Washington and Lee Law Review

Volume 44 | Issue 1 Article 7

Winter 1-1-1987

Delaware Amendment Relaxes Directors' Liability

DELAWARE AMENDMENT RELAXES DIRECTORS' LIABILITY

The Delaware legislature recently passed an amendment to the Delaware General Corporation Law that allows shareholders to vote to relieve directors of financial liability for breaches of the fiduciary duty of care.[1] The new Delaware law will create a tremendous impact in the law of corporations.[2] Currently, over one-half of the Fortune 500 companies[3] and approximately forty percent of the corporations traded on the New York Stock Exchange are incorporated in Delaware.[4] Thus Delaware corporation law occupies a significant position in the business arena.[5] Moreover, courts must accord full faith and credit to Delaware corporation law in actions involving companies organized in Delaware but operating elsewhere, thus extending Delaware's

---

1. DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986). Section 102 (b)(7) of the new Delaware amendment provides that:

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

DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986). *See infra* notes 13-23 and accompanying text (describing provisions of § 102 (b)(7) of Delaware General Corporation Law).

2. *See infra* notes 5-8 and accompanying text (discussing nationwide application of Delaware law through full faith and credit clause, conflict of laws rules, and *Erie* doctrine); *see also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 2, § 2 comment a, § 5 comment a, § 6, § 6 comment b, § 93 (1967) (defining and explaining conflict of laws and full faith and credit clause); 1A J. MOORE, MOORE'S FEDERAL PRACTICE § .310 (2d ed. 1981) (describing effect of *Erie* doctrine on choice of law issue); Hill, *The Erie Doctrine and the Constitution*, 53 N.W. L. REV. 427, 428 (1958) [hereinafter Hill] (describing *Erie* doctrine).

3. *See* Kanner, *A Trimmer 'Fortune' Carries Its Weight Well After 50 Years*, ADVERTISING AGE, Feb. 4, 1980, at 32 (originating in 1955, Fortune's list of top 500 corporations is most well-known magazine ranking of businesses).

4. *See* Black, *A National Law of Takeovers Evolves in Delaware*, Legal Times, Nov. 25, 1985, at 6, col. 1 (describing Delaware's historical importance in corporation law); Herzel & Richman, *Delaware's Preeminence by Design*, 1 THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS lix, lix (1985) [hereinafter DELAWARE LAW] (tracing development of Delaware's popularity as a state of incorporation).

5. *See* DELAWARE LAW, *supra* note 4, at lix (discussing Delaware's importance in business community).

influence nationwide.[6] Finally, conflicts of law rules[7] and the *Erie* doctrine[8] often require federal courts to rely on both the Delaware code and Delaware case law when deciding cases involving Delaware corporations.[9]

Delaware historically has been a haven for big businesses seeking an attractive climate for incorporation.[10] The Delaware General Assembly has

---

6. *See* U.S. CONST. art. IV, § 1 (full faith and credit clause); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 2 comment b (1967) (describing full faith and credit clause). The full faith and credit clause of the United States Constitution and its enabling provision set forth the effect that each state must give to acts, records, and proceedings of a sister state. RESTATEMENT (SECOND) CONFLICT OF LAWS § 2 comment b (1967). The clause requires states to recognize and enforce a valid judgment that another state issued. *Id.* at § 93.

7. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 2 (1967). Conflict of laws is an issue of state law that determines which law courts must apply in a case in which the parties have a significant relationship with more than one state. *Id.* A state may declare its own policy on conflict of laws. *Id.* at § 5 comment a. In many cases, a court, however, will find no specific statute prescribing the conflict of laws treatment of the fact situation before the court. *Id.* at § 6 comment b. In the absence of statutory language, courts may consider in making the choice of law decision such factors as the needs of the interstate system, relevant policies of the forum state, basic policies underlying the particular field of law, and certainty, predictability, and uniformity of result. *Id.* at § 6; *see* Beard v. Elster, 160 A.2d 731, 735 (Del. 1960) (holding that issuance of New York stock option plans by Delaware corporation involved internal affairs of Delaware corporation and, therefore, was subject to Delaware law rather than New York law); Great Western Producers Co-op. v. Great Western United Corp., 200 Colo. 180, , 613 P.2d 873, 878 (Colo. 1980) (Colorado court imposed upon directors of Delaware corporation duties of fidelity, good faith, and prudence in accordance with Delaware case law and statutes).

8. *See* Erie Railroad v. Tompkins, 304 U.S. 64, 78 (1938) (holding that federal court must apply state substantive law); Hill, *supra* note 2, at 428. In accordance with the *Erie* doctrine, federal courts must use state law to decide matters that are clearly substantive. Hill at 428. In addition, federal courts must apply state law which is outcome determinative in the case. *Id.* Outcome determinative laws are laws that substantially or significantly affect the result of litigation. *Id.* The underlying rationale of the *Erie* doctrine is that the result of federal court litigation should be substantially the same as if the state court tried the action. *Id.*

9. *See* 1A J. MOORE, MOORE'S FEDERAL PRACTICE § .310 (1981) (stating that federal courts must follow state law on matters of corporate liability); *see, e.g.*, Burks v. Lasker, 441 U.S. 471, 475 (1979) (holding that state law governed authority of independent directors to discontinue shareholder derivative suits in cases brought under Investment Company Act of 1940 and Investment Advisor's Act of 1940); Santa Fe Industries v. Green, 430 U.S. 462, 479 (1977) (holding that state law controlled corporation law rather than federal law); Abbey v. Control Data Corp., 603 F.2d 724, 728-29 (8th Cir. 1979) *cert. den.* 444 U.S. 1017 (1980) (court used Delaware case law to analyze application of business judgment rule to directors' termination of shareholder derivative action because company was incorporated in Delaware); Perlman v. Feldman, 219 F.2d 173, 175 (2d Cir. 1955) *cert. den.* 349 U.S. 952 (1955) (court determined fiduciary duty of majority shareholder to minority shareholder by laws of state of incorporation).

10. *See* Moore, *A Brief History of the General Corporation Law of Delaware and the Amendatory Process*, 1 THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS lxxv, lxxxiv (1985) (describing historical development of Delaware corporation law). In 1913, New Jersey Governor Woodrow Wilson's antitrust acts outlawed trusts and holding companies in New Jersey. *Id.* at lxxxiv. As a result, Delaware enjoyed an influx of corporations looking for a new, more congenial base. *Id.* In the next decades, the federal securities acts of the

stated as public policy the desire to treat corporations favorably.[11] Delaware has retained the lead position in the competition between states to attract incorporating businesses through a melding of the policies of the legislature and the structure and support of the Delaware judicial system.[12]

The most recent legislative modification of the Delaware corporation law added section 102 (b)(7) (the amendment),[13] which enables shareholders of a corporation to vote to include a provision in the articles of incorporation

---

1930's tightened corporate regulations thus eliminating many attractive features of the Delaware law. *Id.* In addition, revised corporate laws in other states limited somewhat Delaware's incorporation business. *Id.* at lxxxv. In 1967, however, the Delaware General Assembly approved a major update of the general Corporation Law in an effort to attract businesses to incorporate in Delaware. *Id.* at xc. The aim of the update was to clarify existing language, simplify the mechanics of the statute, and make substantive improvements in the law. *Id.* at lxxxvii.

11. *See* Preamble, 54 DEL. LAWS 724 (1963) (declaration of legislature's policy to support corporations).

12. *See* Black, *supra* note 4, at 6. The Delaware court system has developed a specialized and efficient forum for processing corporate claims in the Court of Chancery. *Id.* The court consists of a chancellor and three vice chancellors, has no juries, and operates much like an appellate court. *Id.* The vast number of issues appearing before the chancery court has led to an advanced development of Delaware's corporate law. *Id.* In addition, judicial rules facilitating obtaining personal jurisdiction over defendants and awarding attorney's fees as a percentage of the outcome of the litigation, add to the attractiveness of the Delaware court system. Herzel & Richman, *Delaware's Preeminence by Design*, DELAWARE LAW at lxiii (1985); *see supra* notes 9-10 and accompanying text (describing Delaware legislature's support of corporations).

13. DEL. CODE ANN. tit. VIII, § 102 (b)(7) (effective date July 1, 1986); *see supra* note 1 and accompanying text (setting forth text of Delaware amendment § 102 (b)(7)). In addition to section 102 (b)(7), the Delaware legislature amended section 145 of the Delaware General Corporation Law. *See* DEL. CODE ANN. tit. VIII, § 145 (1986) (amending aa145 of Delaware corporation law); Black & Sparks, *Analysis of the 1986 Amendments to the Delaware Corporation Law*, PRENTICE-HALL CORPORATION 312 (1986) [hereinafter Black & Sparks] (discussing 1986 amendments to Delaware corporation law). Section 102 (b)(7) provides a solution to liability of outside directors. Black & Sparks, *supra*, at 312. Outside directors are board members that are independent of the corporation. E. BRODSKY & M. ADAMSKY, LAW OF CORPORATE OFFICERS AND DIRECTORS - RIGHTS, DUTIES, AND LIABILITIES ch.2, at 7 (1984) [hereinafter LAW OF CORPORATE OFFICERS]. Section 145, alternatively, provides the solution of indemnification for liability of corporate officers, inside directors, employees, and agents. Black & Sparks, *supra*, at 312. Inside directors are board members that the corporation employed. LAW OF CORPORATE OFFICERS, *supra*, at ch.2, at 7. Through indemnification, corporations may reimburse inside directors for legal expenses, fines, judgments, and settlements incurred in defending suits related to the corporation. *Id.* The Delaware legislature amended section 145 (b) to hold officers liable only for gross negligence rather than ordinary negligence as in the prior statute. Black & Sparks, *supra*, at 312. The change in section 145 (e) shifts the burden of proof of entitlement to indemnification from the claimant to the corporation after the corporation has advanced litigation expenses to the claimant. *Id.* at 313. Another change in section 145 (e) allows advances of legal fees by a general authorization in bylaw provisions, the articles of incorporation, or contracts, rather than by a case-by-case evaluation. *Id.* Finally, section 145 (f) is a legislative statement that indemnification under section 145 is not exclusive. *Id.* Section 145, therefore, does not affect a director's right to seek other mechanisms of indemnification from the corporation such as an individual indemnification contract. *Id.* While section 102 (b)(7) applies to outside directors, inside directors also benefit from relaxed liability standards through the amendments to section 145. *Id.*

