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THE BUSINESS JUDGMENT RULE: AN ANALYSIS OF SOUTH CAROLINA LAW IN LIGHT OF RECENT DELAWARE RULINGS AND LEGISLATION

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I. INTRODUCTION

The business judgment rule[1] is a common-law principle[2] of

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1. This Article will not address the debate on whether (and when) to use the term "business judgment doctrine" as compared to the term "business judgment rule." For a brief discussion thereof, *see* Veasey, *New Insights Into Judicial Deference to Directors' Business Decisions: Should We Trust the Courts?*, 39 BUS. LAW. 1461, 1462 n.2 (1984) [hereinafter Veasey, *New Insights*]; *see also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 n.10 (Del. 1986).

2. The business judgment rule was originally developed by the judiciary; however, in recent years many states have codified the directors' duty of care, which is an integral part of the business judgment rule. Moreover, the American Bar Association, in an effort to produce a uniform codification of the law regarding corporations, promulgated the Model Business Corporation Act, *see* MODEL BUS. CORP. ACT §§ 1.01-16.22 (1969) [hereinafter MBCA], which has since been revised, *see* REVISED MODEL BUS. CORP. ACT §§ 1.01-17.06 (1984) [hereinafter RMBCA]. The MBCA and RMBCA will hereinafter be referred to jointly as the Model Acts. Section 8.30(a) of the RMBCA, patterned after MBCA § 35, sets forth the general standard of care for directors:

> (a) director shall discharge his duties as a director, including his duties as a member of a committee:
> (1) in good faith;
> (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
> (3) in a manner he reasonably believes to be in the best interests of the corporation.

RMBCA § 8.30(a). As of 1986, 31 states had adopted statutory provisions substantially similiar to the MBCA or otherwise had provided for a general standard of care based on prudent or reasonable conduct. *See* ALA. CODE § 10-2A-74 (1980); CAL. CORP. CODE § 309(a) (West 1977); COLO. REV. STAT. § 7-5-101(2) (1986); CONN. GEN. STAT. ANN. § 33-313(d) (West Supp. 1986); FLA. STAT. § 607.111(4) (1977); GA. CODE ANN. § 14-2-152

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corporate governance that has been a part of American jurisprudence for over 150 years.[3] Under this rule, courts generally defer to the business decisions of a corporation's board of directors and will not impose liability upon directors for honest mistakes of business judgment.[4] However, while most states accord corporate boards of directors great latitude in deciding how the business of the corporation shall be managed,[5] at some point the

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(Supp. 1986); HAW. REV. STAT. § 416-91.5(c) (1985); IDAHO CODE § 30-1-35 (1980); IND. CODE ANN. § 1-35-1 (Burns Supp. 1986); IOWA CODE ANN. § 496A.34 (West 1986); LA. REV. STAT. ANN. § 12:91 (West 1969); ME. REV. STAT. ANN. tit. 13-A, § 716 (Supp. 1986); MD. CORPS. & ASS'NS CODE ANN. § 2-405.1(a) (1985); MASS. GEN. LAWS ANN. ch. 156B, § 65 (West Supp. 1986); MICH. COMP. LAWS ANN. § 450.1541(1) (West 1973); MINN. STAT. ANN. § 302A.251 (West 1985); MONT. CODE ANN. § 35-1-401(2) (1985); NEB. REV. STAT. § 21-2035 (1983); N.H. REV. STAT. ANN. § 293-A:35.II (Cum. Supp. 1986) N.J. STAT. ANN. § 14A:6-14 (West 1969); N.M. STAT. ANN. § 53-11-35 (Supp. 1986); N.Y. BUS. CORP. LAW § 717 (McKinney 1986); N.C. GEN. STAT. § 55-35 (1982); OHIO REV. CODE ANN. § 1701.59(B) (Page 1985); OR. REV. STAT. ANN. § 57.228 (Butterworth 1984); PA. STAT. ANN. tit. 15, § 1408(A) (Purdon Supp. 1986); R.I. GEN. LAWS § 7-1.1-43 (1985); S.C. CODE ANN. § 33-13-150 (1976); TENN. CODE ANN. § 48-1-813 (1984); WASH. REV. CODE ANN. § 23A.08.343 (Supp. 1986); WYO. STAT. ANN. § 17-1-133(b) (Michie Cum. Supp. 1986); *see also* Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 593 n.7 (1983). South Carolina's Business Corporation Act is based upon the language of the MBCA; however, the South Carolina Legislature is currently considering a revision of the Act designed to make it conform more closely to the RMBCA. Some states, including Delaware, have not adopted the MBCA, RMBCA, or any codification of the standards of care; rather, case law sets forth the applicable standard of care. *See* Veasey & Manning, *Codified Standard—Safe Harbor or Uncharted Reef? An Analysis of the Model Act Standard of Care Compared with Delaware Law*, 35 BUS. LAW. 919, 921 (1980) [hereinafter Veasey & Manning, *Codified Standard*].

3. *See, e.g.*, Smith v. Prattville Mfg. Co., 29 Ala. 503 (1857); Godbold v. Branch Bank, 11 Ala. 191 (1847); Percy v. Millaudon, 8 Mart. (n.s.) 68 (La. 1829); *see also* Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 93, 134 (1979).

4. Bodell v. General Gas & Elec. Corp., 15 Del. Ch. 420, 140 A. 264 (1927); *see also* Veasey, *New Insights*, *supra* note 1, at 1464. An early Delaware Supreme Court definition of the business judgment rule is an appropriate starting point for further analysis: "If in the particular case there is nothing to show that the directors did not exercise their discretion for what they believed to be the best interest of the corporation, certainly an honest mistake of business judgment should not be reviewable by the Court." *Bodell*, 15 Del. Ch. at 424, 140 A. at 267.

The basic premise underlying the business judgment rule is simply that when directors have acted with due care and in good faith, a court typically will not substitute its judgment for that of the board by reviewing the merits of the transaction itself. To permit judicial review of business transactions that are not tainted with bad faith would be an emasculation of the rule itself. *See* Brown & Phillips, *The Business Judgment Rule*, 1981-82 CORP. PRAC. COMMENTATOR 505, 517-18. Thus, the business judgment rule serves as a gauge of conduct. Under the rule, courts will review the decisionmaking process, but not the decision itself.

5. Most states require corporations to be "managed under the direction of" a board

courts will intervene at the behest of stockholders and impose liability upon directors for their business decisions.[6]

Unfortunately, it is not always clear when directors are entitled to the protection of the business judgment rule.[7] Recent rulings of the Delaware courts, which appear to take differing views of when directors should be held personally liable for their business decisions, highlight the need for clarity in this area.[8] The uncertainty caused by these differing views has casued directors to turn increasingly to corporate attorneys for guidance in ascertaining the standard of conduct required of them to avoid liability.

This Article will analyze the business judgment rule by reviewing its genesis and rationale and by examining its recent application. Because South Carolina has very little corporate jurisprudence, this Article will examine, at some length, recent Delaware court decisions and legislation regarding the rule and attempt to set forth a definitive restatement of the business judgment rule under Delaware law. Finally, this Article will compare existing South Carolina law with that of Delaware and attempt to determine how the South Carolina courts would likely view the business judgment rule today. The objective of the Article is to aid the corporate lawyer both in the boardroom and in the courtroom, by enabling him better to advise directors on the business judgment rule's protections and to defend them

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of directors. *E.g.*, DEL. CODE ANN. tit. 8, § 141(a) (1983); S.C. CODE ANN. § 33-13-10 (1976); *see* RMBCA § 8.01(b); *see also* Veasey, *New Insights*, *supra* note 1, at 1463-65. Shareholders elect directors to oversee their investment. The directors then conduct corporate business independently, without input from the shareholders, except in instances in which a vote may affect the nature of the investment. *See* Brown & Phillips, *supra* note 4, at 507.

Implicit in the statutory language, however, is the directors' right to delegate work—particularly work relating to the day-to-day functioning of the corporation. The drafters of the MBCA opted against the phrase "managed by the board of directors" because they did not wish to require directors to become involved in the detailed administration of corporate affairs. This close involvement was felt to be inconsistent with the advent of the outside director. *See* Veasey & Manning, *Codified Standard*, *supra* note 2, at 923-24.

6. *See* Arsht, *supra* note 3, at 93.

7. *See* Veasey, *New Insights*, *supra* note 1, at 1464.

8. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Moran v. Household Int'l, Inc., 490 A.2d 1059 (Del. Ch. 1985). Decisions on corporate matters rendered by the Delaware courts are of interest in all jurisdictions in the United States because of the vast number of companies incorporated in Delaware and because of the enormous influence that Delaware's courts have on business law.

adequately should a suit be initiated challenging board action.

II. The Business Judgment Rule: Genesis and Application

Most practitioners regard the business judgment rule as a shield from liability.[9] The rule, however, also implicitly imposes significant duties on directors through limitations on its applicability.[10] Stated simply, a corporate director forfeits the benefits of the business judgment rule and exposes himself to personal liability if he violates either his duty of care or his duty of loyalty to the corporation and its shareholders.[11]

This notion of directorial duties is an outgrowth of the corporate form itself, in which the operational control of the enterprise is separated from ownership. A board of directors manages the corporation, and shareholders do not take part in day-to-day business decisions.[12] Because of this separation of ownership and

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9. *See* Block, Barton & Radin, *The Business Judgment Rule—Application, Limitations and the Burden of Proof*, in Practicing Law Institute, Officers' and Directors' Liability: A Review of the Business Judgment Rule 9, 19 (1985). Goldwasser enumerates five elements that must be present in order for the rule to shield directors from liability: (1) a business decision, (2) disinterestedness, (3) due care, (4) no abuse of discretion, and (5) good faith. *Id.* at 19-24; *see also* Arsht, *supra* note 3, at 114-30. As a shield, the rule has two major effects. It prevents the court from reviewing the merits of a directorial decision once it appears that the directors acted diligently and in good faith, and it provides a presumption in the director's favor on the issues of good faith and due care. Balotti, Finkelstein & Abrams, *The Business Judgment Rule in Delaware: Corporate Control Contests and Executive Compensation*, in Practicing Law Institute, Officers' and Directors' Liability: A Review of the Business Judgment Rule 305, 316 (1985).

10. Arsht, *supra* note 3, at 96; *see also* Arsht & Hinsey, *Codified Standard—Same Harbor But Charted Channel: A Response*, 35 Bus. Law. 947, 958-59 (1980). The business judgment rule should not be viewed, however, as an independent source of liability; rather, it is a presumption that directors have met their directorial duties. Directors must fulfill those duties as a precondition to the applicability of the business judgment rule.

11. *See* Veasey, *New Insights*, *supra* note 1, at 1464. For an extensive discussion of directors' legal obligations, which fall into these two broad categories, see generally Committee on Corporate Laws, Section of Corporation, Banking and Business Law, American Bar Association, *Corporate Director's Guidebook*, 33 Bus. Law. 1591 (1978) [hereinafter *Guidebook*]. The *Guidebook* is the second major contribution of the American Bar Association, in addition to the Model Acts, in the area of corporate law. The *Guidebook* focuses essentially upon MBCA § 35 and attempts to set forth the general requirements that directors must meet in discharging their duty of care.

12. *See* Ruder, *Duty of Loyalty—A Law Professor's Status Report*, 40 Bus. Law. 1383, 1385 (1985); *see also* Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (stating that "[a] cardinal precept of the General Corporation law of the State of Delaware is that

control, the law requires corporate directors to act in a manner consistent with the confidence placed in them.[13] Thus, directors owe certain fiduciary duties to the corporation and its shareholder owners. Although analogous to fiduciary duties existing under the law of trusts, these duties are less demanding since directors' obligations are tempered by their corresponding responsibility to take business risks.[14]

Courts thus devised the business judgment rule to accommodate the corporate director's role as a fiduciary with the realities of the business world.[15] The genesis of the rule lies in the judicial concern that persons of reason, intellect, and integrity would not serve as directors if shareholders strictly enforced the fiduciary standard.[16] Early cases established prudence, rather than perfection, as the standard imposed upon directors,[17] in recognition of the fundamental premise that directors are not infallible. Other bases for the rule are the notions that directors cannot please all of the shareholders all of the time and that business and judicial economy would be hampered if dissatisfied stockholders were allowed to challenge every corporate transaction.[18]

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directors, rather than shareholders, manage the business and affairs of the corporation").

13. Ruder, *supra* note 12, at 1385.

14. *Id.* Although the "fiduciary" standard is generally considered inappropriate, courts typically continue to use the term "fiduciary" while nevertheless invoking the business judgment rule to shield directors from liability. *See* Veasey & Manning, *Codified Standard, supra* note 2, at 925-26.

Neither the RMBCA nor the South Carolina version thereof uses the term "fiduciary" in their formulations of the general standard of conduct for directors. *See* RMBCA § 8.30 (1984); S.C. CODE ANN. § 33-13-150(a) (1976). South Carolina case law, however, does proclaim the existence of a fiduciary relationship between directors and individual stockholders. *See infra* notes 160-63 and accompanying text.

15. *See* Moran v. Household Int'l, Inc., 490 A.2d 1059, 1074 (Del. Ch. 1985).

16. Arsht, *supra* note 3, at 97.

17. *See* Godbold v. Branch Bank, 11 Ala. 191 (1847) (rejecting a requirement of extreme accuracy of knowledge and stating that "[t]he inevitable tendency of such a rule would be hostile to the end proposed by it, as no man of ordinary prudence would accept a trust surrounded by such perils"); Percy v. Millaudon, 8 Mart. (n.s.) 68 (La. 1829) (stating that a contrary doctrine would "suppose the possession, and require the exercise of perfect wisdom in fallible beings. No man would undertake to render a service to another on such severe conditions."); Hodges v. New Eng. Screw Co., 12 R.I. 312 (1850) (stating that "[i]f . . . the mistake be such as the directors might well make notwithstanding the exercise of proper care, and if they acted in good faith and for the benefit of the . . . [company], they ought not to be liable"); *see also* Arsht, *supra* note 3, at 97-99.

18. *See* Arsht, *supra* note 3, at 95. Moreover, directors are selected because of their expertise and superior access to information, and they are in the best position to know

Understanding the rationale behind the business judgment rule does not, of course, end the analysis. Whether a director will be found liable under a given set of circumstances depends in large part upon prevailing judicial attitudes and business practices, and courts typically will measure the director's conduct against a specified standard of care.[19] The subjectivity in-

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how much information should be acquired for a particular decision. Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437, 1441 (1985). Mr. Fischel explains:

> Allowing shareholders to challenge business decisions on the basis that they were not "informed" has the effect of substituting the business judgment of some shareholders, their attorneys, and a court on the issue of how much information should be acquired for the business judgment of those entrusted, by virtue of their superior expertise and incentives, with managing the firm's affairs.

Id.

Moreover, shareholder litigation challenging corporate decisions goes against the traditional one-share/one-vote rule, which gives those shareholders with the largest stake in the corporation the greatest influence over corporate policy. *Id.* at 1443. The small shareholder will sue if the expected value of the attorneys' fees award exceeds the cost of litigation. Typically, he will not consider the adverse effects on risktaking or on other areas affecting the value of the company. *Id.* The argument is not that all shareholder litigation is unhealthy, but that the problems connected with such litigation, coupled with other drawbacks of the liability rules, counsel against allowing shareholders to challenge the business decisions of directors, including the decision of how much information to acquire before entering into a transaction. *Id.* at 1444.

