA. L. REV. 320 (1975).
108. The Louisiana section can be found at LA. REV. STAT. § 12:84 (West 1969).

and an interested director, the trend is to relax the higher standard by allowing such contracts.[109] One commentator has pointed out that the indemnification clause[110] absolving a director of all liability short of fraud may shift the burden of proof to those challenging the interested director's contract with the corporation.[111] The Ohio legislature has now expanded this trend to liberalize the standards governing directors of business corporations to include trustees of nonprofit corporations.

While section 1702.301 changes the law regarding nonprofit corporations to make it more closely parallel with that of business corporations, perhaps a move toward greater parllelism should have made the law for business corporations narrower rather than the law for nonprofit corporations broader.[112] The law regarding both types of corporations could have been changed to allow contracts between an interested director or trustee and his corporation when specifically provided for in the corporate charter. In closely held corporations where such contracts are frequently important and necessary,[113] the corporate charter could specifically authorize them.[114] Similarly, in large, publicly held corporations and in nonprofit corporations, where such contracts may not be desirable, the corporate charter would have to authorize them. The law as it has been passed forces the nonprofit corporation to specifically bar private contracts between itself and a trustee if such contracts are not desired. This suggested alternative would force the corporation to specify in its charter that such contracts between an interested trustee and the corporation were allowed.

E. The Use of Communications Equipment for Attendance at Meetings

Ohio law has already allowed directors to conduct full board meetings via communications equipment.[115] Senate Bill 174 extends this privilege of conducting meetings via communications equipment to committees of directors.[116] This addition to the law is primarily a

109. *Id.*

110. *See* notes 21 and 29 *supra.*

111. Miller, *supra* note 1, at 263. *But see* note 108 *supra.*

112. This possible alternative was suggested by Mr. John R. Koverman, Jr., of Stoecklein & Koverman, Dayton, Ohio, in conversation, September 27, 1980.

113. *Id.*

114. An example of how this privilege could be included in the corporate charter was supplied by Mr. Koverman: "SIXTH: A director or officer of the Corporation shall not be disqualified by his office from dealing or contracting with the Corporation as a vendor, purchaser, employee, agent, or otherwise, nor shall any transaction, contract or act of the Corporation be void or voidable. . . ." *Corporate Charter of Foreman Industries, Inc.*, Dayton, Ohio.

115. OHIO REV. CODE ANN. § 1701.61(B) (Page 1978).

116. *See* note 24 *supra.*

statutory recognition of technological changes in society.[117] Indeed, it clarifies an ambiguity by specifically allowing committee meetings to be conducted via conference telephone where the previous law had been unclear whether such meetings were allowed.[118]

Committees of trustees for nonprofit corporations have also been extended the privilege of conducting meetings via communications equipment.[119]

CONCLUSION

S.B. 174 improves Ohio corporate law by eliminating some ambiguities about the directors' liability, by recognizing certain realities of corporate management and delegation of authority, by providing for committee meetings of both directors and trustees via conference telephone, and especially by establishing a precise and sharply defined standard of care for both director of business corporations and trustees of nonprofit corporations. While this new, more precise standard of care does contain an element that could give corporate directors a higher standard of care approaching that of a professional, the impact of this potentially higher standard is limited by the indemnification of directors from liability for all but gross negligence or bad faith. Indeed, it is even limited by the general refusal of courts to interfere with corporate affairs under the aegis of the business judgment rule.

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117. Morris, *supra* note 4, at 3.
118. *Id.*
119. *See* note 31 *supra*.