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Directors' Standard Of Care And Directors' Liability Under The Virginia Stock Corporation Act

DIRECTORS' STANDARD OF CARE AND DIRECTORS' LIABILITY UNDER THE VIRGINIA STOCK CORPORATION ACT

Business corporations are essential institutions in modern society.[1] The inherent structure of corporations requires shareholders, directors, and officers to participate in the governance of corporations.[2] As managers of a corporation, directors and officers owe various duties to the corporation and its shareholders.[3] One important duty of directors is the duty of care that directors owe shareholders in the exercise of their powers as directors.[4]

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1. *See* H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 1, at 5 (3d ed. 1983)(because of size, power, and impact, modern business corporations are indispensible to American and world economies).

2. *See generally* Buxbaum, *The Internal Division of Powers in Corporate Governance*, 73 CALIF. L. REV. 1671, 1671-72 (1985) (discussing role of shareholders in corporations). Shareholders form the ownership base of a corporation and participate in the corporation by electing the directors to serve on the corporate board. *See* H. HENN & J. ALEXANDER, *supra* note 1, at § 188 (as owners of corporation, shareholders exercise control by voting at shareholder meetings). The directors serving on the corporate board manage the corporation and formulate corporate policy. *See id.* § 207 (management functions include making decisions on products and services, selecting and supervising officers, declaring dividends, and supervising welfare of entire enterprise). The officers of the corporation administer the policies set forth by the board of directors in the daily business operations of the corporation. *Id.* § 223.

3. *See* Treadway Cos. v. Care Corp., 638 F.2d 357, 375 (2d Cir. 1980)(directors owe duties to corporation and indirectly to shareholders). As managers of a corporation, officers and directors have the duty to act within their statutory authority. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953 (Del. 1985)(noting that essential element for directors' actions to bind corporation is power granted in corporate statute). Officers and directors also are fiduciaries of the corporation and its shareholders and must discharge their duties with honesty, loyalty, good faith, and fairness. Singer v. Magnavox Co., 380 A.2d 969, 977 (Del. 1977). The duties that officers and directors as fiduciaries owe to the corporation and its shareholders are the duty of care and the duty of loyalty. Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984); *see* Committee on Corporate Laws, American Bar Association, *Corporate Director's Guidebook*, 33 BUS. LAW. 1591, 1599-1604 (1978)[hereinafter Committee on Corporate Laws](noting that directors, in making business decisions, must discharge responsibilities with care and loyalty); *infra* note 5 and accompanying text (discussing duty of care that directors owe corporation and its shareholders). The duty of loyalty that directors and officers owe the corporation and its shareholders requires that directors and officers not profit individually at the expense of the corporation or permit private interests to conflict with interests of the corporation. *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)(directors must not act to injure corporation or deprive corporation of profit and must not allow duty to corporation and self-interest to conflict); Weiss Medical Complex, Ltd. v. Kim, 87 Ill. App. 3d 111, 115, 408 N.E.2d 959, 963 (1980)(directors must discharge duties with undivided and unqualified loyalty and must not gain personally at expense of corporation); Committee on Corporate Laws, *supra*, at 1599 (in allegiance to corporation, directors must place best interests of corporation before own personal interests and must not use position as directors to benefit personally).

4. *See* Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 273 (2d Cir. 1986)(directors owe corporation and shareholders duty of care in discharging managerial duties); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985)(directors managing corporation have unyielding fiduciary duty to corporation and shareholders).

Traditionally, courts have interpreted the duty of care to require that corporate directors exercise their duties as directors in good faith, without a conflict of interest, on an informed basis, and with a reasonable belief that their corporate decisions are in the best interests of the corporation.[5] Courts customarily have afforded directors the rebuttable presumption under the business judgment rule that in making corporate decisions, the directors had satisfied the duty of care.[6] Recently, however, courts have altered the traditional standard of care applicable to directors of corporations and reviewed more closely the directors' corporate decisions involving takeovers.[7]

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5. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (imposing duty of care on directors by affording directors' decisions as members of corporation's litigation committee protection of business judgment rule when directors made decision on informed basis, in good faith, and in honest belief that action was in best interests of corporation); Bodell v. General Gas & Elec. Corp., 15 Del. Ch. 420, 429, 140 A. 264, 268 (Del. 1927)(noting that courts will not review directors' business decisions if directors reach decisions in good faith and in belief that decision will advantage corporation and shareholders); *see also* Hinsey, *Business Judgment and the American Law Institute's Corporate Governance Project: the Rule, the Doctrine, and the Reality*, 52 GEO. WASH. L. REV. 609, 610 (1984)(noting that directors seeking protection of business judgment rule must act in good faith, make reasonable attempt to inform themselves, reasonably believe that board's actions are in corporation's best interests, and not engage in self-dealing). To fulfill the duty of care, officers and directors typically must perform managerial assignments in good faith, with the care of ordinarily prudent persons in similar circumstances, and in a manner reasonably believed to be in the best interests of the corporation. REVISED MODEL BUSINESS CORP. ACT § 8.30(a) (1985); *see infra* notes 12-16 and accompanying text (discussing standard of care in traditional business judgment rule); *infra* notes 26-29 and accompanying text (discussing objective standard of care in Revised Model Business Corporation Act (RMBCA)); *infra* notes 52-57 and accompanying text (discussing enhanced duty of care that Delaware Supreme Court has imposed on directors involved in takeover situations). *But see* VA. CODE ANN. § 13.1-690 (1985)(directors' subjective standard of care in Virginia Stock Corporation Act (VSCA)); *infra* notes 17-21 and accompanying text (discussing directors' subjective standard of care in VSCA).

6. *See* Kaplan v. Goldsamt, 380 A.2d 556, 568 (Del. Ch. 1977) (presuming directors' sound business judgment to repurchase corporation's own stock and to value stock when decisions had rational business purpose); Coffman v. Maryland Pub. Co., 167 Md. 275, 173 A. 248, 254 (1934)(deferring to business judgment of directors when directors honestly and reasonably made decision); 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1039 (rev. perm. ed. 1986)(generally discussing business judgment rule); Hinsey, *supra* note 5, at 610-12 (discussing business judgment rule and business judgment doctrine, both of which protect directors' actions when directors have fulfilled duty of care); *see also infra* notes 12-16 and accompanying text (discussing traditional business judgment rule); *cf.* Smith v. Van Gorkom 488 A.2d 858, 888 (Del. 1985) (refusing to allow business judgment rule to protect directors' decision to approve cash merger because court found directors inadequately informed themselves).

7. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986)(requiring directors to show reasonableness of comprehensive defensive strategy to takeover before affording board's decision protection of business judgment rule); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985)(requiring directors to show reasonableness of board's decision to adopt poison pill rights plan before affording board's decision to approve prospective defensive strategy protection of business judgment rule); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958-59 (Del. 1985)(requiring directors to prove reasonableness of board's decision to authorize selective self-tender offer before allowing business judgment

Because of greater judicial scrutiny of directors' decisions, varying standards of care, and the increasing risk of personal liability, qualified persons are abandoning corporate boards or are hesitating to serve as corporate directors.[8] In 1985, however, the Virginia General Assembly (General Assembly) enacted the Virginia Stock Corporation Act (VSCA),[9] which codifies a

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rule to protect board's response to hostile tender offer); Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985)(imposing liability on corporate directors for gross negligence in authorizing cash-out merger for low share price because directors did not act on informed basis).

8. *See* Baum & Byrne, *The Job Nobody Wants*, BUS. WK., Sept. 8, 1986, at 56 (acknowledging vulnerability to personal liability, outside corporate directors are reluctant to accept positions on corporate boards). A director's duty of care is of vital interest to persons serving on corporate boards, even though directors' decisions generally receive the protection of the business judgment rule. *See* Veasey & Seitz, *The Business Judgment Rule in the Revised Model Act, the* Trans Union *Case, and the ALI Project—A Strange Porridge*, 63 TEX. L. REV. 1483, 1485 (1985)(noting that routine decisions before corporate board and decisions that directors clearly have authority to make present few difficulties for courts when applying business judgment rule); *infra* notes 12-16 and accompanying text (discussing traditional business judgment rule). Most claims before the courts alleging that directors have breached the duty of care involve either derivative actions or takeover attempts. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180-85 (Del. 1986)(determining whether directors who adopted comprehensive defensive scheme to contest takeover breached duty of care to shareholders); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350-57 (Del. 1985)(deciding whether directors, in approving poison pill rights plan when actual struggle for corporation did not exist, breached duty of care); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955-59 (Del. 1985)(examining whether directors breached duty of care to shareholders when directors authorized self-tender offer in response to hostile tender offer); Aronson v. Lewis, 473 A.2d 805, 811-12 (Del. 1984)(addressing close relationship between futility of demand on corporate board in derivative actions and directors' breach of duty of care when directors decline to proceed with derivative action). In a derivative action, a plaintiff-shareholder who has made a demand on the board to proceed with a claim on behalf of the corporation may challenge the board's decision not to pursue the shareholder's claim as a breach of the directors' duty of care. *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 784 (Del. 1981)(applying business judgment rule to board's decision not to pursue shareholder's claim). In the context of a challenge to directors' decisions involving takeovers, a plaintiff-shareholder may allege that board members breached their duty of care in responding to a hostile tender offer. *See* Unocal Corp v. Mesa Petroleum Co. 493 A.2d 946, 949 (Del. 1985)(seeking to enjoin corporate self-tender offer by claiming that directors breached duty of care to shareholders when directors authorized self-tender offer in response to hostile tender offer).

9. VA. CODE ANN. § 13.1-601 to -800 (1985). In response to recent revisions to the Model Business Corporation Act (MBCA), the General Assembly in 1983 instructed the Virginia Code Commission to review chapters one and two of title 13.1 of the Code of Virginia, the existing corporate code in Virginia, and recommend revisions that would clarify and organize the Virginia corporate code. H.J. Res. 3, 1983 Va. Acts 1243; *see* Murphy, *The New Virginia Stock Corporation Act: A Primer*, 20 U. RICH. L. REV. 67, 68 n.1 (1985)(detailing history of VSCA). After a thorough study of potential revisions, the Virginia Code Commission presented to the Governor of Virginia and the General Assembly a report of the proposed revisions. *See* VA. CODE COMM'N, REPORT ON THE REVISION OF CHAPTERS 1 AND 2 OF TITLE 13.1 OF THE CODE OF VIRGINIA, H.R. DOC. NO. 13 (1985)[hereinafter CODE COMM'N REPORT](containing recommended revisions and comments on proposed changes from Virginia Bar Association). After determining which proposed revisions to adopt, the General Assembly passed in February 1985 the VSCA, which became effective on January 1, 1986. *See* VA. CODE ANN. § 13.1-600 to -800 (1985)(VSCA); *id.* § 13.1-601 (effective date of VSCA is January 1, 1986).

relatively low standard of care for corporate directors[10] and grants to corporations broad powers to indemnify directors against a breach of the codified standard of care.[11]

The majority of courts, including courts applying Virginia law before the VSCA, traditionally have required directors to satisfy an objective standard of care under the business judgment rule.[12] The business judgment

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10. *See* VA. CODE ANN. § 13.1-690 (1985)(standard of care for directors in VSCA); *infra* notes 17-21 and accompanying text (discussing Virginia's statutory standard of care under VSCA).

11. *See* VA. CODE ANN. § 13.1-697 to -704 (1985) (indemnification provisions in VSCA); *infra* notes 136-54 and accompanying text (examining indemnification provisions of VSCA).

