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THE ROLE OF THE BUSINESS JUDGMENT RULE IN A LITIGIOUS SOCIETY

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[W]e have created an incredibly overregulated and litigious society. Instead of using the law for the structuring of responsible corporate governance, we have created the total adversary society As a result more and more people spend more and more time not in producing more wealth but in arguing over how to divide up a rather static level of wealth.¹

THE LITIGIOUS SOCIETY

State law has always regarded directors and officers of corporations as fiduciaries for stockholders. In the eyes of the law, those who manage and direct corporations are not fiduciaries for creditors, employees, consumers or any other sector of the public. Accordingly, by virtue of two hundred years of legal conditioning, corporate executives tend to think in terms of a clear line of authority: the employees act for the officers, who are agents of the corporation, which is managed by the directors as fiduciaries for the stockholders. The ultimate source of corporate authority is ownership and, subject only to compliance with applicable law, executives have come to understand that they owe their undivided loyalty to the stockholders. Under state law, so long as directors act in compliance with law and in accordance with their own good faith determinations of the best interests of the stockholders, they will not incur personal liability and will not even be questioned as to whether they are acting in a socially responsible manner.

With occasional protests from those who would hold corporate executives accountable to broader constituencies of society,²

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1. Johnson, *Fiduciary Ethics and the Market*, in CAN THE MARKET SUSTAIN AN ETHIC? 31, 44 (1978) (presented at the University of Chicago as one of the 1977 D.R. Sharpe Lectures on Social Ethics).

2. See, for example, the famous 1932 debate between Professors Dodd and Berle. In Dodd, *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932), Professor Dodd argued that managers should be encouraged to act as "trustees" not only for stockholders but also for employees, customers and perhaps other constituencies. Professor Berle promptly responded, in Berle, *For Whom Corporate Managers Are Trustees*, 45 HARV. L. REV. 1365 (1932), with the view that, at least until

managers have long derived their dominant mind-set from the traditional rule that they are fiduciaries solely for stockholders. In our view, this legal structure and the associated mind-set have had unfortunate consequences. It is true that the traditional fiduciary doctrine has been consonant with free market concepts of the efficient allocation of capital resources. Yet, as large corporations emerged in this century as important social institutions and as the decisions of corporate managers came to exert a major impact on our environment, our safety, our tastes and our workplaces, in the absence of fiduciary concepts of adequate scope, we were compelled to regulate corporate conduct by developing ever more government agencies and regulations, and ever more private rights of action. In short, we produced a litigious society:³ we hemmed the corporate executive in on all sides and created a war-like atmosphere in which we rely on adversarial proceedings to keep corporations and their managers in line. As a result, the possibility of true leadership and stewardship on the part of the executive has been sadly diminished.

Focusing on the symptoms of excessive litigation and regulation, some have suggested reforms of our system of legal administration.⁴ More judges are sought to expedite the process and new administrative agencies are sought to bring expertise to the issues. We also seek solutions in terms of procedure: possibly the

we are prepared to enunciate clear standards of fiduciary obligations to constituencies other than stockholders, it is irresponsible to permit management some vague and ambiguous latitude in making corporate decisions. See note 96 *infra*. Cf., *Herald Co. v. Seawell*, 472 F.2d 1081, 1092 (10th Cir. 1972) (directors may consider their obligations to employees and the public in resisting a takeover); *Panter v. Marshall Field & Co.*, 486 F. Supp. 1168, 1193 (N.D. Ill. 1980) (directors resisted takeover because not in best interest of the company, "its shareholders, and communities served by the company").

3. See generally Manning, *Hyperlexis: Our National Disease*, 71 NW. U.L. REV. 767 (1977). In the federal district courts, 138,770 civil and 35,983 criminal cases were filed in 1978. For each authorized judgeship, 438 new cases were filed and 413 cases were pending. In the federal courts of appeals, each three-judge panel had an average of 585 cases pending in June 1978. *Annual Report of the Director, Administrative Office of the United States Courts* 102-08 (1978). These and other figures set new records. Between 1962 and 1977, the number of corporate filings with the Securities and Exchange Commission increased from 18,000 to 52,000 per year. See *What the SEC Will Do With All Those Filings*, BUSINESS WEEK, Feb. 18, 1980, at 70, 72.

4. For the views of some judges, obviously central to the legal process, see Rehnquist, *The Adversary Society*, 33 U. MIAMI L. REV. 1 (1978); Phillips, *The Expansion of Federal Jurisdiction and the Crisis in the Courts*, 31 VAND. L. REV. 17 (1978). See generally Bell, *Crisis in the Courts: Proposals for Change*, 31 VAND. L. REV. 3 (1978); Grossman & Sarat, *Litigation in the Federal Courts: A Comparative Perspective*, 9 LAW & SOC. REV. 321 (1975).

losing party in litigation should pay the legal fees and costs incurred by the successful party, at least in certain circumstances; perhaps severe limitations should be imposed on the present practice of unlimited civil discovery, with its manifold possibilities of harassment and misuse of discovered information; or perhaps better out-of-court mechanisms can be developed for the resolution of disputes. Many of these proposals are sound, even necessary, but identification of the challenge solely at the systemic level has distracted our attention and prevented us from raising more fundamental inquiries concerning the chief victims of the legal malaise: the modern corporation and its directors and officers.

The litigious society has cast the corporation and its management as the ultimate adversaries, as the paradigmatic targets for the venting of the public spleen. As the volume of litigation generally has increased, the nature of actions brought against large corporations has evolved. For example, when General Motors Corporation installed certain V-8 engines produced by its Chevrolet division in 1977 cars assembled by its Oldsmobile division, it touched off a storm of litigation that would have been beyond imagination in another era. From March 1977 through late 1978, more than 300 engine interchange lawsuits were brought against General Motors, including 41 private class actions and 33 proceedings instituted by state Attorneys General.⁵

This example illustrates the broader problem: resort to the courts for redress of every perceived harm has not only choked our system of law, it has also gone far toward paralyzing our economic system. The ultimate consequence of the adversary society is the ever-increasing transfer of human and non-human capital from wealth-producing roles to what Arthur Laffer, a brash young economist, calls the "garbage" business,⁶ all at great cost to our society in terms of inflated prices for corporate goods and services. This "garbage" business develops when:

- 1) new laws create new agencies and rights of both governmental and private action, which in turn
- 2) require vast numbers of additional government attorneys

5. See *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106, 1114 n.3 (7th Cir.), cert. denied sub nom. *Oswald v. General Motors Corp.*, 444 U.S. 870 (1979). For a description of several recent class actions of major economic significance, see *Getting Into Those Deep Pockets*, FORBES, Aug. 4, 1980, at 59.

6. Professor Laffer made these observations in a 1979 address to the Chicago Committee of the Council on Foreign Relations.

and other employees as well as private plaintiffs' attorneys and their employees to pursue these rights of action, which in turn

3) requires corporations to radically augment the size of their staffs of lawyers, accountants and government relations personnel and to keep outside law firms, accounting firms and other experts close by their sides in order to cope with all the new regulatory developments and litigation, which in turn

4) requires the top management of corporations to spend much more time consulting with these professional advisers so as to avoid the ever-increasing risks of personal and corporate liability, which in turn

5) means that corporate managers today have necessarily tended to become cautious, prudent and non-risk taking preservers of the enterprise and to overlook the possibility of farsighted economic leadership and responsibility.

It is to this fundamental ill that we address our attention in this article. While we focus on the present status of a particular legal doctrine, the business judgment rule, we raise the broad question whether it is possible to devise institutional conditions that breathe new life into the fiduciary concept and encourage corporate executives to flourish as truly responsible leaders. Specifically, we inquire whether means of internal corporate governance can be devised to remove or reduce our dependence on the adversary culture and its negative economic consequences.

The traditional business judgment rule has been substantially re-invigorated in the wake of the corporate "Watergates" of the past decade and has received considerable attention in recent judicial decisions. The balance of this article summarizes the scope and purpose of the rule and certain key developments in its application over the past decade. In the concluding section, the focus is on recent extensions of the business judgment rule which suggest that it could play a still broader role in the future.

DEVELOPMENT OF THE BUSINESS JUDGMENT RULE

The Traditional Rule

The business judgment rule was developed by the courts as a device for insulating corporate decision makers, both officers and directors,⁷ from personal liability for mistakes of business judgment

7. *Kelly v. Bell*, 254 A.2d 62 (Del. Ch. 1969), *aff'd*, 266 A.2d 878 (Del. 1980); 3A W. FLETCHER, CYCLOPEDIA CORPORATIONS §1039, at 38 (perm. ed. 1975).

arrived at in good faith.⁸ Firmly rooted in the common law,⁹ the rule has also made recent appearances in statutory formulations of directors' obligations to their corporations.¹⁰

The traditional business judgment rule has been stated as follows:

In the absence of a showing of bad faith on the part of the directors or of a gross abuse of discretion the business judgment of the directors will not be interfered with by the courts. . . . The acts of directors are presumptively acts taken in good faith and inspired for the best interests of the corporation, and a minority stockholder who challenges their *bona fides* of purpose has the burden of proof.¹¹

Application of the business judgment rule presupposes that a court has made initial determinations that the officers or the board of directors acted in good faith and in the exercise of due care,¹² and

8. See generally Comment, *The Business Judgment Rule: A Guide to Corporate Directors' Liability*, 7 ST. LOUIS U.L.J. 151 (1962); Lewis, *The Business Judgment Rule and Corporate Directors' Liability for Mismanagement*, 22 BAYLOR L. REV. 157 (1970); Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1980).