limiting or completely eliminating director liability for breaches of the directors' duty of due care.[14] The amendment, though, only applies to outside directors.[15] Outside directors have no connection with the corporation, and serve as independent monitors of corporate activity.[16] Inside directors, in contrast, generally are officers or employees of the corporation.[17] By only applying to outside directors, the amendment attempts to encourage outside directors to continue serving on boards.[18] The amendment, however, does not excuse outside directors for violations of their duty of loyalty to the company.[19] Furthermore, the amendment does not excuse a director from liability for: acts not performed in good faith, conduct involving intentional violations of the law, payment of unlawful dividends, unlawful stock repurchases, and transactions resulting in personal benefit accruing to the director.[20] The amendment also does not impair available equitable remedies.[21] Finally, the amendment gives shareholders the option of imposing a specific dollar cap or other limitation on director liability, rather than voting to relieve directors from all financial liability for breaches of the duty of care.[22]

---

14. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (provision allowing shareholders to relieve directors from financial liability for duty of care violations); *infra* notes 24-44 and accompanying text (discussing directors' fiduciary duty of care and business judgment rule). The duty of care requires that a director act with the care of an ordinary person in a similar position when carrying out his responsibilities to the corporation. LAW OF CORPORATE OFFICERS, *supra* note 13, at ch. 2, at 1.

15. *See* Greenhouse, *Liability Curb Aids Directors*, N.Y. Times, Aug. 12, 1986, at D2, col. 1 (stating amendment does not affect liability of inside directors); Black & Sparks, *supra* note 13, at 312 (implying continued liability for inside directors by predicting that officers will refer risky decisions to protected directors); Crossen, *Companies Ask Holders To Limit Liability*, Wall St. J., Oct. 7, 1986, at 35, col. 3 (stating that amendment applies only to outside directors); *supra* note 13 and accompanying text (§ 102 (b)(7) addresses insurance crisis for outside directors, while § 145 provides expanded indemnification solution for inside directors).

16. *See* LAW OF CORPORATE OFFICERS, *supra* note 12, at ch. 2, at 7 (defining outside director); *infra* note 28 and accompanying text (listing activities required of outside director). *Cf.* LAW OF CORPORATE OFFICERS, *supra* note 13, at ch.2, at 7 (describing activities of inside directors as active participation in daily affairs of corporation and receipt of full-time compensation).

17. *See* LAW OF CORPORATE OFFICERS, *supra* note 13, at ch.2, at 7 (defining inside director).

18. *See* Black & Sparks, *supra* note 13 (stating purpose of amendment is to attract directors to serve on boards).

19. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (stating that amendment does not address duty of loyalty violations); *see infra* notes 47-50 and accompanying text (discussing fiduciary duty of loyalty). The fiduciary duty of loyalty requires that a director maintain undivided and unqualified loyalty to the corporation. LAW OF CORPORATE OFFICERS, *supra* note 13, at ch. 3, at 1.

20. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (listing directors' actions that amendment does not address).

21. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (amendment does not eliminate equitable remedies); Black & Sparks, *supra* note 13, at 312 (stating that section 102 (b)(7) does not eliminate the availability of equitable remedies such as injunctions or rescissions based on breaches of duty of care).

22. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (stating that shareholders may

While allowing shareholders to reduce directors' financial liability, the amendment differentiates between breaches of the duty of care and breaches of the duty of loyalty.[23] Specifically, the amendment only applies to breaches of the duty of care.[24] The duty of care requires that directors act with the degree of care that an ordinarily prudent person would exercise in similar circumstances.[25] Specific requirements of the fiduciary duty of care often are absent in state statutes.[26] Rather, the judiciary traditionally has determined the specific requirements of the duty of care.[27] The duty of care requires that directors attend directors' meetings, gather adequate information upon which to make decisions, carefully review the information provided, and monitor activities delegated to officers.[28] The underlying premise of the duty of care is that a director must act responsibly, and should not function as a director without assuming the accompanying responsibilities.[29]

An important development in the duty of care is the business judgment rule.[30] The business judgment rule presumes that boards exercise sound business judgment.[31] More specifically, a court will not disturb a board's decision if the board attributes the decision to a rational business purpose.[32] Directors must satisfy four prerequisites when seeking the protection of the business judgment rule.[33] Directors must be disinterested in the transaction.[34]

---

impose a limitation upon director liability). Examples of limitations that shareholders may approve include a stated maximum dollar level of liability, or limited liability for certain types of transactions. Black & Sparks, *supra* note 13, at 312.

23. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (stating that amendment does not apply to duty of loyalty violations); *infra* notes 25-51 and accompanying text (describing and defining directors' duty of care and duty of loyalty).

24. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (allowing shareholders to vote to relieve directors of liability for violations of duty of care).

25. *See* Briggs v. Spaulding, 141 U.S. 132, 152 (1891) (describing duty of care standard as care that ordinary, prudent, and diligent men would exercise in circumstances); W. GRANGE, CORPORATION LAW FOR OFFICERS AND DIRECTORS: A GUIDE TO CORRECT PROCEDURE 402, 405 (1935) (describing duty of care and diligence applicable to directors); LAW OF CORPORATE OFFICERS, *supra* note 13, at ch. 2, at 1 (1984) (discussing directors' duty of care).

26. *See* Soderquist, *Toward A More Effective Corporate Board: Reexamining Roles of Outside Directors*, 52 N.Y.U. L. REV. 1341, 1342 (1977) (describing lack of specific director responsibilities in state statutes).

27. *See* LAW OF CORPORATE OFFICERS, *supra* note 13, at ch.2, at 3 (stating that courts have determined specific functions of directors).

28. *See id.* at ch. 2, at 1 (listing responsibilities that duty of care imposes upon directors).

29. *See id.* at ch. 2, at 2 (describing rationale of duty of care).

30. *See* Soderquist, *supra* note 26, at 1345-46 (business judgment rule modifies duty of care standard); *supra* note 13 (defining duty of care).

31. *See* Arsht, *In Staunch Defense of Delaware*, Commentaries on Corporate Structure and Governance, ALI-ABA Symposiums 238, 240 (1978) (defining business judgment rule).

32. *See* Cox, *Compensation, Deterrence, and the Market as Boundaries for Derivative Suit Procedures*, 52 GEO. WASH. L. REV. 745, 761-62 (1984) (stating that business judgment rule requires that directors' decisions be rational).

33. *See* Hinsey, *Duty of Care; Liability for Negligence; Supervision and Monitoring*, 1983 A.B.A. SEC. OF LITIG. ANNUAL MEETING, 8-9 (listing prerequisites to use of business judgment rule as shield against director liability).

34. *See id.* (directors should receive no personal benefit from and have no personal interest in corporate transaction).

Directors also must exercise due care.[35] Directors must not abuse their discretion.[36] Finally, directors must act in good faith.[37] If a director fails to satisfy any of the prerequisites, then the business judgment rule will not shield a director's actions.[38] Courts have used the business judgment rule to protect directors from liability for ordinary negligence.[39] The business judgment rule prevents judicial evaluation of directors' erroneous business decisions.[40] In protecting directors from personal liability for honest mistakes, the business judgment rule encourages risk-taking by directors thus fostering corporate growth.[41] Furthermore, the business judgment rule enables a corporation to obtain competent directors who do not fear financial exposure.[42] The business judgment rule narrows the duty of care from the ordinary care standard to require only that directors have a reasonable basis for their decisions.[43] The availability of more attractive business alternatives is immaterial to the business judgment rule's protection of a reasonable decision because the business judgment rule only requires that a decision be rational in the circumstances.[44] The business judgment rule protects directors from liability for decisions which, while reasonable at the time, prove to be erroneous.[45]

Protecting only errors in judgment, the business judgment rule does not excuse directors from breaches of the duty of loyalty.[46] Similarly, the amend-

---

35. *See id.* (directors should make reasonable attempts to analyze available information and follow analysis with informed decision).

36. *See id.* (directors should act in best interests of corporation and shareholders).

37. *See id.* (directors must act in good faith).

38. *See id.* (all prerequisites to business judgment rule are necessary to allow directors to invoke protection of business judgment rule).

39. *See* Arsht, *supra* note 31, at 240 (business judgment rule presupposes exercise of due care, thus eliminating liability for ordinary negligence); *infra* notes 40-43 and accompanying text (business judgment rule facilitates director decision making). *See, e.g.*, Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984) (court found dismissal of shareholder derivative suit was informed decision and protected by business judgment rule); Edelman v. Phillips Petroleum Co., C.A. No. 7899 (Del. Ch. Feb. 12, 1985) (court uses business judgment rule to protect directors' use of takeover defense); Thompson v. ENSTAR Corp., C.A. No. 7641 (Del. Ch. Aug. 16, 1984) (applying business judgment rule to directors' action in proxy contest).