19. *See* Arsht, *supra* note 3, at 96-97. While this subjectivity may give rise to criticism, its practical effect simply may be to provide corporate directors with protection analogous to that enjoyed by professionals, such as doctors or lawyers, under tort law if sued for malpractice on the basis of their medical or legal decisions. *Id.* at 97. Some commentators argue that the injection of tort concepts into a boardroom setting is inappropriate. *See, e.g.*, Veasey & Finkelstein, *New Delaware Statute Allows Limits on Director Liability and Modernizes Indemnification Protection*, BUS. LAW. UPDATE, July-Aug. 1986, at 1 [hereinafter Veasey & Finkelstein, *New Delaware Statute*] (criticizing the "gross negligence" standard). Practitioners, however, must accept the subjective standard as necessary in assessing the potential liability of directors for a board decision since the circumstances under which the business judgment rule defense can arise are varied and cannot be addressed effectively under a statutory formulation of the rule. Indeed, the official comments to RMBCA § 8.30 state that courts have sometimes used language similar to the standards set forth in § 8.30(a) when purporting to apply the business judgment rule. Nevertheless, the drafters of the RMBCA noted:

> The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts . . . section 8.30 does not try to codify the business judgment rule or to delineate the differences, if any, between that rule and the standards of director conduct set forth in this section. That is a task left to the courts and possibly to later revisions of this Model Act.

RMBCA § 8.30 official comments at 221. The drafters purposefully chose not to include an extensive analysis of the relationship between § 8.30 and the common-law business

herent in such an analysis underscores the importance of following judicial trends.

Unfortunately, South Carolina has very little jurisprudence in the corporate area, and no South Carolina cases directly address the business judgment rule. It is necessary, therefore, to hypothesize to a degree when attempting to set forth how the courts of this State would respond if faced with a challenge to board action and a defense based upon the business judgment rule. In all likelihood, South Carolina courts would look for guidance to Delaware common law because the courts of that State are highly respected in the area of corporate jurisprudence. Indeed, on at least one occasion, the South Carolina Supreme Court has expressed its willingness to look to Delaware case law when dealing with corporate matters.[20] In any event, reference to Delaware case law specifically addressing the business judgment rule is advisable because of several recent, significant expositions by Delaware courts on that rule.

III. RECENT DELAWARE LAW REGARDING THE BUSINESS JUDGMENT RULE

A. Aronson v. Lewis: *A Restatement of the Business Judgment Rule*

Despite its lofty reputation in the area of corporate law, the Delaware Supreme Court, until recently, had discussed the business judgment rule only in fragments.[21] In 1984, however, that court set forth a comprehensive analysis of the protections and limitations of the rule in *Aronson v. Lewis*,[22] defining it as a pre-

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judgment rule in light of substantial adverse comments to the exposure draft, which included such an attempt. MODEL BUS. CORP. ACT ANN. § 8.30, at 933-934 (1986).

20. *See* Santee Oil Co. v. Cox, 265 S.C. 270, 217 S.E.2d 789 (1975).

21. *See* Pease, Aronson v. Lewis: *When Demand Is Excused and Delaware's Business Judgment Rule*, 9 DEL. J. CORP. L. 39, 57 (1984).

22. 473 A.2d 805 (Del. 1984). *Aronson* dealt with the demand requirement in shareholder derivative suits. In *Aronson* the court addressed a major question that had been left unanswered in the earlier landmark case in this area, Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981), by deciding when demand is futile and, therefore, excused. 473 A.2d at 813-14. The court stated that demand is excused only when a shareholder alleges specific facts that create a reasonable doubt that the business judgment rule protects the directors' action. *Id.* at 814-15. *See generally* Note, *Shareholder Seeking to Excuse Demand as Futile Must Overcome the Protection of the Business Judgment Rule*, 63 WASH. U.L.Q. 167 (1985).

sumption that in making a business decision the directors of a corporation acted: (1) on an informed basis, (2) in good faith, and (3) in the honest belief that the action taken was in the best interests of the company.[23] Absent an abuse of discretion,[24]

The *Aronson* decision demonstrates that the business judgment rule may be used not only as a defense on the merits to a suit challenging board action, but also as a tool to cut off derivative litigation that is not considered to be in the best interest of the corporation. *See* Brown & Phillips, *supra* note 4, at 505. When used in this manner, the rule is said to be used "offensively"; it is not used to defend the propriety of the underlying action, but, rather, to secure the dismissal of a suit without ever reaching the merits of the claims. *See* Block, Barton & Radin, *supra* note 9, at 72.

The *Aronson* analysis of the business judgment rule presumably is not limited to the question of demand futility and is, instead, applicable to various transactions that are addressed by a board of directors. The court in *Aronson*, however, probably sought to further the policies that the demand requirement imposes upon derivative plaintiffs—primarily the desire not to impinge too greatly on the managerial freedom of directors—by rigidly adhering to the business judgment rule. *See* Note, *supra*, at 172. One effect of the *Aronson* decision is to strengthen the position of corporate boards of directors, making it more difficult for derivative actions to proceed without their support. *Id.* at 173. For a comprehensive discussion of the effect of *Aronson* on earlier decisions, see Block & Prussin, *Termination of Derivative Suits Against Directors on Business Judgment Grounds: From* Zapata *to* Aronson, 39 BUS. LAW. 1503 (1984).

23. 473 A.2d at 812. Stated another way, the business judgment rule, under the *Aronson* formulation, will not apply if the plaintiff can show that:

> (1) the directors (a) stood on both sides of the transaction, (b) had a personal financial interest not shared by the corporation and shareholders, or (c) lacked independence because of domination and control by a person or group, or (2) the directors (a) did not inform themselves, prior to making a business decision, of all material information reasonably available to them, and (b) did not act with requisite care in the discharge of their duties.

Pease, *supra* note 21, at 71 (citations omitted).

The *Aronson* formulation of the business judgment rule represents the majority view on the protection of directors against personal liability in the context of the adoption of defensive mechanisms. *See* Committee on Corporate Laws, *Guidelines for Directors: Planning for and Responding to Unsolicited Tender Offers*, 41 BUS. LAW. 209, 211 n.3 (1985) [hereinafter *Guidelines for Directors*]. One view is that the board of directors, in defending against takeover attempts, may have an inherent self-interest and that the board should bear the burden of demonstrating that its actions were not designed solely to entrench incumbent management or perpetuate its control. Another view is that the court should independently review the business justification for the action of a board defending against a takeover. *Id.* at 211. A third view is that the burden of proof should shift to the board: actions shown by the plaintiff to be likely to perpetuate the current board's control are presumed invalid, but the board may rebut this presumption by proving that its actions were taken in the reasonable belief that they were in the corporation's best interests. *Id.*

24. 473 A.2d at 812. The "abuse of discretion" restriction may not be a limitation at all, "but simply an application of the fundamental principle behind the rule. An honest error in judgment is allowed. But a judgment that cannot be sustained on some rational basis falls outside the protection of the business judgment rule. . . ." Arsht, *supra* note 3, at 122; *see also* Pease, *supra* note 21, at 62. The judgment of the directors may, for

stated the court in *Aronson*, the courts will respect the judgment of the directors. Thus, the initial burden of proof lies with the party challenging a corporate transaction,[25] and a court typically will defer to the managerial decisions of the board of directors if the board can establish that it acted in conformity with the assumptions underlying the three-fold presumption set forth in *Aronson*'s definition of the rule.[26]

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example, be considered irrational or outside the bounds of reason when the valuation of assets approved by directors in a merger or sale of assets is far removed from the range of values recommended by financial advisors. *See* Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch. 1974); Cottrell v. Pawcatuck Co., 36 Del. Ch. 169, 128 A.2d 225 (1956), *appeal dismissed*, 355 U.S. 12 (1957); Allied Chem. & Dye Corp. v. Steel & Tube Co., 14 Del. Ch. 1, 120 A. 486 (1923); *see also* Pease, *supra* note 21, at 62. An abuse of discretion may also be found when the board of directors attempts to change the date of its annual meeting to obstruct the legitimate efforts of dissident stockholders to undertake a proxy contest. *See* Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. 1971); *see also* Pease, *supra* note 21, at 62. The abuse of discretion limitation thus underscores the prohibition against directors utilizing corporate machinery for the purpose of keeping themselves in office. *See Schnell*, 285 A.2d at 439; *cf.* Petty v. Penntech Papers, Inc., 347 A.2d 140 (Del. Ch. 1975) (officer used corporate funds for the sole purpose of entrenching management).

25. 473 A.2d at 812; *see also* Puma v. Marriott, 283 A.2d 693, 695 (Del. Ch. 1971). This burden is to show by the preponderance of the evidence that the business judgment rule does not apply. Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983); *see also* Pease, *supra* note 21, at 58 n.95. Mere conclusory allegations will not meet the burden. *Aronson*, 473 A.2d at 817. Once a plaintiff establishes a breach of the duty of loyalty or the duty of care, the burden shifts to the directors to prove that the transaction at issue was undertaken in good faith and after reasonable investigation or that it was fair and in the best interests of the shareholders. *See, e.g.*, Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

26. The degree of judicial deference accorded to a board decision may vary depending on the type of decision involved. When, for example, a board addresses a pending takeover bid, it has an obligation "to determine whether the offer is in the best interests of the shareholders," and the board's decision should be no less entitled to the same respect generally accorded other types of business decisions. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985). Because of the constant concern that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, "there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred." *Id.* Indeed, the court must "bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is also involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult." *Id.* at 955 (quoting Bennett v. Propp, 41 Del. Ch. 14, 22, 187 A.2d 405, 409 (1962)). In *Unocal* the court summarized the directors' duties by stating that they "must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership" and that "they satisfy that burden 'by showing good faith and reasonable investigation.'" 493 A.2d at 955. The court further stated that "such proof is materially enhanced . . . by the approval of a board comprised of a majority of outside independent directors

In order for directors to take advantage of the "informed basis" aspect of the *Aronson* presumption, two conditions must be met. First, "directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them."[27] Additionally, "having become so informed, they must then act with requisite care in the discharge of their duties."[28] The *Aronson* court based its definition of "requisite care" upon concepts of "gross negligence."[29] Although this terminology has generated much criticism,[30] Delaware precedent clearly justified the formulation of a standard of care "less exacting than simple negligence,"[31] and subsequent Dela-

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who have acted in accordance with the foregoing standards." *Id.*

27. *Aronson*, 473 A.2d at 812. Questions of materiality and reasonableness of the availability of information often arise in connection with the information requirement. *See* Pease, *supra* note 21, at 66. For instance, a board may be presented with an opportunity to purchase the stock, assets, or product line of another company where there are competing offers. Under these circumstances, there may not be sufficient time for directors to review all material information before a meeting, or this information may not reasonably be available within the deadlines set by the offeree. Thus, directors often have to rely upon the recommendations of the chief executive officer and outside experts. Directors who approve a transaction without enough time to consider all material information assume the risk that their action will not be shielded by the business judgment rule. *Id.*; *see also* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (directors held liable after making a quick decision relying primarily on the presentation and recommendation of their chief executive officer).

The rationale for close judicial scrutiny of decisions made in haste is that "the interests of the shareholders are more likely to be injured when the board has acted without making a thorough investigation." Brown & Phillips, *supra* note 4, at 511. *Contra* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01, at 60 (Tent. Draft No. 3, 1984) [hereinafter ALI Draft No. 3] ("A decision to accept the risk of incomplete information, so long as the director reasonably believes such informational risk taking to be appropriate under the circumstances, will be fully consistent with the application of the business judgment rule to decisions made with respect to the principal transaction.").

Although not specifically set forth in *Aronson*, a useful rule of thumb regarding the level of information that a corporate director should demand when deciding how to vote upon a given issue is that he should feel "sufficiently informed about a proposal so that he can explain a vote for or against it." *Guidebook*, *supra* note 11, at 1609. The *Guidebook* further suggests that if a director believes that adequate information is not being provided and is unsuccessful in his efforts to remedy the situation, he should consider resigning. *Id.*

28. *Aronson*, 473 A.2d at 812.

29. *Id.*

30. *See* Arsht, *supra* note 3, at 94 n.5; Pease, *supra* note 21, at 69-76. For a criticism of the duty of care formulation itself in light of the real world conduct of directors, see generally Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477 (1984) [hereinafter Manning, *Time for Reality*].

31. *Aronson*, 473 A.2d at 812 n.6.

ware cases, as well, have adopted the gross negligence standard as appropriate.[32] The second part of the *Aronson* definition of the business judgment rule is that directors are presumed to have acted in "good faith." A director essentially meets this standard by acting in the best interests of shareholders[33] and within the bounds of the law.[34] The third portion of the presumption is that directors act in the honest belief that a given action taken was in the best interests of the corporation.[35] This component of the definition apparently contemplates a *bona fide* regard for the interests of the corporation.[36]

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32. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

33. Directors who improperly attempt to keep themselves in office, putting their own interests above those of the shareholders, do not meet the standard. *See, e.g.*, Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981); Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984); Kaplan v. Goldsamt, 380 A.2d 556 (Del. Ch. 1977); Baron v. Allied Artist Pictures Corp., 337 A.2d 653 (Del. Ch. 1975); Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405 (1962); *see also* Pease, *supra* note 21, at 59. If the plaintiff can establish that directors authorized the transaction solely or primarily to maintain themselves in office, the business judgment rule is inapplicable even if the transaction is in the best interests of the corporation. If, however, the effect of preserving control is merely incidental to a transaction that is otherwise in the best interest of the corporation, the rule does apply. Arsht, *supra* note 3, at 128-29; *see also* Block, Barton & Radin, *supra* note 9, at 24.

34. Directors who knowingly violate laws do not meet the good faith standard, even if they believe that they are acting in the corporation's best interest. *See* Pease, *supra* note 21, at 59; *Guidelines for Directors*, *supra* note 23, at 213.

35. The court in *Aronson* stated that "the business judgment rule operates only in the context of director action. Technically speaking, it has no role where directors have either abdicated their functions, or absent a conscious decision [to refrain], failed to act." 473 A.2d at 813. "A conscious decision to refrain from acting," explained the court, "may . . . be a valid exercise of business judgment and enjoy the protections of the rule." *Id.*; *see also* Graham v. Allis-Chalmers Mfg. Co., 41 Del. Ch. 78, 188 A.2d 125 (1963); Pease, *supra* note 21, at 76-79. This distinction, however, is often overlooked. *See, e.g.*, *Aronson*, 473 A.2d at 813 n.7; Block, Barton & Radin, *supra* note 9, at 19; Cohn, *supra* note 2, at 604-05.

36. The court in *Aronson* cited Robinson v. Pittsburgh Oil Ref. Corp., 14 Del. Ch. 193, 126 A. 46 (1924), as support for its definition of the business judgment rule. 473 A.2d at 812. In *Robinson* the court stated that the law presumes the directors were "actuated in their conduct by a bona fide regard for the interests of the corporation" and that they "honestly believed that they were securing terms and conditions which were expedient and for the corporation's best interests." *Robinson*, 14 Del. Ch. at ___, 126 A. at 48; *accord* Baron v. Pressed Metals of Am., 35 Del. Ch. 325, 117 A.2d 357 (1955); Karasik v. Pacific E. Corp., 21 Del. Ch. 81, 180 A. 604 (1935); Mitchell v. Highland-W. Glass Co., 19 Del. Ch. 326, 167 A. 831 (1933); *see also* Pease, *supra* note 21, at 59-60.