9. See, e.g., *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 722 (Del. 1971); *Warshaw v. Calhoun*, 43 Del. 148, 221 A.2d 487, 492-93 (1966); *Beard v. Elster*, 39 Del. 153, 160 A.2d 731, 738 (1960); *Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971); *Puma v. Marriott*, 283 A.2d 693, 695-96 (Del. Ch. 1971); *Prince v. Bensinger*, 224 A.2d 89, 94 (Del. Ch. 1968); *Bodell v. General Gas & Elec. Corp.*, 15 Del. Ch. 420, 140 A. 264 (1927).

10. See, e.g., ABA-ALI MODEL BUS. CORP. ACT §35, Para. 2 (1976): "A director shall perform his duties as a director . . . in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances." See Veasey & Manning, *Codified Standard—Safe Harbor or Uncharted Reef?*, 35 BUS. LAW 919 (1980); Arsht & Hinsey, *Codified Standard—Same Harbor but Charted Channel: A Response*, 35 BUS. LAW (1980).

11. *Warshaw v. Calhoun*, 43 Del. 148, 221 A.2d 487, 492-93 (1966). Another court has stated: "[S]ince the transaction complained of was accomplished as a result of the exercise of independent business judgment of the outside, independent directors whose sole interest was the furtherance of the corporate enterprise, the court is precluded from substituting its uninformed opinion for that of the experienced, independent board members" *Puma v. Marriott*, 283 A.2d 693, 696 (Del. Ch. 1971). *Accord*, *Marsili v. Pacific Gas & Elec. Co.*, 51 Cal. App. 3d 212, 324, 124 Cal. Rptr. 313, 329 (1975); *Everett v. Phillips*, 288 N.Y. 227, 232, 43 N.E.2d 426, 431 (1952); *Pollitz v. Wabash R.R.*, 207 N.Y. 113, 124, 100 N.E. 721, 724 (1921); *Gauger v. Hintz*, 262 Wis. 333, 55 N.W.2d 426 (1952).

12. With regard to the due care aspect of directors' duties, the courts initially presume that reasonable diligence has been exercised. See, e.g., *Kaplan v. Goldsamt*, 380 A.2d 556, 568 (Del. Ch. 1977); *Otis & Co. v. Pennsylvania R.R.*, 61 F. Supp. 905, 911-12 (E.D. Pa. 1945), *aff'd*, 155 F.2d 522 (3d Cir. 1946). With respect to good faith and disinterestedness, however, courts are in general less willing to presume that directors

that they did in fact exercise "judgment."¹³ If these conditions are met, a court will cut short its review of the underlying business decision. To borrow from the language of administrative law, the appropriate scope of review is to look to the procedures underlying the decision, to check for arbitrariness or caprice, but not to inquire into the substance of a judgment better left to those with expertise and business acumen.

Within the ambit of its application, the business judgment rule can be a powerful instrument for diffusing power and responsibility and for encouraging entrepreneurial risk-taking.¹⁴ In its classic form, however, the rule was confined to insulating corporate directors and officers from personal liability arising from their business decisions. The protection of the rule was not extended to the corporation itself.

Stockholders' Derivative Actions

The name "business judgment rule" has long been applied to a doctrine that is in certain respects distinct from the traditional rule discussed above. The traditional rule was designed by the courts to protect individual members of management from personal liability for simple errors of judgment. Since the beginning of this century,¹⁵

have discharged their duty. *See, e.g.,* Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 599 (1921). *But see* Warshaw v. Calhoun, 43 Del. 148, 221 A.2d at 492-93. Regardless of the burden of proof, the business judgment rule is applied only when both tests are met. *See* Casey v. Woodruff, 49 N.Y.S.2d 625, 642-43 (Sup. Ct. 1944). *See generally* Comment, *The Business Judgment Rule*, *supra* note 8, at 154-55.

13. When the courts say that they will not interfere in matters of business judgment, it is presupposed that judgment—reasonable diligence—has in fact been exercised. A director cannot close his eyes to what is going on about him in the conduct of the business of the corporation and have it said that he is exercising business judgment.

Casey v. Woodruff, 49 N.Y.S.2d at 642-43.

14. For example, the rule gives management freedom from being second-guessed should it tend to the long-term interests of the corporation and its stockholders instead of realizing short-term profits in a takeover. *See* Panter v. Marshall Field & Co., 486 F. Supp. 1168, 1194 (N.D. Ill. 1980): "Corporations in the kind of business as important as that in which Marshall Field was engaged plan to exist as ongoing commercial or merchandising entities. Plaintiffs appear to believe that large companies like Field are developed for takeovers. . . . Plaintiffs are mistaken. . . ." *Compare* Treadway Companies, Inc. v. Care Corp., [Current] FED. SEC. L. REP. (CCH) ¶ 97,603 (2d Cir. 1980), *with* Johnson v. Trueblood, No. 79-1892 (3d Cir. July 31, 1980).

15. *See, e.g.,* Corbus v. Alaska Treadwell Gold Mining Co., 187 U.S. 455, 463 (1903): "The directors may sometimes properly waive a legal right vested in the corporation in the belief that its best interests will be promoted by not insisting on such right." *See* Estes, *Corporate Governance in the Courts*, 58 HARV. BUS. REV. 50 (1980) (discussing evolution of business judgment rule).

courts have applied similar concepts to bar maintenance by shareholders of lawsuits, brought against third parties "derivatively" in the right and on behalf of their corporation, when a disinterested board of directors has decided in good faith that the interests of the corporation would not be served by such suits.¹⁶

In an early leading case, the Supreme Court refused to permit a shareholder to maintain a derivative action based on the antitrust laws when the board of directors had decided not to pursue the claim. In a concurring opinion, Justice Brandeis wrote:

Whether or not the corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors, in the absence of instruction by a vote of the stockholders. Courts interfere seldom to control such discretion *intra vires* the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment. . . .¹⁷

It should be noted that the decision not to sue need not be based primarily on the legal merits of the claim. "To the contrary, the essence of the business judgment rule in this context is that directors may freely find that certain *meritorious* actions are not in the corporation's best interests to pursue."¹⁸

16. As a procedural mechanism to ensure that the board will have an opportunity to consider the merits of the underlying claim before derivative litigation is commenced, many jurisdictions require a prospective plaintiff to make demand upon the board to institute its own action. See, e.g., FED. R. CIV. P. 23.1; DEL. RULE OF THE COURT OF CHANCERY 23.1. See *Hawes v. City of Oakland*, 104 U.S. 450 (1881); *Cathedral Estates, Inc. v. Taft Realty Corp.*, 228 F.2d 85 (2d Cir. 1955). "The demand requirement enables corporate management to pursue alternative remedies, thus often ending unnecessary litigation." *Cramer v. General Tel. & Elec. Corp.*, 582 F.2d 259, 275 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979). See generally Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?* 75 NEV. U.L. REV. 96 (1980); Note, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CHI. L. REV. 168 (1976).

17. *United Copper Sec. Co. v. Amalgamated Copper Co.*, 244 U.S. 261, 263 (1917).

18. *Maldonado v. Flynn*, 485 F. Supp. 274, 285 (S.D.N.Y. 1980) (emphasis in original). See *Cramer v. General Tel. & Elec. Corp.*, 582 F.2d at 275: "Even if a particular suit has some merit, the litigation costs and the adverse effect on the business relationship between the corporation and the potential defendant might outweigh any potential recovery in the lawsuit."

So long as the procedural conditions of the rule are satisfied, the board's judgment not to sue unrelated third parties,¹⁹ or even particular officers²⁰ or directors,²¹ will not be second-guessed by the courts. Business judgment initiation of dismissal of a derivative suit is thus a special application of the general business judgment rule, based on the same theory: "an individual stockholder has no more right to challenge by a derivative suit a decision by the board of directors not to sue than to so challenge any other decision by the board."²²

With respect to derivative lawsuits against members of management, moreover, business judgment dismissal interposes the rule at a novel and important stage. No longer is the rule limited to protecting an individual officer or director from personal liability on the merits. Instead, the question is whether it is in the interests of the corporation to maintain a legal action against an officer or director regardless of the merits of the suit, and the issue is resolved by the board of directors subject only to judicial review of the good faith and disinterestedness of the decision.

