Washington and Lee Law Review

Volume 56 | Issue 4 Article 2

Fall 9-1-1999

Misunderstanding Director Duties: The Strange Case of Virginia

Lyman Johnson

Misunderstanding Director Duties: The Strange Case of Virginia

Lyman Johnson*

Table of Contents

Introduction

What sources of legal authority govern the conduct of corporate directors in Virginia? Many directors and their legal counsel take great comfort from Virginia's unique and generous statutory standard for director behavior.[1] This

---

* Robert O. Bentley Professor of Law, Washington and Lee University. Financial support was provided by the Frances Lewis Law Center, Washington and Lee University. The author expresses his gratitude for the generosity of Mrs. Robert O. Bentley and that of her late husband, Mr. Robert O. Bentley.

1. VA. CODE ANN. § 13.1-690 (Michie 1999).

General standards of conduct for director. –

A. A director shall discharge his duties as a director, including his duties as a member of a committee, in accordance with his good faith business judgment of the best interests of the corporation.

B. Unless he has knowledge or information concerning the matter in question that makes reliance unwarranted, a director is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, if prepared or presented by:

standard – that a director must discharge his duties in accordance with his good faith business judgment of the best interests of the corporation – supplied the legal foundation for WLR Foods' successful resistance to Tyson Foods' hostile takeover bid in the mid-1990s.[2] The protracted, high-profile *WLR Foods* litigation rightly focused national attention on Virginia's director-friendly corporate laws,[3] especially its novel formula for director conduct.[4] It would be both wrong and dangerous, however, to read the holdings in *WLR Foods* or the statutory standard itself as either wholly expounding director duties in Virginia or creating an unassailable legal warrant for any and all director conduct.

This Article seeks to locate Virginia's powerful director conduct statute – *Virginia Code Annotated* § 13.1-690 (Section 690) – in the larger context of director duties. The thesis is simple: Notwithstanding the potency of the statute and the strong reading given to it by the important *WLR Foods* decisions,[5] directors of Virginia corporations continue to be subject to duties of care and loyalty outside the statute. These judicially created duties arise in several illustrative non-*WLR Foods* settings: the renascent director duty to monitor corporate affairs and to exercise responsible supervisory oversight;[6]

> 1. One or more officers or employees of the corporation whom the director believes, in good faith, to be reliable and competent in the matters presented;
>
> 2. Legal counsel, public accountants, or other persons as to matters the director believes, in good faith, are within the person's professional or expert competence; or
>
> 3. A committee of the board of directors of which he is not a member if the director believes, in good faith, that the committee merits confidence.
>
> C. A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.
>
> D. A person alleging a violation of this section has the burden of proving the violation.

Id. An early commentator described Section 690 as "a unique statute nationally." Daniel T. Murphy, *The New Virginia Stock Corporation Act: A Primer*, 20 RICH. L. REV. 67, 106 (1985).

2. *See* WLR Foods, Inc. v. Tyson Foods, Inc., 155 F.R.D. 142, 146 (W.D. Va.) (finding that § 13.1-690 focuses on director's decision-making process rather than substance of director's decision), *aff'd*, 857 F. Supp. 492 (W.D. Va. 1994); WLR Foods, Inc. v. Tyson Foods, Inc., 869 F. Supp. 419 (W.D. Va. 1994), *aff'd*, 65 F.3d 1172 (4th Cir. 1995). Constitutional challenges to Virginia's corporate statutes governing takeovers were rejected in *WLR Foods, Inc. v. Tyson Foods, Inc.*, 861 F. Supp. 1277 (W.D. Va. 1994) (holding that Virginia's corporate statutes are not preempted and do not violate commerce clause), *aff'd*, 65 F.3d 1172 (4th Cir. 1995), *cert. denied*, 516 U.S. 1117 (1996). This author served as a consultant to legal counsel for WLR Foods.

3. *See, e.g.*, Jerry E. Whitson, *Law Keeps Fox from Hen House*, NAT'L L.J., Dec. 11, 1995, at B9 (examining *WLR Foods* decision).

4. *Id.*

5. *See supra* note 2 (citing *WLR Foods* decisions).

6. *See infra* text accompanying notes 43-59.

the emergent director duty of disclosure, a duty likely to gain increased stature in our information-centered investment culture;[7] the so-called director "*Revlon*" duty to obtain the best economic value for shareholders in a corporate break-up or sale-of-control setting;[8] and the venerable director duty of loyalty,[9] applying in a variety of settings to regulate, for example, self-dealing transactions, unfair competition, and usurpation of corporate opportunities.

By sketching director responsibilities in several common non-*WLR Foods* contexts, this Article argues that Section 690 is not the sole source of authority over director conduct. Rather, longstanding common law and equity principles remain vital supplements to this statutory standard.[10] The upshot of this thesis is two-fold. First, at a practical level, an appreciation of the continuing place of common law and equitable precepts in corporate law will better enable legal counsel to guide client boards in discharging *all* their legal duties. Moreover, judges who encounter challenges to director conduct will appreciate that they continue to possess the richer, adaptive tenets of common law and equity that are so vital in the review of fiduciary performance.

Second, at a deeper conceptual and policy level, the Article argues that Virginia's celebrated director conduct statute contains a fundamental defect in its design. The critical flaw stems from the statute's apparent aim to be a generally applicable director care statute while it confusingly uses key terminology – "business judgment" – drawn from a judicial review standard that is designed to operate rather narrowly. Properly understood, director care always has been a pervasive duty to act at all times in a reasonable and prudent *man-*

7. *See infra* Part III.B (discussing director duty of disclosure).

8. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 184 (Del. 1986) (stating that once sale of company becomes inevitable, board of directors has duty to maximize price for stockholders' equity). The *Revlon* analysis has been elaborated on and refined by the Delaware Supreme Court over the years. *See, e.g.*, Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 43 (Del. 1994) (applying "enhanced scrutiny" to determine whether directors of corporation fulfilled their fiduciary obligation by seeking best value reasonably available to stockholders); *infra* Part III.C (discussing *Revlon* duty).

9. *See infra* Part III.A (discussing director duty of loyalty).

10. Recent judicial pronouncements on the origin and continuing vitality of equity in the judicial review of corporate director conduct can be found in *McMahon v. Newcastle Assocs.*, 532 A.2d 601, 604 (Del. Ch. 1987) (explaining that fiduciary duty of corporate officers and directors finds its source in equity) and in *Malone v. Brincat*, 722 A.2d 5, 9-10 (Del. 1998) (detailing meaning of fiduciary duty under Delaware law). Equitable principles, of course, operate notwithstanding the existence of legal standards, whether those legal standards are set forth in statutes or other sources. *See* MARGARET HALLIWELL, EQUITY AND GOOD CONSCIENCE IN A CONTEMPORARY CONTEXT 6 (1997) ("Fundamental misconceptions of equity abound because of a persistent refusal to acknowledge that equity is, by its very nature, subversive of the law."). In Virginia, the role of equity in devising director duties is well-established. *See* Rowland v. Kable, 6 S.E.2d 633, 642 (Va. 1940) ("We must rely upon general principles of equity.").

ner, that is, to act carefully.[11] For various policy reasons, courts will not (and should not) review the *substance* of director decisions, but courts may review the *manner* in which a board of directors acted or did not act. The judicial policy of non-review of the substance of business decisions is encapsulated in the so-called "business judgment rule."[12] The business judgment rule is vitally important, but it does not articulate affirmatively or comprehensively the full contours of the director duty of care. Therefore, for Virginia to purportedly express a pervasive and all-encompassing director duty, that is, care, in the cramped language of "business judgment" is to formulate confusingly what purports to be a general *director* duty through the use of terminology describing *judicial* policy toward only one facet of director conduct.

The by-product of Section 690's faulty architecture is a disquieting two-fold tendency, first, to regard Section 690 as embodying exhaustively a Virginia director's duty of *care* and, second, to regard Section 690 as codifying *all* director duties, including the quite distinct duty of *loyalty*.[13] Properly understood, Section 690 is an important *partial* expression of a director's discrete duty of care, and it is no expression at all of a director's duty of loyalty or any other duty, such as a director duty of disclosure. A June 1999 decision by the Virginia Supreme Court – *Willard ex rel. Moneta Building Supply, Inc. v. Moneta Building Supply, Inc.*[14] – embodies the profound misunderstanding of Section 690's role in Virginia's law of director duties that this Article decries.

After Parts I and II of this Article develop the argument that Section 690 only partially encompasses the director duty of care, Part III examines the *Willard* opinion and contends that three other crucial director duties – loyalty, disclosure, *Revlon* – likewise are not grounded in that section. Instead, those duties originate in and take ongoing shape from common law and equity. The

---

11. Recently, the Delaware Supreme Court expressed the constant and pervasive nature of director duty: "[F]iduciary duty does not operate intermittently but is the constant compass by which all director actions for the corporation and interactions with its shareholders must be guided." *Malone*, 722 A.2d at 9. For authoritative recognition that the director duty of care focuses only on the *manner* in which a director performs his or her responsibilities and does not involve examining the substantive wisdom of director decisions, see the Official Comment to section 8.30 cmt. 2 of the Model Business Corporation Act. MODEL BUS. CORP. ACT ANN. § 8.30 cmt. 2, at 8-159 (3d ed. Supp. 1997) (describing director conduct statute as "focusing on the manner in which the director performs his duties, not the correctness of his decisions").

12. For an explication of the relationship between the director duty of care and the business judgment rule, see Lyman Johnson, *Rethinking Judicial Review of Director Care*, 24 DEL. J. CORP. L. (forthcoming 1999) [hereinafter Johnson, *Rethinking Judicial Review*]; Lyman Johnson, *The Modest Business Judgment Rule*, 55 BUS. LAW. (forthcoming 2000) [hereinafter Johnson, *Business Judgment*].

13. *See infra* Part III.A (discussing director duty of loyalty).

14. 515 S.E.2d 277 (Va. 1999), *reh'g denied*, July 30, 1999.

overall thrust of the argument is the need for clear thinking about the continuing multiple legal demands on directors of Virginia corporations if Virginia corporate law is to occupy the place of prominence many seek for it. This broader-gauged view of director duty is essential to legitimate the power that corporate directors wield and to assure the well-being of investors and others that depend on a proper discharge of those duties.

I. The Scope of Virginia's Statutory Standard of Conduct for Directors

Virginia's statutory standard of behavior for directors contains four parts.[15] The first part articulates the applicable standard for director conduct.[16] The second part authorizes directors to rely on specified third parties.[17] The third part protects a director from personal liability if he acts in compliance with the stated standard.[18] The fourth part assigns the burden of proof to the person who alleges director noncompliance with the stated standard.[19]

The heart of the statute is the first part, Section 690(A).[20] It mandates that a director discharge his "duties as a director in accordance with his good

---

15. VA. CODE ANN. § 13.1-690 (Michie 1999).
16. *Id.* § 13.1-690(A).
17. *Id.* § 13.1-690(B).
18. *Id.* § 13.1-690(C).
19. *Id.* § 13.1-690(D).
20. Before analyzing the components of the general standard, this Article will make a few comments about the other three subparts of Section 690 statute. Subsection (B) authorizes directors to rely on designated persons. *See id.* § 13.1-690(B); *supra* note 1. In *WLR Foods*, the district court relied heavily on subsection (B) in construing the general standard set forth in subsection (A). WLR Foods, Inc. v. Tyson Foods, Inc., 857 F. Supp. 492, 494 (W.D. Va. 1994). Seeking to give meaning to the phrase "good faith business judgment" found in the general conduct standard, the district court held that proper director reliance under subsection (B) was one way – "something of a safe harbor" – for a director to fulfill the general standard. *Id.* Two points about this holding are important. First, although the *WLR Foods* court offered *one* way for directors to act in good faith, the court did not provide an *exclusive* interpretation of that key phrase. *Id.* Second, by its own terms, subsection (B) does not allow director reliance when the director has "knowledge or information" that makes "reliance unwarranted." VA. CODE ANN. § 13.1-690(B). The Virginia Supreme Court has interpreted that phrase in a way that makes it a meaningful constraint on "blind" director reliance. *See* Commonwealth Transp. Comm'r v. Mateyiko, 481 S.E.2d 468, 471-72 (Va. 1997) (finding directors personally liable when they voted to distribute corporate assets upon dissolution because they had knowledge that condemnation award would probably be less than amount to be distributed under "drawdown" order, thereby making reliance unwarranted); *see also infra* note 154.

Subsection (C) expressly absolves a director of personal liability if he complies with the general standard of conduct. § 13.1-690(C); *see supra* note 1. Necessarily, if directors comply with the stated standard of conduct, their actions themselves also should be free of attack. The Fourth Circuit so held in *WLR Foods*. WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172, 1183 (4th Cir. 1995).

Subsection (D) assigns the burden of proof in the conventional manner in litigation. § 13.1-690(D); *see supra* note 1. Although the statute uses the more general burden of proof faith business judgment of the best interests of the corporation."[21] The "duties" referred to in Section 690(A) include those identified in Section 673, captioned "Requirement for and duties of board of directors."[22] Section 673(B), in essence, describes the board of directors as the decision-making body possessing plenary authority over all corporate powers and also as the body charged with directing the management of the business and affairs of the corporation.[23] The "duties" referred to in Section 690, then, encompass *all* facets of directing the management of a corporation's business and affairs. Consequently, the standard of conduct set forth in Section 690 would seem to apply pervasively to all facets of director behavior.

Notwithstanding the apparent intended breadth of Section 690(A) – that a director shall discharge *all* Section 673 duties in conformance to the statutory standard – the section goes on to mandate that those duties be discharged in a way that radically limits the breadth of its application. The statute requires a director to act in accordance with "his good faith business judgment. . . ."[24] An obvious and critical interpretive question under this statute is its application to a director who, for good reasons or bad, does not exercise a "business judgment." The *WLR Foods* decisions did not address this basic issue because the WLR Foods board of directors undisputably exercised business judgment. The board exercised such judgment both in rejecting as inadequate an unsolicited takeover bid from Tysons Foods and in taking certain defensive measures to support that underlying business decision.[25]

---

language rather than the more specific burden of production and burden of persuasion terminology, both of the latter burdens should be encompassed within the statute's language and assigned to the complainant. The key function of subsection (D) in a change of control or hostile takeover defensive measure setting is to avoid in Virginia the Delaware rule assigning to directors a two-part threshold burden of proof that they had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the director response was "reasonable in relation to the threat posed." Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985). Fortuitously, it also avoids application in Virginia of the disturbing Delaware holding that, in certain duty of care situations, directors bear the burden of proving the "fairness" of their conduct. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1162-63 (Del. 1995) (applying two prong "entire fairness" standard when presumption of business judgment rule had been rebutted). For a recent critique of Delaware law on this last point, see generally Johnson, *Rethinking Judicial Review*, *supra* note 12. In Virginia, as to conduct within the scope of Section 690, directors have no such *Unocal* or *Cinerama* burden of proof. As to conduct *outside* the scope of the statute, however, such as a director self-dealing transaction, the burden may shift to directors in accordance with other applicable statutory, common law, or equitable principles. *See infra* note 133 and accompanying text.