Some respected commentators would use "reasonable" in place of "honest" as an element of the presumption. *See* Arsht, *supra* note 3, at 111-12. Both the Model Acts and the South Carolina Code use "reasonably" as a modifier of "believes." *See* RMBCA

After discussing the three-fold presumption and the general duty of care, the court in *Aronson* addressed the other primary duty imposed upon corporate directors, the duty of loyalty.[37]

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§ 8.30(a)(3); MBCA § 35; S.C. CODE ANN. § 33-13-150(a) (1976). The American Law Institute, on the other hand, supports the use of the phrase "rational basis" in place of *Aronson*'s "honest belief" and the Model Acts' "reasonable belief" test. The ALI apparently believes that the use of the term "rational" would allow directors wider discretion than would a reasonableness standard. *See* ALI Draft No. 3, *supra* note 27, at 63-64.

The Business Roundtable disagrees: "By making 'rational' basis an issue in every case, the protection of the business judgment rule is substantially narrowed and, perhaps more important, shareholder plaintiffs will always have a basis to demand discovery on the merits of the decision." *See* Pease, *supra* note 21, at 61. Mr. Pease, himself, felt that the phrase "good faith" could be substituted for "honest" in the *Aronson* presumption. *Id.*

For a discussion of the differences, if any, between South Carolina's use of the term "reasonably" and Delaware's use of the word "honest," see *infra* notes 135-43 and accompanying text.

37. The duty of loyalty must be distinguished from the duty to inform oneself, which is in the nature of a duty of care. *See infra* note 53 and accompanying text. At least one commentator has found the duty of loyalty to contain two components: a substantive element and a procedural element. *See generally* Ruder, *supra* note 12. The substantive areas include self-dealing, dealings by a corporate parent with its subsidiaries, majority shareholder injury to minority shareholders in corporate acquisition and reorganization transactions, excessive compensation, the use of corporate funds to perpetuate control, the sale of control at a premium, insider trading, usurpation of corporate opportunities, competition by corporate officers and directors with their corporation, and fiduciary obligations in bankruptcy. *Id.* Procedural considerations, stated in question form, include the following: Was adequate disclosure made to the decision maker? Did the alleged conflict of interest transaction receive independent scrutiny? Who has the burden of proving that the duty of loyalty was breached? Is the transaction fair? *Id.*

The director's loyalty runs to the corporation and its shareholders and not to a dominant shareholder or chief executive officer, since acting under the influence of such controlling persons would "sterilize" the discretion of the board. 473 A.2d at 814. Thus, independence, along with care and loyalty, might be viewed as a component of the business judgment rule. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986). The court in *Aronson* explained this principle:

> Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences. While directors may confer, debate, and resolve their differences through compromise, or by reasonable reliance upon the expertise of their colleagues and other qualified persons, the end result, nonetheless, must be that each director has brought his or her own informed business judgment to bear with specificity upon the corporate merits of the issues without regard for or succumbing to influences which convert an otherwise valid business decision into a faithless act.

473 A.2d at 816. The court then concluded that plaintiffs who allege domination and control of one or more directors must, as a threshold matter, plead particularized facts showing that wishes of the controlling person are being served. The mere fact that certain board members are large stockholders, however, "does not create a disqualifying 'personal pecuniary interest' to defeat the operation of the business judgment rule."

This duty dictates that directors "can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally."[38] The protection of the business judgment rule can only be claimed by disinterested directors who reach an impartial decision and whose conduct otherwise meets the tests of the rule.[39]

Delaware courts subsequently have applied the *Aronson* principles in numerous cases,[40] and the *Aronson* restatement of

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Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985) (citation omitted).

38. 473 A.2d at 812. When a decision is tainted with self-interest or self-dealing, a director may not have brought his "*business* judgment to bear on the matter." Brown & Phillips, *supra* note 4, at 513 (emphasis in original). Self-dealing entails the receipt by a director of some benefit from the corporation to the exclusion of and in detriment to the other stockholders. *See* Sparks, *Recent Developments in Substantive Business Judgment Rule*, 61 N.C.L. REV. 534, 537 (1983). If the director is himself a stockholder, self-dealing occurs when he appropriates to himself some corporate benefit that he does not share pro rata with other stockholders. *Id.*

When the party challenging board action establishes personal interest or self-dealing on the part of one or more directors, the business judgment rule is rendered inapplicable and a presumption of overreaching arises that can be overcome only if the defendants can prove that the transaction was intrinsically fair to the corporation. Balotti, Finkelstein & Abrams, *supra* note 9, at 328-30; Block, Barton & Radin, *supra* note 9, at 20; *see also* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (stating that "[w]hen directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain"); Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (1952); Veasey, *Further Reflections on Court Review of Judgment of Directors: Is the Judicial Process Under Control?*, 40 BUS. LAW. 1373, 1378 (1985) [hereinafter Veasey, *Further Reflections*].

39. 473 A.2d at 812. The court concluded that "if . . . director interest is present, and the transaction is not approved by a majority consisting of the disinterested directors, then the business judgment rule has no application whatever in determining demand futility." *Id.* The court acknowledged that "drawing the line on a majority of the board may be an arguably arbitrary dividing point," but it concluded that, at least in demand futility cases, the discretionary review by the court of chancery of complaints alleging specific facts pointing to bias on a particular board would be sufficient for determining demand futility. *Id.* at 815 n.8. Presumably, the "majority rule" is not limited to demand futility cases.

40. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Pogostin v. Rice, 480 A.2d 619 (Del. 1984). The court in *Pogostin* stated that a plaintiff, in order to overcome the business judgment rule and prove demand futility, must demonstrate divided loyalties or personal financial benefit, create a reasonable doubt that the directors' decision to reject the takeover proposal was "an informed decision," or otherwise show "improper motive in a given set of circumstances, i.e., perpetuation of self in office or otherwise in control, was the sole or primary purpose of the wrongdoer's conduct." *Id.* at 627.

the business judgment rule represents the controlling interpretation of the rule in Delaware. As noted above, however, the courts of Delaware have not always been uniform in their application of the rule. For instance, shortly after the *Aronson* decision, the Delaware Supreme Court and the Delaware Court of Chancery handed down two separate, significant cases, reaching what appeared to be contradicting decisions. A discussion of the business judgment rule would be incomplete without a discussion of these important decisions.

B. Smith v. Van Gorkom: *A Rude Awakening for Corporate Directors?*

1. *Holding and Discussion of Duty of Care*

In *Smith v. Van Gorkom*[41] the Delaware Supreme Court "exploded a bomb."[42] Prior to that decision, courts generally

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In *Pogostin* the court held that the complaint did not overcome the presumption that the board properly and prudently exercised its managerial discretion. The court noted:

> Valuation studies, carefully prepared by outsiders, were presented to the board prior to its decision. A special committee of independent, outside directors was charged with gathering and analyzing this information. There is nothing in the complaint to suggest that the board's action was other than a carefully considered decision made on an informed basis.

Id.; *see also* Veasey, *Further Reflections*, *supra* note 38, at 1376. Naming directors as defendants and making conclusory allegations of director wrongdoing will not suffice to excuse a plaintiff shareholder from demanding board action in the absence of particular allegations of participation, self-dealing, bias, bad faith, or corrupt motive on the part of a majority of the directors. Allison v. General Motors Corp., 604 F. Supp. 1106, 1114 (D. Del. 1985).

41 488 A.2d 858 (Del. 1985).

42. Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 BUS. LAW. 1, 1 (1985) [hereinafter Manning, *Life in the Boardroom*]. Most corporate attorneys and directors were shocked with the outcome of that case. As one commentator summarized:

> At first blush, the challenge to the merger must have seemed like a nuisance action at best. The merger was negotiated at arm's length with no allegation that the decision of the directors of Trans Union was tainted by conflict of interest. Nor was there any challenge to the competence or experience of the directors who approved the merger. The credentials of the five inside and five outside directors were impeccable. Moreover, the rationale for the merger was obvious. Trans Union for many years had investment tax credits that it could not fully use. Prior attempts to obtain the benefit of these credits had failed. The merger allowed the shareholders of Trans Union to sell the tax credits that the firm otherwise could not use. Finally, the terms of the merger pro-

held corporate directors to be shielded from personal liability for business decisions.[43] In *Van Gorkom*, however, the court, in a three-to-two decision, held the directors of Trans Union Corporation *personally* liable when they agreed to sell the company for about $688 million to the Marmon Group, a company controlled by the Pritzker family of Chicago.[44] The court concluded that the directors had not exercised due care in deciding to recommend the cash-out merger[45] and held them liable in damages for the difference between the fair value of the stock of Trans Union and the cash received by the Trans Union stockholders.[46] Specifically, the court held that the board's decision to approve the proposed merger was not the product of an informed business judgment, that the board's subsequent efforts to amend the merger agreement and take other curative action were ineffectual, and that the board did not deal in complete candor with the stockholders because it failed to disclose all material facts that it knew or should have known before securing the stock-

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> vided shareholders of Trans Union with $55 in cash for their shares which were previously trading in the mid-$30's, a premium of approximately fifty percent. The shareholders overwhelmingly approved the merger.

Fischel, *supra* note 18, at 1437. *But see* Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch. 1974), *aff'd per curiam*, 316 A.2d 619 (Del. 1974) (enjoining the sale of a wholly owned subsidiary, after finding gross negligence in the directors' approval of the sale during a two-hour meeting held on one and one-half days' notice, without notification of the purpose to outside directors, and without obtaining an appraisal of the value of the subsidiary).

43. *See* Arsht, *supra* note 3, at 93-100; *see also* authority cited *supra* note 4.

44. 488 A.2d at 864.

45. Manning, *Life in the Boardroom*, *supra* note 42, at 1. The court thus reversed the decision of the court of chancery, which had granted judgment for the defendant directors. The lower court held that the directors had acted in an informed manner, entitling them to the protection of the business judgment rule, and that the shareholder vote was "fairly informed" and should not be set aside. *Id.* The lower court cited the following factors in support of its conclusion: (1) the premium paid (approximately $17) over the market value of the stock; (2) the "business acumen" of the Trans Union directors; and (3) the lack of any other bids for the stock.

Justices McNeilly and Christie of the Delaware Supreme Court dissented from the finding that the Trans Union directors had been grossly negligent. These justices argued that the Trans Union directors exercised proper business judgment and disclosed all material facts to the shareholders. 488 A.2d at 893 (McNeilly, J., dissenting); *id.* at 898-99 (Christie, J., dissenting). Justice McNeilly stressed the credentials and combined experience of the board members and concluded: "Directors of this caliber are not ordinarily taken in by a 'fast shuffle.'" *Id.* at 894 (McNeilly, J., dissenting). For a thorough criticism of the majority holding in *Van Gorkom*, see generally Fischel, *supra* note 18.

46. 488 A.2d at 893.

holders' approval of the merger.[47]

In discussing the business judgment rule, the court repeated the *Aronson* language that 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 taken was in the best interests of the company."[48] The *Van Gorkom* decision rested primarily on the first of these presumptions, the duty of directors to inform themselves "prior to making a business decision of all material information reasonably available to them."[49] The court flatly stated that, under the business judgment rule, there is no protection for directors who have made "an unintelligent or unadvised judgment."[50]

The director's duty to exercise an informed judgment, explained the court, derives from his fiduciary duty to the corporation and its shareholders.[51] This obligation, which does not tolerate faithlessness or self-dealing, requires more than the mere absence of bad faith or fraud. Rather, the director has an affirmative duty to protect shareholder interests and to proceed with a critical eye in assessing information.[52] The court stated that a

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47. *Id.* at 864. In discussing the directors' breach of their fiduciary duty of candor to the stockholders, the court enumerated several material deficiencies in the proxy statement issued by the Trans Union directors. For instance, the board failed to disclose its own lack of valuation information and did not provide a complete and true recital of the events leading up to the meeting at which it voted to approve the merger. *Id.* at 890-92. It also mischaracterized the nature of the $55 per share price by failing to reveal that this price was the result of a "search for ways to justify a price in connection with" a leveraged buy-out transaction, rather than a determination of what the shares were worth. *Id.* at 891. The board also referred to a "substantial" premium that shareholders would receive without disclosing the board's failure to assess the premium offered in terms of relevant valuation techniques, which rendered its determination questionable in light of the admittedly depressed stock market price. *Id.* Moreover, the board issued a supplemental proxy statement of "new" information, much of which was known or reasonably available at the time of the original proxy statement. *Id.*

48. 488 A.2d at 872.

49. *Id.* The court in *Van Gorkom* thus analyzed the decisionmaking process rather than the decision resulting from that process. *See* Veasey, *New Insights*, *supra* note 1.

50. 488 A.2d at 872; *see also* Sparks, *supra* note 38, at 535.

51. 488 A.2d at 872.

52. *Id.* A director may not abdicate this duty by leaving to the shareholders alone the decision to approve or disapprove a given transaction. *Id.* at 873. The delegation of decisions to shareholders must be distinguished, however, from the delegation of a task to an expert or one otherwise in a position to render advice. In Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985), for example, the court stated:

> An informed decision to delegate a task is as much an exercise of business judgment as any other. The realities of modern corporate life are such that

director's duty to inform himself is in the nature of a duty of care, as distinguished from a duty of loyalty, and it repeated the *Aronson* conclusion that the standard of care is predicated upon concepts of gross negligence.[53]

In *Van Gorkom* there were no allegations of fraud, bad faith, or self-dealing, nor was there proof thereof. Thus, the directors were presumed to have acted in good faith and on an informed basis.[54] The court, however, found various instances of "grossly negligent" behavior that rebutted these presumptions. For example, at their meeting of September 20, 1980, the directors approved a fifty-five dollar per share offer after only two hours of consideration, without prior notice, and without the exigency of a crisis or emergency.[55] The board based its approval on a twenty-minute oral presentation by the chief executive officer, Van Gorkom, without ever having seen a copy of the merger agreement or even a written summary of the terms of the merger.[56] The board had only Van Gorkom's statement of his

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> directors cannot be expected to manage the day to day activities of a company. This is recognized by the provisions of [DEL. CODE ANN. tit. 8, § 141(a) (1983)] that the business and affairs of a Delaware corporation are managed "by or under the direction" of its board. In setting its agenda as to the matters in which it will be directly involved, and those it will delegate, a board's decisions in those areas are entitled to equal consideration as exercises of business judgment.

Id. at 943 (citations omitted). In *Rosenblatt* the court upheld the delegation of subsurface asset valuation to DeGolyer & MacNaughton (D & M), a respected engineering firm engaged in supplying independent estimates of the worth of oil and gas properties. *Id.* at 942-43. The court stated that there was no proof that D & M lacked independence or was in any way beholden to either party. *Id.* at 943. Therefore, the court concluded that D & M had the requisite reputation and experience to assist Getty and Skelly Oil. *Id.*

53. 488 A.2d at 872-73.

54. *Id.* at 873.

55. *Id.* at 874. Most corporate directors and attorneys probably did not consider this behavior to constitute "gross negligence" and would regard two hours' consideration of a plan together with reliance on a corporate officer's recommendation as being prudent business behavior. *See supra* note 42 and accompanying text.

