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Corporation Law: Delaware Supreme Court Exercises Its Own Business Judgment

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CORPORATION LAW: DELAWARE SUPREME COURT EXERCISES ITS OWN BUSINESS JUDGMENT, *Zapata Corporation v. Maldonado, 430 A.2d 779 (Del. 1981).*

I. INTRODUCTION

The derivative suit[1] is a device by which minority shareholders can enforce corporate rights that are violated by corporate management. The business judgment rule[2] is the defense mechanism asserted by the board of directors to compel dismissal of the shareholder's suit.[3] The continued vitality of derivative suits has been seriously threatened by state and federal decisions which have consistently upheld reliance on the business judgment rule as a grounds for disinterested directors to dismiss derivative actions they deem detrimental to the corporation.[4] Provided the directors do not stand in a "dual relation"[5] creating the risk of biased decisions, the traditional application of the rule bars judi-

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1. A derivative suit is brought by a shareholder on behalf of the corporation which has been wronged, but which refuses to assert the cause of action. H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES §§ 358-360 (2d ed. 1970). When there is a wrong to a corporation, redress must be sought in a derivative suit. W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5908 (rev. perm. ed. 1980). *See, e.g.,* Continental Sec. Co. v. Belmont, 206 N.Y. 7, 99 N.E. 138 (1912)(the shareholder's derivative action in a sense involves a double wrong to the corporation: (1) the basic wrong done to it, and (2) its not redressing the wrong directly).

2. The business judgment rule sustains corporate transactions and immunizes management from liability when the transaction is within the powers of the corporation and the authority of management. By definition, the rule presupposes an honest, unbiased judgment and compliance with applicable fiduciary duties. H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 242 (2d ed. 1970). *See* note 38 *infra.*

3. Arsht, *The Business Judgment Rule Revisited,* 8 HOFSTRA L. REV. 93 (1979). "The business judgment rule is a defensive rule, the effect of which is to permit corporate directors to exercise their discretion in managing the corporation's business affairs in the manner they deem in the corporation's best interests in accordance with their power to govern the corporation pursuant to 8 Del. C. § 141(a)." Maldonado v. Flynn, 413 A.2d 1251, 1256 (Del.Ch. 1980). *See also* Note, *Corporations- The Business Judgment Rule Shields the Good Faith Decision of Disinterested Directors to Terminate a Derivative Suit Against the Corporation's Directors,* 25 VILL. L. REV. 551 (1979-80).

4. Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit,* 75 NW. U.L. REV. 96, 98 (1980) (hereinafter cited as Dent). Dent points out that "[t]he rule generally has been held not to apply if a majority of the board is implicated in the alleged wrong." *Id.* at 97.

5. United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263 (1917) ("Courts interfere seldom to control such discretion *intra vires* the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment."). The rule generally cannot be applied if a majority of the board is involved in the wrongdoing. Yet, recent cases have permitted dismissal if a duly appointed investigative committee not involved in the wrongdoing decides in its business judgment that the suit is not in the best interest of the corporation. Dent, *supra* note 4, at 97. *See also* Maldonado v. Flynn, 485 F.Supp. 274 (S.D.N.Y. 1980).

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cial inquiry into actions of directors taken in good faith and in honest pursuit of the legitimate purposes of the corporation.[6]

This long line of precedent was broken in May, 1981, with the Supreme Court of Delaware decision *Zapata Corp. v. Maldonado.*[7] In this decision, the Delaware court created a new two prong test to be employed when deciding whether directors' dismissal of a derivative suit is proper. The change of precedent occurs in the test's second step which calls upon the trial court to exercise its own business judgment to decide whether the board's motion to dismiss a shareholder's derivative suit should be granted.[8] "This means, of course, that instances could arise where a committee can establish its independence and sound basis for its good faith decisions and still have the corporation's motion denied."[9] This note outlines the reasoning behind the *Zapata* court's new approach, and discusses its potential impact on future appeals determining the validity of an independent board's decision not to sue.[10]

II. FACTS AND HOLDING

In 1970, the board of directors of Zapata Corporation adopted a stock option plan granting to certain officers and directors options to purchase Zapata common stock.[11] The exercise of the option was to be

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6. *See, e.g.*, Abramowitz v. Posner, 513 F.Supp. 120 (S.D.N.Y. 1981); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979) (judicial inquiry into the board's business judgment not to sue is forbidden unless those reaching the decision are deemed to have acted in bad faith or not independently); Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980). *See also* Brodsky, *Terminating Derivative Cases Under Business Judgment Rule*, New York Law Journal, May 20, 1981, at 1, col. 1.

7. 430 A.2d 779 (Del. 1981). This decision reversed the chancery court's decision. *See* notes 27-28 and accompanying text *infra*.

8. Missing from the *Zapata* test is the usual presumption that the board acts in good faith and in the best interests of the corporation unless proven otherwise. J. Coffee & D. Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal For Legislative Reform*, 81 COLUM. L. REV. 261 (1981) (hereinafter cited as Coffee). *See* Hays, *A Study In Trial Tactics: Derivative Stockholder's Suits*, 43 COLUM. L. REV. 275, 276-77 (1943) (Some courts have lost sight of the fundamental principles concerning the value of minority shareholder's actions. The result has been exculpation of corporate fiduciaries in instances where liability would otherwise have followed). *Cf.* Jackson v. Ludeling, 88 U.S. 616, 624 (21 Wall. 1874) (interested directors' dealings with the corporation are subjected to rigorous scrutiny and, where any of their contracts or engagements with the corporation are challenged, the burden is on the director not only to prove the good faith of the transaction but also to show its inherent fairness).

9. 430 A.2d 779, 789 (Del. 1981).

10. The law of the state of incorporation is decisive on the question whether directors have power of dismissal. Burks v. Lasker, 441 U.S. 471 (1979). *See* DEL. CODE ANN. tit. 8 § 141(c).

