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PREFACE

This issue is an edited and annotated transcript of the proceedings at a symposium on *Delaware Corporation Law and Some Federal Considerations,* held on February 15 and 16, 1979 at THE DELAWARE LAW SCHOOL. The symposium was sponsored jointly by the Delaware State Bar Association and the American Society of Corporate Secretaries. The symposium is an annual event discussing recent developments in and topics related to the corporation law of Delaware and other states.

Selected outlines prepared for the 1979 symposium are reprinted in the appendices.

FIDUCIARY RESPONSIBILITIES OF DIRECTORS, OFFICERS AND KEY EMPLOYEES

BY S. SAMUEL ARSHT*

What I am going to talk about is Delaware's Business Judgment Rule, and particularly its application and relationship to the fiduciary responsibility of directors, key officers and controlling stockholders.

In recent years, Delaware's standards which govern the performance by a director, key officer or controlling stockholder of the fiduciary duty he owes to his corporation and its stockholders have been under attack;[1] frequently on the wholly inaccurate premise that Delaware law is tantamount to a license to mismanage or to deal unfairly with stockholders, and that Delaware courts will not enforce even minimal standards.[2]

The aspect of Delaware law that draws the hottest fire is Delaware's so-called "Business Judgment Rule."[3] That rule must be the least understood of corporate law concepts. I cannot conceive otherwise of how it can have been so consistently maligned by those who would replace state corporation law with Federal Corporation Law and simultaneously held out by defenders of the status quo as promising more in the way of immunity from liability than I think it does.

There have been a lot of articles written, and speeches made, on director's liability, but what I have found is that nearly all discussion of the Business Judgment Rule that is included in the larger discussion of director's liability is superficial, and it is with the utmost regret that I include in that category Professor Folk's discussion in his book on the Delaware Corporation Law.[4]

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1. *See, e.g.,* Schwartz, *A Case for Federal Chartering of Corporations,* 31 BUS. LAW. 1125 (1976); Jennings, *Federalization of Corporation Law: Part Way or All the Way,* 31 BUS. LAW. 991, 997 (1976); R. NADER, M. GREEN & J. SELIGMAN, CONSTITUTIONALIZING THE CORPORATION: THE CASE FOR THE FEDERAL CHARTERING OF GIANT CORPORATIONS (1976); Cary, *Federalism and Corporate Law: Reflections Upon Delaware,* 83 YALE L.J. 663 (1974); Cary, *A Proposed Federal Corporate Minimum Standards Act,* 29 BUS. LAW. 1101 (1974).

2. Guth v. Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503 (1939); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971), *rev'g* 285 A.2d 430 (Del. Ch. 1971); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977), *rev'g* 367 A.2d 1349 (Del. Ch. 1976); Gimbel v. Signal Co., 316 A.2d 599 (Del. Ch. 1974), *aff'd,* 316 A.2d 619 (Del. 1974); Arsht, *Reply to Professor Carey,* 31 BUS. LAW. 1113 (1976).

3. *See* note 1 *supra.*

4. E. FOLK, THE DELAWARE GENERAL CORPORATION LAW at 75-81 (1972). Curiously, Professor Folk does not deal with the Business Judgment Rule in his

I say this with the utmost regret because Professor Folk and I are good friends and I have a very, very high regard for his academic talents generally, but I find that what he has written in his book on the Delaware Corporation Law was, in my view, rather superficial, and because of his eminence and great reputation, what he says on any subject on Delaware law has much influence. Now I suspect that my analysis will also be thought superficial by those who disagree with the conclusions I draw.

I plan to analyze the Business Judgment Rule on the basis of the more than twenty Delaware decisions in which the words "business judgment" or their equivalent appear. I must warn you again, however, that it may be dangerous to your legal health, as some of my colleagues in the Delaware Bar disagree with my understanding of the rule's operation as a defense in litigation. They rest their disagreement on specific language in a number of Delaware cases,[5] and, of course, on what Professor Folk said as well.[6] In my opinion, the language they point to in those cases was unnecessarily broad and somewhat loose. In speaking directly to the courts and the judges, this language I talk about I would say was imprecise rather than use the adjective "loose". However, given the facts in those cases, the language pointed to did not cause any of the cases to be decided differently than they would have been decided had the language in question been tighter, or more precise.

