

# JUDICIAL SCHIZOPHRENIA IN CORPORATE LAW: CONFUSING THE STANDARD OF CARE WITH THE BUSINESS JUDGMENT RULE

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*Courts are confusing the Business Judgment Rule with the standard of care that governs the conduct of corporate directors and officers. The Alaska Supreme Court declared in recent dictum that the Business Judgment Rule has been codified in Alaska Statute section 10.06.450(b), the directors' duty-of-care statute. The court deviated from well-established principles of corporate law by confusing the corporate directors' statutory standard of care with the Business Judgment Rule, a widely-applied, but uncodified, common law rule about the standard of directors' liability for their mistakes. The former is an ex-ante measuring stick by which directors' decisions are guided; the latter is a presumption of correctness and a safe harbor that protects business decisions from ex-post review in the courts. This Comment identifies this common error of law, describes the difference between these two concepts, explains why many state and federal courts across the nation are confused, and credits the courts that have already discovered the error. It concludes with some reasons why the Business Judgment Rule should not be codified.*

## I. INTRODUCTION: A FIERY BEGINNING

The Business Judgment Rule (“BJR”) first appeared in Alaska in 1975 after a fire destroyed a small factory in Fairbanks that was owned by Alaska Plastics, Inc.<sup>1</sup> The fire caused the end of production at the factory, terminated operation of the enterprise, and triggered the beginning of a lawsuit that brought the arrival of the BJR in Alaska.<sup>2</sup> To Alaska Plastics' everlasting woe, its

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1. Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 278 (Alaska 1980).

2. *Id.* at 270.

directors had decided not to obtain any fire insurance on the facility.<sup>3</sup> Annoyed by this foolish decision, Patricia Coppock, a minority shareholder, filed a derivative action against the directors in which she complained that the directors had breached their duty of care.<sup>4</sup>

In *Alaska Plastics*, the Supreme Court of Alaska affirmed the trial court's rejection of the dissident shareholder's complaint about lack of fire insurance and other directorial misconduct.<sup>5</sup> The supreme court held that the directors' decision not to insure the property was protected by the BJR, and therefore it would not be reviewed by the court.<sup>6</sup> This was the first time the Alaska Supreme Court had discussed or applied the BJR. The court's most recent BJR case, *Shields v. Cape Fox Corp.*,<sup>7</sup> is substantially more controversial, as it mistakenly asserts that the BJR is codified in Alaska Statute section 10.06.450(b),<sup>8</sup> confusing the common law rule with the codified corporate directors' standard of care.<sup>9</sup>

This Comment traces the history of the BJR in Alaska. It explains where and how the court has erred in its definition of the rule; it explains the difference between two concepts—standard of directors' care and standard of directors' liability—and their separate treatment in the Model Act.<sup>10</sup> It also collects examples of the same judicial misunderstanding from the case law of other states. It concludes that the BJR has not been codified in Alaska nor in most other U.S. jurisdictions, although there have been recent suggestions to do so in the Model Act<sup>11</sup> and in the American Law Institute's Principles of Corporate Governance.<sup>12</sup> Finally, this Comment provides reasons why the BJR should not be codified.

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3. *Id.* at 273.

4. *Id.* at 278.

5. *Id.* The dissident shareholder complained that “the directors failed to insure the Fairbanks plant, they kept large reserves of cash in noninterest-bearing checking accounts, and they loaned an employee money at a rate below prevailing rates of interest.” *Id.*

6. *Id.*

7. 42 P.3d 1083 (Alaska 2002).

8. ALASKA STAT. § 10.06.450(b) (2006).

9. See *Shields*, 42 P.3d at 1083.

10. MODEL BUS. CORP. ACT (2005).

11. *Id.* § 8.31.

12. 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(c) (1994).

## II. A WRONG TURN IN ALASKA'S CORPORATE LAW

Since its first appearance in the *Alaska Plastics* decision, the Business Judgment Rule has received only occasional mention in subsequent decisions of the supreme court.<sup>13</sup> That is, until the court decided *Shields v. Cape Fox Corp.*<sup>14</sup> in 2002. In *Shields*, the court confused the BJR with the directors' statutory standard of care that is codified in Alaska Statute section 10.06.450(b).<sup>15</sup> The court erroneously referred to a statutory formulation of the BJR: "*The business judgment rule is set out in AS 10.06.450(b)*. It requires a director to use 'the care . . . that an ordinarily prudent person in a like position would use under similar circumstances.'"<sup>16</sup>

For the reasons explained below,<sup>17</sup> this dictum is contrary to the great weight of modern corporate law and should be repudiated. However, Alaska is not alone in making this mistake; courts in several other jurisdictions have made the same error.<sup>18</sup>

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13. In the twenty years after *Alaska Plastics*, the BJR received brief mention in four reported decisions. See *Bennett v. Weimar*, 975 P.2d 691, 697 nn.21–22 (Alaska 1999) (applying the BJR to condominium associations and giving a useful statement of the rule); *Demmert v. Kootznoowoo, Inc.*, 960 P.2d 606, 608 n.1 (Alaska 1998) (quoting an argument of counsel in which the phrase "business judgment rule" appears); *Wirum & Cash, Architects v. Cash*, 837 P.2d 692, 702 (Alaska 1992) ("Alaska recognizes the business judgement [sic] rule."); *O'Buck v. Cottonwood Vill. Condo. Ass'n*, 750 P.2d 813, 817 n.4 (Alaska 1988) (analogizing between the BJR and condominium association rule). The next decision in which the term "business judgment rule" appeared was *Shields*, 42 P.3d at 1091–92.

14. *Shields*, 42 P.3d at 1091 ("The business judgment rule is set out in AS 10.06.450(b)."). In the five years since its decision in *Shields*, the Alaska Supreme Court has not applied the BJR, although the term "business judgment rule" does appear in three recent decisions. See *Matanuska Elec. Ass'n v. Waterman*, 87 P.3d 820, 822 (Alaska 2004); *Quality Asphalt Paving, Inc. v. State, Dep't of Transp. and Pub. Facilities*, 71 P.3d 865, 876 (Alaska 2003); *Jerue v. Millett*, 66 P.3d 736, 750 (Alaska 2003).

15. Alaska Statute section 10.06.450, titled "Board of directors; duty of care; right of inspection; failure to dissent," provides, in relevant part:

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

ALASKA STAT. § 10.06.450 (2006).

16. *Shields*, 42 P.3d at 1091–92 (emphasis added).

