

Fall 1992

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Recommended Citation

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NOTES

PROTECTING SHAREHOLDERS: ILLINOIS NEEDS A DIRECTOR LIABILITY STATUTE

INTRODUCTION

On May 4, 1988, the Illinois House of Representatives effectively killed Senate Bill 1214.¹ The bill would have permitted Illinois corporations to protect their directors from personal liability for monetary damages in shareholder suits for negligence.² Such protection would have helped Illinois corporations attract highly qualified persons to serve on their boards of directors. Illinois is now one of only nine states that does not provide some form of statutory liability protection for corporate directors.³

This Note advocates that the Illinois General Assembly pass a director liability statute as a means of helping attract qualified persons to serve as outside directors on the boards of Illinois corporations. Outside directors⁴ play a critically important role⁵ in the

1. The Illinois House of Representatives tabled Senate Bill 1214 pursuant to House Rule 26. LEGIS. SYNOPSIS & DIG., 85th Ill. Gen. Assembly, 1988 Sess., at 268 (No. 11, Vol. I) (1988) [hereinafter LEGIS. SYNOPSIS & DIG.]; 1 J.H.R. 778 (1988). See *infra* notes 137-152 and accompanying text for a discussion of the legislative history of Senate Bill 1214.

2. See *infra* notes 139-140 and accompanying text for a discussion of the directors' liability statute proposed in Senate Bill 1214.

3. See *infra* notes 116 and 123 for a discussion of directors' liability statutes adopted in other states. The nine states which have not yet enacted director liability statutes are Alabama, Connecticut, Illinois, Mississippi, Missouri, North Dakota, South Carolina, Vermont, and West Virginia.

4. In the simplest formulation, outside directors are those members of a corporation's board of directors who are neither officers nor employees of the corporation. See Donald E. Pease, *Outside Directors: Their Importance to the Corporation and Protection from Liability*, 12 DEL. J. CORP. L. 25, 30 (1987). Other definitions of outside directors draw more precise distinctions. See, e.g., A.B.A. Sec. Corp., Banking & Bus. L., *Corporate Director's Guidebook*, (Rev. ed. Jan. 1978), reprinted in 33 BUS. LAW. 1595, 1619-20 (1978) [hereinafter *Guidebook*]. The Guidebook distinguishes three categories of directors: 1) management directors, who are involved full-time in the affairs of the corporation; 2) affiliated non-management directors, who may be former officers or employees of the corporation, attorneys, commercial bankers, investment bankers, and others who provide goods or services to the corporation, or directors who have close family ties to key members or management; 3) unaffiliated non-management directors, who have no relationship with the corporation which would interfere with the exercise of his independent judgment. *Id.*

governance of the contemporary publicly-held corporation in America.⁶ While all directors are charged with representing the interests of the shareholders,⁷ outside directors have the added responsibility of monitoring the performance of management on behalf of the shareholders.⁸ Illinois can protect shareholders and assist management by encouraging Illinois corporations to include highly qualified outside directors on their boards.

Section I of this Note provides an overview of the evolution of the American business corporation and the changing relationship among corporate directors, management, and shareholders. Section I also explores state and federal courts' traditional application of the business judgment rule to shield directors from personal liability for business decisions.⁹ Section II examines the directors' liability crisis of 1985 to 1990 when unprecedented merger and acquisition activity; changes in the insurance industry; and a series of decisions by the Delaware Supreme Court, the nation's most influential interpreter of corporation law,¹⁰ combined to create a nationwide directors' liability crisis.¹¹ Section III examines legislative

5. Both outside and inside directors of the corporation are responsible for exercising the power of the corporation. Under the Revised Model Business Corporation Act, "All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors . . ." REVISED MODEL BUSINESS CORP. ACT § 8.01 (1991) [hereinafter RMBCA]. See *infra* notes 71-82 and accompanying text for a discussion of the special role of the outside director.

6. In this Note, "corporations" refers to large, publicly-held corporations whose shares are publicly traded. This usage follows the definition of the American Law Institute, which provides that a large, publicly-held corporation is one that has 2,000 or more record holders of its equity securities and total assets of at least \$100 million. Am. Law Inst., *Principles of Corporate Governance: Analysis and Recommendations* § 1.16 (Tent. Draft No. 2, 1984), as cited in Pease, *supra* note 4, at 26.

7. See *Guidebook, supra* note 4, at 1606 (stating that a director's fundamental responsibility is to represent the shareholders, who are the owners of the corporation).

8. Elliott J. Weiss & Donald E. Schwartz, *Using Disclosure to Activate the Board of Directors, as cited in CORPORATIONS AT THE CROSSROADS: GOVERNANCE AND REFORM* 109, 121-22 (Deborah A. DeMott ed., 1980) (observing the consensus developed in recent years that boards of directors should have a majority of outside directors who are completely independent of management and whose principal function is not to manage the business but to monitor management's performance).

9. See *infra* notes 25-66 and accompanying text for a discussion of the evolution of the American business corporation; the changing relationship among corporate directors, management, and shareholders; and state and federal courts' use of the business judgment rule to shield directors from personal liability for their business decisions.

10. See ROBERT W. HAMILTON, *THE LAW OF CORPORATIONS IN A NUTSHELL* 7 (2d ed. 1987) (describing the Delaware Legislature and the Delaware Supreme Court as "the principal sources of modern corporation law today").

11. See *infra* notes 83-108 and accompanying text for a discussion of the unprecedented merger and acquisition activity, reduced availability of director and officer liability insurance, and Delaware Supreme Court decisions subject-

responses by the states to the directors' liability crisis, focusing primarily on the Delaware director liability statute passed in 1986.¹² Section III also examines factors which may explain the Illinois General Assembly's rejection of a similar statute in 1988.¹³ Section IV analyzes *In re Dataproducts Shareholders' Litigation*,¹⁴ the first case applying the Delaware director liability statute, as a means for evaluating the provisions of the Delaware statute.¹⁵ Lastly, Section V concludes that passage of a director liability statute would greatly benefit Illinois corporations and their shareholders.¹⁶

I. THE PROBLEM OF CORPORATE CONTROL

Large publicly-held corporations control billions of dollars in capital.¹⁷ Corporations acquire their capital from shareholders who exchange their dollars for shares of ownership in the corporation because they expect to earn a profit on their investment.¹⁸ Even though shareholders own the corporation, shareholders do not decide how the corporation will use the capital it acquires.¹⁹ Instead, managers of the corporation run the business and make the decisions which determine whether the shareholders' hopes of profits

ing directors' business decisions to a heightened scrutiny which combined to create the 1985-90 directors' liability crisis.

12. DEL. CODE ANN. tit. 8, § 102(b)(7) (1986).

13. See *infra* notes 137-153 and accompanying text for a discussion of the Illinois General Assembly's rejection of a director liability statute.

14. *In re Dataproducts Shareholders' Litigation*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,227, 91,178 (Del. Ch. Aug. 22, 1991).

15. See *infra* notes 160-182 and accompanying text for a discussion of *In re Dataproducts Shareholders' Litigation*, the first case applying the Delaware director liability statute.

16. See *infra* notes 183-195 and accompanying text for a discussion of the reasons why Illinois should adopt a director liability statute. A proposed director liability statute which specifically excludes from protection acts which are grossly negligent or reckless is included in the Appendix to this Note.

17. Shareholders' equity in the following corporations demonstrates the amount of capital controlled by large, publicly-held corporations: General Motors, \$34,982,500,000; Ford Motor Co., \$22,727,800,000; Exxon, \$30,244,000,000; International Business Machines, \$38,509,000,000; General Electric, \$20,890,000,000; and Mobil, \$16,274,000,000. LOUIS RUKESYER'S BUSINESS ALMANAC 562 (Louis Rukesyser ed., 1991).

18. See FRANK H. EASTERBROOK & DANIEL R. FISCHER, THE ECONOMIC STRUCTURE OF CORPORATE LAW 4-5 (1991) (describing the operation of the financial market in which corporations compete for investors' dollars by promising to deliver higher returns).