Time, of course, does not permit a meaningful discussion of the individual cases which make up the more than fifty years of relevant Delaware case law. However, I will not ignore the two Delaware Supreme Court cases, *Getty Oil Co. v. Skelly Oil Co.*,[7] decided in 1970, and *Sinclair Oil Corp. v. Levien*,[8] decided in 1971, which contain the most extreme language on the subject and which led Professor Folk into what I have already indicated was error.[9]

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discussion of § 141(a) of the Delaware General Corporation Law which is the section which imposes on the directors the duty of managing the corporation's business and affairs; rather he deals with the Business Judgment Rule in his discussion of § 144 of the Corporation Law whose subject matter, interested director transactions, is outside the scope of the Business Judgment Rule.

5. Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971), *rev'g* 261 A.2d 917 (Del. Ch. 1969) ("fraud or gross overreaching"); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970), *rev'g* 255 A.2d 717 (Del. Ch. 1969) ("gross and palpable overreaching"); Warshaw v. Calhoun, 221 A.2d 487 (Del. 1966) ("bad faith . . . or a gross abuse of discretion"); Moskowitz v. Bantrell, 190 A.2d 749 (Del. 1963) ("fraud or gross abuse of discretion"); Kors v. Carey, 158 A.2d 136 (Del. Ch. 1960) ("fraud, misconduct or abuse of discretion"); Allaun v. Consol. Oil Co., 147 A. 257 (Del. Ch. 1929) ("reckless indifference to or a deliberate disregard of the stockholders").

6. *See* note 4 *supra*.

7. *See* note 5 *supra*.

8. *Id.*

9. E. FOLK, *supra* note 4, at 80.

The facts in *Getty* were simple. Getty and Skelly were both integrated oil companies with public stockholders. Getty owned 71% of Skelly stock, sufficient to elect the entire Skelly board. Up to 1967, Getty and Skelly had each received its own oil import allocation under the Federal Mandatory Oil Import Program. That's a federal statute. Each company's allocation was based solely on its own past use of imported oil. In 1967 the federal administrator of that act, acting on the basis of federal law, stopped awarding allocations to Skelly because it was controlled by Getty and continued to award allocations to Getty based only on Getty's own prior use, that is, the allocations to Getty after they stopped issuing to Skelly were not increased to reflect Skelly's prior use of oil. Rather, they continued in precisely the same amount or size as before, based only on Getty's individual prior use of oil.

Getty declined to share its allocations with Skelly and sought a declaratory judgment that it was not obligated to share its allocations with Skelly. Because Skelly's claim of entitlement to a share of the allocations was premised on the fact that Getty was its controlling stockholder, Getty asserted, among other things, that the Business Judgment Rule foreclosed Skelly from challenging Getty's decision not to share its allocations.

One wonders what the Business Judgment Rule, at least insofar as applicable to Skelly, had to do with this case, since none of Skelly's directors, nor any Skelly officer, nor Skelly's controlling stockholder, Getty, made or had any occasion to make a decision respecting the conduct of Skelly's business or involving any Skelly asset, unless the allocations were a Skelly asset.

Getty did not use its influence as Skelly's majority stockholder to cause Skelly's directors or officers to do its bidding. Getty received nothing whatever from Skelly; rather, it was Skelly who was seeking something from Getty. Chancellor Duffy, now Justice Duffy, but not for the reason I have just indicated, held that the Business Judgment Rule was not applicable because he equated the non-transaction between the two related corporations with an actual transaction between them in which the majority stockholder had overreached its controlled corporation, and on that basis he ordered Getty to share its oil with Skelly.

The Supreme Court reversed, holding that Getty's decision not to have a transaction with Skelly was not governed by the same rule as would have governed if there had indeed been a transaction between them. However, it did not clearly rest its decision for Getty on what I think is a non-debatable ground that the mere status, without more, of a majority stockholder does not require the majority stockholder to

assist its less-than-wholly-owned subsidiary, particularly without adequate consideration or other compensating benefit to the majority stockholder.

Instead of resting its decision on that proposition of law for which support could have been found in the cases of about I think every jurisdiction in the land, the Supreme Court rested its decision on the ground that the Court would not review the business judgment of Getty, or its directors, not to give some of Getty's oil allocation to Skelly.