21. VA. CODE ANN. § 13.1-690(A) (Michie 1999).

22. *Id.* § 13.1-673.

23. *Id.*

24. *Id.* § 13.1-690(A).

25. *See supra* note 2 (citing *WLR Foods* cases).

Consequently, the *WLR Foods* opinions are important both for what they did and for what they did not do.

The *WLR Foods* holdings provide guidance that is key to conducting pretrial discovery in the context of a board decision *not* to sell corporate control. More generally, the holdings construe Section 690 as essentially a process-oriented statute designed to accord substantial deference to board judgments.[26] In this vein, the district court reasoned that Section 690's rejection of a "reasonableness" standard in favor of a simple "good faith" standard "signals legislative rejection of a substantive evaluation of director conduct, that is, evaluation in terms of rationality of the conduct."[27] According to the court, the key statutory phrase "good faith" means a director's subjective good faith, measured not by the rationality of the decision ultimately made but by the "procedural indicia of whether the directors resorted in good faith to an informed decision-making process."[28] A key component of good board practice in the business judgment context is found in the statute's authorization of director reliance on experts,[29] a feature heavily relied on in the court's process-oriented construction of Section 690.[30]

Important as the *WLR Foods* litigation was in the hostile takeover setting, specifically in the context of a "no sale" decision by a target company board of directors, it simply did not address other key interpretive issues that Section 690 raises. One portion of the statute's terminology not addressed in *WLR Foods* is the pivotal phrase "business judgment." Linguistically, the statute specifies that a director "shall" discharge all duties in accordance with his good faith "business judgment."[31] One possible interpretation, then, is that a director who does not exercise a judgment at all, whether for reasons he or anybody else deems to be good or bad, has violated automatically the mandate that he act in accordance with his good faith business judgment. One simply cannot have acted in accordance with a particular standard for judgment – "good faith business" judgment – if no judgment whatsoever is exercised.

This interpretation, however, means that any and all directors not making business judgments as to matters concerning the business and affairs of a

---

26. WLR Foods, Inc. v. Tyson Foods, Inc., 857 F. Supp. 492, 493 (W.D. Va. 1994) (construing § 13.1-690 to apply only to process by which business decisions are made).

27. *Id.* at 494.

28. *Id.*

29. VA. CODE ANN. § 13.1-690(B) (Michie 1999) (listing classes of persons on whose opinions director may rely).

30. The district court in *WLR Foods* sought to give content to the phrase "good faith business judgment of the best interests of the corporation" – the standard set forth in Section 690(A) – by stating that "for the most part, the statute provides this indicia in Subsection B which creates something of a safe harbor for directors who rely on competent advice. § 13.1-690(B)." *WLR Foods*, 857 F. Supp. at 494.

31. VA. CODE ANN. § 13.1-690(A).

corporation necessarily violate the statutory standard of conduct. This strict liability reading would encompass not only nonfeasant directors who did not make a business judgment because they were "asleep at the switch," it would also include vigilant directors who did not make a business judgment about a particular matter because they believed, by some standard, that the matter did not even warrant the exercise of judgment. An example of an inept director might be a director who in 1999 made no judgment concerning a corporation's preparedness for Y2K issues. An example of a possibly vigilant director might be a generally very conscientious director who in 1990 made no judgment concerning a corporation's preparedness for Y2K because he did not then believe – wrongly, to be sure, as it turns out – that the particular technological issue even existed much less required action. Both the inept and the diligent directors could be said to violate the statutory standard simply by failing to exercise judgment at all. Such violations occur without regard to whether, by reference to some other nonstatutory standard, the particular non-exercise of judgment in the one case is thought to be very foolish although, in the other case, the same behavior is quite understandable.

This interpretive difficulty of overinclusiveness can be sidestepped by construing the word "judgment" not as a mandate that judgment must be exercised to avoid violating the statute per se, but as a necessary predicate for triggering application of the statute. In other words, the statute is best construed as covering only that subset of director conduct involving the actual exercise of business judgment. This would include, to be sure, a deliberate judgment *not* to take action as well as a judgment to take a particular action. The former is covered because Section 690(C) provides that a director is not liable for "failure to take any action" if, importantly, "he performed his duties in compliance with this section [Section 690(A)]."[32] Section 690(A), as just seen, however, requires the exercise of "judgment." Consequently, a director who fails to take action because he did not exercise judgment does not fall under Section 690(C) because, contrary to Section 690(C)'s requirement that such a director perform "in compliance with this section," he did not exercise the "judgment" required by Section 690(A). In this reading of Section 690's scope, a director's nonfeasance (or passive negligence) falls outside the statute's coverage when such stance does not reflect the deliberate exercise of judgment to adopt such a stance.

This interpretation finds support in commentary to the analogous section – section 8.30 – of the Model Business Corporation Act (Model Act).[33] The Model Act states that the statute applies to any "conscious consideration of matters"[34] and does not apply only "when the director has failed to

32. *Id.* § 13.1-690(C).

33. MODEL BUS. CORP. ACT ANN. § 8.30 cmt. 2, at 8-159 (3d ed. 1996).

34. *Id.* at 8-164.

consider taking action which under the circumstances he is obliged to consider taking."[35] The Virginia Bar Association commentary to Section 690 is confusing on this point because it both refers to the above-quoted very clear Model Act commentary *and* states that Section 690 does apply to "conduct generally, including passive non-conduct."[36] The latter comment in the Virginia commentary is wrong in that it cites as authority Section 690(C),[37] which, as seen above, protects a failure to take action only if, in failing to act, the standard of Section 690(A) is met, a standard predicated on the actual exercise of "judgment."[38]

The Model Act, interestingly, does not narrowly mandate that a director exercise "business judgment." Rather, prior to being amended in 1998, it articulated the director care standard in the far-reaching terms of "prudent" and "reasonable" behavior and, after changes in 1998, relies broadly on "reasonableness" alone.[39] Thus, a nonfeasant director who does not act in a way that

35. *Id.*

36. Joint Bar Committee, *Commentary on Virginia Code Commission's Proposed Revision of the Virginia Stock Corporation Act*, Report of the Virginia Code Comm'n on the Revision of Chapters 1 and 2 of Title 13.1 of the Code of Virginia to the Governor and the General Assembly of Virginia, H. DOC. NO. 13, app. 4 at 250 (1985) [hereinafter Report of the Virginia Code Commission].

37. The Bar Association Commentary, found in Report of the Virginia Code Commission states: "Section 13.1-690 applies to conduct generally, including passive non-conduct. Subsection C reflects this by providing that a director does not become liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section." *Id.* As indicated, however, the key to coming within coverage of subsection (C) is that a director comply with subsection (A) of Section 690, which requires the exercise of "judgment." VA. CODE ANN. § 13.1-690(A), (C) (Michie 1999). Therefore, "passive non-conduct" does not comply with Section 690(C) because it does not comply with Section 690(A). *Id.*

38. § 13.1-690(A), (C).

39. Section 8.30 of the Model Business Corporation Act was amended on June 13, 1998. Both the pre-June 13, 1998 version and the June 13, 1998 version are set forth below:

§ 8.30. *General Standards for Directors* [as in effect prior to June 13, 1998].

(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.

(b) In discharging his duties a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

(1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;

(2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence; or

(3) a committee of the board of directors of which he is not a member if the director reasonably believes the committee merits confidence.

a "prudent" or "reasonable" director would act nonetheless can be said both to be *within* the coverage of the Model Act *and* to violate it. Therefore, under the Model Act and the statutes of the approximately three dozen states that more or less follow its design,[40] a director who does *not* exercise judgment on a matter in which a "reasonable" director *would* exercise judgment violates the codified standard. Because Virginia's standard of conduct, by way of contrast, is couched uniquely in terms of "judgment," a director who fails to decide *deliberately* not to take an action cannot be *within* coverage of the statute

---

(c) A director is not acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.

MODEL BUS. CORP. ACT ANN. § 8.30 (3d ed. 1996). The following provision was proposed in 1997 and accepted in 1998. *See* Committee on Corporate Laws, *Changes in the Model Business Corporation Act – Amendments Pertaining to Electronic Filing/Standards of Conduct and Standards of Liability for Directors*, 53 Bus. Law. 157, 160-61 (1997) [hereinafter Committee on Corporate Laws, *Amendment*] (proposing amendment to § 8.30); Committee on Corporate Laws, *Changes in the Model Business Corporation Act Pertaining to the Standards of Liability for Directors – Final Adoption*, 53 Bus. Law. 813 (1998) (adopting amendments to § 8.30).

§ 8.30. *General Conduct for Directors* [as adopted on June 13, 1998].

(a) Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation.

(b) The members of the board of directors or a committee of the board, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.

(c) In discharging board or committee duties a director, who does not have knowledge that makes reliance unwarranted, is entitled to rely on the performance by any of the persons specified in subsection (e)(1) or subsection (e)(3) to whom the board may have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law.

(d) In discharging board or committee duties a director, who does not have knowledge that makes reliance unwarranted, is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (e).

(e) A director is entitled to rely, in accordance with subsection (c) or (d), on:

(1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;

(2) legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the director reasonably believes are matters (i) within the particular person's professional or expert competence or (ii) as to which the particular person merits confidence; or

(3) a committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

Committee on Corporate Laws, *Amendment*, *supra*, at 160-61.

40. *Id.* § 8.30, at 8-166 to 8-167.

because, in failing to exercise "judgment,"[41] necessarily he failed to comply with the predicate of the statute.

This technical interpretive issue is of immense importance for two reasons. First, if Section 690 applies *only* if a director exercises judgment, an additional non-statutory standard of care must exist to evaluate the propriety of director behavior falling outside the statute's coverage, unless nonfeasance or abdication of responsibilities by Virginia directors is not actionable. This additional source of authority is the common-law duty of care.[42] This duty of care is longstanding in Virginia and, after adoption of Section 690, governs all director responsibilities not involving the exercise of considered judgment. Indeed, most decisions that a corporation's numerous agents make are not the subject of considered director attention[43] but are made deeper within the organization. Yet a corporation's financial and legal welfare depends vitally on proper director oversight of this organizational complexity. This means that the common law duty of care still provides the applicable standard of conduct for directors who do not exercise judgment with respect to this sizable domain of responsibility. Consequently, Section 690(A) is a partial, not exhaustive, expression of the manner in which Virginia directors are to discharge their far-reaching Section 673 duties.

Second, the scope of director responsibilities to which Section 690 may not apply because judgment is not exercised is growing in significance. Although negligence in failing to monitor carefully the business and affairs of a corporation long has been a theoretical concern,[44] this issue received renewed attention as a result of an important 1996 Delaware Chancery Court decision, *In re Caremark International, Inc.*[45] This decision approved the settlement of a shareholder derivative action against directors for negligence in carrying out their oversight responsibilities concerning federal and state

---

41. The necessity of judgment being exercised before the "business judgment" rule, or in Virginia's case a "business judgment" statute, can operate was made plain by the Delaware Supreme Court: "The business judgment rule operates only in the context of director action. Technically speaking, it has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act." Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984) (footnote omitted); *see* Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971) (stating that application of business judgment rule first requires showing that informed director actually made business judgment).

42. *See infra* text accompanying notes 64-75.

43. This point was made by then-Chancellor William Allen in *In re Caremark Int'l, Inc.*, 698 A.2d 959, 968 (Del. Ch. 1996).

44. *See, e.g.*, Thomas Lee Hazen, *Observation: Corporate Director's Accountability: The Race to the Bottom – The Second Lap*, 66 N.C. L. REV. 171 (1987) (examining state statutes protective of director's personal liability).

45. 698 A.2d 959 (Del. Ch. 1996).

health law violations committed by subordinates.[46] Chancellor Allen, discussing a director's duty of care under Delaware law, stated that director "liability to the corporation for a loss may be said to arise from an *unconsidered failure of the board to act* in circumstances in which due attention, would, arguably, have prevented the loss."[47] Moreover, abandonment of oversight responsibilities may be not only a breach of the director duty of care but also a breach of the stricter duty of loyalty.[48]

Numerous recent high-profile lapses of director oversight[49] and the reasoning of *Caremark* have prompted a growing body of commentary spotlighting the increased risk of personal liability that corporate directors face for failing to discharge their duty to direct, or to oversee, the business and affairs of a corporation.[50] Notable among director oversight responsibilities is the duty to monitor a corporation's compliance with various regulatory regimes governing its activities. These regulatory regimes include securities laws that

46. *See Caremark*, 698 A.2d at 972 (approving settlement and stating that settlement was adequate, reasonable and beneficial outcome for all parties).

47. *See id.* at 967 (emphasis added) (citation omitted).

48. The Delaware Supreme Court once described the conduct of disinterested directors who had abandoned their oversight responsibilities as a breach of their duties of care and loyalty. *See* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1281-84 & n.32 (Del. 1988) (explaining that although board of directors may rely on expert opinion, it may not avoid direct and active role in oversight of significant matters). Even without director self-interest, such abdication so fundamentally violates director duty to the intended recipients of director attention – i.e., the corporate enterprise and its shareholders – that it might constitute director disloyalty. *See infra* Part III.A.

49. Such illustrious corporations as General Motors, Archer Daniels Midland, W.R. Grace, IBM, AT&T, Morrison Knudsen, and Kidder Peabody, among many others, have experienced various crises as a result of inattentive boards of directors. For a description of certain of these lapses, see Sanjai Bhagat et al., *Director Ownership, Corporate Performance, and Management Turnover*, 54 BUS. LAW. 885, 889-90 & n.15 (1999); and see also *In re* Caremark, 698 A.2d 959, 968-69 (Del. Ch. 1996) (noting management failure to monitor at Kidder Peabody and others).