12. *See* O'Connor v. First Nat'l Investors' Corp., 163 Va. 908, 927, 177 S.E. 852, 860 (1935)(finding that by placing control of clients' investments in hands of one person, directors of investment corporation failed to exercise ordinary care and thus breached duty of care); Anderson v. Bundy, 161 Va. 1, 21, 171 S.E. 501, 508 (1933)(holding bank directors liable for not exercising due care in managing affairs of bank); Marshall v. Farmers' & Mechanics' Sav. Bank, 85 Va. 676, 686-87, 8 S.E. 586, 591-92 (1889)(holding bank directors liable for not exercising ordinary care in overseeing affairs of bank); *see also* Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985)(finding that directors' decision to authorize cash-out merger for low share price did not receive protection of business judgment rule because directors were grossly negligent in approving merger); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)(when directors exercised ordinary care in deciding not to proceed with shareholder's claim, directors' decision falls within business judgment of directors); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971)(directors' decision to declare and issue excessive dividends received protection of business judgment rule because directors did not have improper motive or commit corporate waste); Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966)(because directors acted reasonably in deciding to form new holding company, court granted directors' decision protection of business judgment rule); Bodell v. General Gas & Elec. Corp., 140 A. 264, 268 (Del. 1927)(courts will not scrutinize directors' decisions made in good faith and for benefit of corporation and its shareholders); Muschel v. Western Union Corp., 310 A.2d 904, 908-09 (Del. Ch. 1973)(when directors exercise ordinary care, business judgment rule protects directors' decision to value corporation for purposes of merger); Auerbach v. Bennett, 47 N.Y.2d 619, 632-33, 393 N.E.2d 994, 1001-02, 419 N.Y.S.2d 920, 928 (1979)(when shareholder alleges directors have breached duty of care, business judgment rule applies to directors' decisions that are reasonable); Everett v. Phillips, 288 N.Y. 227, 236-37, 43 N.E.2d 18, 21-22 (1942)(deferring to business judgment of directors who reasonably extended time for corporation's debtor to repay indebtedness); Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437, 1439 (1985)(business judgment rule is basic principle in corporate law). *See generally* Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979)(comprehensively reviewing business judgment rule). Although courts universally accept the business judgment rule as a defense to directors' decisions involving corporate affairs, commentators have noted that courts have not been able to articulate a precise definition of the rule. *See* Veasey & Seitz, *supra* note 8, at 1485 (presenting different courts' definitions of business judgment rule); *see also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)(business judgment rule is presumption that directors made decision on informed basis, in good faith, and in honest belief that action was in best interests of corporation); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)(courts will not interfere with decision of directors if directors' decision has rational business purpose); Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966)(courts will defer to business judgment of directors unless showing of bad faith or gross abuse); Bodell v. General Gas & Elec. Corp., 140 A. 264, 268 (Del. 1927)(courts will not scrutinize directors' decisions made in good faith and for benefit of corporation and its shareholders); Muschel v. Western Union Corp., 310 A.2d 904, 908 (Del.

rule is a judicial presumption that the corporate directors have made an informed decision and acted in good faith, without self-interest, and in the sincere belief that the decision was in the best interests of the corporation.[13]

Ch. 1973) (courts will not intervene with directors' business judgments made in good faith, with honest motives, and for honest ends).

13. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *see* Veasey & Seitz, *supra* note 8, at 1485 (business judgment rule is presumption favoring directors' decisions). To justify the judicial presumption that in making corporate decisions directors exercised sound business judgment, courts and commentators have suggested three underlying rationales. First, courts have allowed directors the protection of the business judgment rule to give directors wide latitude in managing the affairs of, and making decisions for, the corporation. *See* Cramer v. General Tel. & Elec. Corp., 582 F.2d 259, 274 (3d Cir. 1978)(to manage affairs of corporation properly and efficiently, directors must have ample leeway in making corporate decisions); Evangelist v. Fidelity Management & Research Co., 554 F. Supp. 87, 91 (D. Mass. 1982)(intent of business judgment rule is to give directors freedom in managing affairs of corporation). Second, courts defer to managerial decisions of directors because judges who are not competent to make business decisions should not substitute their judgment for, or interfere with, the judgment of corporate directors. *See* Crouse-Hinds Co. v. Internorth, Inc., 634 F.2d 690, 702 (2d Cir. 1980)(noting that courts are not qualified to make corporate business decisions); Auerbach v. Bennett, 47 N.Y.2d 619, 630, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979)(noting that courts have insufficient ability to make corporate business determinations). Last, commentators suggest that judges should defer to actions by corporate directors because directors will make overly cautious decisions regarding corporate affairs if courts unrestrictively can review directors' decisions. *See* 3A W. FLETCHER, *supra* note 6, § 1039 (business judgment rule allows directors to take same type of risks in making corporate decisions that they would take in personal affairs); Fischel, *supra* note 12, at 1439 (fear of personal liability influences directors to act cautiously). Regardless of the justification for the rule, courts have allowed directors to invoke the business judgment rule in derivative actions or in suits by shareholders of corporations involved in takeovers or mergers as a defense to challenges of directors' corporate decisions. *See supra* note 8 (noting recent cases involving derivative actions or takeovers). In the context of derivative actions, the business judgment rule is important in a shareholder's making demand on a corporation's board to proceed with a shareholder's claim or in a court's excusing the requirement of demand. *See* Cramer v. General Tel. & Elec. Corp., 582 F.2d 259, 274-75 (3d Cir. 1978)(noting that independent directors' decision not to proceed with shareholder's claim against corporation falls within protection of business judgment rule when directors act in good faith and without self-interest); 3A W. FLETCHER, *supra* note 6, § 1041.1 (examining business judgment rule's relationship to derivative actions). The business judgment rule is also important in the context of derivative actions when courts analyze a decision of a corporation's litigation committee to dismiss a shareholder's claim. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)(affording directors' decisions as members of corporation's litigation committee protection of business judgment rule when directors made decision on informed basis, in good faith, and in honest belief that action was in best interests of corporation). *See generally* Block & Prussin, *Termination of Derivative Suits Against Directors on Business Judgment Grounds: From* Zapata *to* Aronson, 39 BUS. LAW. 1503 (1984)(comprehensively reviewing derivative actions involving directors and special litigation committees).

In the context of takeovers, courts have applied the business judgment rule to determine whether directors' actions in opposing a takeover are in the best interests of the corporation or constitute a means of directors' maintaining control of the corporation. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180-84 (Del. 1986)(applying business judgment rule to directors' decision to adopt rights plan and lock-up option as defensive measures in takeover situation); Moran v. Household Int'l, Inc., 500 A.2d 1346,

Thus, the business judgment rule potentially protects directors from liability for actions taken while making decisions for the corporation.[14] The plaintiff-shareholder alleging a breach of the duty of care may rebut the presumption of the business judgment rule by showing that in making a corporate decision, directors acted in bad faith, failed to use ordinary care, or engaged in self-dealing.[15] Under the traditional business judgment rule, when a plaintiff-shareholder has offered evidence sufficient to rebut the presumption of the business judgment rule, the burden shifts to the directors to prove the reasonableness of the directors' actions.[16]

Although the majority of courts continue to apply the objective standard of care under the business judgment rule, section 13.1-690 of the VSCA

1356-57 (Del. 1985)(allowing business judgment rule to protect directors' decision to approve poison pill rights plan before actual takeover threat existed); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955-59 (Del. 1985)(allowing business judgment rule to protect directors' decision to authorize selective self-tender offer in response to hostile tender offer). Because of the possibility for directors' self-interest in maintaining control of a corporation, Delaware courts recently have placed an initial burden on directors to prove the reasonableness of the corporate board's responsive or prospective defensive strategy. *See infra* notes 58-77 and accompanying text (examining *Unocal* court's placing initial burden on directors in takeover situations).

14. *See, e.g.,* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180-84 (Del. 1986)(applying business judgment rule to directors' decision to adopt rights plan and lock-up option as defensive measures); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356-57 (Del. 1985)(allowing business judgment rule to protect directors who adopted poison pill rights plan); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955-59 (Del. 1985)(allowing business judgment rule to protect directors' decision to authorize selective self-tender offer); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)(directors' decision not to proceed with shareholder's claim falls within business judgment of directors); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971)(directors' decision to declare and issue excessive dividends received protection of business judgment rule because directors did not have improper motive or commit corporate waste); Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966)(granting protection of business judgment rule to directors' decision to form new holding company); Muschel v. Western Union Corp., 310 A.2d 904, 908-09 (Del. Ch. 1973)(business judgment rule protects directors' decision to value corporation for purposes of merger); Everett v. Phillips, 288 N.Y. 227, 236-37, 43 N.E.2d 18, 21-22 (1942)(deferring to business judgment of directors who extended time for corporation's debtor to repay indebtedness); *see also* Veasey & Seitz, *supra* note 8, at 1485 (discussing effect of business judgment rule).

15. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)(person challenging decision of directors has burden of proving facts that rebut presumption of directors' sound business judgment); Warshaw v. Calhoun, 221 A.2d 487, 492-93 (Del. 1966)(burden on plaintiff to show directors' bad faith or abuse of discretion); 3A W. FLETCHER, *supra* note 6, § 1041.4 (discussing burden of proof under business judgment rule); Arsht, *supra* note 12, at 131 (courts require plaintiff to prove directors' bad faith or self-dealing when directors invoke business judgment rule as defense for corporate decision); *see also infra* note 16 (noting burden of directors in proving reasonableness of board's actions).

16. *See* Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 265 (2d Cir. 1984)(under New York law, directors bear burden of proving reasonableness of board's actions after plaintiff has shown bad faith or self-dealing); Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980)(under New Jersey law, directors bear burden of proving reasonableness of board's actions after plaintiff has shown bad faith, self-interest, or fraud); *see also* 3A W. FLETCHER, *supra* note 6, § 1041.4 (discussing burden of proof under business judgment rule).

codifies a subjective standard of care to which directors of Virginia corporations must adhere in discharging their duties as corporate directors.[17] Section 13.1-690(A) of the VSCA provides an affirmative standard of care that requires directors to perform their obligations as directors in "accordance with their good faith business judgment of the best interests of the corporation."[18] In challenging directors' actions under section 13.1-690(A), a plaintiff-shareholder must prove that the directors have breached the statutory standard of care.[19] The drafters of the VSCA intended that in determining whether a plaintiff-shareholder satisfied the burden of proving the directors' breach, courts should examine all of the circumstances surrounding the board's decision to determine whether directors acted in the good faith business judgment of the best interests of a corporation.[20] In examining the evidence of the directors' alleged breach of the VSCA's duty of care, a court must make a subjective inquiry into the directors' good faith judgment.[21]

In addition to establishing a general standard of care in section 13.1-690(A), the VSCA provides in section 13.1-690(B) a standard of conduct for directors to follow when directors rely on information from other individuals or groups in making corporate decisions.[22] Section 13.1-690(B)

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17. *See* VA. CODE ANN. § 13.1-690(A) (1985)(requiring corporate directors to act in good faith business judgment in corporation's best interests); *supra* notes 12-16 and accompanying text (discussing traditional business judgment rule). *But see* Murphy, *supra* note 9, at 108 (noting that General Assembly substantially may have diluted standard of care in VSCA).

18. VA. CODE ANN. § 13.1-690(A) (1985). Although the General Assembly did not define the term "good faith" in § 13.1-690 of the VSCA, the term "good faith" generally means honesty in intention. *See* Prudential Ins. Co. v. Miller Brewing Co., 789 F.2d 1269, 1279 (7th Cir. 1986)(recognizing that term "good faith" means honesty in fact); Efron v. Kalmanovitz, 249 Cal. App. 2d 187, , 57 Cal. Rptr. 248, 251 (1967)(noting that term "good faith" generally denotes honesty of purpose and being faithful to duty or obligation); Doyle v. Gordon, 158 N.Y.S.2d 248, 259-60 (N.Y. Sup. Ct. 1954)(noting that term "good faith" generally means honesty in intention); *cf.* REVISED MODEL BUSINESS CORP. ACT § 8.30(c) (1985)(establishing circumstances when director acts in good faith). The standard in § 13.1-690(A) of the VSCA applies both to directors' affirmative actions and to directors' failures to attend to their duties. VA. CODE ANN. § 13.1-690(C) (1985); *see* CODE COMM'N REPORT, *supra* note 9, app. 4, at 249-50 (standard of care in VSCA applies to directors' failure to act and to directors' actual misconduct); Murphy, *supra* note 9, at 107-08 (standard of care in VSCA applies to both actual and passive misconduct).

19. *See* VA. CODE ANN. § 13.1-690(D) (1985)(placing burden of proof that directors breached duty of care on person alleging directors' breach of duty of care).

20. Telephone interview with Allen C. Goolsby, III, Primary Drafter of the VSCA (Feb. 12, 1987)(noting that VSCA implicitly instructs courts to ascertain whether directors breached duty of care under VSCA by determining whether directors failed to make due inquiry, failed to attend sufficiently to directorial responsibilities, or failed to read available reports relevant to corporate decisions).

21. *See* VA. CODE ANN. § 13.1-690 (1985)(providing that to satisfy standard of care under VSCA, directors must act in good faith, rather than as ordinarily prudent persons); *see also* CODE COMM'N REPORT, *supra* note 9, app. 4, at 249 (noting that General Assembly's failure to use term "reasonable" in standard of care provisions of VSCA eliminates comparison of director's actions to idealized, objective standard).