There can be little doubt that the Court's statement that the business judgment of directors will be sustained unless there is—and here I am quoting the language from the Court's decision—"a showing of gross and palpable overreaching." [10] Now that language was broader than was required for a case which did not involve a self-dealing transaction, which the Court said was the case. The Court stated that that was not a self-dealing transaction, and why the Court used the words it did, particularly the word "overreach", I don't know, because the word "overreach" itself implies a transaction between parties rather than used to describe a transaction in which there was no transaction.

I think the Court intended to hold nothing more in *Getty* than that, under the facts, Getty's majority stockholder status imposed no greater obligation on it to give or sell Skelly some of Getty's imported oil than Getty would have been under had a Skelly refinery or a Skelly pipeline been shut down by a strike or by a fire, or any other disaster.

If the Business Judgment Rule was involved, as the Supreme Court evidently thought it was, it was the business judgment of Getty's directors, vis-à-vis Getty and its stockholders, not the business judgment of Getty or Getty's directors or officers acting as a stockholder or as directors or officers of Skelly. One can agree with the decision of either the chancery court or the Supreme Court, but in fact, neither court contributed meaningfully to the ascertainment of the standards which govern performance of duty by directors under Delaware law.

The issues in that case were whether the allocations given Getty via the federal government were impressed with a trust for Skelly, notwithstanding that the allocation was based only on Getty's, and not Skelly's, prior use. While the chancery court may have thought the allocation was impressed with a trust, and the Supreme Court may have thought that it was not, neither court used language of that kind, or neither court articulated its reason for deciding as it did on that ground. Rather, they talked about business judgment which, as I have indicated, had nothing to do with the case.

10. 267 A.2d at 888.

The *Sinclair* case involved, of all things, and this is the second case the language of which has caused so much trouble, a complaint that Sinclair Oil, which owned 97% of the stock of the corporation in which the plaintiff was also a stockholder, had caused that corporation to pay excessively generous dividends with the consequence that the subsidiary had not expanded its operations to the extent plaintiff claimed it might have had its dividends been smaller.

I think this is the only case on record where the stockholder ever complained that the dividends were too large, and that's why the Court had trouble coping with that kind of complaint.

Here, as in *Getty,* plaintiff claimed breach of fiduciary duty, and Sinclair's defense was that whether or not dividends should be paid, and if so how much, was a matter covered by the Business Judgment Rule. As in *Getty,* the chancery court agreed with plaintiff, and the Chancellor at that time, of course, was Justice Duffy, not Justice Quillen. I don't want anybody to wonder whether the Chancellor that decided both of these cases was our good friend, Justice Quillen. He was not Chancellor in either of those cases. I'll have occasion to mention some of his cases a little bit later.

Anyway, as in *Getty,* the chancery court agreed with plaintiff that the Business Judgment Rule was not applicable and that the applicable rule was the one which applied to a self-dealing transaction. Again the Supreme Court reversed, holding that the payment of a dividend in which all stockholders shared pro-rata according to their stockholdings, and from which no stockholder was excluded, is not a self-dealing transaction between a corporation and its controlling stockholder, and therefore the question whether the dividends were higher than they should have been in the circumstances is governed by the Business Judgment Rule which, said the Court, forecloses judicial intervention if the directors' decision—and here is where they use what I call that broad, loose, imprecise language that has created the trouble —"can be attributed to any rational business purpose." [11] Professor Folk says this formulation of the Business Judgment Rule, that it can be attributed to any rational business purpose, puts upon a stockholder "the seemingly impossible task of proving 'irrationality'." [12] That's what Folk said about that decision. I disagree. "Irrational," which was Folk's term, is of course, an antonym of "rational." However, the synonyms of "rational" are "reasonable" and "reasoning," and it is in that sense that the Supreme Court used the word "rational."

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11. 280 A.2d at 720.

12. E. FOLK, *supra* note 4, at 78.

If the facts will support the charge, it is not a "seemingly impossible task" for a stockholder to prove that directors acted unreasonably, or unreasoningly or arbitrarily. Those words mean no more than "abuse of discretion," a finding often made by both trial and appellate courts in other frameworks.