11. The Zapata Corporation was incorporated in Delaware in 1954. The company is engaged in drilling oil and gas wells in foreign and domestic waters. Zapata and its subsidiaries also engage in fishing and mining industries. MOODY'S INDUSTRIAL MANUAL, 3531 (1981). A management stock option plan affords the privilege of obtaining shares at less than the fair market price. It is viewed as a bonus form of compensation for the purpose of retaining executive, key, and

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in separate installments ending July 14, 1974.[12] Prior to the time for the final option, Zapata also planned a tender offer[13] of its own shares to be announced shortly before July 14, 1974. Announcement of the offer was expected to cause an increase in the market value of Zapata stock.[14]

Zapata's directors, many of whom were optionees of the 1970 plan, realized that if the final option were exercised after the tender offer announcement, they would incur additional federal income tax liability due to the increased difference between the option price and the market price of Zapata stock.[15] To avoid the increased tax, Zapata's directors accelerated the date of the last option to July 2, 1974. On that day, after exercising their options, the directors ceased market trading of Zapata shares pending announcement of the tender offer. The announcement was made on July 8, 1974, and the prices of Zapata stock promptly rose.[16]

In 1975, William Maldonado, a stockholder of Zapata Corporation, instituted a derivative action[17] in the Delaware Court of Chancery against the directors and officers involved in planning the acceleration. Maldonado claimed that modification of the stock option plan constituted a breach of fiduciary duty[18] owed to the corporation and its shareholders.[19] Maldonado did not first demand that the board bring

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qualified personnel. W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2143.1 (rev. perm. ed. 1980). *See also* B. MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL 145 (1977) (stock option plans are a form of incentive compensation because they increase the executive's equity position in the corporation and conserve the assets of the corporation).

12. In 1971, Zapata shareholders ratified this plan. Maldonado v. Flynn, 413 A.2d 1251, 1254 (Del.Ch. 1980), *rev'd and remanded sub nom.* Zapata Corp. v. Maldonado 430 A.2d 779 (Del. 1981).

13. Generally a tender offer is an invitation by a corporation to shareholders of the "target company" to sell their shares at a specified consideration. The offer is usually above the market price of the securities sought, and is for a limited time period. W. CARY, M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS, 1562 (5th ed. 1980). *See* DEL. CODE ANN. tit. 8 § 203 (supp. 1980).

14. Maldonado v. Flynn, 413 A.2d 1251, 1254 (Del. Ch. 1980), *rev'd and remanded sub nom.* Zapata Corp. v. Maldonado 430 A.2d 779 (Del. 1981). At the time the price of stock was $18.19 per share to be raised to nearly $25.00 per share for the tender offer price. *Id.*

15. The additional tax liability was due to the amount of capital gain that would be realized. This amount would depend on the difference between the option price and the market price. The optionees would pay the price difference between the $12.15 option price and the price on the date of the exercise; i.e., $18.00-$19.00 if exercised prior to the tender offer, or nearly $25.00 if exercised afterwards. *Id.*

16. *Id.*

17. *See* note 1 *supra,* for a definition of a shareholder's derivative suit. *See also* DEL. CH. CT. R. 23.1 DERIVATIVE ACTIONS BY SHAREHOLDERS,. *See* note 20 *infra.*

18. Directors owe fiduciary duties to their corporation. Corporate managerial powers are powers in trust and thereby must be exercised honestly and in good faith. H. HENN. HANDBOOK ON THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 235 (2d ed. 1970).

19. Maldonado v. Flynn, 413 A.2d 1251, 1255 (Del. Ch. 1980), *rev'd and remanded sub*

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the action; he claimed demand would be futile since all directors were named as defendants and allegedly participated in the acts specified.[20] In June, 1977, Maldonado commenced a second action in the United States District Court for the Southern District of New York against nine of the directors, alleging federal security law violations as well as the common law claims made in the court of chancery.[21]

By June, 1979, four of the defendant directors were no longer on the board, and two new directors had been appointed by the remaining directors. The two new directors were designated to act as an "Independent Investigative Committee"[22] for the purpose of determining whether either of Maldonado's actions or an action then pending in Texas[23] against the directors should continue. In view of its findings, the committee concluded that the three actions should "be dismissed forthwith as their continued maintenance is inimical to the Company's best interests."[24]

Pursuant to the committee's directive Zapata moved for dismissal or summary judgment in both the state and the federal derivative ac-

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nom. Zapata Corp. v. Maldonado 430 A.2d 779 (Del. 1981). More specifically, Maldonado claimed that the acceleration of the option date deprived the corporation of a tax deduction in an amount equal to the taxes saved by the optionees. The defendant directors denied these allegations and claimed that if there was any deduction it would have been minimal due to operating and capital loss carrybacks available to the corporation for income tax purposes. *Id.*

20. Since the United States Supreme Court case, Hawes v. City of Oakland, 104 U.S. 450 (1882), a plaintiff shareholder has a duty to make demands on directors as a prerequisite to maintaining his suit. Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit,* 73 HARV. L. REV. 746, 748 (1960). The reason for this duty is that a shareholder seeking to file a derivative suit must first exhaust available intracorporate remedies by making a demand on the board of directors to bring suit. Coffee, note 8 *supra,* at 262. It is well established, however, that demand need not be made on the board if a majority of the directors are involved in the alleged wrongdoing. W. CARY, M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 926 (5th ed. 1980). E.g., Mayer v. Adams, 37 Del. Ch. 298, 141 A.2d 458 (1958); Sohland v. Baker,. 15 Del. Ch. 431, 141 A. 277 (1927); Continental Sec. Co. v. Belmont, 206 N.Y. 7, 99 N.E. 138 (1912). The demand requirement has been codified in FED. R. CIV. P. 23(b) and DEL. CH. CT. R. 23.1 which states in pertinent part: "The complaint shall allege with particularity the efforts if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and the reasons for his failure to obtain the action or for not making the effort." *See also* Heit v. Baird, 567 F.2d 1157 (1st Cir. 1957) (the purpose of the demand requirement is to require resort to the body legally charged with conduct of the company's affairs before licensing suit in the company's name by persons not so charged).

21. Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980).