22. *See* VA. CODE ANN. § 13.1-690(B) (1985)(authorizing directors to rely on information that others furnish to corporation's board of directors in making decisions).

authorizes directors to rely on information, opinions, reports, or statements of other specified individuals or groups unless the directors possess actual knowledge that makes reliance on the specific information unwarranted.[23] In addition, section 13.1-690(B) requires directors to believe in good faith that the person giving the information or report is reliable and competent regarding the specific matter relied upon.[24] When the directors' reliance on the information from the qualified individuals or groups is warranted and in good faith, therefore, section 13.1-690(B) protects directors from any liability that might arise because of false information furnished to the directors.[25]

In contrast to the subjective standard of care provisions in the VSCA, the standard of care provisions in the Revised Model Business Corporation Act (RMBCA) contain an objective standard of care for directors.[26] Under section 8.30(a) of the RMBCA directors must exercise their duties not only in good faith, but also with the care of ordinarily prudent persons and in a manner they reasonably believe to be in the best interest of the corporation.[27] By requiring directors to act as ordinarily prudent persons, section 8.30(a) of the RMBCA requires a court to construct a hypothetical reasonable man standard and to judge directors' actions against this objective standard.[28] The general duty of care under the RMBCA, therefore, implicitly

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23. *Id.*; *see* Blain & Repp, *Virginia's New Stock Corporation Act: A Farewell To Forms*, 11 VA. B.A.J. 9, 13 (1985)(directors' reliance on outside information is unwarranted when directors possess information that questions reliability or competency of individuals furnishing information). Under section 13.1-690(B) of the VSCA, a specified person is

> 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;
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> 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
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> 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.

VA. CODE ANN. § 13.1-690(B) (1985).

24. *See* VA. CODE ANN. § 13.1-690(B) (1985)(authorizing directors' reliance on information of others and containing terms such as "reliable," "competent," "professional or expert competence," and "merit[ing] confidence" to refer to individuals or committees); *supra* note 23 (quoting reliance provision of VSCA); *supra* note 18 (noting that § 13.1-690 of VSCA does not define term "good faith," but that good faith usually means honest in fact).

25. *See* VA. CODE ANN. § 13.1-690(C) (1985)(exculpating directors who satisfy standard of care in § 13.1-690 of VSCA).

26. *Compare* REVISED MODEL BUSINESS CORP. ACT §8.30 (1985) (standard of care in RMBCA requires court to devise hypothetical reasonable man standard in determining directors' breach of duty of care); *and infra* notes 26-29 and accompanying text (discussing RMBCA's standard of care); *with* VA. CODE ANN. § 13.1-690 (1985)(standard of care in VSCA requires court only to determine directors' good faith in ascertaining whether directors breached duty of care); *and supra* notes 17-21 and accompanying text (examining VSCA's standard of care for directors).

27. REVISED MODEL BUSINESS CORP. ACT § 8.30(a) (1985).

28. *Id.*; *see* Murphy, *supra* note 9, at 105 (RMBCA embraces reasonable man standard adopted from tort law). Under the RMBCA's standard of care a court must fabricate a factual

requires directors to inform themselves of the matters upon which they are acting because an ordinary person acting reasonably would become knowledgeable regarding such matters.[29]

In addition to imposing an objective standard of care on directors for actions taken as corporate directors, the RMBCA in section 8.30(b) authorizes directors to rely on other specified individuals or groups for information.[30] To rely on the information of specified individuals or groups under the RMBCA, directors not only must comply with the objective standard of care in section 8.30(a) of the RMBCA, but also reasonably must believe in the reliability and competency of the individual or group of individuals providing the information.[31] Additionally, section 8.30(b) of the RMBCA requires that directors inform themselves of the contents of the information or report on which they rely, and that the directors have no actual knowledge of relevant matter that would make reliance on another individual or group unwarranted.[32] After fulfilling the requirements in section 8.30(b) of the RMBCA, directors may rely on information obtained from others to make business decisions regarding all matters that are the responsibility of the board of directors.[33]

Comparing the VSCA's standard of care with the RMBCA's standard of care applicable to the activities of corporate directors reveals two significant differences. The first difference is the absence in the VSCA of an

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framework and compare directors' specific actions with the actions that ordinarily prudent persons would exercise in the same situation and determine if the directors acted reasonably. *See* REVISED MODEL BUSINESS CORP. ACT § 8.30(a) (1985)(objective standard of care in RMBCA); Murphy, *supra* note 9, at 105 (noting that factual background includes time and information constraints, makeup of board of directors, and board's role in corporate decisionmaking).

29. *See* REVISED MODEL BUSINESS CORP. ACT § 8.30 comment 1 (1985)(requiring directors to exercise common sense, practical wisdom, and informed judgment, even if directors have no particular business expertise).

30. *See id.* § 8.30(b) (establishing directors' standard of care for relying on information that others supply to corporate board). A specified individual or group under the RMBCA includes an officer or employee of the corporation, legal or financial professionals, other experts, or an independent committee of the board of directors. *Id.* § 8.30(b); *see* VA. CODE ANN. § 13.1-690(B) (1985)(listing persons on whom directors may rely for information or reports); *supra* note 23 (quoting VSCA's provision imposing standard of care on directors who rely on information furnished by others).

31. *See* REVISED MODEL BUSINESS CORP. ACT § 8.30(b) (1985) (authorizing directors making corporate decisions to rely reasonably on information of others); *id.* § 8.30 comment 2 (addressing requirements in RMBCA of directors' standard of care in relying on information of others). By using the term "reasonable" throughout section 8.30(b) of the RMBCA, the ABA Committee that drafted the RMBCA established an objective standard of care for directors' reliance on others. *See id.* § 8.30(b) (objective standard for directors' reliance on others in making corporate decisions).

32. *See id.* § 8.30 comment 2 (section 8.30(b) of RMBCA requires that to rely on information or reports of others, directors must become familiar with information or reports' contents); *id.* § 8.30(c) (establishing that to act in good faith, directors must not possess actual knowledge that makes reliance on others' information unwarranted).

33. *Id.* § 8.30 comment 2.

objective standard of reasonableness for evaluating directors' decisions.[34] In enacting section 13.1-690 of the VSCA, the General Assembly intended to enact a standard of care that did not require the court to assess directors' conduct against an idealized reasonable man standard.[35] The General Assembly, instead, intentionally avoided using the term "reasonable" in section 13.1-690 of the VSCA to circumvent problems that courts might have in determining an allowable degree of deviation from the idealized standard.[36] Placing great significance on circumstantial evidence concerning the directors' decision, the General Assembly intended courts considering the liability of directors for corporate decisions to inquire only about the directors' good faith belief of what is in the best interests of the corporation.[37] The General Assembly did not contemplate, however, imposing a purely subjective standard on directors' managerial decisions because the General Assembly realized that courts may consider reasonableness.[38] But by not using the

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34. *See* VA. CODE ANN. § 13.1-690 (1985)(imposing subjective good faith requirement on directors in managing corporate affairs); *cf.* REVISED MODEL BUSINESS CORP. ACT § 8.30 (1985) (imposing on directors making corporate decisions subjective requirement to act in good faith and objective requirements to act with care of ordinarily prudent persons in similar circumstances and in manner believed to be in best interests of corporation).

35. *See* CODE COMM'N REPORT, *supra* note 9, app. 4, at 249 (subjective standard of care in VSCA does not require comparison of director conduct to hypothetical reasonable man standard); Murphy, *supra* note 9, at 106 (standard of care under VSCA appears simple by imposing only two requirements on directors acting for corporation because VSCA requires only good faith and business judgment in corporation's best interests).

36. *See* CODE COMM'N REPORT, *supra* note 9, app. 4, at 249 (absence of term "reasonable" in VSCA's standard of care removes necessity of courts' comparing directors' actions with idealized standard); Murphy, *supra* note 9, at 108 (noting complication and artificiality of RMBCA's objective standard of care for directors). *But see* Murphy, *supra* note 9, at 106 (courts may have difficulty construing limits of good faith requirement).

37. CODE COMM'N REPORT, *supra* note 9, app. 4, at 249; Telephone interview with Allen C. Goolsby, III, Primary Drafter of VSCA (Feb. 12, 1987)(in determining directors' good faith under VSCA, courts should consider circumstantial evidence, such as directors' attempt to make due inquiry, to attend sufficiently to directors' responsibilities, or to read available accounts). The language of the VSCA's standard of care indicates that a court should not compare directors' actions with the actions of reasonable men. *See* VA. CODE ANN. § 13.1-690 (1985)(lacking language indicating tort law's reasonable man standard); CODE COMM'N REPORT, *supra* note 9, app. 4, at 249-50 (General Assembly intentionally avoided using terms "reasonable" or "ordinary" in VSCA's standard of care); Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1493 (1984)(difficulty with tort law's reasonable man standard is that no clear perception of what constitutes reasonable action for directors exists); Murphy, *supra* note 9, at 108 (court should not compare directors' actions with actions of reasonable men because directors' own good faith and business judgment comprise only requirements under VSCA's standard of care).

38. Telephone interview with Allen C. Goolsby, III, Primary Drafter of VSCA (Feb. 12, 1987)(commenting that court may consider reasonableness of directors' decision in determining directors' good faith); *see* CODE COMM'N REPORT, *supra* note 9, app. 4, at 249 (recognizing that directors' good faith partially depends on reasonableness of directors' decisions). In interpreting the standard of care in the VSCA, one commentator has argued that rational conduct is an assumed element of the standard. *See* Murphy, *supra* note 9, at 109 (directors have difficulty proving that irrational acts are in best interests of corporation because statutory standard requires action in best interests of corporation).

term "reasonable" in section 13.1-690 of the VSCA, the General Assembly did not require the court to construct an elaborate reasonable man framework for measuring the directors' conduct.[39]

The second significant difference between directors' standards of care under the RMBCA and the VSCA is that although the American Bar Association's Committee on Corporate Laws (ABA Committee), which drafted the RMBCA, did not intend to codify the business judgment rule in section 8.30 of the RMBCA, the General Assembly intended to codify the business judgment rule in section 13.1-690 of the VSCA.[40] In proposing the directors' standard of care in section 8.30 of the RMBCA, the ABA Committee acknowledged that courts have not developed completely the business judgment rule.[41] The ABA Committee concluded, therefore, that a uniform codification of the business judgment rule in the RMBCA was not possible.[42] According to the ABA Committee, section 8.30 of the RMBCA simply contains a general standard of care for directors to which directors must adhere in making corporate decisions.[43] When a court determines that directors satisfy the standard of care under section 8.30 of the RMBCA in making a corporate decision, the RMBCA protects the directors from liability for the corporate decision.[44] Even when a court finds that directors do not satisfy the standard of care in section 8.30 of the RMBCA, however, the directors may rely on the traditional business judgment rule for protection from liability.[45]

In enacting section 13.1-690 of the VSCA, however, the General Assembly attempted to bring the standard of care in section 13.1-690 into con-

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39. CODE COMM'N REPORT, *supra* note 9, app. 4, at 249; *cf.* REVISED MODEL BUSINESS CORP. ACT § 8.30 (1985)(requiring courts to measure directors' conduct against objective standard of reasonableness).

40. *See* VA. CODE ANN. § 13.1-690 (1985)(VSCA's standard of care provision contains term "business judgment"); *cf.* REVISED MODEL BUSINESS CORP. ACT § 8.30 general comment (1985)(explicitly rejecting directors' standard of care as attempt to codify business judgment rule).

41. REVISED MODEL BUSINESS CORP. ACT § 8.30 general comment (1985)(ABA Committee refusing to codify business judgment rule because courts constantly are developing directors' standard of care and circumstances when courts should apply business judgment rule are changing).

42. *Id.*

43. *Id.* § 8.30 comment 1.

44. *See id.* § 8.30(d) (absolving directors from liability when directors fulfill duty of care); *id.* § 8.30 general comment (noting that directors are not liable for actions when directors satisfy standard of care).

45. *See* D. BLOCK, N. BARTON & S. RADIN, THE BUSINESS JUDGMENT RULE 24-25 (1987)[hereinafter BLOCK & BARTON](noting that directors who breach standard of care under RMBCA may not be liable because greater culpability than breach of statutory standard of care is necessary to impose liability on directors); Hinsey, *supra* note 5, at 614 (noting that courts have held that directors have breached duty of care by not acting as reasonable persons, but have escaped liability by acting in good faith); Manning, *supra* note 37, at 1479 n.2 (noting that drafters of MBCA's standard of care for directors were uncertain whether breach of duty of care would result in directors' legal liability); *supra* notes 12-16 and accompanying text (discussing traditional business judgment rule).

formity with the common-law business judgment rule.[46] Recognizing that directors usually reach corporate decisions by consensus and under time restrictions, the General Assembly intended for courts to defer to directors' decisions when the directors satisfied the standard of care under section 13.1-690 of the VSCA.[47] In addition, the General Assembly intended to deter courts from using hindsight to re-evaluate the decisions of corporate boards.[48] When directors satisfy the standard of care in section 13.1-690 of the VSCA, the VSCA protects the directors from liability for the corporate decision.[49] When directors breach the standard of care in section 13.1-690 of the VSCA, however, they should not be able to rely upon the business judgment rule for exoneration because the General Assembly attempted to merge the business judgment rule into section 13.1-690 of the VSCA.[50]

Because the standard of care in section 13.1-690 of the VSCA is new, Virginia courts have not had the opportunity to apply the standard to directors' actions. In applying the standard of care under section 13.1-690, Virginia courts may seek guidance from recent cases in Delaware—a leading state for corporation law—whose courts apply the traditional business judgment rule.[51] Although the traditional business judgment rule in Virginia and other jurisdictions affords directors the rebuttable presumption of sound

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46. Telephone interview with Allen C. Goolsby, III, Primary Drafter of VSCA (Feb. 12, 1987)(General Assembly basically intended to codify business judgment rule in enacting standard of care in VSCA).