I'm sure Justice Quillen has found occasion to reverse trial courts for both abusive discretion, and maybe even when he was a trial court judge—well, maybe not in his case—but some trial courts have been reversed by supreme courts on the ground that they had abused their discretion and no one hangs their head in shame because that is how their decision was characterized. It's a term of art, and nothing particularly invidious. When Professor Folk said it was a seemingly impossible task to prove what he said the Supreme Court required to be proved, I think he was overstating.

That neither the Supreme Court nor the Chancery Court of Delaware have attributed to the *Getty* and *Sinclair* cases the immunizing effect that Professor Folk and those who want to federalize Corporate Law attribute to them is proved by, among other cases, the Supreme Court's decision in 1971—the same year and only a few months after these horrible decisions Folk talked about—in *Schnell v. Chris-Craft Industries, Inc.*,[13] which belies Professor Folk's interpretation; the Supreme Court's decision in 1977 in *Singer v. Magnavox*[14]—about which we have already heard a great deal in other contexts and I'm sure in the course of today and tomorrow you will hear again and again and again; the Chancery Court's decision in 1973 in *Thomas v. Kempner*[15]—that was by Chancellor Marvel; and the Chancery Court's 1974 decision by the then Chancellor Quillen in *Gimbel v. Signal Companies*.[16]

I don't have time to discuss those cases, even briefly. However, in none of them did the Court feel that the Business Judgment Rule required the stockholder who prevailed in each of those cases to prove actual fraud, gross fraud, gross and palpable overreaching, gross abuse of discretion, irrationality, or something equally invidious.

Indeed Chancellor Marvel in 1971, when the ink was hardly dry on the *Getty* and *Sinclair* opinions, held that a plaintiff must lose because he had not shown that the defendant was, and I'm quoting, "guilty of bad faith, negligence or gross abuse of discretion, the type

13. *See* note 2 *supra*.

14. *Id.*

15. No. 4138 (Del. Ch., March 22, 1973).

16. *See* note 2 *supra*.

of conduct looked for when a non-self-dealing fiduciary is charged with losses to the corporation." [17]

I think Chancellor Marvel was a little bit carried away when he said "gross discretion," but whatever "gross abuse of discretion" may mean, the fact that Chancellor Marvel equated it with "bad faith" and "negligence" indicates that he viewed it as something less invidious than fraud.

The word "fraud" appears in many of the cases that have dealt with the Business Judgment Rule. To many people that word connotes invidious conduct of an extreme nature. But this is not the sense in which the word "fraud" has been used by the Delaware courts in drawing a line between proper and improper performance of fiduciary duty.

The earliest case in which the Delaware Supreme Court spoke to the point was *Bodell v. General Gas & Electric* [18] decided in 1927. There the Court stated, "[W]e think the discretion of a board of directors in the sale of its no par value stock should not be interfered with, except for fraud, actual or constructive, such as improper motive or personal gain or arbitrary action or conscious disregard of the interests of the corporation and the rights of its stockholders." [19]

Thus, the Court indicated that it would indeed interfere with the discretion which the statute vested in the directors upon a finding, not necessarily of fraud, but upon a finding that the conduct complained of was not the product of a proper motive, or was inspired by a hope of personal gain, or was arbitrary, or resulted from a conscious disregard of the corporation's and its stockholders' best interests.

Having thus listed some of the kinds of directors' conduct that would taint a proposed transaction, the Court concluded, after examining the entire record, that the corporation would not be enjoined from issuing the shares because, here again the Court's words, "the acts of the directors objected to were performed in good faith, in the exercise of their best judgment, and for what they believed to be the advantage of the corporation and its stockholders." [20]

This, in my view, is a clear statement of standards to which a director of a Delaware corporation must conform. In light of that language and explicit holding, I don't think it would ever have been possible to persuade Delaware courts that the Business Judgment Rule prevents a transaction from being enjoined or immunizes directors

17. Chasin v. Bluck, 282 A.2d 188, 193 (Del. Ch. 1971).
18. 140 A. 264 (Del. 1927).
19. *Id.* at 267.
20. *Id.* at 268.

from personal liability if it is established that the directors did not act in good faith, in the exercise of their best judgment and for what they believed reasonably to be the advantage of the corporation and its stockholders. I think the *Bodell* case is as much the law in Delaware today as it was in 1927.