40. *See* Easterbrook and Jarrell, *Do Targets Gain From Defeating Tender Offers?*, 59 N.Y.U. L. REV. 277, 277 (1984) (discussing policy underlying business judgment rule). The policy deterring judicial intervention relies on the desire to prohibit ill-equipped courts from making strictly business decisions. W. GROENING, THE MODERN CORPORATE MANAGER: RESPONSIBILITY AND REGULATION 36 (1981).

41. *See* Herzel & Katz, *The Business of Judging Business Judgment*, 41 BUS. LAW. 1187, 1189 (1985) (stating that business judgment rule generates corporate boldness needed for entrepreneurial development).

42. *See* DELAWARE LAW, *supra* note 4, at 78 (1985) (explaining that effect of business judgment rule is to attract directors to corporation).

43. *See* COX, *supra* note 32, at 761-62 (discussing effect of business judgment rule on duty of care).

44. *See id.* (discussing effect of alternative decisions on director's ability to invoke protection of business judgment rule).

45. *See supra* notes 32-37 and accompanying text (discussing requirements of business judgment rule).

46. *See* DELAWARE LAW, *supra* note 4, at 74 (stating that directors violating duty of loyalty may not invoke protection of business judgment rule).

ment retains director liability for breaches of the duty of loyalty.[47] The duty of loyalty requires that a director act honestly, loyally, and in good faith in his relationship with the corporation.[48] The duty of loyalty extends to actions by directors falling under the general category of conflicts of interest.[49] Specifically, the duty of loyalty prohibits directors from seizing corporate opportunities, participating in competing businesses, using confidential information, or other similar acts.[50] Ultimately, the fiduciary duty of loyalty attempts to prevent self-dealing by directors in corporate fiduciary relationships.[51]

Leaving untouched the fiduciary duty of loyalty, the Delaware legislature adopted the new amendment in response to the recent threat to Delaware's profitable position in the incorporation market arising out of the shortage of Directors' and Officers' liability insurance (D & O).[52] In the past, D & O policies were available that provided coverage for corporate reimbursement and individual liability.[53] Recently, however, substantial changes have occurred in the area of D & O insurance.[54] Insurance companies have withdrawn D & O coverage because of rising numbers of claims and adverse judgments and settlements.[55] D & O policies that remain available charge premium rates that

---

47. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (stating that amendment does not address violations of directors' duty of loyalty); *supra* note 19 (defining duty of loyalty).

48. *See* W. FLETCHER, 3 CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 838 (Supp. 1985) (defining duty of loyalty).

49. *See* W. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS 50 (3d ed. 1978). Conflicts of interest involve situations in which a director utilizes his position to obtain personal benefit. *Id.* Conflicts of interest violate the duty of loyalty requirement that directors not profit personally from corporate transactions. *Id.* at 8.

50. *See* N. LATTIN, LATTIN ON CORPORATIONS § 79, at 283 (2d ed.) (1971) [hereinafter Lattin] (describing breaches of duty of loyalty).

51. *See Responsibilities of Corporate Officers and Directors Under Federal Securities Laws*, 2 CORPORATION LAW GUIDE (CCH) 16 (1986) (discussing underlying premise of duty of loyalty).

52. *See* Olson, *The D & O Insurance Gap: Strategies for Coping*, Legal Times, Mar. 3, 1986, at 25, col. 1 (describing D & O insurance and current shortage); *infra* notes 53-57 and accompanying text (defining and discussing Directors' and Officers' liability insurance); *supra* notes 4-12 and accompanying text (discussing Delaware's preeminence in incorporation market).

53. *See* Olson, *supra* note 52, at 25 (describing D & O coverage). D & O policies insured the corporation for amounts paid out through indemnification of directors and officers by the corporation. *Id.* D & O policies provided direct benefits to directors and officers that courts found personally liable. *Id.*

54. *See* Baum & Byrne, *The Job Nobody Wants*, BUS. WK., Sept. 8, 1986, at 56 (discussing changes in D & O market); *infra* notes 55-57 and accompanying text (discussing changes in D & O market).

55. *See* Lewin, *Director Insurance Drying Up*, N.Y. Times, Mar. 7, 1986, at D1, col. 3 (discussing decline in D & O insurance availability); Darlin, *Most of Armada's Directors Resign Over Insurance*, Wall St. J., Feb. 5, 1986, at 40, col.3 (describing factors contributing to D & O insurance crisis); Olson, *supra* note 52, at 25 (discussing D & O insurance shortage). *But see* Greenhouse, *supra* note 15, at D2 (quoting Harvey J. Goldschmid, professor of law at Columbia University, who contends that D & O crisis also is result of litigation on environmental, products liability, and securities issues).

are fifteen to twenty times as expensive as previous rates and frequently have higher deductible amounts.[56] Similarly, many available policies exclude coverage for takeover violations and shareholder derivative claims.[57] With the frequent number of shareholder suits and takeovers,[58] directors have become more cautious about accepting directorships and risking personal assets.[59] Directors fear that courts will hold the directors personally liable for negligent actions.[60] To combat the fear of personal liability, directors traditionally relied upon the availability of D & O coverage before accepting employment positions.[61] Currently, however, the insurance shortage has forced many potential directors to refuse to accept positions.[62] Moreover, uninsured directors presently serving on boards are approaching critical decisions with unprecedented caution.[63]

While the Delaware legislature primarily directed the new amendment at relieving the insurance crisis by eliminating financial liability for directors, the amendment also serves as the latest effort by the Delaware General Assembly to relax the corporate liabilities of business and management.[64] Prior to the enactment of the amendment, the business judgment rule pro-

---

56. *See* Olson, *supra* note 52, at 25 (describing increased expense of D & O insurance).

57. *Id.*

58. *See* Baum & Byrne, *supra* note 54, at 56 (discussing increased litigation against directors); M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS 1-4 (1978) [hereinafter Lipton & Steinberger]. A takeover is an attempt by a bidder to gain control of a company by acquiring outstanding shares. *Id. See* Lattin, *supra* note 50, at 413. A shareholder derivative suit is an action that shareholders bring to enforce a corporate right against the corporation's directors or managers. Lattin, at 413.

59. *See* Lewin, *supra* note 55, at D4 (discussing directors' fears of liability for judgments in absence of D & O coverage); Bennett, *Board Members Draw Fire and Some Think Twice About Serving*, Wall St. J., Feb. 5, 1986, at 1, col. 6 (describing directors' concerns about continuing to serve on boards because of lack of available insurance protection); Baum & Byrne, *supra* note 54, at 56 (directors are unwilling to continue serving for fear of personal liability).

60. *See* Bacon, *Directors: The Heat's On*, ACROSS THE BOARD, Jan. 1986, at 13 (directors fear personal liability for negligence); Olson, *The D & O Insurance Disaster*, ACROSS THE BOARD, July/Aug. 1986, at 38 (describing current public trend of requiring greater board accountability). The decision of the Delaware Supreme Court in *Smith v. Van Gorkom*, which imposed liability on directors for gross negligence, is the source of much of directors' concerns regarding personal liability. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). Lewin, *Delaware Law Allows Less Liability*, N.Y. Times, June 19, 1986, at D1, col. 1; *infra* notes 131-59 and accompanying text (discussing *Van Gorkom* and fear that *Van Gorkom* decision generated among directors).

61. *See* Olson, *supra* note 52, at 25 (discussing directors' traditional reliance on D & O coverage).

62. *See supra* notes 59-60 and accompanying text (describing directors' refusal to accept board positions because of fear of personal liability for judgments).

63. *See* Baum & Byrne, *supra* note 54, at 60 (describing cautious director behavior as result of D & O shortage); Herzel & Harris, *Uninsured Boards Mount Weak Defense*, Nat'l L. J., April 21, 1986, at 36 (predicting that uninsured boards will remain passive during crisis moments requiring critical decision making).

64. *See infra* notes 65-72 and accompanying text (tracing gradual relaxation of standards of director liability by Delaware General Assembly).

tected directors of Delaware-based corporations from liability for ordinary negligence in the exercise of the duty of care.[65] Directors remained liable, however, for gross negligence arising from breaches of the duty of care.[66] The amendment excuses directors for gross negligence.[67] Directors, therefore, currently are shielded from liability for all negligence.[68] The amendment protects director actions that are sufficiently uninformed to fall beyond the protection of the business judgment rule and yet are not violations of the duty of loyalty.[69] In the past, there arose few cases in which courts held directors liable for violating the duty of care.[70] Courts generally invoked the business judgment rule to protect directors' actions.[71] Recently, however, issues of grossly negligent board actions are receiving attention from the public as a result of a trend toward board accountability.[72] The amendment, however, operates to halt possible further development of cases holding directors liable for negligence in the exercise of the directors' duty of care.[73]

Relieving directors of liability for all negligence, section 102 (b)(7) has generated extensive debate among commentators.[74] Supporters of the amendment strenuously defend the amendment's attributes.[75] Delaware officials argue that the amendment fulfills a policy of encouraging individuals to perform the socially valuable monitoring functions of an outside director by freeing

---

65. *See* Soderquist, *supra* note 26, at 1348 (describing business judgment rule's protection of directors from liability for ordinary negligence); *supra* note 39 and accompanying text (discussing business judgment rule exculpating directors for ordinary negligence).

66. H. HENN, LAW OF CORPORATIONS 453 (2d ed. 1970) (noting that directors are negligent in failing to perform board responsibilities).

67. *See* Black & Sparks, *supra* note 13, at 312 (stating that charter provisions adopted under new amendment absolve directors of liability for gross negligence).