47. *Id.* According to the primary drafter of the VSCA, the circumstances surrounding directors' decisions significantly influenced the General Assembly's adoption of a directors' standard of care that attempted to codify the business judgment rule. *Id.* (referring to Manning, *supra* note 37, at 1477). The General Assembly recognized the realities that severely restrict the decisionmaking process of corporate boards, including the corporate boards' time constraints, the complexity of corporate enterprises, management's control of board meetings, the limited participation by corporate directors, the reaching of decisions by consensus, and the directors' reliance on others' reports. Telephone interview with Allen C. Goolsby, III, Primary Drafter of VSCA (Feb. 12, 1987)(referring to Manning, *supra* note 37, at 1477); *see* Manning, *supra* note 37, at 1481-91 (noting that realities of directors' actions in corporate boardroom do not conform to objective, conceptual theory).

48. Telephone Interview with Allen C. Goolsby, III, Primary Drafter of VSCA (Feb. 12, 1987); *see supra* notes 12-16 and accompanying text (examining traditional business judgment rule).

49. VA. CODE ANN. § 13.1-690 (1985).

50. Telephone Interview with Allen C. Goolsby, III, Primary Drafter of VSCA (Feb. 12, 1987). *But see supra* note 46 and accompanying text (noting that directors may fall within protection of business judgment rule even though directors have breached traditional standard of care in RMBCA).

51. VA. CODE ANN. § 13.1-690 (1985); *see* H. HENN & J. ALEXANDER, *supra* note 1, § 93 (noting that Delaware corporate statute is flexible basis for corporate action, is most accommodating corporate statute to corporations, and has resulted in well-settled corporate law); Schmidt, *Md. Bill Would Cut Liability of Corporation Directors*, Wash. Post, Feb. 5, 1987, at 1, col. 5 (referring to Delaware as "mecca" for corporations in reporting that Maryland legislature may adopt new corporate liability law); *supra* note 6 and accompanying text (discussing traditional business judgment rule); *supra* note 7 (noting recent Delaware Supreme Court decisions involving directors' standard of care in takeover situations).

business judgment, the Delaware Supreme Court recently has reviewed more closely the decisions of corporate directors in takeover situations.[52] In analyzing directors' actions to prevent takeovers, the Delaware Supreme Court has determined initially whether a board of directors has the authority to adopt specific defensive measures that oppose takeover attempts.[53] Invoking both statutory and case law, the Delaware Supreme Court has recognized that a board of directors possesses the authority to manage the business and affairs of the corporation and the obligation to protect the corporation and its shareholders from harm.[54] The Delaware Supreme Court has acknowledged, therefore, the authority of a corporate board to contest a takeover when the board reasonably concludes that the takeover is not in the best interests of the corporation.[55] Although recognizing the authority of corporate directors to contest corporate takeovers, the Delaware Supreme Court has altered the burden of proof in applying the business judgment rule to directors' decisions involving takeovers.[56] Instead of initially deferring to decisions of corporate directors, the Delaware Supreme Court in recent decisions has placed a threshold burden on corporate directors to show the reasonableness of their responses to takeover attempts.[57]

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52. *See* Smith v. Van Gorkom, 488 A.2d 858, 872-98 (Del. 1985)(closely analyzing decisionmaking process of board of directors in takeover situation and not allowing business judgment rule to protect directors who authorized cash-out merger for low share price); *supra* note 7 (noting recent Delaware cases in which Delaware Supreme Court closely has scrutinized actions of directors of corporations involved in takeovers); *supra* notes 12-16 and accompanying text (discussing common-law standard of care under traditional business judgment rule).

53. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986)(before considering application of traditional business judgment rule, court found that directors had authority to adopt comprehensive defensive strategy in response to specific takeover); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1353 (Del. 1985)(before determining whether traditional business judgment rule applied to directors' decision to adopt poison pill rights plan, court found that directors had authority to approve rights plan for prospective corporate threat); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985)(finding that directors had authority to adopt selective self-tender offer as response to hostile tender offer before considering whether traditional business judgment rule applied to directors' decision approving self-tender).

54. *See supra* note 53 and accompanying text (noting cases in which Delaware Supreme Court has examined authority of corporate board to contest takeovers); *see also* Panter v. Marshall Field & Co., 646 F.2d 271, 297 (7th Cir. 1981)(corporate board has duty to shareholders to protect corporate enterprise from reasonably perceived harm); Crouse-Hinds Co. v. Internorth, Inc., 634 F.2d 690, 704 (2d Cir. 1980)(board of directors has obligation to protect corporation from harm); DEL. CODE ANN. tit. 8, § 141 (1974)(board of directors has duty and responsibility to manage business and affairs of corporation).

55. *See Revlon*, 506 A.2d at 179 (noting that even when corporation involved in takeover, corporate directors required to act in best interests of corporation); *Moran*, 500 A.2d at 1356 (requiring directors to act in best interests of corporation); *Unocal*, 493 A.2d at 954 (noting that in managing affairs of corporation, directors' duty is to act in best interests of corporation even when corporation faces takeover); *supra* note 54 and accompanying text (discussing general authority of corporate board to manage affairs of corporation).

56. *See infra* notes 65-77 and accompanying text (examining how Delaware Supreme Court in *Unocal* shifted burden to defendant directors to prove initial reasonableness of board's response to takeover).

57. *See Revlon*, 506 A.2d at 180 (requiring directors to show reasonableness of

For example, in *Unocal Corp. v. Mesa Petroleum Co.*[58] the Delaware Supreme Court considered whether the business judgment rule protected a corporate board's decision to reject a hostile tender offer and to adopt a selective self-tender offer that excluded the shareholder making the hostile offer.[59] In *Unocal* the board of directors of Unocal Corp. (Unocal) met and considered a tender offer by Mesa Petroleum Co. (Mesa), which owned thirteen percent of Unocal's outstanding common stock, to purchase an additional thirty-seven percent of Unocal's stock.[60] After consulting with legal and financial advisors, the Unocal directors resolved to oppose Mesa's tender offer.[61] Two days later, the Unocal board adopted a selective self-tender offer in which Unocal would purchase, upon Mesa's successful acquisition of thirty-seven percent of Unocal's outstanding common stock, forty-nine percent of its own outstanding common stock in an exchange for debt securities having an aggregate par value of seventy-two dollars per note.[62] Mesa prevented Unocal from purchasing its own stock, however, by

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comprehensive defensive strategy in response to specific takeover before applying traditional business judgment rule); *Moran*, 500 A.2d at 1356 (requiring directors to bear burden of proving reasonableness of decision to approve poison pill rights plan for prospective corporate threat before applying traditional business judgment rule); *Unocal*, 493 A.2d at 955 (requiring directors to prove reasonableness of selective self-tender offer as response to hostile tender offer before applying traditional business judgment rule).

58. 493 A.2d 946 (Del. 1985).

59. *Id.* at 955-59.

60. *Id.* at 949-50. In *Unocal*, Mesa Petroleum Co. (Mesa), a 13% shareholder in Unocal Corporation (Unocal), made a two-tier cash tender offer for an additional 37% of Unocal's outstanding common stock. *Id.* at 949. A two-tier tender offer consists of a cash tender offer for outstanding stock of a corporation in the first tier and an offer to exchange the remaining outstanding stock of a corporation with securities having a value below the value of the cash tender offer in the second tier. 1 M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS § 1.07[4][c] (1986). In Mesa's hostile tender offer Mesa's first tier consisted of an offer to pay $54 in cash per share of Unocal stock. *Unocal*, 493 A.2d at 949. The second tier of Mesa's tender offer involved an offer to exchange debt securities and preferred stock for the remaining outstanding common stock of Unocal. *Id.* at 950 n.3. In offering the exchange of debt securities for common stock, Mesa intended to eliminate the publicly held common shares of Unocal. *Id.* at 949.

61. *Unocal*, 493 A.2d at 950-51. In *Unocal* the corporate board of Unocal, consisting of eight outside directors and six inside directors, received advice from Unocal's counsel who instructed the board on the directors' legal obligations under Delaware corporate law and federal securities law in considering tender offers. *Id.* at 950. In addition to the legal counsel's presentation, an investment banker who represented two leading investment banking firms presented to the board a detailed analysis of the Mesa tender offer, the bases of the investment banking firms' opinion of the offer, and possible defensive measures available to Unocal's board. *Id.* The investment banker advised the Unocal board that the Mesa tender offer was wholly inadequate because the value of 100% of Unocal stock exceeded $60 per share. *Id.* In addition to advising the Unocal board to reject the hostile tender offer, the investment banker proposed to the Unocal board possible defensive strategies, including a self-tender offer by Unocal with a price range of $70-$75 per share of stock. *Id.* After the presentations by legal counsel and the investment banker, the Unocal board resolved to reject the Mesa tender offer and adjourned the board meeting, which had lasted for 9 1/2 hours. *Id.*

62. *Id.* at 950-51. In *Unocal*, Unocal's Vice-President of Finance, Assistant General

petitioning successfully the Delaware Court of Chancery for a preliminary injunction.[63] Challenging the court of chancery's conclusion that the selective self-tender offer legally was impermissible because the selective self-tender offer was not fair to all stockholders, Unocal appealed to the Delaware Supreme Court.[64]

On appeal the Delaware Supreme Court in *Unocal* invoked a heightened standard of care to judge the decisions of the Unocal directors.[65] The *Unocal* court noted that Delaware statutory law authorized a corporate board to trade in the corporation's own stock and that Delaware common law allowed a board to oppose takeovers.[66] The *Unocal* court also noted that Delaware courts traditionally defer to a corporate board's decision having a rational business purpose.[67] The Delaware Supreme Court explained, however, that directors involved in a takeover have an inherent conflict of interest to maintain control of the corporation to further their own interests rather than the corporation's interests.[68] The *Unocal* court determined, therefore, that when a plaintiff-shareholder challenges a corporate board's decision to

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Counsel, and investment bankers presented to the corporate board a detailed analysis of the self-tender offer. *Id.* After these presentations, the Unocal board resolved that if Mesa acquired 37% of Unocal's outstanding stock (Mesa Purchase Condition), Unocal would purchase the remaining 49% of Unocal's outstanding common stock with debt securities valued at $72 per share of stock. *Id.* at 951. The Unocal board also resolved to exclude Mesa from the self-tender offer. *Id.*

63. *Id.* at 951. In *Unocal* the Unocal board met to review the board's self-tender offer shortly after Mesa filed suit to enjoin Unocal from exchanging common stock for debt. *Id.* During this meeting of the Unocal board, Unocal's investment bankers advised the Unocal directors to remove the Mesa Purchase Condition from the tender offer (waiver of Mesa Purchase Condition), to sell their own stock as a showing of confidence in the self-tender offer, and to review Mesa's exclusion from the self-tender offer to ascertain a legitimate corporate purpose. *Id.* After the board meeting Unocal issued a supplement to the self-tender offer that described the waiver of the Mesa Purchase Condition and extended the expiration dates of the self-tender offer. *Id.* The Vice Chancellor of the Delaware Court of Chancery issued a temporary restraining order prohibiting Unocal from excluding Mesa from the self-tender offer. *Id.* at 952. The Vice Chancellor, subsequently, granted Mesa a preliminary injunction prohibiting Unocal's selective self-tender offer. *Id.*

64. *Id.* at 953.

65. *See id.* at 954-55 (court determined that because directors have inherent conflict of interest in struggle for control of corporation, court's analysis must begin with determining whether directors involved in takeover can make objective decision).

66. *Id.* at 953-54; *see* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)(noting that court will not substitute own judgment for directors' judgment having rational business purpose); DEL. CODE ANN. tit. 8, § 160(a) (1974)(authorizing corporation to trade in corporation's own stock); *supra* notes 54-55 and accompanying text (discussing authority of corporate board to oppose takeover).

67. *Unocal*, 493 A.2d at 954; *see* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)(noting that court will not substitute own judgment for directors' judgment having rational business purpose).