19. *Id.* at 2, 4 (discussing the decision-making powers of managers and the control exercised by managers as compared to the inability of shareholders to control managers). See also Melvin A. Eisenberg, *The Modernization of Corporate Law: An Essay for Bill Carey*, 37 U. MIAMI L. REV. 187, 204 (1983) [hereinafter Eisenberg, *The Modernization of Corporate Law*] (describing management's control of the business of the corporation and shareholders' inability to oversee management).

will be realized.²⁰ This separation of ownership from control is at the heart of the problem of corporate control.²¹

Understanding the problem of corporate control is essential to a recognition of the importance of outside corporate directors. An outside director can act as a monitor of corporate decision-making and as a representative of shareholder interests.²² Thus, shareholder interests will best be served if highly qualified persons agree to serve as outside directors. Shareholder interests are not served when qualified persons refuse to serve as outside directors because they fear they will be held personally liable for monetary damages for mistakes that were made in good faith. A statutory limitation on director liability for monetary damages for ordinary negligence is, therefore, in the interests of shareholders.²³

Part A of this section will trace the evolution of corporate governance and show how the problem of corporate control developed. Part B will examine three traditional means of control available to shareholders: directors' fiduciary responsibility to shareholders, shareholder voting, and shareholder class action suits. Part B will show why shareholder voting is an ineffective means of controlling management decisions. Part B will also show that shareholder suits to enforce the directors' fiduciary duty of care are ineffective due to the courts' application of the business judgment rule.²⁴ Part C will explain the role of the outside director and show how the outside director can ameliorate the problem of corporate control by serving as a representative of shareholder interests.

A. *The Evolution of Corporate Governance*

1. *Early History of American Corporations*

Immediately after the American Revolution, state legislatures assumed the English sovereign's power to award corporate char-

20. EASTERBROOK & FISCHER, *supra* note 18, at 2; Eisenberg, *The Modernization of Corporate Law*, *supra* note 19, at 204.

21. See *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 565 (1933) (Brandeis, J., dissenting) (describing the growth of corporations which led to the separation of shareholder ownership from control of the corporation and the removal of checks which once operated to curb corporations' "misuse of wealth and power").

22. See *infra* notes 72-76 and 82 and accompanying text for a discussion of the role of the outside director as a representative of shareholders' interests.

23. A statutory limitation on director liability for monetary damages is in the interests of shareholders to the extent that it encourages qualified persons to serve as outside directors. See *infra* notes 72-76 and 82 and accompanying text for a discussion of the importance to shareholders of qualified outside directors.

24. See *infra* notes 52-66 and accompanying text for a discussion of the use of the business judgment rule to shield corporate directors from liability for their business decisions.

ters.²⁵ Initially, however, state legislatures awarded charters sparingly, because the legislators feared that corporations might abuse the power that they derived from large accumulations of capital.²⁶ Even when legislatures permitted incorporation, legislators imposed restrictions on the purpose of the corporation, the amount of capital it could acquire, and the persons who could serve as its directors.²⁷ By the end of the nineteenth century, however, states had adopted a much more permissive stance toward business corporations because the corporate form facilitated commercial development.²⁸ Ultimately, the legislatures' desire for commercial expansion overwhelmed their desire to keep corporations under tight restrictions.²⁹

2. *The Rise of New Jersey and Delaware as States of Incorporation*

By the end of the nineteenth century, states such as New Jersey and Delaware, seeing an opportunity to collect handsome amounts in incorporation fees and license and franchise taxes, went even further.³⁰ They adopted very liberal corporation laws designed to attract businesses to incorporate in their states, even if the businesses might operate in other states.³¹ Delaware quickly gained a position of dominance in the race for incorporations and continues to occupy that position today.³² Because corporations are

25. ROBERT W. HAMILTON, CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS 128 (3d ed. 1986) [hereinafter HAMILTON, CORPORATIONS].

26. *Id.* See also *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 548-49 (1933) (Brandeis, J., dissenting) (discussing fear of abuse of power engendered by corporate form and corporations' aggregation of capital).

27. HAMILTON, CORPORATIONS, *supra* note 25, at 128. See also *Liggett*, 288 U.S. at 550-56 (Brandeis, J., dissenting) (describing state limitations on the amount of capital authorized for business corporations, limitations on the purposes of corporations, and requirements that directors be residents of the state of incorporation).

28. HAMILTON, CORPORATIONS, *supra* note 25, at 128.

29. *Id.* See also *Liggett*, 288 U.S. at 549 (Brandeis, J., dissenting) (describing the "irresistible demand for charters" created by desire for business expansion).

30. See *Liggett*, 288 U.S. at 557-63 (Brandeis, J., dissenting) (describing the efforts of New Jersey, Delaware, Maine, Arizona, and South Dakota to attract incorporations by liberalizing their corporate laws).

31. *Id.*

32. Delaware has been extremely successful in attracting corporations. In 1985, more than half of the Fortune 500 companies and approximately 40% of the corporations traded on the New York Stock Exchange were incorporated in Delaware. Stacy D. Blank, Note, *Delaware Amendment Relaxes Directors' Liability*, 44 WASH. & LEE L. R. 111, 111 (1987). Delaware is the state of incorporation of 256 of the corporations which are included in the Standard & Poor's 500 Composite Stock Index (S&P 500) and corporation tax revenues account for 17% of the state's income. ROBERT A.G. MONKS & NELL MINOW, POWER AND ACCOUNTABILITY 136 (1991).

governed by the law of their state of incorporation, Delaware corporate law and the Delaware courts exert an enormous impact on American corporate law.³³

3. *From the Deep Freeze to the Big Chill*

Once state legislatures abandoned their earlier restrictions on corporations, the statutes which governed publicly-held corporations entered a sort of "ice age" that lasted until the mid-1970s.³⁴ In the interim, corporations changed dramatically.³⁵ In the late nineteenth century, the board of directors of a typical corporation actually managed the business of the corporation.³⁶ In that time period, the corporation's small number of shareholders monitored the performance of the directors and held them accountable for their deci-

33. The importance of the law of the state in which a corporation is incorporated is heightened by the "internal affairs rule" which requires foreign courts to apply the law of the state of incorporation to issues relating to the internal affairs of a foreign corporation. HAMILTON, CORPORATIONS, *supra* note 25, at 151 n.1. See also RMBCA, *supra* note 5, § 15.05(c) (discussing internal affairs rule). For discussions of Delaware corporation law and its national impact, see generally S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 DEL. J. CORP. L. 1 (1976). Arsht was one of the drafters of the 1967 revision of the Delaware General Corporation Law. In the cited article, he traces the 189-year history of Delaware General Corporation law with an eye to dispelling notions of "sinister motives and methods in its development." *Id.* at 1. See also William Cary, *Federalism and the Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663 (1974) (describing Delaware corporation law as overly pro-management and arguing that Delaware led other states into a "race to the bottom" in an effort to attract corporations); Joel Seligman, Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861 (1969) (describing the dominant role of the Delaware corporate bar in drafting the revision of the Delaware General Corporation Law); Joel Seligman, *A Brief History of Delaware's General Corporation Law of 1889*, 1 DEL. J. CORP. L. 249, 282 (1976) [hereinafter Seligman, *A Brief History*] (describing Delaware General Corporation Law as "the most influential business statute" in the United States and the "closest thing we have to a national corporate law"). For discussions of Delaware corporate law from a law and economics perspective, see RONALD WINTER, GOVERNMENT AND THE CORPORATION 9-10 (1978) (rejecting the notion that Delaware corporate law is too liberal and arguing that if Delaware law hurt profits and performance of Delaware corporations, investors would reflect that fact in the marketplace); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U. L. REV. 913 (1982) (rejecting Professor Cary's characterization of Delaware corporation law and arguing that market operates more effectively than law to regulate corporations).

34. Eisenberg, *The Modernization of Corporate Law*, *supra* note 19, at 188 (describing state legislatures' failure to change their corporation laws to keep up with important new developments and problems in business).

35. *Id.* at 204 (discussing the change in scale of the corporation from small firms managed by the board of directors and accountable to the shareholders to huge, publicly-held corporations controlled by full-time managers and officers accountable to the board of directors).

36. *Id.* (describing the board-managed firm as the "implicit model" which served as the basis for traditional corporation statutes).

sions.³⁷ By the 1970s, however, full-time executives managed large, publicly-held corporations and the board of directors monitored the performance of management.³⁸ Management was no longer directly accountable to shareholders, who stood on the periphery, without effective means of assuring that management's decisions actually maximized shareholder profits.³⁹ Thus, the problem of corporate control arose because late 20th century corporations still operated under corporate governance structures designed for the 19th century corporation.⁴⁰ Part B will show that more traditional means of shareholder control over management, such as the fiduciary relationship between directors and shareholders, shareholder voting, and shareholder class action suits have proven to be limited in their effectiveness.

B. Traditional Means of Shareholder Control

1. Fiduciary Duties of Corporate Directors

Directors of corporations have a fiduciary relationship to the corporation's shareholders.⁴¹ This fiduciary relationship imposes

37. *Id.* (describing the model of the firm in which management is directly accountable to shareholders as correct 100 years ago but observing that this model "has long since ceased to be the norm").