56. The court held that the presentation was not a report within the meaning of DEL. CODE ANN. tit. 8, § 141(e) (1983), which protects directors who rely in good faith on reports of officers. 488 A.2d at 875. Moreover, the board's reliance on Van Gorkom's presentation alone violated the warning in *Aronson* that a director must bring "his or her own informed judgment to bear with specificity upon the corporate merits of the issues without regard for or succumbing to influences which convert an otherwise valid business decision into a faithless act." *Aronson*, 473 A.2d at 816; *see also supra* note 37. The *Van Gorkom* court, however, denied that it was suggesting that a board "must read *in haec verba* every contract or legal document which it approves" and stated that there need only be "some credible contemporary evidence demonstrating that the directors

understanding of the substance of the agreement. Neither Van Gorkom nor any board member had ever read the document itself.[57] Moreover, the directors did not adequately inform themselves of Van Gorkom's role in arranging the sale and purchase price,[58] the intrinsic value of the corporation, or the adequacy of the price offered.[59] They neither consulted with an investment banker nor sought documentation to support the fifty-five dollar per share price. The directors also failed to consider relevant information at their meeting of October 8, 1980, at which they approved certain amendments to the merger agreement without ever having seen the amendments in writing.[60] Nevertheless, Van Gorkom executed the amendments without conferring further with the board.

On these facts, the court concluded that the directors had behaved in a grossly negligent manner, both in approving the merger agreement and in adopting the subsequent amendments. It held that the business judgment rule did not shield the directors from personal liability since they had failed to exercise the *informed* business judgment required under the *Aronson* formulation of the rule.[61] The court assessed damages as the amount

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knew what they were doing, and ensured that their purported action was given effect." 488 A.2d at 833 n.25.

57. 488 A.2d at 875. During the trial, the defendants were unable to produce or identify the original merger agreement. *Id.* at 878. The court concluded that the defendants' unexplained failure to produce this document "permits the logical inferences that the instrument would not support their assertions" regarding Trans Union's authority to receive competitive proposals. *Id.*

58. 488 A.2d at 874. Van Gorkom conceived the idea of a merger and approached Pritzker with a per share price proposal. *Id.* at 866.

59. 488 A.2d at 874.

60. *Id.* at 883. The actual amendments were not drafted until some time after this meeting, and, when drafted, they differed materially from the proposed form approved by the directors.

61. *Id.* at 872 (emphasis added). The defendants argued that the following factors demonstrated that the board's decision was informed:

> (1) the magnitude of the premium or spread between the $55 Pritzker offering price and Trans Union's current market price of $38 per share; (2) the amendment of the Agreement as submitted on September 20 to permit the Board to accept any better offer during the "market test" period; (3) the collective experience and expertise of the Board's "inside" and "outside" directors; and (4) their reliance on Brennan's legal advice that directors might be sued if they rejected the Pritzker proposal.

Id. at 875.

An analogous case is Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985). In *Rosenblatt*, which was decided several months after *Van Gorkom*, the Delaware Supreme

by which the fair value of Trans Union exceeded fifty-five dollars per share and remanded for a determination of the fair value of the shares represented by the plaintiff's class. The valuation was to be based upon the intrinsic value of Trans Union on September 20, 1980, the date upon which the merger was approved.[62] The defendant directors subsequently settled out of

Court held that the approval of the merger proposal by the Getty and Skelly Oil boards was made on an informed basis. *Id.* at 939. The court noted that the Skelly directors were fully briefed by the investment banking firms of Smith Barney Harris Upham & Company and Blyth, Eastman, Dillon & Company. Their reports were based on copies of valuation books prepared and distributed by the two investment banks. The directors had seen copies of the proxy statement prior to the meeting. The board also received a legal opinion on the merger, as well as copies of the final estimate prepared by DeGolyer and MacNaughton, a Dallas, Texas petroleum engineering firm with an outstanding reputation. The directors also heard from the attorney representing Gruss, the Skelly shareholder who had been threatening suit since May 1976. Additionally, certain Skelly directors, including one outside director who controlled more stock than the plaintiff class, questioned Getty representatives and Getty management on the fairness of the exchange ratio. Following this discussion, three Skelly directors, who were also Getty and Mission officers, were excused from the Skelly board meeting. An outside director then moved to approve the proposed merger ratio, and the resolution was unanimously adopted. At the Getty board meeting, Getty's directors were given a similar, in-depth briefing on the proposed merger before voting to approve it. *Id.*

62. 488 A.2d at 893. Bayless Manning criticized the court's use of the phrase "intrinsic value," stating as follows:

> Something must be said about the court's talk about the "intrinsic value" of the Trans Union stock. It is disappointing to see a modern court, especially a commercially oriented Delaware court, lapse into anachronistic language of "true value," as though we have learned nothing from 150 years of market economy analytics. And one wonders just how the lower court on remand will go about determining the "intrinsic value" of the Trans Union stock to set the benchmark for the directors' liability. . . .
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> . . . Perhaps the term to describe that measure of value [i.e., damages] should have been "as-if market value"—the price that would have eventuated from an open auction. If, as I believe, "as-if market value" is what the court means by its term "intrinsic value," while the standard is certainly difficult to apply, it is not quite accurate to say that the court reverted to discredited economic theology of "real value."
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> Second—and here is a practical lesson—the materials sent to shareholders by the directors *stated* in just so many words that the book value of the stock was less than "the intrinsic value of the Company's assets," and that the price of common stock on the market did not reflect "the inherent value of the Company." The quoted language was a direct invitation to a plaintiff to sue, and an invitation to the court to set a damages benchmark--and both invitations were taken up. The court also used the same quoted language to argue that the board purported to *know* what the "intrinsic value" was—but in fact had not tried to find out. . . .

Manning, *Life in the Boardroom*, *supra* note 42, at 4 (emphasis in original).

court for $23.5 million.[63]

2. *The Real Winners and Losers in* Van Gorkom

The *Van Gorkom* decision drew immediate and widespread attention. Commentators generally predicted negative effects, many of which came to pass. The most obvious of these effects were the exodus of corporate directors and the inability of corporations to recruit new directors, particularly outside directors.[64] The increased likelihood of suits caused an increase in the cost of directors' liability insurance and a decrease in the availability of such coverage.[65] It was feared that this phenomenon

63. Wall St. J., Aug. 2, 1985, at 18, col. 2. The company was insured for only $10 million. Thus, the directors were held personally liable for $13.5 million. N.Y. Times, Mar. 4, 1987, at 31, col. 2 (nat'l ed.). Ultimately, the Pritzker family paid this difference. *Id.*

64. NEWSWEEK, Aug. 5, 1985, at 46, col. 1. While these effects were felt primarily in Delaware, where the *Van Gorkom* decision was controlling, they were also felt across the nation because of the large number of corporations incorporated in Delaware and because of the respect generally accorded to the Delaware Supreme Court on corporate matters. Directors of major companies receiving average annual fees of $24,000, were weighing the benefits of being corporate directors against the potential liability; for many, it did not add up. *Id.* at col. 3. In response to this problem, many companies now offer higher fees, stock options, and other perquisites in an effort to keep directors happy "even as the risk of lawsuits keeps them awake." *Id.*; *see also* Brown & Phillips, *supra* note 4, at 507-08 ("[A] strict standard of liability for directors may deter capable persons from serving as directors: If one shoots the piano player for hitting a sour note, it may not be easy to find someone else to take his place.").

65. Manning, *Life in the Boardroom, supra* note 42, at 6. Soaring insurance claims have forced some underwriters to raise premiums for directors' insurance, reduce the face amount of policies, and cancel coverage for lawsuit-prone companies. NEWSWEEK, Aug. 5, 1985, at 46, col. 3. The companies that can still get insurance face a double blow: coverage has been cut dramatically (from as much as $50 to $150 million in 1985 to $10 to $35 million as of March 1986), while premiums paid for even the reduced coverage have increased substantially. N.Y. Times, Mar. 4, 1986, at 29, col. 2 (nat'l ed.). A recent account observed the following:

> A sharp contraction in the availability of directors' and officers' liability insurance (D & O) has occurred in the last year. In 1984, brokers could choose from well over 30 carriers, and limits of up to $200 million were available. Today there are only a handful of D & O insurers, and industry representatives say $50 million in coverage is a realistic maximum in standard market coverage. Premiums have escalated, with rate increases of 200[%] to 1,000[%]. Many corporations cannot find coverage for their boards at any price. Industries that are not favorites with underwriters include financial institutions, high tech, utilities, real estate, petrochemicals, steel, and insurance.
>
> Policies that are being written today contain more restrictions than was typical a few years ago. Instead of a three-year policy, one-year terms with a stated expiration date are standard. Carriers are requiring higher corporate

would thwart the decade-old drive to create boards that were independent of management,[66] a result contrary to the pluralistic objectives usually sought by those who argue for more stringent liability standards for directors.[67]

A related effect feared in the aftermath of *Van Gorkom* was a decrease in the amount of risk-taking by those corporate directors who continue to serve.[68] Since the *Van Gorkom* decision held directors personally liable for monetary damages, it was feared that directors might attempt to minimize their exposure by avoiding transactions and decisions for which they might likely be sued.[69] Thus, not only will they be less willing to serve, but when they do serve, they may be less entrepreneurial, tend to overinvest in information,[70] and consult and employ outside experts more often than necessary in order to avoid liability. These precautionary measures would function as a judicially imposed tax on corporate transactions, diminishing the returns to shareholders.[71] Ironically, shareholders may thus be viewed as the real losers in *Van Gorkom*, and although the court held for the shareholders on the facts of that case, the ultimate effect of

> and individual deductibles and some underwriters have reimposed the 5[%] participation clause on the corporation reimbursement side of the policy. The following exclusions are common: pending and prior litigation, takeover activity, insured [versus] insured, and, for financial institutions, regulatory activity.

Veasey & Finkelstein, *New Delaware Statute*, *supra* note 19, at 1. Insurers, however, defend their behavior by pointing out that, recently, many insurance companies have paid out three to four times as much in claims as they collected in premiums.

When no insurer will provide coverage, one solution is self-insurance, which can be provided either through a captive subsidiary or by creating an insurance consortium with several companies. N.Y. Times, *supra*, col. 1. Many states, however, including Delaware, forbid corporations to indemnify board members for damages sustained in certain lawsuits because the shareholders who prevail in those suits should not be paid out of corporate funds. *Id.* at 31, col. 3. Thus, courts may view self-insurance as inappropriate. *Id.* Indeed, from tax and accounting standpoints, it can be argued that self-insurance is not really insurance at all, but a form of reserve funds. *Id.*

Delaware has recently responded to the phenomenon of escalating insurance costs by passing legislation that permits shareholders to limit directors' personal liability for monetary damages arising out of due care violations. *See infra* notes 110-18 and accompanying text.

66. NEWSWEEK, Aug. 5, 1985, at 46, col. 1; *see also* Veasey & Finkelstein, *New Delaware Statute*, *supra* note 19, at 1-2.

67. Manning, *Life in the Boardroom*, *supra* note 42, at 6.

68. Fischel, *supra* note 18, at 1453.

69. *Id.* at 1453-54.

70. *Id.* at 1454.

71. *Id.* at 1453.

the decision could be a general decrease in shareholder profits.[72]

The big winners in *Van Gorkom* are investment bankers and outside consultants.[73] Although *Van Gorkom* did not require that directors always obtain a fairness letter or other outside documentation before voting upon a fundamental corporate change,[74] such documentation would better enable directors to prove that their vote upon a given issue was reasoned and informed, if board action were challenged. Indeed, the decision in *Van Gorkom* apparently encourages the participation of outside consultants in corporate decisionmaking as a form of insurance, and directors probably will be willing to spend corporate funds to obtain this protection rather than risk personal liability for making an "uninformed" decision.

In light of the above-mentioned considerations, *Van Gorkom* appears to conflict with the basic rationale behind the business judgment rule itself,[75] which recognizes that neither judges[76] nor shareholders[77] should be allowed to substitute their

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72. *Id.*

73. *Id.*

74. 488 A.2d at 876. The court stated:

> We do not imply that an outside valuation study is essential to support an informed business judgment; nor do we state that fairness opinions by independent investment bankers are required as a matter of law. Often insiders familiar with the business of a going concern are in a better position than any outsiders to gather relevant information; and under appropriate circumstances, such directors may be fully protected in relying in good faith upon the valuation reports of their management.

Id. Thus, it would be an overstatement to view *Van Gorkom* as "the Investment Bankers' Relief Act of 1985, requiring that boards of directors *must* henceforth get an investment banker's 'fairness' opinion on every valuation transaction." Manning, *Life in the Boardroom*, *supra* note 42, at 3 (emphasis in original). The decision, however, can be viewed as highlighting "the critical need for the retention of independent experts and for careful preparation and documentation in connection with handling takeover proposals." Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities—An Update*, 40 BUS. LAW. 1403, 1410 (1985).

75. *See generally* Fischel, *supra* note 18.

76. *Id.* at 1439; *see also* Brown & Phillips, *supra* note 4, at 507-08. The basic rationale behind the business judgment rule is that businessmen, rather than judges, are better able to make business decisions, and the "substitution of a judge's or jury's notion of what is reasonable (after the fact) for that of a corporate director (before the fact) runs counter to society's traditional encouragement offered to the creative entrepreneur." Veasey & Manning, *supra* note 2, at 932. Indeed, there is no way for courts to define the precise level of information that a director must acquire before making a business decision. Fischel, *supra* note 18, at 1441. Not only would the level vary from company to company and decision to decision, but courts have the advantage of hindsight, whereas directors must make judgment calls during the negotiation of a business deal. When di-

judgment for that of corporate directors. Subsequent cases, however, have shown that the *Van Gorkom* decision did not signal the end of judicial deference to board decisions. For instance, some of the fears raised by *Van Gorkom* were put to rest by the Delaware Supreme Court in *Moran v. Household International, Inc.*[78]

C. Moran v. Household International: *The Calm After the Storm*

1. *The Holding*

The Delaware Court of Chancery's opinion in *Moran v. Household International, Inc.*[79] addressed a challenge to the adoption by the board of directors of Household International, Inc. (Household) of a "poison pill"[80] preferred stock rights divi-

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rectors must weigh the cost of additional expenditures against the value of the additional information that must be gained, it is difficult to know exactly how much is enough. *Id*; *see also* Herzel & Katz, Smith v. Van Gorkom: *The Business of Judging Business Judgment*, 41 BUS. LAW. 1187, 1189 (1986).

The *Guidebook* states in pertinent part:

> Recognizing that, consistent with the business corporation's profit orientation, business judgment inevitably involves risk evaluation and assumption, and recognizing that the office of corporate director, as such, does not require fulltime commitment to the affairs of the enterprise, the corporate director frequently makes important decisions which may eventually prove to be erroneous. A director exercising his good faith judgment may be protected from liability to his corporation under the Business Judgment Rule. . . . Recognizing that business decisions may seem simply [sic] when viewed with hindsight, and expressing reluctance to substitute their judgment for that of directors, courts have generally refrained from questioning the wisdom of board decisions.

Guidebook, *supra* note 11, at 1603-04.

77. *See supra* note 18 and accompanying text.

78. 500 A.2d 1346 (Del. 1985).

79. 490 A.2d 1059 (Del. Ch. 1985). Ironically, the court of chancery decided *Moran* in favor of the corporate directors on the same day that *Van Gorkom* was decided by the Delaware Supreme Court.