22. Corporations facing a derivative action have used the Independent Investigative Committee to attempt to avoid court holdings that the board's refusal to sue will not block a derivative suit where a majority of the directors are defendants. *See* Dent, *supra* note 4, at 105.

23. Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980). Plaintiffs filed a shareholder's derivative suit pursuant to the federal securities laws, the Texas Business Corporation Act and the common law for the same wrongdoing. The court denied Zapata's motion for summary judgment in an opinion consistent with Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980), *rev'd and remanded sub nom.* Zapata Corp. v. Maldonado 430 A.2d 779 (Del. 1981).

24. 430 A.2d at 781.

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tions. On January 24, 1980, the District Court for the Southern District of New York granted Zapata's motion for summary judgment in the federal action, holding, under its interpretation of Delaware law,[25] that the committee had authority, in the exercise of its business judgment, to require termination of the derivative action.[26] Maldonado appealed that decision to the Second Circuit Court of Appeals.

On March 18, 1980, the Delaware Court of Chancery denied Zapata's motion in the state action, holding first that Delaware law does not sanction this means of dismissal, and second that the "business judgment" rule is not a grant of authority for directors or a committee to compel dismissal of derivative actions.[27] More specifically, the court held that under the facts before it, the shareholder maintained an individual right to pursue derivative litigation.[28]

The Zapata Corporation filed an interlocutory appeal from the chancery court decision to the Delaware Supreme Court in June, 1980.[29] In May, 1980, the court of chancery granted a motion to dismiss Maldonado's action on res judicata principles, contingent on the second circuit affirming the New York district court's decision.[30] The second circuit appeal was ordered stayed pending the Delaware Supreme Court's resolution of the appeal from the court of chancery's decision to deny dismissal and summary judgment.

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25. *See* note 10 *supra*. The district court relied mainly on two Delaware cases; Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert denied*, 444 U.S. 1017 (1980) and Beard v. Elster, 39 Del. Ch. 153, 160 A.2d 731, 738 (1960), in which the Supreme Court of Delaware stated: "We think the fact that a disinterested Board of Directors reached this decision by the exercise of its business judgment is entitled to the utmost consideration by the courts in passing upon the results of that decision. Such has long been the law of this state." Maldonado v. Flynn, 485 F. Supp. 274, 286-87 (S.D.N.Y. 1980).

26. Maldonado v. Flynn, 485 F. Supp. 274, 286-87 (S.D.N.Y. 1980).

27. Maldonado v. Flynn, 413 A.2d 1251, 1262 (Del. Ch. 1980), *rev'd and remanded sub nom.* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

28. *Id.*

29. Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

30. Maldonado v. Flynn, 417 A.2d 378 (Del. Ch. 1980). Maldonado brought suit asserting breach of fiduciary duty by Zapata directors. Zapata Corporation moved to dismiss this action on the basis that the decision in Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980) was a final judgment and binding on all issues pending. In the district court case, Maldonado had amended his complaint deleting the common law claim for breach of fiduciary duty. Thus the chancery court granted Zapata's motion to dismiss holding that Maldonado's failure to present all his theories of recovery in the district court precluded his assertion of such theories if the district court judgment dismissing his claim was not overturned on appeal. The chancery court judge stated:

> If the result seems harsh in view of my March 18, 1980, ruling that Zapata does not have the power under Delaware law to compel dismissal of a stockholder's derivative suit by relying on the business judgment rule, it should be remembered that sound policy mandates but one trial for one claim.

417 A.2d 378, 385 (Del. Ch. 1980).

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Finding the Zapata Corporation was "in a procedural gridlock,"[31] the Delaware Supreme Court recognized the need to determine whether the committee had the power to dismiss in order to decide if the chancery court decision allowing the shareholder to sue directly should be maintained. The Delaware Supreme Court reversed and remanded the case, directing the chancery court to apply a two-step test to determine whether to grant the board's motion to dismiss. Under the first part of the test, the court was to inquire into the committee's independence and good faith and into the quality of the investigations it made. The test placed on the corporation the burden of proving independence, good faith, and that a reasonable investigation had been made.[32] If the burden was not met or the court was not satisfied for other reasons relating to the process, including but not limited to, the good faith of the committee, the corporation's dismissal motion was to be denied. If, however, in accordance with Court of Chancery Rule 56[33] standards, the court was satisfied that the committee was independent and showed reasonable basis for good faith findings, the court could in its discretion proceed to the second prong of the test.

The second prong required the court to exercise its own business judgment to determine whether the derivative suit should be dismissed.[34] In doing so the court must consider how compelling is the corporate interest in dismissing a nonfrivolous suit and, if appropriate, consider matters of law, public policy, and the corporation's best interests. The *Zapata* court stressed this step as the key to striking the balance between legitimate corporate claims set forth in the shareholder's

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31. 430 A.2d at 781.

32. A court must determine whether the committee has conducted an adequate investigation. The investigation must at least have been conducted with due care; that is, with the care and skill that a reasonably prudent person under similar circumstances would use. Dent, *supra* note 4, at 128. *See* Gall v. Exxon Corp., 418 F. Supp. 508, 511 (S.D.N.Y. 1976) (the defendant corporation required its special committee to follow a specific procedure to ensure that their investigation would be deemed to be adequate and reasonable).

33. Delaware Chancery Court Rule 56 provides in pertinent part:

(b) For Defending Party. A party against whom a claim, counterclaim, crossclaim or declaratory judgment is asserted may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.

(c) Motions and Proceedings thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages, or some other matter.

DEL. CH. CT. R. 56.

34. 430 A.2d at 789.