A New Approach to Questionable Payments

Use of the business judgment rule to shelter corporations from burdensome litigation was nowhere more evident than in the wake of the recent revelations by dozens of major corporations about foreign and domestic "questionable payments."²³ Promptly following their public disclosure of such payments, many of these corporations

19. See *United Copper Sec. Co. v. Amalgamated Copper Co.*, 244 U.S. 261 (1917); *Corbus v. Alaska Treadwell Gold Mining Co.*, 187 U.S. 455 (1903). See also *Miller v. American Tel. & Tel. Co.*, 507 F.2d 759 (3d Cir. 1974); *Klotz v. Consol. Edison Co.*, 386 F. Supp. 577 (S.D.N.Y. 1974); *Bernstein v. Mediobanca Banca di Credito Finanziario-Societa Per Azioni*, 69 F.R.D. 592 (S.D.N.Y. 1974).

20. See *Gilbert v. Curtiss-Wright Corp.*, 179 Misc. 641, 38 N.Y.S.2d 548 (Sup. Ct. 1942); *Foster v. Bowen*, 311 Mass. 359, 41 N.E.2d 181 (1942).

21. See *Cramer v. General Tel. & Elec. Corp.*, 582 F.2d 259 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); *In re Kauffman Mut. Fund Actions*, 479 F.2d 257 (1st Cir.), *cert. denied*, 414 U.S. 857 (1973); *Shlensky v. Wrigley*, 95 Ill. App. 2d 173, 237 N.E.2d 776 (1968).

22. *Swanson v. Traer*, 249 F.2d 854, 859 (7th Cir. 1957).

23. For a useful discussion of corporate disclosures in this area, see SENATE BANKING, HOUSING, AND URBAN AFFAIRS COMM., 94TH CONG., 2D SESS., REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES 37-43 (Comm. Print 1976). See generally Coffee, *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099 (1977); Herlihy & Levine, *Corporate Crisis: The Overseas Payment Problem*, 8 L. & POL'Y INT'L BUS. 547 (1976).

were deluged²⁴ with derivative actions seeking to hold persons who had been directors at the time of the payments liable for corporate waste and for incurring contingent liabilities, for example, under the federal securities laws.²⁵

One of the most striking developments associated with the questionable payments cases has been the widespread use of minority committees of disinterested directors,²⁶ usually assisted by independent legal counsel, to investigate the merits of possible corporate claims and to decide, on behalf of the full board, whether or not to maintain the action. A leading example is *Gall v. Exxon Corp.*,²⁷ where a derivative action was instituted based on questionable political payments in Italy, amounting to \$59 million from 1963 to 1974. Exxon established a Special Committee on Litigation, comprised of one employee director (who did not join the board until after 1974) and two outside directors, which conducted an extensive investigation and then concluded that Exxon should seek dismissal of the derivative suit.²⁸ The court in *Gall* specifically condoned use of a minority board committee when the conditions of good faith and disinterest are satisfied:

24. For example, at least four derivative actions were filed by minority stockholders of ITT. See *Rosengarten v. International Tel. & Tel. Co.*, 466 F. Supp. 817 (S.D.N.Y. 1979). In addition, the SEC investigated ITT, with the result that a consent decree was entered whereby the company not only would maintain the Special Review Committee of its board but would also appoint a "Review Person" to review the work of the committee. See *SEC International Tel. & Tel. Co.*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,948 (D.D.C. 1979).

25. To the extent that these suits alleged only corporate waste and could not find a federal disclosure violation, they have often been dismissed by the federal courts. See, e.g., *Lewis v. Elam*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,013 (S.D.N.Y. 1977); *Limmer v. General Tel. & Elec. Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,111 (S.D.N.Y. 1977); *Levy v. Johnson*, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,899 (S.D.N.Y. 1977). Cf. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

26. The committee must be entirely unbiased if it is to provide the Corporation with access to the business judgment rule. See *Grynberg v. Farmer*, [Current] FED. SEC. L. REP. (CCH) ¶ 97,683 (D. Colo. 1980). State law generally permits a board of directors to delegate its powers to a committee. See, e.g., DEL. CODE ANN. tit. 8, § 141(c) (1975) (Delaware Corporation Law). See generally McMullen, *Committees of the Board of Directors*, 29 BUS. LAW 755 (1974); 3 J. CORP. LAW 400 (1978). As of June 30, 1978, the New York Stock Exchange made it a prerequisite of listing that each domestic company maintain an audit committee of independent directors.

27. 418 F. Supp. 508 (S.D.N.Y. 1976). See 3 J. CORP. LAW 208 (1977).

28. Among other factors considered, the Committee cited the unfavorable prospects for success in the litigation, the cost of the suit, the interruption of corporate business activity that would result, and the undermining of personnel morale that might occur. *Gall v. Exxon Corp.*, 418 F. Supp. at 514 n.13.

The focus of the business judgment rule inquiry is on those who actually wield the decision-making authority, not on those who might have possessed such authority at different times and under different circumstances. In no sense was the decision of the Special Committee not to sue merely an advisory one. Indeed, in carrying out its investigation and in reaching its conclusions, the Special Committee exercised the full powers of the Board.²⁹

Nevertheless, the court declined to grant summary judgment in order to allow the plaintiff to test the independence of the Special Committee through discovery.

General Telephone & Electronics Corporation (GTE) also was subjected to a series of derivative claims immediately following the report of its board of directors' Audit Committee disclosing the making of certain questionable payments.³⁰ GTE responded to the stockholders' suits by establishing a second independent committee, called the Special Litigation Committee, which was comprised of three directors who had joined the board after the payments were made. After conducting an investigation, the committee recommended that the general counsel seek dismissal of the actions.³¹

In *Auerbach v. Bennett*, the New York Court of Appeals upheld the trial court's entry of summary judgment in one of the actions brought on behalf of GTE. The Court of Appeals correctly noted that the business judgment question presented a two-tiered aspect since the underlying corporate action, the payments to foreign government and private customers, was itself the product of

29. *Id.* at 517. See *Puma v. Marriott*, 283 A.2d 693, 696 (Del. Ch. 1971).

30. See *Cramer v. General Tel. & Elec. Corp.*, 582 F.2d 259 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); *Limmer v. General Tel. & Elec. Corp.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,111 (S.D.N.Y. 1977); *Parkoff v. General Tel. & Elec. Corp.*, 74 App. Div. 2d 762, 425 N.Y.S.2d 599 (1980); *Auerbach v. Bennett*, 64 App. Div. 2d 98, 408 N.Y.S.2d 83 (1978), *rev'd*, 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994 (1979).

31. The Committee based its recommendation on its conclusions that none of the individual defendants had violated the New York State statutory standard of care, that none had profited personally or gained in any way, that the claims asserted in the present action are without merit, that if the action were allowed to proceed the time and talents of the corporation's senior management would be wasted on lengthy pretrial and trial proceedings, that litigation costs would be inordinately high in view of the likelihood of success, and that the continuing publicity could be damaging to the corporation's business.

Auerbach v. Bennett, 47 N.Y.2d at 625-26, 393 N.E.2d at 997, 419 N.Y.S.2d at 923.

business decisions intended to advance the corporate interests. That first tier was then sought to be protected by the interposition of a Special Litigation Committee which determined that no claims should be pursued. "The motions for summary judgment were predicated principally on the report and determination of the special litigation committee and on the contention that this second-tier corporate action insulated the first-tier transactions from judicial inquiry and was itself subject to the shelter of the business judgment doctrine."³² Although the committee consisted of only three members of the board, the court upheld its action by analogy to the familiar principle that a disinterested minority may approve transactions between a corporation and one or more of its directors. In addition, "[c]ourts have consistently held that the business judgment rule applies where some directors are charged with wrongdoing, so long as the remaining directors making the decision are disinterested and independent."³³

Thus, the decision of the Special Litigation Committee was sufficient under New York law to insulate the first-tier business judgment (that the foreign payments be made) from further inquiry. Review at the second level was procedural and involved only the good faith and disinterest of the committee. It should be noted that the layering of the business judgments effectively precluded even procedural review of the first tier. That is, the *Auerbach* court did not address the good faith of the officers and directors who knew of or approved the foreign payments, but only that of the committee which reviewed the underlying transaction.³⁴

32. *Id.* at 630, 393 N.E.2d at 1000, 419 N.Y.S.2d at 926.

33. *Id.* at 632, 393 N.E.2d at 1001-02, 419 N.Y.S.2d at 928. The court elaborated on the business judgment doctrine itself:

It appears to us that the business judgment doctrine, at least in part, is grounded in the prudent recognition that *courts are ill equipped and infrequently called on to evaluate what are and must be essentially business judgments*. The authority and responsibilities vested in corporate directors both by statute and decisional law proceed on the assumption that inescapably there can be no available objective standard by which the correctness of every corporate decision may be measured, by the courts or otherwise. Even if that were not the case, *by definition the responsibility for business judgments must rest with the corporate directors; their individual capabilities and expertise peculiarly qualify them for the discharge of that responsibility*. Thus, absent evidence of bad faith or fraud (of which there is none here) the courts must and properly should respect their determinations.

Id. at 630-31, 393 N.E.2d at 1000, 419 N.Y.S.2d at 926-27 (emphases added).

34. *Auerbach* has been followed in the dismissal of another derivative suit involving GTE, *Parkoff v. General Tel. & Elec. Corp.*, 74 App. Div. 2d 762, 425 N.Y.S.2d 599 (1980).