80. A "poison pill" is a defensive device that dilutes the value of a company or increases its debt to make it a less attractive target to an unwanted suitor. *See* Block, Barton & Radin, *supra* note 9, at 56. In other words, a poison pill rights plan is "a plan by which shareholders receive the right to be bought out by the corporation at a substantial premium on the occurrence of a stated triggering event." Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986). A review of the various defensive mechanisms that may be adopted by directors to prevent takeovers is beyond the scope of this Article. For a discussion of the application of the business judgment rule to defensive strategies other than the poison pill (e.g., greenmail, golden parachutes,

dend plan.[81] The Household board purportedly enacted the plan to protect the corporation against takeover attempts. The plaintiff, however, a former Household director, alleged that the plan was designed solely for the entrenchment of management, that it arbitrarily restricted the marketability of shares,[82] and that it impermissibly limited the ability of shareholders to engage in proxy contests.[83] Vice Chancellor Walsh, writing for the court, however, rejected the plaintiff's claims and found that the adoption of the plan was a legitimate and informed exercise of managerial judgment under the business judgment rule.[84] The court observed that the board had acted upon information showing that Household was vulnerable to a two-tier takeover[85] and upon

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shark repellant amendments), see Block, Barton & Radin, *supra* note 9, at 37-72; Lerner & Burke, *The Application of the Business Judgment Rule to Corporate Defensive Actions*, in PRACTICING LAW INSTITUTE, OFFICERS' AND DIRECTORS' LIABILITY: A REVIEW OF THE BUSINESS JUDGMENT RULE 379, 399-423 (1985); NAT'L L.J., Nov. 3, 1986, at 21-23. *See generally* Rosenzweig & Orens, *Tipping the Scales—The Business Judgment Rule in the Antitakeover Context*, 14 SEC. REG. L.J. 23 (1986).

81. Household's rights plan allowed a director to issue one right for each outstanding share to shareholders. The rights entitled their holders to purchase 1/100 share of a new, nonredeemable series of preferred stock. Additionally, if a hostile suitor were to acquire at least 20% in Household, shareholders had the right to purchase shares in that company at half price. If they exercised that right, they would thus dilute the acquiror's capital. *See* 490 A.2d at 1066; *see also* Block, Barton & Radin, *supra* note 9, at 57-58. For a detailed discussion of the rights plan adopted by the Household board, see Rosenzweig & Orens, *supra* note 80, at 24-25.

82. The court recognized that the plan had an indirect effect on the alienability of shares by deterring prospective purchasers who wished to pursue a hostile two-tier tender offer, but it held this impact "sustainable, within the parameters of the business judgment rule." 490 A.2d at 1082.

For additional information regarding offensive and defensive tactics that can be employed in tender offer, see generally E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 193-99 (1977); A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES AND PLANNING 291-396 (1983); M. LIPTON & E. STEINBERGER, TAKEOVERS AND FREEZEOUTS §§ 51.01-17 (1984); 1 ALI/ABA Resource Materials, *Takeover Defenses and Director's Liabilities* (M. Lipton ed. 1986).

One should note that when reacting to a tender offer, a company, through its directors, must notify its shareholders within 10 days whether it "(1) [r]ecommends acceptance or rejection of the bidder's tender offer; (2) [e]xpresses no opinion and is remaining neutral toward the bidder's offer; or (3) [i]s unable to take a position with respect to the bidder's tender offer." Securities Exchange Commission rule 14e-2(a), 17 C.F.R. § 240.14e-2(a) (1)-(3) (1986) (promulgated pursuant to the Securities Exchange Act of 1934, 15 U.S.C. § 78n (1982 & Supp. I 1983 & Supp. III 1985)).

83. *See* 490 A.2d at 1082-83.

84. *Id.*

85. *See id.* at 1077-79.

documentation setting forth the particulars of the plan itself.[86]

On appeal the Delaware Supreme Court unanimously affirmed the chancery court, holding that the directors were authorized to adopt the plan, that the plan did not usurp the rights of the stockholders to receive tender offers by changing the corporation's fundamental structure, and that the adoption of the plan was a legitimate exercise of business judgment.[87] The court distinguished *Moran* from earlier cases involving the business judgment rule on the ground that *Moran* concerned the adoption of a defensive mechanism to ward off possible hostile advances in the future, rather than one adopted in reaction to a specific threat.[88] It reasoned that this distinguishing factor made application of the rule even more appropriate since preplanning for the contingency of a hostile takeover may reduce the risk that management would fail to exercise reasonable judgment under the pressure of a takeover bid.[89]

After repeating the *Aronson* definition of the business judgment rule, the court discussed the proper burdens of proof applicable to the adoption of defensive mechanisms:

> [W]hen the business judgment rule applies to adoption of a defensive mechanism, the initial burden will lie with the directors. The directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed. . . . [T]hey satisfy that burden "by showing good faith and reasonable investigation. . . ." In addition the directors must show that the defensive mechanism was reasonable in relation to the threat posed. Moreover, that proof is

86. *Id.* at 1083.

87. Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985). Joseph T. Walsh, the vice chancellor who authored the lower court opinion in *Moran*, was a justice of the Delaware Supreme Court at the time this decision was rendered. N.Y. Times, Nov. 20, 1985, at D5, col. 4 (nat'l ed.). It is interesting to note that *Moran*, in which the directors' actions were upheld, addressed a hostile takeover attempt, whereas *Van Gorkom*, in which liability was imposed on the director, addressed a friendly takeover approved by the shareholders. *See* Rosenzweig & Orens, *supra* note 80, at 30.

88. 500 A.2d at 1350.

89. *Id.*; *cf.* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Unocal Corp. v. Mesa v. Petroleum Co., 493 A.2d 946 (Del. 1985). Although corporate directors generally act under the protection of the business judgment rule, both in prospective measures and in reactive measures, in seeking to ward off a threatened hostile takeover, corporate action that seeks to undo a takeover bid *after* control has already passed to another group is not protected by the business judgment rule. *See* Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401 (Del. 1985).

> materially enhanced . . . where, as here, a majority of the board favoring the proposal consisted of outside independent directors who have acted in accordance with the foregoing standards. Then, the burden shifts back to the plaintiffs who have the ultimate burden of persuasion to show a breach of the directors' fiduciary duties.[90]

The court concluded that the Household board adequately met its burden by demonstrating that the adoption of the rights plan was in reaction to a perceived threat in the market place of coercive two-tier tender offers.[91] The court found that the board reasonably believed that Household was vulnerable to coercive acquisition since the record reflected the board's concern over the

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90. 500 A.2d at 1356 (citiations omitted). *Household* is merely one case in the recent trilogy addressing the application of the business judgment rule to the adoption of defensive mechanisms by the board of directors of a target corporation. *See* NAT'L L.J., Nov. 3, 1986, at 21, col. 1. The Delaware Supreme Court, in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985), and Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), clearly established that the rule's protection is available in such situations only if the board shows: (1) reasonable grounds for believing that a danger to corporate policy and effectiveness existed; (2) that its actions were primarily in fulfillment of its duty to protect the corporation; and (3) that the defensive measure met the "balance" requirement—i.e., that it was reasonable in relation to the threat posed. NAT'L L.J., Nov. 3, 1986, at 21, col. 1. The court in *Unocal* stated that the determination of whether a defensive measure is reasonable in relation to the threat posed entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. 493 A.2d at 955. Examples of such concerns may include: the inadequacy of the price offered, the nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of securities being offered in the exchange. *Id.* The Delaware Supreme Court in *Revlon*, however, stressed that "while concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefit accruing to the shareholders." 506 A.2d at 176. The court found no such benefits on the facts of that case. *Id.* The *Revlon* holding, however, did not render lock-up and no-shop provisions illegal per se. Rather, such provisions are impermissible in takeover situations in which a board's primary duty has become that of an auctioneer responsible for selling the company to the highest bidder. *Id.* at 184. In such a situation, market forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity. *Id.* As the court in *Revlon* stated:

> Favoritism for a white knight to the total exclusion of a hostile bidder might be justifiable when the latter's offer adversely affects shareholder interests, but when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* duties by playing favorites with the contending factions.

Id.

91. 500 A.2d at 1357.

increasing frequency of "boot-strap" and "bust-up" takeovers as well as two-tier offers.[92] Furthermore, the board was aware of Moran's overture on behalf of Dyson-Kissner-Moran Corporation to acquire Household in a leveraged buy-out because Household's stock was significantly undervalued in relation to the company's break-up value. Thus, the court concluded that the adoption of the rights plan was reasonable in relation to the specific threat posed.[93]

The court then held that the plaintiff had failed to meet his burden of showing a breach of duty by the board. The plaintiff made no allegations of bad faith or self-interest on the part of the directors. His primary contention was that the board did not exercise an informed business judgment.[94] The plaintiff contended, *inter alia*, that the directors were uninformed since they had been told that the plan would not inhibit a proxy contest and were not told that it would preclude all hostile takeover attempts. The court, however, concluded that the plan would not preclude all hostile acquisitions and that the directors were not misinformed.[95]

Reaffirming its position in *Aronson* and *Van Gorkom*, the court stated that gross negligence is the proper standard to use in determining whether a board of directors reached an informed judgment on a given set of facts.[96] The court then concluded that the Household directors had not behaved in a grossly negligent manner in adopting the rights plan since they were supplied, at the time of their meeting, with information setting forth the essentials of the plan, including a description of the triggering events, the issue price and dividend rights of the preferred stock, the "flip-over" effect of the rights plan and its consequent dilution of a hostile acquiror's capital, and the redeemability of the rights prior to a triggering event.[97]

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92. *Id.*

93. *Id.*

94. *Id.* at 1356. The court was thus able to avoid the potential breach of loyalty issues presented by the facts.

95. *Id.*

96. *Id.* The court stated that the actions of the Household board were "clearly distinguishable from the actions of the directors of Trans Union Corporation who displayed gross negligence in approving a cash-out merger." *Id.*

97. *Id.*; *cf. Moran*, 490 A.2d at 1076 (court of chancery arrived at a similar conclusion, finding good faith supported judgment for directors). For a discussion of "flip-in" rights, as opposed to "flip-over" rights, see Amalgamated Sugar Co. v. NL Indus., 644 F.

Moreover, not only did the directors receive a three-page summary of the plan along with articles on the current takeover environment, but they also engaged in a full and candid evaluation of the plan during which Moran, the plaintiff in the later suit, presented them with a knowledgeable critique of the plan.[98] Thus the directors made an informed, reasoned business decision after being adequately briefed from competing perspectives. The court, therefore, found that the plaintiff had failed to demonstrate any breach of fiduciary duties, and it held that the directors were entitled to the benefit of the business judgment rule in their adoption of the rights plan.[99]

The court pointed out, however, that the "ultimate response to an actual takeover bid must be judged by the [d]irectors' actions at that time, and nothing we say here relieves them of their basic fundamental duties to the corporation and its stockholders. Their use of the [p]lan will be evaluated when and if the issue arises."[100]

Supp. 1229, 1232-33 (S.D.N.Y. 1986) (holding rights plan adopted by takeover target's board of directors held ultra vires under New Jersey law and invalid because of the "flip-in" provisions that discriminated among shareholders of the same class and series; by parties' stipulation, business judgment questions were not addressed); *see also* Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986), *prob. juris. noted*, 107 S.Ct. 258 (1986).

98. 500 A.2d at 1356.

99. *Id.* at 1357.

100. *Id.* (citations omitted). This limitation on the directors' discretion can be even more clearly seen if one reads *Moran* in conjunction with Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). In *Revlon* the directors of Revlon, Inc. (Revlon) rebuffed offers by Pantry Pride, Inc. (Pantry Pride) to acquire Revlon and voted to adopt a two-part poison pill program as a defensive mechanism. The Revlon board also courted and granted many concessions to a white knight, Forstmann Little & Company, including: (1) the allowance of a "lock-up" option, whereby Forstmann Little could acquire two of Revlon's health aid divisions for a price at least $75 million below the lowest estimate of Revlon's own investment banker; and (2) the allowance of a "no-shop" provision, which prevented the Revlon board from entertaining further bids from any third party, including Pantry Pride, and ended the negotiating role that the board had used as its initial rationale for its poison pill devices. *Id.* at 176-79.

In reviewing the actions of the board, the court in *Revlon* found the poison pill rights plan adopted by the Revlon board to be acceptable. The court concluded that its adoption fell within the business judgment rule as a prospective device calculated to strengthen the board's bargaining position. The court noted that the board relied in part upon the advice of its investment banker, who opined that Pantry Pride would finance its tender offer with "junk bonds" and then sell Revlon's divisions separately to pay the financing and make a profit. *Id.* at 177. According to the investment banker, Pantry Pride's offer was grossly inadequate in light of the amount that Revlon could expect to receive if it sold its divisions separately.

2. *Analysis of the Decision*

The Delaware Supreme Court apparently used *Moran* to reaffirm the viability of the business judgment rule.[101] Alternatively, it could have used *Moran* as a vehicle to deliver a lecture on director self-interest in much the same way that it used *Van Gorkom* to provide a general exegesis on gross negligence.[102] In light of the criticism of *Van Gorkom,* however, the court apparently believed that the "patient [could not] survive two serious operations so close together."[103] Instead, the court found it more prudent simply to swallow the Household "poison pill" and defer to managerial discretion in a situation in which the board could provide documentation sufficient to show that it was adequately informed about the matter under consideration.

In so holding, the court managed to square the *Van Gorkom* decision with existing judicial interpretations of the business

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The court then noted, however, that once the Revlon board authorized management to negotiate a merger or buyout with a third party, it became apparent to all that the break-up and sale of the company was inevitable. According to the court:

> The duty of the board thus had changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. This significantly altered the board's responsibilities under the *Unocal* standards. It no longer faced threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures became moot. The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.

Id. at 182.

Consequently, the court stated that the Revlon board was wrong to permit considerations other than price to dictate its approach and to favor one bidder (Forstmann Little) over another (Pantry Pride). *Id.* By agreeing to lock-up and no-shop clauses, which were in exchange for protecting the rights of noteholders, the board breached is fiduciary duty of loyalty to the shareholders. *Id.* at 182. The court then noted, that, because the notes accepted by the holders specifically contemplated a waiver to permit the sale of the company at a fair price, nothing remained for the board legitimately to protect. Thus, the merger agreement with Forstmann was unreasonable in relation to the threat posed. *Id.* at 184; *cf.* Edelman v. Fruehauf Corp., 798 F.2d 882, 885 (6th Cir. 1986) (holding that the Fruehauf directors "unreasonably preferred incumbent management in the bidding process—acting without objectivity and requisite loyalty to the corporation. Their actions were not taken in a good faith effort to negotiate the best deal for the shareholders").

101. For a criticism of *Moran* as having gone too far in widening the protection afforded by the business judgment rule, see generally Rosenzweig & Orens, *supra* note 80.

102. *See* Smith v. Van Gorkom, 488 A.2d 858, 882-84 (Del. 1985).

103. Manning, *Life in the Boardroom*, *supra* note 42, at 5.

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judgment rule. It is now clear that the court in *Van Gorkom* did not abandon the business judgment rule and substitute its own judgment for that of the Trans Union board. Instead, it simply refused to apply the rule,[104] concluding that the directors failed to make an informed business judgment. After examining the process by which the decision was made, the court in *Van Gorkom* concluded that the directors acted in a manner not in keeping with the presumptions underlying the business judgment rule.[105] Consequently, that rule could not operate to shield the directors from personal liability.

This limitation is entirely reasonable since shareholders should expect directors to perform diligently the functions for which they were selected.[106] Perhaps the lesson to be learned from *Van Gorkom* is that directors, having been given considera-

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104. BUS. WK., Mar. 18, 1985, at 56, col. 2.