38. Eisenberg, *The Modernization of Corporate Law*, *supra* note 19, at 204 (describing the management function as having "dropped down one step in the corporate pyramid" from the board of directors to the full-time executives and the oversight function dropping from shareholders to the board).

39. *Id.* (describing the futility of expecting shareholders in large, publicly-held corporations to monitor or oversee management of corporation).

40. *See id.* at 204-05 (arguing that model of director accountability was accurate for late 19th century corporation but seriously inaccurate for much larger, management-dominated corporations 100 years later).

41. Marcia M. McMurray, *An Historical Perspective on the Duty of Loyalty, and the Business Judgement Rule*, 40 VAND. L. REV. 605, 606 (1987). A fiduciary has a duty "to act primarily for another's benefit." BLACK'S LAW DICTIONARY 625 (6th ed. 1990). A fiduciary relationship "gives rise to certain legal incidents and obligations . . ." *Id.* A fiduciary who breaches this responsibility is liable to the person for whose benefit he is acting for damages caused by the breach. *Id.* *See also* Ronald M. Loeb, *Current Legal Environment*, in DUTIES AND RESPONSIBILITIES OF OUTSIDE DIRECTORS 19, 20-21 (Avery S. Cohen & Ronald M. Loeb eds., 1978) (discussing the evolution of the definition of fiduciary duties of corporate directors from its origin in laws governing trustees to the "prudent man" definition in modern corporation statutes).

Under Delaware law, directors owe fiduciary responsibilities to the shareholders because "directors, rather than shareholders, manage the business and affairs of the corporation. . . . [T]he existence and exercise of this power carries with it certain fundamental fiduciary obligations to the corporation and its shareholders." *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984). *See also* *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (stating that directors have an "unyielding fiduciary duty to the corporation and its shareholders"). For a discussion of corporate directors' fiduciary relationship and duties, see Stephen A. Radin, *The Director's Duty of Care Three Years After Smith v. Van Gorkom*, 39 HASTINGS L. J. 707, 710 (1988) (observing that corporate directors owe fiduciary duties of care and loyalty to both the corporation and its shareholders); Robert

on directors the duties of care and loyalty when making decisions regarding the business of the corporation.⁴² These duties arise from

E. Bull, *Directors' Responsibilities and Shareholders' Interests In the Aftermath of Paramount Communications v. Time, Inc.*, 65 CHI.-KENT L. REV. 885, 890 (1989) (explaining that fiduciary obligations flow from the fact that directors, rather than shareholders, manage the affairs of the corporation). *But see* RMBCA, *supra* note 5, § 8.30 (rejecting the notion of a fiduciary relationship between directors and shareholders). Although § 8.30 requires directors of corporations to perform their duties in "good faith," the RMBCA does not use the term "fiduciary." RMBCA, *supra* note 5, § 8.30. The purpose for rejecting the term "fiduciary" is to avoid confusing the standard of care for directors with the "unique attributes and obligations of a fiduciary imposed by the law of trusts" which are deemed inappropriate for directors of corporations. RMBCA, *supra* note 5, § 8.30 and Official Comment to § 8.30 at 245. *See also* Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, in *ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION* 91, 98 (Richard A. Posner & Kenneth E. Scott eds., 1980) (arguing that the analogy between trustees and corporate directors is faulty because trustees and corporate directors have "utterly different economic functions and operate under utterly different economic constraints"); Bayless Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1499-1500 (1984) (rejecting both trustee model of fiduciary duties and torts model of prudent person in favor of more realistic "duty of attention").

42. Section 8.30(a)(2) of the Revised Model Business Corporation Act defines the director's duty of care as "the care an ordinarily prudent person in a like position would exercise under similar circumstances." RMBCA, *supra* note 5, § 8.30(a)(2). Section 8.30(a)(3) requires the director to act "in a manner he reasonably believes to be in the best interests of the corporation." *Id.* at § 8.30(a)(3). Under the Revised Model Business Corporation Act, the duty of care requires that a director become informed before making a decision or taking an action. *See* RMBCA, *supra* note 5, Official Comment to § 8.30 at 245.

Delaware law holds directors to a duty of care which is very similar to the duty of care under the RMBCA. *See* E. Norman Veasey, *Directors and Officers*, in *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* § 4.7 at 4-169 (R. Franklin Balotti & Jesse A. Finkelstein eds., Supp. 1991). The Delaware duty of care for corporate directors is set forth in dictum in *Graham v. Allis-Chalmers Mfg.*, 188 A.2d 125, 130 (Del. 1963). *Id.* Under the *Graham* standard of care, directors managing a corporation must use the same amount of care that an ordinarily prudent person would use in similar circumstances. *Id.*

In Illinois, in the absence of a statutory standard of care, the courts have applied a common law standard which is stricter than that of the Revised Model Business Corporation Act: the "degree of care and prudence that men prompted by self-interest exercise in the management of their own affairs." *Romanik v. Lurie Home Supply Center, Inc.*, 435 N.E.2d 712, 722 (Ill. App. 1982). *See also* Michael L. English, *Current Trends In Directors' Liability*, ISBA CORP. & SEC., Sept. 1986 at 1 (describing Illinois courts' application of "prudent man" common law standard to measure directors' conduct, in absence of statutory definition of standard of care).

The duty of care may be characterized as a duty to refrain from negligence. *MORTIMER FEUER, PERSONAL LIABILITIES OF CORPORATE OFFICERS AND DIRECTORS* 28 (2d ed. 1974). By contrast, the duty of loyalty is the duty to avoid conflicts of interest or self-dealing. *Id.* The duty of loyalty requires the director to be disinterested. *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984). A director is not disinterested in a transaction if he enjoys or expects to enjoy a "personal financial benefit" which will not be extended to all the stockholders. *Id.*

Although the duties of care and loyalty have traditionally been regarded as separate and distinct, some law and economics theorists reject the conventional distinction between the duty of care and the duty of loyalty. *See* EASTERBROOK

the nature of the corporation as an institution in which management and ownership are separated. The board of directors is ultimately responsible for managing the corporation on behalf of the shareholders who are the corporation's owners.⁴³ Because courts recognize a fiduciary relationship between the directors and the shareholders, shareholders have enforceable rights against the directors.⁴⁴

In theory, shareholders control the management of the corporation because they elect the board of directors and they vote on fundamental questions of corporate policy.⁴⁵ In practice, however, shareholders' control over the corporation is illusory.⁴⁶ Moreover,

& FISCHER, *supra* note 18, at 103 (arguing that violations of either duty should be viewed simply as "agency costs . . . that reduce shareholders' wealth").

43. Traditionally, the corporation has been regarded as a three-tiered structure consisting of: 1) shareholders who are the ultimate owners of the enterprise, 2) the board of directors who are responsible for managing the corporation, and 3) the officers who are charged with acting for the corporation to implement the decisions of the board of directors. HAMILTON, CORPORATIONS, *supra* note 25, at 3. In their classic 1932 work on the nature of the American business corporation, Berle and Means identified three trends which fundamentally changed the character of the economy: concentration of economic power, dispersion of stock ownership, and separation of ownership and control. See ADOLPH A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY xxix (1968 rev. ed.). They observed in the introduction to their 1968 revised edition that these trends had continued so that, 35 years later, economic power had "built up in the hands of corporate management" and "the separation of ownership and control has released management from the over-riding requirement that it serve stockholders." *Id.* xxxv.

44. The fact that "directors, rather than shareholders, manage the . . . corporation" creates the fiduciary relationship between directors and shareholders. *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984).

45. Shareholder approval is required for fundamental changes in the structure of the corporation such as merger, sale of substantially all of the corporation's assets, amendment of the corporation's certificate of incorporation, and dissolution of the corporation. MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 3 (1976) [hereinafter EISENBERG, THE STRUCTURE OF THE CORPORATION]. Shareholders also elect the members of the board of directors. *Id.* at 2.

