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Rethinking Judicial Review of Director Care

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RETHINKING JUDICIAL REVIEW OF DIRECTOR CARE

BY LYMAN JOHNSON*

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Once when "Care" was crossing a river, she saw some clay; she thoughtfully took up a piece and began to shape it. While she was meditating on what she had made, Jupiter came by. "Care" asked him to give it spirit, and this he gladly granted. But when she wanted her name to be bestowed upon it, he forbade this, and demanded that it be given his name instead. While "Care" and Jupiter were disputing, Earth arose and desired that her own name be conferred on the creature, since she had furnished it with part of her body. They asked Saturn to be their arbiter, and he made the following decision, which seemed a just one: "Since you, Jupiter, have given its spirit, you shall receive that spirit at its death; and since you, Earth, have given its body, you shall receive its body. But since 'Care' first shaped this creature, she shall possess it as long as it lives. And because there is now a dispute among you as to its name, let it be called '*homo*', for it is made out of *humus* (earth)."¹

I. INTRODUCTION

The Delaware Supreme Court has held² — to the continuing detriment of corporate law³ — that under certain conditions it will review duty of care

¹MARTIN HEIDEGGER, *BEING AND TIME* 242 (John Macquarrie & Edward Robinson trans., Harper & Row 1962) (1927) (quoting No. 220 of the Fables of Hyginus).

²*Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156 (Del. 1995); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), *on reargument*, 636 A.2d 956 (Del. 1994). The litigation resulting from the sale of Technicolor, Inc. has produced many reported opinions, in addition to those cited above. *Cede & Co. v. Technicolor, Inc.*, No. 7129, 1998 Del. Ch. LEXIS 196, at *1 (Del. Ch. Oct. 9, 1998); *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134 (Del. Ch. 1994), *aff'd*, *Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156 (Del. 1995); *Cinerama, Inc. v. Technicolor, Inc.*, No. 8358, 1991 Del. Ch. LEXIS 105, at *1 (Del. Ch. June 21, 1991), *reprinted in*, 17 DEL. J. CORP. L. 551 (1991), *rev'd in part*, *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993); *Cede & Co. v. Technicolor, Inc.*, No. 7129, 1990 Del. Ch. LEXIS 259, at *1 (Del. Ch. Oct. 19, 1990), *rev'd*, 684 A.2d 289 (Del. 1996). Where it is unnecessary in this article to refer to a specific judicial opinion in the above litigation, reference will simply be made to "*Cede*." For ease of reference, *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), will be referred to as *Cede II*; *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156 (Del. 1995), will be referred to as *Cede III*.

³The Delaware Supreme Court continues to adhere to the holdings in the *Cede* litigation. *See Emerald Partners v. Berlin*, 726 A.2d 1215, 1220 (Del. 1999). Delaware corporate law decisions not only affect Delaware corporations but are frequently used by other state courts for guidance. *See, e.g., Hilton Hotels Corp. v. ITT Corp.*, 978 F. Supp. 1342, 1346 (D. Nev. 1997) (applying Delaware law as persuasive authority where Nevada law is silent on the issue). A California court relied upon the *Cede III* holding for the grossly overgeneralized proposition that "in Delaware, analysis of a breach of fiduciary duty claim involves application of the 'entire fairness test.'" *Interactive Multimedia Artists, Inc. v. Superior Court (Allstate Ins. Co.)*, 73 Cal. Rptr.2d 462, 466 (Cal. Ct. App. 1998).

claims using a strict "entire fairness" test, a test traditionally reserved for duty of loyalty claims.⁴ Conversely, Delaware courts have held that under certain conditions they will review duty of loyalty claims under the slack "business judgment rule" standard traditionally applied to duty of care claims.⁵ This startling reversal of review standards upends conventional thinking about the distinctiveness of the core concepts of care and loyalty.⁶ More than that, it reflects the Delaware Supreme Court's quest to bring an overarching doctrinal coherence to its fiduciary analysis of corporate director conduct.⁷

Coherence in legal doctrine is an appealing idea,⁸ especially in areas plagued by conceptual complexity. It is thus understandable that, following the doctrinal upheaval of corporate law in the 1980s,⁹ the Delaware Supreme Court sought in the 1990s to advance a more unified framework for reviewing challenged conduct of corporate directors.¹⁰ Analytical uniformity is only apparently achieved, however, at an unacceptably high and continuing cost. This cost includes the ongoing, puzzling absence in Delaware of a fully-articulated duty of due care, an ironic outcome given the *Cede* court's effort to showcase renewed attention to that much-ignored concept. An attendant cost is the complete failure to appreciate sound,

⁴See *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1340-41, 1345 (Del. 1987) (comparing judicial review standards and contrasting the duty of loyalty with the duty of care); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983) (holding the entire fairness test applies in a loyalty case).

⁵The business judgment rule review applies where a director's self-dealing transaction is approved by disinterested, fully-informed directors. See *Cede & Co.*, 634 A.2d at 366 n.34; *In re Wheelabrator Tech., Inc. Shareholders Litig.*, 663 A.2d 1194, 1205 (Del. Ch. 1995). But see *Cooke v. Oolie*, No. 11,134, 1997 Del. Ch. LEXIS 92, at *1, *5 (Del. Ch. June 23, 1997), reprinted in 23 DEL. J. CORP. L. 775, 795-96 (1998) (applying entire fairness test to a claim of breach of director loyalty).

⁶See *infra* text accompanying notes 17-25, 179-99.

⁷Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Duty Law After QVC and Technicolor: A Unified Standard (and the End of Revlon Duties?)*, 49 BUS. LAW. 1593, 1594, 1601 (1994) (arguing that from one perspective, the Delaware Supreme Court is moving toward a single, more unified judicial review standard).

⁸See HAROLD J. BERMAN, *LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION* 37-38 (Harvard University Press 1983) ("Law in the twentieth century, both in theory and in practice, has been treated less and less as a coherent whole, a body, a *corpus juris*, and more and more as a hodgepodge, a fragmented mass of ad hoc decisions and conflicting rules, united only by common 'techniques.'").

⁹For a discussion of rapid doctrinal developments in Delaware corporate law in the 1980s, see Cunningham & Yablon, *supra* note 7, at 1609-14; Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 910-36 (1990).

¹⁰Cunningham & Yablon, *supra* note 7, at 1618-20.

longstanding policy reasons for sharply distinguishing judicial treatment of care and loyalty claims.¹¹

This article will examine the *Cede* court's faulty decision to review some duty of care claims under an entire fairness standard. The aim is not merely to critique a single decision, however important, but rather to probe more generally into the undeveloped notion of due care in Delaware corporate law. This will be done by arguing that *Cede* is misguided due to a chronic, underlying problem in Delaware law that has yet to be faced — the steadfast refusal of either the Delaware legislature or judiciary to fully expound a robust, all-encompassing duty of due care. Instead of facing that fundamental, decades-long failing directly, the *Cede* court first shrank care to one of its components — informedness — and then, paradoxically, sought to reinvigorate the significance of care in Delaware law by holding, for the first time, that breaches of its enfeebled duty of care will be strictly scrutinized under an entire fairness standard.¹² The result is a decision thought by the Delaware Supreme Court to be an important reprise on director care in Delaware jurisprudence. The decision, however, actually sets back efforts to inject a more vigorous notion of care into Delaware law, a disquieting setback that continues to this day.

Part II of this article briefly describes, for background purposes, the three standards of judicial review deployed by Delaware courts in assessing director conduct prior to *Cede*. Part III then focuses on that crucial portion of the *Cede* decision that purports to articulate a unified standard of review and offers certain threshold critiques of that standard. Part IV deepens the critique by identifying the absence of a robust duty of due care — or what this article calls "entire care" — as the root cause of Delaware's standard of review confusion. The argument proceeds along both doctrinal and policy grounds and offers numerous reasons favoring a fuller expression of care. One such reason — virtually unacknowledged in corporate law discourse — is to recall the rich and primordial nature of care as a basic stance for director discharge of responsibility. Finally, Part V formulates a proposal for a general director duty of entire due care in Delaware. The proposal advocates that the Delaware Supreme Court adopt a "prudent and reasonable" standard for director conduct and for judicially reviewing care claims, thereby providing what Delaware law has for too long failed to fully verbalize — a richer, more comprehensive (yet still streamlined) duty of entire care. Adopting the proposal will give the foundational concept of care the prominence it deserves in Delaware law without drawing on judicial

¹¹See *infra* text accompanying notes 179-99.

¹²Moreover, under *Cede* the burden of proof on entire fairness shifts to directors upon breach of the duty of care. See *infra* text accompanying notes 68-76.

practices — such as *Cede's* problematic burden shift and substantive judicial review of business decisions — best reserved for the quite different policy concerns raised by loyalty claims.

II. DELAWARE'S PRE-*CEDE* STANDARDS OF JUDICIAL REVIEW

Prior to 1985, the Delaware Supreme Court used one of two judicial standards in reviewing director conduct involving a business judgment.¹³ In 1985 the court added a third, intermediate standard of review.¹⁴ The court readily acknowledges the often outcome-determinative nature of its disparate review standards.¹⁵ What follows below is a highly condensed summary of these three standards, putting aside for now the infrequently addressed Delaware standard for director conduct not involving an exercise of judgment.¹⁶

A. *Business Judgment Rule Review*

The first standard of judicial review, highly deferential to directors and their decisions, is embodied in the business judgment rule. Under this most common standard, directors' decisions are presumed to have been made "on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."¹⁷ This standard presumptively applies unless the plaintiff can demonstrate grounds for triggering one of the other less deferential review standards.¹⁸ The plaintiff has the burden of proof to rebut the presumption under the business judgment rule.¹⁹ When this standard applies — the standard most desired by director defendants — "the Court gives great deference to the substance of the directors' decision and will not invalidate the decision, will not examine

¹³See *infra* Parts II.A.-C.

¹⁴*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985) (finding an "enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred").

¹⁵The supreme court has acknowledged that "[b]ecause the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation." *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1279 (Del. 1988) (quoting *A.C. Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 111 (Del. Ch. 1986)); accord *Nixon v. Blackwell*, 626 A.2d 1366, 1381 (Del. 1993).

¹⁶See *infra* text accompanying notes 161-67, 221-25.

¹⁷*Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

¹⁸See *id.*; *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 42 (Del. 1993).

¹⁹*Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985); *Aronson*, 473 A.2d at 812.

its reasonableness, and 'will not substitute [its] views for those of the board if the latter's decision can be 'attributed to any rational business purpose.'²⁰ Rarely does a plaintiff prevail under this standard.

B. *Entire Fairness Review*

If the plaintiff challenges director loyalty, as by charging directors with self-dealing of a type evidencing disloyalty, the court will abandon business judgment review.²¹ In such a case, defendant-directors will bear the burden of proof that a self-dealing transaction meets an exacting "entire fairness" standard.²² This fairness inquiry, although described as a unitary rather than bifurcated inquiry, has both a process and a substantive component.²³ Self-dealing directors must meet a process standard of "fair dealing" and a qualitative standard of having achieved a "fair price" in the business decision itself.²⁴ Under the entire fairness standard of review, a court will not defer to the substantive decision of directors. Rather, the court itself must be satisfied as to the entire fairness of a challenged transaction.²⁵ Understandably, this stringent review standard is the standard most desired by plaintiffs.

C. *Enhanced or Intermediate Review*

The flurry of hostile takeovers in the 1980s led the Delaware Supreme Court in 1985 to articulate a third review standard specially designed for evaluating defensive measures adopted in response to or in anticipation of a threat to corporate control.²⁶ Essentially, this third review standard also applies to a transaction involving a sale of the control of the corporation.²⁷

²⁰*QVC Network, Inc.*, 637 A.2d at 45 n.17 (quoting *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949 (Del. 1985) (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971))).

²¹*Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988); *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1341 (Del. 1987).

²²*Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983). "Entire fairness," however, may not always be the standard of review in loyalty claims. *See supra* text accompanying note 5.

²³*Weinberger*, 457 A.2d at 711.

²⁴*Id.* "Fair dealing" embodies inquiries into the timing of a transaction, how it was negotiated, structured, disclosed to the directors, and the way in which the approvals of the shareholders and the directors were acquired. *Id.* "Fair price" involves the economic and financial considerations of the transaction, including all elements that affect the inherent stock value of a company. *Id.*

²⁵*Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993); *Weinberger*, 457 A.2d at 710.

²⁶*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985).

²⁷*See Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 45 (Del. 1993); *see Cunningham & Yablon, supra* note 7, at 1594.

Under this threshold standard, judicial review is stricter than under ordinary business judgment review, but more deferential than entire fairness review.²⁸ Specifically, as to a challenged defensive measure the board carries the initial burden of proving, first, that it has "reasonable grounds for believing that a danger to corporate policy and effectiveness existed"²⁹ — which can be shown by demonstrating "good faith and reasonable investigation."³⁰ Second, the board must prove that its chosen defensive measure was "reasonable in relation to the threat posed."³¹ If directors overcome their two-pronged burden, the ordinary business judgment rule review standard is applied and the plaintiff bears the usual difficult burden of proof.³² If directors fail to carry either of their initial burdens, the entire fairness review standard becomes applicable and defendants bear the burden of proof under that exacting standard.³³

The word "care" does not appear in any of the three verbalized review standards. Moreover, in first articulating the standards, the Delaware Supreme Court did not identify the connection, if any, between the judicial review standards and a director's duty of care. If present and in force in Delaware law, the duty of care is left lurking beneath the surface of expression, its shape and role either so clearly understood as to require no delineation or so little understood as to preclude it.

III. THE *CEDE* UNIFIED STANDARD OF REVIEW

A. *Background*

Five months after the publication of the Delaware Supreme Court's opinion in *Cede II*, Justice Horsey, the author of the opinion, delivered a lecture at Widener University School of Law entitled "The Duty of Care Component of the Delaware Business Judgment Rule."³⁴ In this revealing speech (later published as an article), Justice Horsey traces the history of a director's duty of care under Delaware law.³⁵ He finds, rather surprisingly he admits, that "[o]nly a creative reading of Delaware decisional law through the 1950s, and usually through dicta, would arguably support a thesis that a

²⁸*QVC Network, Inc.*, 637 A.2d at 42 & n.9.

²⁹*Unocal Corp.*, 493 A.2d at 955.

³⁰*Id.* (quoting *Cheff v. Mathes*, 199 A.2d 548, 555 (Del. 1964)).

³¹*Id.*

³²*Id.* at 954, 958. See *infra* note 213 for a critique of this "double burden" approach.

³³*Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1377 n.18 (Del. 1995).

³⁴Justice Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971 (1994).

