Book Review

D. Block, N. Barton and S. Radin, The Business Judgment Rule: Fiduciary Duties of Corporate Directors (3d ed. 1989) ($80.00, Prentice Hall Law & Business, Englewood Cliffs, New Jersey 07632).

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When courts intone the rubric of the business judgment rule, it sounds simple enough: the rule is a presumption that in making a business decision the directors of a corporation acted independently, on an informed basis, in good faith, and in the honest belief that the action taken was in the best interest of the company.[1] The rule is easy to state and sometimes easy to apply, but the phenomenon which has led to an explosion of case law is that it is complex in its application to "ownership" issues (those involving control or the direct equity interest of stockholders), as contrasted with the relative ease of application of the rule to "enterprise" issues (those involving business operations).[2]

This phenomenon has led to an abundance of recent books and articles by experienced practitioners and scholars.[3] Unlike other books that deal extensively with Delaware corporation law and securities law, the Block, Barton and Radin treatise, *The Business Judgment Rule*, does not purport to be an encyclopedic analysis of corporation or

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1. *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984); Dooley & Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 Bus. Law. 503, 522 (1989).

2. *See* Panter v. Marshall Field & Co., 646 F.2d 271, 299-304 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981) (Cudahy, J., concurring and dissenting); Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 Bus. Law. 1 (1985); Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 Bus. Law. 1477 (1984).

3. The book-length or multi-volume works include: R. Balotti & J. Finkelstein, The Delaware Law of Corporations and Business Organizations (1988 & Supp. 1989); D. Drexler, L. Black & A. Sparks, Delaware Corporate Law and Practice (1989); A. Fleischer, Tender Offers: Defenses, Responses and Planning (1987); E. Folk, R. Ward & E. Welch, Folk on the Delaware General Corporation Law (2d ed. 1988 & Supp. 1989); and M. Lipton & E. Steinberger, Takeovers and Freezeouts (1989). The articles are too numerous for a sample listing to be meaningful.

securities law. Rather, it is quite specifically focused on four principal areas: the duties of care, loyalty, and candor;[4] transactions in control;[5] derivative litigation;[6] and indemnification of corporate officials.[7]

It could reasonably be argued that no treatise has surpassed this work in its comprehensive treatment of the intellectual underpinnings and practical applications of the business judgment rule as applied in the takeover context. This part of the book contains over half of its volumetric content (320 pages) and is the "crown jewel" of its analysis. One should not, however, overlook the quality of the other major areas developed in this excellent work. The duties of care, loyalty, and candor are crisply analyzed and documented. The indemnification-insurance area is developed in a very comprehensive and practical manner. Perhaps the area in which this book makes its second most significant contribution (after the takeover area) is its analysis of derivative actions and the demand requirement. The authors are particularly qualified, from experience and deep understanding, to write in the takeover and derivative suit[8] areas since they have been at the vortex of some of the most significant litigated cases in those areas.

Reading this book led me to revisit the critical distinction between "enterprise" decisions—whether they be routine or extraordinary—and "ownership" decisions—particularly those involving contests for control.[9] Today most boards of public companies consist of a majority of outside directors, a trend which has heightened the presumption of the business judgment rule. Indeed, almost all outside directors are disinterested decisionmakers in almost every enterprise decision. While there may be times when the independence[10] of some may be open to question in certain contexts, today's directors (of public companies, at least) are, for the most part, honest, conscientious, and concerned about behaving properly, even punctiliously, in carrying out their fiduciary duties. Seldom does a duty of loyalty

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4. D. BLOCK, N. BARTON & S. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 27-117 (3d ed. 1989).

5. *Id.* at 118-436.

6. *Id.* at 437-560.

7. *Id.* at 561-620.

8. Indeed, they are making even further contributions in these areas. *See, e.g.*, Block, Radin & Rosenzweig, *The Role of the Business Judgment Rule in Shareholder Litigation at the Turn of the Decade*, 45 BUS. LAW. 469 (Feb. 1990) (substantially improving and enhancing the analysis of chapter IV of the book).

9. *See supra* text accompanying note 2.