17. See discussion *infra* Parts II.B, II.D.

18. See discussion *infra* Part III. Examples are collected in the Appendix.

### A. What is the Business Judgment Rule?

The essence of the BJR is deference to directors' decision-making based on judicial unwillingness to re-examine a business decision and judicial reluctance to discourage directors from risk-taking.<sup>19</sup> The BJR is characterized by a number of features.<sup>20</sup> First, the BJR applies to business decisions that have been made by corporate directors and officers by supplying a presumption of correctness.<sup>21</sup> Second, the BJR requires a judgment or decision.<sup>22</sup>

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19. There are three principal formulations of the Business Judgment Rule: (1) the Delaware rule, (2) the ALI rule, and (3) the Model Act rule. See R. Franklin Balotti & James J. Hanks, Jr., *Rejudging The Business Judgment Rule*, 48 BUS. LAW. 1337, 1337–39 (1993) (explaining the “three major positions on the business judgment rule”); see also Meredith M. Brown & William I. Phillips, *The Business Judgment Rule: Burks v. Lasker and Other Recent Developments*, 6 J. Corp. L. 453, 454–61 (1981) (discussing the policy behind the business judgment rule and outlining the necessary conditions for its application); Charles Hansen, *The Duty of Care, the Business Judgment Rule, and The American Law Institute Corporate Governance Project*, 48 BUS. LAW. 1355, 1363–68 (1993) (outlining the elements of the BJR).

20. An introduction to the BJR can be found in several popular texts and treatises on the law of corporations. See, e.g., ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW § 8.03[C], at 209–14 (2d ed. 2004); 1 AM. LAW INST., *supra* note 12, § 4.01(c) & cmt. at 172–86 (providing the ALI's formulation of the BJR); WILLIAM L. CARY & MELVIN ARON EISENBERG, CASES AND MATERIALS ON CORPORATIONS 592–634 (7th ed. 1995); JAMES D. COX & THOMAS L. HAZEN, COX & HAZEN ON CORPORATIONS § 15.07 (2d ed. 2003); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 93–100 (1991); MELVIN ARON EISENBERG, THE STRUCTURE OF THE CORPORATION 13–17 (1976) (discussing various types of business decisions); ROBERT W. HAMILTON & JONATHAN R. MACEY, CASES AND MATERIALS ON CORPORATIONS 800–817 (8th ed. 2003); 3A WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 1036–40, at 37–52 (perm. ed., rev. vol. 3A 1994); ROBERT W. HAMILTON, THE LAW OF CORPORATIONS IN A NUTSHELL §§ 14.4–5, (5th ed. 2000) [hereinafter HAMILTON NUTSHELL] (distinguishing the standard of care and the BJR); HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 242 (3d ed. 1983); DAVID COWAN BAYNE, S.J., THE PHILOSOPHY OF CORPORATE CONTROL—A TREATISE ON THE LAW OF FIDUCIARY DUTY 71–73 (1986); JAMES A. FANTO, DIRECTORS' AND OFFICERS' LIABILITY § 2:2.3[A][3], at 2-26 (2d ed. 2006) (noting that the rationale for the BJR “is institutional, economic, and psychological”).

21. See HAMILTON NUTSHELL, *supra* note 20, § 14.5, at 453. The presumption component of the BJR is developed in Balotti & Hanks, *supra* note 19, at 1339–50. It is also discussed in DOUGLAS M. BRANSON, CORPORATE GOVERNANCE § 7.13 (1993) (discussing “something above and beyond the routine

Third, the BJR protects corporate directors and officers from liability for mistakes that were made in business decisions, even when such a decision proves to have been unsound or downright erroneous.<sup>23</sup> Finally, the BJR supplies judicial restraint and abstention, for it furnishes a deferential standard of review by which courts will abstain from second guessing the directors' business decisions.<sup>24</sup>

The BJR insulates corporate directors from those decisions that are within their authority and are not tainted by fraud or self-dealing.<sup>25</sup> The BJR is a venerable common law rule<sup>26</sup> that is recognized and applied by courts everywhere to protect directors when they are acting within the scope of their corporate authority:

The rule is simply that the business judgment of the directors will not be challenged or overturned by courts or shareholders,

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presumption of regularity”). The BJR protects officers as well as directors. *Id.* § 7.03 & n.31. *But see* Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439, 458–69 (2005) (arguing against the application of the business judgment rule to protect corporate officers who are not also directors).

22. *See, e.g.*, DOUGLAS M. BRANSON, NO SEAT AT THE TABLE 56 (2007) (“One salient feature of the rule is that the directors must have made a judgment or decision—the rule does not protect directors who do nothing.”).

23. HAMILTON NUTSHELL, *supra* note 20, §14.5, at 453 (“Decisions made by the board of directors upon reasonable information and with some rationality do not give rise to directorial liability even if they turn out badly or disastrously.”). Even the fertile young minds of law students could not devise a better example of a business decision gone awry than the parsimonious mistake of Alaska Plastics’ directors: not buying fire insurance to protect its only production facility.

24. The abstention feature of the BJR is developed in Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004).

25. For a useful summary of the rule and its purpose as a shield to protect directors, see *Gries Sports Enter., Inc. v. Cleveland Browns Football Co.*, 496 N.E.2d 959, 963 (Ohio 1986) (“The business judgment rule is a principle of corporate law that has been part of the common law for at least one hundred fifty years.”). The historical roots of the BJR are reviewed in S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 97–100 (1979).

26. The common law origin of the BJR is discussed in MELVIN ARON EISENBERG, THE NATURE OF THE COMMON LAW 38–39 (1988) (giving a brief statement of the Business Judgment Rule and its policy bases). In the era before codification *vel non* became a disputed topic, the rule’s common law genesis was axiomatic: “Under the common law, courts are disposed to give directors a wide latitude in the management of a corporation’s affairs, as long as they reasonably exercise an honest, unbiased judgment. This is often referred to as the ‘business judgment rule.’” 1 WILLIAM E. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS, § 1.08, at 20 (3d ed. 1978) (footnote omitted).

and the directors will not be held liable for the consequences of their exercise of business judgment—even for judgments that appear to have been clear mistakes—unless certain exceptions apply. Put another way, the rule is “a presumption that in making a business decision, the directors of a corporation acted on an informed basis in good faith and in the honest belief that the action was taken in the best interests of the company.”<sup>27</sup>

The exceptions referred to by Dean Clark are “managerial fraud and self-dealing.”<sup>28</sup>

The BJR provides a safe harbor to directors only for decisions in which they have *discretion* and for which they are permitted to choose between rational business alternatives. The correct expression of the BJR is seen in *Alaska Plastics*: “Judges are not business experts, a fact which has become expressed in the so-called ‘business judgment rule.’ The essence of that doctrine is that courts are reluctant to substitute their judgment for that of the board of directors unless the board’s decisions are unreasonable.”<sup>29</sup>

*Alaska Plastics* provides an excellent example of judicial deference to business decisions. In that case, the shareholder-plaintiff complained that the defendant-directors were negligent in

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27. ROBERT CHARLES CLARK, CORPORATE LAW, §3.4, at 123–24 (1986) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)) (footnote omitted); see also BRANSON, *supra* note 21, §7.01–.17; see generally, 1–2 DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS (5th ed. 1998). Two frequently cited expressions of the BJR in the case law are *Aronson* and *Joy v. North*, 692 F.2d 880, 885–86 (2d Cir. 1982). A useful analysis can be found in *United Artists Theater Co. v. Walton*, 315 F.3d 217, 233 (3d Cir. 2003). The BJR is the focal point of the most famous—some might say *infamous*—corporate law case in our life time: *Smith v. Van Gorkom*, 488 A.2d 858, 871–73 (Del. 1985) (holding the BJR is not a defense for directors who acted with haste, failed to consult outside professionals, and failed to make adequate inquiry about the terms of a proposed merger).