³⁵See *id.* at 971-73.

director . . . should be held to a duty to act with care in the manner a reasonable and prudent person would act under similar circumstances."³⁶ Justice Horsey concludes that not until 1963 did the Delaware Supreme Court "first recognize the existence of a director's fiduciary duty to act in an informed and prudent manner, i.e., with due care"³⁷

A judge's law review article appearing contemporaneously with an opinion authored by him on the same subject can serve as a helpful resource in understanding the opinion. This is the case, in two ways, with Justice Horsey's article and opinion. First, having identified the relatively late emergence of the duty of care in Delaware, Justice Horsey seeks to bolster care in Delaware by linking it to the business judgment rule, a less shadowy, more stalwart concept in Delaware corporate law.³⁸ Although his commendable goal is to reinvigorate the foundational concept of director care, ironically Justice Horsey enfeebles care by conceiving of it — as the title of his lecture-article reveals — merely as a "component" of the business judgment rule.³⁹ He offers that conception of the inter-relationship of care and the business judgment rule repeatedly and in various ways: "an enforceable duty of care component in the Delaware business judgment rule;"⁴⁰ "a duty of care component within the Delaware business judgment rule;"⁴¹ and "[the supreme court has] placed a concept of the standard of care expected of directors into Delaware's business judgment rule."⁴² Having made that linkage between care and the business judgment rule, his article then describes *Cede II* "as a logical and predictable application of the duty of care component of our business judgment rule as formulated . . . since at least 1963."⁴³ In Justice Horsey's attempted reprise of care, the business judgment rule emerges, inexplicably, as predominant, with the duty of care supposedly bolstered even as it is subsumed under the rule itself as a "component."

Second, having analytically subcategorized the duty of care, Justice Horsey mysteriously abandons his earlier and proper description of care as a duty to act "in the manner a reasonable and prudent person would act under similar circumstances"⁴⁴ and ends his article with a faulty reading of

³⁶*Id.* at 985.

³⁷*Id.* (citing *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125 (Del. 1963)).

³⁸See Horsey, *supra* note 34, at 985-91.

³⁹*Id.* at 989.

⁴⁰*Id.*

⁴¹*Id.* at 991.

⁴²Horsey, *supra* note 34, at 996.

⁴³*Id.* at 997.

⁴⁴*Id.* at 985.

Aronson v. Lewis.⁴⁵ This reading diminishes care by making that core concept coextensive with the informedness element found in *Aronson's* flawed (but oft-cited) formulation of the business judgment rule.⁴⁶ Justice Horsey's two-step effort, first, to annex care to the business judgment rule and, next, to begin shrinking care to informedness, also pervades his *Cede II* analysis of care. Oddly, that analysis lacks any attention to the vital care properties of "prudence" and "reasonableness" cited by Justice Horsey himself in the first part of his article.

B. *Cede Facts*

The facts of the *Cede* litigation, which is still active after seventeen years, are voluminous.⁴⁷ Fortunately, the facts relevant to the issues discussed in this article can be briefly stated. Technicolor, Inc. operated a variety of businesses in the early 1980s. Its core business, however, was film processing for motion pictures.⁴⁸ Concerned about the growth prospects of its core business, Morton Kamerman, Technicolor's chairman and chief executive officer, sought to expand Technicolor into the "One-Hour-Photo" (OHP) business.⁴⁹ Kamerman's plan involved the opening of several hundred stores and the investment of \$150 million, a sum approximately twice the existing shareholders' equity as of June 1982.⁵⁰ Store openings did not take place on the schedule and the stores that did open were not profitable.⁵¹ By September 1982, Technicolor stock had dropped from \$22.13 to a low of \$8.37 per share.⁵² Technicolor's September 1982 annual

⁴⁵*Id.* at 996-97.

⁴⁶Justice Horsey asserts that to invoke the business judgment rule a director must, among other requirements, act "in an informed manner; that is, in the manner originally described by our supreme court in *Graham v. Allis-Chalmers*, and later applied by the court of chancery in *Kaplan [v. Centex Corp.]*, 284 A.2d 119 (Del. Ch. 1971)], and as later clarified by our court in *Aronson v. Lewis . . .*" Horsey, *supra* note 34, at 998. To equate acting in an "informed manner" with acting "in the manner a reasonable and prudent person would act under similar circumstances" is not merely a "clarified" standard of care, it is a severely truncated standard. *Id.* at 998, 985. For a critique of Delaware's formulation and use of the business judgment rule, see Lyman Johnson, *The Modest Business Judgment Rule*, 55 BUS. LAW. 625 (2000).

⁴⁷Jesse A. Finkelstein & Russell C. Silberglied, *Technicolor IV: Appraisal Valuation in a Two-Step Merger*, 52 BUS. LAW. 801, 801 n.5 (1997). The statement of facts provided by Messrs. Finkelstein and Silberglied, who represented certain parties in the *Cede* litigation, is substantially relied on in this article.

⁴⁸*Id.* at 801.

⁴⁹*Id.*

⁵⁰*Id.* at 802.

⁵¹Finkelstein & Silberglied, *supra* note 47, at 802.

⁵²*Id.*

report, however, contained a statement by Kamerman to the effect that "the company remained optimistic about the future prospects of OHP."⁵³

In October 1982, Kamerman met with Ronald Perelman, the controlling shareholder of MacAndrews & Forbes, Inc. (MAF), to discuss a possible sale of Technicolor to MAF.⁵⁴ Goldman Sachs, Technicolor's investment banker, opined (based on somewhat limited information) that a sale price of \$20-22 was worth pursuing, that \$25 was a feasible price, and that other possible purchasers should be sought. In late October 1982, Kamerman, on behalf of Technicolor and MAF, agreed to a sale price of \$23 per share.⁵⁵ The form of the acquisition was that MAF would make a first-step all-cash tender offer at \$23 and then conduct a second-step merger by which all remaining shareholders would also be cashed out at a price of \$23 per share.⁵⁶ A special meeting of the Technicolor board of directors was held just two days after Kamerman and MAF agreed on the \$23 price.⁵⁷ At that meeting the board of directors approved the agreement and recommended that Technicolor shareholders accept the agreed-upon price and approve the merger agreement.⁵⁸ Subsequently, Technicolor's shareholders voted to approve the sale, and the sale was completed as agreed.⁵⁹

Plaintiff shareholders initially filed an appraisal action against Technicolor, and later brought a second action for fraud and breach of fiduciary duty against, among others, Technicolor, MAF, and the directors of Technicolor.⁶⁰ The chancellor made, in the fiduciary duty action, what the Delaware Supreme Court later described as "presumed findings of the directors' failure to reach an informed decision in approving the sale of the company."⁶¹ The findings were described as "presumed" because, although the chancellor found it unnecessary to make such findings as a result of having concluded that plaintiffs had failed to prove injury caused by defendants' misbehavior, nonetheless he had "grave doubts" as to whether the defendants had acted with due care.⁶² The chancellor's doubts were based on several predicate findings he made on the issue of director lack of

⁵³*Id.*

⁵⁴*Id.*

⁵⁵Finkelstein & Silberglied, *supra* note 47, at 802.

⁵⁶*Id.*

⁵⁷Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 356 (Del. 1993).

⁵⁸*Id.* at 356-57.

⁵⁹*Id.* at 358.

⁶⁰*Id.* at 349. Messrs. Finkelstein and Silberglied provide an excellent summary of the procedural history of the ensuing litigation. Finkelstein & Silberglied, *supra* note 47, at 803-04.

⁶¹Cede & Co., 634 A.2d at 369-70.

⁶²*Id.* at 369.

due care.⁶³ Specifically, the chancellor found that the agreement between Technicolor and MAF was not preceded by a "prudent search for alternatives";⁶⁴ the terms and circumstances of the merger were likely to preclude a third party from making a better offer for Technicolor;⁶⁵ a majority of the directors had little or no knowledge of the impending sale of Technicolor until their arrival at the meeting called on short notice (and only a few had prior knowledge of the terms of the sale);⁶⁶ and the board did not meet its obligation to take reasonable steps to become adequately informed before authorizing the merger agreement with MAF.⁶⁷

C. *The Cede Unified Review Standard*

Cede II and *Cede III* articulate in a novel way the linkage between a corporate director's fiduciary duties and a court's standards for reviewing claims where one or more of those duties were breached.⁶⁸ The court used the business judgment rule to draw together, in a single analytical framework, those duties and judicial review of their alleged breach. The court in *Cede II* began by noting the procedural and substantive dimensions of Delaware's business judgment rule.⁶⁹ Next, the court repeated the well-known but flawed *Aronson v. Lewis* formulation of that rule,⁷⁰ and then described the rule's "powerful presumption in favor of actions taken by the directors."⁷¹ Finally, the court made the critical (if thin) connection between the rule and director duties:

To rebut the rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decisions, breached any one of the *triads* of their fiduciary duty — good faith, loyalty or due care If a shareholder plaintiff fails to meet this evidentiary burden, the business judgment rule attaches to protect corporate officers and directors and the

⁶³*See id.*

⁶⁴*Id.*

⁶⁵*Cede & Co.*, 634 A.2d at 369.

⁶⁶*Id.*

⁶⁷*Id.*

⁶⁸*Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156, 1162-63 (Del. 1995); *Cede & Co.*, 634 A.2d at 360-61.

⁶⁹*Cede & Co.*, 634 A.2d at 360. *See Cinerama, Inc.*, 663 A.2d at 1163 (explaining the procedural and substantive dimensions of the business judgment rule).

⁷⁰*Cede & Co.*, 634 A.2d at 360-61. *See generally infra* text accompanying notes 107-18 (explaining how the *Aronson* business judgment rule formulation is faulty and inconsistent with the larger and proper thrust of the *Aronson* opinion).

⁷¹*Cede & Co.*, 634 A.2d at 361.

decisions they make, and our courts will not second-guess these business judgments If the rule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the "entire fairness" of the transaction to the shareholder plaintiff.⁷²

Under this analytical approach, the business judgment rule *always* applies for the procedural purpose of assigning to the plaintiff the burden of production and persuasion on the issue of whether a director breached one or more duties. If the plaintiff *does not meet* that evidentiary burden (it never being wholly clear what degree of judicial scrutiny is brought to this inquiry), the substantive dimension of the business judgment rule thereupon "attaches" to protect a director against further judicial inquiry, including inquiry into the merits or quality of the business decision itself.⁷³ If the plaintiff *does meet* the burden assigned to him under the procedural aspect of the business judgment rule — as by proving (by means of some unstated degree of scrutiny) a director's breach of duty, such as care — the substantive aspect of the rule does not apply.

The nonapplication of the substantive aspect of the business judgment rule does not, however, according to the court in *Cede II*⁷⁴ and *Cede III*,⁷⁵ itself establish the substantive liability of the director. Instead, although a plaintiff achieves nonapplication of the substantive business judgment rule by proving a breach of duty, the breach itself does not substantively go beyond that effect. Rather, at this stage, it merely has the further procedural effect of shifting to the defendants the burden of proving the entire fairness of a challenged transaction.⁷⁶ Substantive director liability and the damages outcome of the case turn on whether, subsequently, a defendant successfully carries that high burden. In short, a proven duty of care breach results not in liability, but in application of the entire fairness review standard, the same standard traditionally reserved for determining whether a director violated the duty of loyalty.

D. Opening Critique

Although *Cede* apparently brings succinct rhetorical coherence to Delaware fiduciary law, its formulation of the interrelationship between

⁷²*Id.*

⁷³*Id.*

⁷⁴*Id.*

⁷⁵*Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156, 1163 (Del. 1995).

⁷⁶*Id.*

director duties and the business judgment rule is initially problematic on two grounds.

First, none of the authority cited in either *Cede II* or *Cede III* supports the novel proposition that, in a duty of care case, a director must carry the burden of proving the entire fairness of a challenged transaction.⁷⁷ The court is far too careless and cavalier about this vital point. *Cede III* cites as authority for its holding a footnote collecting cases in *Unitrin, Inc. v. American General Corp.*⁷⁸ The first case quoted in the *Unitrin* footnote, *Grobow v. Perot*,⁷⁹ involved the issue of whether pre-suit demand in a derivative action was excused. *Grobow*, in turn, simply cited *Aronson v. Lewis*,⁸⁰ another case addressing demand futility which states the uncontroversial rule that business judgment review has no application when director self-interest is present (i.e., when loyalty is at issue).⁸¹ The other two decisions cited in the *Unitrin* footnote, *Mills Acquisition Co. v. Macmillan, Inc.*⁸² and *Weinberger v. UOP, Inc.*,⁸³ both involved director self-interest and thus implicate director loyalty, not simply care.⁸⁴ Likewise, the Delaware Supreme Court decisions cited in *Cede II* to support the proposition that in a duty of care case the defendant directors have the burden of proving the entire fairness of a transaction, all involved director self-interest, thus again implicating loyalty and not merely care.⁸⁵

⁷⁷Professors Cunningham and Yablon agree with this article's position that *Cede & Co.* represents a "novel holding" on this point. Cunningham & Yablon, *supra* note 7, at 1596. As recently as 1993, one of the leading treatises on Delaware law stated, contrary to the as yet undecided *Cede & Co.* opinion, that the effect of a plaintiff overcoming the presumption of due care was that the burden shifted to defendant directors to prove they acted with the "requisite degree of care." DENNIS J. BLOCK ET AL., *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* 53-54 (4th ed. 1993) (citing *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 273 (2d Cir. 1986)). Rather than a burden to "prove" due care, such a burden is better understood as one of production, with the ultimate burden of persuasion remaining with the plaintiff. The chief point, however, is that the experienced treatise writers rightly regarded the issue as remaining a *care* issue throughout, not as one transmuting into a fairness inquiry. See *NCR Corp. v. American Tel. & Tel. Co.*, 761 F. Supp. 475, 490 (S.D. Ohio 1991) (properly describing effect of plaintiff rebutting initial presumption).

⁷⁸*Cinerama, Inc.*, 663 A.2d at 1162 (citing *Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1371 n.7 (Del. 1995) (collecting cases)).

⁷⁹539 A.2d 180, 187 (Del. 1988).

⁸⁰473 A.2d 805 (Del. 1984).

⁸¹*Id.* at 812.

⁸²559 A.2d 1261, 1280 (Del. 1988).

⁸³457 A.2d 701, 710-11 (Del. 1983).

⁸⁴For further discussion of the *Macmillan* case, see *infra* note 85.