50. *See, e.g.*, NACD BEST PRACTICES COUNCIL, NATIONAL ASS'N OF CORPORATE DIRS., COPING WITH FRAUD AND OTHER ILLEGAL ACTIVITY (1998) (suggesting steps directors can take to avoid liability); John Gibeault, *Getting Your House in Order*, A.B.A. J., June 1999, at 64 (discussing implications of *Caremark*); Mark Kessel, *Building a Better Audit Committee*, BUS. L. TODAY, Jan./Feb. 1999, at 5 (discussing oversight duties of audit committee); Frances A. McMorris, *Employers Face Greater Liability in Race Cases*, WALL ST. J., July 1, 1999, at B1 (discussing employer liability for racial harassment in light of recent Supreme Court cases); Richard A. Rosen, *Corporate Governance in the 1990's*, DIRECTOR'S MONTHLY, June 1997, at 5 (noting possible director liability for use of derivative products, violation of environmental laws, insider trading, failure to institute compliance program, and violation of Foreign Corrupt Practices Act); E. Norman Veasey, *Directors and the Dynamics of Delaware Corporation Law*, DIRECTOR'S MONTHLY, Nov. 1997, at 1 (discussing director duties of oversight and disclosure); Christine B. Whelan, *EEOC Issues Liability Guidelines on Workplace Harassment*, WALL ST. J., June 22, 1999, at B25 (noting guidelines' implications for employer liability).

prohibit insider securities trading,[51] environmental laws,[52] product safety regulations,[53] employee relations laws (including the recent worrisome issue of employer vicarious liability for employee-on-employee sexual, racial, and other protected category harassment),[54] health and safety regulations,[55] finan-

51. Several legal regimes regulate insider trading. These include: The Insider Trading Sanctions Act of 1984, 15 U.S.C. §§ 78u-1(a)(1), 78ff(a) (1994) (establishing sanctions for insider trading and civil liability for false or misleading statements in SEC filings); § 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1994); and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1999) (prohibiting fraud in sale or purchase of securities); § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1994) (allowing issuer to recover profits from insider trading); and Securities and Exchange Commission Rule 14e-3 promulgated under §14(e) of the Securities Exchange Act of 1934, 17 C.F.R. § 240.14e-3 (1999) (prohibiting insider trading in context of tender offers). In addition, the so-called "misappropriation theory" under SEC Rule 10b-5 and state common law also govern insider trading. *See generally* United States v. O'Hagan, 521 U.S. 642 (1997) (holding that person who traded securities by using misappropriated information was in violation of SEC rules); Diamond v. Oreamuno, 248 N.E.2d 910 (N.Y. 1969) (holding directors liable in derivative action for profits realized from use of misappropriated information); STEPHEN M. BAINBRIDGE, SECURITIES LAW: INSIDER TRADING (1999) (setting out state and federal statutory and common law prohibitions on insider trading).

52. *See, e.g.*, Toxic Substances Control Act of 1976, 15 U.S.C. §§ 2601-2692 (1994); Oil Pollution Act of 1990, 33 U.S.C. §§ 2701-2761 (1994) (imposing liability for oil spills); Clean Water Act of 1977, Pub. L. No. 95-217 (codified as amended in scattered sections of 33 U.S.C.); National Environmental Policy Act of 1969, 42 U.S.C. §§ 4321-4347 (1994); Clean Air Act, 42 U.S.C. §§ 7401-7671 (1994) (establishing air quality regulations); Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. § 9601 (1994) (establishing sanctions for release of hazardous substances); Pollution Prevention Act of 1990, 42 U.S.C. §§ 13101-13102 (1994); Resource Conservation and Recovery Act of 1976, Pub. L. No. 94-580 (codified as amended in scattered sections of 42 U.S.C.) (regulating treatment, storage, and disposal of hazardous waste); Virginia Environmental Regulations, 9 VA. ADMIN. CODE (1996) (establishing environmental standards).

53. *See, e.g.*, 15 U.S.C. §§ 1191-6004 (1995) (including *inter alia* Consumer Product Safety Act) (regulating flammable fabrics); 42 U.S.C. §§ 283-6601 (1995) (establishing National Institutes of Health); Virginia Consumer Protection Act of 1977, VA. CODE ANN. §§ 59.1-196 to 59.1-207 (Michie 1999) (promoting fair and ethical standards for dealings between consumers and suppliers).

54. *See, e.g.*, Equal Pay Act of 1963, 29 U.S.C. § 206(d) (1994) (prohibiting employers from paying unequal wages based on gender); Age Discrimination in Employment Act of 1967, 29 U.S.C. § 621 (1994) (prohibiting arbitrary age discrimination); Rehabilitation Act of 1973, 29 U.S.C. § 791 (1994) (encouraging employment of individuals with disabilities); Civil Rights Act, 42 U.S.C. § 2000(e) (1964) (setting out Title VII, dealing with discrimination); Americans With Disabilities Act of 1990, 42 U.S.C. § 12101 (1994) (prohibiting discrimination against individuals with disabilities); Equal Opportunity Commission Regulations, 29 C.F.R. §§ 1600 to 1691 (1998) (establishing employee ethical conduct standards).

In 1998, the U.S. Supreme Court held that employers are subject to vicarious liability for unlawful sexual harassment by supervisors. Faragher v. Boca Raton, 524 U.S. 775 (1998); Burlington Indus., Inc. v. Ellerth, 524 U.S. 724 (1998); *see generally* B. Glenn George, *Employer Liability for Sexual Harassment: The Buck Stops Where?*, 34 WAKE FOREST L. REV. 1 (1999). On June 18, 1999, the EEOC promulgated guidelines on the subject of vicarious cial reporting practices and standards,[56] antitrust laws,[57] Federal Sentencing Guidelines,[58] and others.

In short, Virginia directors who do not deliberately exercise judgment concerning the discharge of their oversight responsibilities, and thereby fail to ensure corporate compliance with applicable legal regimes, will not fall within the generous protection of Section 690 and the deferential process-oriented reading given to that statute by *WLR Foods*. This result means that legal counsel to Virginia boards of directors should highlight this issue for their clients and strongly urge client boards to study and implement measures to monitor and report on their corporations' compliance with applicable legal regimes and other governing standards of sound business performance. The latter might include director attention to a range of issues including assurance of computer security and safeguarding of electronic data privacy, as well as, for example, the propriety of and guidelines for overseeing the use of derivative financial products as part of a risk management strategy.[59] In other words, the board should exercise good faith business judgment aimed at establishing a well-functioning internal information and reporting system. By deliberately and regularly attending to, and exercising business judgment on, all those matters touching the direction of a corporation's "business and affairs," the deferential protection of Section 690 will apply. Without the exercise of such judgment, however, the legal consequences of director non-

employer liability for unlawful harassment. EEOC, *Enforcement Guidance: Vicarious Employer Liability for Unlawful Harassment by Supervisors* (June 18, 1999) <http://www.eeoc.gov/docs/harassment.html>. A recent Virginia federal district court case addressing employer liability for sexual harassment, rendered prior to the most recent promulgation of EEOC Guidelines, is *Pritchard v. Earthgrains Baking Cos., Inc.*, No. 7:98 CVO 536, 1999 WL 397910 (W. D. Va. Mar. 5, 1999).

55. *See, e.g.*, Occupational Health and Safety Act of 1970 (OSHA), 29 U.S.C. §§ 651-678 (1994); Occupational Health and Safety Administration Regulations, 29 C.F.R. §§ 1910-1990 (1998); Labor and Employment Safety Regulations, VA. CODE ANN. §§ 40.1-44.1 to 40.1-51.4:4 (Michie 1999).

56. *See, e.g.*, AUDITING STANDARDS BD., AMERICAN INST. OF CERTIFIED PUBLIC ACCOUNTANTS, CONSIDERATION OF FRAUD IN A FINANCIAL STATEMENT AUDIT: STATEMENT ON AUDITING STANDARDS 82 (Feb. 1997).

57. *See, e.g.*, 15 U.S.C. §§ 1-36 (1994) (including *inter alia* Sherman Act); Virginia Antitrust Act, VA. CODE ANN. § 59.1-9.1 to 59.1-9.17.

58. *See* Sentencing Reform Act of 1984, 18 U.S.C. §§ 3551-3626 (1994); UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL § 8 (Nov. 1994); *see also* F. Joseph Warin & Jason C. Schwartz, *Corporate Compliance Programs as a Component of Plea Agreements and Civil and Administrative Settlements*, 24 J. CORP. L. 71 (1998).

59. *See, e.g.*, Brane v. Roth, 590 N.E.2d 587 (Ind. Ct. App. 1992) (holding directors liable for failure to supervise management hedging). For a full treatment of the director liability issues associated with a corporation's use of derivative products – on which there is a dearth of legal authority – see ROBERT M. MCLAUGHLIN, OVER-THE-COUNTER DERIVATIVE PRODUCTS: A GUIDE TO BUSINESS AND LEGAL RISK MANAGEMENT AND DOCUMENTATION chs. 16-17 (1999).

action in the monitoring area will be measured by director compliance with Virginia's judge-made duty of care. What is the scope of that duty?

II. Virginia's Non-Statutory Standard of Care for Directors

In Virginia, as seen above, two sources of authority govern a director's duty of care, Section 690 when director business judgment is exercised and common law (or equity) when business judgment is not exercised. Certain judicial statements that assert the exclusivity of Section 690, therefore, are faulty. For example, in *FDIC v. Cohen*,[60] the district court for the Southern District of New York completely misstated the relationship between Section 690 and the common law duty of care when it said that "the fiduciary duty of care does not survive §13.1-690 . . . ."[61] The court's overly broad statement treats the duty of care as subsumed entirely within Section 690 although the former continues to govern directors outside the limited business judgment context of Section 690. Also, in the recent Virginia Supreme Court decision of *Willard ex rel. Moneta Building Supply, Inc. v. Moneta Building Supply, Inc.*, the court stated wrongly that Section 690(A) "does not abrogate the common law duties of a director. It does, however, set the standard by which a director is to discharge those duties."[62] The latter statement is accurate only as to conduct *within* the coverage of Section 690, that is, conduct involving the exercise of deliberate judgment. The statement is inaccurate, however, as to director conduct falling *outside* the scope of Section 690. As to conduct outside the scope of Section 690, the common law duty of care still sets "the standard by which a director is to discharge those duties."[63]

In Virginia, courts frequently have set out the director's common-law duty of care. For example, in *Winston v. Gordon*,[64] the Virginia Supreme Court stated that directors are "responsible for the exercise of reasonable care in the performance of their duties."[65] In *Anderson v. Bundy*,[66] the court elaborated on the meaning of "reasonable care" by stating that it meant asking whether directors had conducted corporate affairs as "might reasonably be expected of ordinarily prudent [directors]."[67]

---

60. No. 95 CIV 683 (LLS), 1996 WL 87248, at *8 (S.D.N.Y. Feb. 29, 1996).

61. FDIC v. Cohen, No. 95 CIV 683 (US), 1996 WL 87248, at *11 (S.D.N.Y. Feb. 29, 1996).

62. Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 284 (Va. 1999).

63. *Id.*

64. 80 S.E. 756 (Va. 1914).

65. Winston v. Gordon, 80 S.E. 756, 761 (Va. 1914).

66. 171 S.E. 501 (Va. 1933).

67. Anderson v. Bundy, 171 S.E. 501, 507 (Va. 1933).

A 1935 Virginia decision, *O'Connor v. First National Investors' Corp. of Virginia*,[68] like the more recent *Caremark* decision in Delaware, is an instructive reminder of the standards that apply to modern Virginia directors who abdicate their duty to oversee and monitor corporate business and affairs. *O'Connor* involved a stockholder negligence claim against the directors of an investment corporation for failing to supervise the investment activities of the president.[69] The president converted to his personal use and grossly mismanaged corporate assets, and the stockholders sought to hold the directors liable for damages resulting from their breach of care.[70]

Discussing the applicable standard of conduct, the Virginia Supreme Court stated that corporate directors "implicitly undertake to use as much diligence and care as the proper performance of the duties of their office requires."[71] As to director supervision over management activities, the court quoted approvingly from authorities stating that directors had a duty of maintaining "reasonable supervision."[72] The court rejected as inconsistent with that duty the defense that none of the directors had any reason to suspect that the president was misusing assets,[73] observing that such wrongdoing would have been prevented had the directors conducted even an occasional audit.[74] Applying a negligence standard, the court held all directors jointly and severally liable, some for failing entirely to discharge their duties as directors and others for failing to discover what easily could have been discovered by the exercise of ordinary care.[75]

Although decided in 1935, the *O'Connor* decision remains sound and instructive in the increasingly critical area of director monitoring and oversight responsibilities. Its language requiring directors to maintain "reasonable supervision" conforms with Chancellor Allen's sobering 1996 reminder in *Caremark* that directors have an

> obligation to be reasonably informed concerning the corporation, . . . [and that directors' obligations include] 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 sufficient to allow management and the board, each within its

68. 177 S.E. 852 (Va. 1935).

69. O'Connor v. First Nat'l Investors' Corp., 177 S.E. 852, 857 (Va. 1935) (quoting Marshall v. F&M Savings Bank, 8 S.E. 586, 590 (Va. 1889)).

70. *Id.*

71. *Id.*

72. *Id.* at 857-59.

73. *Id.* at 858.

74. *Id.* at 859; *see* Meltzer v. Atlantic Research Corp., 330 F.2d 946, 949 (4th Cir. 1964) (asserting directors' liability for failing to discover questionable loans) (citing *O'Connor*)).

75. *O'Connor*, 177 S.E. at 860.

> scope, to reach informed judgment concerning both the corporation's compliance with law and its business performance . . . and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards.[76]

The *O'Connor* decision, impliedly, and the more recent *Caremark* opinion, explicitly, cast serious doubt on the wisdom and force of the renowned 1961 Delaware Supreme Court decision in *Graham v. Allis-Chalmers Manufacturing.*[77] In that case, the Delaware court ruled that, absent actual cause for suspicion, in Delaware "there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists."[78] The Chancery Court's decision in *Caremark* strongly suggests that the Delaware Supreme Court probably would not follow *Allis-Chalmers* today and, further, might articulate a simple negligence standard for director care in the oversight (as opposed to the business judgment) context.[79] As interesting and important as this question is for directors and legal counsel representing Delaware corporations, in Virginia *O'Connor* establishes negligence as the standard for director care in the oversight context.

The American Law Institute's *Principles of Corporate Governance* and the American Bar Association's *Corporate Director's Guidebook* also highlight the importance of the director's duty of prudent care in the oversight context.[80] As expressed by the American Law Institute:

> One aspect of the board's general duty of care obligation in the oversight and inquiry areas is an affirmative obligation of directors to be reasonably concerned with the existence and effectiveness of procedures, programs, and other techniques . . . to assist the board in overseeing the corporation's business . . . . Today an ordinarily prudent person serving as director of a corporation of any significant scale or complexity should recognize the need to be reasonably concerned with the existence and effectiveness of

---

76. In re Caremark Int'l, Inc., 698 A.2d 959, 970 (Del. Ch. 1996).

77. 188 A.2d 125 (Del. 1963).

78. Graham v. Allis-Chalmers Mfg., 188 A.2d 125, 130 (Del. 1963).

79. The Chief Justice of the Delaware Supreme Court, the Honorable E. Norman Veasey, believes the Delaware Supreme Court has not yet addressed the issue of whether simple negligence or gross negligence is the proper liability standard for directors in the oversight context, as opposed to the business judgment context. E. Norman Veasey, *Directors and the Dynamics of Delaware Corporation Law*, DIRECTOR'S MONTHLY, Nov. 1997, at 3 (casting doubt on *Allis-Chalmers* by suggesting directors must institute reporting system to satisfy obligation to be informed).