105. *See id.* at 4. This analysis is in keeping with the basic premise underlying the business judgment rule: the court should examine the decisionmaking process, not the merits of the decision itself. *See supra* note 1. A critic of the *Van Gorkom* decision however, could argue that the court's language regarding the decisionmaking process was simply a guise to cover their substantive displeasure. The type of decision at issue may well influence how the criteria within the business judgment rule will be applied. Manning, *Life in the Boardroom*, *supra* note 42, at 5. As Mr. Manning has explained:

> Our corporation laws grant to directors exclusive power, or primary power, or shared power to decide most enterprise issues and many ownership claim issues. Currently no language in judicial opinions supports the following statement, but one may predict that the standards of stringency of care (and loyalty) that will be applied by the courts with respect to the business judgment rule as it ultimately develops will differentiate across a spectrum between "enterprise issues" and "ownership claim issues." Directors will find that they will have little to fear from judicial Monday morning quarterbacking on a board's decision, for example, to expand the company's slide rule business, even if it soon becomes clear that the decision was ruinously wrong. But when the question before the board directly involves *shares*—the personal property of the shareholders—when it considers, for example, stock issuance, redemption, cashout, reverse split, merger, and the like, the corporate lawyer had better emphasize that those matters are very close to a nerve, and that the directors would be well advised to be more than usually alert, deliberative, focused, prepared, counseled, paper-tracked, and generally professional in their behavior.

Id. at 6 (emphasis in original). Mr. Manning noted that it was "no accident that the court chose a cashout merger case for the lecture it delivered in the *Van Gorkom* opinion. The particular issue before the Trans Union board was the single most sensitive 'ownership claim' issue of all: the price to be paid to the shareholder for *his* stock." *Id.*; *see also* Veasey, *Further Reflections*, *supra* note 38, at 1374.

106. This limitation, highlighted in *Van Gorkom*, merely echoes earlier interpretations of the business judgment rule. *See* Sparks, *supra* note 38, at 535; Veasey, *New Insights*, *supra* note 1, at 1464.

ble protection under the *Aronson* presumptions, must pay the price for this judicial deference by tending to corporate matters in a deliberate manner.[107] This interpretation of *Van Gorkom* reinforces the view that directors must live up to the standards imposed upon them by the twin duties of care and loyalty before they may seek refuge behind the business judgment rule.[108]

This reading of *Van Gorkom*, when appraised in conjunction with *Moran* and other Delaware cases, provides a coherent, consistent, and straightforward explanation of the business judgment rule. The fear generated in the aftermath of *Van Gorkom* should, to a large extent, be put to rest. Directors should neither resign nor be overly cautious in taking business risks. The protection provided by the business judgment rule will be available as long as those directors examine the fundamentals of any transaction upon which they are voting, weigh competing views, and reach a reasoned, informed decision.[109]

D. *Statutory Revisions*

The Delaware legislature recently amended its corporate code to provide a mechanism by which further comfort might be provided to directors. In the summer of 1986, the Delaware Legislature enacted section 102(b)(7),[110] which permits shareholders to include in a corporation's certificate of incorporation a provision limiting or eliminating directors' personal monetary liability for certain breaches of the duty of care.[111]

Section 102(b)(7) of the Delaware Code provides:

> In addition to the matters required to be set forth in the

107. Veasey, *Further Reflections*, *supra* note 38, at 1382.

108. *See supra* notes 9-10 and accompanying text.

109. This statement is easy to make, but difficult to apply. The *Van Gorkom* opinion is helpful, however, when read as a "discourse on doctrine and judicial attitude," setting forth the "explicit and implicit do's and don'ts" of the life in the boardroom. *See* Manning, *Life in the Boardroom*, *supra* note 42, at 3. Mr. Manning lists these "do's and don'ts," with specific references to the facts of *Van Gorkom* in the Appendix to his article. *See id.* at 8-14.

110. DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1986). Subsection (7) was added to the existing provisions of § 102(b), which deals with the contents of the certificate of incorporation. The Delaware Legislature also clarified and revised portions of § 145, which deals with the indemnification of officers, directors, employees, and agents. *See id.* § 145(b), (e), (f) & (j) (effective July 1, 1986).

111. Veasey and Finkelstein, *New Delaware Statute*, *supra* note 9, at 3.

certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters: . . .

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under section 174 of this Title, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. All references in this subsection to a director shall also be deemed to refer to a member of the governing body of a corporation which is not authorized to issue capital stock.[112]

The effective date of the new legislation was July 1, 1986, and the limited liability permitted by section 102(7)(b) will become effective if and when appropriate charter amendments are proposed by a corporation's board of directors and adopted by its shareholders.[113]

In all probability, this statute is a response to the recent decline in the availability and scope of coverage of officers' and directors' liability insurance.[114] The statute primarily addresses the concerns raised by the *Van Gorkom* decision, discussed above, in which the court found the directors personally liable in money damages for their gross negligence. Interestingly, the statute disallows any limitation of directors' liability for violations of the duty of loyalty.[115]

Section 102(b)(7) appropriately places the ability to limit or eliminate directors' liability for due care violations in the hands of those to whom the directors owe their duty of care.[116] Addi-

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112. DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1986).

113. Veasey & Finkelstein, *New Delaware Statute, supra* note 19, at 3.

114. *Id.* at 1-2. The charter provisions, however, only apply prospectively and only to directors' actions *qua* directors and not to officers' actions *qua* officers. *Id.* at 3.

115. Veasey & Finkelstein, *New Delaware Statute, supra* note 9, at 1. The statute also pertains only to limitations on money damages. Other remedies for violation of the duty of care, such as injunctions and recission, remain unaffected. *Id.* at 3.

116. Veasey & Finkelstein, *New Delaware Statute, supra* note 9, at 3. The legisla-

tionally, it provides shareholders with great flexibility in making such decisions. For instance, shareholders of a corporation may place a ceiling on directors' liability, restrict the types or categories of conduct to which limitations apply, or eliminate their liability altogether.[117] Thus, the Delaware Legislature has given shareholders of corporations the ability to implement a limitation of liability plan tailored to their individual needs. Although section 102(b)(7) clearly does not represent a codification of the business judgment rule nor does it provide directors with an all-purpose shield from personal liability, it is clearly significant because it gives shareholders the ability to eliminate or limit personal liability of directors for due care violations.[118] Other states may follow Delaware's lead in explicitly allowing such action.

IV. A Comparison of Delaware and South Carolina Law

A. *Codification of the Standard of Care*

Although the courts of South Carolina have not explicitly discussed the business judgment rule, several cases have addressed the directorial duties of care and loyalty. These cases recognize the general concepts behind the rule even though they do not contain an articulation of the rule itself. Additionally, the Legislature, in South Carolina Code section 33-13-150(a),[119] has codified various corporate matters touching upon the rule, in-

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ture considered and rejected several alternative proposals. For instance, it rejected as circular the proposal that Delaware Code § 145(b) be amended to allow indemnification of judgments or amounts paid in settlement in derivative suits since such indemnification would, in effect, enable the corporation to pay itself for injuries caused by its directors. *Id.* at 2. Also rejected as circular was the proposal that § 145(g) be amended to allow wholly owned subsidiaries or captives to provide "insurance" without any true risk sharing. *Id.* The Legislature also opted against an arbitrary statutory limit on personal liability of directors. *Id.* at 2-3. Finally, a statutory exemption for certain types of liability was rejected because such a scheme would deprive shareholders of any input into the matter. *Id.* at 3. Clearly, § 102(b)(7) was carefully worded to allow shareholders to make the ultimate decision about the limitation of directors' liability in cases involving gross negligence.

117. Veasey & Finkelstein, *New Delaware Statute*, *supra* note 9, at 3.

118. *Id.*

119. S.C. Code Ann. § 33-13-150(a) (1976). Section 33-13-150(a) may also be read to impose a duty of loyalty on directors and officers. *See infra* Part IV.C. Delaware has not codified the standard of care for directors. The "gross negligence" standard is the product of case law. *See, e.g.*, *supra* notes 32-35 and accompanying text.

cluding the general standard of care required of directors. Section 33-13-150(a) states:

> A director or officer shall perform his duties as a director or officer, including his duties as a member of any committee of the board of directors upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation and of its shareholders, and with such care as an ordinary prudent person in a like position would use under similar circumstances.[120]

A director who performs in accordance with this standard will be shielded from personal liability to the corporation or its shareholders.[121]

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120. S.C. CODE ANN. § 33-13-150(a) (1976). Under this statute, the duty clearly runs to both the corporation and its shareholders. Delaware apparently recognizes this dual duty even though it is not codified. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Lynch v. Vickers Energy Corp., 429 A.2d 497, 503 (Del. 1981), *overruled on other grounds*, 457 A.2d 701, 703-704 (Del. 1983). The RMBCA, however, does not provide for such dual duty and states, instead, that the duty runs to the corporation only. *See supra* note 2. The preliminary version of the reporter's comments to the proposed revision of South Carolina Code § 33-13-150(a) discusses this difference:

> Under the Model Act, the duties owed run only to the benefit of the corporation, whereas under . . . [South Carolina state law] the duty has run to the corporation *and* its shareholders. Shareholders have been express *statutory* beneficiaries of duties owed by corporate insiders. [T]he underlying principle of shareholders being express beneficiaries of fiduciary duties pre-dates the technical amendment made in 1963. South Carolina case law since Black v. Simpson, 94 S.C. 312, 77 S.E. 1023 (1913), has firmly embraced the notion that officers and directors owe duties to shareholders as well as the entity. The principle has been applied in insider trading cases, *see* Jacobson v. Yaschik, 249 S.C. 577, 584, 155 S.E.2d 601, 605 (1967), and squeeze-out cases, *see* Dibble v. Sumter Ice & Fuel Co., 283 S.C. 278, 322 S.E.2d 674 (1984).
>
> In 1981 the South Carolina Legislature adopted verbatim the Model Act's articulation of duties owed with the exception that the established principle that shareholders of South Carolina corporations are express statutory beneficiaries of duties owed was *retained*. . . . The substance of the current Model Act provisions has not changed since it was last reviewed at the time of the 1981 amendments.

S.C. CODE ANN. § 3-8-300 comments (Proposed Official Draft 1986) (emphasis in original). This proposed section would replace § 33-13-150.

Whether the revised version of § 33-13-150(a) should include the words "and of its shareholders" has been debated by the Corporate Code Revision Study Committee. Advocates of the inclusion of this language argue that the deletion of this language would signal a repudiation of prior law. Those arguing for the deletion of this language argue that the South Carolina Code should parallel the RMBCA and that eliminating the reference to the duty as running to shareholders would encourage people to serve as directors. *Id.*

121. Director liability failure to meet the standards set forth in § 33-13-150 is infer-

The language in section 33-13-150(a), which incorporates the twin duties of loyalty and care, resembles the *Aronson* formulation of the business judgment rule; however, the two standards are not identical. One obvious distinction is that the South Carolina version has codified a general standard of care, whereas the Delaware formulation is supplied by common law.[122] In addition to the statutory versus common law distinction, the substantive differences between the formulations of the stan-

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entially imposed by § 33-13-150(c), which states, "A person performing his duties as an officer or director in accord with the standard required under subsections (a) and (b) of this section shall have no liability to the corporation or its shareholders by reason of being or having been an officer or director for any acts or omissions." S.C. CODE ANN. § 33-13-150(c) (1976). The standard of conduct codified in the RMBCA has been described as aspirational. *See* Veasey, *New Insights*, *supra* note 1, at 1466. A director who discharges his duties in accordance with this standard should not be held personally liable. Additionally, § 33-13-190, which deals with the liability of directors in certain cases, states: "A director shall not be liable under this section if he has met the requirements of § 33-13-150." S.C. CODE ANN. § 33-13-190(d) (1976). Section 33-13-190 imposes liability upon directors "in addition to any other liabilities imposed by law" and specifically states that directors may be held liable for the declaration of any dividends or other distribution of the assets of the corporation to its shareholders contrary to statutory provisions, for the purchase or redemption of shares contrary to statutory provisions, for the improper distribution of corporate assets during liquidation, and for the making of any loan or guaranty or other form of security in violation of § 33-13-170. *Id.* § 33-13-190(b).

Directors have also been held liable, on the basis of common-law principles, for various derelictions of duty in cases predating the enactment of the South Carolina Business Corporation Act. *See* Olin Mathieson Chem. Corp. v. Planters Corp., 236 S.C. 318, 114 S.E.2d 321 (1960) (holding directors liable for inattention and negligent supervision of officers); Baker v. Mutual Loan & Inv. Co., 213 S.C. 558, 50 S.E.2d 692 (1949) (holding directors liable for the wrongful payment of dividends through bad faith, gross negligence, or inattentiveness); Mortimer v. D.T. McKeithan Lumber Corp., 127 S.C. 266, 120 S.E. 723 (1923) (holding directors liable for mismanagement of corporate affairs as result of gross negligence or willful destruction and for the misappropriation of corporate funds and property); Black v. Simpson, 94 S.C. 312, 77 S.E. 1023 (1913) (holding directors liable for fraudulent breach of trust).

Section 33-13-150(d) provides that "[a]n action against a director or officer for failure to perform the duties imposed by this section shall be commenced within three (3) years after the cause of action has accrued, or within two (2) years after the time when the cause of action is discovered, or should reasonably have been discovered, by a person complaining thereof, whichever sooner occurs." S.C. CODE ANN. § 33-13-150(d) (1976). A similar limitations provision is found in S.C. CODE ANN. § 33-13-190(h) (1976). This language does not provide for tolling based upon fraudulent concealment. The proposed revision would read the same as § 33-13-150(d), but would add a provision stating, "provided, however, that this limitations period shall not apply to breaches of duty which have been fraudulently concealed." S.C. CODE ANN. § 33-8-300 comments (Proposed Official Draft 1986).

122. *Compare* S.C. CODE ANN. § 33-13-150(a) *with* Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

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dard of care in the two states appear striking. South Carolina law requires that directors act with ordinary prudence,[123] whereas Delaware courts impose liability only upon a showing of gross negligence.

The courts of South Carolina have not yet applied section 33-13-150(a), and practitioners can only speculate about how the ordinary prudence standard will be applied. Does the requirement of ordinary prudence imply that directors will be held liable for ordinary negligence? Such an expectation appears reasonable.[124] If this interpretation is correct, however, other state courts have "cheat[ed] the expectation" despite their application of an identical standard.[125]

Perhaps one should view liability associated with the general standard of care of directors as neither "ordinary negligence" nor "gross negligence," but as the failure to exercise the requisite degree of care.[126] This distinction is more than semantic and is reinforced by the blurring of these phrases by courts. While the difference between the ordinary and gross negligence standards appears great, some commentators have argued that an ordinary prudence statute does not result in a higher standard nor does it necessarily ensure that a court applying that standard will impose liability in situations in which a Delaware court, applying the gross negligence standard, would not.[127] Perhaps the phrase "gross negligence" is not used to lower the standard of care, but, rather, to refer to conduct that fails to satisfy the ordinary prudence standard.[128]

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123. Several cases decided before the enactment of § 33-13-150(a) applied a similar standard. *See, e.g.*, Olin Mathieson Chem. Corp. v. Planters Corp., 236 S.C. 318, 114 S.E.2d 321 (1960); Alderman v. Alderman, 178 S.C. 9, 181 S.E. 897 (1935). Some cases, however, referred to gross negligence as the proper standard. *See, e.g.*, Baker v. Mutual Loan & Inv. Co., 213 S.C. 558, 50 S.E.2d 692 (1948); Mortimer v. D.T. McKeithan Lumber Corp., 127 S.C. 266, 120 S.E. 723 (1923).