⁸⁵*Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (citing *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993); *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1279 (Del. 1988); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983)). Later in the *Cede II* opinion, the court cites a court of chancery decision, *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 271 (Del. Ch. 1989), in support of entire fairness review where director care

The *Cede III* court strained to read its decision in *Smith v. Van Gorkom* as holding that when the business judgment rule is inapplicable because directors were uninformed, the applicable standard of review is entire fairness.⁸⁶ The problem is that *Van Gorkom* never said anything like that. The *Cede III* opinion tries to skirt that fact by a revisionist reading of *Van Gorkom* as a case where, purportedly, the Delaware Supreme Court itself decided the substantive entire fairness issue adversely to the directors because a duty of disclosure breach (a duty grounded in loyalty as well as care) compounded the duty of care breach in that case.⁸⁷ That very difference, however, supports the point that *Van Gorkom* is not authority for applying the entire fairness standard where *only* a duty of care breach exists.⁸⁸ The better interpretation of *Van Gorkom*, as a combined breach of the duty of disclosure and the duty of care case, seems especially likely given

has been breached. *Cede & Co.*, 634 A.2d at 368, 371. *Shamrock Holdings* never found a breach of duty of care because then Vice-Chancellor Berger concluded it was not "necessary to the disposition of this case." *Shamrock Holdings*, 559 A.2d at 271. The *Shamrock* court indicated that fairness is the applicable test where a board fails to become informed. *Id.* The *Shamrock* court cited, in support, *Macmillan*, 550 A.2d 35 (summary disposition), a decision which, when the *Shamrock* opinion was written, had only orally been ruled on, the written opinion not being handed down until four months after Berger's opinion. See *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1988).

Macmillan itself involved a sale transaction in which certain directors who had significant self-interest illicitly manipulated the board's decision-making process. *Id.* at 1265-78. That self-interest seemed critical (notwithstanding the board's larger abdication of responsibility for supervising the sale process) to the court's application of entire fairness review. Moreover, the court described the conduct of the disinterested board members in abandoning their oversight function as a breach of care *and* loyalty. *Id.* at 1284 n.32.

The *Shamrock* court also cited dictum from *Unocal* to the effect that a court will not substitute its judgment for a board's "unless it is shown by a preponderance of the evidence that the directors' decisions were primarily based on perpetuating themselves in office, or some other breach of fiduciary duty such as . . . being uninformed." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985). The *Unocal* court nowhere mentioned the fairness test in conjunction with that remark, nor were any case citations given in support of it. Both the thrust and context of the remark indicate simply that the business judgment rule precludes court substitution of its judgment for that of the board where, as in *Unocal*, there is *no* breach of duty.

Vice-Chancellor Berger's final case authority in *Shamrock Holdings* was *Smith v. Van Gorkom*, 488 A.2d 858, 893 (Del. 1985), which itself is possibly the underlying case behind the dictum in *Unocal*, *Van Gorkom* having only been decided a few months before *Unocal*. *Shamrock Holdings*, 559 A.2d at 271. For reasons why *Van Gorkom* does not support application of an entire fairness review standard in a breach of duty of care case, see *infra* text accompanying notes 86-90.

⁸⁶*Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156, 1166 (Del. 1995). *Cede II* describes *Van Gorkom* only very cryptically on this point. *Cede & Co.*, 634 A.2d at 368, 371.

⁸⁷*Cinerama, Inc.*, 663 A.2d at 1166.

⁸⁸The duty of disclosure itself arises under "[a] combination of the fiduciary duties of care and loyalty." *Id.* at 1163 (citing *Zirm v. VLI Corp.*, 621 A.2d 773, 778 (Del. 1993)). Recently, the Delaware Supreme Court stated that "[t]he duty of directors to observe proper disclosure requirements derives from the combination of the fiduciary duties of care, loyalty and good faith." *Malone v. Brincat*, 722 A.2d 5, 11 (Del. 1998).

that a duty of disclosure breach uniquely results in "a virtual *per se* rule of [awarding] damages."⁸⁹ Indeed, the opinion in *Cede III* includes, in its reinterpretation of *Van Gorkom*, a citation to the very case establishing this principle of *per se* damages.⁹⁰

The fact remains that no clear and reasoned prior authority exists for the *Cede II* and *Cede III* holdings that director breach of the duty of care results in application of an exacting entire fairness analysis. Moreover, the Delaware Supreme Court opinions and the chancery court's opinion in *Shamrock Holdings* are utterly devoid of any attempt at explaining why, on policy grounds, care claims should receive the same searching substantive review traditionally reserved for loyalty claims. Director carelessness does not doctrinally, logically, or policy-wise, necessitate that a burden of proof shift to the defendants accompanied by close judicial scrutiny of the quality or merits of a business decision.⁹¹ This remains true even if the protective presumptions of the business judgment rule are overcome. With or without the rule, the case remains one of director carelessness, not disloyalty.

The failure by the *Cede* court to elaborate policy rationales for stringently reviewing care claims in the manner of loyalty claims may simply be because adjudicated breaches of the duty of care have been so rare in Delaware that the courts have had little occasion to develop more nuanced standards for addressing them. Or, it may reflect an overly hasty zeal for embracing a coherent and unified fiduciary analysis,⁹² such zeal leading the court to treat all duty breaches the same, as if their policy roots were indistinguishable. Two deeper reasons for the confusion are developed shortly but warrant mention here.⁹³ The first is the court's faulty equating of a director's informedness with a director's duty of care (thereby not grasping the genuine fullness of a due care inquiry).⁹⁴ The second reason is Justice Horsey's overarching quest — seen as well in his lecture-article — to give

⁸⁹*In re Tri-Star Pictures, Inc., Litig.*, 634 A.2d 319, 333 (Del. 1993). At least this is the case where the nondisclosure "caused impairment to the economic or voting rights of stockholders." *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 142 (Del. 1997).

⁹⁰*Cinerama, Inc.*, 663 A.2d at 1166 (citing *In re Tri-Star Pictures, Inc., Litig.*, 634 A.2d 319 (Del. 1993)). This point was not made in *Cede II*, a case decided before *Tri-Star Pictures*. Recent Delaware Supreme Court opinions describe *Van Gorkom* as holding that directors in that case breached the duty of disclosure as well as the duty of care. *Malone*, 722 A.2d at 11 n.21; *Loudon*, 700 A.2d at 142 n.24.

⁹¹See *infra* text accompanying notes 130-99. A recent decision by the Connecticut Supreme Court rejected a claim that proving negligence in a fiduciary's administration of an estate would shift to the fiduciary the burden to prove fairness, holding that such a burden shift would require a prior showing of fraud, self-dealing, or conflict of interest. *Murphy v. Wakelee*, 721 A.2d 1181, 1186 (Conn. 1998).

⁹²See *supra* text accompanying notes 8-10.

⁹³See *infra* text accompanying notes 101-06.

⁹⁴See *infra* text accompanying notes 107-21.

Delaware's duty of care a shot in the arm, to the point of inappropriately applying a novel heightened burden of proof in what amounts to a carelessness claim.⁹⁵

The second problem with Cede's quest for rhetorical coherence is that the business judgment rule is ill-equipped to serve as the umbrella concept for analytically linking director duties (care, loyalty, and good faith) with standards of judicial review. This flaw permeates Justice Horsey's lecture-article as well as his judicial opinion.⁹⁶ His *Cede II* opinion wrongly subsumes director duties under a rule (really, a policy of review) that is narrower in scope than the duties themselves, repeatedly mentioning what he calls "the duty of care element of the rule."⁹⁷ Both the duty of care and the duty of loyalty govern corporate directors whether or not directors make business decisions, while the business judgment rule applies only when directors do make such decisions.⁹⁸ As a much narrower legal notion than the broad duties of care, loyalty, and good faith, the business judgment rule

⁹⁵See Horsey, *supra* note 34, at 971-73.

⁹⁶See *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993); Horsey, *supra* note 34.

⁹⁷*Cede & Co.*, 634 A.2d at 366. See *supra* text accompanying notes 40-43. This unfortunate phraseology seems to originate with Samuel Arshnt's well-known article on the Delaware business judgment rule. S. Samuel Arshnt, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979). In arguing that the business judgment rule presupposes the exercise of due care, Mr. Arshnt, an experienced corporate lawyer, blithely refers to "the rule's standard-of-care element." *Id.* at 119. Justice Horsey's article openly draws on Mr. Arshnt's work. Horsey, *supra* note 34, at 978, 994-96. Moreover, Justice Horsey believed that Mr. Arshnt's views played a role in the Delaware Supreme Court's subsequent formulation of the business judgment rule in *Aronson v. Lewis*. *Id.* at 996. Justice Horsey's position on Mr. Arshnt's influence appears sound, for Mr. Arshnt emphasizes that due care requires gaining "all relevant facts" and sums up that: "It is one thing to make a decision, and another thing to make an informed decision. It is only the latter type of decision that the business judgment rule protects." Arshnt, *supra*, at 119-120. The regrettable tendency to equate due care with informedness in Delaware, therefore, may stem from a well-intentioned, but thoughtless, conceptualizing of care as an "element" of the business judgment rule. This characterization may have originated with Mr. Arshnt, found doctrinal expression in *Aronson*, and gained important reinforcement from Justice Horsey and *Cede II*. See *infra* note 107.

⁹⁸There is a substantial collection of commentary on the corporate law duty of care. See Arshnt, *supra* note 97, at 120 n.118; Horsey, *supra* note 34, at 977-79 & n.20. Professor Stuart Cohn provides an excellent discussion of the "demise" of care in corporate law and the blurring of its relationship with the business judgment rule. Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 594, 602-07 (1983). Justice Horsey acknowledges Professor Cohn's article, Horsey, *supra* note 34, at 979-80. However, Justice Horsey does not address Cohn's telling observation that due care had become "enveloped" in the business judgment rule. Cohn, *supra*, at 594. Horsey's "component" language actually exacerbates the problem.

See also William L. Cary & Sam Harris, *Standards of Conduct Under Common Law, Present Day Statutes and the Model Act*, 27 BUS. LAW. 61, 70 (1972) (suggesting that "the distinction between the business judgment rule and the negligence rule . . . which is already somewhat obscure, will largely vanish"). A more recent treatment of care includes Melvin A. Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. PITT. L. REV. 945 (1990).

should not be made the chief rhetorical or analytical vessel either for reinvigorating the duty of care or for unifying the judiciary's fiduciary analysis of director conduct. The result will either be to mistakenly contract the pervasive duty of due care to fit the business judgment rule framework, or eventually to regard the new framework as considerably less-encompassing than might initially appear. Thus, to cite just one example, breaches of the duty of care resulting from faulty director monitoring, where no identifiable business judgments were made, do not fit into a formulation that analytically subsumes the richer duty of care under the important but more confined business judgment rubric.⁹⁹ Coherence and unity in any intellectual endeavor require that the special (here, the business judgment rule) be an instance of the general (here, the duty of due care), not vice versa.

Moreover, there is no reason why, as in *Cede III*, the effect of a proven care breach is described as having "rebutted" the business judgment rule and thereby depicted only in procedural terms of effecting a threshold change in the standard of judicial review.¹⁰⁰ The result is that an established duty of care breach has no legal consequences until the ensuing entire fairness review is completed. Contrary to Justice Horsey's intent, this approach does not rejuvenate the duty of care. Instead, the judicial move of giving a proven director care breach only the procedural effect of applying a second, more exacting review standard originally designed solely for loyalty claims, actually drains distinctive meaning from the notion of care, within as well as outside the business judgment context.

IV. A DEEPER CRITIQUE OF *CEDE*—THE SHRINKING OF DUE CARE

A. *Due Care in Cede*

The *Cede* court not only rhetorically *subsumed* care (a pervasive duty) *under* the business judgment rule (a specialized judicial review policy), but also wrongly *correlated* the duty of due care *with* the informedness element of the business judgment rule. The truncation of care to informedness can be seen in its quotation of an earlier opinion in which the well-known *Aronson* formulation of the business judgment rule was recast as follows: The business judgment rule "creates a 'presumption that in making a business decision, the directors of a corporation acted on an informed basis

⁹⁹See *infra* text accompanying notes 161-67, 221-25.

¹⁰⁰*Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156, 1163 (Del. 1995).

[i.e., with due care]"¹⁰¹ Later the *Cede II* court stated, "[T]he defendant directors were grossly negligent in failing to reach an informed decision when they approved the agreement of merger, and . . . have thereby breached their duty of care."¹⁰² Lest one conclude from this passage that care was breached only because informedness is a necessary but not sufficient condition to acting with care, the court found that a board will not have "breached its duty of care *unless* the directors individually and the board collectively have failed to inform themselves fully and in a deliberate manner *Only* on such a judicial finding will a board lose the protection of the business judgment rule under the duty of care element"¹⁰³ Moreover, the Delaware Supreme Court adopted the chancellor's presumed finding that the directors were not fully informed, the chancellor also wrongly having made care and informedness coextensive as follows: "the due care theory and the *Revlon* theory do not present two separate legal theories justifying shareholder recovery. . . . [B]oth theories *reduce to a claim that directors were inadequately informed*"¹⁰⁴

The result of this conflation is that, because the *procedural* effect of the business judgment rule is to place on the plaintiff the burden of rebutting the presumption of director informedness, a plaintiff's failure to do so means the *substantive* effect of the business judgment rule "attaches." This, in turn, not only means that a court will not inquire into the *substantive* quality of the business decision at all (or will inquire only for irrationality),¹⁰⁵ but it also means that a court might not inquire into the decision-making *process* to determine whether a director *acted carelessly in a manner* other than informedness. In other words, a plaintiff's failure to carry his or her burden on the issue of director informedness conceivably ends further judicial inquiry into any other aspect of director due care, confining judicial review thereafter to a mild form of substantive business decision review. The peculiar upshot of this is that an *informed* director could act in a way not reasonably related to (or wholly without regard to) the information at hand, or act carelessly in some manner other than informedness, without judicial sanction. In this scenario, equating care and informedness leads to judicial review that might be too deferential.

Conversely, after *Cede*, if the plaintiff does prove lack of full informedness, such proof alone apparently constitutes a breach of due care.

¹⁰¹*Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993) (quoting *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989)).

¹⁰²*Id.* at 366.

¹⁰³*Id.* at 368 (emphasis added).

¹⁰⁴*Id.* at 369-70 n.37 (emphasis added).

¹⁰⁵See *supra* text accompanying note 20. For a critique of the "rationality" review in the business judgment setting, see *infra* notes 194-95 and accompanying text.

The defendant thereupon is assigned the burden of proving "entire fairness" of the transaction, one aspect of which is proving substantive fairness of the business transaction. In this scenario, equating care and informedness leads to judicial review that is too demanding.