46. One commentator has termed shareholder democracy a myth, declaring the mechanism of shareholder voting to be meaningless as a device for controlling the management of the corporation. See Bayless Manning, Book Review, 67 YALE L. J. 1477, 1489 (1958) (reviewing J. A. LIVINGSTON, THE AMERICAN STOCKHOLDER (1958)). The conventional explanation for the meaninglessness of shareholder voting is that "shareholdings are atomistically dispersed" so that no single shareholder owns enough stock to make a difference in the outcome. EISENBERG, THE STRUCTURE OF THE CORPORATION, *supra* note 45, at 64. However, Eisenberg suggests that this model is empirically unfounded, especially in corporations with 1,000 or more shareholders. *Id.* He finds that in at least half of the corporations which have between 1,000 and 2,999 shareholders, "the ten largest record shareholders" own 30-40% of the stock. *Id.* He also finds that in corporations with 3,000 or more shareholders, "only a small fraction of the stock is owned by unsophisticated investors with small investments." *Id.* Rather, at least half the stock in these corporations is held by sophisticated institutional investors who have both the ability and the incentive to cast their

the board of directors' virtually exclusive access to the corporate

votes seriously. *Id.* Eisenberg's data on institutional investors were compiled in the mid-1970's. Since that time, institutional investors have grown to a position of even greater dominance. See Ira M. Millstein, *The Responsibility of the Institutional Investor in Corporate Management*, in *THE BATTLE FOR CORPORATE CONTROL: SHAREHOLDER RIGHTS, STAKEHOLDER INTERESTS, AND MANAGERIAL RESPONSIBILITIES* 67, 70 (Alfred W. Sametz ed., 1991). A study conducted by the Institutional Investor Project shows that the assets of pension funds grew at a rate of 14.6% per year from 1981-87, increasing from \$891 billion to over \$2 trillion by 1987. *Id.* In 1987, pension funds accounted for 43.5% of all institutional investors. *Id.* Altogether, institutional investors controlled approximately 49% of the shares in the top 50 American corporations. *Id.* The Institutional Investor Project estimates that pension funds will hold over two-thirds of the shares of large, publicly-traded corporations by the year 2000. *Id.* Despite the concentration of ownership in the hands of pension funds, however, Millstein contends that pension funds have abdicated "their ownership responsibilities by not participating in the corporate governance process," by failing to vote their proxies, or by always voting with management, or, on some issues, by always voting against management. *Id.*

It appears that the explanation for this failure is traceable to the legal structure of the corporation, the rules that specify which issues management must submit to a vote of the shareholders, and the rules that permit shareholders to vote only to accept or reject proposals formulated and approved by the board of directors. EISENBERG, *THE STRUCTURE OF THE CORPORATION*, *supra* note 45, at 3. As Eisenberg points out, shareholder approval is not required for a number of actions which he terms "modern fundamental changes — business combinations other than mergers, corporate contractions, and corporate divisions." *Id.* Moreover, most states require board approval of the traditional fundamental changes (mergers, corporation contractions, and corporate divisions) before management can submit the question to the shareholders for a vote. *Id.* at 4. Even when such questions are submitted to the shareholders, shareholders' power is limited to approving or disapproving the package formulated by the board; the shareholders cannot alter the package. *Id.* at 4. Similarly, shareholders vote to elect directors but in most states, shareholders cannot remove directors except for good cause. *Id.* at 2.

Recent events suggest, however, that institutional investors can exert significant pressure on corporate managers by withholding their votes for the slated directors, by introducing or supporting shareholder proposals, and by winning changes in the rules which govern control of the proxy machinery. See, e.g., Bret D. Fromson, *SEC Offers Shareholders More Say Over Directors*, INT'L HERALD TRIB., Mar. 6, 1992, § 1 at 11 (discussing Securities and Exchange Commission ruling that permitted Exxon shareholders to vote on a shareholder proposal to create a watchdog panel to oversee Exxon's board of directors); Kevin G. Salwen & Joann S. Lublin, *Giant Investors Flex Their Muscles More at U.S. Corporations*, WALL ST. J., Apr. 27, 1992, § A at 1 (Midwest ed.) (discussing institutional investors' new activism, the impact of institutional investors on corporations such as ITT Corp., UAL Corp., and International Paper Co., and the likelihood that the Securities and Exchange Commission will enhance investors' ability to affect management decisions by easing rules which currently inhibit communication among shareholders); John Schmeltzer, *Mutual Fund's Vote Will Buck Sears Board*, CHI. TRIB., May 6, 1992, § 2 at 1 (describing Fidelity Investments' plan to vote its eight million shares of Sears stock in support of shareholder proposals to make shareholder votes confidential and to end staggered terms for directors as a response to Sears' poor performance and the declining value of Sears shares); John Schmeltzer, *Stockholders Take Aim at Performance by Sears*, CHI. TRIB., May 14, 1992, § 3 at 1 (describing the decisions of two of the nation's largest pension funds to express their dissatisfaction with Sears' performance: California Public Employees Retirement System (Calpers), holding 1.97 million shares of Sears stock, voted against the re-election of three

proxy machinery effectively prevents shareholders from raising issues, forming coalitions, or otherwise organizing any meaningful opposition to the policies pursued by the directors.⁴⁷

Although shareholder voting appears to be ineffective as a means of controlling the board, shareholder class action suits allow a group of shareholders to sue the directors. Shareholders who are directly injured by an action taken by the corporation can bring a claim against the directors for equitable relief or monetary damages.⁴⁸ Alternatively, shareholders who are only indirectly injured can bring a derivative action in which they sue the directors on be-

directors; TIAA-CREF, holding millions of shares of Sears stock, abstained from voting for the three directors); John Schmeltzer & Charles Storch, *Sears' Shareholders Fire "Warning Shot" at Execs*, CHI. TRIB., May 15, 1992, § 1 at 1 (discussing the outcome of voting on shareholder proposals and re-election of directors to the board of Sears, Roebuck and Co., and observing that although none of the protest votes garnered the support of a majority of shareholders, the surprising strength of the shareholder revolt should serve as a warning to Sears' management); Pat Widder, *New Role for Big-time Money Managers: Rebel*, CHI. TRIB., May 20, 1992, § 1 at 1 (discussing growing importance of institutional investors and their increasing willingness to use "their clout to insist on change" in corporations such as Sears); *A Wobbly California Giant*, ECONOMIST, May 30, 1992, at 75 (describing Calpers' position as "America's largest pension fund" and its willingness to use its position as a major shareholder to press for changes in twelve targeted corporations).

47. Since voting by proxy is the dominant mode of shareholder decision-making, board control of corporate proxy machinery helps insure that directors control the outcome of the vote. EISENBERG, *THE STRUCTURE OF THE CORPORATION*, *supra* note 45, at 97. State laws and SEC Proxy Rules give the board preferential access to the corporate proxy machinery. *Id.* at 111. For example, SEC Proxy Rule 14-a-7 requires the corporation to provide a shareholder list to a shareholder who wants to communicate with the corporation's shareholders. *Id.* at 111 n.55. Although this rule appears to facilitate communication among shareholders, it has drawbacks which limit its effectiveness. *Id.* A major limitation is the requirement that a shareholder who takes advantage of the provision must pay the cost of the communication. *Id.* The board of directors, by contrast, can communicate with shareholders using the funds of the corporation. *Id.* at 112. SEC Proxy Rule 14-a-8 imposes an even more severe restriction by excepting elections to office from the coverage of Rule 14-a-7. *Id.* at 111. However, on October 15, 1992, the SEC adopted regulations which facilitate communication among shareholders and permit shareholders to cast their votes for individual candidates for the board of directors, rather than limiting shareholders to voting for or against a proposed slate of directors. Stephen Labaton, *S.E.C. Votes Rules on Pay, As Expected*, N.Y. TIMES, Oct. 16, 1992, at C1, C6. The new regulations also require corporations to make more complete disclosures regarding executive compensation. *Id.* at C1. The new regulations could make it easier for shareholders to challenge directors and could lead to the election of a greater number of outside directors. *Id.*

48. See HAMILTON, *CORPORATIONS*, *supra* note 25, at 1088 (distinguishing between direct claims "based on a direct injury to the shareholder as such" and derivative claims "based on an injury to the corporation" which only indirectly constitutes an injury to the shareholder). Rule 23 of the Federal Rules of Civil Procedure governs shareholder class action suits presenting direct claims. See FED. R. CIV. P. 23. The statute governing Illinois class action claims is ILL. REV. STAT. ch. 110, para. 2-801 to 2-806 (1991).

half of the corporation.⁴⁹ However, seeking *post facto* redress for injury through a class action suit is an imperfect and inefficient means for shareholders to maximize their interests as owners of the corporation.⁵⁰ Litigation is expensive, time-consuming and diverts management from its principal task of maximizing shareholder profits.⁵¹

2. The Business Judgment Rule

Another reason that shareholder suits are an ineffective means of controlling corporate directors' decisions is that American courts have traditionally been reluctant to second-guess the decisions of corporate directors.⁵² Instead, courts apply the common law business judgment rule.⁵³ Under the business judgment rule, the court

49. Shareholder derivative actions are governed by Rule 23.1. FED. R. CIV. P. 23.1. Rule 23.1 imposes requirements on shareholder-plaintiffs bringing derivative claims that Rule 23 does not impose on shareholders who bring direct claims. For example, a derivative claim must allege with particularity the plaintiffs' efforts to seek the desired action from the corporation's board of directors before bringing suit. *Id.* The additional requirements of Rule 23.1 may stem from a desire to prevent shareholders from bringing "strike suits," defined as suits brought "solely for their settlement value." HAMILTON, CORPORATIONS, *supra* note 25, at 1085. A New Jersey Federal judge recently initiated disciplinary proceedings against an attorney who allegedly took advantage of class-action procedures to earn millions of dollars from the operation of a "virtual shareholder litigation factory." Jonathan M. Moses, *Lawyer Give to Filing Shareholder Lawsuits Comes Under Scrutiny*, Wall St. J., Cot. 28, 1992, § A at 1 (Midwest ed.).