68. *See* DEL CODE ANN. tit. VIII, § 102 (b)(7) (1986) (provision allowing shareholders to relieve directors of liability for breaches of duty of care); Black & Sparks, *supra* note 13, at 312 (amendment allows shareholders to relieve directors of liability for negligence).

69. *See* DEL. CODE ANN. tit. VIII, § 102 (b) (7) (1986) (allowing shareholders to eliminate directors' liability for negligence); *supra* notes 30-51 and accompanying text (discussing business judgment rule and duty of loyalty).

70. *See* Soderquist, *supra* note 26, at 1348 (discussing lack of cases holding directors liable for breaches of fiduciary duty in absence of self-dealing).

71. *See* Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968) (stating that few decisions imposed liability for duty of care violations).

72. *See* Bacon, *supra* note 60, at 13 (predicting a continuation of trend of public demand for greater director accountability).

73. *See infra* notes 180-91 and accompanying text (analyzing effects of new amendment).

74. *See* Greenhouse, *supra* note 15, at D2 (stating that amendment has generated debate over responsibilities of directors).

75. *See* Greenhouse, *supra* note 15, at D2 (commentators describing advantageous features of new Delaware amendment); Crossen, *supra* note 15, at 35 (presenting views of supporters and critics of amendment); Kaplan, *Delaware's Misguided Law to Ease Corporate Directors' Burden*, N.Y. Times, Aug. 9, 1986, at 22, col. 4 (letter to editor) (answering supporters views on amendment with criticism); *infra* notes 75-97 and accompanying text (describing positive attributes of the amendment).

directors from the threat of personal liability.[76] The insurance crisis forced the resignations of many directors.[77] By relaxing personal liability standards, the amendment provides incentive for individuals to accept again positions as directors.[78] Supporters argue vigorously that the amendment will encourage individuals to serve as directors.[79]

In addition to favoring the amendment for its effect of increasing board service, some commentators supporting the amendment are critical of the entire duty of care standard.[80] The commentators favor the complete abolition of the duty of care.[81] One commentator asserts that the application of the negligence-based duty of care to the corporate director is unsound analytically.[82] The commentator reasons that the concept of negligence is based upon a departure from an ordinary level of behavior, yet there exist no common standards addressing the function of directors.[83] Other commentators recognize that stringent judicial imposition of the duty of care renders directors hesitant to take risks when making business decisions.[84] Director hesitancy precludes

---

76. *See* Greenhouse, *supra* note 15, at D2 (quoting Anthony G. Flynn, counsel to Delaware Governor Michael N. Castle, discussing beneficial effect of amendment attracting outside directors to provide independent scrutiny of management); Black & Sparks, *supra* note 13, at 311 (stating purpose of amendment is to attract outside directors).

77. *See* Baum & Byrne, *supra* note 54, at 57 (discussing D & O shortage as prompting directors' resignations); Lewin, *supra* note 55, at D4 (explaining director refusal to continue serving on boards); Greenhouse, *supra* note 15, at D2 (discussing directors' refusals to serve on boards).

78. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (amendment relieves directors of liability for duty of care violations); Black & Sparks, *supra* note 13, at 311 (explaining amendment's purpose to attract individuals to serve on boards); Crossen, *supra* note 15, at 35 (new amendment allows companies to secure outside directors); Greenhouse, *supra* note 15, at D2 (new amendment encourages directors to accept board positions).

79. *See supra* notes 75-77 and accompanying text (discussing effect of amendment encouraging directors to accept board positions).

80. *See* Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1493 (1984) (discussing flaws in applying duty of care to corporate directors); Olson, *supra* note 60, at 40-41 (directors' personal liability is ineffective to deter director misbehavior); Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 937 (1983) (discussing benefits of eliminating duty of care).

81. *See supra* note 80 (discussing abolition of duty of care).

82. *See* Manning, *supra* note 80, at 1493-94. The commentator asserts that applying a traditional duty of care analysis to corporate directors is ineffective. *Id.* at 1493. Directors have no standard list of regularly performed tasks. *Id.* Rather, director functions vary depending upon the company, situation, and time. *Id.* The concept of negligence rests upon a clear understanding of a normal level of performance as opposed to an individual's lesser level of performance. *Id.* at 1494. No clear understanding exists regarding the proper role of a director. *Id.* Furthermore, juries usually rely on a general standard of conduct in deciding negligence issues. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 205 (4th ed.) (1971).

83. *See* Manning, *supra* note 79, at 1493-94 (discussing application of negligence concepts to corporate director action).

84. *See* Coffee, *Litigation and Corporate Governance: An Essay on Steering Between Scylla and Charybdis*, 52 GEO. WASH. L. REV. 789, 802 (1984). Directors facing liability for negligent acts under the duty of care generally are hesitant to approve high-risk decisions. *Id.*

directors from seizing opportunities that may benefit the company and be desirable for shareholders.[85] Stringently adhering to the duty of care also prompts directors to initiate costly and time consuming procedures to verify managerial efforts.[86] One commentator summarizes that eliminating the duty of care saves litigation expenses, the cost of insurance premiums, and time and money that directors invest in documenting the decision-making processes.[87] Additionally, the absence of a duty of care prompts high-risk decision making by directors.[88] High-risk decision making is crucial in the business world in order for corporations to maintain a competitive market advantage.[89] By protecting directors from liability for their actions, the amendment practically renders the duty of care obsolete, thus fulfilling commentators' desires to eliminate the duty.[90]

Proponents of the amendment contend that the concept of eliminating fiduciary duty is not unusual, but rather is taken from the law of trusts.[91] A trustee is not liable to beneficiaries for breach of trust in the absence of a conflict of interest.[92] Specifically, exculpatory provisions in the terms of the trust relieve a trustee from liability for breach of trust.[93] The rationale for allowing the trust instrument to relieve trustees of liability is that the grantor of the trust has the power to determine a trustee's duties and responsibilities.[94] Similarly, supporters of the amendment argue that the shareholders possess

---

In contrast, corporate shareholders enjoy limited liability, risking only the amount of their investment. *Id.* Shareholders, therefore, favor more risky decisions that carry the potential for high returns. *Id.* Frankel, *Corporate Directors' Duty of Care: The American Law Institute's Project on Corporate Governance*, 52 GEO. WASH. L. REV. 705, 713 (1984) (discussing critics contention that duty of care deters directors from taking risks); Herzel & Katz, *supra* note 41, at 1189 (court's imposing duty of care on directors fails to recognize need for bold director action).

85. *See* Coffee, *supra* note 84, at 802 (discussing results of director hesitancy).

86. *See* Conard, *A Behavioral Analysis of Directors Liability for Negligence*, 1972 DUKE L.J. 895, 904-05 (1972) (threat of director liability results in wasteful time spent seeking to verify decision making process).

87. *See* Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 937 (1983) (listing benefits of abolition of duty of care standard).

88. *See id.* (elimination of duty of care prompts high-risk decision making by removing threat of personal liability).

89. *See* Herzel & Katz, *supra* note 41, at 1189 (describing situations when exercise of caution resulted in losses to competitors).

90. *See supra* notes 80-88 and accompanying text (describing commentators' arguments for abolition of duty of care).

91. *See* Victor, *Statutory Response to D & O Crisis Studied*, Legal Times, Mar. 31, 1986, at 5, col. 3 (tracing theory of elimination of fiduciary duty to law of trusts); RESTATEMENT (SECOND) OF TRUSTS § 222 (1959) (stating that trustee is not liable for good faith negligence).

92. *See* RESTATEMENT (SECOND) OF TRUSTS § 222 (1959) (exculpatory provisions in trusts relieve trustees of liability to beneficiaries for breaches of trust).

93. *Id.*

94. *See* G. BOGERT, LAW OF TRUSTS 248 (4th ed.) (1963) (discussing exculpatory provisions in trusts).

the power to approve provisions dictating directors' responsibilities.[95]

The supporters also find appealing the democratic nature of the amendment which requires a shareholder vote of approval.[96] Specifically, the amendment permits shareholders, rather than directors, to decide whether directors are liable for violations of the duty of care by approving or rejecting the proposed charter provision.[97] Drafted as an enabling provision, the amendment applies to a corporation only if shareholders approve the change in a shareholder vote.[98]

In spite of the amendment's requirement of shareholder approval, critics of 102 (b)(7) have been vocal in their objections to the legislation.[99] Stanley Kaplan, Chicago attorney and former chairman of the American Law Institute (ALI) Project on Corporate Governance characterizes section 102 (b)(7) as an invitation to directors to manage inadequately.[100] Kaplan argues that managers should be liable if they do not perform management duties.[101] Kaplan states that by exempting directors from liability, the amendment encourages an unsound policy allowing directors to be inattentive and careless.[102] One supporter of director accountability explains that the duty of care provides a mechanism for compensating corporate shareholders that suffer losses from grossly negligent management.[103] Thus, the duty of care does not discourage meaningful business activity as some proponents of the new amendment contend.[104] Rather, as critics of the new amendment explain, the

---

95. *See* Greenhouse, *supra* note 15, at D2 (noting that amendment is democratic because it requires shareholder approval); Crossen, *supra* note 15, at 35 (discussing shareholder choice with regard to liability issue); Lewin, *supra* note 55, at D1 (quoting Wilmington attorney Rodman Ward commenting that shareholder vote is important element of amendment). *Cf.* Greenhouse, *supra* note 15, at D2 (quoting Harvey J. Goldschmid's doubts regarding shareholder comprehension of vote on liability provision); Crossen, *supra* note 15, at 35 (quoting Elliot J. Weiss discussing lack of shareholder understanding of ramifications of signing proxy).

96. *See supra* note 95 (discussing democratic nature of amendment).