The result under *Cede* is that a plaintiff's showing on one matter — informedness — leads either to little or no inquiry into the substantive business decision or to a very exacting inquiry. These quite disparate standards of judicial scrutiny in the care setting stem from the faulty ruling that a plaintiff's proof of a breach of due care claim turns solely on demonstrating the nonexistence of one element — informedness — in the business judgment rule. This mistaken correlation of due care with the informedness element of that rule is one more reason, as argued earlier,¹⁰⁶ not to rhetorically subsume the richer duty of care under the business judgment rule. Indeed, the wrongful equating in *Cede* probably is a direct result of that confusing subjunction; once the duty of care is *methodologically* subsumed in the business judgment rule framework, the *scope* of the duty might thoughtlessly be compressed into that framework's existing (but smaller) category of informedness.

B. Restoring Due Care

The conflating of care and informedness found in *Cede* distorts existing Delaware doctrine, although Delaware's continuing failure to articulate a robust, all-encompassing duty of care underlies and contributes to the error. The only alternative conclusion is the disturbing one that there really is no director duty of care in the decision-making context in Delaware, at least beyond a duty simply to be informed.

One likely cause for doctrinal confusion about the duty of care in Delaware law can be traced to the modern expression of the business judgment rule as formulated in *Aronson*.¹⁰⁷ In that case, the business rule is described, in part, as a "presumption that in making a business decision the directors of a corporation acted on an informed basis."¹⁰⁸ The court in

¹⁰⁶See *supra* text accompanying notes 98-100.

¹⁰⁷The *Aronson* decision itself, as pointed out earlier, *supra* note 97, seems to build on Samuel Arsh't's rather pointed emphasis on informedness, as well as a 1977 statement of the General Corporation Law Committee of the Delaware State Bar that the business judgment rule would only apply to decision makers who "paid informed attention to their duties." *Resource Document on Delaware Corporation Law*, 2 DEL. J. CORP. L. 176, 186 (1977). See also *Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971) (stating that business judgment rule "depends upon a showing that informed directors did, in fact, make a business judgment"). *Aronson* cites to the *Kaplan* passage just-quoted immediately after *Aronson's* famous formulation of the business judgment rule as including a presumption of informedness. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

¹⁰⁸*Aronson*, 473 A.2d at 812.

Aronson, however, goes on to place the concept of informedness into the larger context of care.¹⁰⁹ The court makes clear that "directors have a duty to inform themselves . . . of all material information reasonably available to them."¹¹⁰ After directors have "become so *informed*, they must *then act with* requisite *care* in the discharge of their duties."¹¹¹ The court goes on to state that although a "variety of terms"¹¹² have been used to "describe the applicable standard of care"¹¹³ (note that the court's reference is to "care" not "informedness") the best view is that "under the business judgment rule director liability is predicated upon concepts of gross negligence."¹¹⁴

In *Aronson*, the Delaware Supreme Court clearly distinguishes the step of becoming informed from the larger process of directors subsequently acting with "requisite care in the discharge of their duties."¹¹⁵ That difference having been noted, the court's oft-quoted earlier formulation of the business judgment rule should have been phrased as — or at least should properly be understood as — a presumption that directors "acted with due care"¹¹⁶ or "acted with due care on an informed basis."¹¹⁷ That much-needed clarification would analytically differentiate one facet of (or predicate to) acting with care — being informed — from the notion of care itself¹¹⁸ and

¹⁰⁹*Id.* at 812-13.

¹¹⁰*Id.*

¹¹¹*Id.* (emphasis added). *Cede II* cites the indicated language of *Aronson*, but then sums up the duty of care as a duty "to act on an informed basis," *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993), ignoring *Aronson's* requirement that directors "act with requisite care" once they are informed. *Aronson*, 473 A.2d at 812 (emphasis added).

¹¹²*Aronson*, 473 A.2d at 812.

¹¹³*Id.*

¹¹⁴*Id.*

¹¹⁵*Id.* The court stated that *after* becoming informed, directors must "then act" with requisite care. *Id.*

¹¹⁶An example of such a proper and more accurate formulation of the business judgment rule was provided by Chief Justice Veasey, when recently in dictum he re-phrased *Aronson* as follows: "The business judgment rule is a presumption that directors are acting independently, in good faith and with due care in making a business decision." *Brazen v. Bell Atlantic Corp.*, 695 A.2d 43, 49 (Del. 1997). Vice-Chancellor Jacobs even more pointedly re-cast *Aronson*: "[O]ur law presumes that in making a [business] decision . . . , the directors acted with due care and in good faith to advance the best interests of shareholders." *Ryan v. Tad's Enters., Inc.*, 709 A.2d 682, 689 (Del. Ch. 1996). The key to those proper *verbal* formulations is that they must genuinely regard due care in the richer sense argued for in the text, not as equivalent only to informedness, as in *Citron*. See *supra* note 101 and accompanying text.

¹¹⁷Chief Justice Veasey has captured the distinction made by *Aronson* between *becoming informed* and thereafter *acting* with care when he describes a director as having a two-fold obligation "to obtain, and act with due care on, all material information reasonably available." *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 48 (Del. 1993).

¹¹⁸Writing elsewhere, Chief Justice Veasey refrains from equating care and informedness by rightly viewing care as *including* (but not being limited to) informedness: "The duty of care includes the requirement that directors inform themselves of all material information reasonably

avoid a wrong belief that the larger care analysis is exhausted with the informedness inquiry under the business judgment rule.

Restoring due care as a meaningful cornerstone of Delaware law will require the plaintiff (and the court) to address not only the directors' state of informedness, but also, critically, whether directors acted with due care in light of that information. At a fundamental level, this will require the Delaware Supreme Court to finally elaborate on the concept of due care. As this article will argue,¹¹⁹ due care requires directors at all times to act with the care an ordinarily prudent person would reasonably be expected to exercise in a like position under similar circumstances. In the business judgment setting, the due care inquiry should focus on the totality of the board's decision-making process.¹²⁰ Resolution of the care issue in the business judgment context, therefore, will not turn on the state of director informedness standing in isolation, but on whether the board used a reasonable decision-making process in arriving at a decision.

A key part of that investigation would be whether the extent, type, source, reliability, presentation, and use of information — not simply its possession and assimilation — were appropriate under the circumstances of the particular decision. This, in turn, requires evaluation of many factors such as time constraints, costs, subject matter and magnitude of the decision, other rightful contemporaneous demands on directors' attention, the pre-existing state of director knowledge of the overall business and of the particular matter under consideration, director views on likely growth and future prospects, anticipated disruption for employees and customers resulting from either an actual combination or protracted hostilities, and probably several other factors as well. In short, although being properly

available to them before making a business decision." E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW. 393, 397-98 (1997). The seminal case on director informedness — *Smith v. Van Gorkom* — also described the director's duty to exercise an informed business judgment as being "in the nature of a duty of care," pointedly not describing that obligation as being "the" duty of care. *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985). Moreover, in adopting a gross negligence standard for the informedness issue, the court in *Van Gorkom* cited *Aronson* as having adopted a gross negligence standard for care, then went on to "confirm that view" and, subsequently, stated that gross negligence would "also" be the standard on the informedness issue. *Id.* at 873. Once again, this reveals a judicial effort to articulate a distinction between care and informedness.

¹¹⁹See *infra* Part V.

¹²⁰The Delaware Supreme Court occasionally makes strong *statements* that the due care inquiry in the business judgment context should focus on a board's decision-making process, as seen in the following: "[O]ur due care examination has focused on a board's decision-making process." *Citron v. Fairchild Camera & Instrument Corp.* 569 A.2d 53, 66 (Del. 1989). Largely, however, the process inquiry, as in *Cede*, too often becomes an inquiry into the board's state of informedness. Samuel Arshat, rather tersely, and Professor Cohn, more extensively, advocate judicial attention to a board's larger decision-making process. See Arshat, *supra* note 97, at 100; Cohn, *supra* note 98, at 605-07.

informed is an essential aspect of due care, it does not exhaust that duty. Nor can due care be understood in a contextual vacuum. The requirement, after all, is not care alone, but "due" care, that is, the care sufficient for, and properly proportioned and owed to, the particular situation. Moreover, even the informedness element itself is qualified in *Aronson* by the concepts of materiality and reasonableness,¹²¹ concepts that take on meaning only in a larger context. Informedness, then, is best understood as a key, but by itself, insufficient ingredient in the larger inquiry into the reasonableness of the overall decision-making process undertaken by directors.

C. *A Broader Due Care Duty*

1. The Meaning(s) of Care

Far from being a simple concept, care is multidimensional. At least three meanings of care are relevant to corporate law. First, section 141(a) of the Delaware General Corporations Law places the business and affairs of a corporation under the "direction" of a board of directors.¹²² "Direction" means the guidance and supervision of action or conduct,¹²³ one meaning as well of "care," as in the phrase "under a doctor's care."¹²⁴ In corporate law then, by statute, the business and affairs of a corporation are "under the board of directors' *care*." The board therefore is to "take care of" the corporation's business and affairs. Director neglect of corporate affairs, or a director's abdication of his or her duties, is a violation of care in this most fundamental, statutory sense. It is a failure to direct, or "take care of," the corporation.

Second, besides taking "care of" a corporation's business and affairs, a board in doing so is to "care for" the interests of the corporate enterprise and its shareholders. That is, the affirmative object of director attention and energy must be the enterprise and its shareholders, not the directors' interests or those of any other third party. Unconsidered director neglect violates this obligation of care because it is a failure to "care for" the enterprise and its shareholders. Equally important, a director acting out of self-interest (disloyally) or out of a motive other than the interest of the corporate enterprise and shareholders (bad faith), also is failing to "care for" the proper interests. In this sense, care as solicitude *for* the interests of the enterprise

¹²¹*Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

¹²²DEL. CODE ANN. tit. 8, § 141(a) (1998).

¹²³WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 640 (1986).

¹²⁴*Id.* at 338.

and shareholders is the foundation of the notions of loyalty and good faith.¹²⁵ A director simply cannot discharge the obligation to "care for" the corporation and its shareholders by serving, instead, his or her own, or another party's interests. In fact, this facet of care — concern and solicitude — is sufficiently fundamental and sufficiently different from yet a third meaning of care — acting "with care" — that the altogether different terminology of loyalty and good faith are used to more sharply capture this second meaning.

Third, directors are not only to "take care of" and "care for" the corporation and its shareholders, but when doing so they are to act "with care." That is, directors are to act "carefully" or in a careful manner. One can "care for" (as by being concerned about) the interests of another without necessarily acting "with care" regarding those interests. Likewise, one can behave "with care" without acting out of "care for" the interests of another. A hired driver, for example, may operate a vehicle with great care — i.e., carefully — although he or she does not "care for" the welfare of the passenger in that the driver may proceed to the destination that he or she, rather than the passenger, prefers.

The point here is that, far from being a thin concept, care in corporate law, as in human existence generally, is a rich and primordial concept.¹²⁶ It is such a first-order concept that, for the most part, the first two meanings generally are not at issue and can often safely be assumed. Thus, when a board takes considered action (or considered inaction), there is no care issue in the first sense. By way of contrast, in a board abdication case there is a fundamental failure to direct or "take care of" the corporation in just that basic sense.¹²⁷ Unless loyalty or bad faith is pointedly the issue, generally care in the second sense — "care for" — likewise is not often at stake. This is easily seen, for example, in the old charitable contribution cases and the more recent hostile takeover cases involving board-adopted antitakeover

¹²⁵The Delaware Supreme Court once described the conduct of disinterested directors who abandoned their oversight responsibilities as a breach of their duties of care *and* loyalty. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1284 n.32 (Del. 1988). Such abdication so fundamentally violates care in the first and second senses that it constitutes disloyalty to the intended recipients of director attention, even without director self-interest. This is seen as well in one sometimes-forgotten clause in a larger famous passage about director loyalty in *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (finding a director under the duty "affirmatively to protect the interests of the corporation committed to his charge."). The court in *Unocal* described the "fundamental duty and obligation to protect the corporate enterprise" as a "duty of care." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985).

¹²⁶This is the point of the fable of Care in the Introduction to this article. Indeed, human care understood ontologically (not merely psychologically) is regarded by Martin Heidegger as such "a primordial structural totality," that "Being must be defined as 'care.'" MARTIN HEIDEGGER, *BEING AND TIME* 238 (John Macquarrie & Edward Robinson trans., Harper & Row 1962) (1927).

¹²⁷See *supra* note 125.

measures where the second meaning of care was brought into sharp issue and debate.¹²⁸ The issue is the very basic one of whether these actions are consistent with "caring for" the interests of the corporation and its shareholders. Answering this complex social policy question requires very different judicial involvement¹²⁹ than answering, as in the third sense of care, whether or not the directors acted "with care."

That leaves the third sense of care — are directors acting "with care" — as the predominant part of the due care inquiry. It is a qualitatively different, less foundational inquiry than the first two. Judicial review of director care in this sense should, therefore, focus on the *manner* in which directors acted, because the duty of due care so understood is a duty to conduct oneself in a certain (careful) manner. This manner includes, but goes beyond, proper informedness.

2. Benefits of a Broader Due Care Duty

Due care as both a more inclusive notion than informedness and as having broader application than the business judgment setting should be clearly instilled in Delaware law. The duty of due care — which applies to all directors at all times — is a duty to act "with care" and is easy to state. It is a duty to act with the care an ordinarily prudent person would reasonably be expected to exercise in a like position under similar circumstances.¹³⁰ Specifically, in the business judgment context, the business judgment review standard would include a presumption that directors acted with due care (i.e., with a reasonable overall decision-making process). The contours of the proposed due care duty are more fully developed in Part V. The remainder of Part IV identifies several reasons for expressly implanting in Delaware law such a concept of due care.

¹²⁸Lyman Johnson, *The Eventual Clash Between Judicial And Legislative Notions Of Target Management Conduct*, 14 J. CORP. L 35, 42-61 (1988). A contemporary setting where the duties of loyalty and good faith — i.e., care as to "care for" — will be contested and closely analyzed involves claims for damages against directors where the duty of care is unavailable (or is unattractive) as a theory of recovery due to an exculpatory provision adopted pursuant to § 102(b)(7) of the Delaware Corporations statute. DEL. CODE ANN. tit. 8, § 102(b)(7) (1998). See, e.g., *Goodwin v. Live Entertainment, Inc.*, No. 15,765 (Del. Ch. Jan. 22, 1999), *reprinted in* 24 DEL. J. CORP. L. 1084 (1999). See *infra* note 190.

¹²⁹See Johnson, *supra* note 9, at 910-36.