68. *See Unocal*, 493 A.2d at 954-55 (noting that directors involved in takeovers have conflict of interest because directors sometimes act to remove threat to directors' own control of corporation, rather than to remove threat to corporation and shareholders).

contest a takeover, the directors must bear the initial burden of showing the reasonableness of their managerial decision.[69]

The Delaware Supreme Court in *Unocal* determined that to show the reasonableness of managerial actions contesting a takeover, directors first must prove that they reasonably perceived a threat to the corporation.[70] The court in *Unocal* noted that by showing good faith and reasonable investigation, directors satisfy the threshold burden of proving a reasonable belief of a corporate threat.[71] The *Unocal* court found that Unocal's directors had concluded in good faith and after reasonable investigation that Mesa's tender offer was grossly inadequate.[72] The Delaware Supreme Court then found that the Unocal directors reasonably had perceived a threat to the corporation.[73]

The *Unocal* court next determined that after directors involved in a takeover show a reasonably perceived threat to the corporation, the directors must prove that the corporate board's response to the reasonably perceived threat was reasonable.[74] The *Unocal* court found that the directors of Unocal sought to protect Unocal shareholders by adopting the self-tender offer and that if Unocal allowed Mesa to participate in the self-tender offer, the self-

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69. *See Unocal*, 493 A.2d at 954 (noting that directors involved in takeovers sometimes act to fruther personal, rather than corporate, interests); *infra* notes 70-77 and accompanying text (discussing requirement that directors prove reasonably perceived corporate threat and reasonable response to takeover threat). Although the *Unocal* court specifically did not indicate any shift of the burden of proof other than requiring the directors initially to prove reasonableness of the board's actions, the Delaware Supreme Court in another recent takeover case noted that after directors have proved the reasonableness of their actions, the burden shifts to the plaintiff-shareholder to prove that the directors did not comply with the directors' fiduciary duties. *See Moran*, 500 A.2d at 1356 (shifting back to plaintiff-shareholder ultimate burden of persuasion that directors breached duty of care in defending corporation from takeover attempt).

70. *Unocal*, 493 A.2d at 955.

71. *Id.* In *Unocal* the Delaware Supreme Court noted that because the Unocal board consisted of a majority of outside directors, the board was independent. *Id.* The *Unocal* court noted that the independence of the Unocal board substantially strengthened the reasonableness of the board's decision to approve the self-tender offer. *Id.*

72. *Id.* at 956. In *Unocal* the Unocal directors found that because the value of the corporation far exceeded Mesa's $54 per share price, Mesa's tender offer was inadequate. *Id.*

73. *Id.* In *Unocal* the Unocal directors concluded that Mesa's inadequate price was harmful to the interests of Unocal shareholders and that the debt securities in Mesa's two-tier tender offer were junk bonds that had a value far below $54 per share of stock. *See id.* (commenting that use of junk bonds forces stockholder to tender stock to tender offeror for inadequate share price in first tier because of threat that shareholders otherwise will receive overvalued debt securities in second tier). Unocal's directors recognized that, moreover, a renowned "greenmailer" had threatened the corporate enterprise. *See id.* (noting that greenmailer is person threatening to takeover corporation solely to make large profits when corporation, to prevent takeover, purchases stock back from greenmailer at substantial premium).

74. *Id.* at 955. The *Unocal* court noted that to determine whether a board's response to a takeover is reasonable, the directors must analyze the nature of the takeover bid and the impact on the corporation. *Id.*

tender offer would not deter Mesa.[75] The Delaware Supreme Court concluded that in rejecting Mesa's tender offer and approving a selective self-tender offer, the Unocal board of directors had responded reasonably to Mesa's threat to Unocal.[76] The Delaware Supreme Court held, therefore, that the business judgment rule protected the decision of the Unocal board to reject Mesa's hostile tender offer and to adopt the selective self-tender offer.[77]

In *Moran v. Household International, Inc.*[78] the Delaware Supreme Court further modified the business judgment rule by imposing *Unocal*'s heightened burden on a directors' decision to adopt a prospective antitakeover mechanism.[79] In *Moran* the board of directors of Household International, Inc. (Household) believed that Household had become generally vulnerable as a possible target for a takeover.[80] Although not presented with a specific takeover threat, the Household board, after seeking advice from legal counsel and financial experts, adopted a poison pill rights plan[81] that entitled Household's common shareholders to receive a dividend of one right for each share of Household common stock.[82] The Household rights

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75. *Id.* at 956. In *Unocal* the directors adopted the selective self-tender offer either to defeat Mesa's hostile tender offer of an inadequate price or to provide senior debt to remaining shareholders if Mesa purchased 37% of Unocal's outstanding common stock. *Id.* The *Unocal* court noted, however, that Unocal's attempt to protect shareholders would have been futile had the Unocal board allowed Mesa to participate in the self-tender offer. *See id.* (noting that Mesa was not within class of Unocal shareholders that Unocal board tried to protect with self-tender offer).

76. *See supra* note 75 and accompanying text (discussing Unocal board's intent in adopting selective self-tender offer).

77. *Unocal*, 493 A.2d at 959.

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

79. *See id.* at 1350 (shifting burden to directors to prove reasonableness of board's decision to adopt prospective poison pill rights plan).

80. *Id.* at 1349. In *Moran* Household's directors, responding to a perceived susceptibility to a takeover, engaged legal and financial expertise to devise a prospective defensive scheme. *Id.*

81. *See generally* S. LORNE, ACQUISITIONS AND MERGERS: NEGOTIATED AND CONTESTED TRANSACTIONS § 4.05[1][d] (1986)(discussing poison pill redemption provisions as defensive measure against tender offers); Fogelson, *Some Recent Defensive Strategies in Corporate Takeovers*, in 1 PLI, HOSTILE BATTLES FOR CORPORATE CONTROL 1985 191-208 (D. Block & H. Pitt eds. 1985)(PLI Corporate Law & Practice Handbook Series No. 474)(examining poison pill rights plan as defensive mechanism against takeovers); Note, Moran *and The Poison Pill: A Target's Savior?* 43 WASH. & LEE L. REV. 955, 955-63 (1986)(examining poison pill rights plans as defense to takeover attempts). Under a typical poison pill rights plan, the corporation targeted for a takeover (target corporation) distributes as a dividend to its shareholders rights that entitle the rightsholder to purchase common or preferred stock of the target corporation when events specified in the rights plan occur. S. LORNE, *supra*, § 4.05[1][d]. The events that typically trigger the execution of the rights are a tender offer for the outstanding common stock of the target corporation or the accumulation of a certain amount of shares of the target corporation. *Id.* Upon the consumation of a merger or other business comination of the target company with an acquiring entity, poison pill rights plans typically allow rightsholders to purchase stock of the surviving entity at a substantial discount, which renders the target company less attractive to potential acquirors. *Id.*

82. *Moran*, 500 A.2d at 1349. Each right in the rights plan in *Moran* allowed a

plan provided that upon a merger or other combination of Household with an outside acquiror, each rightsholder could purchase stock of the acquiring entity at one-half the market value of the acquiror's stock.[83] In response to the board's approval of the prospective defensive mechanism, the plaintiff, a Household director and shareholder, unsuccessfully challenged the validity of the rights plan in the Delaware Court of Chancery and appealed to the Delaware Supreme Court.[84]

On appeal the Delaware Supreme Court imposed *Unocal*'s enhanced standard of care on Household's corporate directors.[85] After determining that Delaware statutory law authorized the board to adopt the rights plan,[86] the court in *Moran* considered whether the business judgment rule protected the Household directors' approval of the poison pill rights plan.[87] Relying on *Unocal*, the Delaware Supreme Court in *Moran* required the Household directors to articulate the reasonableness for adopting the defensive mechanism, even though Household was not contesting a specific takeover.[88] In

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rightsholder to purchase, for an exercise price of $100, 1/100 of a share of new preferred Household stock. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1066 (Del. Ch. 1985). In addition, for any rightsholder in *Moran* to exercise the rights, a person or entity either must announce a tender offer for 30% of Household's outstanding common stock or acquire, as an individual or a single entity, 20% of Household's outstanding common shares. *Moran*, 500 A.2d at 1349.

83. *Moran*, 500 A.2d at 1349. Under the *Moran* rights plan, if a rightsholder did not exercise the holder's rights, and a merger or other business combination between Household and a tender offeror subsequently occurred, the rights entitled the holder to purchase common stock of the tender offeror for 50% of the stock's value. *Id.*

84. *Id.* at 1349-50. In *Moran* the Delaware Court of Chancery upheld the Moran board's decision to approve a poison pill rights plan. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1082 (Del. Ch. 1985). The court of chancery found that the Moran board's motive in approving the rights plan was to further a rational business purpose, rather than to entrench management. *Id.*

85. *See Moran*. 500 A.2d at 1350-57 (requiring directors to have authority for actions responding to takeover and initially to show reasonableness of actions attacking takeover attempt); *Unocal*, 493 A.2d at 954-55 (requiring enhanced duty of care for directors involved in takeover context); *supra* notes 58-77 and accompanying text (discussing *Unocal*).

86. *See Moran*, 500 A.2d at 1351 (before considering application of business judgment rule, court noted general authority of directors to approve rights plan under Delaware law that authorizes corporations to issue rights entitling rightsholders to purchase shares and to issue shares of stock); DEL. CODE ANN. tit. 8, § 151(g) (1974)(authorizing corporations to issue shares of stock); *id.* § 157 (authorizing corporations to issue rights to purchase shares of stock); *supra* notes 54-55 and accompanying text (discussing authority of boards of Delaware corporations to manage business and affairs of corporation).

87. *Moran*, 500 A.2d at 1355-57.

88. *Id.* at 1356; *see Unocal*, 493 A.2d at 954-55 (requiring directors to show reasonableness of decision to oppose takeover attempt). In *Moran* a majority of the Household board that approved the decision to adopt the rights plan were outside directors. *Moran*, 500 A.2d at 1356. The Delaware Supreme Court noted that the independence of the corporate board substantially strengthened the reasonableness of the board's decision to approve the poison pill rights plan. *Id.* The *Moran* court also recognized that by anticipating rather than reacting to a possible takeover, the Household board reduced the risk that the directors would fail to use reasonable business judgment because the directors were not under pressure to respond to a threatening takeover. *Id.* at 1350.

examining whether the directors reasonably perceived a threat to Household, the *Moran* court found that the plaintiffs did not allege that the directors acted in bad faith and that the Household directors, in seeking legal and financial advice, had made a reasonable investigation of the general takeover environment in the market.[89] The Delaware Supreme Court concluded, therefore, that the Household directors reasonably perceived a threat to the corporation.[90] In examining the reasonableness of the directors' response to the corporate threat, the Delaware Supreme Court found that because the directors had expressed concern regarding the increasing frequency of takeovers and Household's perceived vulnerability to takeovers, the poison pill rights plan was a reasonable response to the corporate threat.[91] The Delaware Supreme Court held, therefore, that the business judgment rule protected the Household board's decision to adopt the rights plan.[92]

In the most recent Delaware decision altering the traditional business judgment rule, the Delaware Supreme Court considered whether the business judgment rule protected a board's decision to adopt a comprehensive defensive strategy to deter a specific hostile takeover attempt.[93] In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[94] Pantry Pride, Inc. (Pantry Pride) entered a bidding contest for the stock of Revlon, Inc. (Revlon).[95] To oppose Pantry Pride, Revlon sought as a white knight[96] the investment

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89. *Moran*, 500 A.2d at 1356; *see supra* notes 69-77 and accompanying text (discussing *Unocal* court's requirement that directors show reasonableness of board's perceived threat to corporation). In *Moran* the Delaware Supreme Court recognized that in addition to not asserting directors' bad faith, the plaintiff-shareholder did not assert that the directors' motive was to entrench management. *Moran*, 500 A.2d at 1356. The *Moran* court found that the fear of two-tiered takeovers motivated the Household directors to adopt the poison pill rights plan. *Id.*; *see supra* note 60 (explaining two-tier tender offer). The court in *Moran* concluded that, furthermore, the directors' decision to approve the rights plan was informed. *Moran*, 500 A.2d at 1356. To determine whether the directors reached an informed decision to adopt the rights plan, the court in *Moran* judged the directors' actions against a standard of gross negligence. *Id.* The Delaware Supreme Court found that the directors were not grossly negligent in adopting the rights plan because the directors received a written summary of the rights plan and the stock market's takeover environment and sought legal and financial advice regarding the rights plan. *Id.* at 1357.

90. *See Moran*, 500 A.2d at 1356 (noting that Household board adopted rights plan in response to general environment of coercive tender offers).

91. *Id.* at 1357.

92. *Id.*

93. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180-84 (Del. 1986)(examining whether directors' resolution to approve defensive scheme opposing takeover was reasonable).

94. 506 A.2d 173 (Del. 1986).

95. *Id.* at 175-79. In *Revlon* Pantry Pride expressed to Revlon the possibility of a friendly acquisition of Revlon, or the potential for a hostile takeover if the friendly acquisition failed. *Id.* at 175-76. In response to Pantry Pride's interest, the Revlon board searched for a white knight. *Id.* at 178; *see infra* note 96 (explaining term "white knight"). Both Pantry Pride and Revlon's white knight bid on Revlon's outstanding common stock. *Revlon*, 506 A.2d at 178-79.