97. *See* DEL. CODE ANN. tit. VIII, § 102 (b)(7) (1986) (requiring shareholder approval of provision eliminating director liability).

98. *See supra* note 95 (commentators debate democratic character of amendment).

99. *See* Greenhouse, *supra* note 15, at D2 (presenting critics' objections to new amendment).

100. *See* Kaplan, *supra* note 75, at 22 (articulating objections to Delaware amendment); Greenhouse, *supra* note 15, at D2 (quoting Stanley Kaplan discussing negative effects of new amendment); *see also* Crossen, *supra* note 15, at 35 (enunciating commentators' additional criticisms of amendment).

101. Kaplan, *supra* note 75, at 22 (stating that directors should be liable for failures to perform responsibly); *see also* Greenhouse, *supra* note 15, at D2 (arguing that directors should be responsible for directing).

102. *See* Kaplan, *supra* note 75, at 22 (stating that amendment allows directors to behave irresponsibly); Greenhouse, *supra* note 15, at D2 (quoting Stanley Kaplan who argues that law is unsound which allows directors to be inattentive and careless), *see also* Crossen, *supra* note 15, at 35 (quoting investment officer Richard Schlefer arguing that eliminating gross negligence is dangerous because directors are not deterred from careless behavior).

103. *See* Cox, *supra* note 32, at 761-62 (discussing duty of care providing compensation to shareholders for director negligence).

104. *See id.* at 762 (contending that duty of care does not restrict business activity). *But see supra* notes 80-88 and accompanying text (discussing criticism of duty of care standard).

duty of care encourages directors to give increased attention to the affairs of the corporation.[105]

Critics of the amendment also state that by allowing directors to give less attention to corporate responsibilities, the amendment will lead to a decline in shareholder derivative suits.[106] Shareholder derivative suits are actions that corporate shareholders bring against management to enforce rights belonging to the corporation.[107] The new amendment will decrease derivative actions because shareholders, in approving exculpatory provisions, clearly state that directors are not responsible for negligent mismanagement.[108] The possibility of decreased derivative actions has lured commentators into debates on the value and effectiveness of shareholder derivative suits.[109] One supporter of the amendment argues that shareholders often have little faith that derivative suits will recompense shareholder losses.[110] Other supporters of the amendment further contend that shareholders will be willing to give up the right to sue directors as the cost of securing competent directors.[111] Some commentators, however, assert that shareholder derivative suits are important and necessary elements of shareholder ownership.[112] Finally, commentators express concern that the new statute may have gone too far in relaxing standards governing the behavior of directors.[113] The commentators

105. *See* Cox, *supra* note 32, at 761-62 (leading to conclusion that duty of care prompts directors to perform more responsibly the responsibilities to the corporation).

106. *See* Victor, *supra* note 91, at 5 (quoting Leo Herzel stating that eliminating director liability will discourage shareholder derivative suits); Crossen, *supra* note 15, at 35 (explaining that shareholders approving charter provisions under amendment forfeit right to sue directors). Shareholder derivative suits are actions that shareholders bring to seek recovery for wrongs that the corporation has suffered. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS 526 (3d ed. 1978). The plaintiff shareholder either must have been a shareholder at the time of the contested transaction, or have received his interest in the corporation since the transaction by operation of law. *Id.* at 528. Plaintiff shareholder then must make a demand upon the directors of the corporation to initiate suit on behalf of the corporation, or allege in the shareholder's complaint that a demand on the directors would be futile. *Id.* at 537. Shareholders, by approving provisions eliminating directors' duty of care, also eliminate a basis for holding directors liable for harming the corporation. Crossen, *supra* note 15, at 35.

107. *See* Lattin, *supra* note 50, at 414 (defining shareholder derivative actions).

108. *See* Victor, *supra* note 91, at 5 (quoting Lewis S. Black, Jr. recognizing that limiting director liability may eliminate shareholders' ability to receive compensation for corporate wrongs thus eliminating incentive for shareholder derivative suits).

109. *See infra* notes 110-12 and accompanying text (discussing debate over shareholder derivative suits).

110. *See* Victor, *supra* note 91, at 5 (quoting Herzel's contention that shareholders put little value in shareholder derivative suits).

111. *See id.* at 5 (Herzel argues that shareholders will willingly forfeit right to sue directors); Crossen, *supra* note 15, at 35 (quoting Wilmington attorney and amendment drafter Gilchrist Sparks' belief that shareholders will weigh right to sue directors against need for qualified directors and choose to relieve directors of liability).

112. *See* Victor, *supra* note 91, at 5 (discussing shareholder derivative suits). John Small of Prickett, Jones, Elliott, Kristol & Schnee states that derivative suits serve a salutary purpose. *Id.* Edward M. McNally of Morris, James, Hitchens & Williams states that derivative actions serve as an important policing device. *Id.*

113. *See* Greenhouse, *supra* note 15, at D2 (summarizing critics' views on detrimental effect of new amendment).

fear that the amendment will be significant in prompting Congress to enact a uniform law of incorporation.[114]

The director liability issue already has generated responses less severe than congressional action.[115] Most similar to the Delaware model is an Indiana statute that combines limited exculpation and indemnification of directors.[116] The Indiana statute imposes liability upon directors for breaches of the duty of care that involve willful misconduct and recklessness.[117] The Indiana legislature, however, eliminated liability for all director negligence.[118] Thus, by eliminating the most common negligence claims, the statute attempts to solve the insurance problem.[119] The Indiana statute is similar to the Delaware amendment in shielding directors from liability for negligence.[120] The Delaware amendment, however, also excuses directors from liability for reckless disregard of shareholder interests, thus eliminating all requirements that directors manage responsibly.[121] While the Indiana statute and the Delaware amendment are similar, the impact of the Delaware amendment will be more substantial due to the large number of companies incorporated in Delaware.[122]

While Delaware and Indiana seek to remedy the D & O crisis by statute, individual corporations in other states are seeking alternatives to D & O policies.[123] In some states, companies are offering indemnification contracts

---

114. *See* Kaplan, *supra* note 75, at 22 (warning that amendment may prompt congressional examination of corporate governance); Greenhouse, *supra* note 15, at D2 (quoting Harvey J. Goldschmid raising question of congressional action in corporate law area).

115. *See* Herzel & Harris, *supra* note 63, at 37 (discussing various solutions other than congressional action to D & O insurance problem); Rovner, *D & O Indemnity: Discrete Contracts Seen as an Option*, Legal Times, Nov. 25, 1985, at 1, col. 3 (describing substitutes for D & O insurance that corporations use to remedy D & O crisis).

116. *See* IND. CODE § 23-1-35-1 (1986) (exculpating directors from financial liability); Herzel & Harris, *supra* note 63, at 37 (describing Indiana's new indemnification statute); *infra* notes 117-119 and accompanying text (discussing provisions of Indiana statute).

117. *See* IND. CODE § 23-1-35-1 (e) (1986) (listing directors' actions that statute does not address); Herzel & Harris, *supra* note 63, at 37 (identifying limitations on application of Indiana statute).

118. *See* IND. CODE § 23-1-35-1 (1986) (eliminating director liability for due care violations); Herzel & Harris, *supra* note 63, at 37 (effect of Indiana statute is to eliminate liability for negligence).

119. *See* Herzel & Harris, *supra* note 63, at 37 (stating that Indiana statute effectively eliminates negligence claims).

120. *See supra* notes 67-69 and accompanying text (discussing Delaware amendment relieving directors of liability for negligence).

121. *See* DEL. CODE ANN. tit. VIII, § 102 (b) (7) (1986) (provision eliminating director liability for reckless disregard of shareholder interests); Kaplan, *supra* note 75, at 22 (stating that Delaware amendment eliminates director liability for recklessness). The Indiana statute differs from the Delaware amendment in that the Indiana statute mandatorily applies to corporations without a shareholder vote. Herzel & Harris, *supra* note 63, at 37.

122. *See supra* notes 6-9 and accompanying text (describing nationwide application of Delaware corporation law).

123. *See* Rovner, *supra* note 115, at 1 (describing search by corporations for alternatives to D & O policies).

to directors.[124] The contracts are available only in states that have nonexclusive indemnification statutes.[125] The indemnification contracts represent a company's guarantee to indemnify directors for personal liability up to the limits of the corporation's assets.[126] Indemnification contracts primarily offer security to individuals, thus inducing individuals to accept board positions.[127] The efficacy of indemnification contracts as replacements for insurance policies is questionable, however, since directors will be liable for any judgment greater than the assets of the company.[128] Other corporations, hoping to avoid expensive premiums or seeking to provide insurance when none is available, are securing insurance through company owned subsidiaries or joining other companies to form mutual insurance funds.[129] The D & O crisis thus generated various responses in addition to the Delaware amendment.[130]

An important consideration for corporations deciding whether to utilize the strategies developed to combat the D & O crisis or to take advantage of the amendment available to Delaware corporations is the effect that the Delaware courts will give the new amendment.[131] In spite of the Delaware judiciary's tendency to render pro-management decisions,[132] many commentators assert that a recent decision of the Delaware Supreme Court generated a significant amount of fear of personal liability among directors.[133] In *Smith*

In addition to statutory and contractual alternatives, the American Law Institute (ALI) also has addressed the issue of providing a mechanism by which to limit directors liability. PART VII PRINCIPLES OF CORPORATE GOVERNANCE § 7.17. ALI is engaged in a continuing project on corporate governance the aim of which is to draft a comprehensive corporation law. *Id.* at § 1.01. Part VII of the current ALI draft contains a provision thatplaces a limit on the amount of damages for which a director may be liable. *Id.* at § 7.17. The suggested liability limit would not be disproportionate to the benefits that the outside director received for serving the corporation. *Id.*

124. *See*, Rovner, *supra* note 115, at 1 (describing search for D & O alternatives).