Cases in which stockholders have charged directors with breach of their duty to manage properly the corporation's affairs fall into two main categories. The first category, involving an insignificantly small percentage of the cases, are those cases where the directors have been charged with a failure to take corrective or preventive action due, plaintiff says, to the directors' inexcusable unawareness of or inattention to matters about which something should have been done. Examples of such cases are *Lutz v. Boas*,[21] *Graham v. Allis-Chalmers Manufacturing Co.*,[22] and *Kelly v. Bell*.[23] This category of cases does not involve the Business Judgment Rule since the charge deals not with directorial action but a failure to act. The standard which a Delaware court will apply in such cases to determine whether the director is liable is whether he exercised such case as an ordinarily prudent person in a like position would have used under similar circumstances.[24]

The second category of cases comprises those which challenge a transaction which was authorized by a decision which the directors made. The Business Judgment Rule concerns this category of case.

This category is itself made up of two subdivisions: first are those cases brought to enjoin a proposed transaction. Whatever colorful words may be used by the stockholder to depict the proposed transaction and the directors' authorization thereof, the gravamen of the complaint is usually that the challenged transaction is not in the best interests of the corporation or its stockholders. The second subdivision are cases where the challenged transaction has been completed and the plaintiff stockholder is seeking, usually derivatively on behalf of the corporation, to recover from the directors, officers or controlling stockholder, the damages which plaintiff claims the corporation or the

21. 39 Del. Ch. 585, 171 A.2d 381 (1961), where two outside directors of Allis-Chalmers pleaded the defense was excusable ignorance of what the plaintiff stockholder charged the directors knew or should have known.

22. 41 Del. Ch. 78, 188 A.2d 125 (1963), *aff'g*, 40 Del. Ch. 335, 182 A.2d 328 (1962), a case against all of the directors of Allis-Chalmers in which the defense was excusable ignorance of what the plaintiff stockholder charged the directors knew or should have known.

23. 266 A.2d 878 (Del. 1970), *aff'g*, 254 A.2d 62 (Del. Ch. 1969), a case against all of the directors (both inside and outside) and some key officers of United States Steel in which the defense of the outside directors of excusable ignorance of challenged payments to municipalities was sustained.

24. *See* note 22, *supra*.

stockholders suffered as a consequence. However, whether the action be one to enjoin a proposed transaction or to recover damages for a consummated transaction, the key issue is whether the directors, officers or controlling stockholders have complied with the legal standards which the courts apply to determine whether directors have properly performed their duties.[25] If they have met those standards, the court will not enjoin the transaction or hold them liable.

As I have already said, both the critics and the most ardent supporters of the Business Judgment Rule read too much into the language the Delaware courts have used when they have recognized that the acts of a board of directors are clothed with a variety of favorable, albeit rebuttable, presumptions. Admitting that my understanding of the rule may seem to some to fly in the teeth of some words and phrases in a number of Delaware cases, some of which I have mentioned, I will now tell you what, in my view, the Business Judgment Rule is.

Simply put, the Business Judgment Rule is that a transaction which involves no self-dealing by the directors or no personal interest of the directors will not be enjoined for misconduct of directors, and the directors who authorize such transactions will not be held personally liable for resultant damages unless the record discloses at least one of three circumstances or conditions: (1) that the directors did not exercise due care to ascertain the relevance of the available facts before voting to authorize the transaction; or (2) that the directors voted to authorize the transaction even though they could not have reasonably believed the transaction to be for the best interest of the corporation; or (3) that in some other way the directors' authorization of the transaction was not in good faith.

The Business Judgment Rule is circumscribed by two important limitations which I have included in my formulation of the rule. Those limitations are: (1) it is available only to a director who has no personal interest in the transaction;[26] *and,* (2) only if he has paid informed attention to his duties.[27] A director cannot close his eyes to what is going on about him in the conduct of a corporate business and have it said that he is exercising business judgment.[28] For the Busi-

25. *See* note 2, *supra;* David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Marks v. Wolfson, 41 Del. Ch. 115, 188 A.2d 680 (1963); Allied Chemical & Dye Corp. v. Steel Tube Co., 14 Del. Ch. 1 (1923).