The same conclusions were reached by a federal court in *Rosengarten v. International Telephone & Telegraph Co.*,³⁵ where several shareholders' derivative suits were brought against ITT after its Legal Affairs Committee reported questionable payments of about \$3.8 million. ITT established a Special Review Committee composed of three outside directors who had not been affiliated with the corporation at the time of the payments. The committee conducted its own investigation (concluding that the payments in fact amounted to \$8.7 million) and decided that the company was not injured by the payments since they were a necessary means of obtaining foreign business. In addition, the committee found that none of the defendants had acted improperly or for personal benefit and that the suits were unnecessary as policing actions since ITT had subsequently adopted a policy forbidding such payments. Finally, the committee determined that the substantial problems, including cost, that would arise from the litigation did not support allowing the suits to proceed.

The district court in *Rosengarten* made preliminary findings that the Special Review Committee acted in good faith and considered appropriate factors in reaching its decision. The court also found that reliance on independent legal counsel for much of the investigatory work was permissible, even desirable, and that the committee's inquiry had not been hampered by friendship or other conflicts of interest. Having made this review of the underpinnings of the business judgment rule, the court went no further:

In light of all the factors discussed above, we find that the Committee's decision not to pursue these lawsuits was made in the exercise of its bona fide business judgment. This finding does not deal with the propriety or impropriety of the practices which are the subject of the lawsuits.³⁶

As in *Auerbach*, satisfaction of the business judgment conditions at the second tier was held to be sufficient to insulate the primary business decisions—the practices which are the subject of the lawsuits—from review even at the level of procedure.

Similar issues were raised in a recent case in the Court of Appeals for the Eighth Circuit, *Abbey v. Control Data Corp.*³⁷ There,

35. 466 F. Supp. 817 (S.D.N.Y. 1979).

36. *Id.* at 829.

37. 460 F. Supp. 1242 (D. Minn. 1978), *aff'd*, 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980).

Control Data responded to a derivative suit by creating a minority Special Litigation Committee which, after a concededly disinterested inquiry, recommended that the action be dismissed.³⁸ Applying the procedure enunciated by the Supreme Court in *Burks v. Lasker*,³⁹ the court of appeals looked to the relevant state corporate law in the absence of an overriding federal statutory policy, and concluded that Delaware law permitted an independent board committee to terminate the derivative action.⁴⁰

The disclosure of questionable payments by hundreds of major United States corporations led to many corporate "Watergates" like those addressed in *Gall*, *Auerbach*, *Rosengarten* and *Abbey*. As a result of their innovative use of independent board committees, however, many of the companies involved created a strong watchdog function that, without resort to litigation, led to recoveries of monetary damages from some individuals and to the institution of changes in top management as well as new programs and policies to prevent the recurrence of unlawful activity. The special committees generally achieved levels of corporate accountability and governance that no adversary proceedings could have accomplished.

At the same time these committees were able to fend off a rash of lawyer-inspired stockholder suits by convincing the courts that they, not some stockholder represented by a lawyer looking for easy work and substantial fees, should have the exclusive right to make all determinations as to corporate rights against management.⁴¹

38. This decision was based on the following considerations: none of the defendant directors had personal knowledge that the foreign payments were illegal; none of the defendant directors personally profited from those payments; the payments were intended to serve CDC's business interests; the litigation would seriously disrupt the effectiveness of a highly successful senior management team, to CDC's detriment; full public disclosure or the details of the foreign payments might prejudice CDC's present and future business activities and possibly even endanger the lives of some CDC employees; the defendant directors fully cooperated with the committee's investigation and with the investigation of the United States; and the United States, following its investigations, elected not to bring criminal or civil charges against the defendant directors.

Id. at 1244.

39. 441 U.S. 471, 476-77 (1979). See notes 75-79 *infra* and accompanying text.

40. The soundness of this determination has been cast in some doubt by the recent decision of Vice Chancellor Hartnett in *Maldonado v. Flynn*, Civ. No. 4800 (Del. Ch. March 18, 1980). See notes 56-62 *infra* and accompanying text.

41. Johnson, *Fiduciary Ethics and the Market*, *supra* note 1, at 45.

The questionable payments controversy, therefore, opened a bold new horizon for the business judgment rule.

Federal Securities Cases

In addition to supporting state law protection of officers and directors from personal liability, the principles underlying the business judgment rule have been applied in federal securities cases to insulate corporate entities from liability in certain circumstances. In *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*,⁴² the Second Circuit considered corporate and individual liability arising from delayed corporate disclosure of a rich mineral strike, in violation of the prompt disclosure requirements of the Securities and Exchange Commission's Rule 10b-5. Echoing language familiar from the state law rule, the court determined that, absent trading by insiders, "the timing of disclosure is a matter for the *business judgment* of the corporate officers entrusted with the management of the corporation. . . ."⁴³ If no other prohibited activity occurred, Rule 10b-5 liability would not attach so long as nondisclosure of material information served a legitimate "corporate purpose."⁴⁴

Taking its cue from *Texas Gulf Sulphur*, the Court of Appeals for the Tenth Circuit more fully articulated the Rule 10b-5 defense of corporate purpose in *Financial Industrial Fund, Inc. v. McDonnell Douglas Corp.*⁴⁵ In that case, a mutual fund sued McDonnell Douglas for failing promptly to disclose that its earnings would be drastically reduced. Release of the information had been delayed for several days while management checked the extent of production hold-ups and inventory write-offs. After noting that the case involved only corporate "silence," not actual misrepresentation, the court all but embraced the business judgment rule in its classic form:

Since the timing decision is one concerned fundamentally and almost exclusively with matters of discretion and the exercise of business judgment, it is appropriate to

42. 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom.* Coates v. SEC, 394 U.S. 976 (1969). Even before the Second Circuit's decision in *Texas Gulf Sulphur*, it had been recognized that Rule 10b-5 "does not impose a general obligation to publicly disclose all business secrets, when *sound business practice* indicates discretion." Schoenbaum v. Firstbrook, 268 F. Supp. 385, 395 (S.D.N.Y. 1967) (emphasis added), *aff'd*, 405 F.2d 200 (2d Cir.), *modified on reh. on other grounds*, 405 F.2d 215 (2d Cir.) (en banc), *cert. denied sub nom.* Manley v. Schoenbaum, 395 U.S. 906 (1969).

43. SEC v. Texas Gulf Sulphur Co., 401 F.2d at 850 n.12 (emphasis added).

44. *Id.*

45. 474 F.2d 514 (10th Cir.) (en banc), *cert. denied*, 414 U.S. 874 (1973).

consider the rationale of the "business judgment" rule. . . . The business judgment rule has been expressed in a variety of ways but it may be stated that the directors and officers of a corporation will not be held liable for errors or mistakes in judgment, pertaining to law or fact, when they have acted on a matter calling for the exercise of their judgment or discretion, when they have used such judgment and have so acted in good faith. . . . *The rule itself, of course, is not directly applicable, and it is not to be so applied here, but the reasons for it are considered as extended to the corporate entity.* . . . [W]e must hold that the decision of the officers or directors, and the corporate decision of the defendant to issue an earnings statement on other than the customary date for such statements, and the timing of such statement was a matter of discretion.⁴⁶

The opinion in *McDonnell Douglas* has the business judgment rule straining at the leash. The court of appeals would not apply the rule outright because it has historically been thought to protect only individual officers and directors, not corporate entities. But the rationale of the rule, including the lack of expertise of judge and jury in this area and the need for effective and unimpaired decision making,⁴⁷ prompted the court to apply the Rule 10b-5 corporate purpose defense at the entity level.⁴⁸ Surely this is little more than the traditional business judgment rule masquerading as a new doctrine.

A recent district court case has taken a salutary step toward unmasking the application of the business judgment rule in securities cases. In *State Teachers Retirement Board v. Fluor Corp.*,⁴⁹ a pension fund that sold Fluor stock sued the company for

46. *Id.* at 518 (emphases added).

47. *Id.* See generally 5A A. Jacobs, *THE IMPACT OF RULE 10b-5* §88.04(a), at 4-8 (1978).

48. For similar determinations of a legitimate corporate purpose, see *Segal v. Coburn Corp. of America*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶94,002, at 94,020 (E.D.N.Y. 1973); *Matarese v. Aero-Chatillon Corp.*, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶93,322, at 91,732 (S.D.N.Y. 1971); *Reynolds v. Texas Gulf Sulphur Co.*, 309 F. Supp. 548, 588 (D. Utah 1970), *modified on other grounds*, 446 F.2d 90 (10th Cir. 1971), *cert. denied*, 405 U.S. 918 (1972); *Astor v. Texas Gulf Sulphur Co.*, 306 F. Supp. 1333, 1338-39 (S.D.N.Y. 1969); *In re Investors Management Co.*, SEC Rel. No. 34-9267 (July 29, 1971), [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶78,163, at 80,521.