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suit, and the corporation's interest as expressed by the independent committee.[35]

III. ANALYSIS

A basic premise underlying the corporate structure is that the corporation is to be managed by or under the authority of the board of directors.[36] This vested authority has been protected from judicial attack by the business judgment rule.[37] Reliance on this rule has consistently enabled courts to uphold refusals by boards of directors to maintain shareholder derivative suits deemed not to be in the best interests of the corporation.[38] More recently, the rule has been extended to uphold decisions of independent investigative committees appointed when the directors are involved in wrongdoing alleged in the derivative suit.[39] Permitting the board this wide discretion often effectively strips the minority shareholder of his right to sue derivatively.[40] Concomitant with

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35. *Id.*

36. *See* Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants*, 63 CAL. L. REV. 375 (1975) (the legal model of corporate operating procedure is pyramidal: at the base is the shareholder; at the next level is the board of directors whose duties are to select officers, make policy, and generally manage the corporation's business). Corporation statutes generally provide that the business of a corporation shall be managed by its board of directors. For example, Delaware Code § 141(a) provides in part: "The business and affairs of every corporation organized under this Chapter shall be managed by or under the direction of a board of directors." DEL CODE ANN. tit. 8, § 141(a).

37. *See* notes 2-3 *supra* for an explanation of how the Rule operates.

38. Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 97-100 (1979) (the business judgment rule grew principally from the judicial concern that competent individuals would not serve as directors if the law exacted from them a degree of precision not possessed by people of ordinary knowledge. The rule is a necessary recognition of human fallibility). *See also* United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, note 5 *supra;* Ash v. International Business Machines Inc., 353 F.2d 491 (3d Cir. 1965), *cert. denied*, 384 U.S. 927 (1966) (minority stockholder lacked standing to maintain derivative suit absent a showing that refusal of directors to sue in the corporation's behalf was fraudulent, collusive, or represented anything worse than unsound business judgment honestly exercised in corporate interest); Bennett v. Propp 41 Del. Ch. 14, 187 A.2d 405 (1962) (holding president and chairman liable for damages but allowing the business judgment rule as a defense for directors who ratified chairman's unauthorized stock purchase).

39. *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 shields deliberations and conclusions of chosen representatives if they possess disinterested independence and do not stand in dual relations which prevent an unprejudiced exercise of judgment). Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979), *cert. denied*, 449 U.S. 869 (1980) (good faith exercise of business judgment by a special litigation committee of disinterested directors is immune from attack by shareholders or the courts). Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980) (even where some board members are disqualified from participating in board decisions, actions taken by independent, disinterested directors in exercise of their independent business judgment will be sustained).

40. *See* Block & Barton, *The Business Judgment Rule As Applied to Stockholder Proxy Derivative Suits Under the Securities Exchange Act*, 8 SEC. REG. L. J. 99, 121 (1980)("If business judgment dismissal of derivative suits is permitted, shareholders may be deprived of the ability to mandate a fundamental corporate claim . . . ."). Hays, *A Study in Trial Tactics: Deriva-*

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reliance upon the business judgment rule in this situation is the concern that if the rule is not applied to these board decisions the corporation could easily be subjected to frivolous and vexatious litigation.[41] The *Zapata* court sought to strike a new balance between these opposing interests.[42]

A. Previous Application of the Business Judgment Rule

A logical starting point for discussing shareholders' derivative suits[43] is the leading case of *Burks v. Lasker*,[44] in which the United States Supreme Court held that, in suits alleging violation of federal laws, a court is to apply state law governing the authority of independent directors to discontinue derivative suits, to the extent that such law is consistent with the policy underlying the federal laws.[45]

The first case to follow the *Burks* analysis was *Abbey v. Control Data Corp.*,[46] a case arising out of Delaware. The *Abbey* court held

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tive Stockholders' Suits, 43 COLUM. L. REV. 275, 277 (1943) ("The minority shareholders' suit is often the only instrumentality by which the scattered majority of shareholders can effectively exercise any control over the management.").

41. Block & Barton, *The Business Judgment Rule as Applied to Stockholder Proxy Derivative Suits Under the Securities Exchange Act*, 8 SEC. REG. L.J. 99, 122 (1980)(if business judgment dismissal is precluded, the corporation may be forced to fund massive litigation expenses without a reasonable expectation of achieving a benefit in excess of such expenses). Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979) (accepting plaintiff shareholders' assertions to disqualify the board would render the corporation powerless to make an effective business judgment regarding the derivative suit).

42. 430 A.2d 779, 789 (Del. 1980).

43. The business judgment rule has often been confused and applied inconsistently to shareholder derivative suits. It has been noted that Delaware decisions have been the most highly criticized for the way they have applied the rule. Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 94 (1979).

44. 441 U.S. 471 (1979). While there are cases before *Burks* and its progeny, they generally do not deal with the peculiar problem of claims against members of the board of directors arising out of alleged breaches of fiduciary duty and/or violation of the federal security laws. Prior cases employ the business judgment rule to dismiss derivative actions against unrelated third parties. *E.g.*, Ash v. International Business Machines, Inc., 353 F.2d 491 (3d Cir. 1965), *cert. denied*, 384 U.S. 927 (1966); United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261 (1917).

45. 441 U.S. 471, 486 (1979). The *Burks* Court did not detail the precise nature of either inquiry. The Court did, however, explain that absent inconsistency with federal law, state law was primary on issues of corporate government. It stated, "[m]utual funds, like other corporations, are incorporated pursuant to state, not federal law. . . . The Investment Company Act does not purport to be the source of authority for managerial power; rather, the Act functions primarily to 'impose' . . . *controls* and *restrictions* on the internal management of investment companies." *Id.* at 478.

46. 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980). In *Abbey*, shareholders sued derivatively to recover illegal payments made by seven board members to foreign governments. In response to the suit, the board created an autonomous "Special Litigation Committee" to investigate the charges. The committee concluded that the suit was not in the best interests of the corporation. *Id.* at 726-28.

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that under Delaware law the business judgment rule protects any reasonable good faith determination by an independent board of directors that a derivative suit is not in the best interests of the corporation.[47]

The problems arising out of the *Abbey* decision and similar cases[48] are threefold. First, these decisions failed to distinguish the traditional business judgment rule from the independent committee's specialized business judgment not to sue. The former is the traditional defense asserted by members of the board of directors when their actions as managers of the corporation are challenged.[49] The latter pertains to the propriety of an independent committee's decision not to sue made after the alleged wrongdoing has been challenged.[50] Second, the impact of the *Burks* analysis was ignored when these courts applied almost nonexistent state law as being consistent with federal policy.[51] Finally, they failed to make a factual determination of the disinterestedness of directors;[52] so long as the deciding directors were not implicated in the alleged wrongdoing their decision not to sue was automatically respected.[53]

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47. 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980).

48. Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979), *cert. denied*, 449 U.S. 869 (1980). Relying on the *Abbey* decision, the ninth circuit held that the good faith exercise of business judgment by a special litigation committee of disinterested directors is immune from attack by shareholders or the courts. *Id.* at 783. *See also* Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976) (the business judgment rule is applicable to decision by special litigation committee acting as corporation's board of directors in deciding not to sue); Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980)(court concluding it was necessary to examine the state law to determine if defendant directors could dismiss the derivative suit on the basis of the business judgment rule).

49. There is a necessary distinction between the traditional "business judgment rule" and the "business judgment" not to sue. The former is the defense asserted by the board of directors when their actions as managers of the corporation are challenged. The latter goes to the propriety of an independent committee's decision not to sue after the alleged wrongdoing has been challenged. Maldonado v. Flynn, 413 A.2d 1251, 1257 (Del. Ch. 1980), *rev'd and remanded sub nom.* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

50. *See* Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600 (1980). In regard to treatment given to the latter type of "business judgment" the author states: "Most courts have applied the business judgment and refuse to review the decision of these committees." *Id.* at 608.

51. Brodsky, *Business - Judgment Rule*, New York Law Journal, July 2, 1980, at 1, col. 1.

52. *See* Galef v. Alexander, 615 F.2d 51, 61 (2d Cir. 1980). In *Galef* the court treated the issue of "disinterestedness" as a question of law not fact. Specifically, the court stated: "It may be that under Ohio law a director's being sued merely on account of having authorized, without financial interest, the underlying transaction does not make him sufficiently 'interested' to deprive him of the power to initiate a business judgment summary dismissal of the suit." *Id. But see* Maldonado v. Flynn, 485 F. Supp. 274, 282 (S.D.N.Y. 1980)("No court is required to take for granted that the committee members exercised their business judgment in good faith, thus the shareholder is free to challenge the committee's bona fides.").

53. *See* Auerbach v. Bennett, 47 N.Y.2d 619, 628, 393 N.E.2d 994, 1002, 419 N.Y.S.2d 920, 928 (1979)(maintaining that courts cannot inquire into factors considered by the committee the court stated: "Inquiry into such matters would go to the very core of the business judgment rule made by the committee. To permit judicial probing of such issues would be to emasculate the

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The Maldonado cases,[54] although derived from the *Abbey* line of reasoning, reached incongruous results. The New York district court decision[55] followed the *Burks* analysis and also made a factual determination regarding the "disinterestedness"[56] of an independent committee. The court concluded, however, that Delaware case law upholding the business judgment of directors implied that the board of directors of a Delaware corporation had the authority to terminate derivative suits.[57] Conversely, the Delaware Chancery Court decision[58] distinguished the two types of business judgments[59] maintaining that the traditional business judgment is irrelevant to the decision not to sue, because it is not applicable as a defense to the independent board's actions.[60] The chancery court held further that a shareholder maintained an individual right to assert his cause of action.[61]

B. *Reversing the Opinion Below*

The Supreme Court of Delaware disagreed with both findings of the chancery court's decision. First, according to the *Zapata* court, the rule that a shareholder maintains an individual right to sue derivatively

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business judgment doctrine as applied to the actions and determinations of the special litigation committee."). Beard v. Elster, 39 Del. Ch. 153, 165, 160 A.2d 731, 738-39 (1960) (where board members are disqualified from participating in the board's decision, actions taken by independent, disinterested directors in the exercise of their independent business judgment will be sustained). Maldonado v. Flynn, 485 F. Supp. 274, 279-80 (S.D.N.Y. 1980) (applying Delaware law, a committee of disinterested directors may in the exercise of their business judgment require termination of a shareholder's derivative suit even though directors are named as defendants in the suit).

54. Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980), Maldonado v. Flynn 413 A.2d 1251 (Del. Ch. 1980), *rev'd and remanded sub nom.* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981). *See* notes 17-29 and accompanying text *supra* for explanation and holdings.

55. 485 F. Supp. 274 (S.D.N.Y. 1980).

56. "The cornerstone of the business judgment rule is the independence and disinterestedness of the directors charged with responsibility for decisions." *Id.* at 282.

57. *Id.* at 278-79. The Court relied on Abbey v. Control Data Corp., 603 F.2d 724 (1979), *cert. denied,* 444 U.S. 1017 (1980) (citing Beard v. Elster, 39 Del. Ch. 153, 165, 160 A.2d 731, 738-39 (1960) which stated: "We think the fact that a disinterested Board of Directors reaches this decision by the exercise of its business judgment is entitled to the utmost consideration by the courts in passing upon the results of that decision. Such has long been the law of this State."). *Contra,* Coffee, *supra* note 8 at 274, in which the author discussed the district court case, noting that Delaware has no precedent directly dealing with a board decision not to sue.

58. Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980), *rev'd and remanded sub nom.* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1980).

59. *See* note 49 and accompanying text *supra.*

60. 413 A.2d at 1257.

61. *Id.* at 1262. The chancery court recognized the demand requirement but stated:

> The purpose of a pre-suit demand is only to require the stockholder to show he has good cause to depart from the policy that the directors are normally the persons to control the corporation, and the ones who should ordinarily bring and dismiss litigation on its behalf. Its purpose is not to entirely deny the stockholder the right to redress a breach of fiduciary duty to the corporation.

Id. at 1262.