28. CLARK, *supra* note 27, §3.5, at 140.

29. *Alaska Plastics, Inc. v. Coppock*, 621 P.2d 270, 278 (Alaska 1980) (citation omitted). The introductory phrase “judges are not business experts,” which Justice Connor derives from *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919), is not the BJR but merely a statement of one principal policy basis for the rule (among several). This often-quoted phrase is discussed in Bainbridge, *supra* note 24, at 117–23 (noting that “this too is an incomplete explanation for the business judgment rule” and offering an alternative that judges “have an incentive to duck these cases” because “many judges are ‘radically incompetent’”); *id.* at 119 (quoting Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749, 754, 758 (2000) (noting that “courts have trouble understanding the simplest of business relationships” and that “[t]heir frequent failure to understand transactions is well-documented”)).

failing to insure company property—a plant in Fairbanks—and that they kept large amounts of cash in non-interest-bearing checking accounts, thus violating the directors’ duty of care.<sup>30</sup> The court rejected these arguments for the reason expressed in the quoted passage above:<sup>31</sup> the directors have *discretion* about insurance and banking practices, and a court should show deference because “[j]udges are not business experts.”<sup>32</sup>

## B. Distinguishing the Directors’ Standard of Care and the Business Judgment Rule

The key difference between the standard of care and the Business Judgment Rule is that the standard of care defines *ex ante* the conduct to which directors must aspire while the BJR is an *ex post* standard of review applied by the courts.<sup>33</sup> Although some courts fail to distinguish between the standard of care and the BJR, legal scholars have recognized the distinction between these two doctrines.<sup>34</sup> The standard of care and the BJR are often confused because “[i]n many or most areas of law, standards of conduct and standards of review are identical.”<sup>35</sup> But these standards are not identical in the law of corporations:

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30. *Coppock*, 621 P.2d at 278.

31. *Id.*

32. *Id.* *Alaska Plastics* also explains that the BJR does not protect directors who violate the rights of shareholders. For example, in *Alaska Plastics*, the court recognized that management could not avoid liability if it violated the shareholders’ right to equal treatment in the matter of dividends: “[I]f a stockholder is being unjustly deprived of dividends that should be his, a court of equity will not permit management to cloak itself in the immunity of the business judgment rule.” *Id.* (quoting *Santarelli v. Katz*, 270 F.2d 762, 768 (7th Cir. 1959)) (alteration in original).

33. Elizabeth S. Miller & Thomas E. Rutledge, *The Duty Of Finest Loyalty And Reasonable Decisions: The Business Judgment Rule In Unincorporated Business Organizations?*, 30 DEL. J. CORP. L. 343, 352–53 (2005) (“It is important to note the difference between the standard of care, which is the standard of conduct expected of directors in their decision making, and the business judgment rule, which is the standard of review that determines whether directors will be held liable for a poor decision.”); see also LEWIS D. SOLOMON, DONALD E. SCHWARTZ, JEFFREY D. BAUMAN, & ELLIOT J. WEISS, *CORPORATIONS: LAW AND POLICY*, 705–710 (4th ed. 1998) (distinguishing between due care and the BJR).

34. A useful discussion is found in HAMILTON NUTSHELL, *supra* note 20, §§ 14.4–5.

35. CARY & EISENBERG, *supra* note 20, at 602 (“A *standard of conduct* states how an actor should conduct a given activity or play a given role. A *standard of*

An identity between standards of conduct and standards of review is so common that it is easy to overlook the fact that the two kinds of standards may diverge in any given area—that is, the standard of conduct that states how an actor should conduct himself may differ from the standard of review by which courts determine whether to impose liability on the basis of the actor's conduct. . . .

The duty of care is a leading example of this divergence.<sup>36</sup>

To illustrate, Professor Douglas Branson explains that a director's conduct must meet a standard of due care:

[T]he standard of care applicable to corporate directors remains due care. As the Model Business Corporation Act and the Indiana statute phrase it, a director is to discharge her duties “with the care an ordinarily reasonably prudent person in a like position would exercise under similar circumstances.” The standard of conduct is not “slight care,” or “gross negligence,” or anything other than due care. . . . With that established, the business judgment rule may be the *de facto* standard of conduct in cases in which directors are proactive, making a judgment or decision, that may be a deliberative decision to take no action, as opposed to cases of complete nonfeasance.<sup>37</sup>

The directors have many duties under the standard of care, including the duty of monitoring, the duty of inquiry, the duty to make reasonable and prudent decisions regarding matters upon which the board is obligated or chooses to act, and also the duty to employ a reasonable decision-making process.<sup>38</sup>

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*review* states the test a court should apply when it reviews an actor's conduct to determine whether to impose liability or grant injunctive relief.”).

36. *Id.* (“For example, the standard of conduct that governs an automobile driver is that he should drive carefully. Correspondingly, the standard of review in a liability claim against a driver is whether he drove carefully. The standard of conduct that governs an agent who engages in a transaction with his principal that involves the subject matter of the agency is that the agent must deal fairly. Correspondingly, the standard of review in a liability claim by the principal against the agent based on such a transaction is whether the agent dealt fairly.”). Professor Eisenberg's complete explanation can be found in Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 63 FORDHAM L. REV. 437 (1993).

37. Douglas M. Branson, *The Rule That Isn't a Rule – The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 631, 638 (2002) (footnote omitted); see also RICHARD W. JENNINGS & RICHARD M. BUXBAUM, CORPORATIONS: CASES AND MATERIALS, 171–99 (5th ed. 1979).

38. See CARY & EISENBERG, *supra* note 20, at 602; 1 AM. LAW INST., *supra* note 12, § 4.01(a) (“A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a



In contrast, the BJR is a presumption of correctness for business decisions applied by the courts to shield directors from liability, even if the decision is unreasonable. The BJR precludes the court from examining the merits of a business decision unless the directors were grossly negligent.

Where the business judgment rule applies, a director will not be held liable for a decision, “even one that is unreasonable” and results in a loss to the corporation, so long as the director was not grossly negligent in reaching the decision. Furthermore, while the plaintiff is required to show gross negligence in order to overcome the presumption of the business judgment rule, proof of a grossly negligent decision alone is not sufficient to set aside the decision or yield an award of damages. Liability may be avoided in the absence of causation or damages, or where the directors can establish the fairness of the challenged transaction. The decision, in such instances, will be respected, and the directors will not be exposed to personal liability.<sup>39</sup>

According to the official comments to the Model Business Corporation Act, the drafters purposely left it to the courts to sort out the relationship, if any, between directors’ statutory duty of care and the BJR.<sup>40</sup> Table I summarizes the difference between these two concepts.