50. See EASTERBROOK & FISCHER, *supra* note 18, at 98-99 (describing courts' inability to rectify "shortcomings in the boardroom" and concluding that while the threat of civil liability may deter "large, one-shot frauds," it is ineffective as a deterrent to negligent conduct); Richard W. Duesenberg, *The Business Judgment Rule and Shareholder Derivative Suits: A View from the Inside*, 60 WASH. U. L.Q. 311, 331-33 (1982) (contending that cultural and professional values, rather than the threat of shareholder suits, motivate directors to perform effectively and maximize shareholder interests).

51. Duesenberg, *supra* note 50, at 332 (describing expense of litigation, injury to organizational morale, and diversion of management's "time and talent" as the negative impact shareholder suits have on profitable operation of the corporation and, ultimately, on the value of the shareholders' investment).

52. Courts' reluctance to second-guess the decisions of a corporation's board of directors stems from the "cardinal precept . . . that directors, rather than shareholders, manage the business and affairs of the corporation." Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984). Thus, "the business judgment rule is an acknowledgment of the managerial prerogatives" of corporate directors. *Id.* at 812. See also *Paramount Communications, Inc. v. Time, Inc.* [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514 (Del. Ch. July 14, 1989) (stating that the court will not interfere with board's decision, even when majority of shareholders oppose decision, "because directors, not shareholders, are charged with the duty to manage" the corporation).

53. The business judgment rule in English common law can be traced to a 1742 case, *Charitable Corp. v. Sutton*, 2 Eng. Rep. 400, 404 (1742). Bartley A. Brennan, *Current Developments Surrounding the Business Judgment Rule: A "Race to the Bottom" Theory of Corporation Law Revived*, 12 WHITTIER L. REV. 299, 301 & n.6 (1991). The Louisiana Supreme Court was the first American

presumes that directors of a corporation make business decisions "on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company."⁵⁴ Thus, the court will respect the judgment of the board of directors, unless the party challenging the board's decision can establish facts which rebut the presumption that the directors made a good faith decision.⁵⁵ This is an extremely difficult task.

In *Aronson v. Lewis*,⁵⁶ the Delaware Supreme Court stated two principles which govern the application of the business judgment rule. First, the business judgment rule does not protect a director who has breached the duty of loyalty; only disinterested directors can claim the protection of the rule.⁵⁷ Directors who appear on both sides of a transaction or who expect any personal gain from the challenged decision cannot seek the benefit of the business judgment rule's presumption that they acted in good faith.⁵⁸ Second, the court will only use the business judgment rule to protect

court to set out the business judgment rule as a principle of corporate law. *Id.* at 301. The Rhode Island Supreme Court's statement of the business judgment rule in 1853 is strikingly similar to the understanding of the rule today: "a board of directors acting in good faith and with reasonable care and diligence who nevertheless falls into mistake . . . [is] not liable for the consequences of such a mistake." *Id.*, citing *Hodges v. New England Screw Co.*, 3 R.I. 9, 18 (1853).

Illinois courts have interpreted the business judgment rule in three leading cases. See *Shlensky v. Wrigley*, 237 N.E.2d 776, 781 (Ill. App. 1968) (stating that "the courts cannot require [directors] to forego their judgment" and "follow the lead of other corporations in the field" absent a "clear showing of dereliction of duty" on the part of the directors); *Romanik v. Lurie Home Supply Center, Inc.*, 435 N.E.2d 712, 722 (Ill. App. 1982) (holding that "a director will not be held liable for mere errors in judgment as long as decision does not involve fraud, illegality, or conflict of interest"); *Fields v. Sax*, 462 N.E.2d 983, 986 (Ill. App. 1984) (noting that when actions are corporate decisions "which fall within the purview of the business judgment rule," the court has no authority to "substitute its judgment for the lawful decisions of the directors").

54. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

55. *Id.* (demonstrating that courts will respect the decision of a board of directors unless plaintiffs can show that the directors abused their discretion by violating either their duty of care or their duty of loyalty).

56. 473 A.2d 805 (Del. 1984).

57. *Id.* at 812 (stating that if directors will enjoy a "personal financial benefit" which will not "devolve upon the corporation or all stockholders generally," the court will consider them "interested" directors and will not presume that the interested directors acted in the best interest of the corporation). See also *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939) (stating that directors' fiduciary relationship to the corporation and to its shareholders demands that directors not "use their position . . . to further their private interests" at the expense of the corporation).

58. *Aronson*, 473 A.2d at 812. (illustrating that courts will not apply the business judgment rule to a decision which confers a personal benefit on interested directors, unless the decision was approved by a majority of directors who did not benefit from the decision). See also Thomas A. D'Ambrosio, Note, *The Duty of Care and the Duty of Loyalty in the Revised Model Business Corporation Act*, 40 VAND. L. REV. 663, 687-88 (1987) (discussing the question of the burden of proof once a disinterested board has approved a decision made by interested directors and arguing that the burden of proving that the decision

an informed decision.⁵⁹ Directors who seek the business judgment rule's protection, therefore, have a duty to be well-informed.⁶⁰ Prior to making a decision, directors must take into account all material information reasonably available to them.⁶¹ Once they have obtained and considered the information, the directors must "act with requisite care in the discharge of their duties."⁶² The *Aronson* court established the Delaware standard of care under the business judgment rule as gross negligence.⁶³ Therefore, in order to prevail in a suit, shareholders are required to plead and prove gross negligence on the part of directors who allegedly failed to exercise their fiduciary duty of care. Directors whose actions constitute ordinary negligence are protected by the business judgment rule.⁶⁴

should not be protected by the business judgment rule should shift back to the party attacking the transaction).

59. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (directors have "a duty to inform themselves" prior to making a decision).

60. *Id.* See also Melvin A. Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. PITT. L. REV. 945, 958-59 (1990) [hereinafter Eisenberg, *The Duty of Care*] (discussing the conditions for the application of the business judgment rule and describing the following considerations which determine whether a director has "reasonably informed himself" prior to making a decision: "[the] scale of the decision, [the] time available to make it, the cost involved, and the confidence the director . . . can reasonably have in analyses and recommendations of subordinates").

61. *Aronson*, 473 A.2d at 812. See also Eisenberg, *The Duty of Care*, *supra* note 60, at 958-59 (discussing the amount of time the directors had to make a decision as a factor in determining whether the directors took into account information "reasonably available" and suggesting that directors "compelled . . . to act in a matter of hours" may meet the standard on the basis of less inquiry than would be required if several weeks were available for inquiry).

62. *Aronson*, 473 A.2d at 812. The degree of care required varies widely. FEUER, *supra* note 42, at 29-30. The standard applied ranges from "that degree of care an ordinarily prudent person would exercise in managing his own affairs" to a standard under which directors "will be liable only for 'gross negligence.'" *Id.* At the furthest extreme, some courts have held that directors are not liable for failure to exercise requisite care, "unless they are guilty of 'actual or constructive fraud.'" *Id.*

63. *Aronson*, 473 A.2d at 812. In a footnote to the opinion, the *Aronson* court observed that despite the fact that the "standard by which the exercise of business judgment is governed" has been articulated in varying language in Delaware cases, "a long line of Delaware cases holds that director liability is predicated on a standard which is less exacting than simple negligence." *Id.* at 812 n.6. As examples of the standards used, the *Aronson* court cited *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971) ("fraud or gross over-reaching"); *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883, 887 (Del. 1970) ("gross and palpable over-reaching"); *Warshaw v. Calhoun*, 221 A.2d 487, 492-93 (Del. 1966) ("bad faith . . . or a gross abuse of discretion"); *Moskowitz v. Bantrell*, 190 A.2d 749, 750 (Del. 1963) ("fraud or gross abuse of discretion"); *Penn Mart Realty v. Becker*, 298 A.2d 349, 351 (Del. Ch. 1972) ("grossly negligent"); *Kors v. Carey*, 158 A.2d 136, 140 (Del. Ch. 1960) ("fraud, misconduct or abuse of discretion"); and *Allaun v. Consol. Oil Co.*, 147 A.2d 257, 261 (Del. Ch. 1929) ("reckless indifference to or a deliberate disregard of the stockholders"). *Aronson*, 473 A.2d at 812 n.6.