49. [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶97,340 (S.D.N.Y. 1980). See Vaughan, *Timing of Disclosure*, 13 REV. SEC. REG. 911 (1980).

delaying disclosure of a major contract with SASOL, a South African company. SASOL made a preliminary award of the contract to Fluor on February 25, 1980, but disclosure was delayed until March 10, 1980, so that SASOL could involve the French government in financing the project.⁵⁰

In *Fluor*, the court tied the business judgment theories of *Texas Gulf Sulphur* and *McDonnell Douglas* directly to the scienter requirement articulated in *Ernst & Ernst v. Hochfelder*.⁵¹ Corporate executives who exercise honest business judgment do not possess the "intent to deceive, manipulate or defraud"⁵² that Rule 10b-5 prohibits. Thus, the court stated in *Fluor*:

Some years prior to the decision in *Ernst & Ernst v. Hochfelder*, *supra*, the courts began to borrow the "business judgment" rule from general corporate law to protect officers and directors of corporations from 10b-5 liability for the exercise of their good faith discretion. . . . The rationale for the rule is that in order to make the corporation function effectively, those having management responsibility must have the freedom to make in good faith the many necessary decisions quickly and without the fear of potential liability for an honest error in judgment.⁵³

On this basis, the court granted summary judgment in favor of the defendant corporation since its officers had made a good faith business decision to preserve the confidentiality of the contract award while financing was being negotiated. Any reluctance to apply the business judgment rule to the corporate entity was discarded.

PROBLEMS IN THE MODERN BUSINESS JUDGMENT RULE

Fiduciary Obligations

One of the conditions of access to the traditional business judgment rule has always been the disinterestedness of the officers or

50. It is notable that the delay-in-disclosure cases have so far involved only a few weeks' delay. There is no reason in principle why the business judgment delay should not be upheld for longer periods (nor is there authority to the contrary), particularly if the information itself develops gradually over a substantial period.

51. 425 U.S. 185 (1976). "[W]e are quite unwilling to extend the scope of [§10(b)] to negligent conduct." *Id.* at 214.

52. *Id.* at 193; see *State Teachers Retirement Bd. v. Fluor Corp.*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶97,340, at 97,252.

53. *State Teachers Retirement Bd. v. Fluor Corp.*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶97,340, at 97,253.

directors involved. The business judgment rule bars judicial inquiry only into actions "taken in good faith and in the exercise of honest judgment in the lawful furtherance of *corporate purposes*."⁵⁴ When a claim is brought against corporate executives on the basis, not that they erred in pursuit of the interests of the shareholders, but rather that they placed their own interest above their fiduciary duty to corporate owners, then their actions are judged according to a standard of "entire fairness" instead of "business judgment."⁵⁵

In the double-tiered questionable payments cases, this principle of disinterestedness emerged as a requirement that the review committees be composed entirely of directors who had no involvement with the practices which they were charged to investigate. It may also be significant in these cases that the underlying corporate action—the making of questionable payments—was not self-serving on the part of executives but was intended to advance corporate interests. Certainly, this was a factor often cited by the review committees in determining not to bring suit on behalf of the corporations.

Only one court has been presented squarely with the question whether a principled distinction can be drawn between (1) independent review by a board committee of action which arguably served corporate interests and (2) equally independent committee review of conduct alleged to have been a violation of some fiduciary obligation. In *Maldonado v. Flynn*,⁵⁶ the Delaware Chancery Court attempted to draw such a line where the underlying action was an alleged abuse by its directors of Zapata Corporation's stock option plan to the tax detriment of the company:

54. *Parkoff v. General Tel. & Elec. Corp.*, 74 App. Div. 2d 762, 762, 425 N.Y.S.2d 599, 600 (1980) (emphasis added).

55. *See, e.g., Sterling v. Mayflower Hotel Corp.*, 33 Del. 293, 93 A.2d 107 (1952).

56. Civ. No. 4800 (Del. Ch. March 18, 1980). *Cf. Maldonado v. Flynn*, 485 F. Supp. 274 (S.D.N.Y. 1980), a parallel federal case in which Judge Weinfeld predicted that Delaware courts would apply the double-tiered principles of *Auerbach* to the facts of *Maldonado*. In a May 29, 1980 order, the Delaware Chancery Court held that Judge Weinfeld's decision constitutes *res judicata* and precludes assertion of the state claim in Delaware court; however, dismissal of the state case was stayed pending the outcome of the appeal of Judge Weinfeld's decision. In the most recent case arising out of these facts, *Maher v. Zapata Corp.*, [Current] FED. SEC. L. REP. (CCH) ¶97,549 (S.D. Tex. 1980), the federal district court looked to state law, as evidenced by the Chancery Court's March 18, 1980 decision in *Maldonado*, and concluded that a stockholder's derivative action could not be dismissed upon the recommendation of a board committee. The court also questioned the independence of the Zapata committee "in view of the fact that the Committee was appointed by the alleged wrongdoers." *Id.*, at 97,865.

Maldonado's complaint does not attack as improper the 1979 decision of the Committee to seek the dismissal of this litigation, which was probably an exercise of business judgment, although it was irrelevant to the dismissal issue now before me. Rather, Maldonado is attacking the 1974 decision of the directors to accelerate the option dates as being in bad faith or in breach of the directors' fiduciary duties. Although it is not necessary at this time to decide the issue, the 1974 decision to accelerate the options may not be entitled to the protection of the business judgment rule because the directors had a personal interest in that decision.⁵⁷

Vice Chancellor Hartnett proceeded to decide against Zapata's motion to dismiss on grounds related both to the nature of derivative actions and to the context of alleged breach of fiduciary duty:

The stockholder's right to litigate is secondary to the corporate right to bring suit only for so long as the corporation has not decided to refuse to bring suit. Once the corporation refuses, or impliedly refuses, to assert an apparently valid claim, *involving a breach of fiduciary duty by corporate directors*, the stockholder is vested with a primary and independent right to redress the wrong by bringing a derivative suit.⁵⁸

At least where breach of fiduciary duty is alleged, therefore, the Delaware court rejected the efficacy of the second-tier business judgment to preclude judicial review of corporate action:

Under our system of law, courts and not litigants should decide the merits of litigation. Aggrieved stockholders of Delaware corporations ought to be able to expect that an impartial tribunal, and not a committee appointed by the alleged wrongdoers, will decide whether a stockholder's derivative suit alleging breach of fiduciary duty has any merit.⁵⁹

57. *Maldonado v. Flynn*, Civ. No. 4800, slip op. at 15. *Maldonado* has recently been followed on this issue in *Abella v. Universal Leaf Tobacco Co.*, Civ. No. CA 79-0073-R (E.D. Va. August 6, 1980).

58. *Maldonado v. Flynn*, Cir. No. 4800, slip op. at 22 (emphasis added). The court relied (p. 19) on the dual aspect of derivative suits expressed in *Cantor v. Sachs*, 18 Del. Ch. 359, 365-66, 162 A. 73, 76 (1932). *But see* cases cited at notes 15-22 *supra* and accompanying text.

59. *Maldonado v. Flynn*, Civ. No. 4800, slip op. at 23.

The distinction suggested in *Maldonado* is perhaps deceptively appealing. True, the Zapata directors' decision to accelerate their stock options in 1974 was not entitled to any shelter behind the business judgment rule. But the independent committee review upheld in *Auerbach* and related cases constituted a second judgment, that the best interests of the corporation would not be served by bringing suit: this is not a matter of whether the claim has any merit but instead encompasses diverse business factors such as the disruption that a lawsuit brings, the accompanying publicity and the impact on employees' morale. Indeed, as Judge Weinstein said in the parallel *Maldonado* case in federal court, "the essence of the business judgment rule in this context is that directors may freely find that certain *meritorious* actions are not in the corporation's best interests to pursue."⁶⁰

If the underlying decision was to facilitate corporate activity by making questionable payments, that would be a legitimate factor to be considered by the review committee, presumably making a conclusion not to seek corporate recovery more likely in such cases. So long as the second judgment is disinterested and made in the exercise of due care, however, the impact of dismissal on shareholders is the same whether the first-level decision was in violation of a fiduciary duty or in advancement of corporate interests. In either case, the review committee is presumably deciding not to seek a recovery that could ultimately redound to each shareholders' financial benefit. To hold that any violation of fiduciary obligations uniquely injures shareholders in ways (presumably nonfinancial) that other misconduct does not, as Vice Chancellor Hartnett implied, necessarily resurrects his related theory of the primary and independent right of shareholders to bring derivative suits, contrary to the generally-accepted rule of *United Copper Securities* that the right of action belongs to the corporation.⁶¹

At bottom, the court in *Maldonado* seemed to be suspicious of the apparent ease with which unscrupulous directors could insulate themselves from derivative suits by appointing new board members to form a committee guaranteed not to pursue corporate claims

60. *Maldonado v. Flynn*, 485 F. Supp. at 285 (emphasis in original). See factors cited in notes 28, 31, 35 and 38 *supra* and accompanying text.