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like position and under similar circumstances.”). The American Law Institute’s formulation of the duty of care is similar to the Model Act’s, and thus it is similar to the law of Alaska and most states.

39. Miller, *supra* note 33, at 352–53 (footnotes omitted); *see also* SOLOMON ET AL., *supra* note 33, at 705–710 (distinguishing between due care and the BJR).

40. MODEL BUS. CORP. ACT § 8.30 cmt. at 8-163 (3d ed. 2005 Supp.) (“The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts.”).

Table I: Differences between the standard of care and the BJR:

<i>Directors' Standard of Care</i>	<i>Business Judgment Rule</i>
Standard of <i>conduct</i> for directors & officers	Standard of <i>review</i> for use by courts
Guidelines to advise a director or officer in contemplation of board action	Liability test a court should apply when it reviews a director's or officer's conduct
How a director should conduct a given activity or make a decision	Limits the use of liability rules against directors to evaluate their performance
Fiduciary duties of care and loyalty	Not a description of a duty or standard
Aspirational goals for present and future conduct; guides directors	Presumption of correctness of completed acts; a safe harbor to protect directors
Requires an informed judgment or decision	An abstention doctrine in which courts will not interfere with business decisions
Forward looking; operates <i>ex ante</i>	Retrospective; operates <i>ex post</i>
Codified; MBCA § 8.30; ALASKA STAT. § 10.06.450.	Not codified; a common law rule

### C. The Standard Matters

When a court uses the wrong legal standard, confusing the standard of conduct with the standard of review, the mistake can be outcome determinative. In *Shields*, the Supreme Court of Alaska compounded the trial court's erroneous jury instruction (which incorporated the wrong legal standard) by approving the instruction with the mistaken holding that it made no difference:

Defendants contend that Jury Instruction Nos. 14 and 15 concerning Martinez's liability as a director of the corporation were plain error because they did not reflect the business judgment rule. The business judgment rule is set out in AS 10.06.450(b). It requires a director to use the care...that an ordinarily prudent person in a like position would use under similar circumstances. As such, *liability under the business judgment rule does not differ appreciably from negligence liability*—the standard used in Instructions Nos. 14 and 15. Thus

it was not plain error to fail to instruct on the business judgment rule.<sup>41</sup>

The court's mistake was in saying that liability under the business judgment rule "does not differ appreciably" from negligence liability.<sup>42</sup> The court was flat wrong in equating the BJR with a classical negligence standard. Most courts that have reached the issue have said that a plaintiff who sues a director must overcome the BJR's presumption of correctness and then must establish gross negligence (followed by causation and damages) in order to recover.<sup>43</sup>

In a suit against a corporate director or officer for breach of the duty of care, the plaintiff cannot simply show a violation of the duty of care statute, such as section 10.06.450(b). Instead, the plaintiff must show gross negligence to overcome the director's protection of the BJR. Without such a showing, the BJR's safe harbor insulates the director from liability for defective decision making. In summary, a violation of the standard of care does not automatically translate into a violation of the standard of liability. In corporate law, the standards of conduct diverge from the standards of review; they are not synonymous.<sup>44</sup>

Thus, the *Shields* court made three mistakes. First, it confused the codified standard of care with the common law's BJR. Second, it declared the standard of care to be a codification of the BJR. Third, it adopted the wrong legal standard by choosing ordinary negligence instead of gross negligence to evaluate the director's conduct.

#### D. The Business Judgment Rule is Not Codified

*Shields v. Cape Fox Corp.*<sup>45</sup> asserts that Alaska Statute section 10.06.450(b)<sup>46</sup> is the BJR.<sup>47</sup> However, despite widespread

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41. *Shields*, 42 P.3d at 1091–92 (italics added; internal citations and quotation marks omitted).

42. *See id.*

43. *See, e.g.,* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (“[U]nder the business judgment rule director liability is predicated upon concepts of gross negligence . . . .”); Resolution Trust Corp. v. Blasdel, 930 F. Supp. 417, 424 (D. Ariz. 1994) (“[T]he court could find no case in which a court held that the business judgment rule could be overcome by a showing of mere negligence. If it could, the rule would provide very little protection to directors.”). The only counterexample is *Theriot v. Bourg*, 691 So.2d 213, 222 (La. Ct. App. 1997) (holding that the standard for imposing liability on directors is not gross negligence).

44. Eisenberg, *supra* note 36, at 443–45.

45. 42 P.3d 1083 (Alaska 2002).

46. ALASKA STAT. § 10.06.450 (2006).

adoption of the Model Act in Alaska and elsewhere, “the [BJR] remains uncodified.”<sup>48</sup> Alaska’s version of the Model Act, section 10.06.450(b),<sup>49</sup> and its parallel, section 10.06.483(e) (the duty of care for corporate officers),<sup>50</sup> is not the BJR but is simply a statutory “Standard[] of Conduct for Directors” that codifies their duty of care.<sup>51</sup> To this end, the principal authorities on the topic agree that the BJR remains uncodified in all jurisdictions.<sup>52</sup> Indeed, neither the original Model Business Corporation Act of 1969 nor its revision in 1984 makes any claim of codifying the BJR.<sup>53</sup> The 1984 version expressly states the contrary.<sup>54</sup>

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47. *Shields*, 42 P.3d at 1091 (“The business judgment rule is set out in AS 10.06.450(b).”).

48. Branson, *supra* note 37, at 632–33.

49. ALASKA STAT. § 10.06.450(b) (2006).

50. *Id.* § 10.06.483(e) (2006) (“An officer shall perform the duties of the office in good faith and with that degree of care, including reasonable inquiry, that an ordinarily prudent person in a like position would use under similar circumstances.”).

51. “Standards of Conduct for Directors” is the title of section 8.30 of the Revised Model Business Corporation Act (RMBCA), MODEL BUS. CORP. ACT § 8.30 (2005), which in turn replicates former Model Business Code Act (MBCA) section 35, MODEL BUS. CORP. ACT § 35 (1969) (amended 1973), from which Alaska’s present law has descended, ALASKA STAT. § 10.06.450(b). The legislative history—the Official Comment—of section 10.06.450 of the Alaska Statutes describes the purpose of the law as “the articulation of a standard for the discharge of the duty of care which must be observed by directors” and “the duty of care to be observed by a corporate director.” Similarly, the Comment to ALASKA STAT. § 10.06.450 describes one of its purposes as to provide “a definition of the standard of care according to which officers are to discharge their responsibilities to the corporation.” 1987 HOUSE-SENATE JOINT JOURNAL SUPPLEMENT No. 9, 98–101, 113 (May 7, 1987) (providing the Alaska Code Revision Commission’s official commentary on Chapter 10.06 of the Alaska Corporations Code). The Comment to ALASKA STAT. § 10.06.483 is similar (“a definition of the standard of care” for officers).