¹³⁰Common law recognizes a duty of care. Cohn, *supra* note 98, at 602-03 & nn.39-45. Delaware law appears to be in accord, see *infra* note 162 and accompanying text, although such a full description of care appears with startling infrequency.

a. *Doctrinal Assertions About Informedness*

First, a more general duty of due care would serve to illuminate certain doctrinal assertions in Delaware law. An example of a problem with focusing on director informedness in isolation is found in the important cases of *Aronson v. Lewis*¹³¹ and *Smith v. Van Gorkom*.¹³² In both cases, the Delaware Supreme Court stated that a director's decision is an informed one if directors have informed themselves "of all material information reasonably available to them."¹³³ The *Van Gorkom* court additionally ruled that gross negligence is the proper standard for determining whether a decision was an informed one.¹³⁴

The latter standard necessarily means directors have considerable latitude in their information gathering efforts and will not literally be required to have "all material information reasonably available" or lose the case. Nor will directors lose even if they were negligent or acted unreasonably in their efforts at becoming informed because a gross negligence standard is meant to provide greater leeway.¹³⁵ If so, a duty of care case will not stand or fall based only on the court ascertaining whether the specified amount of information has been obtained — i.e., all material information reasonably available — but on whether "enough" information was gathered to satisfy a director's obligation not to have acted with gross negligence in becoming informed.¹³⁶ Being held to a stated "reasonableness" standard and being held to a lesser standard that one not be grossly negligent in deviating from the stated standard are two different legal measures.¹³⁷

¹³¹473 A.2d 805 (Del. 1984).

¹³²488 A.2d 858 (Del. 1985).

¹³³*Van Gorkom*, 488 A.2d at 872 (quoting *Aronson*, 473 A.2d at 812).

¹³⁴*Id.* at 873.

¹³⁵In criticizing a "reasonable person" standard as lacking precision, the Delaware Supreme Court in *Cede II* interpreted such a standard as protecting "all director action not constituting gross negligence," not "only director actions that do not constitute simple negligence." *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 364 n.31 (Del. 1993). Clearly, the court intends to allow directors more leeway than simple negligence. For a critique of a gross negligence standard as confusing, see Arsh, *supra* note 97, at 120-21 n.119; see also E. Norman Veasey & William E. 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, 928 (1980) (noting the confusion and differentiation between "gross" and "ordinary negligence" as the applicable standard).

¹³⁶This exact distinction was made by defendants in *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 270 (Del. Ch. 1989). Faced in that case with the reality that they "did not know all of the relevant facts[,] defendants argued that board failure to become fully informed does not result in loss of business judgment rule protection "unless its lack of information was so extreme as to reflect gross negligence on the part of the directors." *Id.* The vice-chancellor did not resolve the argument.

¹³⁷See *supra* note 135.

Moreover, no matter how the standard of informedness is verbally expressed, the legal sufficiency of a director's degree of informedness is never an abstract or purely quantitative inquiry. Rather, it is one that necessarily sets director culpability on the informedness question into the fuller milieu of the overall decision-making process on a particular matter. "Materiality" and "reasonableness" are unavoidably context-bound, as is the overarching question of whether the care given to, among other matters, director informedness was that "due" under the totality of circumstances. The key determination is whether, overall, the directors acted with "due" care, that is, in examining their behavior as a whole, did they act with "entire care."¹³⁸

A more explicit broadened notion of due care also allows reconciliation of various doctrinal assertions by the Delaware Supreme Court on the relationship of information to the larger decision-making context. The impact of discrete items of information and other factors must always be, when assessing the legal sufficiency of director conduct, "considered in light of the whole case."¹³⁹ The 1974 case of *Gimbel v. Signal Companies, Inc.*,¹⁴⁰ cited in *Van Gorkom*,¹⁴¹ quotes from the 1933 decision of *Mitchell v. Highland-Western Glass Co.*¹⁴² (also cited in *Van Gorkom*) to the effect that a court should ask whether certain information deficiencies, "considered in light of the whole case,"¹⁴³ justify the conclusion that "'directors acted so far without information that they can be said to have passed an unintelligent and unadvised judgment.'"¹⁴⁴ The *Gimbel* court went on to frame the pertinent inquiry in a manner also quoted approvingly in *Van Gorkom*,¹⁴⁵ that being whether, in light of the "full circumstances[,] . . . did the Signal directors act without the bounds of reason and recklessly?"¹⁴⁶ This is not a review of the substance of the decision itself, but of the *manner* in which directors acted under the "full circumstances" of the decision-making context. Since this is a process inquiry, a reviewing court must consider

¹³⁸The term "entire care" is meant to be the analogue, in care analysis, to the term "entire fairness" first coined by the Delaware Supreme Court in the loyalty setting. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-11 (Del. 1983).

¹³⁹*Gimbel v. Signal Cos.*, 316 A.2d 599, 615 (Del. Ch. 1974), *aff'd per curiam*, 316 A.2d 619 (Del. 1974).

¹⁴⁰*Id.*

¹⁴¹*Smith v. Van Gorkom*, 488 A.2d 858, 873 n.13 (Del. 1985).

¹⁴²167 A. 831, 833 (Del. Ch. 1933).

¹⁴³*Gimbel*, 316 A.2d at 615.

¹⁴⁴*Id.* (quoting *Mitchell*, 167 A. at 833 (emphasis added)).

¹⁴⁵*Van Gorkom*, 488 A.2d at 873 n.13.

¹⁴⁶*Gimbel*, 316 A.2d at 615 (emphasis added).

evidence of the directors' entire decision-making process, a "whole record" review standard, to borrow a phrase from administrative law.¹⁴⁷

The case authority cited by *Van Gorkom* supports the view that such a process inquiry can only be done in the context of the directors' assessment of the "entire situation."¹⁴⁸ The importance of director conduct in addition to the gathering of information is also visible in *Van Gorkom's* admonition that directors must "proceed with a critical eye in *assessing information* of the type and under the circumstances present here."¹⁴⁹ When information is "assessed," it is analyzed in a deliberate and disciplined manner. Due care, therefore, includes obtaining, analyzing, and bringing considered deliberation to,¹⁵⁰ all reasonably available material information prior to the exercise of judgment.¹⁵¹ Were this not the case, the word "judgment" would mean little more than the formal utterance of a decision, rather than the intellectual process of forming an opinion through deliberation on all material information. It is the latter "judgment" that shareholders and society at large seek and expect from directors.

The context-sensitive nature of the informedness inquiry, as well as the fact that the informedness requirement is only one component of due care, was recognized by the Delaware Supreme Court in its 1994 statement that "the circumstances of each particular case will determine the steps that a board must take to inform itself, and *what other action, if any, is required as a matter of fiduciary duty.*"¹⁵² Later in that same opinion, the court described directors' duties "to obtain, and act with due care on, all material

¹⁴⁷"Whole record" review is an administrative law concept found in the Administrative Procedure Act. 5 U.S.C. §§ 551, 706 (1994). See *Universal Camera Corp. v. National Labor Relations Bd.*, 340 U.S. 474, 488 (1951); BERNARD SCHWARTZ, ADMINISTRATIVE LAW § 10.7 (3d ed. 1991). Unlike in administrative law, however, where the court reviewing administrative agency action is to look at the "whole record," in corporate law the reviewing court should examine whether the directors looked at the "whole record," i.e., what Chief Justice Veasey once called the directors' analysis of "the entire situation." *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 44 (Del. 1993).

¹⁴⁸*QVC Network, Inc.*, 637 A.2d at 44.

¹⁴⁹*Van Gorkom*, 488 A.2d at 872 (emphasis added).

¹⁵⁰See *infra* text accompanying note 160; Cohn, *supra* note 98, at 615; see also *Panter v. Marshall Field & Co.*, 646 F.2d 271, 306 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981) (Judge Cudahy, concurring in part and dissenting in part) (stating that the "[b]oard gave the CHH merger proposal no bona fide consideration").

¹⁵¹*Van Gorkom* clearly states that a director has a duty "to act in an informed and deliberate manner." *Van Gorkom*, 488 A.2d at 873. *Cede II*, citing *Van Gorkom*, subtly distorts the quoted language in a way that alters the dual nature of the directors' duty so that it becomes a duty "to inform themselves fully and in a deliberate manner." *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 368 (Del. 1993). Whereas *Van Gorkom* differentiates "informed" and "deliberate," *Cede II* converts "deliberate" into a description of *how* directors are to inform themselves. *Id.*

¹⁵²*QVC Network, Inc.*, 637 A.2d at 43 n.13 (emphasis added).

information reasonably available."¹⁵³ That statement — made prior to *Cede III* — reflects the court's appreciation that due care properly includes, but is not limited to, the informedness inquiry, as *Cede* and certain antecedent decisions wrongly suggest. Moreover, this view rightly regards the exercise of such due care as an essential precondition to the decision — upholding protection of the business judgment rule.¹⁵⁴

The contextual nature of any judicial assessment of director conduct was succinctly captured by Chancellor Allen in stating that "inquiries concerning fiduciary duties are inherently particularized and contextual."¹⁵⁵ This belief about judicial review of director conduct is further reinforced by the Delaware Supreme Court's statement in *Barkan v. Amsted Industries, Inc.*¹⁵⁶ that "a board's actions must be evaluated in light of relevant circumstances to determine if they were undertaken with due diligence and in good faith."¹⁵⁷ The court pointedly applied this to the informedness inquiry, stating that "[t]he need for *adequate information* is central to the *enlightened evaluation* of a transaction" by a board,¹⁵⁸ while recognizing "there is no single method that a board must employ to acquire such information."¹⁵⁹ The key judicial inquiry is the soundness of a board's overall decision-making process (in practice and necessity a multifactor analysis), an inquiry designed, ultimately, to determine "whether a board has acted in a deliberate and knowledgeable way in identifying and exploring alternatives."¹⁶⁰ Doctrinally, then, the concept of care encompasses much

¹⁵³*Id.* at 48.

¹⁵⁴Many decisions contend that the exercise of due care is a predicate to the business judgment rule. A New York decision states that "[w]hen courts say that they will not interfere in matters of business judgment, it is presupposed that judgment — reasonable diligence — has in fact been exercised . . . [that] an honest, unbiased judgment, is reasonably exercised by them." *Casey v. Woodruff*, 49 N.Y.S.2d 625, 643 (N.Y. App. Div. 1944). An even clearer statement is that "the business judgment rule protects directors from liability for good faith errors only after the directors have exercised reasonable care in fulfilling their corporate obligations." *Resolution Trust Corp. v. Hess*, 820 F. Supp. 1359, 1367 (D. Utah 1993) (applying Utah law). These statements indicate that "judgment" in the phrase "business judgment" means more than the discrete formal utterance of a decision; it is the process — to be engaged in with care — of forming an opinion by evaluating information. *See generally* Johnson, *supra* note 46 (critiquing Delaware's formulation and use of the business judgment rule).

¹⁵⁵*Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1125 (Del. Ch. 1990).

¹⁵⁶567 A.2d 1279 (Del. 1989).

¹⁵⁷*Id.* at 1286; *see* *Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1292 (Del. 1998) (stating that "the exact course of conduct that must be charted to properly discharge that responsibility will change in the specific context of the action the director is taking").

¹⁵⁸*Barkan*, 567 A.2d at 1287 (emphasis added).

¹⁵⁹*Id.*

¹⁶⁰*Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 66 (Del. 1989). Interestingly, *Citron* is the case that, rhetorically at least, equated the informedness element of *Aronson's* business judgment rule with due care.

more than informedness. A fully-articulated duty of due care would seal this issue in Delaware law.

b. *Care Outside Business Judgment Setting*

A second benefit of expressly verbalizing a broader duty of due care is that the duty applies outside the business judgment setting and, outside that setting, the duty is usefully seen as broader than mere informedness. Justice Horsey traces the emergence of care in Delaware law and finds the Delaware Supreme Court acknowledging such a duty in dictum in 1963:¹⁶¹ "[I]t appears that directors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances."¹⁶² Two years earlier in a case not involving business judgment, the chancellor held corporate directors liable for losses proximately caused by their failure to discharge supervisory responsibilities related to violations of corporate investment policy.¹⁶³ Liability resulted only because directors had breached a legal duty to perform with a certain level of care, what the chancellor called "a reasonable

¹⁶¹Horsey, *supra* note 34, at 985.

¹⁶²*Id.* at 986 (quoting *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963)). The *Allis-Chalmers* dictum appears to be the chief basis for believing that the Delaware Supreme Court recognizes a director duty of care. See, e.g., Horsey, *supra* note 34, at 986-87; R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* § 4.34, at 4-216 (1998); see also *Rabkin v. Philip A. Hunt Chem. Corp.*, 547 A.2d 963, 972 (Del. Ch. 1986) (finding that, outside the business judgment setting, care required is that of an ordinarily careful and prudent person); *Chasin v. Gluck*, 282 A.2d 188, 192-93 (Del. Ch. 1971) (recognizing, in dictum, negligence as basis for director liability).

Cede II describes the *Allis-Chalmers* care formulation as "quite confusing and unhelpful," *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 364 n.31 (Del. 1993), a peculiar description to apply to such a longstanding and widespread formulation. See Richard B. Dyson, *The Director's Liability for Negligence*, 40 IND. L.J. 341, 371 (1965) (stating that a vast majority of jurisdictions require ordinary care). If anything, Delaware's "gross negligence" formulation is confusing and unhelpful, as Samuel Arsht pointed out twenty years ago. Arsht, *supra* note 97, at 120-21 n.119. Chief Justice Veasey long ago made a similar point in stating that little attempt is made to define gross negligence. Veasey & Manning, *supra* note 135, at 928. Moreover, the *Cede II* critique of *Allis-Chalmers* is misleading because, although *Allis-Chalmers* does, in part, later speak of director liability in terms of "reckless" conduct, it also clearly states that liability will result if a director "neglected" to perform her duty or ignored it "through inattention [to] obvious danger signs." *Allis-Chalmers*, 188 A.2d at 130. Neglect and inattention can easily be understood as simple negligence.

Chancellor Allen critically discussed the *Allis-Chalmers* decision in *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 969-71 (Del. Ch. 1996). Chancellor Allen offers possible broad and narrow readings of *Allis-Chalmers*, concluding that an overly broad reading — i.e., that directors need not establish an appropriate information and reporting system — would not be accepted by the Delaware Supreme Court in 1996. *Id.* at 969-70.

¹⁶³*Lutz v. Boas*, 171 A.2d 381, 396 (Del. Ch. 1961).

discharge of their duties."¹⁶⁴ This duty of care applied even though the directors had not exercised business judgment. Notwithstanding *Cede II* and *Cede III*, this reveals both that due care in Delaware encompasses more than informedness and that due care is rightly seen as a duty comprising more than a "component" of the business judgment rule. This point would not have to be methodically excavated from various cases — and would not disappear so readily — were the Delaware Supreme Court to articulate the duty more fully and forthrightly.