96. *See* BLOCK & BARTON, *supra* note 45, at 91 (explaining concept of white knight in

banking firm of Forstmann Little & Co. (Forstmann Little).[97] Additionally, pursuant to the advice of legal and financial experts,[98] Revlon's board adopted several antitakeover measures, including a stock repurchase plan,[99] a poison pill rights plan,[100] a lock-up option,[101] a no-shop clause,[102] and a

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transactions involving corporate control). A white knight is a person or group that makes a negotiated acquisition of a corporation threatened by a hostile takeover before an unwanted acquiror can complete its hostile takeover. *Id.*

97. *Revlon*, 506 A.2d at 178-79. In *Revlon* the corporate board of Revlon sought interested parties to purchase Revlon. *Id.* at 177. In the board's search for a white knight, the Revlon board negotiated a leveraged buyout by Forstmann Little. *Id.* at 178.

98. *See id.* at 176-79. In *Revlon* the corporate directors sought expertise from Revlon's legal counsel and Revlon's investment banking firm before the Revlon board approved the defensive strategy. *Id.* at 176-79. Revlon's investment banker counseled the corporate board that Pantry Pride's tender offer was grossly inadequate, that Pantry Pride was financing the takeover with junk bonds, and that Pantry Pride intended to dissolve Revlon. *Id.* at 176-77. Furthermore, the investment banker warned Revlon's directors that the acquisition and dissolution of Revlon by Pantry Pride would benefit Pantry Pride at the expense of Revlon's shareholders. *Id.*

99. *Id.* at 177. In *Revlon* the Revlon board approved a stock repurchase plan that authorized Revlon to purchase 5 million of the 30 million outstanding shares of Revlon common stock. *Id.*

100. *Id.* at 178; *see supra* note 81 (discussing typical rights plan). In *Revlon* the rights plan that the Revlon board of directors approved entitled Revlon shareholders to receive as a dividend one note purchase right per share of Revlon outstanding common stock. *Revlon*, 506 A.2d 176-77. The Revlon rights plan would trigger unless a tender offer contained a minimum share price for Revlon common stock of $65. *Id.* at 177. Under the Revlon rights plan, a holder of a right could exchange one share of Revlon outstanding common stock for Revlon debt securities having a $65 principal amount, yielding 12% interest, and maturing in one year. *Id.* For a shareholder to exercise the right to exchange shares of stock for notes, a person or investing group had to acquire 20% of Revlon's outstanding common stock for less than $65 cash per share of stock. *Id.* The Revlon rights plan, however, authorized the Revlon board of directors to redeem the rights for $.10 per right before the triggering event occurred. *Id.*

101. *Id.* at 178. In *Revlon* the Revlon board negotiated a proposed leveraged buyout agreement with Forstmann Little that included an asset lock-up option. *Id.* In an asset lock-up option, a target corporation grants an optionee, generally a white knight, the right to acquire key assets of the target corporation. BLOCK & BARTON, *supra* note 45, at 99. Under Revlon's agreement, Revlon contracted to grant Forstmann Little an option to purchase two of Revlon's key divisions at prices substantially below market value. *See Revlon*, 506 A.2d at 178 (Revlon contracted to sell for $525 million two divisions having estimated value of between $625 million and $700 million). The triggering event for Forstmann Little to exercise the lock-up option was the acquisition by another investor or group of investors of 40% of Revlon's outstanding common stock. *Id.* The Revlon board unanimously approved the leveraged buyout according to the terms of the agreement. *Id.* at 179.

102. *Revlon*, 506 A.2d at 178. A no-shop provision contained in a leveraged buyout agreement generally prohibits a corporation targeted for a takeover from actively seeking an alternative proposal from other potential acquirors. Cherno & Klein, *Practicalities of Handling Litigation in the Context of a Leveraged Buyout*, in PLI, LEVERAGED ACQUISITIONS AND BUYOUTS 1986 373 (H. Benjamin & M. Goldberg eds. 1986)(PLI Corporate Law & Practice Handbook Series No. 510). In *Revlon*, Revlon's proposed leveraged buyout agreement with Forstmann Little contained a no-shop provision that required Revlon to negotiate solely with Forstmann Little and prohibited Revlon from seeking other possible acquirors. *Revlon*, 506 A.2d at 175. The Revlon board unanimously approved the leveraged buyout according to the terms of the agreement. *Id.* at 179.

cancellation fee.[103] The Revlon board ultimately approved a leveraged buyout with Forstmann Little, even though Pantry Pride indicated a willingness to better any offer of Forstmann Little.[104]

To prevent the execution of the rights plan, Pantry Pride sought in the Delaware Court of Chancery to enjoin Revlon from issuing the rights under the plan to shareholders.[105] After the Revlon board approved the leveraged buyout with Forstmann Little, Pantry Pride amended its complaint to challenge the Revlon directors' decisions to approve the lock-up option and the cancellation fee and to issue the rights.[106] The Delaware Court of Chancery upheld the Revlon board's decision to adopt the rights plan, but sustained Pantry Pride's challenge to the lock-up option, the no-shop clause, and the cancellation fee.[107] The directors of Revlon, subsequently, appealed the court of chancery's injunction of the defensive measures to the Delaware Supreme Court.[108]

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103. *Revlon*, 506 A.2d at 178. In the proposed leveraged buyout agreement in *Revlon* the Revlon board agreed to pay into an escrow account $25 million for Forstmann Little to receive if Revlon rescinded Forstmann Little's acquisition agreement or another acquiror purchased 20% or more of Revlon stock. *Id.* The Revlon board unanimously approved the leveraged buyout according to the terms of the agreement. *Id.* at 179.

104. *See id.* at 178 (approving leveraged buyout with Forstmann Little); *supra* notes 99-103 (discussing terms of Revlon's leveraged buyout agreement with Forstmann Little). In *Revlon* Forstmann Little offered $57.25 cash per share of Revlon common stock. *Revlon*, 506 A.2d at 178. As conditions of its offer, Forstmann Little demanded that the Revlon board accept the lock-up option, the no-shop provision, and the cancellation fee, agree not to participate in the merger, and immediately approve the leveraged buyout. *Id.* at 178-79. In *Revlon* Pantry Pride, subsequent to the Revlon board's approval of the leveraged buyout by Forstmann Little, offered $58 per cash per share of Revlon stock. *Id.*

105. *Revlon*, 506 A.2d at 178-79. In *Revlon* the Revlon board approved the poison pill rights plan during a meeting on August 19, 1985. *Id.* at 176-77. On August 22 Pantry Pride unsuccessfully petitioned the Delaware Court of Chancery for a preliminary injunction barring the execution of the rights plan. *Id.* at 179. Pantry Pride challenged the court of chancery's holding to protect the Revlon board's adoption of the rights plan. *Id.* at 180. The Revlon board, subsequently, resolved during a meeting on October 3 to redeem the rights if Revlon successfully negotiated a leveraged buyout with Forstmann Little. *Id.* at 181. The Revlon board on October 12 added a condition to the rights' redemption which provided that Revlon receive a cash tender offer for at least $57.25 per share. *Id.* On appeal the Delaware Supreme Court concluded that the board's adoption of the rights plan was a moot issue because all offers subsequent to October 12 were above $57.25. *Id.*

106. *Id.* at 181.

107. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 501 A.2d 1239, 1247, 1250-52 (Del. Ch. 1985). In *Revlon* the Delaware Court of Chancery held that because the Revlon board reasonably was concerned that Pantry Pride would use junk bond financing to cause the dissolution of Revlon, the business judgment rule protected the Revlon board's decision to approve the rights plan. *Id.* The court of chancery enjoined Forstmann Little from purchasing Revlon's key divisions under the lock-up option, from negotiating solely with Forstmann Little, and from paying the cancellation fee to Forstmann Little. *Revlon*, 506 A.2d at 175; *see supra* notes 100-04 and accompanying text (discussing provisions of Revlon's leveraged buyout agreement with Forstmann Little). The court of chancery found that because Revlon's directors had breached the duty of care in approving these defensive measures, an injunction should issue. *Revlon*, 506 A.2d at 175-76.

108. *Revlon*, 506 A.2d at 176.

On appeal the Delaware Supreme Court in *Revlon* applied an enhanced duty of care to determine whether the business judgment rule protected the board's decision to adopt a comprehensive defensive strategy.[109] After determining that Delaware statutory law authorized the Revlon board to adopt the rights plan, the *Revlon* court examined the reasonableness of the Revlon directors' adoption of the poison pill rights plan.[110] The Delaware Supreme Court concluded that the Household directors reasonably perceived a threat to the corporation.[111] After determining the reasonableness of the perceived threat to Revlon, the Delaware Supreme Court examined the reasonableness of the board's response to the hostile takeover attempt.[112] The *Revlon* court found that in adopting the rights plan, the Revlon board had attempted to defend the corporation from a tender offer of an inadequate share price and a division of corporate assets.[113] The court in *Revlon* concluded, therefore, that in adopting the rights plan the directors had responded reasonably to the perceived threat imposed by Pantry Pride.[114]

After upholding the Revlon board's adoption of the rights plan, the *Revlon* court considered the reasonableness of the board's other defensive measures.[115] The court reasoned that after the breakup of Revlon became inevitable, the directors' duty was to maximize the purchase share price for Revlon's shareholders.[116] The court found that because the board's defensive

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109. *See id.* at 180 (examining whether directors had authority to adopt defensive measures, whether directors reasonably perceived threat to corporation, and whether directors' decision to adopt defensive measures was reasonable); *infra* notes 110-18 and accompanying text (discussing enhanced duty of care in Revlon); *supra* notes 65-77 and accompanying text (discussing *Unocal*'s heightened duty of care).

110. *See Revlon*, 506 A.2d at 180-81 (finding that Delaware corporate statute gave board of directors authority to manage affairs of corporation and to enter contracts); DEL. CODE ANN. tit. 8, § 141 (1974) (authorizing board to manage corporate affairs); *id.* § 122 (authorizing board of directors to enter contracts on behalf of corporation).

111. *Revlon*, 506 A.2d at 180-81. In *Revlon* the Delaware Supreme Court found that because Revlon's investment banker counseled the Revlon board that Pantry Pride intended to finance the takeover of Revlon with junk bonds and to dissolve Revlon after the acquisition, the Revlon board reasonably believed that Pantry Pride presented a threat to Revlon. *Id.*

112. *Id.* at 181.

113. *Id.*

114. *See id.* at 180-81 (finding that directors' adoption of rights plan benefited shareholders because rights plan partially caused Pantry Pride to raise its bid from $42 per share to $58 per share). Although upholding the reasonableness of the Revlon rights plan, the Delaware Supreme Court in *Revlon* found the usefulness of the rights plan a moot issue because the Revlon board resolved to redeem the rights if any investor offered to buy Revlon for $57.25 or more per share of stock. *Id.* at 181; *see supra* note 104 (discussing Revlon board's resolution to redeem rights).

115. *Revlon*, 506 A.2d at 181. In *Revlon* the Delaware Supreme Court found that the Revlon directors' approval of the self-tender for 10 million shares did not breach the directors' duty of care because the self-tender was a reasonable response to Pantry Pride's initial, inadequate offer of $47.50 per share. *Id.*

116. *Id.* at 182. The *Revlon* court determined that the breakup of Revlon was evident when Pantry Pride continually tried to purchase Revlon stock for an increasingly higher price and when the Revlon board resolved to negotiate a merger with a white knight. *Id.*

strategy diminished the attractiveness of Revlon as a takeover target, the Revlon board effectively had ended any possible bidding contest that would maximize Revlon's share price.[117] The *Revlon* court determined that because the Revlon board had not acted reasonably in adopting the comprehensive defensive strategy, the Revlon directors had breached the common-law duty of care.[118] The Delaware Supreme Court refused, therefore, to allow the business judgment rule to protect the Revlon directors' approval of a complete defensive scheme.[119]

The Delaware Supreme Court's decisions in *Unocal*, *Moran*, and *Revlon* illustrate recent changes in the application of the traditional business judgment rule.[120] If a court had applied the standard of care in section 13.1-690 of the VSCA to the directors in *Unocal* and *Moran*, the directors in *Unocal* and *Moran* would not have breached this statutory standard of care.[121] The circumstances in *Unocal* and *Moran* indicate that the directors

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117. *Id.* at 182-84.