80. AMERICAN LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (1994) [hereinafter PRINCIPLES]; COMMITTEE ON CORPORATE LAWS, AMERICAN BAR ASS'N, CORPORATE DIRECTOR'S GUIDEBOOK (1994), *reprinted in* 49 BUS. LAW. 1243 (1994) [hereinafter CORPORATE DIRECTOR'S GUIDEBOOK].

> procedures, programs, and other techniques to assist the board in its oversight role. . . .
>
> There are no set formulas for oversight techniques that could be used across the board. The size of a business, the diversity of its operations, and numerous similar factors will influence the nature and extent of the oversight techniques that would be appropriate. For example no programs or procedures may be necessary in a very small closely held corporation; in large closely held corporations, however, extensive programs or procedures may be needed.[81]

The American Bar Association addressed director monitoring as follows:

> *Compliance with Law.* Does the corporation have appropriate policies directed to compliance with applicable laws and regulations? For example, when appropriate, does the board receive periodic reports regarding compliance with environmental laws, including estimates of the costs of environmental compliance?
>
> Employees should be informed of corporate policies directed to compliance with applicable laws, including personnel policies designed to comply with health and safety, antidiscrimination and employment laws, and the securities laws, particularly those prohibiting insider trading. The corporation should establish appropriate procedures for monitoring compliance. All persons involved in the compliance process should have direct access to the general counsel or a designee so that sensitive compliance matters may be raised for consideration.[82]

These statements – made earlier in the 1990s – take on even greater significance in today's climate of renewed attention to director oversight.[83]

Specifically with regard to Virginia, Section 690 supplies the applicable standard of conduct – good faith business judgment – in those contexts in which deliberate business judgments are made. This includes judgments as to the nature and extent of oversight techniques appropriate for a particular corporation. The common law, however, supplies the applicable standard of director conduct – reasonable care, a negligence standard – in those contexts in which deliberate judgment is not exercised. This distinction, moreover, conforms with good policy. The deferential standard found in Section 690 fulfills the laudable purpose of according directors wide latitude in exercising judgment, both in protecting the decision itself and in sparing directors exposure to personal liability.[84] Such deference induces talented persons to serve

81. PRINCIPLES, *supra* note 80, § 4.01, at 164-66.

82. CORPORATE DIRECTOR'S GUIDEBOOK, *supra* note 80, at 1251.

83. *See supra* notes 49-50 and accompanying text.

84. In the *WLR Foods* litigation, the Fourth Circuit held that board of director compliance with Section 690 not only protects directors against personal liability, it also serves to uphold board decisions themselves against injunctive attack. WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172, 1183 (4th Cir. 1995), *cert. denied*, 516 U.S. 1117 (1996).

as directors, encourages both desirable business risk-taking and explicit supervisory attention to potential corporate trouble spots, and maintains a healthy barrier to public sector second-guessing of private sector director actions.[85]

None of these policy rationales – precisely the rationales undergirding the business judgment rule[86] – obtains when directors do not exercise deliberate judgment, whether intentionally or negligently, totally or in part. Directors who not only fail to attend explicitly to corporate business and affairs by exercising judgment, but also fail to comply with the common-law default standard of behaving as "might reasonably be expected of ordinarily prudent [directors],"[87] exhibit none of the qualities sound law should encourage. Section 690 therefore will not shelter director abdication or negligence in the important area of overseeing or monitoring corporate business and affairs. Instead, such behavior should lead, as in *O'Connor*, to director liability for all resulting losses.

III. Other Non-Statutory Duties of Directors

This Article's hard look at Section 690 reveals that there is more to a director's duty of care than what is set forth in the frail requirements of that statute. This point will now be generalized by arguing that other director duties in Virginia likewise are not cabined within the slender confines of Section 690. These duties include the duty of loyalty, the duty of disclosure, and possibly a so-called "*Revlon*" duty to maximize share price in a corporate break-up or sale-of-control transaction.[88] The existence of multiple demands on directors of Virginia corporations stems from Section 690 having a much narrower compass than many imagine.

A. Duty of Loyalty

Inasmuch as the duty of loyalty in Virginia, as elsewhere, originated as a judge-made duty,[89] two important rules of construction come into play where a statute – here, Section 690 – is claimed to be in derogation of such decisional law. First, "[t]he common law is not to be considered as altered or changed by statute unless the legislative intent be plainly manifested."[90] Second, "[s]tatutes

85. The policy rationales underlying judicial deference to director decision making are further elaborated on in Johnson, *Rethinking Judicial Review*, *supra* note 12.

86. *See generally id.*

87. Anderson v. Bundy, 171 S.E. 501, 507 (Va. 1933).

88. *See supra* note 8 (citing *Revlon*); *infra* Part III.A (discussing director duty of loyalty); *infra* Part III.B (explaining director duty of disclosure); *infra* Part III.C (considering *Revlon* duty).

89. *See infra* note 99 and accompanying text.

90. Hannabass v. Ryan, 180 S.E. 416, 418 (Va. 1935).

in derogation of the common law are to be strictly construed and not to be enlarged in their operation by construction beyond their express terms."[91] An examination of both "legislative intent" and the "express terms" of Section 690 reveals that the section addresses only director care, not loyalty.

The language of the statute itself says nothing about loyalty. The standard set forth in the statute – good faith business judgment – is not the standard applied to director loyalty but instead closely resembles the standard used to review director care when business judgment has been exercised. Furthermore, the commentary to Section 690 declares that the section is designed to treat – differently to be sure – the "same subject" that section 8.30 of the Model Business Corporation Act addresses.[92] The commentary to section 8.30(a) clearly states that the section "establishes a general standard of *care* for all directors."[93] The commentary also frequently – and exclusively – refers to the duty or standard of "care."[94] Not a word is said in either section, or in either commentary, about loyalty or any other director duty. Therefore, the subject matter of both section 8.30 and Section 690 is care and only care. Consequently, all of the following statements about the ambit of Section 690 are wrong:

> In other words, Section 690 imposes a duty of loyalty.[95]
>
> But the underpinnings for Code Section 13.1-690 includes [sic] both the duty of care and the duty of loyalty.[96]
>
> The duty of loyalty . . . is essentially the same duty that is prescribed in section 13.1-690. . . . Section 13.1-690 does not foreclose the claims of breach of a fiduciary duty of loyalty . . . because that duty is essentially the same as the duty prescribed by Section 13.1-690 . . . .[97]
>
> [Defendants] discharged their duty of loyalty in compliance with Code § 13.1-690.[98]

---

91. C&O Ry. v. Kinzer, 142 S.E.2d 514, 518 (Va. 1965); *see* Hyman v. Glover, S.E.2d 269, 271 (Va. 1986) (asserting more recently that statutes contrary to common law receive narrow construction (citing *Hannabuss* and *Kinzer*)).

92. Report of the Virginia Code Commission, *supra* note 36, at 248; *see, e.g.*, Suter v. San Angelo Foundry & Mach. Co., 406 A.2d 140, 145 (N.J. 1979) (approving interpretation of statute by examining statute from another jurisdiction from which it was copied).

93. MODEL BUS. CORP. ACT ANN. § 8.30(a), at 8-10 (3d ed. 1996) (emphasis added).

94. *Id.*

95. Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion to Dismiss the Second Amended and Supplemental Class Action Complaint at 5, Feldman v. Cohen, No. 98 CIV. 3789 (LAK) (S.D.N.Y. 1999).

96. ALLEN C. GOOLSBY, VIRGINIA CORPORATION LAW AND PRACTICE § 9.8, at 122.9 (Supp. 1998).

97. FDIC v. Cohen, No. 95 CIV. 683 (LLS), 1996 WL 87248, at *8-*9 (S.D.N.Y. Feb. 29, 1996).

98. Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 287 (Va. 1999).

In Virginia, the director duty of loyalty remains a matter of decisional law.[99] The Virginia Supreme Court has stated plainly that under general principles of equity – the root source of director fiduciary duties – corporate directors "owe[ ] a *loyalty* to their trust which [i]s superior to their personal interests."[100] Although relatively few Virginia decisions address loyalty, it is clear that courts have strictly scrutinized classic self-dealing and conflict of interest transactions by directors. The policy behind doing so is to "secure fidelity in the director."[101] Indeed, Virginia so severely disapproved of director self-dealing transactions that they were voidable at common law, notwithstanding the presence of good faith and adequacy of price.[102] A director may transact with his corporation when he has a direct or indirect conflict only if, in addition to good faith, the "transactions are open, fair and honest, and the corporation is represented by competent and authorized agents."[103]

The severe judicial treatment of director transactions raising loyalty concerns led many states, including Virginia in 1975,[104] to enact a statute changing the common law voidability rule. Importantly, the original statute and its successor (current Section 691) have a very narrow scope – abrogating the common law remedial rule that director self-dealing transactions were *voidable*. These statutes in no way nullify or narrow the pervasive common law duty of loyalty itself, nor do the statutes even address matters, other than "transactions," that raise loyalty concerns.[105] Consequently, as to a transaction

---

99. This point was reaffirmed in *WLR Foods*, in which the district court acknowledged that a "Virginia Corporation's directors and officers owe a duty of loyalty both to the corporation and to the corporation's stockholders." WLR Foods, Inc. v. Tyson Foods, Inc., 869 F. Supp. 419, 421 (W.D. Va. 1994) (citation omitted), *aff'd*, 65 F.3d 1172 (4th Cir. 1995).

100. Rowland v. Kable, 6 S.E.2d 633, 644 (Va. 1940) (emphasis added).

101. *See id.* at 642 (explaining purpose behind principle forbidding director self-interest from clashing with duty owed to corporation).

102. *See* Kessler v. Commonwealth Doctors Hosp., Inc., 185 S.E.2d 43, 46-47 (Va. 1971) (finding corporate director's self-dealing transactions voidable, even if he acted in good faith and even if there was no showing of actual injury).

103. *Rowland*, 6 S.E.2d at 642; *see* Giannotti v. Hamway, 387 S.E.2d 725, 733 (Va. 1990) (denying contention that director can deal with his corporation and sell property to it when defendants failed to establish fairness and honesty of transactions).

104. Act of Mar. 22, 1975, Va. Acts ch. 500, §13.1-39.1 (repealed) (adding Va. Code § 13.1-39.1).

105. Section 691's application only to "transactions" means that one ancillary ruling by the Fourth Circuit in the *WLR Foods* decision is erroneous. In assessing Tyson's claim that Section 690 should not apply in that case because of an alleged conflict of interest on the part of the WLR Foods board of directors, the Fourth Circuit pointed to Section 691 as a provision of Virginia law "which addresses director conflicts of interest arising from hostile takeover situations." WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172, 1183 (4th Cir. 1995). That statement by the Fourth Circuit is incorrect because the hostile takeover situation, at least in the *WLR Foods* setting, did not involve a "transaction" as is required for application of Section 691.

within the scope of Section 691, although the transaction itself might not be voidable solely on conflict of interest grounds, a self-dealing director still faces personal liability for restitution or damages for breach of the underlying, and still applicable, duty of loyalty. A note to section 8.61 of the Model Act makes abundantly clear the legislative intent that modern validating statutes, such as Section 691, leave to judicial decision the separate issue of director liability for breaching loyalty:

> At common law, articulation of the legal principles applicable to directors' conflicts of interest typically declare the transaction to be void or (sometimes) voidable. These formulations say little about the *liabilities*, if any, of the parties to the transaction. It is clear, however, that in some special circumstances a court would hold that the interested director must disgorge the profits he made from the transaction or must respond in damages for injury suffered by the corporation as a result of the transaction. Such sanctions could arise in contexts where the court leaves the transaction itself in place as well as in situations where the court rescinds the transaction. Subchapter F leaves these matters of sanction entirely to the judgment of the court.[106]

Likewise, the commentary to Section 691 sharply differentiates its validating function from the separate issue of director liability for breach of duty and expressly leaves to common law the latter issue:

> The statute does not directly address the question of a director's liability to the corporation for breach of fiduciary duty. An example is a transaction that was in fact unfair, because it conferred an excessive benefit on the officer or director, but was fully performed by the time the issue was raised. The corporation's right to recover the excess benefit would not be governed by this section, but by common law of fiduciary duties.[107]

As to self-dealing transactions falling outside the coverage of Section 691,[108] prior to *Willard ex rel. Moneta Building Supply, Inc. v. Moneta Build-*

A useful discussion of the term "transaction" is found in the Introductory Comment to Subchapter F of the Model Business Corporation Act § 860 (discussing term "transaction"), and in Official Comment No. 2 following section 8.60 of the Act, *id.* § 8.60 cmt. 2 (discussing term "transaction"). Briefly, a "transaction" is said generally to connote "negotiations or a consensual bilateral arrangement between the corporation and another party or parties that concern their respective and differing economic rights or interests – not simply a unilateral action by the corporation but rather a 'deal.'" *Id.* at 8-373.

106. *Id.* § 8.61, at 8-403 (emphasis added).

107. Report of the Virginia Code Commission, *supra* note 36, at 250-51.

108. An example of a transaction the Virginia Supreme Court might regard as falling outside Section 691 is a transaction in which a close family member of the director, rather than the director himself, had a material interest adverse to the corporation. *See* Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 286-87 (Va. 1999) (finding challenged transaction fair and declining to address whether conflict of interest existed

ing Supply, Inc., it appeared to be an open question whether Virginia courts would adhere to the older principle of voidability. By not addressing the issue of whether an adult child's adverse financial interests created a director conflict of interest transaction for purposes of Section 691 – because the court found the challenged transaction to be "fair"[109] – *Willard* impliedly rejected the common law voidability rule even as to transactions outside Section 691. An alternative reading of *Willard* is that the voidability rule still applies unless the transaction is proven "fair," although it is unclear in this context whether disinterested director or disinterested shareholder approval of the transaction negates the necessity of proving fairness. In either event, directors still face personal liability for conflict transactions not covered by Section 691, just as they do for transactions falling within the scope of that section. Moreover, loyalty breaches both within and those outside Section 691 should be construed as "willful misconduct" for purposes of avoiding the exoneration provision set forth in Section 692.1,[110] which applies only to "damages" and should not foreclose pursuit of a restitutionary remedy.

In addition to strictly constraining a director's ability to self-deal with his corporation, the common-law duty of loyalty broadly prohibits directors from wrongly usurping corporate opportunities and from engaging in unfair competition with corporations on whose board of directors they sit.[111] In all of these loyalty areas Virginia has relatively little decisional law, but its adherence to strict standards has been uncompromising.[112] Furthermore, Virginia's articulation of the high standards that directors must meet to transact business with their own corporation – "open, fair and honest, and the corporation is represented [competently]"[113] – and its oft-forgotten requirement that directors owe "the duty of frankness and fair dealing" in self-dealing matters,[114] come very

because corporation director's son owned corporation that purchased assets of director's corporation).