61. See text accompanying notes 16-22 *supra*. Of course, to the extent a shareholder has been harmed in any individual capacity by breach of a director's fiduciary obligation, nothing in the business judgment rule as currently applied would preclude an independent action based on a direct rather than a derivative claim.

against them.⁶² The court was surely right to be wary of such abusive conduct; any evidence that committee members have been hand-picked to ensure a particular result should eviscerate the second-tier protection of committee review. The appropriate mechanism for achieving this result, however, is not to deny business judgment rule dismissals in all cases alleging underlying violations of fiduciary duties. Instead, when there is evidence that the directors have abused the independent committee procedures, the court should deny access to the business judgment rule on the ground that its necessary conditions have not been met: *Auerbach* is entirely consistent with denying any power to a review committee that is neither truly independent nor conducts its deliberations in good faith and with due care.

The *Maldonado* court's valid concern over the committee's independence apparently prompted it to reach an unsound and overboard denial of second-tier business judgment dismissals in cases alleging breach of fiduciary duty. It is apparent, nevertheless, that the business judgment rule has been, and should be, sensitive to conflicts of interest. Perhaps a middle ground is possible. The questionable payments cases support the view that shareholders seeking to persevere in their derivative actions must first produce some evidence that the review committee was not truly disinterested; perhaps the burden of proof of independence should be shifted when the underlying conduct involves an alleged breach of fiduciary duty by directors. In future cases presenting issues like those in *Maldonado*, business judgment dismissal should be entered only if the defendants establish the independence of any board committee that recommends against corporate action.⁶³ If that burden is met, however, business judgment rule dismissal of derivative claims should be made available regardless of the nature of the underlying conduct.

Attorney-Client Privilege

The questionable payments and subsequent cases have established that use of an independent board committee to investigate

62. See also *Maher v. Zapata Corp.*, [Current] FED. SEC. L. REP. (CCH) ¶97,549, at 97,864-65 (S.D. Tex. 1980) (following *Maldonado*). It should be noted, however, that this concern would not necessarily apply to alleged breaches of fiduciary duty by non-director officers and employees. Moreover, the independent status which many outside directors enjoy in the business community and the growing popularity of nominating committees may alleviate the problem.

63. Substantially the same solution is proposed in Black & Smith, *Business Judgment*, 13 REV. SEC. REG. 935, 937-38 (1980). See also Estes, *Corporate Governance in the Courts*, 58 HARV. BUS. REV. 50 (1980). See *Treadway Companies, Inc. v. Care*

corporate practices may enhance access to the business judgment rule. In effect, the resources of the corporation are placed in the service of its self-policing body and societal resources are conserved by the policy of deference once the independence and good faith of the committee and the thoroughness of its procedures have been reviewed. Because of these advantages, independent committee investigations, usually with the assistance of independent counsel, have been used extensively despite the absence of any law requiring their use.⁶⁴

As demonstrated by the many questionable payments investigations, the usefulness of independent board committees is dependent in large measure on their ability to engage the services of independent legal counsel.⁶⁵ Committee counsel both advises as to the applicable legal standards and conducts much of the factual investigation, including interviews and document review. Employees are generally instructed to cooperate with the investigating counsel, without the overshadowing atmosphere of adversary process and compelled discovery that would prevail in a civil or administrative proceeding. Such cooperation, in turn, has been desirable from corporate management's point of view because the investigation truly is for the company, conducted by lawyers employed by it (although selected by the committee), and protected by the attorney-client privilege. The privilege ensures the free flow of information to the internal investigators, with the result that they can uncover the full facts and make appropriate recommendations concerning corrective and legal action.

The advantages of using independent committees and their counsel for the identification and correction of corporate problems have recently been threatened by the decision in *United States v.*

Corp., [Current] FED. SEC. L. REP. (CCH) ¶ 97,603 (2d Cir. 1980); *Grynberg v. Farmer*, [Current] FED. SEC. L. REP. (CCH) ¶ 97,683 (D. Colo. 1980).

64. It has been suggested that such investigations may sometimes be required in order to discharge directors' obligations of due care when they have notice of questionable practices. See Block & Barton, *Internal Corporate Investigations: Maintaining the Confidentiality of a Corporate Client's Communications With Investigative Counsel*, 35 BUS. LAW. 5, 7-8 (1979) (dealing extensively with the issue discussed in this section). It will be a rare case, however, in which the duty of care will require a committee inquiry with assistance of counsel.

65. The Voluntary Disclosure Program of the Securities and Exchange Commission, created to deal with the questionable payments investigations of the 1970s, recommended that board committees retain outside counsel. See SENATE BANKING, HOUSING AND URBAN AFFAIRS COMM., 94TH CONG., 2D SESS., REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES 8 (Comm. Print 1976). See generally Silverstein, *Special Problems Regarding the Role of Counsel*, THE EMERGENCE OF THE CORPORATE AUDIT COMMITTEE 78, 83-85 (P.L.I. 1978).

The Upjohn Co.,⁶⁶ holding that information given by middle-management personnel to counsel conducting an independent investigation is not within the protection of the attorney-client privilege. Until this matter is resolved, it is unlikely that many corporations will authorize a thorough internal inquiry concerning corporate conduct or other potential liabilities and thereby risk civil discovery of counsel's notes that would provide a road-map for subsequent plaintiffs.

In *Upjohn*, an investigation concerning questionable foreign payments was made by in-house counsel with the assistance of outside lawyers: "At the request of Upjohn's top management, officers and employees of the company were urged to respond to counsel's questions candidly and confidentially. The responses were recorded in answers to written questionnaires and in counsel's notes and memoranda describing oral interviews."⁶⁷ The Internal Revenue Service sought and obtained the documents prepared by counsel except with respect to statements made by the management control group, which was held to "possess an identity analogous to the corporation as a whole"⁶⁸ and thus to constitute the "client" for purposes of the attorney-client privilege.⁶⁹ The court rejected the broader subject-matter standard for the privilege, which protects information given to corporate counsel by any employee who obtained it as a result of the subject matter of the employee's responsibilities.⁷⁰

66. 600 F.2d 1223 (6th Cir. 1979), *cert. granted*, 445 U.S. 925, (1980). See *In re Grand Jury Investigation*, 599 F.2d 1224 (3d Cir. 1979); *United States v. Amerada Hess Corp.*, [Advance Sheets] STAND. FED. TAX REP (CCH) ¶9,160. See generally Block & Barton, *Internal Corporate Investigations*, *supra* note 64.

67. *United States v. The Upjohn Co.*, 600 F.2d at 1225.

68. *Id.* at 1226.

69. See *City of Phil. v. Westinghouse Elec. Co.*, 210 F. Supp. 483 (E.D. Pa.), *mandamus denied sub nom.* *General Elec. Co. v. Kirkpatrick*, 312 F.2d 742 (3d Cir.), *cert. denied*, 372 U.S. 943 (1962). See also *In re Grand Jury Investigation*, 599 F.2d 1224 (3d Cir. 1979); *Natta v. Hogan*, 392 F.2d 686 (10th Cir. 1968); *In re Grand Jury Subpoena*, 81 F.R.D. 691 (S.D.N.Y.), *rev'd on other grounds*, 599 F.2d 504 (2d Cir. 1979). See generally H. MILSTEIN, *ATTORNEY-CLIENT PRIVILEGE AND THE WORK PRODUCT DOCTRINE: CORPORATE APPLICATIONS* (B.N.A. 1980); Note, *Attorney-Client Privilege for Corporate Clients: The Control Group Test*, 84 HARV. L. REV. 242 (1970).

70. See, e.g., *Diversified Indus. Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1977) (*en banc*) (investigation of slush fund protected by privilege); *Harper & Row Publishers, Inc. v. Decker*, 423 F.2d 487, 491-92 (7th Cir. 1970) (*per curiam*) (privilege applies when "the employee makes the communications at the direction of his superiors. . . ." and the subject matter relates to employment duties), *aff'd without opinion by an equally divided court*, 400 U.S. 348 (1971); *In re Ampicillin Antitrust Litigation*, 1978-1 TRADE CAS. ¶62,043 (D.D.C. 1978); *Duplan Corp. v. Deering Milliken, Inc.*, 397 F. Supp. 1146, 1164 (D.S.C. 1975).

The court in *Upjohn* was no doubt correct to state that "[c]orporate counsel should not be the exclusive repository of unpleasant facts."⁷¹ The point of special investigations, however, is not to shield managers from the facts but rather to ensure that all the relevant facts are brought to the attention of responsible corporate officials and that adequate attention is given to corrective action, disclosure and other legal responsibilities. "To the degree that either test protects communications between management and lower-level employees, it is the broader 'subject matter' test and not the restrictive 'control group' test which enhances such open and honest discussion."⁷²

A more potent argument against the attorney-client privilege in this context is that made in *In re Grand Jury Investigations*,⁷³ recently decided by the Court of Appeals for the Third Circuit. There, the court denied the privilege in part because "the potential costs of undetected noncompliance [with law] are themselves high enough to ensure that corporate officials will authorize investigations regardless of an inability to keep such investigations completely confidential."⁷⁴ Clearly, there will be such cases; *Upjohn* and *Grand Jury* do not mean that no audit or other committee investigation will ever again be conducted. Nevertheless, it cannot be expected that internal inquiries, without the protection of the attorney-client privilege, will often be so cost-effective as the court implied.