52. *See e.g.*, BLOCK ET AL., *supra* note 27, at 100–06 (“The [ABA] Committee on Corporate Laws determined that the rule is better left as an uncodified equitable doctrine.”); *see also* FLETCHER ET AL., *supra* note 20, §§ 1035–40.

53. MODEL BUS. CORP. ACT § 8.30 (1984). According to the official comments, the drafters purposely left it to the courts to sort out the relationship, if any, between directors’ statutory duty of care and the business judgment rule. MODEL BUS. CORP. ACT § 8.30 cmt. (1984).

54. MOD. BUS. CORP. ACT § 8.30 cmt. at 8-163 (3d ed. 2005 Supp.) (“Section 8.30 does not try to codify the business judgment rule.”), *reprinted in* BRANSON, *supra* note 21, § 7.01 n.8; *see id.* § 7.02, at 328 (“The business judgment rule is by and large uncodified.”); *see also* FLETCHER ET AL., *supra* note 20, § 1038 (“The

The error in *Shields v. Cape Fox Corp.* can be understood by examining the Model Act's treatment of the standard of care and of the BJR in sections 8.30 and 8.31, respectively.<sup>55</sup> The Alaska duty of care statute, section 10.06.450(b) is taken almost verbatim from section 8.30 of the Revised Model Business Corporation Act (RMBCA).<sup>56</sup> Alaska's statute adds *only* an express requirement of "reasonable inquiry" to the Model Act's language.<sup>57</sup> In all other respects, the operative clauses are identically worded. Instead of being a codification of the BJR, Alaska Statute section 10.06.450(b) and RMBCA section 8.30 are codifications of the common law duty of care applicable to corporate directors.<sup>58</sup> The Official Comment to RMBCA section 8.30 makes this clear: "[t]he elements of the [BJR] and the circumstances for its application are continuing to be developed by the courts. Section 8.30 does not try to codify the BJR or to delineate the differences between that defensive rule and the section's standards of director conduct."<sup>59</sup>

In an effort to reduce the confusion about the duty of care in section 8.30 (Standards of Conduct for Directors), a new section was added to the revised Model Act in 1999. The new section, section 8.31 (Standards of Liability for Directors), arguably is a partial codification of the BJR, or at least a *suggestion* or proposal for codification. The Official Comment to section 8.31 explains that the BJR is a common law rule, not a statute: "the operative elements of the standard of judicial review commonly referred to as the BJR have been widely recognized [and] courts have used a number of different word formulations to articulate the concept."<sup>60</sup> "Section 8.31 does not codify the [BJR] as a whole."<sup>61</sup>

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business judgment rule has not been expressly codified in any state corporation statute nor in any version of the Model Business Corporation Act.").

55. 42 P.3d 1083, 1091 (Alaska 2002) ("The business judgment rule is set out in AS 10.06.450(b).").

56. Compare ALASKA STAT. § 10.06.450(b) (2006), with MODEL BUS. CORP. ACT § 8.30 (2005).

57. See ALASKA STAT. § 10.06.450(b) ("and with the care, including reasonable inquiry . . .").

58. See, e.g., BRANSON, *supra* note 21, § 7.04 ("Relationship of the Business Judgment Rule to the Duty of Care"). The difference between the duty of care and the Business Judgment Rule is also explained in HAMILTON NUTSHELL, *supra* note 20, §§ 14.4–.5, which also distinguishes the different roles of RMBCA §§ 8.30 and 8.31.

59. 2 MOD. BUS. CORP. ACT § 8.30 cmt. at 8-163 (3d ed. 2005 Supp.), reprinted in BRANSON, *supra* note 21, § 7.01 n.8.

60. *Id.* at 8-67.

61. *Id.*

Even assuming that section 8.31 codifies part of the BJR, however, it has been adopted by only three states, and Alaska is not one of them.<sup>62</sup> Thus, the only possible conclusion is that Alaska Statute section 10.06.450(b) is not the BJR.

Professor Robert Hamilton supports this conclusion by distinguishing the diverse roles of RMBCA Sections 8.30 and 8.31:

A critical and sometimes misunderstood principle is that § 8.30 is not the operative test for determining whether directors are liable for damages for failing to exercise reasonable care. The proper test for liability is the “[BJR]” described in the following section [§ 14.5] of this Nutshell. The 1999 amendments to the Model Act make this crystal clear: The revised § 8.30 is entitled “Standards of Conduct for Directors,” while a completely new § 8.31, entitled “Standards of Liability for Directors,” is added. Essentially, § 8.31 codifies the “[BJR]” described in the following section [§ 14.5, of this Nutshell].

....

In a word, one should not look at the provisions of revised § 8.30 of MBCA (1984) to determine whether directors are personally responsible for bad decisions.<sup>65</sup>

There has been only one attempt at a full codification of the BJR—but not by a legislature. When drafting a restatement of the law of corporations, the American Law Institute (ALI) distilled the common law BJR into this formulation, titled “Duty of Care of Directors and Officers; the [BJR]”:

(c) A director or officer who makes a business judgment in good faith fulfills the duty under this Section [4.01] if the director or officer:

- (1) is not interested in the subject of the business judgment;
- (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
- (3) rationally believes that the business judgment is in the best interests of the corporation.<sup>64</sup>

Although still relatively new, the ALI formulation of the BJR has been adopted by some state courts—but not codified by their respective legislatures.<sup>65</sup> Even the ALI has recognized that “[t]here

62. The three states that have adopted § 8.31 are Idaho, IDAHO CODE ANN. § 30-1-831 (2006); Iowa, IOWA CODE § 490.831 (2006); and Mississippi, MISS. CODE ANN. § 79-4-8.31 (2006).

63. HAMILTON NUTSHELL, *supra* note 20, § 14.4, at 449–50.

64. AM. LAW INST., *supra* note 12, § 4.01(c).

65. *See, e.g.*, *Rosenfield v. Metals Selling Corp.*, 643 A.2d 1253, 1261 (Conn. 1994); *Omni Bank v. United S. Bank*, 607 So.2d 76, 86 (Miss. 1992); *cf. Brehm v. Eisner*, 746 A.2d 244, 259 n.47 (Del. 2000) (“Because [the American Law

are no statutory formulations of the [BJR].”<sup>66</sup> Professor Branson confirms that the BJR is “by and large uncodified,” despite the ALI’s proposed codification in section 4.01(c).<sup>67</sup>

### III. ALASKA’S COURTS ARE NOT ALONE IN CONFUSING THE DIRECTORS’ STANDARD OF CARE WITH THE BUSINESS JUDGMENT RULE

More than a dozen courts have confused the difference between the directors’ standard of care and the Business Judgment Rule. Forty states have adopted the Model Act’s section 8.30(a), the standard of care provision.<sup>68</sup> As noted above, the commentary to the Model Act expressly rejects the notion that it codifies the BJR.<sup>69</sup> Nevertheless, courts across the country have ignored the commentary to section 8.30 and have pronounced that their state’s version of the Model Act is a codification of the BJR.<sup>70</sup> These examples include courts in states that either have adopted the operative language of section 8.30(a) verbatim<sup>71</sup> or have replicated it with substantially the same language (i.e., states like Alaska).<sup>72</sup>

Institute] test also is based on the objective test of reasonableness, it could be argued that it is essentially synonymous with the Delaware test. But there is room to argue that the Delaware test is stricter. . . . In the end, the debate may be mostly semantic.”).