125. *See, e.g.*, COLO. REV. STAT. § 7-3-101 (1)(o)(VI) (1981) (nonexclusive indemnification statute); DEL. CODE ANN. tit. VIII, § 145 (f) (1986) (same); ILL. REV. STAT. ch. 32, § 157.42-12 (f) (1983) (same); N.J. STAT. ANN. § 14.A: 3-5 (8) (1973) (same); OHIO REV. CODE ANN. § 1701.13 (E) (6) (1974) (same); PA. STAT. ANN. tit. 15, § 410 (f) (1968) (same); WIS. STAT. ANN. § 180.05 (1980) (same). Nonexclusive indemnification statutes allow corporations to provide indemnification through means beyond the scope of the statute. LAW OF CORPORATE OFFICERS, *supra* note 13, at ch.19, at 3.

126. *See* Rovner, *supra* note 115, at 2 (describing indemnification contracts and their effect).

127. *See id.* at 2 (noting that effect of indemnification contracts is to encourage individuals to serve on boards).

128. *See id.* at 2 (discussion of limitations of indemnification contracts). Corporations only may contract to indemnify directors up to the assets of the company. *Id.* Court awards may exceed the company's assets, thus leaving directors personally liable for the excess amount. *Id.*

129. *See id.* at 2 (discussing D & O solutions).

130. *See supra* notes 123-29 and accompanying text (describing solutions to D & O crisis).

131. *See infra* notes 181-92 and accompanying text (discussing potential judicial treatment of amendment).

132. *See* Olson, *supra* note 60, at 42 (identifying Delaware courts' promanagement stance).

133. 488 A.2d 858 (Del. 1985). *See generally* Herzel & Katz, *Smith v. Van.Gorkom: The*

v. Van Gorkom,[134] the Delaware Supreme Court held directors personally liable for breaching the duty of care.[135] Specifically, directors feared that the *Van Gorkom* decision, combined with the lack of D & O insurance, forced directors to risk personal assets when serving on boards.[136] In *Van Gorkom*, the Trans Union corporation, a publicly-traded company principally involved in the railcar leasing business, merged with a subsidiary company of the Marmon Group, Inc.[137] Prior to the merger, Trans Union experienced difficulty utilizing available investment tax credits.[138] The investment tax credit problem plagued Trans Union from the late 1960's until 1980 when the senior management of Trans Union first discussed the alternative of a sale of Trans Union to a company with a large taxable income.[139] The initial discussion was preliminary and brief.[140] Senior management again discussed the solution of selling Trans Union at a meeting in September of 1980.[141] The managers effected some computations, but did not establish a sale price for Trans Union shares, nor reach any conclusions regarding a sale.[142] Following the meeting, defendant Van Gorkom, chairman and chief executive officer of Trans Union, formulated a sales proposal and negotiated the terms of the sale of Trans Union to an owner of the Marmon Group.[143] The chief executive officer first proposed the merger to the Trans Union board in a twenty-minute presentation.[144] The directors approved the sale of Trans Union during

---

Business of Judging Business Judgment, 41 BUS. LAW. 1187 (1985) (discussing impact of *Van Gorkom* decision); Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 BUS. LAW. 1 (1985) (commenting upon effect of *Van Gorkom*); *Mining the Safe Harbor? The Business Judgment Rule After Trans Union*, 10 DEL. J. CORP. L. 545 (1985) [hereinafter *Mining the Safe Harbor*] (discussing effect of *Van Gorkom* decision on business judgment rule); Moskin, *Trans Union: A Nailed Board*, 10 DEL. J. CORP. L. 405 (discussing commentary following *Van Gorkom* decision).

134. 488 A.2d 858 (Del. 1985).

135. *Id.* at 893.

136. *See* Lewin, *supra* note 55, at D26 (discussing D & O crisis and fear that *Van Gorkom* generated).

137. *Van Gorkom*, 488 A.2d at 864.

138. *Id.* at 864. During the late 1970's, defendant lobbied Congress seeking investment tax credits refundable in cash to firms unable to use the credits. *Id.* at 864-65.

139. *Id.* at 865. The Trans Union senior management met on August 27, 1980 at which time defendant Van Gorkom reported on his lobbying efforts. *Id.* The Trans Union managers preliminarily discussed a variety of alternatives to the investment tax credit problem. *Id.*

140. *Id.* at 865.

141. *Id.* at 865.

142. *Id.* At the September 1980 meeting, Trans Union's chief financial officer again proposed a sale of the company. *Id.* Officers of Trans Union roughly calculated needed cash flow for a sale. *Id.* The officers did not make extensive calculations, thus the officers did not possess sufficient data with which to make an informed decision. *Id.*

143. *Id.* at 866. Defendant and Trans Union chief executive officer approached Pritzker, an owner of the Marmon Group, with a buy-out proposal without consulting the board of directors of Trans Union. *Id.* Through a series of meetings, Van Gorkom and Pritzker negotiated the specific terms of the merger and discussed financing for the deal. *Id.* at 867.

144. *Id.* at 868. Van Gorkom presented the proposed merger to the senior management of Trans Union one hour before the board meeting. *Id.* Senior management was opposed to

the same meeting.[145] The entire procedure lasted approximately two hours.[146]

Plaintiffs, shareholders of Trans Union, brought an action in the Delaware Court of Chancery seeking damages and rescission of the merger.[147] Plaintiffs alleged that the directors violated the duty of care in approving the merger because the directors did not make an informed decision.[148] The Court of Chancery, however, determined that the directors' decision to approve the merger was an informed decision.[149] Thus, the Court of Chancery protected the directors' action under the business judgment rule.[150] The Supreme Court of Delaware, however, reversed the decision of the Court of Chancery, finding that the directors failed to exercise informed business judgment in deciding to approve the sale of Trans Union.[151] The court concluded, therefore, that the directors had been grossly negligent.[152] The court noted that the directors had received no prior notice of the intended sale, and were not familiar with the defendant's method of determining the sale price, nor with the intrinsic value of the company.[153] The Delaware court further found that the directors acted with undue haste in an absence of supporting documentation.[154] Although the sale price was substantially higher than the current market price, thus providing a profit to shareholders, the court held the directors personally liable for failing to make an informed decision.[155]

In holding the Trans Union directors personally liable, the *Van Gorkom* court demonstrated that the Delaware courts would scrutinize more strictly directors' actions.[156] Some commentators regard *Van Gorkom* as the Delaware

---

the merger. *Id.* Van Gorkom, however, proceeded to present the merger to the board. *Id.* Van Gorkom called the board meeting with only one day's notice. *Id.* Van Gorkom did not inform board members of the purpose of the meeting. *Id.* Moreover, copies of the proposed merger were not available at the meeting. *Id.*

145. *Id.* at 869. On September 22, 1980, Trans Union announced the merger agreement with Marmon. *Id.* Because of dissent and threatened resignations of senior management, Van Gorkom secured director approval of amendments to the merger agreement at a meeting. *Id.* The board, in addition to approving the amendments, authorized Van Gorkom to hire an investment firm to solicit other potential bidders. *Id.* at 869. The investment firm located only one bidder and that bidder refused to make an offer unless Trans Union rescinded the agreement with Marmon. *Id.* at 870.

146. *Id.* at 869. The board formally executed the merger agreement at a party that Van Gorkom hosted to celebrate the opening of the opera season. *Id.* None of the directors read the amendment before signing. *Id.*

147. *Id.* at 863.

148. *Id.* at 864.

149. *Id.*

150. *Id.*

151. *Id.* at 871.

152. *Id.* at 881.

153. *Id.* at 874. In approving the merger, the directors relied entirely upon Van Gorkom's presentation in approving the merger. *Id.* The Delaware Supreme Court found neither evidence of a written summary of the merger nor documentation of the method of price determination. *Id.*

154. *Id.*

155. *Id.* at 893.

156. *See Mining the Safe Harbor*, *supra* note 133, at 545 (discussing impact of *Van*

court's response to a growing public desire to require higher standards of accountability from directors.[157] The *Van Gorkom* court did not create new law, but rather applied a previously dormant gross negligence standard to directors' actions.[158] *Van Gorkom* served to warn directors that the business judgment rule is not an absolute defense to shareholders' negligence claims.[159] The *Van Gorkom* court made clear that the Delaware courts would analyze more closely directors' efforts to prepare for decision making.[160]

After the *Van Gorkom* decision, however, the Delaware Supreme Court again invoked the business judgment rule to protect directors in *Moran v.*

Gorkom); Schatz, *Directors Feel the Legal Heat*, N.Y. Times, Dec. 15, 1985, sect. 3, at 12, col. 3 (discussing Delaware courts scrutiny of director performance).

157. *See* Olson, *supra* note 60, at 42 (discussing Delaware court's motivation in rendering *Van Gorkom*); *see also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986) (holding that directors breached duty of care). In *Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court found directors liable for a breach of the fiduciary duty of care. *Revlon*, 506 A.2d at 176. The *Revlon* case involved efforts by Pantry Pride, Inc. to acquire control of Revlon, Inc. *Id.* at 176. In defending against the Pantry Pride takeover attempt, the directors of Revlon entered into a lock-up option with Forstmann Little. *Id.* at 179. A lock-up option is a defensive mechanism used to discourage competitive offers by other potential bidders. Nathan, *Lock-Ups and Leg-Ups: The Search for Security in the Acquisitions Market Place*, 13 AM. INST. SEC. REG. 13, 16 (P.L.I. Course Handbook No. 373, 1981). The result of the Revlon directors' action was to deter other possible offers for the company or price competition between current offerors. *Revlon*, 506 A.2d at 175-76. Thus, the directors deprived shareholders of a higher price per share. *Id.* The Delaware Supreme Court found that when the directors realized that Revlon faced certain sale, the directors' duty shifted from defending against the takeover to securing the best price per share for stockholders. *Id.* at 182.