In our view, however, the more important question concerns the nature of the signals to be sent to corporate management: Should corporate self-examination and self-policing be a last resort, fraught with litigation hazards, or should it be encouraged and sheltered by applicable rules of law? The court in *Grand Jury*, as in *Upjohn*, elected the first alternative and placed a significant impediment in the way of corporate self-governance. We believe that this was an unwise policy choice and that the Supreme Court should ultimately settle the conflict among the circuits by establishing the subject matter test as the applicable standard. Until this uncertainty is removed, investigations by audit and other committees cannot realistically be expected to go below the management control group.

71. *United States v. The Upjohn Co.*, 600 F.2d at 1227.

72. *Block & Barton, Internal Corporate Investigations*, *supra* note 64, at 16.

73. 599 F.2d 1224 (3d Cir. 1979).

74. *Id.* at 1237.

Federal Regulatory Policy

The federal courts presently are struggling to define the appropriate scope of business judgment doctrine in the context of suits brought under specific federal statutes. The question in these cases is whether investigation by minority committees, in the fashion of *Gall* and *Auerbach*, will be sufficient to terminate stockholders' derivative actions by means of summary judgment when it is alleged that strong federal policies have been frustrated.

The Supreme Court recently addressed this issue in *Burks v. Lasker*,⁷⁵ a derivative suit based on the Investment Company Act of 1940 and the Investment Advisers Act of 1940. Shareholders of an investment company alleged that several members of its board and the company's investment adviser had violated their statutory and common law duties by purchasing commercial paper of the Penn Central Transportation Company. The investment company established a minority board committee made up of the five directors not implicated in the suit. On the basis of its investigation, assisted by outside counsel, the committee concluded that maintenance of the action was not in the best interests of the corporation or its shareholders.

The district court held that a federal business judgment rule was applicable and that it required deference to a good faith conclusion of an independent committee.⁷⁶ The court initially permitted discovery with respect to the independence of the committee's members. Then, after finding no evidence of lack of independence or good faith, it granted summary judgment.⁷⁷ The court of appeals reversed, basing its decision on a construction of the two federal statutes involved, which it viewed as not permitting the dismissal of a shareholders' action regardless of the independence of the committee.

In the Supreme Court, Justice Brennan's majority opinion treated the issue primarily as one of choice of law. The action was based on two federal statutes, but the existence of a federal right did not make state law irrelevant. In particular:

This case involves the question whether directors are authorized to determine that certain claims not be pur-

75. 404 F. Supp. 1172 (S.D.N.Y. 1975), *summary judgment entered*, 426 F. Supp. 844 (S.D.N.Y. 1977), *rev'd*, 567 F.2d 1208 (2d Cir. 1978), *rev'd & rem'd*, 441 U.S. 471 (1979).

76. *Burks v. Lasker*, 404 F. Supp. 1172 (S.D.N.Y. 1975).

77. *Burks v. Lasker*, 426 F. Supp. 844 (S.D.N.Y. 1977).

sued on the corporation's behalf. As we have said in the past, the first place one must look to determine the powers of corporate directors is in the relevant State's corporation law. . . . "Corporations are creatures of state law," . . . , and it is state law which is the font of corporate directors' powers. By contrast, federal law in this area is largely regulatory and prohibitory in nature—it often limits the exercise of directorial power, but only rarely creates it.⁷⁸

Thus, the Court held that the first step in applying federal law is to determine what the state of incorporation would permit directors to do. As a second step, the lower courts should consider whether the state law rule is consistent with federal statutory or regulatory policy. Neither lower court applied this two-pronged test in *Lasker*,⁷⁹ so the case was remanded.

Burks v. Lasker has thus established an authoritative test that will be applied in the context of other federal statutes. The standard is that federal law applies, but that the primary source of federal law is the relevant state business judgment rule, unless the rule is inconsistent with an overriding federal policy. *Lasker* was followed in *Abbey v. Control Data Corp.*, a sensitive payments case discussed above.⁸⁰ It also has been applied in two recent and possibly conflicting opinions in the Second and Ninth Circuits.

In *Lewis v. Anderson*,⁸¹ the Court of Appeals for the Ninth Circuit considered a derivative action against a majority of the directors of Walt Disney Productions based on their participation in a stock option plan. A special litigation committee was appointed and ultimately sought dismissal of the suit.⁸² Following *Lasker*, the court of appeals first determined that California law would defer to an independent determination by a board committee to seek dismissal of the suit.⁸³ Then, the court considered federal policies expressed in

78. *Burks v. Lasker*, 441 U.S. at 478 (citations omitted).

79. The district court applied the business judgment rule as a matter of direct federal law.

80. See text accompanying notes 37-39 *supra*.

81. 615 F.2d 778 (9th Cir. 1979).

82. The committee consisted of two outside directors appointed after the option transactions and one director, named as a defendant, who received no benefits from the challenged conduct.

83. In the absence of direct precedent, the federal court concluded that California would follow the lead of the other cases previously discussed. "*Auerbach* and *Abbey* reflect a clear trend in corporate law, and we are confident that a California court would follow this trend." *Lewis v. Anderson*, 615 F.2d at 783.

section 14(a) of the Securities Exchange Act of 1934 and in Rule 10b-5 of the Securities and Exchange Commission. "Allowing disinterested directors to exercise their business judgment to dismiss what they see as groundless causes of action would in no way weaken the regulatory provisions of the federal securities laws."⁸⁴ The Court of Appeals for the Ninth Circuit therefore affirmed the district court's foreclosure of the suit by entry of partial summary judgment.⁸⁵

More recently, the Second Circuit held in *Galef v. Alexander*⁸⁶ that the business judgment rule could not be invoked to bar a derivative action alleging proxy violations by all of a company's fifteen directors. The suit, brought on behalf of TRW, Inc. under section 14(a), involved inadequate disclosure with respect to stock option plans. A majority of TRW's directors, consisting entirely of directors who received no options (but who approved the plans and their disclosure), determined that the action was contrary to the best interests of the company; the district court dismissed pursuant to the business judgment rule.

The Court of Appeals for the Second Circuit followed *Lasker* and looked to Ohio state law for guidance. The court noted that Ohio law was unclear but might hold that a director sued merely on account of having authorized the underlying transaction is sufficiently disinterested to initiate a business judgment summary dismissal of the suit.⁸⁷ However, the court went on to declare that even if the Ohio law would so hold, federal policy expressed in section 14(a) would be inconsistent: "In short, we conclude that to the extent that a complaint states claims against directors under §14(a) upon which relief may be granted, federal policy prevents the summary dismissal of those claims pursuant to the business judgment of those defendant directors."⁸⁸

84. *Id.* at 784.

85. The district court had reserved the factual question whether the committee did exercise good faith judgment.

86. 615 F.2d 51 (2d Cir. 1980).

87. *Id.* at 61.

88. *Id.* at 64. The court noted that, in *Lewis v. Anderson*, two out of three committee members were not named defendants. *Id.* at 64 n.20. *Galef* was carefully limited to situations in which a federal claim is properly stated against directors and is not subject to dismissal or summary judgment. See FED. R. CIV. P. 12(b)(6) and 56. In addition, the court noted that partial summary judgment might be allowed, pursuant to the relevant state's business judgment rule, for any state law claims joined with the proxy allegations. *Galef v. Alexander*, 615 F.2d at 67.

Galef has been distinguished by one of the district courts which has considered similar issues since the opinion was handed down. In *Maldonado v. Flynn*,⁸⁹ Judge Weinfeld reviewed the determination by the Independent Investigation Committee of Zapata Corporation, composed of two newly-appointed outside directors, that pursuit by Zapata of any meritorious claim it might have against other directors pursuant to section 14(a) would not be in the company's best interest. The court found no evidence to contradict the committee's good faith and disinterestedness; applying the two-step *Lasker* formula, it further found no conflict between what it perceived as the Delaware rule permitting dismissal⁹⁰ and the federal policies of section 14(a);⁹¹ "the rule does not infringe directly upon the protections accorded investors by the regulatory scheme of section 14(a). It does not condone conduct violative of that section."⁹²

An opposite result was reached in *Maher v. Zapata Corp.*,⁹³ a federal case which arose out of the same facts as *Maldonado*. There, the court noted the holding of the Chancery Court of Delaware in a parallel *Maldonado* opinion that rejected Judge Weinfeld's prediction and declared the Delaware rule to preclude business judgment dismissal of a derivative action alleging breach of directors' fiduciary duty.⁹⁴ Although the Supreme Court of Delaware has yet to address the issue, the court in *Maher* followed the Chancery Court precedent and concluded: "Since Delaware law does not permit independent directors to terminate a derivative action against

89. 485 F. Supp. 274 (S.D.N.Y. 1980).

90. Although Judge Weinfeld and other federal judges uniformly predicted that Delaware law would support dismissal in this case, a lower court in Delaware recently held, in a case parallel to that discussed in the text, that the business judgment rule cannot be relied on to dismiss a derivative suit that alleges breach of fiduciary duty by directors, even though the committee members making the determination are not themselves defendants. *Maldonado v. Flynn*, Civ. No. 4800, slip op. at 22. Subsequently, the Delaware court held that Judge Weinfeld's decision was *res judicata* and that it will govern the state case unless it is reversed on appeal in the Second Circuit. *Maldonado v. Flynn*, Civ. No. 4800 (Del. Ch. May 29, 1980).