26. David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964).

27. Kaplan v. Centex Corp., 284 A.2d 119 (Del. Ch. 1971); Lutz v. Boas, 39 Del. Ch. 585, 171 A.2d 381 (Del. Ch. 1961); Mitchell v. Highland-Western Glass Co., 167 A. 831 (Del. Ch. 1933).

28. Lutz v. Boas, 39 Del. Ch. 585, 171 A.2d 381 (Del. 1961).

ness Judgment Rule to be applicable, a director's judgment must be brought to bear with specificity on the challenged transaction.[29]

If the directors acted without sufficient information, and I mean by sufficient information that they did not consider the relevant facts that were available to them when they made their decision and as a result passed an unintelligent or unadvised judgment, the transaction is capable of successful challenge and the directors are indeed liable for the resulting damage.

The Business Judgment Rule extends to directors only the same necessary protection that professional persons, doctors, lawyers, architects, engineers, enjoy under the Anglo-American Tort Law if sued for malpractice. In short, the Delaware cases eschew intervention in corporate decisionmaking if the judgment of the directors is not influenced by personal considerations and is exercised in good faith. In this context, good faith means that the director has exercised due care by informing himself of the relevant and available facts and that he reasonably believed that the challenged transaction served the best interest of the corporation.

The disagreement I mentioned earlier between me and other Delaware lawyers regarding the scope, operation and effect of the Business Judgment Rule arises from the fact that for more than fifty years the opinions of the Delaware courts have contained such statements as "a board of directors enjoys a presumption of sound business judgment," [30] and "the acts of directors are presumptively acts taken in good faith and inspired for the best interests of the corporatoin" [31] and, because of such presumption, the courts have also said that to establish a breach of the director's duty a plaintiff is required to show "fraud," [32] "palpable overreaching," [33] "reckless indifference," [34] or "deliberate disregard of the interests of stockholders." [35] These and similar phrases can be found in many Delaware cases.[36] However, as I read the cases, the term "Business Judgment Rule" and the presumption which often identifies it mean no more than that a stockholder who challenges a non-self-dealing transaction, must persuade the court that the corporation's directors, officers or controlling stock-

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

30. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. Ch. 1971).

31. Warshaw v. Calhoun, 43 Del. Ch. 148, 154, 221 A.2d 487, 493 (1966).

32. Bodell v. Gen. Gas & Elec. Corp., 15 Del. Ch. 420, 423, 140 A.2d 264, 267 (1927).

33. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971).

34. Allaun v. Consol. Oil Co., 16 Del. Ch. 318, 322, 147 A. 257, 261 (1929).

35. *Id.*

36. *See* note 5, *supra* ("bad faith or gross abuse of discretion").

holders in authorizing such transaction either did not act in good faith, or did not act in a manner they reasonably believed to be in the best interest of the corporation, or did not exercise the care an ordinarily prudent person in a like position would use under similar circumstances. Often the Delaware courts have framed the Business Judgment Rule as a presumption that the directors acted in good faith and in the honest belief that they were acting for the best interests of the corporation.[37] But that presumption is, of course, rebuttable and not conclusive.[38]

If a plaintiff stockholder can prove any one of the three items of misconduct or malfeasance I have enumerated, I have no doubt that a Delaware court, even the ones that decided the *Getty* and *Sinclair* cases,[39] would enjoin the transaction if not consummated[40] or would render judgment against the directors for the corporation's consequent damages if it had been completed.[41] Not for one moment would a Delaware court think that it was precluded from so doing by Delaware's Business Judgment Rule.

If my understanding of Delaware's Business Judgment Rule is correct, then it is not substantively different from section 35 of the Model Business Corporation Act which has come to be generally accepted as the proper standard by which to measure a director's performance of his duties. I think maybe Norm Veasey, who was supposed to precede me but now follows me, might disagree with that, as perhaps will Drew Moore and a lot of other people.

But anyway, what I am telling you is that the Business Judgment Rule in Delaware is, in my view as I read the cases, not substantively different from section 35 of the Model Business Corporation Act which has been embraced by academicians and by those who would replace state law with federal law as being a proper statement of what a fiduciary duty of a director to the corporation and the stockholders ought to be.