64. See *McMurray*, *supra* note 41, at 615 (describing protection of business judgement rule for "acts short of gross negligence or fraud").

Given the presumption in favor of the validity of directors' decisions, few shareholders in any jurisdiction succeeded in suits against directors for a breach of the duty of care.⁶⁵ Indeed, as one critic has described it, trying to find cases in which shareholders have successfully sued directors of industrial corporations for negligence is like looking for "a very small number of needles in a very large haystack."⁶⁶ Thus, the application of the business judgment rule reinforced the effect of 19th century corporate governance structure and prevented shareholders from exerting control over the corporation. Part C will examine a major change in corporate governance that offered shareholders a new way to protect their interests.

C. *Outside Directors as Representatives of Shareholder Interests*

In the mid-1970s, in response to the threat that the federal government might preempt state regulation of corporations, the legal profession proposed changes in corporate governance that would address the problem of corporate control.⁶⁷ Specifically, the Committee on Corporate Laws of the American Bar Association's Section on Corporation, Banking, and Business Law redefined the role of the board of directors set forth in the Revised Model Business Corporation Act ("RMBCA") to reflect the reality that the board oversees, rather than manages, the corporation.⁶⁸ In the *Corporate Director's Guidebook*, published in 1978, the Committee on Corporate Laws defined important new responsibilities for outside directors who were to serve explicitly as independent monitors of the board of directors and as representatives of the interests of the shareholders and recommended that the majority of a corporation's board be made up of outside directors.⁶⁹ The new definitions of the board of directors and the role of the outside directors reflects the

65. Thomas C. Lee, *Limiting Corporate Directors' Liability: Delaware's Section 102(b)(7) and the Erosion of the Directors' Duty of Care*, 136 U. PA. L. REV. 239, 240 (1987) (discussing the paucity of cases in which directors were found liable solely on negligence grounds and concluding that the duty of care is a doctrine "whose bark is worse than its bite").

66. Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968). See also Thomas Lee Hazen, *Corporate Directors' Accountability: The Race to the Bottom - The Second Lap*, 66 N.C. L. REV. 171, 171 n.5 (1987) (describing as "only a handful" the number of cases holding directors accountable for breach of duty of care "in situations not raising questions of divided loyalty" and finding only six such instances "since the inception of American corporate law").

67. Eisenberg, *The Modernization of Corporate Law*, *supra* note 19, at 209-11.

68. See *Guidebook*, *supra* note 4, at 1606-07.

69. See *id.* at 1623-25.

reality of the modern corporation.⁷⁰

The RMBCA recognizes that the board of directors no longer directly manages the affairs of large, publicly-held corporations.⁷¹ Rather, the role of the board of directors is to review and monitor the performance of management.⁷² The special role of the outside director is to serve as an independent, disinterested monitor who can maintain an arm's-length relationship with inside directors and other members of management.⁷³

70. See Eisenberg, *The Modernization of Corporate Law*, *supra* note 19, at 205 (describing the primary functions of a modern board of directors as selecting chief executive officer and other top managers and monitoring their overall conduct of the corporation, rather than actually managing the day-to-day business of the corporation).

71. Under the Model Business Corporation Act, the board of directors *exercised* all corporate powers and *managed* the business and affairs of the corporation. MODEL BUSINESS CORP. ACT § 8.01(b) (1950) (emphasis added). By contrast, the Revised Model Business Corporation Act provides for alternative management roles for the board of directors. RMBCA § 8.01(b) (1991). Under the revised section, the board may still exercise corporate powers and manage the corporation directly. *Id.* However, the revision also provides for an alternative situation in which the board oversees, rather than manages, the corporation. See RMBCA § 8.01(b) (1991). Thus, corporate powers may be exercised "under the authority of" the board and the corporation's business and affairs may be "managed under the direction of" the board of directors. *Id.* (emphasis added).

The revised section 8.01(b) codifies the expectation that directors of large, publicly-held corporations will not participate in the day-to-day management of the corporation. See *Guidebook*, *supra* note 4, at 1607. Although directors may still initiate policy, for the most part, management will develop and implement basic corporate objectives which the board will review and evaluate. *Id.* at 1606-07.

72. The primary function of the board is to select the key members of the management team and then to monitor and oversee their performance. Eisenberg, *The Modernization of Corporate Law*, *supra* note 19, at 205. The board should continually assess the efficiency of management. *Id.* In addition, the board should be alert to whether management is running the corporation in accordance with the standards of law and ethics. *Id.*

The outside directors of General Motors Corporation recently demonstrated their power to effect change in management on behalf of the shareholders. Steve Lohr, *Party Seems Over For Chief Executives*, INT'L HERALD TRIB., Apr. 13, 1992, § 1, at 1. The outside directors ousted General Motors' chairman and chief executive officer, Robert Stempel, from his position as head of the executive committee of the General Motors board and replaced him with an outside director. *Id.* Lohr described this action as an example of the growing power and independence of outside directors as watchdogs over management on behalf of shareholders. *Id.* On October 26, 1992, Robert Stempel resigned from the position of chairman and chief executive officer of General Motors in response to continued pressure from GM outside directors. Jim Mateja and Stephen Franklin, *Boardroom Coup at GM*, CHI. TRIB., Oct. 27, 1992, s.1, at 1. See also Nancy Ryan, *New Assertiveness Challenges "Pet Rock", Rubber Stamp Images*, CHI. TRIB., Oct. 28, 1992, s.3, at 1 (describing Stempel resignation as evidence that the higher percentage of outside directors had led to a new assertiveness on the part of corporate boards).

73. Commentators disagree regarding the appropriate stance of the outside director with respect to inside directors and management. For example, according to the American Bar Association, the outside director functions as a monitor

The importance of the disinterested outside director is most apparent in change of ownership situations, such as proposed takeovers.⁷⁴ In these situations, the interests of inside directors, who seek to protect their jobs, are most likely to come into conflict with the interests of shareholders, who seek the highest price for their shares of stock. By contrast, outside directors, whose livelihoods are not at stake, can assess the situation in a disinterested way and can act to protect shareholders' interests in maximizing profits. Even when the ownership of the corporation is not at stake, the disinterested outside director is in a better position than inside directors to protect shareholder interests in at least three ongoing functions of the board: auditing financial reports of management's performance, determining the compensation paid to management, and identifying nominees for positions on the board of directors.⁷⁵ In all three areas, inside directors' interests are likely to conflict with the interests of shareholders. Because the possibility of conflict of interest is great, shareholders are better served when

"in an environment of loyal but independent oversight" and "in a framework of collaborative support to operating management." *Guidebook, supra* note 4, at 1621. A less congenial approach regards the outside directors' power to oust management as the basis for outside directors to "goad" managers to effectively maximize shareholder profits and to insure management integrity in the division of "corporate assets between themselves and stockholders." Victor Brudney, *The Independent Director - Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 602 (1982). The Securities and Exchange Commission appears to see the relationship between the outside director and management as an almost adversarial one. See Morgan E. Shipman, *Role of Outside Director Distinguished from that of Inside Director*, in DUTIES AND RESPONSIBILITIES OF OUTSIDE DIRECTORS 41, 52-54 (Avery S. Cohen & Ronald M. Loeb eds., 1978) (describing the SEC's delineation of outside directors' duties as a "very demanding arms-length standard").

74. The Delaware Supreme Court has described the special difficulty involved in the takeover bid as "the omnipresent specter" that inside directors, faced with a threat to their control of the corporation, may act in their own interests rather than in the interests of the corporation and its shareholders. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985). Similarly, the interest of an ineffective or incapacitated chief executive officer who seeks to maintain his position is in direct conflict with shareholders' interest in having the corporation run by the most talented and capable person available. See Pease, *supra* note 4, at 33-34. Because there is an inherent conflict of interest in the decision to replace an officer or to select new corporate officers or managers, outside directors should play a central role in these processes. *Guidebook, supra* note 4, at 1625.

75. The audit committee recommends the firm which will serve as the corporation's outside auditor, consults with that firm on the plan for the audit, reviews the audit report and consults periodically with the auditors regarding the adequacy of internal financial control procedures. *Guidebook, supra* note 4, at 1626. The compensation committee recommends to the board the compensation to be paid to the corporation's senior management. *Id.* The nominating committee recommends to the board persons to fill board vacancies. *Id.* As part of the nominating process, the committee should solicit recommendations from shareholders. *Id.*

outside, rather than inside, directors are responsible for the board committees on auditing, compensation, and nominations.