Analyzing the directors' fiduciary duty to the shareholdes, the *Revlon* court appeared to employ both the duty of loyalty and the duty of care. *Id.* at 182. The *Revlon* court stated that the Revlon directors breached the duty of loyalty by entering into the lock-up agreement. *Id.* at 182. The court, however, concluded by characterizing the board action as a breach of the duty of care falling outside the protection of the business judgment rule. *Id.* at 184. One possible justification for the court's language is the overlap of the element of disinterest of the business judgment rule with the prohibition against self-dealing found in the duty of loyalty in the takeover context. DELAWARE LAW, supra note 10, at 80. One element of the business judgment rule is director disinterest. LAW OF CORPORATE OFFICERS, *supra* note 13, at ch.2, at 17. Similarly, the duty of loyalty requires that directors have no conflicts of interest. Knepper, *supra* note 49, at 50. When a director in the midst of a takeover exhibits self-interest, a court may examine the action as a breach of the duty of loyalty or as a breach of the duty of care which the business judgment rule does not protect. DELAWARE LAW, *supra* note 10, at 80. Since the court decided the *Revlon* case before the effective date of the new amendment, the court was not making an effort to circumvent the statute. DEL. CODE ANN. tit. VIII, § 102 (b) (7) (effective date July 1, 1986). Rather, the *Revlon* case presented the possibility that in specific fact situations courts may manipulate the fiduciary standards. Therefore, if lawyers draft alleged takeover complaints in duty of loyalty language, courts may hold directors personally liable for breaches of the duty of loyalty.

158. *See Mining the Safe Harbor*, *supra* note 133, at 567 (describing use of existing gross negligence standard in *Van Gorkom* decision).

159. *See id.* (discussing *Van Gorkom* message to persons serving as directors).

160. *See supra* note 133 (listing commentators discussing import of *Van Gorkom* decision).

Household International, Inc.[161] The court upheld the directors' adoption of a Preferred Stock Purchase Rights Plan (Rights Plan) as a legitimate exercise of business judgment.[162] In *Moran*, the board of directors of Household International, concerned about the current trend of corporate takeovers, sought the advice of takeover specialists in formulating a defensive strategy for the company.[163] The specialists recommended adoption of a Rights Plan to protect the company from potential hostile takeovers.[164] A Right is an instrument issued to a shareholder giving the shareholder an option to purchase certain stock in the corporation.[165] The Rights Plan in *Moran* provided that common stockholders would receive one Right per share of stock upon the announcement of a tender offer for 30% of Household's shares, or upon the acquisition by a single shareholder of 20% of Household's stock.[166] The board subsequently approved the plan.[167]

The plaintiff, chairman of the corporation that was Household's largest shareholder, filed suit in the Delaware Court of Chancery.[168] The plaintiff alleged that the Household board lacked authority to adopt the Rights Plan.[169] Plaintiff also alleged that the Rights Plan interfered with the shareholders' rights to entertain hostile tender offers and conduct proxy contests.[170] Finally,

---

161. 500 A.2d 1346 (Del. 1985); *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (Delaware court invoked the business judgment rule to protect directors). In *Unocal Corp. v. Mesa Petroleum Co.*, the Supreme Court of Delaware approved the directors' decision to effect a self-tender offer in an effort to defeat a hostile tender offer. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985). A self-tender offer is a defensive mechanism involving an offer by the target company to repurchase its own shares of stock. 1 A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES, AND PLANNING 378.2 (1985). The *Unocal* court held that the business judgment rule protected the boards' decision. 493 A.2d at 949. The directors of Unocal analyzed the nature of the hostile takeover bid and its effect on the corporation. *Id.* at 950. Upon completing the analysis, the board instituted a reasonable action in the self-tender offer to protect shareholder interests. *Id.* at 959.

162. *Moran*, 500 A.2d at 1348. A Preferred Share Purchase Rights Plan (Rights Plan) is a takeover defense mechanism designed to protect stock values for shareholders of a company whose stock is currently selling in the market for less than the long-term value of the stock. Lipton & Steinberger, *supra* note 58, at 6-44.

163. *Moran*, 500 A.2d at 1349. Investment counselors distributed information concerning the Rights Plan to directors prior to the August 14 board meeting. *Id.* The counselors attended the meeting and discussed the operation of the Plan. *Id.*

164. *Id.*

165. *See* Lipton & Steinberger, *supra* note 58, at 6-44 (defining Preferred Share Purchase Rights Plan).

166. *Moran*, 500 A.2d at 1358. The Rights Plan enabled common stockholders to purchase 1/100 share of new preferred stock for $100 upon announcement of a tender offer for 30% of Household's stock. *Id.* at 1349. Rights also were redeemable for $.50 each. *Id.* If a single shareholder acquired 20% of Household's stock, each Right enabled a shareholder to purchase 1/100 share of preferred stock. *Id.* Shareholders, however, could not redeem the Right. *Id.* If a shareholder chose not to exercise a Right and a merger occurred, the Plan allowed a shareholder to purchase $200 of the offeror's common stock for $100. *Id.*

167. *Id.* at 1349.

168. *Id.*

169. *Id.*

170. *Id.* at 1351.

plaintiff contended that the board did not exercise informed business judgment in adopting the plan.[171] The Court of Chancery upheld the board's action as a valid business decision.[172] The Delaware Supreme Court, distinguishing *Smith v. Van Gorkom*, affirmed the decision of the Court of Chancery.[173]

In *Moran*, the Delaware Supreme Court initially discussed the authority of the board to adopt the Rights Plan.[174] After declaring that the board acted within its authority, the court progressed to the primary issue of the applicability of the business judgment rule to the board's adoption of the Rights Plan.[175] Citing *Van Gorkom*, the court stated that to determine if a business decision was informed, the court must determine if the directors were grossly negligent.[176] The court explained that if the directors were grossly negligent, then the business judgment rule would not apply and the court would hold the directors personally liable.[177] The court found that by examining and discussing a three-page summary of the plan and several articles on the takeover environment, the board possessed sufficient information with which to make a satisfactory evaluation of the Rights Plan and, therefore, the board was not grossly negligent.[178] Thus, the court held that the business judgment rule protected the directors' decision.[179] The court distinguished the actions of the directors in *Moran* from the actions of the directors in *Van Gorkom* who displayed gross negligence in approving a merger.[180]

Shielding directors from liability for gross negligence such as the negligence of the directors in *Van Gorkom*, the new amendment severely limits the Delaware courts' ability to protect shareholder interests.[181] When facts exist that bring an action within the context of the duty of loyalty, a court will continue to scrutinize strictly alleged conflict of interest violations.[182]

---

171. *Id.* at 1356.

172. *Id.* at 1348.

173. *Id.* at 1348.

174. *See id.* at 1350-55. In *Moran*, the Delaware Supreme Court noted that the Delaware legislature authorized directors adoption of Rights Plans. *Id.*; *see* DEL. CODE ANN. tit. VIII, § 157 (1986) (granting corporations authority to issue rights or options that enable holders to purchase stock from corporation). The court concluded that the Rights Plan allowed shareholders to receive tender offers. *Moran*, 500 A.2d at 1354. The *Moran* court also found that the shareholders' right to conduct proxy contests also remained intact. *Id.* at 1355.

175. *Id.* at 1355.

176. *Id.* at 1356.

177. *Id.* at 1356.

178. *Id.* The directors examined in advance of the board meeting a notebook containing a three-page summary of the Rights Plan and articles on takeovers. *Id.* The directors also discussed the Plan with investment counselors. *Id.* The court found that the preparations were sufficient to inform directors about the proposal. *Id.*

179. *Id.* at 1357.

180. *Id.* at 1356; *see Van Gorkom*, 488 A.2d at 860 (holding directors liable for gross negligence); *supra* notes 123-160 and accompanying text (discussing *Van Gorkom* decision).

181. *See* Kaplan, *supra* note 75, at 22 (leading to conclusion that amendment will restrict shareholders from bringing actions by relieving directors of responsibility to promote shareholder interests).

182. *See* Black, *supra* note 4, at 7 (amendment does not apply to breaches of duty of loyalty thus amendment does not affect courts' treatment of duty of loyalty violations).

Otherwise, the amendment will provide additional legislative support for the courts to embrace pro-management policies.[183] In the past, the Delaware courts have attempted to balance Delaware's pro-management policies with the courts' own perception of the judicial duty to establish and maintain standards of management conduct in order to protect shareholders.[184] The Delaware courts are aware of the state's dependence upon the tremendous revenues that the state government collects annually from corporate taxes and franchise fees.[185] In contrast, the Delaware courts also have been sensitive to the public trend toward management accountability.[186] The amendment simplifies the dilemma facing the judiciary.[187] In order to solve the dilemma, the courts will hold directors liable only in instances of conflict of interest.[188] By holding directors liable for conflicts of interest, the judiciary will pay tribute in part to the courts' responsibility to protect shareholders.[189] On the other hand, by adhering to the statute, courts will continue to lend support to Delaware's incorporation business.[190] The effect of the amendment will be to prohibit the courts from protecting shareholder interests by rendering decisions similar to *Van Gorkom*.[191] The public desire for greater accountability from directors will not progress in the Delaware court system since the amendment eliminates the potential for a trend of cases holding directors liable for gross negligence.[192]

In addition to limiting a trend toward director accountability, the amendment results in a lower standard of director responsibility that is not excused by the amendment's alleged democratic nature.[193] Forced to consider the

---

183. *See supra* note 132 and accompanying text (describing Delaware judiciary's support of management).