109. *See id.* (finding challenged transaction fair and declining to address whether conflict of interest existed because corporation director's son owned corporation that purchased assets of director's corporation).

110. VA. CODE ANN. § 13.1-692.1 (Michie 1999) (limiting damages that can be assessed against director provided that director has not engaged in willful misconduct or violation of criminal law or state and federal securities law).

111. *See* PRINCIPLES, *supra* note 80, at 1254-56 (noting that duty of loyalty requires director to disclose all information regarding personal interest to board members and to make corporate opportunities available to his corporation before pursuing those opportunities himself).

112. *See infra* text accompanying notes 113-14, 121-28.

113. Rowland v. Kable, 6 S.E.2d 633, 642 (Va. 1940) (describing circumstances under which director may deal with his corporation or sell his property to his corporation).

114. *See* Upton v. Southern Produce Co., 133 S.E. 576, 580 (Va. 1926) (finding principal officers failed in their duty as fiduciaries when they secretly purchased stock in their corporation following execution of contract to sell majority of their corporation's stock to another company).

close to the modern Delaware requirements of "fair dealing" and "fair price," which together comprise the twin components of an "entire fairness" inquiry.[115] Virginia courts could readily adopt this exacting "entire fairness" standard, as well as more developed judicial standards for analyzing wrongful appropriation of corporate opportunities and unfair competition, as more elaborate expressions of Virginia's existing common law on these director loyalty subjects. From whatever sources Virginia courts derive sound policy and doctrine in the loyalty area, the overarching point here is that director loyalty in Virginia largely remains a common law and equity subject. Section 690 does not address the duty of loyalty at all, and Section 691 treats only one dimension of that bedrock duty.

Failing to appreciate this, recently the Virginia Supreme Court analyzed wrongly, and thereby potentially weakened, this core fiduciary duty. In *Willard*, a twenty-percent shareholder in a close corporation challenged the decision of the two elderly controlling shareholders, who were also the only directors, to sell substantially all of the corporate assets to a newly-formed corporation entirely owned by their adult son, himself a five-percent shareholder in the first corporation and also its newly-resigned president and director.[116] The directors made no efforts to solicit other bids and did not enter into serious price negotiations with their son.[117] The directors sold the corporation's assets for $1.3 million, a figure that two business valuation experts opined to be fair.[118] Critically, however, both experts made their valuations *prior* to the date on which the twenty-percent minority shareholder made an unconditional offer to purchase the assets at a price – $1.9 million – forty-six percent higher than the son's offer.[119] Moreover, the twenty-percent shareholder made a "request" (not phrased as a condition) in his rival offer for an additional thirty days to "fully evaluate the assets and determine whether a higher value is appropriate."[120] The two directors never acted as a board to

115. *See* Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) (finding burden of showing entire fairness of transaction fell on defendants but noting that in present case only fair dealing component applied); Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (observing that fairness inquiry requires examination of both components).

116. *See* Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 280-83 (Va. 1999) (describing circumstances leading up to and surrounding challenged action by elderly directors).

117. *See id.* at 282 (noting directors' refusal to consider minority shareholder's competing offer to purchase corporation's assets at higher price).

118. *See id.* at 281-82 (describing valuation reports prepared by Hope Player and Associates, P.C. and by Dr. Larry A. Lynch).

119. *See id.* at 287 (referring to letter in which minority shareholder offered $600,000 more than amount offered by director's son).

120. *See id.* at 290 (Koontz and Hassell, JJ., dissenting) (quoting Letter from Ronald L. Willard, to Amerigo S. and Rose Mary Cappellari (Dec. 19, 1996) (discussing directors'

consider or act on the rival bid, and the father-shareholder never disclosed or transmitted it to the mother-shareholder, who had given her husband a proxy to vote her stock at a shareholder meeting called to act on the proposed sale to their son. Instead, ignoring the rival bid the directors acted in their capacity as shareholders to approve the sale to their son that they had earlier authorized as directors.[121]

The twenty-percent shareholder launched several attacks on the transaction, including a claim that the two parents had breached their duty of loyalty to the corporation and to him, both in their capacity as directors and as controlling shareholders.[122] The Supreme Court of Virginia affirmed the trial court's judgment for defendants.[123] Although the trial court quite remarkably found the sale of corporate assets to their son to involve no conflict of interest on the part of the parents under Section 691, the Supreme Court of Virginia refrained from addressing that issue on the ground that, even if there were such a conflict, the asset sale was "fair" and thus not voidable under Section 691.[124] Setting aside discussion of the court's startling fairness analysis for a moment, the court's faulty grounding of director loyalty in Section 690 warrants emphasis first.

Upon concluding that the asset sale to the directors' son was not voidable under Section 691 because it was found to be "fair," the court next addressed the plaintiff's proper contention that the Section 691 voidability issue was distinct from his alternative claim for damages for the two directors' breach of common law loyalty.[125] The court concluded that, although it generally

---

refusal to consider minority shareholder's competing offer to purchase corporation's assets at higher price)).

121. *See id.* at 282 (noting that father-shareholder, in person, and mother-shareholder, by proxy, voted to accept son's offer and refused to discuss minority shareholder's competing offer at stockholder's special meeting on December 20, 1996).

122. *See id.* at 282-83 (explaining that minority shareholder brought suit alleging violation of § 13.1-691, breach of fiduciary duties, violation of § 18.2-499, and common law conspiracy). The author served as a consultant to legal counsel representing the minority shareholder, Ronald Willard, and thus is familiar with claims brought in this action.

123. *See id.* at 289 (finding directors discharged their duties in good faith and in best interests of corporation and finding transaction fair to corporation).

124. *Id.* at 286-87. For a realistic assessment of how immediate family members should be treated as "a single controlling group," see *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 519-20 (Mass. 1975) (observing that "it is realistic to assume that appreciation, gratitude, and filial devotion" may create community of interests within family), see also *Chaffin v. GNI Group, Inc.*, No. Civ. A. 16211-NC, 1999 WL 721569, at *5-6 (Del. Ch. 1999) (stating that merger with company in which director's son is economically interested involves director conflict of interest).

125. *See* Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 227, 287 (Va. 1999) (noting minority shareholder's assertion that finding transaction not voidable under Section 13.1-691 does not resolve issue of director liability for breach of duty of loyalty).

agreed with plaintiff's proposition,[126] a finding of fairness under Section 691 "necessarily" meant defendants had "discharged their duty of loyalty in compliance with Code Section 13.1-690."[127] Although not made explicit, the court appeared to base this statement on an assertion made earlier in the opinion that the fairness standard under Section 691 is "more exacting" than that under Section 690.[128]

The court's statement about director loyalty having been discharged in compliance with Section 690 is a non sequitur. As argued above, Section 690 does not codify the duty of loyalty. Moreover, its standard – "good faith business judgment of the best interests of the corporation"[129] – is not and never has been the common law standard for loyalty in Virginia or anywhere else. The Supreme Court of Virginia itself has pointedly held, in the loyalty context, that good faith alone,[130] or even coupled with price adequacy,[131] is not sufficient to sustain a self-dealing transaction. Moreover, Section 690 logically cannot be the standard for loyalty because that section places the burden of proof on the complaining party,[132] whereas Virginia decisional law clearly places the burden of proof on the director in a loyalty claim.[133] Rather, the proper test for a loyalty claim is the strict traditional test of complete fairness, with the directors bearing the burden of proof. This means, at a minimum, that the transaction "as a whole" must be "open, fair and honest at the time it

126. *Id.*

127. *Id.*

128. *See id.* (discussing standards to use in determining fairness of directors' sale of corporation assets to son).

129. VA. CODE ANN. § 13.1-690(A) (Michie 1999) (establishing general standard by which director shall perform his duties as director).

130. *See* Kessler v. Commonwealth Doctors Hosp., Inc., 185 S.E.2d 43, 46-47 (Va. 1971) (finding director's failure to consult all directors interested in buying more stock before selling unclaimed shares of corporation stock to himself constituted breach of his duty to corporation even if director acted in good faith); Rowland v. Kable, 6 S.E.2d 633, 643-44 (Va. 1940) (explaining that, in absence of full disclosure to interested parties, good faith alone on part of directors will not excuse departure from requirement that directors cannot act inconsistently with interest of beneficiary they represent).

131. *See Kessler*, 185 S.E.2d at 47 (finding director's acquisition of 3,275 shares of corporation stock voidable despite adequacy of price because directors failed to consult all directors interested in buying more stock before selling unclaimed shares of corporation to himself).

132. VA. CODE ANN. § 13.1-690(D).

133. *See, e.g.*, Izadpanah v. Boeing Joint Venture, 412 S.E.2d 708, 709 (Va. 1992) (stating that "when a conflict of interest as defined in §13.1-691 exists . . . the burden shifts to directors to show that their actions complied with requirements of that section"); Giannotti v. Hamway, 387 S.E.2d 725, 731 (Va. 1990) (noting burden of proof is on directors to show transaction was fair and acknowledging this rule as exception to business judgment rule which presumes directors acted properly and in good faith when exercising their business judgment).

was consummated."[134] Furthermore, Virginia directors who self-deal must comply with their additional "duty of frankness and fair dealing."[135]

Virginia's insistence on the process values of openness, honesty, frankness, and fair dealing, assessed in the transaction as a whole, reveals its appreciation that the element of "fairness" is not limited to the matter of price but is multi-faceted. Fairness demands, first, that the particular transaction, even if entered on economically fair terms, must be affirmatively shown by the directors to be in the *corporation's* best interest, not the directors' interest or that of their child.[136] Second, the Delaware Supreme Court has elaborated further on the notion of fairness in self-dealing transactions by stating that it has two aspects:

> The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed [transaction], including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.[137]

The exacting entire fairness standard requires the interested directors in a self-dealing transaction to establish "to the *court's* satisfaction that the transaction was the product of both fair dealing *and* fair price."[138] The duty to deal fairly requires the fiduciary, among other matters, "not to time or structure the transaction, or to manipulate the corporation's value, so as to permit or facilitate the forced elimination of the minority stockholders at an unfair price."[139]

---

134. Deford v. Ballentine Realty Corp., 180 S.E. 164, 169 (Va. 1935); *see Rowland*, 6 S.E.2d at 642 (noting that director may deal with his corporation if transactions are open, fair, and honest).

135. Upton v. Southern Produce Co., 133 S.E. 576, 580 (Va. 1926).

136. *See* Cookies Food Prods. v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 447 (Iowa 1988) (citing Fill Bldgs. Inc. v. Alexander Hamilton Life Ins. Co., 241 N.W.2d 466, 469 (Mich. 1976) (agreeing with contention that corporate profitability should not be sole criterion to test fairness and reasonableness of transaction); *Fill Bldgs., Inc.*, 241 N.W.2d at 469 (defining fairness as requirement that director self-dealing be fair to and in interest of corporation); *see also* MODEL BUS. CORP. ACT ANN. § 8.60, at 8-419 to 20 (discussing fair transactions).

137. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (citations omitted).

138. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1163 (Del. 1995) (emphasis added).

139. Sealy Mattress Co., Inc. v. Sealy, Inc., 532 A.2d 1324, 1335 (Del. Ch. 1987); *see* Boyer v. Wilmington Materials, Inc., No. 12549, 1999 WL 39549, at *16-*18 (Del. Ch. Jan. 20,

"[T]he 'fair price' aspect of an entire fairness analysis requires the board of directors to demonstrate 'that the price offered was the highest value reasonably available under the circumstances.'"[140]

Virginia law should be interpreted similarly to require "entire fairness," given that it already requires that a transaction be examined "*as a whole*, [and be] open, fair, and honest."[141] Virginia law also expressly requires "frankness" and "fair dealing" in director conflict transactions, not simply economic fairness.[142] In *Rowland v. Kable*,[143] the Virginia Supreme Court underscored the importance of fair *process* – not simply fair price – to the court's scrutiny of transactions raising director loyalty concerns. The court, accordingly, stated that "good faith" on the part of an interested director in a self-dealing transaction is not sufficient; rather, there must also be "full disclosure and consent of the interested parties, to make an exception to the general rule that a trustee or director cannot enter into any relation or do any act inconsistent with the interest of the beneficiary he represents."[144] Moreover, the corporation must be "represented by competent and authorized agents,"[145] who, needless to say, should be persons other than the parents of a potential buyer of corporate assets. Additionally, notwithstanding the *Willard* court's terse reference to "the earmarks of an arms-length bargain"[146] as an indication of

1999) (finding controlling stockholders gained benefit of manipulated asset values, causing minority shareholders to suffer damages).

140. *Cinerama*, 663 A.2d at 1163 (quoting Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993)). Note that in Delaware when a self-dealing transaction involves the sale of a company, the "fair price" aspect of the entire fairness analysis requires the board of directors to demonstrate, in effect, that they also complied with the *Revlon* standard of "highest value reasonably available." *See Cede & Co.*, 634 A.2d at 361. This confluence of the "fairness" test and the *Revlon* standard makes sense when the director's self-dealing transaction under review involves the end-stage sale of a corporation. In that context, to fulfill their burden of proving price "fairness," directors should be required to prove that they obtained the "highest value reasonably available under the circumstances." In this way, whether Virginia has more generally adopted or rejected *Revlon* in the break-up or sale context, *see infra* Part III.C, at least in the more limited context of a break-up or sale involving director self-interest, the *Revlon* standard and the "fair price" standard sensibly dovetail.

141. Deford v. Ballentine Realty Corp., 180 S.E. 164, 169 (Va. 1935) (emphasis added) (finding fact that president made profit was insufficient reason to rescind contract when president acted in good faith and transaction was fair and honest).

142. *See* Upton v. Southern Produce Co., 133 S.E. 576, 580 (Va. 1926) (stating that officers of corporation owe duty of frankness and fair dealings as fiduciaries to stockholders and cannot use position for personal profit).

143. 6 S.E.2d 633 (Va. 1940).

144. Rowland v. Kable, 6 S.E.2d 633, 643-44 (Va. 1940); *see* Pepper v. Litton, 308 U.S. 295, 306 (1939) (stating that self-dealing director must show fairness in addition to good faith).

145. *Rowland*, 6 S.E.2d at 642.

146. Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply Inc., 515 S.E.2d 277, 287 (Va. 1999) (quoting *Pepper*, 308 U.S. at 306-07).

fairness – hardly evidenced in *Willard* as there was no indication of "bargaining" at all – the very case cited by *Rowland* just prior to that phrase had squarely rejected as insufficient a defense that a challenged self-dealing transaction was at "arms-length," based on the presence of other shareholder-harming factors.[147]

Commentary to the Model Act supports Virginia and Delaware case law that insists on fair process and economic fairness in the overall judicial inquiry into "fairness." The Model Act addresses the importance of fair "process" (or "fair dealing") in this area of corporate law, indicating that its absence, even if a deal is economically fair, is grounds for rescission:

> *Process of Decision.* In some circumstances, the behavior of the director having the conflicting interest can itself affect the finding and content of "fairness." The most obvious illustration of unfair dealing arises out of the director's failure to disclose fully his interest or hidden defects known to him regarding the transaction. Another illustration could be the exertion of improper pressure by the director upon the other directors. When the facts of such unfair dealing become known, the court should offer the corporation its option as to whether to rescind the transaction on grounds of "unfairness" even if it appears that the terms were "fair" by market standards and the corporation profited from it. If the corporation decides not to rescind the transaction because of business advantages accruing to the corporation from it, the court may still find in the director's misconduct a basis for judicially imposed sanction against the director personally. Thus, the course of dealing – or process – is a key component to a "fairness" determination.[148]

The policy rationale for the common law's strict treatment of loyalty claims, as seen in the burden of proof shift and in the close judicial scrutiny of the procedural and substantive components of a transaction's entire fairness, is easy to understand. Where director self-interest is present and affects a majority of the directors approving a transaction, the focus of concern pointedly becomes not merely director *competence* – a concern sufficiently addressed by the duty of care – but the baseline issue of director *loyalty*. Troubled about the foundational issue of director fidelity to the corporation's interests,[149] judges carefully scrutinize for themselves whether a transaction is entirely fair to the corporation and its stockholders.[150] Courts abandon the

147. *See* Adelman v. Conotti Corp., 213 S.E.2d 774, 779-81 (Va. 1975) (finding violation of fiduciary duty and rejecting defense that transaction was at arms-length when plaintiff presented evidence of secrecy surrounding transaction, of directors' motivation to retain control, and of issuance of stock to directors at below value).

148. *See* MODEL BUS. CORP. ACT ANN. § 8.61 cmt. 2, at 8-420 (discussing fair transactions).

149. *See Rowland*, 6 S.E.2d at 642 (discussing unbending rule of directors' duty to act in utmost good faith and fairly in dealings with his corporation).

150. *See, e.g.*, Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1279 (Del. 1988)

deference of the lax business judgment standard and adopt a far more invasive test in the loyalty area. As there is no independent decision-maker within the corporation to oversee its business and affairs, the court necessarily becomes, on behalf of the shareholders, the only "neutral decision-making body" available to pass critical judgment on the matter.[151]

In *Willard*, the court discarded this settled area of the law. It did so by grounding the weighty demand of loyalty in the thin soil of Section 690.[152] Though the defendants in that particular case supposedly had proven the "fairness" of the sale, such a showing is really unnecessary if, as the court held, the applicable loyalty standard is now found in Section 690, where only a modest "good faith" showing is required. Legal counsel advising a board of directors on a future self-dealing transaction might read *Willard* as holding that even interested directors need only comply with Section 690. In effect, then, *Willard* makes the fairness standard of Section 691 a dead letter. Why bother to prove the "fairness" of a transaction if Section 690 now supplies the governing standard and that standard is so easily met? The answer, of course, is that for an interested director the "good faith" of Section 690 is conclusively nonexistent and that statute simply does not govern the conduct of the interested director. Rather, Section 691, to the extent applicable, and the pervasive common law duty of loyalty – both with demanding "fairness" standards – continue to regulate the behavior of the conflicted director.

The *Willard* court, anchoring loyalty in the frail language of Section 690, blithely abandoned its own longstanding equitable principles and endorsed a deferential rather than strict review of director behavior.[153] Furthermore, the court did not honor its earlier decisions that good faith, even if coupled with price adequacy, is insufficient to sustain conflict transactions. The court also wrongly failed to insist that "fairness" entail the key procedural aspects of "fair dealing" (including, among other factors, Virginia's longstanding requirements of openness and full disclosure) as well as fair price. On price fairness grounds alone, it is not demonstrably fair for a board to cavalierly

---

(stating that "judicial reluctance to assess the merits of a business decision ends in the face of illicit manipulation of a board's deliberative processes by self-interested corporate fiduciaries").

151. *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1170 & n.25 (Del. 1995) (stating that when board of directors' loyalty is in question, Delaware courts have duty to determine whether conflict has deprived stockholders of "neutral decision-making body"); *see generally* Johnson, *Business Judgment*, *supra* note 12.

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

153. Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 287 (Va. 1999). That the *Willard* court brought the same intensity (or lack thereof) to its review of the loyalty issue as to the Section 690 care issue can be seen in its assertion that the "facts that support the circuit court's conclusion that A.S. and Rose Mary exercised their 'good faith business judgment of the best interests of the corporation' equally sustains the court's judgment on this [fairness] issue and need not be repeated." *Id.*

ignore a bid forty-six percent higher than the alternative. Nor do expert valuations made before the date of the rival bid provide support for a finding of fair price, where fair price means the only sensible thing it can mean in this setting: the "highest value reasonably available."[154]

Overall, to honor the sound policy rationales underpinning the duty of loyalty and to preserve integrity in Virginia corporate law, the *Willard* court should have held that an asset sale to the son of the only two directors, conducted solely by directors who were unwilling to consider a rival topping bid, to disclose it to an absent shareholder, or to seek expert revaluation of an earlier bid, constitutes unfair dealing and an egregious breach of director loyalty. The transaction either should have been nullified under Section 691 or the two parent-director/shareholders should have been found personally liable to the twenty-percent shareholder for twenty percent of the difference between a "fair price" (minimally, the rival bid) and the actual sales price.

The unremitting rigor of loyalty in Virginia corporate law must be reclaimed. This begins with an appreciation that Section 690's deferential standard was designed to encourage risk-taking by directors *on behalf of* the enterprise and its shareholders, not to shield director action squarely *opposed to* those interests. The innovation of Section 690 in the care area does not detract from the importance of continued zealous judicial oversight in the loyalty area. Care and loyalty are distinctive legal virtues. After *Willard*, however, minority shareholders in start-up Virginia ventures must bargain expressly for protections formerly provided by a robust duty of loyalty. This is inefficient and impedes and raises the cost of capital formation for Virginia

---

154. *See supra* text accompanying note 140. A separate but related point about director reliance on expert valuation opinions should be made here. In *Willard*, the directors defended the price of the asset sale to their son on the ground that they had two expert opinions that the sale price was fair and, under Section 690(B), directors are entitled to rely on opinions of experts. The fatal flaw in that argument, a flaw the court did not even address, is that the two fairness opinions preceded the minority shareholder's rival bid. Therefore, the directors lost their ability under Section 690(B) to rely on the opinions because that subsection conditions director reliance on a director having no "knowledge or information concerning the matter in question that makes reliance unwarranted . . . ." VA. CODE ANN. § 13.1-690(B) (Michie 1999); *see* Commonwealth Transp. Comm'r v. Mateyiko, 481 S.E.2d 468, 471 (Va. 1997) (finding directors personally liable when they voted to distribute corporate assets upon dissolution because they had knowledge that condemnation award probably would be less than amount to be distributed under "drawdown" order, thereby making reliance unwarranted). The directors in *Willard*, of course, knew that the two earlier expert opinions were rendered before the appearance of an unqualified offer to purchase corporate assets at a 46% higher price, and accordingly, the directors possessed knowledge that made reliance on those earlier expert opinions unwarranted. As former Chancellor William Allen aptly stated and the Delaware Supreme Court quoted: "A decent respect for reality forces one to admit that . . . advice [of an investment banker] is frequently a pale substitute for the dependable information that a canvas of the relevant market can provide." Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1287 (Del. 1989) (quoting *In re* Amsted Indus. Litig., No. CIV.A.8224, 1988 WL 92736, at *7 (Del. Ch. Aug. 24, 1988)).

corporations. Current minority shareholders already in Virginia corporations cannot now contract for protection that was thought at the time of investment to have been amply provided by loyalty. They must press for a revisiting of the issues evaded in *Willard*, with the hope of restoring that healthy skepticism long brought to judicial monitoring of these disturbing transactions. The full mischief might not end with Virginia companies, however. Having both a "unique" standard of *care* and (post-*Willard*) a unique standard of *loyalty*, Virginia may gain an unenviable reputation among out of state companies and counsel as the preferred haven of *re*-incorporation when lax review of contemplated director self-dealing is sought.

B. Duty of Disclosure

Under Virginia corporate law, after adopting a plan in a merger or asset sale, directors must submit the proposed transaction to shareholders for approval.[155] Is there, in conjunction with this submittal, a director duty to disclose fully all material facts and a duty not to make material misstatements in such disclosures? What is the source of such duties? Is it Section 690?

In Delaware, directors have a duty to shareholders to disclose accurately all material information when seeking shareholder action.[156] Recently, director duty was extended to cover situations in which shareholder action is not requested but corporate injury or financial damage to shareholders could occur as a result of disseminating false information.[157] In both settings, directors must "provide a balanced, truthful account of all matters disclosed in the communications with shareholders."[158] The duty includes an obligation to avoid misleading partial disclosures and to update such prior partial disclosures as may be misleading if not supplemented.[159]

155. *See* VA. CODE ANN. §§ 13.1-718-724.

156. *See* Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998) (stating that directors have fiduciary duty to disclose fully and fairly all material information within their control when seeking shareholder action); *see also* Lawrence A. Hamermesh, *Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087, 1125 (1996) ("[I]n a facet of the opinion much less heralded than its duty of care ruling, *Van Gorkom* took one further, significant step to enunciate an independent duty on the part of directors to disclose material information when submitting a merger proposal to stockholders and to authorize a *post hoc* damages remedy against directors who fail to fulfill that duty.") (discussing *Smith v. Van Gorkom*, 488 A.2d 858, 893 (Del. 1985)).

157. *See Malone*, 722 A.2d at 12 (stating that fiduciary duties of care, loyalty, and good faith apply when directors disseminate information to stockholders, even when no stockholder action is sought).

158. *Id.*

159. *See* Zion v. V.I. Corp., 681 A.2d 1050, 1056 (Del. 1996) (noting that directors have obligation to provide shareholders with accurate, full, and fair characterization of "historic events" to which partial disclosure relates); Kahn v. Household Acquisition Corp., 591 A.2d

The source of the director disclosure duty is not statutory;[160] it is equitable in nature and "derives from the combination of the fiduciary duties of care, loyalty and good faith."[161] Where a board specifically seeks shareholder approval for a director self-dealing transaction, however, the duty of disclosure "exists as an essential component of the duty of loyalty . . . ."[162] Concerning damages for breach of the duty of disclosure when nondisclosure causes "impairment to the economic or voting rights of shareholders,"[163] Delaware has adopted a "virtual per se rule of damages."[164] Finally, director conduct in duty of disclosure cases is not reviewed under the deferential business judgment standard.[165] The reason for this is simply that the key rationale for judicial deference – *business* judgment – is not present when director compliance with a *legal* standard (sufficiency of disclosure) is at issue.

Virginia courts follow the latter principle of confining deferential review to director decisions that are *business* judgments and not, for example, to director decisions construing or applying statutes or bylaws.[166] The propriety of a board's construction of applicable *legal* standards – such as a duty of disclosure – remains fully subject to judicial review. This result makes sense on policy grounds because judicial deference is inappropriate when legal rather than business judgments are at issue. The result also makes sense under Section 690 which, as seen above,[167] is a partial expression of the director duty of care, based on the exercise of "business judgment." When business judgment has not

---

166, 171 (Del. 1991) ("If subsequent events impart a new and significant slant on information already discussed, their disclosure is mandated.").

160. A possible exception to this statement arises when a director conflict of interest statute, such as VA. CODE ANN. § 13.1-691 (Michie 1999), codifies a director duty of disclosure as a prerequisite to obtaining director or shareholder approval of interested deals involving a director. *See In re* Walt Disney Co. Derivative Litig., 731 A.2d 342, 368 n.70 (Del. Ch. 1998) (stating that Delaware code codifies such duty).

161. *Malone*, 722 A.2d at 11.

162. *Walt Disney*, 731 A.2d at 369.

163. *See* Loudon v. Archer-Daniels-Midland Co., 700 A.2d 135, 142 (Del. 1997) (limiting *In re Tri-Star Pictures, Inc. Litig.*, 634 A.2d 319 (Del. 1993)).

164. *Tri-Star Pictures*, 634 A.2d at 333.

165. *See* Goodwin v. Live Entertainment, Inc., No. CIV.A.15765, 1999 WL 64265, at *6 n.4 (Del. Ch. Jan. 25, 1999) (refusing to rely exclusively on business judgment rule analysis); *In re* Anderson, Clayton Shareholder's Litig., 519 A.2d 669, 675 (Del. Ch. 1986) (finding directors not entitled to benefit of business judgment presumption because matter did not concern management of business or affairs of enterprise but rather related to directors' duty to shareholders).

166. *See* Lake Monticello Owners' Ass'n v. Lake, 463 S.E.2d 652, 656 (Va. 1995) ("[A] necessary predicate for the application of the business judgment rule is that the directors' decision be that of a *business* judgment and not a decision, such as that in this case, which construes and applies a statute and a corporate bylaw.") (emphasis added).

167. *See supra* Part I.

been exercised or when a director obligation is not wholly rooted in the duty of care and its underlying policy rationales, Section 690 is not implicated. The issue of whether Virginia recognizes a particular director duty – here, disclosure – then becomes, as with loyalty, a matter of common law and equity.[168]

Virginia long ago recognized, in equity, that directors owe a disclosure duty in the self-dealing context.[169] In *Upton v. Southern Produce Co.*,[170] controlling officer-directors purchased shares of stock from their corporation and from other shareholders while possessing a third-party offer to buy all such stock at a higher price.[171] The officer-directors did not disclose to the corporation or its shareholders the former parties' contractual right to sell the purchased stock to a third party at a price higher than the price paid to the selling corporation and shareholders.[172] The Virginia Supreme Court stated that the officer-directors could not "legitimately purchase" the stock "without *disclosure* of all the facts to the other directors or stockholders."[173] As controlling officers they were said to owe "the duty of frankness and fair dealing as fiduciaries to all the stockholders . . . ."[174]

In *Willard*, the court did not address how the father-director might have breached this director disclosure duty.[175] In that case, the day before the shareholder meeting called to consider approval of an asset sale to the directors' son's company, the father-director received from the twenty-percent minority shareholder a rival bid forty-six percent higher than the proposed sale price.[176] Holding a proxy to vote his wife's stock, the father-director did not disclose the significantly higher offer to his wife, a substantial shareholder.[177] Such a competing bid was "material" in that a reasonable shareholder would consider it important in deciding how to vote.[178] Specifically, in light of the

168. The exception in Virginia, as in Delaware, *see supra* note 160, is the disclosure required of an interested director who seeks the protection of Section 691.