Another court of chancery case where the business judgment rule was unavailable (because directors did not exercise a considered business judgment on certain transactions) also found for the plaintiff-shareholder, thereby necessarily ruling that directors had violated a duty to act with care in a way that extended beyond the business judgment rule setting.¹⁶⁵ Even within the business judgment context, the court of chancery has made clear that directors could breach their duties in ways other than by fraud or self-dealing; directors could "breach that duty by being grossly negligent."¹⁶⁶ This nameless duty in *Penn Mart Realty* to avoid acting with gross negligence is, like the unnamed duty in *Kaplan*, none other than the requirement later articulated by the Delaware Supreme Court in *Aronson* that directors must act with "requisite care."¹⁶⁷ The key point is not whether the level of culpability associated with "requisite care" is gross negligence or ordinary negligence. The point here is the much more basic one of demonstrating that Delaware *recognizes* a pervasive (if ill-defined) duty of care both in and outside the business judgment setting, whether or not it consistently *designates* that duty as *care*. Were this duty of due care made

¹⁶⁴*Id.* at 395. Although the chancellor described the directors' conduct as "grossly negligent," it does not mean the legal standard that was applied (as opposed to the actual low level of director conduct therein described) was gross negligence rather than simple negligence. See Veasey & Manning, *supra* note 135, at 928 (tersely describing *Lutz* as applying a gross negligence standard because of the chancellor's phrasing). Indeed, the chancellor's reference to "reasonable discharge" of duties, his assertion that "even an average attention to duty" would have revealed wrongdoing, his statement that had directors "discharged their responsibilities as to general supervision" violations would have been discovered, and his description, twice, of director behavior as "negligence," support the view that ordinary negligence was the legal standard applied in *Lutz*. See *Rabkin*, 547 A.2d at 972. See also S. Samuel Arsht, *Fiduciary Responsibilities of Directors, Officers and Key Employees*, 4 DEL. J. CORP. L. 652, 659 (1979) (arguing that *Allis-Chalmers* establishes a negligence standard). Chief Justice Veasey since has indicated his view that the Delaware Supreme Court has not yet addressed whether negligence or gross negligence is the proper standard in the oversight context, as opposed to the business judgment context. E. Norman Veasey, *Directors and the Dynamics of Delaware Corporation Law*, 21 DIRECTOR'S MONTHLY 3 (Nov. 1997).

¹⁶⁵*Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971).

¹⁶⁶*Penn Mart Realty Co. v. Becker*, 298 A.2d 349, 351 (Del. Ch. 1972).

¹⁶⁷*Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). The court stated that, in that case, gross negligence was the standard by which "requisite care" was to be measured. *Id.*

more prominent, and its contours elucidated more fully, it would not fall so frequently from judicial view.

c. *Entire Fairness Not Feasible in All Care Cases*

Third, the *Cede* standard of entire fairness, said to be triggered by a breach of care, is meaningless in duty of care cases that do not involve discrete transactions. It is therefore not a generalizable or uniform review standard that can be applied in all breach of due care cases. Care cases in non-transactional settings such as, for example, uninformed or otherwise careless decisions on corporate distributions, or decisions to expand or contract a business (other than through purchase or divestiture of an entire corporation) cannot be fitted into an entire fairness framework because they do not involve discrete market-based events lending themselves to a "fairness" analysis.¹⁶⁸ Moreover, cases involving director failure to monitor also are non-transactional — indeed, they may not even involve business judgments — and thus likewise do not fit into a "fair dealing" and "fair price" matrix, because no specific "deal" at a particular price has been made. Yet, as the recent *Caremark* case teaches, faulty monitoring cases clearly implicate a director's duty of care.¹⁶⁹

Even within the business judgment transactional setting, a fairness analysis makes no sense when the challenged director behavior was that *no deal* was done (unless the court chooses to evaluate the "entire fairness" of the status quo as compared to a spurned transaction), unlike the *Cede* litigation where a board-endorsed deal thought by shareholders to be inferior to a better alternative could be judicially assessed for entire fairness. If *Cede II* and *Cede III* articulate an analytical framework useful for analyzing care claims only when one, rather than another, transaction is done — or, more generally, only where a transaction of any sort is done — it addresses only a special category of care and does not, as it purports, articulate a uniformly applicable method for generally reviewing director due care claims.

d. *Cede Fair Dealing Factors as Disguised Entire Care Factors*

Fourth, an explicit and enriched duty of care more forthrightly injects into judicial analysis, at an earlier stage, those factors the *Cede III* court

¹⁶⁸This is also the problem with applying the entire fairness standard when directors fail to carry their initial two-pronged burden under *Unocal*. See *infra* note 213. This test originated in a context where a specific, self-dealing business transaction could be assessed for fairness. *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

¹⁶⁹*In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996). For a fuller discussion of the *Caremark* decision, see *infra* text accompanying notes 221-26.

eventually considered under its entire fairness standard as bearing on "fair dealing."¹⁷⁰ Having found a director duty of care breach because the board's failure to make a market check resulted in a finding of uninformedness,¹⁷¹ the *Cede III* court subsequently assessed a host of factors that the board had done properly, and concluded the board had, nonetheless, engaged in fair dealing.¹⁷²

This analysis could and should have been done as part of the threshold duty of care analysis. The inquiry would have been whether under "the circumstances of [this] particular case,"¹⁷³ "considered in light of the whole case,"¹⁷⁴ the directors, in considering that same host of factors in the context of "the entire situation,"¹⁷⁵ had fulfilled their duty of due care — or entire care. Instead, the court sheepishly recognized the care nature of the factors it was smuggling into its fairness test and made the peculiar statement that "[t]he degree of procedural due care a board of directors exercises has been recognized as a continuing component of an entire fairness analysis."¹⁷⁶

This strange outcome stems from the court's basic error in treating the plaintiff's rebuttal of prevailing formulations of the Delaware business judgment rule as *itself* proving a due care breach, rather than bearing only one facet of care, insufficient informedness. The informedness issue itself should have been addressed in the larger context of the other care-like factors later considered under the "fair dealing" analysis. Although the defendants would have the burden to *produce* evidence on this issue, the plaintiff should have continued to bear the burden of *persuasion* that the directors failed to act with overall or "entire" care. The plaintiff would fail to meet this burden because the directors could cite, in defense of their due care position, the very factors eventually found by the court to support a finding of fair dealing. The result in *Cede* is that the directors ultimately were found to have acted fairly, but not (initially, at least) carefully, although due care was said to be a "component" of fairness.¹⁷⁷ Fulfilling a higher review standard after failing a lower one could happen only if, first, fairness review is disguised (re-visited) care review or, second, there is, within the ambit of entire fairness review, an odd "balancing" of the *breach* of duty of

¹⁷⁰*Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156, 1172 (Del. 1995).

¹⁷¹*Id.* at 1172-73.

¹⁷²*Id.* at 1175, 1178.

¹⁷³*Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 42 n.13 (Del. 1993).

¹⁷⁴*Gimbel v. Signal Cos.*, 316 A.2d 599, 615 (Del. Ch. 1974).

¹⁷⁵*QVC Network, Inc.*, 637 A.2d at 44.

¹⁷⁶*Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156, 1175 (Del. 1995).

¹⁷⁷*Id.*

care against the *proper discharge* of other fiduciary duties (i.e. loyalty).¹⁷⁸ Each possibility serves to obscure rather than honor the distinctive nature and purpose of those two duties.

3. Undermining Distinctive Policy Rationales for Care and Loyalty

By applying the same standard of review to care and loyalty claims and by somehow "balancing" breaches of one duty against fulfillment of the other under a unitary "entire fairness" test, *Cede* blurs the two duties and betrays the historical policy reasons for judicial deference in care cases and judicial scrutiny in loyalty cases. Recent decisional law in Delaware explains the rationales for divergent review standards in care and loyalty cases.

Chancellor Allen describes the judicial deference accorded director decision making through the business judgment rule — where no self-dealing or improper motive exists — as "protection against a threat of sub-optimal risk acceptance."¹⁷⁹ By this, Chancellor Allen relates that shareholders in public corporations, because they can manage risk by diversifying their portfolio of investments, do not want directors of any particular corporation to be unduly risk averse.¹⁸⁰ A director — who may receive little of the financial payoff from undertaking a risky project — will be more risk averse than shareholders rationally desire if a director faces personal liability for the substantial losses that may result from a business decision regarded, retrospectively, as substantively foolish or simply unreasonable. To more closely align director attitudes toward risk with

¹⁷⁸In *Cede III*, the court stated that the entire fairness analysis requires a "balancing" of the duties *breached vis-à-vis* the manner in which other duties were "properly discharged." *Cinerama, Inc.*, 663 A.2d at 1165. The court also indicated that those aspects of board conduct "properly discharged" were to be "weighed . . . against" board failure. *Id.* at 1179. This is tantamount to saying, with respect to two virtues (e.g., honesty and courtesy), that failing in the one can somehow be compensated for by especial fulfillment of the other. This analysis not only negates the "independent significance" (*Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993)) of two virtues (whether legal or moral), it also suggests that various amalgams of breach of one specific duty and discharge of another specific duty yield some overall fulfillment of a general duty. If an extra portion of one legal duty can, partially at least, substitute for deficiency of another, one wonders why, conversely, in the loyalty setting, an especially *careful* director would not be allowed a measure of *disloyalty*. Perhaps that is what Delaware courts are close to endorsing. *See supra* note 5 and accompanying text.

¹⁷⁹*Gagliardi v. Trifoods Int'l, Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996).

¹⁸⁰*Id.*

shareholder preferences, the business judgment rule is designed to accord directors substantial latitude in their business decision making.¹⁸¹

The business judgment rule — and the judicial deference it provides — is also grounded on a policy to encourage capable persons to serve as directors by reducing their risk exposure, to limit litigation over corporate decision making, and, importantly, to avoid intrusiveness by public officials (judges) into private sector business affairs.¹⁸² The key assumption here, however, is that the directors making decisions are disinterested and independent.¹⁸³

Where director self-interest is present, and the self-interest affects a majority of directors approving a transaction, the focus of concern becomes director *loyalty*, not merely competence. Concerned about director fidelity to the corporation's interests, judges will apply exacting scrutiny to determine for themselves whether a transaction is entirely fair (including substantively fair) to shareholders.¹⁸⁴ The reason for abandoning the deference of the business judgment standard and adopting such an invasive test is that, there being no other independent decision maker within the corporation, the court necessarily becomes, on behalf of the shareholders, the only available "neutral decision-making body" passing judgment on the matter.¹⁸⁵

The key policy question where directors carefulness has been challenged is whether, upon concluding that directors have breached the duty of care (whether *Cede's* informedness or this article's broader entire care notion), the usual policy rationales for deference necessarily should fall away *and* the rationales favoring judicial scrutiny of the substantive merits of a

¹⁸¹*Id.* at 1052-53. Importantly, the rationale for deference depends, first, on the board exercising its statutory responsibilities for management of the business and affairs of the corporation, and second, that the challenged director action be a *business* judgment, not, for example, a legal judgment concerning whether shareholders have been given all material information to which they are entitled under Delaware's director-disclosure obligations. This is why director conduct in duty of disclosure cases is not reviewed under a business judgment standard even though loyalty or good faith may not be implicated. *See, e.g., In re Anderson, Clayton Shareholders Litig.*, 519 A.2d 669, 675 (Del. Ch. 1986). The key rationale for deference — *business* judgment — is not present, even though disloyalty or bad faith also may not be present. This demonstrates the need for one or more judicial review standards for director conduct where both business judgment review and the fairness review triggered by disloyalty are inappropriate.

¹⁸²Harvey Goldschmid, *The Duty of Care and the Business Judgment Rule*, SC53 ALI-ABA 1, 5 (1997); *see Joy v. North*, 692 F.2d 880, 886 (2d Cir. 1982), *cert. denied*, 460 U.S. 1051 (1983); *A.C. Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 111 (Del. Ch. 1986). *See also Riley*, *supra* note 98, at 709-12 (describing rationales for deference).

¹⁸³*Gagliardi*, 683 A.2d at 1053.

¹⁸⁴*See supra* text accompanying notes 21-25; *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 42 n.9 (Del. 1993).

¹⁸⁵*Cinerama, Inc. v. Technicolor, Inc.* 663 A.2d 1156, 1170 & n.25 (Del. 1995).

decision are thereby triggered, resulting in loyalty-like entire fairness review. Beginning with the customary rationales for judicial deference in the business judgment setting,¹⁸⁶ disinterested directors who must prove the entire fairness of transactions or face potential personal liability if they were not adequately informed, may reduce risk either by making very certain they are fully informed (perhaps acting with an excess of counter-productive, costly and time-consuming caution) or by concluding that *not* doing a deal (any deal) is *always* a safer route than doing one and risking an expensive judicial finding of unfairness.¹⁸⁷ The latter outcome surely does not advance shareholder interests and the former may or may not, depending on whether director zeal to avoid the entire fairness test leads to a bias toward inefficient, deal-clogging behavior out of an overabundance of caution.

From a shareholder risk preference standpoint, requiring directors to demonstrate the substantive merits of a business decision to a court's exacting satisfaction or face personal liability, should not turn only on director error in becoming informed any more than on any other director error in business judgment, assuming actual judgment on the matter of informedness was exercised. Shareholders would seem to have the same tolerance for according latitude to director judgment in the one area as well as in the other, lest directors take risk-averse courses of action in either undertaking. Director liability on this shareholder risk preference rationale should turn on the *overall* unreasonableness of the director decision-making process, not just a single component (be it informedness or any other), because it is only such an *overall* sound decision-making process that shareholders should, *ex ante*, rationally desire.

An exclusive focus on informedness alone (or on any other single element of care), even as a sort of crude proxy for due care, almost inevitably invites *ex post* claims that directors were not "informed enough." This one-sided scrutiny is reminiscent, in reverse, of the pre-Administrative Procedure Act substantial evidence test, whereby an agency finding was upheld if a court could "find *something* in the evidence that support[ed] it."¹⁸⁸ Focusing on informedness without regard to the larger decision-making context means, likewise, that plaintiff wins on the care issue by attacking

¹⁸⁶See *supra* text accompanying notes 179-82. See generally Johnson, *supra* note 46 (critiquing Delaware's formulation and use of the business judgment rule).

¹⁸⁷This point builds on the earlier critique of applying an entire fairness standard in the care area as unhelpful, where no transaction at all was undertaken, as opposed to where one rather than another transaction was undertaken. See *supra* Part IV.C.2.c. This bias is possible because a decision to maintain the status quo is evaluated more mildly in corporate law than a decision to change course.