118. *Id.* The *Revlon* court held that because the entire defensive scheme consisting of the lock-up option, the no-shop provision, and the cancellation fee virtually precluded an open bidding contest for Revlon and precluded Revlon shareholders from receiving the highest possible price for their shares, the directors had breached their fiduciary duty of care to shareholders. *Id.* at 182. The *Revlon* court held that the directors, therefore, breached the duty of care to Revlon's shareholders. *Id.* In addition to holding that the Revlon directors breached the duty of care, the *Revlon* court found that the directors breached the duty of loyalty. *Id.*

In *Revlon* the Revlon board responded to Pantry Pride's initial tender offer with a self-tender offer to exchange each tendered share of common stock for one senior debt security with a $47.50 principal amount, an 11.75% interest rate, and a 10-year maturity (Exchange Notes), and 1/10 of a share of $9.00 cumulative convertible preferred stock having a value of $100 per share. *Id.* at 177. During the struggle for control of Revlon, the value of the Exchange Notes decreased and holders of the Exchange Notes threatened to sue the Revlon board. *Id.* at 182. The Delaware Supreme Court found that in bargaining with Revlon for the lock-up option in the leveraged buyout contract, Forstmann Little promised to shore up the value of the previously issued Exchange Notes to deter the Exchange Noteholders from suing the Revlon board. *Id.* The *Revlon* court held, therefore, that by allowing considerations of self-interest to influence the Revlon board's decision to approve the lock-up option, the board breached its duty of loyalty to the corporation and its shareholders. *Id.*

119. *Id.* at 185.

120. *See id.* at 180 (placing burden of proof on directors to show reasonableness of comprehensive defensive strategy in response to specific takeover before applying traditional business judgment rule); *Moran*, 500 A.2d at 1356 (placing burden on directors to prove reasonableness of approval of prospective poison pill rights plan before applying traditional business judgment rule); *Unocal*, 493 A.2d at 955 (transferring burden to directors to prove reasonableness of selective self-tender offer before applying traditional business judgment rule); *supra* notes 58-119 and accompanying text (discussing cases in which Delaware Supreme Court reallocated directors' burden of proof under business judgment rule in takeover situations).

121. *See Moran*, 500 A.2d at 1355-57 (ascertaining whether business judgment rule protected directors' adoption of prospective poison pill rights plan); *Unocal*, 493 A.2d at 954-57 (examining whether business judgment rule protected directors' approval of selective self-tender offer to oppose hostile takeover was reasonable); VA. CODE ANN. § 13.1-690 (1985) (requiring directors to discharge duties as directors in good faith business judgment in best interests of corporation); *supra* notes 17-21 and accompanying text (examining standard of care under VSCA).

acted in good faith business judgment and relied in good faith on reports of legal counsel and investment bankers.[122] In addition, under the facts of *Revlon* a court applying the VSCA's standard of care probably would not have found that the Revlon directors breached the VSCA's standard of care in approving the rights plan because the directors adopted in good faith the poison pill rights plan in response to a perceived inadequate tender offer.[123] The directors in *Revlon* probably would have violated the standard of care under the VSCA, however, in accepting terms in the leveraged buyout agreement that severely restricted Revlon's ability to maximize the share price for Revlon shareholders.[124] The Revlon directors, however, had a duty to maximize the share price for Revlon stock and the board apparently breached this duty by accepting a restrictive leveraged buyout agreement.[125] In approving the leveraged buyout agreement with Forstmann Little, the Revlon board foreclosed the opportunity to acquire a higher share price for Revlon stock even though another potential acquiror offered a higher price per share.[126] The Revlon directors, therefore, did not fulfill their fiduciary duties to the corporation or its shareholders because the Revlon directors did not act in good faith for the best interests of the corporation.[127] Thus,

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122. *See Moran*, 500 A.2d at 1355-57 (finding that directors' adoption of prospective poison pill rights plan was reasonable); *Unocal*, 493 A.2d at 954-57 (finding that directors' approval of selective self-tender offer to oppose hostile takeover was reasonable); *supra* notes 62-63 and accompanying text (discussing Unocal board's adoption of selective self-tender offer as defensive measure against hostile tender offer); *supra* notes 80-83 and accompanying text (discussing Household board's approval of prospective poison pill rights plan); *supra* notes 17-25 and accompanying text (discussing VSCA's requirement of good faith business judgment and authorization of directors' reliance on others in making corporate decisions).

123. *See Revlon*, 506 A.2d at 180-81 (examining whether directors' approval of rights plan to thwart hostile takeover was reasonable); VA. CODE ANN. § 13.1-690 (1985)(VSCA's standard of care); *supra* notes 100 and accompanying text (discussing Revlon board's adoption of poison pill rights plan to contest hostile tender offer); *supra* notes 17-25 and accompanying text (discussing VSCA's requirement of good faith business judgment and authorization of directors' reliance on others in making corporate decisions).

124. *See Revlon*, 506 A.2d at 181-85 (ascertaining whether directors' approval of leveraged buyout agreement severely restricting marketability of corporation involved in takeover was reasonable); *supra* notes 96-103 and accompanying text (discussing defensive scheme adopted by Revlon board); *supra* notes 17-25 and accompanying text (discussing VSCA's requirement of good faith business judgment and authorization of directors' reliance on others in making corporate decisions).

125. *See Revlon*, 506 A.2d at 183-84 (finding that in approving leveraged buyout agreement that failed to benefit shareholders by maximizing share price of corporation involved in takeover, directors breached duty of care); *supra* notes 99-104 and accompanying text (discussing terms of leveraged buyout agreement adopted by Revlon board).

126. *See Revlon*, 506 A.2d at 183-84 (finding that by approving leveraged buyout agreement despite Pantry Pride's offer to increase purchase price per share of Revlon stock, directors breached duty of care); *supra* note 104 and accompanying text (noting that Pantry Pride offered price for Revlon stock that was higher than price accepted by Revlon directors in leveraged buyout agreement).

127. *See Revlon*, 506 A.2d at 184 (holding that directors breached duty of care under Delaware law); *supra* notes 97-103 and accompanying text (reviewing Revlon board's adoption of comprehensive defensive strategy in struggle for corporate control).

in accepting the restrictive terms in the leveraged buyout agreement, the Revlon directors would have violated the standard of care in section 13.1-690 of the VSCA.[128]

Although the VSCA attempts to codify the traditional business judgment rule, section 13.1-690 of the VSCA provides the appropriate burden of proof that courts should apply to challenges of directors' actions, including directors' actions in response to takeovers.[129] Unlike the Delaware Supreme Court, which has required directors to bear a threshold burden of proving the reasonableness of a corporate board's decision in takeover situations, the VSCA does not require directors to bear an initial burden of proof.[130] Rather, section 13.1-690(d) of the VSCA places the initial burden of proving that directors have breached the duty of care for any decision on the person claiming the directors' breach.[131] Because the VSCA places the initial burden of proof on the plaintiff, more decisions of corporate boards are likely to pass judicial scrutiny.

In addition to requiring the plaintiff to prove initially that the directors reasonably did not respond to a takeover attempt, the VSCA avoids the concept of objective reasonableness in the statutory standard of care.[132] Unlike the RMBCA's standard of care, which requires courts to construct a fictitious framework to determine the reasonableness of directors' actions, the VSCA's standard of care requires courts to examine directors' subjective good faith business judgment.[133] Because courts applying the VSCA only will consider directors' good faith, the standard of care for directors under the VSCA apparently is lower than the standard of care applied in Delaware or under the RMBCA.[134] The VSCA's subjective standard of care will reduce

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128. *See* VA. CODE ANN. § 13.1-690 (1985)(directors' subjective standard of care under VSCA).

129. *See id.* (providing standard of care for corporate directors); *supra* notes 17-21 and accompanying text (discussing standard of care under VSCA).

130. *See* VA. CODE ANN. § 13.1-690(D) (1985)(placing burden of proving directors' alleged breach of care under VSCA on plaintiff); *cf. supra* notes 58-119 and accompanying text (in shifting initial burden of proof to directors in takeover situations, Delaware courts have required directors to prove reasonableness of board's response to takeover threat).

131. VA. CODE ANN. § 13.1-690(D) (1985).

132. *See id.* § 13.1-690 (requiring directors to discharge duties in good faith business judgment); *supra* notes 34-39 and accompanying text (noting that General Assembly chose subjective standard of good faith rather than objective standard of reasonableness in good faith).

133. *See supra* notes 20-21 (discussing actions that courts must take to apply standard of care under VSCA); *supra* notes 28-29 and accompanying text (discussing actions that courts must take to apply standard of care under RMBCA).

134. *See Revlon*, 506 A.2d at 180-85 (requiring directors who adopted rights plan and accepted restrictive leveraged buyout agreement to satisfy objective standard of care under Delaware law); *Moran*, 500 A.2d at 1355-57 (requiring directors who approved prospective poison pill rights plan to meet objective standard of care); *Unocal*, 493 A.2d at 955-57 (requiring directors to act reasonably in making self-tender offer for Unocal's stock); VA. CODE ANN. § 13.1-690 (1985)(directors' subjective standard of care under VSCA); REVISED MODEL BUSINESS CORP. ACT § 8.30 (1985)(directors' objective standard of care under RMBCA);

the possibility that courts will second-guess directors' decisions because by acting in good faith, directors satisfy the standard of care in section 13.1-690 of the VSCA.[135]

Even when a court determines that directors have breached the standard of care in section 13.1-690 of the VSCA, directors may seek, or have the right to receive, indemnification from the corporation under the expanded indemnification provisions of the VSCA.[136] The VSCA provides directors with four alternatives for seeking indemnification from the corporation.[137] Section 13.1-697 of the VSCA authorizes corporations to indemnify directors who have acted in good faith and believed either that their conduct was in the best interest of the corporation when they were acting in their official capacity,[138] or that their conduct at least did not oppose the best interests of the corporation when they were not acting in their official capacity.[139] The indemnification provisions in section 13.1-697 of the VSCA shadow the standard of care provisions in section 13.1-690 of the VSCA by requiring directors to act in good faith and with the interests of the corporation in mind.[140] Section 13.1-697(D) of the VSCA, however, proscribes corporations from indemnifying directors when a court finds the directors liable in an action brought by, or on the behalf of, the corporation,[141] or when the directors improperly received a personal benefit from the transaction.[142] Thus, section 13.1-697 of the VSCA, which authorizes corporations to indemnify directors who have satisfied the duty of care in section 13.1-690, is one alternative available to directors seeking indemnification from the corporation.[143] In addition to authorizing Virginia corporations to indem-

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supra notes 17-25 and accompanying text (discussing standard of care under VSCA); *supra* notes 26-29 and accompanying text (discussing standard of care under RMBCA) *supra* notes 58-119 and accompanying text (discussing actions of corporate boards involved in takeover situations).

135. *See* VA. CODE ANN. § 13.1-690 (1985)(directors' objective standard of care under VSCA); Manning, *supra* note 37, at 1500 (noting that standard similar to VSCA's standard would protect directors who have exercised good faith in making business decisions); *supra* notes 17-21 and accompanying text (examining directors' standard of care under VSCA).

136. *See* VA. CODE ANN. § 13.1-696 to -704 (1985)(VSCA's provisions authorizing corporations to indemnify directors).

137. *See infra* notes 138-54 and accompnaying text (discussing directors' rights to mandatory indemnification, voluntary indemnification, or additional indemnification provided in articles of incorporation or corporate bylaws).

138. VA. CODE ANN. § 13.1-697(A)(2)(a) (1985). Under section 13.1-696 of the VSCA directors acting in their role as directors act within their official capacity. *Id.* § 13.1-696.

139. *Id.* § 13.1-697(A)(2)(b).

140. Telephone interview with Allen C. Goolsby, III, Primary Drafter of VSCA (Feb. 12, 1987)(stating that indemnification provision in § 13.1-697 of VSCA "tracks" standard of care provision in § 13.1-690(A) of VSCA). *Compare* VA. CODE ANN. § 13.1-690(A) (1985) (VSCA's standard of care provision); *with id.* § 13.1-697 (VSCA's indemnification of right provision).

141. VA. CODE ANN. § 13.1-697(D)(1) (1985).

142. *Id.* § 13.1-697(D)(2).

143. *Id.* § 13.1-697; *see supra* notes 138-42 and accompanying text (discussing indemnification under § 13.1-697 of VSCA).

nify directors who have acted in good faith, the VSCA grants to directors a conditional right to receive mandatory and discretionary indemnification.[144] Under section 13.1-698 of the VSCA corporations must indemnify directors who entirely prevail in a proceeding challenging a corporate board's actions, provided the articles of incorporation do not limit the director's right to indemnification.[145] In addition, section 13.1-701 of the VSCA allows a corporation to indemnify directors when the directors show that they have a right to indemnification under section 13.1-697 of the VSCA and that the indemnification is to cover reasonable expenses for defending a challenge to the directors' actions.[146] The articles of incorporation, however, may limit directors' rights to discretionary indemnification.[147] Thus, under the VSCA, directors possess the right to receive indemnification when the directors act in good faith[148] or successfully defend a challenge of the directors' actions[149] and also may receive voluntary indemnification under section 13.1-701 when the corporation so desires.[150]

In addition to granting directors the right to mandatory and discretionary indemnification, the VSCA provides that a corporation's articles of incorporation, or a bylaw adopted by the corporation's shareholders, may

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144. *See* VA. CODE ANN. § 13.1-698 (1985)(requiring corporation to indemnify directors); *id.* § 13.1-701 (allowing corporation to indemnify directors); Murphy, *supra* note 9, at 114-15 (discussing indemnification provisions of VSCA).