The courts, the Securities and Exchange Commission, and the New York Stock Exchange have all recognized the importance of the role played by disinterested outside directors. Courts have recognized outside directors' special role by according "enhanced" validity to decisions made by boards comprised of a majority of outside directors.⁷⁶ The Securities and Exchange Commission has demonstrated its confidence in the role of outside directors by ordering a corporation to add outside directors to its board to oversee the corporation's financial reporting and to settle conflict of interest claims brought against the corporation's inside directors, officers, and employees.⁷⁷ The New York Stock Exchange underscores the importance of outside directors by requiring all corporations whose shares are traded on the Exchange to have at least two outside directors and to have an audit committee comprised of outside directors.⁷⁸

Corporations have also recognized the value of outside direc-

76. Especially in takeover situations, the presence of outside directors on the board and their active involvement in the decision-making process often persuades the court that the board's decision was the product of reasonable investigation and was not colored by self-interest. See *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (stating that the inference that a board had reasonable grounds for purchasing shares with corporate funds was "materially enhanced" if the board had a majority of outside directors). See also *Panter v. Marshall Field & Co.* 646 F.2d 271, 295 (7th Cir. 1981) (observing that when a board acts to prevent a takeover, the presumption of good faith is heightened if the majority of the board is comprised of independent outside directors); *Polk v. Good*, 507 A.2d 531, 537 (Del. 1986) (stating that the presence of 10 outside directors on board of directors plus the advice of an investment banker and an attorney constituted a *prima facie* showing of good faith and reasonable investigation); *Puma v. Marriott*, 283 A.2d 693, 696 (Del. 1971) (holding that the court will not substitute its opinion of valuation of stock for the opinion of "experienced, independent board members").

The presumption of good faith may be denied when the majority of the board is not comprised of independent outside directors. See *Revlon v. MacAndrews & Forbes Holdings*, 506 A.2d 173, 176 n.3 (Del. 1986) (refusing to accord the presumption of good faith that generally attaches to decisions by boards having a majority of "truly independent directors" to a board where six of the 14 members were senior managers of the company, two others held significant amounts of the company's stock, and four had business relationships with the company).

77. See *SEC v. Mattel, Inc.*, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,754 (D.D.C. Aug. 8, 1974).

78. Companies which seek to be listed on the New York Stock Exchange must have a minimum of two outside directors. Pease, *supra* note 4, at 30. In addition, as a condition of continued listing on the Exchange, a company must have an audit committee "composed of one or more directors who are independent of management" and in a position to exercise independent judgment. *Id.* See also *BISHOP*, *infra* note 79, § 1.03 at 7 (specifying that audit committee must be composed entirely of outside directors to comply with New York Stock Exchange requirement).

tors.⁷⁹ A 1986 survey revealed that the average board of directors was comprised of ten outside directors and four inside directors.⁸⁰ In 1991, the survey showed that the average board included nine outside directors and three inside directors.⁸¹ From the shareholders' point of view, the outside directors who monitor the performance of management on an ongoing basis provide a valuable check and balance device which helps to represent the interests of the shareholder.⁸²

II. THE 1985-1990 DIRECTORS' LIABILITY CRISIS

In 1984, outside corporate directors could feel certain that the business judgment rule would protect them against personal liability for business decisions which ultimately proved erroneous.⁸³ Moreover, the availability of director and officer liability insurance provided assurance that even if directors were held liable for a breach of their fiduciary duty, they would not be forced to pay damages from their own resources.⁸⁴ However, by the mid-1980s, in an economic environment shaped by rapidly increasing merger and acquisition activity, these certainties were swept away by judicial decisions that undermined the security provided by the business judgment rule.⁸⁵ The resulting directors' liability crisis became a

79. Outside directors now constitute the majority on the boards of most publicly-held corporations and virtually no publicly-held corporation has a board made up entirely of inside directors. JOSEPH BISHOP, JR., *LAW OF CORPORATE OFFICERS AND DIRECTORS: INDEMNIFICATION AND INSURANCE* § 1.03 at 7 (1988).

80. KORN/FERRY INTERNATIONAL, BOARD OF DIRECTORS' THIRTEENTH ANNUAL STUDY 4, 13 (Feb. 1986), *cited in* Pease, *supra* note 4, at 35.

81. KORN/FERRY INTERNATIONAL, BOARD OF DIRECTORS' EIGHTEENTH ANNUAL STUDY 5, 15 (June 1991).

82. For an argument challenging the effectiveness of outside directors as representatives of shareholders' interests, see MONKS & MINOW, *supra* note 31, at 73-107.

83. See e.g. Harvey Gelb, *Director Due Care Liability: An Assessment of the New Statutes*, 61 TEMP. L. REV. 13, 14-17 (1988) (describing business rule as one reason prospective corporate directors could feel confident that directors would not be held liable for violations of the duty of care).

84. State corporation statutes may permit corporations to indemnify corporate directors for expenses and liabilities they incur in connection with corporate duties. Karen L. Chapman, Note, *Statutory Responses To Boardroom Fears*, 1987 COLUM. BUS. L. REV. 749, 751 (1987). Corporations purchase director and officer liability insurance to reimburse the corporation for indemnification costs it pays to its officers and directors. *Id.* Corporations can also buy a type of director and officer insurance to pay liability amounts for which directors and officers are not indemnified. *Id.*

85. See Mark A. Sargent, *Two Cheers for the Maryland Director and Officer Liability Statute*, 18 BALT. L. REV. 278, 294 (1989) (describing uncertainty generated by *Van Gorkom* and other decisions that "appeared to erode fundamental tenets and to increase the risk that duty of care claims would go to the jury" and arguing that this uncertainty led to the realization that courts could force further change, making the future unpredictable); Stephen A. Radin, *The Di-*

dominant concern in corporate law for the next five years.⁸⁶

Beginning in 1985, the Delaware Supreme Court created substantial uncertainty by handing down a series of opinions which appeared to significantly change the application of the business judgment rule.⁸⁷ All the cases involved shareholder challenges to corporate takeovers.⁸⁸ Undoubtedly, the most notable of these

rector's Duty of Care Three Years After Smith v. Van Gorkom, 39 HASTINGS L.J. 707, 707 (1988) (describing the *Van Gorkom* court's refusal to accord directors the protection of the business judgment rule as a shock to the corporate world that provoked extensive commentary in both general media and law journals, much of which predicted "dire consequences"); Gelb, *supra* note 83 at 23 (discussing several recent developments which produced particularly deep anxieties about serving on a board of directors and describing *Van Gorkom* as "one of the most traumatic of the developments"); Kristin A. Linsley, Comment, *Statutory Limitations on Directors' Liability in Delaware: A New Look at Conflicts of Interest and the Business Judgment Rule*, 24 HARV. J. ON LEGIS. 527, 527 (1987) (describing *Van Gorkom* as "blowing a hole in" the business judgment rule, which had long been corporate directors' primary shield from liability, and thereby sending a "shockwave across corporate America"); R. Link Newcomb, Note, *The Limitation of Directors' Liability: A Proposal For Legislative Reform*, 66 TEX. L. REV. 411, 411-12 (1987) (describing the difficulty corporations had in retaining outside directors after *Van Gorkom* and noting that fear of liability was the primary reason that directors resigned from the boards of several major corporations); Lynne A. Whited, Note, *Corporate Directors - An Endangered Species? A More Reasonable Standard for Director and Officer Liability in Illinois*, 1987 U. ILL. L. REV. 495, 502 (1987) (describing *Van Gorkom* as sending a "strong message to corporate directors that the business judgment rule was no longer an impenetrable shield"); Jonathan W. Groessl, *Delaware's New Section 102(b)(7): Boon or Bane for Corporate Directors?*, 37 DEPAUL L. REV. 411, 429 (1988) (describing three factors which made corporations less likely to attract qualified outside directors: a decline in the scope and availability of director and officer liability insurance, the willingness of courts to impose personal liability on directors, and a volatile environment in which directors faced an increased likelihood of litigation).

86. Concern with directors' liability was not confined to the legal community. Business publications carried many articles on the directors' liability crisis. Groessl, *supra* note 85, at 429, nn.122, 125, citing Laurie Baumahrons, *The Job Nobody Wants*, BUS. WK., Sept. 8, 1986, at 56; *Business Struggles to Adapt as Insurance Crisis Spreads*, WALL ST. J., Jan. 21, 1986, at 31; *Director Insurance Drying Up*, WALL ST. J., Mar. 7, 1986, at 1; *Insurers Beginning to Refuse Coverage on Directors and Officers in Takeover Cases*, WALL ST. J., Jan. 20, 1986, at 3; *Liability Insurance is Difficult to Find Now for Directors*, WALL ST. J., July 10, 1985, at 10.