124. *See* Veasey & Manning, *supra* note 2, at 926. One commentator, Professor Dyson, claims that at least three-fourths of the jurisdictions that require ordinary care impose liability for its correlative—ordinary negligence. *Id.*

125. *Id.*

126. *See* Arsht & Hinsey, *supra* note 10, at 948-49.

127. Veasey & Manning, *Codified Standard*, *supra* note 2, at 930; *see also* Pease, *supra* note 21, at 69.

128. Arsht & Hinsey, *supra* note 10, at 949; *see also* Pease, *supra* note 21, at 71-72. The counter-argument is that gross negligence is qualitatively different from ordinary negligence since it requires a finding of reckless disregard of a known risk. *See* Veasey & Manning, *Codified Standard*, *supra* note 2, at 928.

In other words, the label does not determine the outcome;[129] a court typically will decide a case based upon its own views of how directors should behave. Varying results generally are not the product of different standards, but rather, of varying judicial attitudes.[130] Thus, courts do not attempt to define gross negligence;[131] they simply point to behavior that constitutes gross negligence. Similarly:

> Courts do not hear evidence as to what an "ordinary prudent man" would do, either in the conduct of his own affairs or in the particular circumstances of the case. Nor do they compare the facts of cases, arguing, for example, that since other courts have decided that it is negligent for directors to buy a piece of real estate without actually seeing it, any director who does so is liable for subsequent loss to the company. Instead, courts repeat that "negligence is a question of fact dependent upon the circumstances of each case" and proceed to apply their own ideas of what is reasonable conduct for a director.[132]

As one commentator noted, "Since our 'excellent, but odious' friend—the ordinarily prudent person—never takes the stand to enlighten judges or juries, the standard of care that exalts his prudence actually encourages a substitution of the court's judgment for that of the defendant director."[133]

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129. Arsht & Hinsey, *supra* note 10, at 950-51; Veasey & Manning, *Codified Standard*, *supra* note 2, at 928.

130. Veasey & Manning, *Codified Standard*, *supra* note 2, at 930.

131. *Id.* at 928.

132. Nielsen, *Directors' Duties Under Anglo-American Corporation Law*, 43 U. DET. L.J. 605, 612 (1966), *quoted in* Veasey & Manning, *Codified Standard*, *supra* note 2, at 931.

133. Veasey & Manning, *Codified Standard*, *supra* note 2, at 931. This effect is in conflict with the basic premises upon which the business judgment rule is based. *See supra* note 76 and accompanying text. Thus, the application of the ordinarily prudent man standard to corporate directors has been criticized as inappropriate. Bayless Manning, for example, stated as follows:

> In the general field of negligence law we are all able to talk of the "reasonable man" and of the prudent standard of performance because we have from our daily experience a clear conception of what the actor is doing and a fairly clear conception of the way in which people normally do it. We know what an automobile driver is doing; he is driving a car. We all know from general experience how one would normally do that in the circumstance—and therefore how he should do it.
>
> The situation with regard to the directors of corporations is totally different. There is no agreed upon roster of functions of a director, analogous to driving the car. We do not have any common standard or experience as to what

A decision as to directoral liability depends thus largely upon the trier of fact's perceptions of prevailing business practices and legal requirements.[134] Courts might look to the behavior of directors of other corporations in determining whether the behavior of directors of a given corporation was in keeping with common business practices. A South Carolina court considering a case involving the business judgment rule could legitimately reach a different conclusion than a Delaware court considering the same facts because of different business practices within the two states. If, however, one accepts the proposition that the standard of care for directors is roughly the same in both states, the analysis leading up to the factual holdings should be similar.

Another distinction between the South Carolina statute and the Delaware formulation of the business judgment rule is that the South Carolina Code requires that directors "reasonably" believe action taken to be in the best interests of the corporation and its shareholders, while the courts of Delaware require an "honest" belief that action taken was in the best interests of the company.[135] The significance of this difference is debatable. Some commentators argue that the reasonable belief test is a "hidden reef" in the business judgment rule "safe harbor" because it expands the judiciary's role by allowing inquiry into the quality of the particular decision.[136] Other commentators, however, respond that the reasonableness test is a sensible limitation on the business judgment rule that preserves the full protection afforded by the Delaware formulation of that rule.[137] These commentators explain that determining the reasonableness of the directors' belief is quite different from determining whether the substantive decision was correct.[138] Under either formulation—"reasonable" or "honest"—courts inquire "into the facts and circumstances of a challenged transaction to such extent as

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> directors do; and what they do varies from company to company, from situation to situation, and from time to time.

Manning, *Time for Reality*, *supra* note 30, at 1493; *accord* Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982), *cert. denied*, 460 U.S. 1051 (1983).

134. Arsht & Hinsey, *supra* note 10, at 951.

135. For a discussion of the difference between a reference to the duty as running to the corporation and the shareholders, as opposed to just the corporation, see *supra* note 120.

136. Veasey & Manning, *supra* note 2, at 930-42.

137. Arsht & Hinsey, *supra* note 10, at 962.

138. *Id.* at 955.

may be necessary to enable the court to ascertain whether the directors' decision was an exercise of informed, reasoned judgment or an arbitrary and reckless decision."[139]

The official comments to section 35 of the 1969 Model Business Corporation Act,[140] which was the basis for section 33-13-150(a) of the current South Carolina Code, support the proposition that the use of the word "reasonably" in place of *Aronson*'s "honest" does not represent a substantive difference. The official comments state:

> By combining the requirement of good faith with the statement that a director must act "with such care as an ordinarily prudent person in a like position would use under similar circumstances," section 35 incorporates the familiar concept that, these criteria being satisfied, a director should not be liable for an *honest* mistake of business judgment. A director attempting to create profits for his corporation will frequently make decisions involving risk for the enterprise. No personal liability should be imposed upon him in the event his good faith decision, in the exercise of business judgment, later seems to have been erroneous.[141]

Thus, a strong argument can be made that the "reasonableness" versus "honest" distinction does not create a major substantive difference between the South Carolina and Delaware formulations of directors' duty of care.

On the other hand, the use of the word "reasonably" in section 33-13-150(a) presumably relates to section 33-13-150(b),[142] discussed in more detail below, which allows directors to rely on reports and information supplied by third parties if they "reasonably" believe in those persons' reliability. Subsection (b) thus provides a "due diligence" defense or "safe harbor" in an action alleging want of care or skill by an officer or director.[143] Section 33-13-150(b) also states that a director does not act in good faith if he has actual knowledge that causes the reliance to be unwar-

139. *Id.* at 961; *see also* S.C. CODE ANN. § 33-13-150(b) (1976); *infra* notes 161-65 and accompanying text.

140. MBCA § 35 official comments at 254.

141. *Id.* (emphasis added).

142. S.C. CODE ANN. § 33-13-150(b) (1976); *see also infra* notes 151-52 and accompanying text.

143. S.C. CODE ANN. § 33-13-150 reporter's comments at 241 (Proposed Official Draft 1979).

ranted. If this means that a director must know of the falsity of information before reliance is foreclosed, then the "honest" belief standard is broader than the "reasonable" belief test of section 33-13-150. The "actual knowledge" language, however, may merely impose a requirement that directors act honestly by not relying on information known or suspected to be false. This interpretation reinforces the conclusion that the "reasonably" versus "honest" distinction creates no substantive difference in the law.

B. *Probable South Carolina Treatment of* Van Gorkom

An examination of how the South Carolina Supreme Court might treat Delaware's *Van Gorkom* is helpful in further demonstrating the extent of congruence between business judgment rule jurisprudence in the two states. The primary holding in *Van Gorkom* was that directors, in order to fulfill their duty of care, must inform themselves of all material, relevant facts before voting upon a given matter.[144] Although this duty is not expressly codified within the South Carolina formulation of the duty of care,[145] the South Carolina Supreme Court would be likely to agree with this requirement. Indeed, the court implied such a duty on the basis of common-law principles in *Baker v. Mutual Loan & Investment Co.*,[146] in which it held corporate directors liable for not making an adequate effort to inform themselves before voting to declare a dividend.[147]

In *Baker* the president of the corporation testified that he saw the audits of the corporation, "but not being able to interpret auditor's figures, of course, [he] could not tell much about

144. 488 A.2d at 872.

145. Arguably, the language of § 33-13-150(a) necessarily imposes upon directors a duty to inquire and to inform themselves.

146. 213 S.C. 558, 50 S.E.2d 692 (1948). Additional proof that the South Carolina statute incorporates a duty to inform oneself is found in the comments to RMBCA § 8.30, upon which § 33-13-150(a) was based, which state that the duty of care requires that directors exercise "common sense, practical wisdom, and informed judgment." RMBCA § 8.30 official comments at 222 (1984).

147. 213 S.C. at 566, 50 S.E.2d at 695. At the time this case was decided, South Carolina had no statute expressly imposing civil liability on a director for paying dividends that have not been earned. *Id.* at 565, 50 S.E.2d at 695. Liability is now explicitly provided for by statute. *See* S.C. CODE ANN. § 33-13-190(b), (c) (1976).

them."[148] None of the directors testified that they had made any inquiry of the auditors about the company's earnings.[149] Had the directors so inquired, they would have realized that the audits showed that the business was being operated at a loss, thus making the declaration of a dividend illegal.[150] The court, therefore, ordered the directors to repay to the company the amount that had been paid out as dividends.[151] The requirement to act upon an informed basis presumably is not limited to the decision to declare a dividend and should apply to other corporate decisions as well. Therefore, the South Carolina Supreme Court would probably agree that the defendant directors in *Van Gorkom* had a duty to inform themselves before voting to sell the company.

As discussed above, the law of South Carolina, like that of Delaware, explicitly allows directors to rely on information presented by others. Blind reliance, however, is not condoned. Section 33-13-150(b) of the South Carolina Code[152] provides:

> In performing his duties, a director or officer shall be entitled to rely on information, opinions, reports and statements, including financial statements and other financial data, in each case prepared or presented by:
>
> (1) one or more officers or employees of the corporation whom the director or officer reasonably believes to be reliable and competent in the matters presented;
>
> (2) counsel, public accountants or other persons as to matters which the director or officer reasonably believes to be within such person's professional or expert competence; or
>
> (3) a committee of the board of directors upon which he does not serve, duly designated in accordance with a provision of the articles of incorporation or the bylaws, as to matters within its authority, which committee the director or officer reasonably believes to merit confidence.
>
> In such reliance under subsection (b), such director or officer shall not be considered to be acting in good faith if he has actual knowledge concerning the matter in question that would cause such reliance to be unwarranted.[153]

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148. *Id.* at 566, 50 S.E.2d at 695.
149. *Id.*, 50 S.E.2d at 696.
150. *Id.* at 567, 50 S.E.2d at 696.
151. *Id.* at 558, 50 S.E.2d 693.
152. S.C. CODE ANN. § 33-13-150(b) (1976).
153. *Id.*; *see also* DEL. CODE ANN. tit. 8, § 141(e) (1983), which states:
A member of the board of directors of any corporation organized under

Directors are thus required to act "reasonably" and in "good faith" before they may rely upon this statute.

A component of the good faith test is that actual knowledge of the falsity of information supplied by third parties negates good faith. The comments to the corresponding section of the Revised Model Business Corporation Act state:

> [I]nherent in the concept of good faith is the requirement that, in order to be entitled to rely on a report, statement, opinion, or other matter, the director must have read the report or statement in question, or have been present at a meeting at which it was orally presented, or have taken other steps to become generally familiar with its contents. In short, the director must comply with the general standard of care of section 8.30(a) in making a judgment as to the reliability and competence of the source of information upon which he proposes to rely.[154]

Thus, the decision to rely on the reports of another is itself a business decision, and a South Carolina corporate director has to meet the standards of section 33-13-150(a) in choosing to rely on the report or statement of a third party.

Although *Baker* was decided prior to the enactment of this statute, that case indicates that directors do not discharge their directorial duties in this regard "by shutting their eyes and blindly relying on any statement made by [a third party]."[155] In *Baker* a third party, who was neither a director nor an officer of the corporation, was selling the corporation's stock to the public on a commission basis. Consequently, he had an obvious interest

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> this chapter, or a member of any committee designated by the board of directors shall, in the performance of his duties, be fully protected in relying in good faith upon the books of account or reports made to the corporation by any of its officers, or by an independent certified public accountant, or by an appraiser selected with reasonable care by the board of directors or by any such committee, or in relying in good faith upon other records of the corporation.

Id. The South Carolina Supreme Court might agree with the Delaware Supreme Court's conclusion in *Van Gorkom* that certain presentations, such as that of Van Gorkom on January 21, 1985, do not constitute reports within the meaning of the "right to rely" statutes. *See supra* note 55.

154. RMBCA § 8.30(b) official comments at 223. The South Carolina Supreme Court has also decreed that directors and officers have a duty to supervise one another. *See* Olin Mathieson Chem. Corp. v. Planters Corp., 236 S.C. 318, 328, 114 S.E.2d 321, 326 (1960).

155. 213 S.C. at 566, 50 S.E.2d at 695.

in making it appear that the company was prosperous.[156] The court concluded that the directors had a duty to apprise themselves of this information and to safeguard the interests of the shareholders.

Arguably, directors are on safer ground in relying on their chief executive officer rather than on an interested third party. However, because the chief executive officer may be interested in the outcome of a vote, as was Van Gorkom, the *Baker* concern about third parties may apply as well to insiders who have reason to promote a particular vote. Therefore, directors should be careful to satisfy their general duty of care in deciding whether to rely on another person. Because South Carolina has recognized that directors should inform themselves before a vote,[157] directors should not blindly rely on oral presentations, but should, instead, seek to form their own judgments based on documented facts. Particularly in conflict of interest situations, the board should consult outside advisors before reaching a decision.

This suggestion highlights another lesson of the *Van Gorkom* decision: directors should act professionally in conducting business transactions and should establish a "paper trail" to evidence their efforts to inform themselves. The South Carolina Supreme Court, however, has held that "[f]ormal directors' meetings and minutes are not indispensable to corporate action in all cases."[158] Nevertheless, certain transactions, such as

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156. *Id.* at 566, 50 S.E.2d at 695-96.

157. *See* Olin Mathieson Chem. Corp. v. Planters Corp., 236 S.C. 318, 328-30, 114 S.E.2d 321, 326-27 (1960).

158. Industrial Equip. Co. v. Montague, 224 S.C. 510, 516, 80 S.E.2d 114, 117 (1954). S.C. CODE ANN. § 33-13-120(a)(3) (1976) states as follows:

> (a) Action taken without a meeting by a majority of directors, or by such larger vote as the articles of incorporation or the by-laws may require, shall be deemed action of the board of directors: . . .
>
> (3) If the directors take informal action pursuant to a custom of that corporation known generally to its shareholders, and all directors know of the action taken and no director makes prompt objection thereto.

Id.; *see also id.* § 33-13-160 (revised to delete the requirement that director's interest in a given transaction be noted in board's minutes). *But see* S.C. CODE ANN. § 33-13-190(g) (1976) (requiring dissenting vote to be entered into the minutes; otherwise, assent to a given transaction will be assumed); *see also* Talbot v. James, 259 S.C. 73, 190 S.E.2d 759 (1972).