184. *See* Black, *supra* note 4, at 7 (describing unique task of Delaware courts in paying heed to both Delaware's incorporation industry and the judicial duty to maintain standards of corporate responsibility).

185. *See* DELAWARE LAW, *supra* note 4, at lx (describing Delaware's corporation-generated revenues). In 1983, Delaware earned $80,000,000 from corpoate taxes and franchise fees. *Id.*

186. *See* Olson, *supra* note 60, at 38 (noting existence of trend toward holding directors liable); Baum & Byrne, *supra* note 54, at 57 (public has an increased expectation of director behavior).

187. *See* Black, *supra* note 4, at 7 (describing difficult task that the Delaware courts face); *infra* notes 187-190 and accompanying text (arguing that amendment makes Delaware judiciary's task easier).

188. *See* Black & Sparks, *supra* note 13, at 312 (new amendment effects no change in duty of loyalty).

189. *See* Black, *supra* note 4, at 7 (describing Delaware courts' responsibility to impose limits on corporate behavior).

190. *See supra* notes 64-73 and accompanying text (discussing amendment as effort to relax corporate liability thus supporting Delaware's promanagement stance).

191. *See supra* note 67 and accompanying text (amendment excuses directors from liability for gross negligence).

192. *See* Veasey, *Further Reflections on Court Review of Judgments of Directors: Is the Judicial Process Under Control?*, 40 BUS. LAW. 1373, 1382 (1985) (author predicted future litigation stemming from *Van Gorkom* decision).

193. *See supra* notes 96-98 and accompanying text (describing democratic features of amendment); *infra* notes 194-96 and accompanying text (stating that democratic nature of amendment does not excuse lowered director standard).

liability provision as one topic in a proxy vote, shareholders will not understand the import of the vote.[194] Corporations will encourage shareholders to approve the provisions.[195] Shareholders, however, often will not realize that they are forfeiting a significant right.[196] Furthermore, the amendment reduces shareholders' rights to sue directors in derivative actions.[197] The shareholder derivative suit traditionally is an important mechanism with which to control director behavior.[198] In approving a provision eliminating director liability, shareholders often will not realize that they are waiving protection of shareholder interests.[199] By reducing the availability of derivative actions, the amendment lessens a director's duty to answer to the owners of a corporation for the director's actions.[200]

In the past, the business judgment rule protected directors' actions as long as the directors were acting with the care of an ordinary person in the same position.[201] At the other extreme, the duty of loyalty imposed liability upon directors for conflict of interest violations.[202] Thus, directors feared liability for grossly negligent actions falling within the gap between the business judgment rule and the duty of loyalty.[203] Directors should not escape liability for breaches of the duty of care resulting from gross negligence.[204] Directors should be accountable for failures to accept the responsibility that accompanies a position on a board.[205] Careful and dedicated directors should not enter a directorship assuming in advance the need for protection from liability for inattentiveness and lack of preparation.[206] Supporters of the statute contend

---

194. *See* Crossen, *supra* note 15, at 35 (discussing shareholder approval of provisions by proxy vote). General Mills, Inc., Burroughs Corp., and Pillsbury Co. already have secured shareholder approval of liability provisions. *Id.*

195. *See* Greenhouse, *supra* note 15, at D2 (quoting Harvey J. Goldschmid discussing lack of shareholder understanding of votes on amendment provisions).

196. *See* Crossen, *supra* note 15, at 35 (predicting lack of shareholder understanding of implications of voting away director liability).

197. *See supra* notes 106-12 and accompanying text (discussing critics' views of adverse effect of amendment on shareholder derivative suits).

198. *See* Lattin, *supra* note 50, at 414 (describing shareholder derivative actions as instruments of control and self-defense).

199. *See* Crossen, *supra* note 15, at 35 (stating that shareholders will not understand that approval of provisions exempting directors from liability will lessen protection of shareholder interests).

200. *See* Kaplan, *supra* note 75, at 22 (directors virtually will be free from responsibility to shareholders under amendment).

201. *See supra* notes 31-45 and accompanying text (discussing traditional protection that business judgment rule afforded directors).

202. *See supra* notes 46-51 and accompanying text (discussing duty of loyalty).

203. *See Mining the Safe Harbor*, *supra* note 133, at 545 (describing gross negligence violations as beyond protection of business judgment rule).

204. *See* Crossen, *supra* note 15, at 35 (quoting Richard Schlefer contending that directors should be liable for gross negligence).

205. *See* Kaplan, *supra* note 75, at 22 (directors should accept the responsibility of directorship); *supra* note 28 and accompanying text (discussing responsibilities of directors).

206. *See* Farrell, *If Directors Are Doing Their Job, They Don't Need Insurance*, Bus. Wk., Sept. 8, 1986, at 61 (directors employing common sense need not fear personal liability).

that directors generally are dedicated persons and will not take advantage of the relaxation of the standard of care.[207] This rather naive supposition fails to recognize that if directors truly were dedicated to performing their jobs thoroughly, the insurance shortage would not have generated fear in directors.[208] The criticism of directors does not imply that directors are unethical or opportunistic.[209] The public, however, is demanding that boards take a more active role as overseers of the corporation.[210] While increased responsibility will leave directors that serve on multiple boards insufficient time to satisfy all responsibilities,[211] the demand for greater accountability suggests a need for a new role for directors.[212] Directors should accept fewer board positions and dedicate more attention to the responsibilities accompanying the positions.[213]

The need to attract corporate directors that are willing to accept the responsibilities of the position is a serious problem.[214] Outside directors provide valuable independent scrutiny of corporate affairs.[215] One desire of the drafters of the amendment is to encourage individuals to serve as outside directors.[216] Yet if the amendment, in an effort to attract directors, relieves directors of liability for failures to perform responsibly, the amendment eliminates the benefit of an outside director because outside directors need not scrutinize diligently the affairs of the corporation.[217] Thus, the amendment divests the role of outside director of the primary function and obligation of providing corporate oversight.[218]

---

207. *See* Greenhouse, *supra* note 15, at D2 (quoting Lewis S. Black and Norman Veasey arguing that directors will not take advantage of having no duty of care standard).

208. *See* Farrell, *supra* note 206, at 61 (directors properly performing tasks do not need liability insurance).

209. *See* Greenhouse, *supra* note 15, at D2 (commentators argue that directors are honest individuals).

210. *See* Bacon, *supra* note 60, at 13 (predicting a continuation of public demand for more effective board performance).

211. *See* Baum and Byrne, *supra* note 54, at 58 (describing increased director time demands).

212. *See* Baum, *'Professional' Directors: So Many Boards: So Little Time*, BUS. WK., Sept. 8, 1986, at 59 (suggesting that directors will accept fewer positions because of the increased demands of board service).

213. *See id.* at 59 (describing trend of directors serving on fewer boards).

214. *See* Baum & Byrne, *supra* note 54, at 56 (discussing shortage of outside directors).

215. *See* Greenhouse, *supra* note 15, at D2 (discussing purpose of outside directors); Leech & Mundheim, *The Outside Directors of the Publicly-Held Corporation*, 31 BUS. LAW. 1799, 1805 (1976) (describing monitoring function of outside directors). The monitoring function of outside directors implies that the directors perform diligently and attentively to determine the best interests of the corporation. *Id*; *see* Soloman, *Restructuring the Corporate Board of Directors: Fond Hope—Faint Promise?*, 76 MICH. L. REV. 581, 588 (1978) (discussing role of outside directors). By asking questions and making suggestions, the board of directors scrutinizes management's actions and forces management to address important problems. *Id.*

216. *See* Black & Sparks, *supra* note 13, at 311 (identifying goal of revision committee to alleviate insurance crisis causing corporations to lose directors).

217. *See* Kaplan, *supra* note 75, at 22 (amendment relieves directors of responsibilities to corporation).

218. *See supra* note 28 and accompanying text (describing function of outside directors).

Another result of relieving directors of liability for breaches of the duty of care is that Delaware has become more attractive to incorporating businesses.[219] Management, looking for a favorable business climate, certainly will incorporate in Delaware where director liability is low.[220] Thus, the amendment assures Delaware of continued high income from corporate taxes and fees.[221] The amendment acts as another mechanism to lure businesses to incorporate in Delaware.[222]

Incidently strengthening Delaware's grasp on the incorporation market, section 102 (b)(7) does aid in alleviating the problems for outside directors in securing D & O insurance.[223] In addition, relaxed director liability will make board positions more desirable.[224] Unfortunately, the price for the change will be a ready pool of directors unwilling to give necessary attention to the affairs of the company.[225] Ultimately, the Delaware amendment is a substantial obstacle to corporate responsibility.[226]

STACY D. BLANK

219. *See supra* notes 64-73 and accompanying text (discussing amendment's promanagement effect).

220. *Id.*

221. *See supra* note 185 and accompanying text (describing Delaware's revenue derived from corporations).

222. *See* Herzel & Harris, *supra* note 63, at 37 (warning that Delaware should enact law solving insurance crisis in order to attract businesses).

223. *See supra* notes 13-25 and accompanying text (discussing provisions of amendment).

224. *See supra* notes 74-79 and accompanying text (describing effect of amendment in encouraging individuals to accept board positions).

225. *See supra* notes 205-13 and accompanying text (stating that amendment results in director inattentiveness).

226. *See supra* notes 65-73 and accompanying text (describing declining standards of corporate responsibility).