91. "The Court of Appeals' holding [in *Galef*] was premised on the fact that the directors making the determination to terminate the suit were not disinterested. . . . The Court of Appeals expressly left undecided whether a state rule permitting non-defendant directors or an independent committee to initiate a business judgment dismissal contravenes federal policy, the very issue addressed here." *Maldonado v. Flynn*, 485 F. Supp. at 286 n.44.

92. *Id.* at 281.

93. [Current] FED. SEC. L. REP. (CCH) ¶97,549 (S.D. Tex. 1980). See also *Abella v. Universal Leaf Tobacco Co.*, Civ. No. CA 79-0073-R (E.D. Va. August 6, 1980).

94. *Maldonado v. Flynn*, Civ. No. 4800 (Del. Ch. March 18, 1980). See notes 56-63 *supra*, and accompanying text.

other board members, this Court need not address whether the state law rule of dismissal is consistent with the policies of the federal securities act. . . ."⁹⁵

It seems clear that the *Burks v. Lasker* tests will take some time before they are worked out in full by the lower courts. With rare exceptions, however, such as the peculiar situation in *Galef*, it appears that federal courts will be able to apply the business judgment rule, based on action by independent board committees, in a wide variety of statutory contexts. These developments suggest the emergence of a powerful new tool based on the fiduciary responsibilities of corporate directors.

A FUTURE ROLE FOR THE BUSINESS JUDGMENT RULE

The traditional legal doctrine that managers are fiduciaries only for stockholders and the related executive mind-set were tried and found wanting in the corporate "Watergates" of the last decade. Whereas the many audit committee investigations of the 1970's exposed very little misconduct that could be labeled breach of fiduciary duty to stockholders, they often revealed an excess of zeal on the part of executives in serving the stockholders' interests narrowly and to the detriment of the larger common good. This excess of zeal frequently involved violations of domestic and foreign laws designed to protect consumers or the general public.

We see a need for broadening the constituencies which corporate fiduciaries serve, but we do not suggest that the scope of fiduciary responsibility be expanded, in the simple-minded adversary spirit of the litigious society, by imposing new forms of personal liability on executives. Rather we propose the development of positive incentives that will simplify the lives of corporate officers and directors who conduct themselves as stewards not only for stockholders but for consumers and the general public as well.⁹⁶ This

95. *Maier v. Zapata Corp.*, [Current] FED. SEC. L. REP. (CCH) ¶97,549, at 97,864.

96. As noted in note 2 *supra*, C. Merrick Dodd made a similar argument, rejoined by Adolph Berle, in 1932. The debate over the inadequacy of traditional fiduciary doctrine has advanced very little since that classic exchange, although it has continued with new actors. For example, Christopher Stone's 1975 book, *Where the Law Ends*, proposed specific mandatory structural reforms designed to cause corporations to act responsibly toward consumers, communities and employees, only to be subjected to Berle-type criticism for failing to enunciate anything but a vague thoughtfulness standard of responsibility. See Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1 (1979). We side, in effect, with Professor Dodd's pro-

article has traced the recent development of the business judgment rule because expansion of this rule under appropriate conditions might provide one such incentive.

We base our proposal to expand the business judgment rule primarily on the widespread adoption by large corporations of reforms in corporate self-governance, including the reconstitution of boards with a majority of outside directors, the establishment of independent audit, compensation and nominating committees, and the adoption of strong internal auditing and control procedures. These institutional changes provide the basic structures within which an extension of the business judgment rule should be encouraged to take place.⁹⁷

As boards of directors and their monitoring committees become more independent of management and more public, they should be encouraged to play a more effective part in determining the policies that will shape our economic life. We are not proposing as a logical next step that a corporation should be able to act through its independent directors as a trial court for resolving major claims against the corporation. What we are proposing is that a qualified corporation, faced with a third-party civil action based on tort law or alleging statutory or regulatory violations, should be able to initiate a business judgment dismissal or summary judgment if the corporate act in question had been subjected to and approved after a prior special review by a committee of independent directors. By qualified corporation we mean at a minimum a reporting⁹⁸ company

posals to encourage, not to require, broader corporate responsibility. To the Berle-Engel view that precise standards must first be articulated, we reply that such precision invites paralysis and that the numerous laws on the books today make sufficiently clear what society's standards are for responsible corporate action. See Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 105-06 (1979) (listing some current legislative and judicial standards for corporate conduct).

97. It seems unlikely that the recent legal developments traced above would have occurred if the companies involved had not been following what was, in effect, the best corporate practice of their time. "The continued willingness of the judiciary to accept its own concept, the business judgment rule, and to apply it to novel and stressful fact situations has to be a tribute to the gains that have been made in strengthening the role of outside directors." Estes, *Corporate Governance in the Courts*, 58 HARV. BUS. REV. 50, 60 (1980). Further expansion of the rule should be tied to continued innovation in the area of responsible corporate self-governance.

98. A reporting company is one which files periodic reports with the Securities and Exchange Commission either voluntarily or as required by §13(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78n(a) (1976). Section 13(a) requires periodic reports from all companies which have securities registered pursuant to §12(a) of the Act, 15 U.S.C. §78l(a) (1976) (securities traded on a national securities exchange),

whose board has a majority of non-employee directors. Certain other qualifications, such as the maintenance of a nominating committee meeting specified standards, also might be appropriate for this enlarged access to the business judgment rule.

Obviously, a qualified corporation would not subject every significant corporate decision to formal committee review so as to maximize its access to the business judgment defense. Such a policy would paralyze the company more effectively than the litigation it is intended to avoid. Most decisions would continue to be made by management under the general supervision of the full board of directors.⁹⁹ The kinds of major corporate decisions that boards would deem appropriate for such prior committee review might include the timing and content of press releases reflecting board action likely to have a very substantial impact on the market price of the corporation's stock, the environmental or safety aspects of important capital expansions or new lines or products, or the rejection of merger proposals or tender offers as not being in the best long-term interests of the corporation. The committee's determination, provided it was made in good faith and with due care, could become a powerful tool for foreclosing claims that a product line or manufacturing process was negligently designed or that material information was inadequately or dilatorily disclosed. In such a case, summary judgment would be appropriate once a court had reviewed the committee's independence and the adequacy of the procedures it employed.

The role here envisioned for independent directors has close parallels with the monitoring function of administrative agencies of government. Indeed, the judicial rhetoric for review of administrative decisions resembles the language employed with respect to the business judgment rule: administrative agencies are "presumably equipped or informed by experience to deal with a specialized field of knowledge"; their "findings within that field

or §12(g), 15 U.S.C. §781(g) (1976) (securities of issuers which have total assets in excess of \$1,000,000 and a class of equity securities held of record by at least 500 persons). Section 15(d) extends the reporting requirements of §13 to companies which have made a registered offering of their securities and which have at least 300 holders of such securities. 15 U.S.C. §78 p(d) (1976).

99. Management and board decisions on these lesser matters would, of course, be entitled to the protection of the business judgment rule as traditionally formulated. In addition, some rule of reason would be appropriate with respect to the submission of matters to special board committees for prior review: failure to seek such review in a particular instance should not be cause for penalizing a corporation.

carry the authority of an expertise which courts do not possess and therefore must respect."¹⁰⁰ Like public administrators, directors and managers of modern corporations are professionals who possess expertise that can never be matched by judges.

Despite the close parallel, we see a need in the economy and in the nature of the corporate enterprise to have important lines of power and responsibility emanate not from centralized government but instead from the public stockholders, those whose economic interests ultimately are at stake. Thus, expansion of the business judgment rule would be grounded firmly in one of its underlying policies of diffusing power and placing it among those who have the necessary practical expertise and accountability.¹⁰¹

Providing legal constraints on corporate action in the form of limited judicial review of independence and care is a necessary condition of allowing corporate executives to exercise broad responsibilities in the context of an enlarged business judgment rule. Thus, deference to decisions of independent board committees in the manner contemplated is justified only if the institutional conditions are ripe, only if the appropriate mechanisms for internal governance are in place. In this sense, the current trend toward outside directors and audit, nominating and other independent committees may indeed be hailed as a significant step in the evolution of corporate structure. If legal theory responds to these structural developments as it has to the use of special litigation committees in the questionable payments context, a powerful, non-adversarial incentive toward socially responsible forms of corporate leadership may develop.

100. *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 488 (1951). See *SEC v. Chenery*, 318 U.S. 80, 88, 94 (1943).

101. Chairman Harold Williams of the Securities and Exchange Commission has made a similar point in relation to subject company responses to tender offers: "[A]n effective board of directors remains the institution best suited to weigh the oft-conflicting factors that may influence a corporate response to such a situation." Chairman Williams also emphasized the "special responsibilities for competence and objectivity" that the board faces in the takeover context and suggested that access to the business judgment rule for decisions to oppose an offer should be conditioned on satisfaction of these responsibilities. "Tender Offers and the Corporate Director," Address by Chairman Williams, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,445, at 82,880 (Jan. 17, 1980).