In *Talbot* the South Carolina Supreme Court held that where the minutes of meetings of stockholders and directors made no mention that the president of the corporation was to be the contractor with which the corporation was contracting the president's execution of the construction contract was done without making a full disclosure of his iden-

a vote on a merger or the adoption of a defensive mechanism, should be treated with greater formality. Moreover, because corporate minutes serve as the best evidence of actions taken, prudence dictates that a clear record should be kept of what transpires at all meetings. Otherwise, directors may be unable to *prove* that they acted with the requisite care if charged with a breach of their directorial duties.

C. *The Duty of Loyalty*

Section 33-13-150(a), which requires that a director act in good faith and in a manner that he reasonably believes to be in the best interest of the corporation,[159] makes it clear that South Carolina imposes a duty of loyalty upon corporate directors. Additionally, several cases predating this statute evidence the existence of a duty of loyalty by explicitly referring to the fiduciary relationship existing between directors and the individual shareholders. These references appear primarily in cases involving "interested director" transactions. In *Talbot v. James*,[160] for instance, the supreme court held that officers and directors of a corporation stand in a fiduciary relationship to individual stockholders and in every instance must make full disclosure of all relevant facts when entering into a contract with the corporation.

Similarly, in *Gilbert v. McLeod Infirmary*[161] the court

tity of interest, and the corporation was entitled to recover the amount of corporate funds received by or paid in behalf of the president. *Id.* at 86, 190 S.E.2d at 766. Thus, the South Carolina Supreme Court appears to support the view, discussed by the Delaware Supreme Court in *Van Gorkom*, that directors owe a fiduciary duty of candor to the shareholders and that directors should make a record of their actions to evidence their fulfillment of this duty. *See supra* notes 68-72.

159. S.C. CODE ANN. § 33-13-150(a) (1976); *see supra* note 135 and accompanying text.

160. 259 S.C. 73, 190 S.E.2d 759 (1972). In *Talbot* the court stated that a transaction between an interested director and the corporation will be voidable if the director has not made full disclosure or paid full value or if the corporation has been imposed upon. *Id.* at 83, 190 S.E.2d at 764; *accord* Jacobson v. Yaschik, 249 S.C. 577, 155 S.E.2d 601 (1967) (stating that officers and directors of a corporation, as a matter of law, stand in a fiduciary relationship to individual stockholders and must make full disclosure of all relevant facts when purchasing shares of stock from a stockholder).

161. 219 S.C. 174, 64 S.E.2d 524 (1951). In *Gilbert* the court stated as follows:

> [W]hen a director, in selling corporation property to himself, represents or joins in the representation of the corporation, the transaction is voidable at the option of the corporation, or others suing in its behalf, merely upon proof of

stated:

> Undoubtedly the directors of a corporation in the management of the corporate affairs occupy a position of extreme trust and confidence and exercise great power for good or bad over the corporation and its shareholders. They are agents for the corporation. Toward it and the shareholders they undoubtedly stand in a fiduciary relation as far as corporate business is concerned.[162]

Presumably, this fiduciary standard will not be strictly enforced, and directors who meet the standards of section 33-13-150(a) will be protected from liability.[163]

South Carolina Code section 33-13-160[164] now codifies South Carolina law regarding the treatment of transactions involving interested directors. Section 33-13-160 states that a transaction tainted by a director's self-interest is not necessarily void or voidable solely for this reason or because of his presence or participation in the meeting or if his vote is counted, if:

> (1) The material facts as to his interest and as to the transaction are disclosed to the board of directors or committee, which the board of directors or committee authorizes, approves or ratifies the transaction by a vote sufficient for such purpose without counting the vote of the interested director or directors; or
>
> (2) Although the vote of the interested director or directors is decisive of approval or disapproval of the transaction, the material facts as to his interest and as to the transaction

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> the fact stated; but when the purchasing director abstains from participation in behalf of the corporation and it is properly represented by others who are personally disinterested, the transaction will stand under attack if the director has made full disclosure, paid full value, and the corporation has not been imposed upon; and the burden is upon the director to establish these requisites by evidence.

Id. at 186-87, 64 S.E.2d at 529. This policy is now codified at S.C. CODE ANN. § 33-13-160(a) (1976). Under the common-law rule, an interested director could not be counted to make a quorum at a meeting when the matter is acted upon. 219 S.C. at 187-88, 64 S.E.2d at 530; *accord Talbot*, 259 S.C. at 82-83, 190 S.E.2d at 764. This rule has been reversed by Code § 33-13-160(d), which states that "[c]ommon or interested directors may always be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes, approves, or ratifies a transaction." S.C. CODE ANN. § 33-13-160(d) (1976).

162. 219 S.C. at 185, 64 S.E.2d at 528-29.

163. *See supra* note 14.

164. S.C. CODE ANN. § 33-13-160 (1976).

are disclosed to the shareholders, and the transaction is specifically approved by vote of the shareholders without counting the votes of any shares owned or controlled by the interested director or directors; or

(3) If not approved pursuant to subparagraphs (1) and (2) of this subsection, the transaction is fair and equitable as to the corporation at the time it is authorized or approved, and the party asserting the fairness of the transaction establishes fairness.[165]

The statute provides the three aforementioned alternative methods to save a transaction involving an interested director from being automatically voidable. Nothing in the statute, however, precludes judicial inquiry. The statute simply precludes invalidation of a contract "solely" because a director is involved.[166]

Although the language of section 33-13-160 does not address director liability, the majority rule in other jurisdictions appears to be that if an interested director fails to sustain his burden of proof that the corporate transaction in which he had a personal interest was fair and made in good faith, the corporation has the option of setting aside the transaction or affirming it and holding the interested director liable for profits that he received or for losses sustained by the corporation as a result of the transac-

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165. *Id.* § 33-13-160(a). The corresponding Delaware statute states in part that transactions between corporations and interested directors are not necessarily void or voidable if "[t]he material facts as to his *relationship or* interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders . . . ." DEL. CODE ANN. tit. 8, § 144 (1983) (emphasis added).

Under South Carolina law, transactions in which a director or officer has a personal interest include: (1) a contract or any other transaction between the corporation and one or more of its directors or officers; and (2) a contract or any other transaction between a corporation and any corporation, partnership, or association in which one or more of its directors or officers are directors or officers or have a material financial interest, direct or indirect. S.C. CODE ANN. § 33-13-160(b) (1976). The notion of adverse interest is qualified by "material" financial interest to cover the situation where a director may have a minor stock ownership or other interest without any real conflict existing. S.C. CODE ANN. § 33-13-160 reporter's comments at 244 (Proposed Official Draft 1979).

There is an overlap in the definitions of interested director contracts and interlocking directorate contracts. *Compare* S.C. CODE ANN. § 33-13-160(a), (b)(2) (1976) *with id.* § 33-13-160(c). Section 33-13-160(a) requires proof of fairness of director contracts, while § 33-13-160(c) requires proof of unfairness in the case of common directors. Thus, contracts between corporations having a common director are subject to different rules.

166. S.C. CODE ANN. § 33-13-160 (1976). This statute does not provide an absolute safe harbor; rather, it shifts the burden of proof to directors to show that a transaction should not be voided.

tion.[167] Thus, under South Carolina law, an interested director arguably could be held personally liable to the corporation for personal profits or corporate losses resulting from a transaction that is deemed unfair and voidable under section 33-13-160, but not from a transaction that is not voidable under that section.

D. *No Provision for Shareholder Limitation of Directors' Liability*

The South Carolina Business Corporation Act contains no provision paralleling section 102(b)(7) of the Delaware Code, which permits shareholders to include within the certificate of incorporation a provision limiting or eliminating directors' liability for due care violations.[168] South Carolina Code section 33-7-30,[169] however, states, in pertinent part, that the articles of incorporation shall set forth:

> (7) Any other provisions [in addition to those enumerated in subsections (1)-(6)] which the incorporators elect to include in the articles if:
>
> (A) Any section of Chapters 1 through 25 of this Title permits or authorizes the articles to contain such a provision; or
>
> (B) Any section of Chapters 1 through 25 of this Title permits or requires the provision to be set forth in the corporation's bylaws or in an agreement or other instrument; or
>
> (C) Such provision relates to the business or affairs of the corporation, or the rights or powers of its shareholders, directors, or officers and although not specifically authorized by Chapters 1 through 25 of this Title, is not inconsistent with law or contrary to public policy.[170]

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167. *See* 19 AM. JUR. 2D *Corporations* § 1291 (1965). The 1979 reporter's comments to South Carolina Code § 33-13-160 state:

> Disclosure of the conflicts of interest must be made pursuant to subsections (a)(1) and (2) to the shareholders and directors of the corporation, whether or not they are entitled to vote. Knowledge will not be presumed under the revised subsections (a)(1) and (a)(2). The disclosure must be made to a properly constructed meeting. It should not apply in the situation where there has been selective disclosure to only those directors or shareholders necessary to approve the transaction. The notation of disclosure in board minutes would be prudent, but it was not felt necessary to mandate its recording.

S.C. CODE ANN. § 33-13-160 reporter's comments at 24 (Proposed Official Draft 1979).

168. S.C. CODE ANN. § 33-8-300 comments (Proposed Official Draft 1986).

169. S.C. CODE ANN. § 33-7-30 (1976).

170. *Id.* § 33-7-30(a)(7)(A)-(C).

Arguably, under this language the incorporators may include in the articles of incorporation a provision limiting the directors' liability for their business decisions.

Moreover, this power, if it exists, is probably transferred to the corporate entity under Code section 33-15-10,[171] which states:

> (a) A corporation may amend its articles of incorporation, from time to time, in any and as many respects as may be desired if such amendment, on the filing date of the articles of amendment incorporating the amendment, contains only such provisions as might then lawfully be contained in the original articles of incorporation, and, if a change in shares or the rights of shareholders, or an exchange, reclassification or cancellation of shares necessary to effect such change, exchange, reclassification or cancellation.
>
> (b) In particular, and without limitation upon the general power of amendment granted by subsection (a) of this section, a corporation may amend its articles of incorporation by one or more amendments so as: . . .
>
> (15) To strike out, change or add any provision for management of the business and conduct of the affairs of the corporation, or creating, defining, limiting and regulating the powers of the corporation, its officers, its directors and shareholders or any class of shareholders, including any provision which under Chapters 1 through 25 of this Title is required or permitted to be set forth in the bylaws, or in any agreement.[172]

While this language might allow provisions limiting or eliminating directors liability to be placed in the articles of incorporation, the enactment of a specific enabling statute is advisable if the South Carolina Legislature decides that the option of providing directors with this protection is desirable. Indeed, an argument could be made that shareholders are precluded from limiting directors' liability by the language of South Carolina Code section 33-13-180,[173] which enumerates the circumstances under which indemnity is permitted and may be viewed as the exclusive statement on this matter. Similarly, the codification of

171. S.C. CODE ANN. § 33-15-10 (1976).
172. *Id.* § 33-15-10(a), (b)(15).
173. S.C. CODE ANN. § 33-13-180 (1976).

the standard of care in section 33-13-150(a) may preclude shareholders from limiting directors' liability for due care violations. Moreover, the Delaware Legislature enacted section 102(b)(7) even though Delaware Code section 102(b)(1) already provided:

> In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:
>
> Any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders, or the members of a nonstock corporation; if such provisions are not contrary to the laws of this State. Any provision which is required or permitted by any section of this chapter to be stated in the bylaws may instead be stated in the certificate of incorporation . . . .[174]

Thus, the Delaware Legislature apparently felt the need to enact an express enabling statute. Whether the South Carolina Code should include an enabling statute similar to section 102(b)(7) is, of course, a decision for the South Carolina Legislature. This decision, however, should be made only after consideration of whether protection for directors is necessary or advisable in South Carolina because of high insurance costs or unease among directors generally.[175]

V. CONCLUSION

Although the vehicles and verbal formulations differ, the law of South Carolina regarding the business judgment rule largely parallels that of Delaware. As a general proposition, the courts of both states recognize the advisability of according judicial deference to business decisions made by corporate directors, but will examine the decisionmaking process behind board decisions to ensure that the directors did not breach the duties of care or loyalty that underlie the business judgment rule.

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174. DEL. CODE ANN. tit. 8, § 102(b)(1) (1983).

175. The Corporate Code Revision Study Committee of South Carolina, at the time of this writing, had considered and rejected the inclusion of such a provision within the South Carolina Revised Business Corporation Act.

The Delaware courts frame the business judgment rule as a presumption. Absent an abuse of discretion, the courts will presume that a director has complied with the twin duties of care and loyalty. A director meets the duty of care by acting on an informed basis. Liability for failure to exercise due care is premised upon concepts of gross negligence. *Van Gorkom* underscores the need to apply informed attention to directorial duties. *Moran*, however, demonstrates that a director need not know all the particulars of a given transaction; the business judgment rule requires only that he acquire all material information reasonably available. A recently enacted Delaware statute permits shareholders to limit or eliminate directors' liability for due care violations by including in the articles of incorporation a provision to that effect. Shareholders of Delaware corporations, however, cannot limit or eliminate the directors' duty of loyalty.

Delaware law regarding the duty of loyalty requires that directors act in good faith and in the honest belief that action taken was in the best interest of the company. A director may not stand on both sides of a transaction, nor may he reap a personal benefit not shared by the corporation and shareholders. He must disclose any personal interest and abstain from participation in any corporate decision touching upon his interest. Furthermore, he must act independently of any control or influence. *Moran*, however, demonstrates that directors may adopt defensive mechanisms, which necessarily give rise to loyalty questions, without breaching their duty of loyalty so long as they act within the ambits of the business judgment rule.

South Carolina has codified most of the above-mentioned propositions in section 33-13-150(a), which states that a director must perform his duties in good faith, in a manner he reasonably believes to be in the best interests of the corporation and shareholders, and with such care as an ordinary prudent person in a like position would use under similar circumstances. This formulation, especially when read in conjunction with pertinent South Carolina case law, is very similar to Delaware law. The courts of South Carolina should, therefore, feel comfortable in looking to Delaware case law when dealing with issues relating to the business judgment rule.

The language within section 33-13-150 may be viewed as the bare bones of the business judgment rule. Courts, however, are free to elaborate upon this statement of the standard of care,

and they have great discretion both in formulating and in applying the complete rule. Nevertheless, the statutory language is the starting point, and a director who meets its standards should not be held liable for business decisions. Corporate counsel, therefore, should advise their client directors to conform their actions to the dictates of this statute, especially when voting upon takeover offers or the implementation of defensive mechanisms.

Practitioners should be aware, however, that the ultimate decision of whether a director has met this standard is left to the courts. The courts decide, for example, what constitutes ordinary prudence. Theoretically, a South Carolina court could read section 33-13-150 to impose liability for ordinary negligence or allow a review of the reasonableness of the decision reached. Such a harsh application of the statute, however, could bring about the ill effects feared in the aftermath of *Van Gorkom* and could severely handicap the smooth functioning of corporate business. The wiser course would be for the judiciary ordinarily to defer to the judgment of the board of directors. To the extent that a board can demonstrate its sensitivity to judicial concerns about breaches of fiduciary duty, the reviewing court should be comfortable with the business judgment rule's presumption of validity.[176] Only when a director effectively rebuts one or more of the presumptions underlying the business judgment rule should the court impose personal liability upon directors for their business decisions.

176. *See Guidelines for Directors, supra* note 23, at 220; *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985).