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after demand has been made and refused is erroneous.[62] The court found the demand requirement to be evidence that managerial power is at all times retained by the board.[63] Distinguishing the cases relied upon by the lower court, the supreme court concluded that only where demand is excused because it is futile does the shareholder possess the ability to initiate the action individually on his corporation's behalf.[64] The court made clear that where demand is required, "a board decision to cause a derivative suit to be dismissed as detrimental to the company, after demand has been made and refused, will be respected unless it is wrongful."[65]

Second, the *Zapata* court refuted the chancery court's contention that an independent committee appointed after the charge by the shareholder cannot compel dismissal merely by reviewing the suit and making a business judgment that it is not in the best interests of the corporation.[66] The supreme court maintained that a board may delegate its power to a board of disinterested directors by virtue of § 141(c) of Delaware's corporation laws.[67] Otherwise, if the corporate right was

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62. 430 A.2d at 782. *Cf.* note 61 *supra.*

63. *Id.* at 785-86.

64. *Id.* at 784. The court relied on Sohland v. Baker, 141 A. 277 (Del. 1927) to support its proposition that if demand is made and refused, the shareholder maintains an absolute right to continue a derivative suit. The supreme court upheld *Sohland,* but distinguished it from the present case on its facts and holding. The *Sohland* court stated the right of a shareholder to file a bill to litigate depends on the facts of each case. 141 A. 277, 282 (Del. 1927). According to the *Zapata* court this language only supports the shareholder's right to initiate the lawsuit. "It does not support an absolute right to continue to control it." 430 A.2d at 783.

65. *Id.* at 784 n.10. In footnote the court pointed out that this decision not to sue falls under the "business judgment rule" and will be respected if the requirements of the rule are met.

66. *Id.* at 785.

67. Delaware general corporation law § 141(c) states:

> (c) The board of directors may, by resolution passed by a majority of the whole board, designate 1 or more committees, each committee to consist of 1 or more of the directors of the corporation. The board may designate 1 or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. The bylaws may provide that in the absence or disqualification of a member of a committee, the member or members present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the board of directors to act at the meeting in the place of any such absent or disqualified member. Any such committee, to the extent provided in the resolution of the board of directors, or in the bylaws of the corporation, shall have and may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to amending the certificate of incorporation, adopting an agreement of merger or consolidation, recommending to the stockholders the sale, lease or exchange of all or substantially all of the corporation's property and assets, recommending to the stockholders a dissolution of the corporation or a revocation of a dissolution, or amending the bylaws of the corporation; and, unless the resolution, bylaws, or certificate of incorporation expressly so provide, no such committee shall have the power or authority to declare a dividend or to

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permitted to vest in the complaining shareholder or group, recognition would be given to their interest to the exclusion of all other interests in the corporation.[68]

The question for the *Zapata* court became, "[w]hen if at all, should an authorized board committee be permitted to cause litigation, properly initiated by a derivative shareholder in his own right to be dismissed?"[69] Finding that Delaware statute § 141(c) permits a board to delegate its authority, the *Zapata* court concluded that a committee in possession of this authority would have power to move for dismissal or summary judgment.[70] The court stated that, without such a procedure, "a single stockholder in an extreme case might control the destiny of the entire corporation."[71] Thus it rejected the chancery court's contention that the appointed board could not determine the destiny of the suit.[72]

C. *The Zapata Test*

The *Zapata* court, reversing the chancery court's opinion, upheld the basic power of a board or a properly delegated committee thereof, to control the destiny of a shareholder's derivative suit.[73] The ultimate result was the formulation of a new test to be used when deciding whether to grant an independent committee's motion to dismiss a shareholder's derivative suit found by the committee not to be in the best interest of the corporation.

The test is as follows: first the court of chancery is to inquire into the committee's good faith and independence, and into the adequacy of its reasons for deciding the suit should be terminated. Limited discovery is permitted on this inquiry,[74] with the burden of proof being placed

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authorize the issuance of stock.

DEL. CODE ANN. tit. 8, § 141(c).

68. 430 A.2d at 785.

69. *Id.* The suit was properly initiated, and Maldonado never made demand on the board, claiming it to be futile. The supreme court treated the demand as properly excused on the facts of the case, given the involvement of the directors in the stock option issue. Thus this question asked by the court concerning the power of the disqualified board is clearly distinguished from the case in which demand is required. *See* note 65 and accompanying text *supra.*

70. 430 A.2d at 785.

71. *Id.*

72. *Id.*

73. *Id.* at 789. *See* Brodsky, *Business-Judgment Rule,* New York Law Journal, May 20, 1981, at 1, col. 1 (the Delaware Supreme Court did not claim that the decision of the board to terminate is to be given great weight and not be overruled unless erroneous nor that it is entitled to a presumption that it is correct).

74. This step resembles that which has been used in similar cases; but in *Zapata* the burden was on the corporation rather than the shareholder. *See* Galef v. Alexander, 615 F.2d 151 (2d Cir. 1980), in which the district court had granted defendant directors' motion to limit discovery to the issue of defendants' good faith in exercising their business judgment to dismiss the suit. *See*

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on the corporation.[75] The corporation must show the court that the independent committee was in fact disinterested,[76] acted in good faith, and made a reasonable investigation into the merits of the pending suit.[77] If the court is not satisfied that the corporation has adequately met its burden of proof regarding the committee, the motion will be denied.[78]

Conversely, if the court deems the corporation to have adequately shown that the committee is sufficiently independent and has offered reasonable bases for its good faith determination that the suit is not in the best interests of the corporation, then the court may, in its discretion, proceed to the second step.[79] This second prong of the *Zapata* test is "the essential key in striking the balance"[80] and maintaining only suits based on legitimate corporate claims. It permits the chancery court to exercise its own business judgment in determining whether the suit is in the best interests of the corporation. "The Court of Chancery of course must carefully consider and weigh how compelling the corporate interest in dismissal is when faced with a non-frivolous lawsuit."[81] If the business judgment of the court is thereby satisfied it may proceed

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also Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980)(shareholder suing derivatively is free to challenge the committee bona fides); Gall v. Exxon Corp., 418 F. Supp. 508 (S.D.N.Y. 1976)(plaintiff must show directors' lack of independence). *But see* Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980), *rev'd and remanded sub nom.* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981) (court placed burden of proving independence and good faith in the defendants).