10. *See Aronson*, 473 A.2d at 812-16.

issue arise in enterprise decisions, and cases like *Smith v. Van Gorkom*[11] have made directors keenly sensitive to the need for deliberate (sometimes painfully plodding) processes. Derivative or class action cases brought against directors for damages based on the directors' alleged breach of the due care component of the business judgment rule in decisionmaking or in directorial oversight in non-decisionmaking contexts[12] are few and far between. This is due not only to improved directorial processes, but also because courts have imposed strict particularized pleading requirements and many state statutes have exculpated directors from liability for damages in certain instances.[13] Duty of loyalty issues outside the takeover area are rare in public companies and are the subject of case law, statutory and scholarly narrowing.[14]

It is important to focus on the distinction between the protection of the decisionmaker against liability for damages and the transactional justification of the decision itself.[15] The essence of the rule had been historically viewed primarily as a shield for directors and officers against pecuniary liability. It is, of course, applied in modern times most visibly in injunction cases, leading one at times to wonder whether protection of the pocketbook of the decisionmaker (which has the salutary effect of encouraging people to be directors and to take risks) is coextensive with the extent to which the decision is to be reviewed in an injunction setting.[16] When the incidence of hostile

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11. 488 A.2d 858 (Del. 1985). *See also* Citron v. Fairchild Camera & Instrument Corp., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,860 (Del. Dec. 22, 1989).

12. *Compare* Lutz v. Boas, 171 A.2d 381 (Del. Ch. 1961), *with* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125 (Del. 1963), *and* Rabkin v. Philip A. Hunt Chem. Corp., 547 A.2d 963 (Del. Ch. 1986), *motion for reargument denied*, No. 5747 (Del. Ch. Dec. 17, 1987), *reprinted in* 13 DEL. J. CORP. L. 1210 (1988).

13. DEL. CODE ANN. tit. 8, § 102(b)(7) (1988) (limiting or eliminating directors' pecuniary liability—without affecting injunction cases—except for certain egregious conduct or statutory violations if such exculpation permitted by certificate of incorporation); DEL. CODE ANN. tit. 8, § 141(e) (1988) (setting forth directors' protection in relying on certain documents, reports, or opinions).

14. *See, e.g.*, *New Subchapter F of the Model Business Corporation Act*, 44 BUS. LAW. 1307 (1989).

15. *See* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1284 n.32 (Del. 1989). *See also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 n.10 (Del. 1986); 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 (1984).

16. *See* Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).

takeovers intensified in the late 1970s and 1980s and directors' positions of control were at stake, courts were looking for a rationale to review the tactics of target boards in attempting to fend off hostile takeovers. Directors were accused of taking action which was not in the interests of the corporation or its stockholders,[17] but rather in furtherance of some primary purpose related to their own entrenchment.[18]

The traditional articulation of the business judgment rule experienced some linguistic strain in Delaware case law until the watershed year of 1985 in Delaware jurisprudence. In that year, the supreme court stated in *Unocal*[19] that, because of the "omnipresent specter" of director interest in maintaining control, the court would alter the business judgment presumption.[20] The application of an "enhanced" business judgment rule in contests for corporate control, as developed in *Unocal* and its progeny, implicates primarily two concepts which depart from the traditional formulation of the rule and its rationale. The first is a threshold shifting in the burden of proof (or at least the burden of going forward with the evidence) requiring directors to show by their good faith and reasonable investigation that they reasonably perceived a threat to corporate policy and effectiveness. The second involves judicial review of the reasonableness or proportionality of the corporate action taken in response to a threatened takeover.

Consider this remarkable development: the rationale of the business judgment rule was rooted in the concept that, in managing or overseeing the management of a business, directors must have wide discretion to delegate, to take risks, and not be second-guessed by courts (at least insofar as their exposure to liability for damages is concerned). The only real limitations on that discretion are: (1) the directors should not enjoy the presumption of the business judgment

17. Note Chancellor Allen's footnote that a reference to duties to the corporation and its stockholders "masks the real issue." TW Servs. Inc. v. Crown, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,178 n.5 (Del. Ch. Mar. 2, 1989).

18. *See* Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981).

19. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

20. Other seminal cases in that watershed year include Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), *aff'g*, MacAndrews & Forbes Inc. v. Revlon, Inc., 501 A.2d 1239 (Del. Ch. 1985); *Van Gorkom*, 488 A.2d at 872 n.11; and Moran v. Household Int'l, Inc., 490 A.2d 1059 (Del. Ch.), *aff'd*, 500 A.2d 1346 (Del. 1985).

rule if they were not making a business decision or if they were interested, not independent, not acting in good faith or grossly negligent in their decisionmaking process; and (2) to be sustainable, their decision may not be shown to have been devoid of any rational business purpose or to be so irrational that no person of ordinary prudence would have believed the decision to have been in the best interests of the corporation.[21]

To permit a court to determine the "reasonableness" of actions of business people or to substitute the court's judgment for that of the directors is anathema to those who would be reluctant to countenance any significant erosion in the business judgment rule.[22] If, however, the limitations on the application of judicial review and burden-shifting of *Unocal* are clearly understood, judicial management of contests for control takes on a life and culture of its own, including a jurisprudence unique to control contests giving rise to many fascinating offshoots-poison pills, lock-ups, leg-ups, white knights, white squires, crown jewel sales, auctions, self tenders, supervoting stock, etc. This jurisprudence may be appropriately compartmentalized so as not to be expanded unduly in allowing courts to substitute their judgment for that of the directors.[23] Indeed, there seems to be a resistance, at least by Delaware courts, to expand the *Unocal* doctrine to other traditional business judgment rule applications such as statutory directorial prerogatives,[24] purely enterprise decisions, directorial

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21. *See* D. BLOCK, N. BARTON & S. RADIN, *supra* note 4, at 4. Note the interesting reference in the book to the venerable Louisiana Supreme Court decision in Percy v. Millaudon, 8 Mart. (n.s.) 68 (La. 1829).

> The test of responsibility, therefore, should be, not the certainty of wisdom in others, but the possession of ordinary knowledge; and by showing that the error of the [director] is of so gross a kind that a man of common sense, and ordinary attention, would not have fallen into it.

Id. at 77-78. *See also In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770, 780-81 n.5 (Del. Ch.), *appeal denied*, 540 A.2d 1088 (Del. 1988) (Chancellor Allen's very interesting footnote); *In re* RJR Nabisco, Inc. Shareholder Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,710 n.13 (Del. Ch. Jan. 31, 1989).

22. Veasey & Manning, *Codified Standard—Safe Harbor or Uncharted Reef? An Analysis of the Model Act Standard of Care Compared with Delaware Law*, 35 BUS. LAW. 919 (1980).

23. *See* City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988). *See also* AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986) (to the effect that a judicial decision, whether the business judgment rule or the entire fairness rule applies, is often outcome determinative).

24. *See* TW Servs., Inc. v. Crown, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,178 n.5 (Del. Ch. Mar. 2, 1989).

pecuniary liability, review of decisions by disinterested and independent directors on stockholder demands to sue their fellow directors and in other areas.

This book should be readily at hand for use by practitioners and scholars working in this area of the law. It is a valuable analytical and research tool which can be used with considerable facility. It is comprehensive and rich in footnotes and appendices. Moreover, this third edition is itself a significant advancement over earlier editions. As the authors note, it includes over 100 cases decided since the mid-1988 second edition. The takeover section has been much improved and expanded with expositions on an extensive laundry list of new bells and whistles (ESOPs, break-up and topping fees, extraordinary dividends, standstills, etc.), as well as penetrating analyses of some of the landmark Delaware cases of the 1988-1989 era, which was another watershed in Delaware jurisprudence.[25]

Most important of all, the book is reliable. The law in this area has been rapidly changing and becoming more complex. The authors have not only kept up, they have done so expertly.

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25. There have been other watersheds in Delaware jurisprudence where significant decisions have been clustered. As noted, *supra* note 20, 1985 was a watershed. The 1988-1989 era included such seminal cases as Paramount Communications Inc. v. Time Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989), *aff'd*, Nos. 279, 283, & 284 (Del. Feb. 26, 1990); Mills Acquisition Co. v. MacMillan, 559 A.2d 1261 (Del. 1989); Shamrock Holdings, Inc. v. Polaroid Corp. ("*Polaroid II*"), 559 A.2d 278 (Del. Ch. 1989); Shamrock Holdings, Inc. v. Polaroid Corp. ("*Polaroid I*"), 559 A.2d 257 (Del. Ch. 1989); TW Servs. Inc. v. Crown, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334 (Del. Ch. Mar. 2, 1989); Grand Metropolitan PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770 (Del. Ch. 1988); *In re* RJR Nabisco, Inc. Shareholder Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194 (Del. Ch. Jan. 31, 1989); *In re* Holly Farms Corp. Shareholders Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,181 (Del. Ch. Dec. 30, 1988), *sub. proceedings*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,443 (Del. Ch. May 18, 1989), and [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,486 (Del. Ch. June 14, 1989), which cases are discussed thoughtfully in the Block, Barton, and Radin book.