145. VA. CODE ANN. § 13.1-698 (1985); *see* CODE COMM'N REPORT, *supra* note 9, app. 4, at 254 (General Assembly intended VSCA to authorize corporations to indemnify directors only if directors successfully defend all claims against directors). When corporations refuse to indemnify directors voluntarily, the directors may seek the assistance of a court. *See* VA. CODE ANN. § 13.1-700 (1985)(authorizing directors to apply to court to order indemnification).

146. *See* VA. CODE ANN. § 13.1-701 (1985)(authorizing discretionary indemnification); *id.* § 13.1-697 (providing circumstances when discretionary indemnification is permissible); *see also* CODE COMM'N REPORT, *supra* note 9, app. 4, at 256 (commenting on authority of corporations in VSCA to indemnify directors voluntarily); Murphy, *supra* note 9, at 115-16 (commenting that before voluntarily permitting corporation to indemnify directors, court first must determine that directors are entitled to indemnification and second must determine amount of indemnity). Section 13.1-701 of the VSCA authorizes a corporation to voluntarily indemnify directors. VA. CODE ANN. § 13.1-701 (1985). For a corporation to voluntarily indemnify directors, one of four groups of people must determine that indemnification is appropriate under § 13.1-697. *Id.* § 13.1-701; *see id.* § 13.1-697 (authorizing statutory indemnification of directors). Under section 13.1-701(B) of the VSCA, a majority of the quorum of the disinterested board, a majority of a committee of disinterested board members, legal counsel selected by a majority of the disinterested board, or the shareholders of the corporation have the authority to determine whether the corporation should indemnify directors in a particular situation. *Id.* § 13.1-701(B).

147. VA. CODE ANN. § 13.1-701 (1985); *see id.* § 13.1-698 (authorizing articles of incorporation to limit corporation's mandatory indemnification of directors).

148. *See id.* § 13.1-697(A)(2) (1985)(authorizing corporations to indemnify directors who have acted in good faith); *supra* notes 136-43 and accompanying text (discussing VSCA's provision requiring corporations to indemnify directors who have acted in good faith).

149. *See* VA. CODE ANN. § 13.1-698 (1985)(authorizing corporation to indemnify directors who entirely prevail in a proceeding challenging a corporate board's actions).

150. *See id.* § 13.1-701 (authorizing corporation voluntarily to indemnify directors).

provide for directors' indemnification.[151] Under section 13.1-704(B) of the VSCA, a corporation in its articles of incorporation or shareholders in the corporate bylaws may provide that the corporation indemnify directors unless the corporate directors are grossly negligent or guilty of willful misconduct.[152] The Virginia Supreme Court has interpreted gross negligence to be an overreaching breach of the care that an ordinarily reasonable man would exercise in similar circumstances.[153] Thus, although the directors could not satisfy the requirements for indemnification in other provisions of the VSCA, directors apparently may receive indemnification when a corporation provides in its articles of incorporation or its bylaws for indemnification under section 13.1-704(B) of the VSCA.[154]

In enacting the indemnification provisions of the VSCA, the General Assembly followed very closely the provisions of the RMBCA.[155] Like section 13.1-697 of the VSCA, section 8.51 of the RMBCA authorizes corporate boards voluntarily to indemnify directors who have acted in good faith and believed either that their conduct was in the best interest of the corporation

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151. *See id.* § 13.1-704(B) (granting corporation authority to provide additional indemnification in articles of incorporation for directors who are not grossly negligent or guilty of willful misconduct); Goolsby & Whitson, *Virginia's New Corporate Code*, 12 REV. OF SEC. & COMMODITIES REG. 147, 154 (1986)(discussing additional indemnification provisions of VSCA).

152. VA. CODE ANN. § 13.1-704(B) (1985); *see* CODE COMM'N REPORT, *supra* note 9, app. 4, at 257 (noting that many Virginia corporations commit themselves to provide as much indemnity as possible); Goolsby & Whitson, *supra* note 151, at 154 (paraphrasing VSCA's additional indemnification provisions). Under section 13.1-704(B) of the VSCA directors should be able to receive additional indemnification for liability in a derivative suit, even though the General Assembly did not provide expressly in section 13.1-704(B) for indemnity in derivative suits. VA. CODE ANN. § 13.1-704(B) (1985); *see* Goolsby & Whitson, *supra* note 151, at 154 (summarizing VSCA's indemnification provisions). The General Assembly expressly restricted indemnification under section 13.1-697 of the VSCA for liability in derivative suits to cases arising under that section. VA. CODE ANN. § 13.1-697(D)(1) (1985); Goolsby & Whitson, *supra* note 151, at 154. The General Assembly did not prohibit, however, indemnification of directors under the additional indemnification provisions of section 13.1-704(B) for liability in derivative actions. VA. CODE ANN. § 13.1-704(B)(1) (1985); Goolsby & Whitson, *supra* note 151, at 154. Directors breaching the good faith standard of care of § 13.1-690 of the VSCA, therefore, may receive additional indemnification under the corporation's articles of incorporation. VA. CODE ANN. § 13.1-704(B)(1) (1985); Goolsby & Whitson, *supra* note 151, at 154.

153. *See* O'Connor v. First Nat'l Investors' Corp., 163 Va. 908, 919-20, 177 S.E. 852, 857 (1935)(noting that gross negligence under Virginia law is directors' failure to exercise degree of care and diligence that circumstances require for proper performance of managerial duties); *see also* Allaun v. Consolidated Oil Co., 147 A. 257, 261 (Del. Ch. 1929)(noting that under Delaware law directors' standard of care is gross negligence, which is reckless indifference to or deliberate disregard of stockholders).

154. *See* VA. CODE ANN. § 13.1-704(B) (1985)(authorizing corporation's articles of incorporation or bylaws to provide indemnification); *supra* notes 144-50 and accompanying text (discussing mandatory and voluntary rights to indemnification under VSCA).

155. *Compare* VA. CODE ANN. § 13.1-696 to -704 (1985)(providing directors with indemnification of right and mandatory, discretionary, and additional indemnification in VSCA); *with* REVISED MODEL BUSINESS CORP. ACT § 8.50-58 (1985)(providing directors with indemnification of right and mandatory and voluntary indemnification in RMBCA).

when they were acting in their official capacity,[156] or that their conduct at least did not oppose the best interests of the corporation when they were not acting in their official capacity.[157] Like section 13.1-697(D) of the VSCA, section 8.51(d) of the RMBCA proscribes a corporate board from indemnifying directors whom courts find liable for improper conduct in, or receive an improper personal benefit from, a transaction.[158] In addition to voluntary indemnification, section 8.52 of the RMBCA, like sections 13.1-698 and 13.1-701 of the VSCA, requires corporations mandatorily to indemnify directors when directors successfully defend in a proceeding all challenges to the directors' corporate actions.[159]

The most significant difference between the indemnification provisions of the VSCA and the RMBCA is the potential for corporations or shareholders, in addition to mandatorily and voluntarily indemnifying directors, to provide for indemnification in the corporation's articles of incorporation or bylaws under the VSCA. When a corporation's articles of incorporation or bylaws authorize indemnification under section 13.1-704(B) of the VSCA, section 13.1-697(D) of the VSCA, which prohibits a corporation from indemnifying directors who are liable in an action brought by the corporation or who received a personal benefit from the transaction, is meaningless because corporations can indemnify directors found liable except when directors were grossly negligent or guilty of willful misconduct.[160] By proscribing corporations from indemnifying directors for grossly negligent behavior, however, section 13.1-704(B) of the VSCA proscribes a corporation from indemnifying directors who do not act as reasonable persons.[161] The

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156. REVISED MODEL BUSINESS CORP. ACT § 8.51(a)(1) (1985); *see* VA. CODE ANN. § 13.1-697(A)(2) (1985)(paralleling provision in RMBCA granting directors indemnification of right). Under section 8.50(5) of the RMBCA directors act within in their official capacity when they act in their role as directors. REVISED MODEL BUSINESS CORP. ACT § 8.50(1) (1985). The RMBCA provides a procedure for corporations to determine whether voluntary indemnification is proper. *Id.* § 8.55. Under section 8.55 of the RMBCA a corporation first must determine whether directors have a right to indemnification under section 8.51 and then authorize indemnification in the proper amount. *Id.*; *see* VA. CODE ANN. § 13.1-701 (1985)(providing discretionary indemnification similar to RMBCA).

157. REVISED MODEL BUSINESS CORP. ACT § 8.51(a)(2) (1985); *see* VA. CODE ANN. § 13.1-697(A)(2) (1985)(containing voluntary indemnification provision identical to provision in RMBCA).

158. REVISED MODEL BUSINESS CORP. ACT § 8.51(d) (1985); *see* VA. CODE ANN. § 13.1-697(D) (1985)(prohibiting corporate board from indemnifying directors when court finds directors liable in action brought by corporation or when directors received improper personal benefit from transaction).

159. REVISED MODEL BUSINESS CORP. ACT § 8.52 (1985). Under either the voluntary or mandatory indemnification provisions of the RMBCA, directors may apply to a court for assistance in receiving appropriate indemnification. *Id.* § 8.54; *see* VA. CODE ANN. § 13.1-700 (1985) (authorizing directors to petition court for assistance to acquire indemnification).

160. *See* VA. CODE ANN. § 13.1-704(B) (1985)(authorizing corporations to provide additional indemnification to directors except for gross negligence or willful misconduct); *id.* § 13.1-697(D) (prohibiting corporation from indemnifying directors whom courts find liable).

161. *See* VA. CODE ANN. § 13.1-704(B) (1985)(proscribing directors' indemnification for gross negligence); *supra* note 147 and accompanying text (discussing concept of gross negligence).

language of section 13.1-704(B) that requires directors to act as reasonable persons to receive additional indemnification conflicts, however, with the General Assembly's intent in section 13.1-690 not to require directors to act as reasonable persons.[162] Thus, under the VSCA, a corporation may indemnify directors who have breached the statutory standard of care by not demonstrating good faith business judgment but whose conduct has not reached the level of gross negligence.[163] The RMBCA, on the contrary, explicitly forbids a corporation from indemnifying directors who are liable for breaching the directors' duty of care under section 8.30(a).[164]

Because the VSCA provides a subjective standard of care and expansive indemnification provisions, the VSCA contains attractive provisions for directors.[165] The new statutory standard of care and the expansive indemnification provisions will encourage a greater number of competent directors—directors who otherwise might decline from serving as directors because of unnecessary risks of personal liability—to participate in corporate governance.[166] Because the standard of care under the VSCA is lower than the Virginia common-law standard of care, directors may no longer have such a great fear of personal liability. The decreasing fear of personal liability may result in greater financial benefits to corporations because directors will be more willing to take risks that they otherwise would avoid because of the fear that courts would scrutinize the decisions of the corporate board.[167] The lower standard of care in the VSCA, however, apparently will result in less accountability for corporate directors because directors need only to discharge their duties as directors in their subjective good faith business judgment of what is in the best interests of the corporation.[168] Even though the VSCA in section 13.1-690 contains a lower standard of care, directors of Virginia corporations realistically will not have less of a personal incentive to perform managerial duties in the best interests of the corporation. Directors, instead, generally will continue to fulfill their obligations as directors to the best of their abilities regardless of the standard of care and attempt to further corporate interests in making corporate decisions.

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162. *See* VA. CODE ANN. § 13.1-690 (1985)(requiring directors to exercise only good faith business judgment); CODE COMM'N REPORT, *supra* note 9, app. 4, at 249 (General Assembly intentionally avoided using term "reasonable" in VSCA's standard of care); *supra* notes 17-21 and accompanying text (examining VSCA's subjective standard of care).

163. *See* VA. CODE ANN. § 13.1-690 (1985)(standard of care in VSCA).

164. REVISED MODEL BUSINESS CORP. ACT § 8.51(d) (1985).

165. Goolsby & Whitson, *supra* note 151, at 147.

166. *Id.* at 154.

167. *See* Fischel, *supra* note 12, at 1439 (positing that traditional business judgment rule and accordingly objective standard of care remove influence on directors to act cautiously in making corporate decisions).

168. *See* VA. CODE ANN. § 13.1-690 (1985)(requiring directors to act in good faith, rather than as ordinarily prudent persons); Manning, *supra* note 37, at 1500 (noting that directors who must satisfy good faith business judgment standard generally would not be liable for breaches of duty of care).