¹⁸⁸Louis L. Jaffe, *Judicial Review: "Substantial Evidence on the Whole Record,"* 64 HARV. L. REV. 1233, 1236 (1951) (quoting Justice Frankfurter) (emphasis added).

informedness alone, without regard to how the "whole record" bears on the soundness of the decision-making process. Instead, shareholders should always have the burden to demonstrate the unreasonableness of director behavior in the *overall* decision-making process. Judicial insistence on an overall sound decision-making process, therefore, "need not quell director initiative"¹⁸⁹ in a way contrary to shareholder risk preferences.

Moreover, because shareholders rightly expect a reasonable decision-making process from their elected representatives, if shareholders prove its absence, then the directors should be liable for all damages proximately caused thereby. The judiciary's views on the substantive merits of the decision are fortuitous at this juncture; a breach of due care is not somehow negated or undone by a business decision's quality. If, however, directors believe, and can demonstrate, that their careless conduct did not cause shareholders any damage because, for example, a transaction was qualitatively "fair," the plaintiff will be unable to prove damages flowing from the directors' faulty decision-making process. The result is a breach of care but no damages caused thereby; therefore, no director liability will ensue. Additionally, if the spectre of liability for care breaches is thought to dampen director initiative in a suboptimal fashion, shareholders might agree *ex ante* to exculpate directors from monetary damages for care breaches,¹⁹⁰ agreeing to seek only equitable relief.

This approach honors another key care rationale for judicial deference better than *Cede*, that of the perceived institutional incompetence of public officials to evaluate the substantive quality of private sector business decisions.¹⁹¹ The absence of informedness alone — or even an affirmative showing of unreasonableness in the overall decision-making process — does not warrant a court to supplant a board of directors and pass its own judgment — usually long after the fact — on the substantive merits of a business decision.¹⁹² Care cases, unlike loyalty cases, do not deprive

¹⁸⁹Cohn, *supra* note 98, at 606.

¹⁹⁰Section 102(b)(7) of Delaware's General Corporation Law allows the certificate of incorporation to limit or eliminate the personal liability of directors for breaches of duty other than the duty of loyalty. DEL. CODE ANN. tit. 8, § 102(b)(7) (1998). Equitable relief would still be available, even with such a provision. Moreover, some breaches thought of as care breaches in the "with care" meaning of that word, *see supra* Part IV.C.1, might be characterized as loyalty breaches in the "care for" sense, and thereby not fall under § 102(b)(7). *See supra* Part IV.C.1. An example is director abdication. *Supra* note 125. Conversely, defendants seeking exculpation will characterize breaches as broadly raising a "care" duty, thereby coming within the statutory exculpation. *See, e.g.,* Goodwin v. Live Entertainment, Inc., No. 15,765, slip op. at 10-11 (Del. Ch. Jan. 22, 1999), *reprinted in* 24 DEL. J. CORP. L. 1084, 1101 (1999).

¹⁹¹*See supra* text accompanying note 182.

¹⁹²Two matters are troublesome in this regard. First, the corporation statute (§ 141(a)) places the business and affairs of a corporation under the direction of a board of directors, not a court. *See* Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1291 (Del. 1998). Failure of

corporations of "neutral decision-makers."¹⁹³ The prevailing loyalty rationale for judicial assessment of substantive fairness of business decisions, therefore, does not apply in care cases, even where care is breached. Consequently, a care breach, contrary to what *Cede II* and *Cede III* hold, should not result in judicial review of *substance*. At the same time, a care breach should have more than *Cede's* burden-shifting *procedural* effect; it should have substantive force. In a meaningful sense, the *substantive* force of the business judgment rule always applies in a care case, immunizing the *quality* of the decision from judicial review whether or not care was exercised.¹⁹⁴ In the care setting, the proper inquiry is whether an undoubtedly neutral decision-maker acted in the proper *manner*; that inquiry does not ever necessitate or warrant judicial inquiry into the substantive merits of a decision,¹⁹⁵ only into the process by which it was made. Whether the decision-making process was sound or unsound, the court is not to pass judgment as such on the substantive merits of the business decision.

If the directors' decision-making process was sound, the court looks at the business decision itself only to verify a linkage between process and outcome. Importantly, the inquiry is not an examination of substance — even for minimal rationality — but only an analysis of whether the decision

a board to act with care in discharging this statutory responsibility neither transfers this responsibility to the judiciary nor is the failure negated by a judicial conclusion that the ultimate outcome was, after all, "fair." Second, although the duty of care mandates that directors act only "with care" (whether understood as informedness or as a richer entire care notion), after *Cede*, a director found to have breached that duty is saddled with the further unexpected duty of proving that what was done is "entirely fair." The *ex post* judicial review standard of fairness, therefore, is more demanding than the *ex ante* duty to act with care. A director acting in good faith and having no disqualifying self-interest in a matter may rightly believe his or her only remaining duty is to act carefully. Yet *Cede* tells a director that, upon a judicial finding of breach of care, having acted fairly will atone for the breach, possibly leading some directors to believe, out of caution, that the *ex ante* duty of care is best regarded as including a fallback duty to act fairly. The judicial review standard, therefore, indirectly may alter the *director* standard of conduct.

¹⁹³See *supra* text accompanying note 185.

¹⁹⁴The view expressed in the text goes farther than Chancellor Allen's proper view that the substance of business decisions are no concern of the court where process is sound. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967-68 (Del. Ch. 1996). That is true, but *whether or not* process is sound, the quality of a business decision is not properly an issue for the judiciary in the care area. See Johnson, *supra* note 46 for an elaboration of this point.

¹⁹⁵Thus, even the mild substantive review found in the "rational business purpose" element of ordinary business judgment rule review should be eliminated. See *supra* text accompanying note 20. Moreover, the *Sinclair* court itself confusingly articulated both a "rational" and a somewhat stricter "reasonable" business purpose standard. Whether the court meant the same thing by these terms is unclear. In this context, however, neither should apply. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720-21 (Del. 1971). The duty of good faith remains, however, and a business decision may be so substantively egregious that an inference of bad faith is permissible. See, e.g., *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1246-47 (Del. 1999); *In re RJR Nabisco, Inc. Shareholders Litig.*, No. 10,389, 1989 Del. Ch. LEXIS 9, at *41 n.13 (Del. Ch. Jan. 31, 1989); *In re Caremark*, 698 A.2d at 967-68.

actually made was a "rational outcome of" the decision-making process actually undertaken. Put another way, the court asks whether there is a "rational connection between" the actual sound process and the decision actually reached.¹⁹⁶ If, on the other hand, the process is defective, directors will be liable without regard to decisional quality (on the rationale that judicial views of decisional quality are irrelevant in the care area) for all damages proximately caused by their carelessness, excepting only rescissory damages.¹⁹⁷ Again, to reduce liability exposure, directors can seek *ex ante* shareholder exculpation from damages or, notwithstanding a proven breach of care, they can defend against an award of damages or equitable relief by extolling the "fair" economic merits of their decision as negating the existence of harm from their breach.

The *Cede* burden shift and entire fairness approach to duty of care breaches, therefore, not only finds no doctrinal support,¹⁹⁸ it also cavalierly negates longstanding rationales for divergent standards of judicial review in the care and loyalty areas. These rationales are better honored, and due care in Delaware would be upgraded as Justice Horsey sought,¹⁹⁹ not by using a strict scrutiny standard coupled with a burden shift, but by fortifying explicitly the concept of due care. An enriched and pervasive concept of entire care would bring to Delaware law the larger coherence rightly sought by *Cede*, while still respecting the sound doctrine and policy long-embedded (if not always openly stated) in Delaware decisions.

V. ENTIRE CARE - A PROPOSAL

The Delaware Supreme Court should declare that directors of Delaware corporations owe a duty of entire due care to their corporations at all times and in all settings. The duty is to act with the care an ordinarily prudent person would reasonably be expected to exercise in a like position under similar circumstances. This duty requires not only that directors make business judgments with care, but also that they discharge all other functions with care,²⁰⁰ including oversight and monitoring of corporate affairs. In the

¹⁹⁶The "rational connection" expression is an administrative law notion, requiring that an agency offer a linkage ("rational connection") between its findings and its decision. *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962).

¹⁹⁷Chancellor Allen has forcefully argued against awarding rescissory damages in a duty of care case. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1144-50 (Del. Ch. 1994), *aff'd*, 663 A.2d 1156 (Del. 1995).

¹⁹⁸*See supra* text accompanying notes 77-90.

¹⁹⁹Horsey, *supra* note 34, at 998.

²⁰⁰Professor Goldschmid describes a director's functions as "the corporate tasks to be performed." Goldschmid, *supra* note 182, at 2. He goes on to state that these functions may be "(a) prescribed by the corporation law of a state (e.g., declaration of dividends); (b) inherent in an office

special context of making a business judgment, entire due care means that directors must use a reasonable decision-making process leading up to the business decision. This means that directors must obtain all reasonably available material information, analyze it, deliberate on it, and otherwise act with entire care under the circumstances. Directors are presumed to have acted with entire due care both when making business judgments and at all other times, meaning simply that in all care claims the plaintiff carries the burden of proving a director failed to act in the required manner. In the special context of a business judgment care case, because of the undoubted importance of director informedness,²⁰¹ if the plaintiff produces evidence at the outset that the directors acted in an uninformed manner — such evidence-production being, at this stage, a milder requirement than *proving* lack of informedness — the defendants then have the burden of *producing* evidence on the overall reasonableness of their decision-making process. The burden of *persuasion* on that ultimate issue, however, remains throughout on the plaintiff.

The substantive quality of any action whether taken or not — whether described as "rational," "reasonable," or "fair" — is not an issue in a care case because only the *manner* of conduct is at issue.²⁰² This is true not only when the plaintiff fails to overcome the presumption of due care by failing to carry the assigned burden of proof, but also when the plaintiff succeeds in carrying the burden of proving a breach of due care. The overall decision-making process that is actually undertaken, however, once determined to have been reasonable, must supply a rational basis for (that is, a "rational connection" to) the actual decision. In other words, sound process cannot be followed by a decision not rationally linked to, or a rational outcome of, the

. . . ; (c) imposed by special legislative provisions (often found in statutes regulating financial institutions); or (d) imposed by the corporation itself (e.g., in certificate provisions, by-laws, or other standards of the corporation)." *Id.*

²⁰¹As stated by the Delaware Supreme Court: "The need for adequate information is central to the enlightened evaluation . . . that a board must make." *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1287 (Del. 1989).

²⁰²Professor Branson has stated: "In the corporate law duty of care cases, the central inquiry always has been process rather than result." Douglas M. Branson, *Intracorporate Process and the Avoidance of Director Liability*, 24 WAKE FOREST L. REV. 97, 97 (1989).

Virginia's statutory standard of conduct for corporate directors, for example, contains no requirement that a director act "reasonably" or in any other specified substantive fashion. Rather, a director is required only to act "in accordance with his good faith business judgment of the best interests of the corporation." VA. CODE ANN. § 13.1-690 (Michie 1998). This statute has been interpreted as prohibiting judicial inquiry into the *substance* of director decisions and allowing only inquiry into the *manner* in which directors discharged their duties. *WLR Foods, Inc. v. Tyson Foods, Inc.* 65 F.3d 1172, 1184-85 (4th Cir. 1995), *cert. denied*, 517 U.S. 1117 (1996). For an extended discussion of Virginia's statute, see Lyman Johnson, *Misunderstanding Director Duties: The Strange Case of Virginia*, 56 WASH. & LEE L. REV. (forthcoming 2000).

actual decision-making process. This mild requirement avoids the unlikely, but theoretically possible, complete disjunction between process and outcome. Judicial review here is *not* a judicial assessment of the decision's substantive merits as such, but rather it remains a process-oriented inquiry into whether the decision actually arrived at could plausibly flow from the process actually undertaken. Although subtle, the difference in judicial function argued for in this Article is critical to maintaining a proper division of managerial and judicial responsibility.

If the plaintiff succeeds in proving that the directors failed to act with requisite care — whether in a business judgment or other care case — the defendants are liable for all damages proximately caused by that breach of duty, except rescissory damages. Damages may be nonexistent or limited if, among other possibilities, the substantive quality of the challenged decision is sufficiently good, as it turns out, that little or no harm was caused by director carelessness.

In addition to the benefits of a general duty of due care cited earlier,²⁰³ there are several advantages to this particular proposal. First, it supplies to Delaware jurisprudence what has long been missing — an express, generally applicable duty of entire due care, applying to, but not subsumed as a component of the business judgment rule, and a duty not expressed as merely requiring director informedness. Second, the proposed formulation of the entire due care duty is succinct but complete. It closely tracks the 1963 *Allis-Chalmers* dictum that first recognized such a duty.²⁰⁴ It is somewhat similar to prevailing formulations summarized by Samuel Arshnt twenty years ago,²⁰⁵ and it is more compact than the standards appearing in either The Model Business Corporation Act²⁰⁶ or The American Law

²⁰³See *supra* Parts IV.C.2. to 3.

²⁰⁴The Delaware Supreme Court stated that "directors . . . are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances." *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963). See Cohn, *supra* note 98, at 602-05 (expressing director duty of care as a prudent and reasonable person standard). The proposal in this Article expresses the duty in gender-neutral language and adds a "reasonably be expected to exercise" and a "like position" qualifier. The last two phrases — "like position" and "similar circumstances" — appear in both The Model Business Corporation Act standard of conduct for directors and the director duty of care found in The American Law Institute's Principles of Corporate Governance. See *infra* notes 206-07. They capture the idea that the care required of a director is that appropriate for the particular corporation in the actual circumstances at hand. The language "reasonably be expected to exercise" is found in The American Law Institute formulation only. See *infra* note 207. This phrase is only designed to provide leeway in the *manner* by which directors discharge duties (whether business judgment or otherwise) and is not a *substantive* standard by which actual considered director decisions are to be judicially assessed.

²⁰⁵See Arshnt, *supra* note 97, at 97-100, 120-21; Cohn, *supra* note 98, at 602-05.

²⁰⁶The Model Business Corporation Act codifies the standard of conduct for directors, in part, as follows:

§ 8.30 General Standards for Directors

Institute's Principles of Corporate Governance,²⁰⁷ deleting the latter two codifications' unhelpful element that a director "reasonably believe" that he or she is acting in a manner best for the corporation.²⁰⁸ The proposal does not separately express an obligation of director informedness.