169. *See* Deford v. Ballentine Realty Corp., 180 S.E. 164, 169 (Va. 1935) (stating that director may deal with his corporation but he must be open, fair, and honest); Upton v. Southern Produce Co., 133 S.E. 576, 580 (Va. 1926) (noting that principal officers of company owed duty of frankness and fair dealing as fiduciaries to stockholders).

170. 133 S.E. 576 (Va. 1926).

171. *Id.* at 577-78.

172. *See id.* at 578.

173. *Id.* at 580 (emphasis added).

174. *Id.*; *see* Kessler v. Commonwealth Doctors Hosp., Inc., 185 S.E.2d 43, 46-47 (Va. 1971) (requiring director to make full disclosure).

175. *See generally* Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply Inc., 515 S.E.2d 277 (Va. 1999).

176. *Id.* at 282.

177. *Id.*

178. The Delaware Supreme Court has described the materiality standard as follows: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would

substantially higher rival bid, the mother-shareholder might have revoked the proxy or otherwise have altered voting instructions to the proxy holder.[179] Failing to make the required disclosure, the father-director breached his equitable duty of disclosure. The non-disclosure impaired shareholder economic and voting rights and, therefore, liability should have resulted without requiring the elements of reliance, causation, or actual quantifiable monetary damages.[180]

Virginia directors who communicate with shareholders – whether or not in a self-dealing context – should be obligated to make full and accurate disclosure. The importance of disclosure is recognized in Section 691, which allows self-dealing transactions to be immunized from common law voidability if director or shareholder approval is gained after disclosure of all material facts.[181] Disclosure in self-dealing transactions already is mandated under Virginia decisional law, and the director duty of disclosure should be generalized. Although the federal securities law's proxy rules broadly dictate disclosure for those Virginia corporations that are reporting companies[182] and provide a private remedy for material misstatements or omissions,[183] non-reporting companies are exempt from federal securities law proxy rules. Moreover, when a controlling shareholder exists, remedies under federal proxy rules for disclosure violations may be foreclosed because of the impos-

---

consider it important in deciding how to vote.... Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Zion v. V.I. Corp., 681 A.2d 1050, 1056 (Del. 1996) (quoting Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985)).

179. *See Willard*, 515 S.E.2d at 286. This possibility must be given credence because the Virginia Supreme Court cited from the trial court record evidence which "demonstrated that David's resignation as an officer and director of Moneta and his new business plans had caused considerable discord between him and his parents." *Id.* The court cannot both refuse to hold as a matter of law that a director has a disabling conflict of interest when selling substantially all the business assets to his or her child *and* not take seriously a claim that the parent-shareholder would want to know about an alternative bid offering 46% more money.

180. *See* Malone v. Brincat, 722 A.2d 5, 12 (Del. 1998) ("An action for a breach of fiduciary duty arising out of disclosure violations in connection with a request for stockholder action does not include the elements of reliance, causation and actual quantifiable monetary damages.").

181. *See* VA. CODE ANN. § 13.1-691 (Michie 1999).

182. *See* Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1994) (making solicitation of proxies in violation of broad disclosure requirements unlawful); 17 CFR § 240.14a-1 to 14a-15 (1999) (describing requirements as to proxy solicitation).

183. *See* 17 CFR § 240.14a-9 (1999) (providing that no solicitation shall contain statement that is false or misleading as to any material fact or that omits any material fact); *see also* J.I. Case Co. v. Borak, 377 U.S. 426, 433 (1964) (stating that Securities Exchange Act authorizes private federal cause of action for recission or damages to stockholder with respect to merger authorized pursuant to proxy statements containing materially false or misleading statements).

sibility of showing the required causation.[184] In contrast, no causation element exists under state disclosure law. Virginia corporations and their directors should not be exempt from what, on policy grounds, is rightly regarded as a duty of growing importance in dealings with information-hungry shareholders,[185] the Virginia state law duty of disclosure. This duty springs not from Section 690, but from equity.

C. Revlon *Duty*

An important open question, prior to the recent *Willard* decision, was whether, notwithstanding Section 690, directors of Virginia corporations had a so-called "*Revlon*" duty[186] to maximize the sale price in a corporate break-up or control change transaction.[187] The *Willard* court held that "the *Revlon* test is not applicable in Virginia."[188] Although there may or may not be good reasons to follow *Revlon* in Virginia, the *Willard* court's reasoning on this issue – that the meager phrasing of Section 690 somehow resolves this complex social policy issue[189] – is shallow and unpersuasive.

The Delaware Supreme Court held in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[190] and its progeny that once a board of directors undertakes a transaction that will "break-up" a corporation or result in a change of its control, the board's duty radically changes from preserving the corporate entity "to the maximization of the company's value at a sale for the stockholders' benefit."[191] Put another way, Delaware holds that, in corporate end-stage

---

184. *See* Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1102 (1991) (stating that causation element cannot be demonstrated by member of class of minority shareholders whose votes are not required to authorize transaction giving rise to claim).

185. *See In re* Walt Disney Co. Derivative Litig., 731 A.2d 342, 369 (Del. Ch. 1998) ("The recognized usefulness of information has pushed disclosure into a far more central role . . . . The increase in importance of the duty of disclosure has taken place in conjunction with the expanded role of the duty of care . . . .").

186. *See supra* note 8.

187. *See* GOOLSBY, *supra* note 96, § 9.7, at 122.2-.7 (advocating that Virginia should follow *Revlon*).

188. Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 284 (Va. 1999).

189. *See id.*

190. 506 A.2d 173 (Del. 1986).

191. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (holding that duty of board of directors changes from preservation of corporate entity to maximization of common stock price when sale of company becomes inevitable). Later cases have extended *Revlon*, obligating directors to obtain the best value reasonably available to stockholders

> in at least the following three scenarios: (1) "[W]hen a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization

settings, directors are singularly "charged with getting the best price for the stockholders at a sale of the company."[192] Considerations other than those centered on shareholder welfare, such as employee well-being, are improper. Later decisions have elaborated and refined the contours of this duty.[193] Thus, the *Revlon* duty has been reformulated as an "obligation . . . to seek the best value reasonably available to the stockholders."[194] Consequently, the Delaware Supreme Court has emphasized that the applicable standard is one of "reasonableness," not perfection.[195] A board decision to pursue what it regards as the "best price" will not be disturbed, therefore, if it selects "one of several reasonable alternatives."[196]

Several points must be understood about this standard and its bearing on Virginia law. First, the *Willard* court completely misdescribed the *Revlon* duty when it stated that "[s]uch a rule would mean that only one offer, among many, was in the best interests of the corporation."[197] As seen above, a correct statement of Delaware law is that a director decision on "best price" need only be "within a range of reasonableness."[198]

Second, *WLR Foods, Inc. v. Tyson Foods, Inc.*[199] is not authority on the *Revlon* issue.[200] *WLR Foods* involved a board of directors' decision *not* to sell the company, the board having concluded that continued independence was

---

> involving a clear break-up of the company," . . . (2) "[W]here, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company," . . . or (3) "[W]hen approval of a transaction results in a 'sale or change of control' . . . ."

Arnold v. Society for Sav. Bancorp, Inc., 650 A.2d 1270, 1290 (Del. 1994) (citations omitted) (discussing corporate directors' duty to seek transaction offering best value reasonably available to stockholders); *see* Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 43 (Del. 1994) (discussing obligation of corporate directors in sale or change of control transaction).

192. *See Revlon*, 506 A.2d at 182 (holding that corporate directors have duty to maximize common stock price when sale of company is inevitable).

193. *See infra* note 194 and accompanying text.

194. *See Paramount Communications*, 637 A.2d at 48 (discussing duty of directors when corporation undertakes transaction that will cause change in corporate control or break-up of corporate entity).

195. *See id.* at 45 (applying reasonableness standard to judicial scrutiny of corporate directors' actions in sale or change of control of corporation).

196. *Id.*

197. *See* Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 285 (Va. 1999) (concluding that *Revlon* test is inapplicable in Virginia).

198. *See supra* text accompanying note 195.

199. 65 F.3d 1172 (4th Cir. 1995), *cert. denied*, 516 U.S. 1117 (1996).

200. *See* WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172 (4th Cir. 1995) (affirming trial court's entry of declaratory judgment ruling target corporation's defensive measures against corporate takeover bidder were valid when target company was not in sale or control change mode).

in both the corporation's and shareholders' best interests.[201] That decision, speaking to a situation completely *within* the coverage of Section 690, is not authority on the quite different question presented by *Revlon* and *Willard*: *once having decided to sell* the company, do directors have a singular duty to attain the "best price" reasonably available for *shareholders*? Moreover, the *Revlon* issue is not answered by the skimpy language of Section 690 because that section – which necessarily assumes the continued existence of the "corporation" in its insistence that directors consider the "best interests of the corporation" – does not even speak to that issue.

Third, as seen earlier, Section 690 specifies the standard of care in those settings in which directors make business judgments discharging their duties on behalf of the (presumably ongoing) corporation.[202] Section 690 does not establish the benchmark for evaluating director conduct when director loyalty is at issue. Establishment of this benchmark has remained the separate province of the judge-made duty of loyalty. In the *Revlon* setting, both director loyalty and care are implicated.[203] The loyalty issue, to be sure, is not like the typical case in which, as in a classic self-dealing transaction, a director's own self-interest pointedly conflicts with the joint interests of the corporation and shareholders. Rather, the loyalty interest in the end-stage setting concerns which one of two potentially divergent sets of interests deserve the unswerving loyalty of directors: *Shareholder* interests only or the wider set of "corporation" interests, which include those of employees and customers as well as shareholders. A director can breach this latter duty of loyalty by failing to be allegiant to the law's intended recipients of director effort, even though a director's own personal self-interest may not be involved.[204] By analogy, a trustee breaches trust not simply by preferring his own personal interests, but by preferring the interests of a stranger over those of the trust's beneficiary. Lack of self-interest alone does not negate a loyalty concern.

The root issue in *Revlon* is whether director loyalty requires exclusive focus on shareholder welfare at a corporation's end-stage or permits (or requires) directors to factor in a broader array of non-shareholder considerations. An understanding of this root issue reveals that Section 690 simply

201. *See supra* text accompanying notes 25-31.

202. *See supra* text accompanying notes 32-39.

203. *See* Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 43 (Del. 1994) (discussing duty of directors when corporation undertakes transaction that will cause change in corporation control or break-up of corporate entity).

204. *See* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1284 n.32 (Del. 1988) (describing conduct of disinterested directors who abdicated responsibilities as breach of duties of care *and* loyalty); *see also* CORPORATE DIRECTOR'S GUIDE BOOK, *supra* note 80, at 1254-55 ("The duty of loyalty requires directors to exercise their powers in the interests of the corporation and not in the directors' own interest *or in the interest of another person (including a family member) or organization.*" (emphasis added)).

does not address that core social policy debate, one that has raged for many years.[205] Consequently, *Willard's* reasoning that *Revlon* does not apply in Virginia simply because Section 690 deleted the "reasonableness" requirement of Model Act section 8.30 is wholly beside the point.[206] The element of "reasonableness" in a standard of care statute does not settle the *Revlon* issue because "reasonableness" in such a statute is not an element pertaining to the substantive business decision, but goes only to the *manner* of director conduct.[207] The duty of care's limited judicial function is to guide a court's inquiry into only the *process* by which directors act. Consequently, a straightforward statutory standard of director conduct, whether a Section 690 good faith or section 8.30 reasonableness standard, simply does not speak to the contentious *substantive* issue of who should be the intended beneficiary of director loyalty upon the imminent demise of a corporate venture.

Respectable policy arguments can be made on both sides of the *Revlon* issue. *Willard* short-circuited the possibility of genuine debate on that critical issue by wrongly holding that Section 690 somehow had settled the point. Factually that was error in *Willard*, given the trial court record that the directors pointedly had approved the asset sale because they thought it was in the best interests of *shareholders*.[208] More problematical, in Virginia, where directors have no statutory duties to attend affirmatively to the interests of *non-shareholders*,[209] *Willard* now relieves directors of a duty to attend vigorously to the interests of *shareholders* as well. In other words, in the break-up or sale context, Virginia directors apparently have no legal duty to advance the interests of shareholders or anyone else. They need not conduct an auction, engage in price-testing market checks, or take any other measures – including exertion of any effort to negotiate vigorously with a buyer-son or consider a substantially higher rival bid – designed to achieve the goal of gaining the "best price." Indeed, after *Willard*, directors will be hard-pressed to withstand an acquirer's insistence on including a "no-shop" or "no-talk" provision in any merger or asset sale agreement. The acquirer will also strongly

---

205. *See generally* Lyman Johnson, *Corporate Takeovers and Corporations: Who Are They For?*, 43 WASH. & LEE L. REV. 781 (1986) (analyzing interests served by corporations and their managements in context of corporate takeovers).

206. *See* Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 285 (Va. 1999) (concluding *Revlon* test inapplicable in Virginia).

207. *See* MODEL BUS. CORP. ACT ANN. § 8.30, at 8-168 (3d ed. 1996).

208. Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Building Supply, Inc., No. 981836, letter op. at 12 (Va. 24th Jud. Cir. May 14, 1998).

209. Over half the states have enacted statutes that expressly allow corporate boards of directors to consider the interests of various non-shareholder constituencies in making board decisions. For a description and analysis of these statutes, see generally David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991) (re-examining role of business corporation in society following recent wave of statutes expressly redefining corporate management's duty).

resist inclusion of the customary "fiduciary out" clause from such a no-shop or no-talk provision to enable the selling corporation to fulfill its duty to pursue a superior bid. After *Willard*, Virginia no longer recognizes a director duty to pursue a "superior" bid. Therefore directors cannot seek, on legal duty grounds, such a "fiduciary out." Thus investors in Virginia corporations lose, with no socially desirable countervailing winner, such as employees, customers, or local communities. Only family members or favored buyers standing on the other side of low-ball sales will gain from this ruling.

IV. The Faulty Architecture of Section 690

Section 690 is not, as seen above, the sole source of legal standard for director conduct in Virginia. It is not even a broadly applicable standard of care. Rather, for all its vaunted uniqueness, it applies more narrowly than any other state's statutory standard. Its scope is limited to those instances in which directors exercise business judgment. This diminished coverage of Section 690 resulted from Virginia's misguided decision to use in a statute purporting to articulate "general standards of conduct" certain language – "good faith business judgment" – that historically does not express a broadly applicable director duty of care. Rather the phrase "business judgment" reflects a powerful but narrowly gauged policy preference disfavoring judicial review of substantive business judgments.