66. AM. LAW INST., *supra* note 12, § 4.01(c) cmt. at 173.

67. BRANSON, *supra* note 21, § 7.02.

68. MODEL BUS. CORP. ACT § 8.30 cmt. at 8-176, 8-178 (including a statutory comparison).

69. MODEL BUS. CORP. ACT § 8.30 cmt. at 8-42 to -43 (2005).

70. *E.g.*, *FDIC v. Castetter*, 184 F.3d 1040, 1044 (9th Cir. 1999) (interpreting California law); *IBS Fin. Corp. v. Seidman & Assoc., L.L.C.*, 136 F.3d 940, 949 (3d Cir. 1998) (interpreting New Jersey law); *In re Xcel Energy, Inc.*, 222 F.R.D. 603, 606 n.3 (D. Minn. 2004) (interpreting Minnesota law); *In re Maresh*, 277 B.R. 339, 349 (Bankr. N.D. Ohio 2001) (interpreting Ohio law); *Shoen v. SAC Holding Corp.*, 137 P.3d 1171, 1179 (Nev. 2006); *Sadler v. Jorad, Inc.*, 680 N.W.2d 165, 171 (Neb. 2004); *Lindner Fund, Inc. v. Waldbaum, Inc.*, 624 N.E.2d 160, 161 (N.Y. 2004); *Sadler v. Dimensions Healthcare Corp.*, 836 A.2d 655, 665 (Md. 2003); *Shields v. Cape Fox Corp.*, 42 P.3d 1083, 1091 (Alaska 2002); *Simmons v. Miller*, 544 S.E.2d 666, 675 (Va. 2001); *Hanrahan v. Kruidenier*, 473 N.W.2d 184, 186 (Iowa 1991); *Jordan v. Hunter*, 865 P.2d 990, 996 n.3 (Idaho Ct. App. 1993); *Krukemeier v. Krukemeier Mach. & Tool Co., Inc.*, 551 N.E.2d 885, 888 (Ind. Ct. App. 1990); *Schwarzmann v. Ass’n of Apartment Owners of Bridgehaven*, 655 P.2d 1177, 1180 (Wash. Ct. App. 1982); *Dunham v. Michael Kane Brick Co.*, 1994 WL 318936, at \*2 (Conn. Super. Ct. 1994).

71. *E.g.*, IOWA CODE § 490.830(1) (2006).

72. *See, e.g.*, ALASKA STAT. § 10.06.450 (2006).

These courts mistakenly insist that section 8.30 codifies the BJR,<sup>73</sup> when in fact it really codifies the standard of care, an altogether different concept. This error is especially remarkable because the American Bar Association's Model Act expressly denies being a codification of the BJR!<sup>74</sup> And yet these courts have ignored the drafters' disavowal of any attempt to codify and have deemed the statute at issue to be a codification of the BJR.<sup>75</sup> Examples of these cases are provided in the Appendix.

Professor Melvin Eisenberg has said about California's appellate decisions (specifically *Gaillard v. Natomas Co.*<sup>76</sup>) what this Comment says about the Alaska case law:

[T]he court stated that Corporations Code Section 309 "codifies California's business-judgment rule." This is incorrect. Section 309 codifies the standard of careful conduct, with which the business-judgment rule is inconsistent.

Indeed, an argument could be made that Section 309 overturns the business-judgment rule, because the business-judgment rule is established by case law, while the standard of Section 309, which is inconsistent with the business-judgment rule, is statutory. The better position, however, is that although Section 309 does not codify<sup>77</sup> the business-judgment rule, neither does it overturn the rule.

Other commentators also have noted the confusion of courts and their failure to distinguish between the statutory standard of care and the BJR itself. Professor Stuart Cohn, for instance, complains that courts have merged the two doctrinal principles into one.<sup>78</sup>

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73. See *FDIC*, 184 F.3d at 1044 ("California Corporations Code § 309 codifies California's business judgment rule.").

74. MODEL BUS. CORP. ACT § 8.30 cmt. at 8-42 (2005) ("Section 8.30 does not try to codify the business judgment rule . . .").

75. See examples collected in the Appendix.

76. 256 Cal. Rptr. 702, 710 (Cal. Ct. App. 1989) ("Section 309 codifies California's business judgment rule.") (internal citation omitted).

77. MELVIN A. EISENBERG, CALIFORNIA LAW REVISION COMMISSION, WHETHER THE BUSINESS-JUDGMENT RULE SHOULD BE CODIFIED 47-48 & n.20 (1998), available at <http://www.clrc.ca.gov/pub/BKST/BKST-EisenbergBJR.pdf> (last visited Feb. 28, 2007). Professor Eisenberg cites to another example of this "incorrect" analysis. See *Barnes v. State Farm Mut. Auto. Ins. Co.*, 20 Cal. Rptr. 2d 87, 95 n.12 (Cal. Ct. App. 1993) ("In California, the business judgment rule is codified in Corporations Code section 309, subdivision (a) . . ." (citing *Gaillard*, 256 Cal. Rptr. at 702)); see also *Lehman v. Superior Court*, 51 Cal. Rptr. 3d 411, 418 (Cal. Ct. App. 2006) ("Section 309 . . . codified common law principles, in particular the business judgment rule.").

78. Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV.



However, a few courts have detected the error that so many jurists are committing. In *Shinn v. Thrust IV, Inc.*,<sup>79</sup> for example, the Washington Court of Appeals recognized the difference between the standard of care that was enacted in its version of Model Act section 8.30 and the Business Judgment Rule:

We note that Washington courts and the Seafirst Corp. court appear to be mistaken in their assumption that RCW 23A.08.343 is a codification of the [BJR]. The comments to the Revised Model Business Corporation Act (sec. 8.30) indicate that the statutory language is not intended to be a codification of the [BJR].<sup>80</sup>

The Maryland Court of Appeals showed similar sophistication and pointed a finger of blame at the Attorney General for failing to understand the difference:

The Attorney General has interpreted § 2-405.1 to be a codification of the [BJR] . . . which is a “presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company.” . . . Contrary to the opinion of the Attorney General, § 2-405.1 and the [BJR] differ in that the former is the code of conduct for corporate directors, while the latter is an aid to judicial review . . . . Nevertheless, the two do overlap. For example, proof of the lack of good faith defeats both the presumption of the [BJR] and the requirements of § 2-405.1(a)(1). The better position is to view the [BJR] as a presumption that corporate directors acted in accordance with § 2-405.1.<sup>81</sup>

While there is nationwide error on this point, some courts and commentators have recognized the important distinction between a director’s duty of care and the BJR.