Third, the proposal rejects the *Cede II* and *Cede III* application of entire fairness review to care breaches as unsound on both doctrinal and policy grounds. At the same time, it more directly achieves the Delaware Supreme Court's goal of bolstering the role of care in Delaware corporate law. This standard, moreover, is pervasive, meaning it applies within the business judgment context and at all other times.²⁰⁹ Furthermore, the

- (a) 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

MODEL BUS. CORP. ACT § 8.30 (1997). Thirty-six states have adopted similar statutes. Section 8.30 of The Model Business Corporation Act was amended in 1998. *See* Committee on Corporate Laws, *Changes in the Model Business Corporation Act — Amendments Pertaining to Electronic Filings/Standards of Conduct and Standards of Liability for Directors*, 53 BUS. LAW. 157 (1997).

²⁰⁷The American Law Institute's Principles of Corporate Governance codify the duty of care, in part, as follows:

§ 4.01 Duty of Care of Directors and Officers; the Business Judgment Rule

(a) A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. This Subsection (a) is subject to the provisions of Subsection (c) (the business judgment rule) where applicable.

(1) The duty in Subsection (a) includes the obligation to make, or cause to be made, an inquiry when, but only when, the circumstances would alert a reasonable director or officer to the need therefor. The extent of such inquiry shall be such as the director or officer reasonably believes to be necessary.

(2) In performing any of his or her functions (including over-sight functions), a director or officer is entitled to rely on materials and persons in accordance with §§ 4.02 and 4.03 (reliance on directors, officers, employees, experts, other persons, and committees of the board)

AMERICAN LAW INSTITUTE PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 (1997).

²⁰⁸New York's corporation statute also deletes that element from its codification of a director's duty. N.Y. BUS. CORP. LAW § 717 (McKinney 1997). *See supra* note 202 (describing Virginia's statute).

²⁰⁹In an important 1998 opinion on the directors' disclosure obligation, the Delaware Supreme Court described the *constant*, rather than intermittent, nature of director duties: "The shareholder constituents of a Delaware corporation are entitled to rely upon their elected directors to discharge their fiduciary duties at all times." *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998); *see Quickturn Design Sys., Inc. v. Shapiro*, 721 A.2d 1281, 1292 (Del. 1998) (describing director fiduciary duty as an "unremitting obligation").

proposal's standard is not one of gross negligence, but that of the care reasonably to be expected of an ordinarily prudent person. The standard of conduct therefore is upgraded straightforwardly, unlike *Cede's* unprecedented fairness standard of review where exacting judicial scrutiny of the substantive soundness of business decisions is coupled with a burden of proof shift to defendants. Nor is the proposed concept of entire due care limited to the frail requirement of director informedness, or, more accurately, to the condition that directors not behave with gross negligence in becoming informed. Instead, the proposal demands that directors act with reasonable prudence throughout the discharge of all their duties (rather than simply avoid gross negligence). Through both adjudication and the advance advice of legal counsel, this should pervasively raise the standard of director performance outside of, as well as within, the business judgment context.

Fourth, although some confusion exists on the point, the proposal's standard of reasonable conduct is rightly lower than a fairness inquiry,²¹⁰ but suitably higher — on process grounds — than the prevailing business judgment formulation of informedness plus judicial scrutiny of a decision's substantive quality under a rationality standard. This achieves the analytical coherence sought by *Cede*, but on a sounder basis for care claims. Not only is the quality of a business decision not examined under a demanding fairness standard, but the quality of the decision in a care claim is not judicially examined at all. The inquiry is not into the *decision* itself, but is, instead, entirely an examination of the manner of the *decision-maker's* conduct in making the decision. That manner of conduct, however, must be more than the avoidance of gross negligence; it must conform throughout to the care of ordinary, reasonable prudence. This proposal takes judicial review of board *process* quite seriously, not shoring it up *ex post* by engaging in judicial scrutiny of *substance*. The proposal therefore also avoids another problem with the *Cede* application of entire fairness review to care claims, a problem common to high-sanction regimes: a greater (possibly unspoken) inclination not to find the existence of the event

²¹⁰Professor Melvin Aron Eisenberg states that, under Delaware law, if the business judgment rule does not apply, "the standard of review is based on entire fairness or reasonability." Melvin Aron Eisenberg, *The Director's Duty of Care in Negotiated Dispositions*, 51 U. MIAMI L. REV. 579, 583 (1997). If Professor Eisenberg is distinguishing fairness and reasonableness from business judgment review, he is correct; if he is equating the two notions of "fairness" and "reasonableness," he misdescribes them under Delaware law. See *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 42 & n.9 (Del. 1993); Craig W. Palm & Mark A. Kearney, *A Primer on the Basics of Directors' Duties in Delaware: The Rules of the Game (Part II)*, 42 VILL. L. REV. 1043, 1052 (1997) (distinguishing entire fairness and reasonableness review). See also *Nixon v. Blackwell*, 626 A.2d 1366, 1378-79 (Del. 1993) (stating, carelessly, that the court searchingly examines the "reasonableness" of a decision under the "entire fairness" review standard).

triggering the sanction because of concern over the severe consequences thereby set in motion.

Finally, in several special situations arising in recent years, use of a "reasonableness" standard of review, intermediate between the quite deferential business judgment rule standard and the quite exacting entire fairness standard, finds growing support in Delaware law. Recognition by the Delaware Supreme Court of the value of a reasonable prudence standard in special contexts paves the way for introducing a more general reasonable prudence standard into the due care area.

The Delaware Supreme Court recognizes that there are "rare situations" where "a court subjects the directors' conduct to enhanced scrutiny to ensure that it is reasonable."²¹¹ Best known of these situations is director adoption of defensive measures in response to a threat to corporate control.²¹² In *Unocal*, the court held that before the traditional business judgment rule was applied to evaluate director conduct, the directors had an initial two-part burden to demonstrate, first, that directors had *reasonable grounds* for believing that a danger to corporate policy and effectiveness existed and, second, that the defensive measure was *reasonable* in relation to the threat posed.²¹³ In this setting, the Delaware Supreme Court avoids the powerful deference of ordinary business judgment rule review, while not engaging inappropriately in a fairness review reserved for loyalty claims. Rather, the court staked out an intermediate review standard of reasonableness.

A second setting where the Delaware Supreme Court has applied an enhanced "reasonableness" review standard is in the sale or change of control context. There, the court summarized its holdings as requiring a board of directors to fulfill its "obligation of acting *reasonably* to seek the

²¹¹*QVC Network, Inc.*, 637 A.2d at 42.

²¹²*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-56 (Del. 1985).

²¹³*Id.* See *Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1373 & n.13 (Del. 1995). The *Unitrin* court separately stated that if directors fail to carry their burden that the defensive measure adopted was reasonable, then entire fairness review is applied to the defensive measure. *Id.* at 1377 n.18. Unless the supreme court is implying that loyalty is implicated whenever a *Unocal* analysis is triggered — a position inconsistent with *Unocal* itself where the duty to protect the corporate enterprise is described as a "duty of care" — fairness review should not automatically be undertaken upon director failure to carry the initial *Unocal* burden. *Unocal*, 493 A.2d at 955. Rather, unless a particular failure is characterized as a loyalty breach, the effect of director failure to carry the special *Unocal* burden because of care concerns ought to be that the larger burden of proving entire due care thereby shifts to defendants. See, e.g., *A.C. Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 114-15 (Del. Ch. 1986). Conversely, if directors *do* carry their two-part *Unocal* burden, the determination that their conduct was "reasonable" would seem necessarily to carry with it a determination that the plaintiffs could not, at least on care grounds, demonstrate noncompliance with the business judgment rule standard of review. As a result, upon the directors carrying their *Unocal* burden, the case is over as far as the duty of care is concerned.

transaction offering the best value *reasonably* available to the stockholders."²¹⁴ The higher *board* obligation, the court held, also required enhanced *judicial* scrutiny. The features of an enhanced scrutiny test are:

- (a) judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision;
- and (b) a judicial examination of the *reasonableness* of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted *reasonably*.²¹⁵

The Delaware Supreme Court clearly articulated an intermediate "reasonableness" standard of review, which it expressly distinguished from entire fairness review.²¹⁶ Moreover, the court's first requirement under its special two-part enhanced scrutiny test for change of control settings is, essentially, what this article calls "entire due care" and advocates for general application in the business judgment context. The difference in the special sale of control context is that the burden of proving the adequacy of the decision-making process (wrongly reduced by the Delaware Supreme Court in the last quoted sentence to the informedness element) lies with the directors. In the ordinary care case, this article places that burden on the plaintiff.

The court in *QVC*, under the second part of its enhanced scrutiny test, judicially reviews "the reasonableness of the substantive merits of a board's actions."²¹⁷ Although arguably the court should not be reviewing the substance of the board decision itself, even in a sale of control setting,²¹⁸ at least the court applied a "reasonableness" test to this undertaking, not the stricter "entire fairness" test used in *Cede II* and *Cede III*. By a parity of reasoning, at the very least, the *Cede* opinions should have held that, upon proof of a duty of care breach, the substantive "reasonableness" (not "fairness") of the board decision would be examined. This is a standard of review by which "courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance,

²¹⁴*QVC Network, Inc.*, 637 A.2d at 43 (emphasis added).

²¹⁵*Id.* at 45 (emphasis added).

²¹⁶*Id.* at 42 & n.9.

²¹⁷*Id.* at 45.

²¹⁸See *supra* text accompanying notes 191-96, 213. See also B. Ellen Taylor, *New and Unjustified Restrictions on Delaware Directors' Authority*, 21 DEL. J. CORP. L. 837, 883, 891-94 (1996) (stating that in a sale of control context, the court should not substitute its judgment for that of the board's).

within a range of reasonableness."²¹⁹ Under this article's proposal, however, the second inquiry (generally and in the special *QVC* setting) would not be an inquiry at all into the quality of the actual decision, but only a very limited inquiry into whether the decision actually made was "rationally related to" (or, in the special *QVC* setting, a higher standard of "reasonably related to") the sound decision-making process actually undertaken.²²⁰

A third setting in which neither the business judgment nor the entire fairness review standard applies to director conduct involves review of director supervision and oversight of the corporation. As noted by Chancellor Allen, most corporate actions are not the subject of director attention, and thus such actions stem from "unconsidered inaction,"²²¹ rather than deliberate business decisions implicating the business judgment rule. In addressing the obligation of a board to supervise and monitor corporate affairs, Chancellor Allen described a board's "obligation to be *reasonably informed* concerning the corporation."²²² He elaborated that the board's obligation involved "assuring themselves that information and reporting systems exist in the organization that are *reasonably designed* to provide to senior management and to the board itself timely, accurate information . . . to reach informed judgments concerning both the corporation's compliance with law and its business performance."²²³ Although generally director liability predicated upon ignorance of liability creating activities requires a "sustained or systematic failure of the board to exercise oversight," Chancellor Allen described an "utter failure to attempt to assure a reasonable information and reporting system exists"²²⁴ as such a failure. Chancellor Allen characterized this responsibility as involving the "directors duty of care."²²⁵

If directors make a considered decision regarding the corporation's "information and reporting systems," that decision, as with any business decision, should be reviewed under the business judgment rule facet of due care. If no such decision is made, however, the business judgment rule does

²¹⁹*QVC Network, Inc.*, 637 A.2d at 45.

²²⁰See *supra* text accompanying notes 202-03.

²²¹*In re Caremark Int'l Inc., Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996).

²²²*Id.* at 970 (emphasis added).

²²³*Id.* (emphasis added). Chief Justice Veasey has also stated that "[i]f a court were to require any system, it would probably be a reasonable system — one within a range of reasonableness, considering the custom of the times, common sense, practicability and all the circumstances." E. Norman Veasey, *The Director and the Dynamic Corporation Law with Special Emphasis on Oversight and Disclosure*, 5 CORP. GOVERNANCE ADVISOR, No. 4 (Jul./Aug. 1997), at 22, 26.

²²⁴*In re Caremark*, 698 A.2d at 971.

²²⁵*Id.* Interestingly, Chancellor Allen also described this duty of care as "satisfied *in part* by assurance of adequate information flows to the board." *Id.* (emphasis added).

not apply and the conduct of directors must be assessed under the general duty of due care. This duty would require a court to determine whether directors failed to act with the care an ordinarily prudent person would reasonably be expected to exercise in a like position under similar circumstances. This failure would seem to be established upon a showing of noncompliance with *Caremark's* requirement of "reasonably designed" information and reporting systems and that this noncompliance proximately caused loss to the plaintiff.²²⁶ In the general monitoring setting, then, as in certain special settings, Delaware law already recognizes the baseline duty of directors to act in a *reasonable manner*.

Finally, the Delaware corporation statute itself recognizes the concept of director "reasonable care" in section 141(e).²²⁷ That statute provides that directors are "fully protected in relying in good faith upon[,] among other matters, "information, opinions, reports or statements" presented by any person as to matters a director "reasonably believes are within such other person's professional or expert competence and who . . . [was] selected with reasonable care."²²⁸ This statute, addressing the important subject of director reliance on experts, requires, as a predicate for such reliance, that the expert must have been selected by the exercise of "reasonable care." This is yet another instance of Delaware corporate law recognizing a director obligation of "reasonableness," rather than either substantive fairness, on the one hand, or mere avoidance of gross negligence, on the other hand.

VI. CONCLUSION

This article proposes that Delaware expressly generalize the director duty to act with reasonable prudence. That duty is the duty of entire due care. If Chancellor Allen is correct, and most corporate decisions are not the subject of considered director action,²²⁹ the *Caremark* "reasonableness" standard probably already *is* the prevailing standard against which most director behavior in the care area will be measured. If so, the applicability of such a pervasive duty of reasonableness in the monitoring area should be acknowledged. Moreover, that such a standard is not — and cannot sensibly be — *Cede's* entire fairness standard ought also to be acknowledged. Finally, that such a reasonableness standard should also apply in that special category of care cases — where business judgment is exercised — must also

²²⁶*Id.* at 970 n.27. Notwithstanding *Cede II's* reversal of Chancellor Allen's lower court ruling in that case that director duty breaches must be causally linked with plaintiff's damages, Allen rightly adheres to the causation requirement in the cited *Caremark* dictum.

²²⁷DEL. CODE ANN. tit. 8, § 141(e) (1991 & Supp. 1998).

²²⁸*Id.*

²²⁹*See supra* text accompanying note 221.

be recognized. Entire fairness review of the sort applied in *Cede* has no role in judicial review of director care, whether in the business judgment or any other setting. The result is that the "reasonableness" standard currently applied both in the general monitoring area and in what Delaware courts might consider to be special settings actually is, when shorn of judicial review of *substantive* reasonableness, very close to the standard by which director behavior should always be measured in the care area. The Delaware Supreme Court should state this.