Bluntly stated, the duty of care and the business judgment rule are two distinct legal concepts.[210] The duty of care governs *directors*. The business judgment rule is a policy of *judicial review*. The duty of care unremittingly requires that, at all times in all settings,[211] corporate directors behave in a particular *manner*. As most frequently formulated, the standard is that a director must act with the care of an ordinarily prudent person in a like position under similar circumstances.[212] Whether or not the director is making a business judgment, the director's duty demands that the director act with a specified degree of care. Such care includes becoming reasonably informed about and paying deliberate attention to all facets of directing the management of the corporation's business and affairs. Absent statutory exoneration,[213] if the director does *not* act with care, whether from nonfeasance or malfeasance, the director is liable for all damages proximately caused by the director's breach

210. *See generally* Johnson, *Business Judgment*, *supra* note 12 (examining relationship between director duty of care and business judgment rule).

211. *See* Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) ("Fiduciary duty does not operate intermittently but is the constant compass by which all director actions for the corporation and interactions with its shareholders must be guided.").

212. *See supra* text accompanying notes 40, 65-68 (discussing director duty of reasonable care in performance of director duties).

213. *See* VA. CODE ANN. § 13.1-692.1 (Michie 1999) (permitting reduction or elimination of officer or director personal liability).

of duty. In such a breach of duty context, there is no need to judicially review the merits of the business decision.

If a director *does* act with care, he is not liable for any damage resulting from the careful conduct. Although much misunderstood, it is only here that the real substantive thrust of the business judgment rule comes into play. The business judgment rule – a judge-made rule – is a policy of judicial review whereby courts will not assess the substantive soundness or unsoundness of a board's business judgments for the purpose of evaluating director care. The rule, moreover, has no application unless a "business judgment" has been made.[214] Thus, director conduct not involving the exercise of business judgment – such as an unconsidered failure to monitor corporate affairs – is reviewed for compliance with the always-applicable duty of care but receives no protective shelter under the business judgment rule.

The protection of the rule is grounded on various well-known and widely-agreed upon policy rationales.[215] Most importantly, the rule provides that for the purpose of determining whether directors have acted in accordance with the applicable standard of care, the resulting substantive business decision will not be judicially reviewed as part of the care inquiry. Consequently, whether or not directors comply with the applicable standard of care, the merits of the business decision will not factor into judicial assessment of director conduct.

The relationship between the pervasive, always-applicable director duty of care and the judicially-created policy of non-review of business judgments housed in the business judgment rule is one of the most important, but least understood, relationships in corporate law. It is not the burden of this Article to disentangle these two central corporate law concepts.[216] The aim, rather, is to elucidate the mischief created by Virginia's conflating of these two related but distinctive notions. What Virginia uniquely and confusingly has done is to implant the highly-specialized terminology of the strictly demarcated business judgment concept into a duty of care statute captioned "General standards of conduct for director."[217]

Seeking to disavow the "prudent" and "reasonable" language of the Model Business Corporation Act and other statutory codifications of care,[218] the drafters of Section 690 wrongly thought those adjectives allow reviewing

---

214. *See supra* notes 41, 166 and accompanying text (discussing requirement that director's decision must be in nature of business judgment for business judgment rule to be applicable).

215. *See generally* Johnson, *Rethinking Judicial Review*, *supra* note 12 (articulating policy rationale for director duty of care).

216. *See generally* Johnson, *Business Judgment*, *supra* note 12 (examining relationship between director duty of care and business judgment rule).

217. VA. CODE ANN. § 13.1-690.

218. *See supra* note 40 and accompanying text (discussing Model Business Corporation Act promulgation of director duty of care standard).

courts to assess the substance of director decisions. The recent *Willard* opinion neatly illustrates this confusion. Contrasting Section 690 with Model Act section 8.30, the Supreme Court of Virginia concluded "that, in Virginia, a director's discharge of duties is not measured by what a reasonable person would do in similar circumstances or by the rationality of the ultimate decision."[219] What the court did not appreciate is that under *no* standard of care, whether found in statute or case law, should a court assess director care by looking at the "reasonableness" or "rationality" of the ultimate business decision. The reason for this is the preclusive operation of the business judgment rule. Virginia's deletion of "prudence" and "reasonableness" from Section 690 was therefore not necessary to achieve a result already attained by a separate legal doctrine.

What the elements of "prudence" and "reasonableness" add, whether at common law or in statutory codifications of care, are only process-oriented standards of *how* a director is to behave – i.e., the *manner* in which a director is to act.[220] Those elements do not introduce into judicial evaluation of director compliance with the duty of care a warrant to assess the *substantive* correctness of director business decisions. To do so – or to interpret Model Act-type statutes as doing so – would be to upend decades of settled law. The duty of care more modestly prescribes only a certain *manner* of conduct, leaving to the separate legal concept of the business judgment rule the job of preventing courts from reviewing the *substantive* merits of director decisions.

Inasmuch as Virginia common law recognized the business judgment rule prior to the enactment of Section 690,[221] that section assuredly did not introduce into Virginia law the concept that substantive business decisions should not be judicially reviewed. If the policy thrust of the pre-existing business judgment rule was not statutorily modified, then Section 690 only altered the duty of care. If anything, without *WLR Foods* insistence on an informed decision-making process,[222] Section 690's singular element of "good faith" would have loosened Virginia's business judgment notion. Virginia, unlike other states, does not require that director *care* (as distinguished from a business decision itself) be measured by standards of prudence or reasonableness. Rather, Section 690 measures director care (as distinguished from a business decision itself) by a "good faith business judgment" standard. Section 690 thus collapses two historically distinct legal concepts so that the

219. *See* Willard *ex rel.* Moneta Bldg. Supply, Inc. v. Moneta Bldg. Supply, Inc., 515 S.E.2d 277, 284 (Va. 1999) (concluding that director must act in accordance with director's good faith business judgment of what is in best interest of corporation).

220. *See supra* text accompanying note 11.

221. *See, e.g.*, Giannotti v. Hamway, 387 S.E.2d 725, 731 (Va. 1990) (collecting authority).

222. *See supra* text accompanying notes 27-30 (analyzing meaning of "good faith" in Section 690).

duty of care is synonymously formulated in terms of a director's good faith *business judgment.*

This means, first, that the scope of Virginia's statutory standard of director conduct is narrower than that in any other state. It is limited, like the business judgment rule itself from which its wording is derived, to those instances in which director judgment is exercised. In other instances in which judgment is not exercised, the common law duty of care, with its requirements of prudence and reasonableness, still governs, however ironic this outcome might be. Any other reading of Section 690, such as that it sets the standard whether or not judgment is exercised, requires reference to some unspecified standard to evaluate the propriety of director conduct in those settings in which judgment was not exercised but a shareholder claims judgment *should have been* exercised. Not referring in that situation to some standard outside Section 690 to resolve *whether* director non-exercise of judgment was proper is to convert Section 690 into a strict liability statute. A more sensible construction is that Section 690 cannot provide the benchmark for evaluating the propriety of director conduct *not* involving the exercise of judgment because Section 690 measures director conduct in *terms of the exercise of judgment.*

Second, given that the director duty of care and the business judgment rule are two distinct concepts in corporate law, it is, at the least, peculiar to express a statutory standard of care that – for reasons presumably grounded in the General Assembly's view of good public policy and morality – directors are legally mandated to fulfill in terms of what the director himself judges to be best. The self-referential standard of Section 690 requires the director to exercise only that degree of care (if that word can still be meaningfully used in this context) which the *director* judges to be in the best interests of the corporation. As long as the director makes a good faith judgment, that judgment itself *is* the standard of care, and so the standard necessarily is fulfilled. Inept directors should be called to account for their incompetence; however, they should not be allowed to lower the bar of legal duty to their own poor performance.

Director care need not be compromised in this fashion simply to preserve director discretion. The venerable business judgment rule provides significant judicial deference when deference is sound on policy grounds. Separately, the duty of care requires that directors behave in a particular *manner.* As long as they do, their decisions will be honored, and they will incur no liability. Virginia, in Section 690, sought to eviscerate with little fanfare a critical director duty – the duty to act with the reasonable care of an ordinarily prudent director. Moreover, many believe that Section 690 sweeps so broadly that a completely unrelated duty – the duty of loyalty – also became lodged in Section 690.[223] This even more bizarre reading makes the director's judgment

223. *See supra* text accompanying notes 94-98.

his own measure of *loyalty*, as well as of care. In this solipsistic view, loyalty becomes radically individualized, meaning whatever a self-referential director says it means. Gone is any sense that loyalty is a meaningful notion only when it reflects and demands adherence to widely shared community values reminding us of our obligation to others.[224] When the very language of loyalty no longer exhorts a fiduciary to transcend the personal, it loses all power to inspire and challenge, much less to sanction. When this happens, the person endowed with responsibility is inclined to slacken in devotion while the person in dependence tends toward disenchantment or self-help, each of which is socially costly.

The upshot of these faulty views on the role of Section 690 in Virginia's law of director duties is that many believe that the section wholly encompasses and defines director duties. This Article argues against this widespread but dangerous misunderstanding of director duties. The misreading of Section 690 must be resisted on many fronts, including in that considerable aspect of director care not involving business judgment, in the still applicable common law duty of loyalty, and in the emergent duty of disclosure. As to Section 690 itself, it should be hailed for what it does do and disregarded for what it does not do. If members of the bar conclude that confining Section 690 to its proper quarters is too difficult at this date, then it should be amended to require simply that directors act with the care reasonably expected from an ordinarily prudent person in a like position under similar circumstances.[225] The business judgment rule will advance the goal of director protection from there. If the scope of Section 690 is not interpreted narrowly as is argued for here or if it is not amended, then the only remaining doubt hanging over that section is this: Will a court of equity engraft onto the pallid legal requirements of Section 690 the further equitable obligation that directors act with genuine care, as that term has been more richly understood over the past countless years?

Conclusion – Recapitulating Director Duties

Director duties in Virginia can be summarized as follows: Directors continue to owe a duty of care and a duty of loyalty to their corporations. If a business judgment is made specifically not to sell control (i.e., the *WLR Foods* case), then the only applicable standard of conduct is Section 690, without regard to whether director care or loyalty is involved. This is not because Section 690 codifies loyalty. It is because several statutory sections

224. For a wonderful sampling of stories portraying how loyalty connects us to our fellow humans, see WILLIAM J. BENNETT, THE BOOK OF VIRTUES 663-737 (1993).

225. This formulation has the virtue of simplicity and is very close to the common law formulation of care found in Virginia and other states. *See supra* notes 64-67 and accompanying text.

combine to make clear that Section 690 applies exclusively in that narrow context,[226] thus making the care or loyalty inquiry irrelevant. If a business judgment is made in a setting other than a decision not to sell control, the applicable standard of care is that set forth in Section 690, *provided* no conflict of interest or other loyalty-implicating factor is involved. If no director business judgment is made – as might happen in, for example, the oversight and monitoring area – the applicable standard of care is the common law duty of reasonable care, again *provided* no conflict of interest or other loyalty-implicating factor is involved.

Outside the narrow setting of a board decision not to sell control – in which Section 690 alone governs – the director duty of loyalty demands that when conflict of interest or unfair competition is involved, the standard of director conduct and of judicial review of such conduct should be entire, or whole, fairness. The burden of proof on the entire fairness issue is on the director(s) with the divided loyalty, and courts should scrutinize closely those matters. Fairness should entail a threshold determination that a matter was affirmatively in the *corporation's* best interests. Thereafter, fairness includes both the process element of "fair dealing" and the economically substantive element of "fair price." As to conflict of interest transactions falling *within* the ambit of Section 691, that statute serves only to modify Virginia's common law rule of transactional voidability. Moreover, the term "fair" in that statute should be construed to mean "entire fairness" as that concept was described above. Section 691 leaves to the common law of loyalty – not Section 690 – the issue of personal liability for damages (or other remedial relief) owed by the conflicted director(s) engaged in the transaction. Here too, the standard of conduct and review on the damages and remedies issue should be "entire fairness" as that concept was described above. As to conflict of interest transactions falling *outside* the scope of Section 691, the common law standard for both transactional validity and personal liability for damages (and other remedial relief) should be "entire fairness" as that concept was described above. Section 691 should be amended by the General Assembly to provide more inclusively for transactional certainty across a broader range of director conflict transactions. Sections 8.60 through 8.63 of the Model Business Corporation Act offer a possible statutory model.[227]

If a business judgment is made specifically to break-up a corporation or to sell control of the corporation, the good faith business judgment standard

226. *See* WLR Foods, Inc. v. Tyson Foods, Inc., 65 F.3d 1172, 1182 (4th Cir. 1995), *cert. denied*, 516 U.S. 1117 (1996) (discussing how VA. CODE ANN. §§ 13.1-646B, 727.1, and 728.9 refer to Section 690 as applicable to declaratory and injunctive action between target corporation and takeover bidder).

227. *See* MODEL BUS. CORP. ACT ANN. §§ 8.60-.63 (3d ed. 1996) (codifying statutory rules applicable when director has conflicting interests in corporate transaction).

of Section 690 applies as to the *manner* of director conduct, provided no conflict of interest or other loyalty implicating factor is involved. An additional issue exists as to the proper recipients of director loyalty in that context. The interpretive issue is actually a complex policy issue: Whether, in the end-stage context, "best interests of the corporation" means best interests of the common shareholders only or some other broader set of "corporate" interests. The answer to that important social policy debate, the so-called *Revlon* issue, lies not in Section 690 itself but must be found, not unexpectedly, in the richer social materials shaping both judicial imagination and interpretation.[228]

Directors of Virginia corporations should be under a general duty of disclosure to shareholders. This duty will only take on more importance in the years ahead as investors rightly clamor for full and accurate corporate information. To be sure, the question, of the proper scope or content of required disclosure to shareholders is, in some respects, a *business* judgment. The prior question of *whether* disclosure is required, however, and, on balance, even whether such disclosure as was made is sufficient, is better regarded as a *legal* judgment not falling solely within the coverage of Section 690. Judges must develop the shape and reach of this duty using the case-by-case common law method.

The above recapitulation is partially normative and not purely descriptive. This is because the recent *Willard* decision is at odds with portions of the above summary and, in this author's view, *Willard* wrongly finds Section 690 to glibly answer the important loyalty and *Revlon* issues raised in that case. With that exception, however, the above recapitulation sets forth current legal demands on directors of Virginia corporations. As can be seen, considerably more than "good faith" is required. Directors have a right to be told this by their attorneys.

---

228. As Holmes expressed this idea long ago: "The first requirement of a sound body of law is, that it should it correspond with the actual feelings and demands of the community, whether right or wrong." OLIVER WENDELL HOLMES, JR., THE COMMON LAW 41 (Dover Publications 1991) (1881). For an example of this idea in the context of director obligations, see generally Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEXAS L. REV. 865 (1990) (examining social expectations of publicly held business corporations as expressed in Delaware judicial decisions concerning hostile corporate takeover bids).