75. The court justified placing the burden on the corporation by analogy to the intrinsic fairness test employed when the actions of interested directors are attacked. 430 A.2d at 789 n.17. *See, e.g.*, Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952)(director owing fiduciary duty has burden of establishing fairness of proposed plan). *See also* Delaware Code § 144(a)(3), which permits transactions and contracts to be made between a corporation and its directors if: "The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee thereof, or the shareholders." DEL. CODE ANN. tit. 8, § 144(a)(3).

76. "Disinterest is defined as lack of any financial stake . . . in the transaction." Maldonado v. Flynn, 597 F.2d 789, 793 (2d Cir. 1979) (lack of any involvement in the challenged transactions). Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994 (1979), 419 N.Y.S.2d 920. Independent director has been defined as the unaffiliated director, "which in turn means he is supposed to safeguard the public — he's a watchdog — against the human tendency of management to take as much as they can get away with." Note, *Mutual Funds as Investments of Large Pools of Money*, 115 U. PA. L. REV. 669, 739 (1967) (remarks of Abraham Pomerantz).

77. The *Zapata* court did not specify how the burden is to be met or what constitutes a reasonable investigation. For an example of a committee's investigation, *See* Gall v. Exxon Corp., 418 F. Supp. 508, 511 (S.D.N.Y. 1976) (the Committee must (A) retain special counsel; (B) conduct a thorough review and investigation of the circumstances surrounding all matters referred to in the claim; (C) reach a final determination, based on the report and opinion of special counsel, whether litigation should be undertaken against any directors).

78. 430 A.2d at 789.

79. *Id.*

80. *Id.*

81. *Id.*

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to grant the motion to dismiss.

According to the *Zapata* decision, application of the test is appropriate only when the corporation, on the advice of an independent committee, files a pretrial motion to dismiss in the Court of Chancery.[82] The corporation, as the moving party, must be prepared to meet the normal burden for summary judgment pursuant to rule 56.[83] This burden may be met only after the committee has made a thorough and objective investigation of the shareholder's derivative suit. With this in mind the court is required to apply the test.

The first prong of the *Zapata* test is similar to that which has been frequently employed in recent cases deciding motions to terminate derivative litigation.[84] "The corporation should have the burden of proving independence, good faith and a reasonable investigation, rather than presuming independence, good faith and reasonableness."[85] A major concern for the *Zapata* court was the ability of an independent committee to be truly disinterested. Practical consideration was given to the fact that these directors were appointed by, and therefore passing judgment on, fellow directors.[86] "The question naturally arises whether a 'there but for the grace of God go I' empathy might not play a role."[87] The court was therefore skeptical whether an inquiry into the independence and good faith of the committee was a sufficient safeguard against structural bias. Mere reliance on the business judgment theory, or the presumption that the committee acted in good faith, could not ensure the proper balance needed between maintaining bona fide shareholder suits and avoiding litigation detrimental to the corporation.[88] The court found that placing on the corporation the burden of showing the committee was disinterested and its decision was made in good faith could diminish the potential for committee abuse and bias.[89]

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82. *Id.*

83. *See* note 33 *supra*. Rule 56 accords determination of whether the plaintiff's claim has merit. This is done without reference to the business judgment rule.

84. *See* note 74 *supra*. For a reference to the standard operating in recent cases.

85. 430 A.2d at 788.

86. *Id.* at 787. This concern for structural bias has been recognized before in conjunction with excusing the need for demand on the board when such demand would be futile. *See* de Haas v. Empire Petroleum Co., 286 F. Supp. 809 (D. Colo. 1968)(outside directors deemed not to be the kind of aggressive majority that would undertake the difficult and demanding task of prosecuting a lawsuit for fraud against those who elected them) *Cf. Mutual Funds as Investors of Large Pools of Money*, 115 U. PA. L. REV. 669, 739 (1967) ("But obviously, you know and I know if you are choosing an unaffiliated director or an independent director you are not going to choose anybody who is going to be too hard on you.").

87. 430 A.2d at 787.

88. Courts have presumed that directors are disinterested unless the plaintiff presents evidence of bias. Commentators have said that such a presumption is unwarranted. Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600, 619 (1980).

89. The court did not specify what is needed to meet this burden which formerly was on the

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To overcome these risks of committee abuse and bias, and to ensure the balance between allowing legitimate shareholder claims and protecting the corporation's best interests expressed by an independent committee, the *Zapata* court set down its second step, enabling a deciding court to apply its own business judgment.[90] Realizing the possibility that there may be instances in which the committee's actions could satisfy the burden in step one but dismissal might still be inappropriate, the court stated: "The second step is intended to thwart instances where corporate actions meet the criteria of step one, but the result does not appear to satisfy its spirit, or where corporate action would simply prematurely terminate a stockholder grievance deserving of further consideration in the Corporation's interest."[91] The standard for the court to follow is that it must carefully consider and weigh how compelling the corporate interest is in seeking to terminate a non-frivolous lawsuit. The court may consider issues of public policy in addition to the corporation's best interests. If the court, in its independent business judgment, is satisfied that the corporation's interest is compelling and outweighs the interest in the non-frivolous derivative suit, it may grant the dismissal motion, subject to any equitable terms found necessary.[92]

To justify the substantive judicial review of the lower court, the *Zapata* court made an analogy of the Chancery Rule 41(a) (2) standard used in settlement of a derivative suit.[93] That rule requires that

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plaintiff. *See* note 74 *supra*. In practice, however, this change makes a difference in procedure, but not in result because the vast majority of cases do not turn on burden of proof issues. Brodsky, *Terminating Derivative Cases Under Business Judgment Rule*, New York Law Journal, May 20, 1981, at 2, col. 1.

90. 430 A.2d at 789.

91. *Id.*

92. *Id.* The *Zapata* court's guidelines are broad and vague. It simply states:

> The Court of Chancery of course must carefully weigh how compelling the corporate interest in dismissal is when faced with a non-frivolous lawsuit. The Court of Chancery should, when appropriate, give special consideration to matters of law and public policy in addition to the corporation's best interests.
>
> If the Court's independent business judgment is satisfied, the Court may proceed to grant the motion, subject, of course, to any equitable terms or conditions the Court finds necessary or desirable.