#### IV. THE BUSINESS JUDGMENT RULE SHOULD NOT BE CODIFIED

The descriptive analysis above makes it clear that the Business Judgment Rule has not been codified in Alaska. While this analysis stands independent from any normative reasons against

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591, 604, 617–23 (1983) (lamenting courts’ and commentators’ proclivity to collapse fully the standard of conduct into the business judgment rule).

79. 786 P.2d 285 (Wash. Ct. App. 1990).

80. *Id.* at 290 n.1 (citing MODEL BUS. CORP. ACT § 8.30 at 928 (3d ed. 1989 supp.)). The Washington Code, while placing the clauses in a slightly different sequence, is worded identically to Alaska’s adoption of section 8.30 of the Model Act. See WASH. REV. CODE § 23B.08.300 (2006); ALASKA STAT. § 10.06.450(b) (2006).

81. *Yost v. Early*, 589 A.2d 1291, 1298 (Md. Ct. Spec. App. 1991) (internal citation omitted). The Maryland Code is patterned after the Model Act. See MD. CODE ANN., CORPS. & ASS’NS § 2-405.1 (2006).

codification of the BJR, many such reasons exist. Most pressing is the problem of how to reconcile the disparate versions of the BJR. There are at least three expressions of the BJR: the formulations of the Delaware courts, the America Law Institute (ALI), and the Model Act.<sup>82</sup> There is no practical way to codify all three versions of the BJR, yet each of these three formulations is useful in the adjudication of certain types of disputes. Indeed, it would be difficult to synthesize the competing formulations into one single enactment. Who would write it? What form would it take?<sup>83</sup>

These questions illuminate a structural problem inherent in the codification process. A legislature would no doubt be influenced by a powerful pro-management lobby that would want to water down and weaken director liability in any codification of the BJR, thereby giving greater protections to management. The risk that the legislature would cave to the corporate lobby is largely alleviated when the formulation of the BJR is left to the courts.

More important is the substantive problem: the legislature would have a difficult choice to make between the competing versions. Professor Eisenberg suggests that the California statute should be amended to blend ALI section 4.01(c) into its present text.<sup>84</sup> However, he could just as well advance RMBCA section

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82. For a comparison, see BRANSON, *supra* note 21, § 7.02; Balotti & Hanks, *supra* note 19, at 1337–39. There are, of course, other formulations of the BJR throughout the above-cited scholarship and case law.

83. The Alaska Code Revision Commission spent a decade revising Chapter 10.05 of the Alaska Statutes, the Alaska's version of the original Model Act that was repealed in 1988 and replaced with the current section 10.06, a task supervised by the Commission's outside counsel and legal expert, Professor Daniel Fessler of UC–Davis. When he wrote the definitive article about the new Alaska Corporations Code, Chapter 10.06, Professor Fessler said nothing about codifying the Business Judgment Rule, a feat which to corporate scholars would be like climbing Mt. St. Elias solo or hitting sixty home runs in a single season. See Daniel William Fessler, *The Alaska Corporations Code: The Forty-Ninth State Claims the Middle Ground*, 7 ALASKA L. REV. 1, 51 (1990). Both Professor Fessler's law review article and the Commission's Official Comment are silent about the BJR and any putative codification. See *id.*; 1987 HOUSE-SENATE JOINT JOURNAL SUPPLEMENT No. 9, 98-101 (May 7, 1987).

84. EISENBERG, *supra* note 77, at 49–50. Professor Branson has made the same suggestion for using the ALI proposal to codify the BJR in Hong Kong. Douglas M. Branson, *Balancing the Scales: A Statutory Business Judgment Rule for Hong Kong?*, 34 HONG KONG L.J. 303, 320 (2004) (arguing that “Hong Kong should adopt a statutory business judgment rule” but mentioning reasons advanced against codification when it was proposed in Australia). The ALI's expression of the BJR has been criticized on the grounds that it is too narrow and that it removes too much of the director's safe harbor by injecting requirements of

8.31 or the operative language from a judicial expression of the rule, such as Delaware's formulation in *Aronson v. Lewis*.<sup>85</sup> Indeed, there are numerous formulations of the BJR in treatises and in the legal literature. Even if consensus could be achieved, any codification would necessarily be exclusive to some degree, almost certainly including conduct that would otherwise be excluded, and vice-versa.

This leads to the final problem with codification: a legislative rule would lack the flexibility of the common law rule.<sup>86</sup> The common law method is able to incorporate and apply social policies, such as the policy grounds for the BJR, while a legislative rule would be more constrained.<sup>87</sup> It would also be difficult to avoid the problem of "dueling statutes," both between the standard of care and the BJR and among the various states, each of which would have its own codified version of the rule. In sum, the present common law rule has worked for more than a century.<sup>88</sup> As the saying goes: if it ain't broke, don't fix it.

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reasonable inquiry and rational basis. See Donald E. Pease, *Aronson v. Lewis: When Demand Is Excused and Delaware's Business Judgment Rule*, 9 DEL. J. CORP. L. 39, 74–76 & n.177 (1984) (relating criticisms of the Business Roundtable, an association of chief executive officers of major U.S. companies).

85. 473 A.2d 805, 812 (Del. 1984), *overruled in part on other grounds* by Brehm v. Eisner, 746 A.2d 244, 253–54 (Del. 2000) (changing the standard of appellate review from abuse of discretion to *de novo*). *Aronson* is the most frequently cited judicial formulation of the BJR.

86. Aside, *The Common Law Origins of the Infield Fly Rule*, 123 U. PA. L. REV. 1474, 1480 (1975) (arguing that the creation of a common law rule is an incremental process of refinement "in which common law precedents are employed to mold existing remedies to new situations").

87. KARL N. LLEWELLYN, *THE COMMON LAW TRADITION* 19–51 (1960) (listing fourteen "strongly stabilizing factors" as reasons why the common law tradition is superior to other methods of resolving disputes); RICHARD A. WASSERSTROM, *THE JUDICIAL DECISION—TOWARD A THEORY OF LEGAL JUSTIFICATION* 75–79 (1961) (noting that legal precedent imposes a restraint upon judges and limits the variation in judicial decision-making).

88. See EISENBERG, *supra* note 26, at 26–37 (explaining the role of policy as a social proposition in common law reasoning); *id.* at 27 (noting that "[t]he administrability policy is that the applicability of a legal rule should not depend on information of a kind that cannot be reliably determined by courts," such as the information directors use in making business decisions); *id.* at 32 ("policies figure so pervasively in legal reasoning").