It is my hope that I can convince my colleagues on the Corporation Law Committee of the Bar Association that my understanding of Delaware's Business Judgment Rule is indeed correct, and that we could put the matter to rest by writing section 35's standard of directorial performance of duty into section 141 of the Delaware Corpora-

37. Robinson v. Pittsburgh Oil Ref. Corp., 14 Del. Ch. 193, 126 A. 46 (1924); *see* note 27, *supra.*

38. Karasik v. Pacific Eastern Corp., 21 Del. Ch. 81, 180 A. 604 (1935); *see* note 2, *supra.*

39. *See* note 5, *supra.*

40. *See* note 2, *supra; see* note 21, *supra.*

41. Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405 (1962), *aff'g,* 40 Del. Ch. 113, 175 A.2d 33 (1961) (The court found that some directors had not acted in good faith and adjudged them liable for corporate damages).

tion Law,[42] which is the section that deals comprehensively with directors and what they are supposed to do and how they are supposed to act.

A discussion of Delaware's Business Judgment Rule would not be complete without a reference to Delaware's so-called Intrinsic Fairness Rule. Here I am infringing somewhat on what Drew Moore is going to say because that's his main topic, but let me say a sentence, and no more than a sentence, because I feel that there are two sides to a coin and I really can't, in the Delaware context, avoid mentioning the Business Judgment Rule and the Intrinsic Fairness Rule in the same breath. But I will keep it brief.

The Intrinsic Fairness Rule is applicable to self-dealing transactions only, and hence comes into play only in cases where the Business Judgment Rule is by definition inapplicable.[43] What Delaware courts mean when they use the terms "Business Judgment Rule" and "Intrinsic Fairness Rule" and undertake to apply one or the other of those rules in a specific case, is that if the challenged transaction does not involve self-dealing by directors or controlling stockholders, the Business Judgment Rule applies, but that if the transaction involves self-dealing, then the Business Judgment Rule does not apply and the Intrinsic Fairness Rule applies. In that kind of case, the plaintiff will win unless the defendants succeed in persuading the court, after the court has investigated the entire record, that the transaction was, in fact, intrinsically fair to the corporation.[44]

Those who read the Business Judgment Rule as condoning conduct less exacting than section 35 of the Model Business Corporation Act misread the Delaware cases. A lawyer who advises his client or a law professor who teaches his students that the Business Judgment Rule would prevent an unconsummated transaction from being enjoined or would immunize a director, officer or controlling stockholder from personal liability if it were consummated, even though the record demonstrated that the director, officer or controlling stockholder in approving a non-self-dealing transaction was either uninformed because he had not exercised due care, or did not reasonably believe when he approved the transaction that it was in the best interest of the corpora-

42. DEL. CODE ANN. tit. 8, § 141 (1974).

43. Kemp v. Angel, 381 A.2d 241 (Del. Ch. 1977); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977), *rev'g* 367 A.2d 1349 (Del. Ch. 1976); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952), *aff'g* 89 A.2d 862 (Del. Ch. 1952).

44. Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977), *rev'g* 367 A.2d 1349 (Del. Ch. 1976); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952), *aff'g* 89 A.2d 862 (Del. Ch. 1952).

tion, in my judgment would be giving bad advice and bad teaching, and I think it's not supported by the holding in any case, and indeed I think it is refuted by the holdings in a number of cases.[45]

While there is no hope or way of stopping lawyers when they represent defendants in the kinds of cases I have been talking about from asserting business judgment as a defense—I'm sorry there aren't more judges here present—but perhaps it is reasonable to hope that the judges will tidy up their language in dealing with the "defense" and stop using such colorful but inappropriate phrases as "palpable overreaching," "gross abuse of discretion," "reckless indifference," and the like, when they mean no more than lack of good faith or negligence.

Those phrases contributed nothing whatever to the court's determinations of which side should win the cases in which those phrases were used. Yet they serve to fuel the fires of those who love to quote those purple phrases to prove that Delaware's standards of fiduciary duties are shockingly low, and therefore that State Corporate Law should be federalized far more than it already is.

45. Gimbel v. Signal Co., 316 A.2d 599 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974); Lutz v. Boas, 171 A.2d 381 (Del. Ch. 1961); Bodell v. General Gas & Elec. Corp., 15 Del. Ch. 420, 140 A. 264 (Del. 1927); Thomas v. Kempner, No. 4138 (Del. Ch., March 22, 1973).