Id. at 789.

See Brodsky, *Terminating Derivative Cases Under Business Judgment rule*, New York Law Journal, May 20, 1981 at 1, col. 1. The author examines the problem and points out that by the time a motion to dismiss is made, the committee has already shown its good faith, made its investigation, and decided how compelling the corporate interest is in dismissing the suit.

> If the court finds that an independent committee acted in good faith and there is reasonable basis for the committee's conclusion it is difficult to predict what circumstances would impel a court to overrule the business judgment of the board — aside from a policy reason which the court, but not the board is compelled to consider.

Id.

93. DEL. CH. CT. R. 41(a)(2).

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"an action shall not be dismissed at the plaintiff's instance save upon order of the Court and upon such terms and conditions as the Court deems proper."[94] This analogy could be considered bootstrapping by the court, due to the fact that Delaware has no general requirement of judicial approval of settlements in derivative actions.[95] Yet, the two areas are so related that the rules may be integrated.[96]

The *Zapata* decision recaptures the problem of when a derivative suit brought by minority shareholders should be dismissed in accordance with a board committee's decision not to sue. The court's goal was to strike a balance between honoring genuine shareholder actions and encouraging directors' decisions to seek dismissal of suits that are detrimental to the corporation.[97] The holding, ultimately employing a new test, reflected dissatisfaction with previous decisions addressing the identical problem. This new methodological approach deems the inquiry into the committee's good faith to be vital, but not sufficient, in order to achieve this goal.

The test resulting from the court's attempt to achieve a balance between the possibly competing interests of board committees and aggrieved shareholders has created three problems. First, notwithstanding the *Zapata* court's concern for structural bias on the part of the committee, its decision still permits a board heavily dominated by defendants to delegate to an independent board its authority not to sue. Thus the potential for structural bias on the part of the so called "disinterested" committee is still present.

Second, to safeguard against any abuse in dismissing a suit, the *Zapata* test directs the court of chancery to exercise its own business judgment. The *Zapata* court claimed this step was essential to strike the balance between the derivative suit and the corporation's best interests.[98] Yet, whether to exercise this business judgment is entirely discretionary with the individual chancery court judge. This would seem to mean that appellate review will be essentially unavailable if the

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94. *Id.*

95. Coffee, *supra* note 8, at 328. *Cf.* Pernine v. Pennroad Corp., 47 A.2d 479, 487 (Del. 1946), Neponsit Inv. Co. v. Abramson, 405 A.2d 97, 100 (Del. 1979) ("In determining whether or not to approve a proposed settlement of a derivative stockholders' action [when directors are on both sides of the transaction] the Court of Chancery is called upon to exercise its own business judgment.").

96. Coffee, *supra*, note 8, at 328 n.352. "On policy grounds, it seems a perverse result to require greater procedural formality in the case of a settlement, where the corporation receives some recovery, than in the case of a termination decision, where it receives none." *Id.*

97. The court stated: "We thus steer a middle course between those cases which yield to the independent business judgment of a board committee and this case as determined below which would yield to unbridled plaintiff stockholder control." 430 A. 2d at 788.

98. *See* note 80 and accompanying text *supra*.

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chancery court decides against using the second step.[99] If the second step is essential, it is inconsistent to allow the chancery court to ignore it.

Third, the *Zapata* court failed to set down guidelines for lower courts to follow, except to direct them to give special consideration to matters of law, public policy, and the corporation's best interests. The only guidelines available to courts regarding the corporation's best interests are those established by the independent committees. It seems unlikely then that the court's business judgment would ever be different from the committee's.[100] While these three problems resulting from the *Zapata* test are apparent, they remain to be grappled with as the test is applied in the future. Nevertheless, the *Zapata* test is an improvement over the typical approach presently used.[101]

IV. CONCLUSION

The business judgment rule has long been used as a barrier and a defense to a shareholder's derivative suit. It is based on the premise that the corporation's decision making power is vested in its board of directors. Yet, when this power is abused and becomes the cause behind a derivative suit, problems of structural bias and conflicts of interest immediately arise. The remedial trend heretofore has been to place the destiny of the suit in the hands of a disinterested committee. The *Zapata* court, however, seriously questioned the ability of a committee to be sufficiently disinterested to make a bona fide decision, and guarantee the upholding of a meritorious and non-frivolous suit.

The *Zapata* court's goal was to strike a balance so that the business judgment rule could be relied upon by a corporation to avoid vexatious litigation, but could not be relied upon to avoid derivative suits brought by aggrieved shareholders with meritorious claims. The *Zapata* test permits the plaintiff to inquire into the merits of an independent committee's decision not to sue in hopes of finding factual issues to defeat the corporation's motion. Potentially, this may increase the amount of litigation on the issue, but it removes the potential harm of never allowing courts to review business judgments of supposedly disinterested committees.

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99. Coffee, *supra* note 8, at 330.

100. *See* Dent, *supra* note 4, at 99. Coffee, *supra* note 8, at 329. The authors contend that although courts have been given new authority by virtue of the *Zapata* decision, they will continue to defer to the business judgment of the board. "Engrained traditions do not disappear overnight, rather they persist in ways that have low visibility." Coffee, *supra* note 8, at 329.

101. *See, e.g.*, Swanson v. Traer, 249 F.2d 854, 858-59 (7th Cir. 1958); Issner v. Aldrich, 254 F. Supp. 696, 701-02 (D. Del. 1966). These cases and others demonstrate how courts have consistently held that the business judgment rule applies even where certain directors are charged with wrongdoing, so long as the deciding directors are independent and disinterested.

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The confidence placed in judicial competency by *Zapata* is great. Questions arise as to the ability of a court to exercise its own business judgment regarding the best interests of the corporation. It creates a risk that the court will merely rely on the committee's reports and findings; however, the alternative of never allowing courts to review business judgments could ultimately lead to the death of the derivative suit.

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