## V. CONCLUSION: CORPORATE LAW NEEDS A COURSE CORRECTION

The standard of care that guides directors' conduct is codified in almost every state, but the Business Judgment Rule is an uncodified common law rule that protects the business decisions of corporate directors and officers when they are brought into court. Some courts have conflated these two notions. These courts have mistakenly declared that the standard of care is the BJR, which it surely is not.

The BJR is important to all corporate directors, officers, and shareholders.<sup>89</sup> It commands special prominence in Alaska because the state courts frequently are called upon to evaluate, *ex post*, the decisions and policies of corporate directors in Alaska Native corporations. These decisions are a source of frequent and contentious litigation in Alaska.<sup>90</sup> For the sake of all interested parties, the Alaska Supreme Court should correct the erroneous dictum in *Shields v. Cape Fox* that mistakenly refers to a statutory formulation of the Business Judgment Rule and thereby adopts the wrong legal standard for determining liability. A correction will ease the burdens on the lower courts in corporate litigation and will move Alaska's corporate jurisprudence towards the mainstream of modern legal thought. The dozen or more other courts around the nation that have committed the same error should make the same course correction.

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89. Bainbridge, *supra* note 24, at 83 n.1 (“The business judgment rule pervades every aspect of state corporate law, from the review of allegedly negligent decisions by directors, to self-dealing transactions, to board decisions to seek dismissal of shareholder litigation, and so on.”).

90. *See, e.g.*, *Broad v. Sealaska*, 85 F.3d 422 (9th Cir. 1996) (involving a shareholders' challenge to directors' approval of discriminatory distributions); *Demmert v. Kootznoowoo, Inc.*, 45 P.3d 1208, 1211 n.3 (Alaska 2002) (involving whether directors can favor local shareholders, including directors' relatives, in a corporate hire program); *Sierra v. Goldbelt*, 25 P.3d 697 (Alaska 2000) (involving whether directors must disclose their resolution when asking shareholders to approve amendment to articles of incorporation); *Hanson v. Kake Tribal Corp.*, 939 P.2d 1320 (Alaska 1997) (involving a shareholders' challenge to directors' adoption of a discriminatory life insurance program for local, original shareholders); *Moses v. McGarvey*, 614 P.2d 1363 (Alaska 1980) (involving a shareholders' challenge to the annual meeting and election of directors); *Aleut Corp. v. McGarvey*, 573 P.2d 473 (Alaska 1978) (involving a dispute about election of directors). Of course, *Shields* fits into this category as well.

Appendix: Examples from case law in  
which courts mistakenly have said the BJR is codified:

<i>State</i>	<i>Case</i>	<i>Statute</i>
AK†	<i>Shields v. Cape Fox Corp.</i> , 42 P.3d 1083, 1091 n. 31 (Alaska 2002).	ALASKA STAT. § 10.06.450(b)
CA†	<i>Lehman v. Superior Court</i> , 51 Cal. Rptr. 3d 411, 418 (Cal. Ct. App. 2006); <i>Barnes v. State Farm Mutual Automobile Insurance Co.</i> , 20 Cal. Rptr. 2d 87, 95 (Cal. Ct. App. 1993); <i>Gaillard v. Natomas Co.</i> , 256 Cal. Rptr. 702 (Cal. Ct. App. 1989); <i>see also FDIC v. Casterter</i> , 184 F.3d 1040, 1044 (9th Cir. 1999).	CAL. CORP. CODE § 309
CT†‡	<i>Dunham v. Michael Kane Brick Co.</i> , 1994 WL 318936 (Conn. Super. Ct. 1994).	CONN. GEN. STAT. § 33-313(d)
IA†	<i>Hanrahan v. Kruidenier</i> , 473 N.W.2d 184, 186 (Iowa 1991).	IOWA CODE § 490.830
ID†‡	<i>Jordan v. Hunter</i> , 865 P.2d 990, 996 n.3 (Idaho Ct. App. 1993).	IDAHO CODE ANN. § 30-1-35
IN†	<i>Krukemeier v. Krukemeier Machine &amp; Tool Co.</i> , 551 N.E.2d 885, 888 (Ind. Ct. App. 1990).	IND. CODE § 23-1-35-1
MD†	<i>Sadler v. Dimensions Healthcare Corp</i> , 836 A.2d 655, 665 (Md. 2003).	MD. CODE ANN., CORPS. & ASS'NS § 2-405.1
MN†‡	<i>In re Xcel Energy, Inc.</i> , 222 F.R.D. 603, 606 n.3 (D. Minn. 2004).	MINN. STAT. § 302A.251 (1)
NE†	<i>Sadler v. Jorad, Inc.</i> , 680 N.W.2d 165, 171 (Neb. 2004).	NEB. REV. STAT. § 21-2095

<i>State</i>	<i>Case</i>	<i>Statute</i>
NJ†	<i>IBS Financial Corp. v. Seidman &amp; Associates, LLC</i> , 136 F.3d 940, 949 (3d Cir. 1998).	N.J. STAT. ANN. § 14A:6-14
NV**	<i>Shoen v. SAC Holding Corp.</i> , 137 P.3d 1171, 1179 n. 11 (Nev. 2006).	NEV. REV. STAT. § 78.138(3)
NY†	<i>Lindner Fund, Inc. v. Waldbaum, Inc.</i> , 624 N.E.2d 160, 161 (N.Y. 2004).	N.Y. BUS. CORP. LAW § 717(a)
OH†‡	<i>In re Maresh</i> , 277 B.R. 339, 349 (Bankr. N.D. Ohio 2001).	OHIO REV. CODE ANN. § 1701.59(B)
VA**	<i>Simmons v. Miller</i> , 544 S.E.2d 666, 675 (Va. 2001).	VA. CODE ANN. § 13.1-690
WA†‡ <sup>91</sup>	<i>Schwarzmann v. Ass'n of Apartment Owners of Bridgehaven</i> , 655 P.2d 1177, 1180 n.1 (Wash. Ct. App. 1982).	WASH. REV. CODE § 23A.08.343 <sup>92</sup>

91. See also *Seafirst Corp. v. Jenkins*, 644 F. Supp. 1152, 1159 (W.D. Wash. 1986) (interpreting Washington law and making the same mistake); *Shinn v. Thrust IV, Inc.*, 786 P.2d 285, 290 n.1 (Wash. Ct. App. 1990) (noting that the *Seafirst* court mistakenly assumed that the Washington statute codified the BJR).

92. This statute was repealed after *Schwarzmann* was decided and was reenacted as WASH. REV. CODE § 23B.08.300(1) (2006), which is worded identically to the Alaska Statute.

† Has adopted the principal operative language of MBCA § 8.30(a): “Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation.”

‡ Has adopted language identical to that which Alaska has adopted in ALASKA STAT. § 10.06.450(b).

\*\* Has adopted language similar to MBCA § 8.30(a).