87. See *supra* note 85 for a discussion of the perception that courts' interpretations of the business judgment rule in *Van Gorkom* and other cases would mean greater liability exposure for corporate directors.

88. *Smith v. Van Gorkom*, 488 A.2d 858, 863 (Del. 1985); *MacAndrews & Forbes Inc. v. Revlon, Inc.*, 506 A.2d 173 (Del. 1986) (finding that directors' decision to enter a "lock-up" agreement with a potential buyer of the corporation breached fiduciary duty and requiring directors to hold an auction to obtain the highest price for company, once the sale of the company had become inevitable); *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (recognizing an "enhanced duty" for directors adopting a defensive mechanism in a takeover context and imposing a two-prong test whereby directors seeking the protection of the business judgment rule must show reasonable grounds for believing the company was endangered and that the defensive mechanism they adopted was reasonable in relation to the threat posed).

cases was *Smith v. Van Gorkom*,⁸⁹ in which the Delaware Supreme Court held directors of Trans-Union Corporation personally liable to the Trans-Union shareholders for \$23.5 million in monetary damages.⁹⁰ Apparently following the standard enunciated in *Aronson*, the *Van Gorkom* court found the directors of Trans-Union grossly negligent for approving the sale of the company to Jay Pritzker's Marmon Group after deliberating for only two hours, without ever seeing the actual Merger Agreement, and without establishing a value for the company or its shares.⁹¹ The court based its conclusion solely on the process the directors used to make the decision, not on the substance of the decision.⁹² The court found the directors' decision-making process inadequate.⁹³ Therefore, the court did not consider the directors' decision an "informed decision" and thus, the court did not afford the protection of the business judgment rule to the decision.⁹⁴

The award of monetary damages in *Van Gorkom* represented a striking departure from the court's traditional reluctance to find directors liable for duty of care violations.⁹⁵ In fact, the *Van Gorkom* court stated explicitly that the decision rested *solely* on the conclusion that the directors had violated their fiduciary duty of care, rather than their duty of loyalty.⁹⁶ Indeed, the court observed that the plaintiff shareholders never alleged that the directors' actions constituted "fraud, bad faith, or self-dealing," *i.e.*, violation of the duty of loyalty.⁹⁷ Essentially, the court presumed that the directors had made the decision to sell the company in good faith and never

89. 488 A.2d 858 (Del. 1985).

90. The court set as the measure of damages "the extent that the fair market value of Trans-Union exceeds [the sale price of] \$55 per share." *Id.* at 893. Ultimately, the parties reached an out-of-court settlement with the approval of the Delaware Chancery Court. HAMILTON, CORPORATIONS, *supra* note 25, at 679 n.14. Under the terms of the settlement, the directors of Trans-Union paid damages of \$23.5 million. *Id.* Of this amount, \$10 million was provided through the defendants' director and officer liability insurance. *Id.* According to rumor, the bulk of the balance of the settlement fund was provided by the Pritzkers, the purchasers of Trans-Union. *Id.*

91. *Smith v. Van Gorkom*, 488 A.2d 858, 874 (Del. 1985). See *supra* notes 56-64 and accompanying text for a discussion of *Aronson*.

92. See *infra* note 101 and accompanying text for a discussion of the *Van Gorkom* court's scrutiny of the decision-making *process* rather than the *substance* of the directors' business decision.

93. *Van Gorkom*, 488 A.2d at 878.

94. *Id.* at 888. As the Delaware Supreme Court stated in *Aronson*, the court will apply the business judgment rule only to informed decisions. See *supra* notes 59-61 and accompanying text for a discussion of the requirement that directors inform themselves prior to making a decision.

95. See *supra* notes 65-66, at 240 (discussing the extremely limited number of cases in which courts have found corporate directors liable for violations of the duty of care in the absence of violations of the duty of loyalty).

96. *Van Gorkom*, 488 A.2d at 873.

97. *Id.*

inquired into the directors' motives.⁹⁸ The *Van Gorkom* court's focus on the directors' duty of care, rather than their duty of loyalty, represented a sharp break from the traditional application of the business judgment rule.

Ostensibly, *Van Gorkom* did not change the business judgment rule or the directors' standard of care stated one year earlier in *Aronson*.⁹⁹ In fact, the *Van Gorkom* court cited *Aronson* when it stated that the plaintiff has the burden of overcoming the presumption that the directors' decision is an informed decision.¹⁰⁰ However, by subjecting the directors' decision-making process to painstakingly close scrutiny and concluding that the directors had forfeited the protection of the business judgment rule because *the process* itself was flawed, the *Van Gorkom* court, in effect, established a new standard.¹⁰¹ Under the new *Van Gorkom* standard, courts must examine the decision-making process in great detail to determine whether the directors adequately informed themselves.¹⁰² The *Van Gorkom* decision created the perception among the business and legal communities that directors could no longer assume they would be protected under the business judgment rule.

This closer judicial scrutiny of directors' decisions came at a time when corporate directors were increasingly called upon to decide questions involving multi-billion dollar mergers and acquisitions.¹⁰³ They also coincided with, and aggravated, the growing

98. *Id.* at 872-73.

99. Indeed, the *Van Gorkom* court repeatedly cited *Aronson* regarding the business judgment rule and the standard of care. *See, e.g., Van Gorkom*, 488 A.2d at 872-73 (describing the business judgment rule as a presumption that directors "acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company" and describing the applicable standard of care as "gross negligence").

100. *Van Gorkom*, 488 A.2d at 872.

101. In 1989, the Delaware Chancery Court described the new standard of director due care which courts had used since *Van Gorkom*. *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 56 (Del. 1989). The focus of the court's due care examination is the board's decision-making process. *Id.* The court must seek evidence that the board acted in a "deliberate and knowledgeable way" in finding and pursuing alternatives. *Id.* In making a decision, a board cannot rely solely on "hired experts" and management. *Id.* The Delaware Chancery Court identified three elements which the court must examine when reviewing the applicability of the business judgement rule: the board's objective financial interests, i.e., its independence; the board's subjective motivations, i.e., its good faith; and *the process by which it reached its decision, i.e., its due care* (emphasis added). *In re RJR Nabisco, Inc. Shareholders' Litigation*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, 91,700, 91,709 (Del. Ch. Jan. 31, 1989).

102. *See supra* note 101 for a discussion of the *Van Gorkom* standard.

103. *See* RUKEYSER, *supra* note 17, at 244 (showing total merger and acquisition activity from 1980 to 1990 and total leveraged buyout activity from 1980 to 1990).

crisis in the availability of directors' liability insurance.¹⁰⁴ Insurers, fearing an increase in liability exposure, either refused to provide coverage for corporate directors or provided insurance at sharply increased premiums over 1984 rates.¹⁰⁵

The award of monetary damages in *Van Gorkom* triggered a national panic among directors and prospective directors.¹⁰⁶ Their concerns were two-fold. First, corporate managers, the corporate bar, and commentators feared that qualified persons would refuse to serve as outside corporate directors rather than expose themselves to the possibility of personal liability.¹⁰⁷ Second, these same parties contended that even if qualified persons agreed to serve as directors, they would react to the threat of personal liability by making overly conservative, risk-averse decisions that would ultimately be harmful to the interests of the corporation.¹⁰⁸ These concerns led the Delaware legislature to enact its director liability statute.¹⁰⁹

104. R. Franklin Balotti & Mark J. Gentile, *Elimination or Limitation of Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5, 6 (1987). For a discussion of the crisis in the availability of director and officer liability insurance and the impact of *Van Gorkom* and its progeny on the insurance crisis, see Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis*, 39 EMORY L.J. 1155, 1158-60 (1989) [hereinafter Romano, *Corporate Governance*] (discussing increases in the demand for director and officer (D & O) liability insurance, the number of lawsuits against corporate boards, and the costs of claims against directors as factors which contributed to the insurance crisis and describing *Van Gorkom* as an example of "the legal uncertainty" that contributed to the crisis by making it difficult for insurers to predict their potential losses); Roberta Romano, *What Went Wrong with Directors' and Officers' Liability Insurance?*, 14 DEL. J. CORP. L. 1 (1989) [hereinafter Romano, *What Went Wrong?*] (discussing in great detail the factors within the insurance industry that led to the insurance crisis, such as the limited number of companies in the D & O market; the dramatic shifts in market share among insurers; and a peak in the competitive cycle in the mid-1980s, and showing how judicial decisions altered allocation of risk, thereby further aggravating the situation by reducing predictability); Sara Slaughter, Comment, *Statutory and Non-Statutory Responses to the Director and Officer Liability Insurance Crisis*, 63 IND. L.J. 181 (1987-88) (describing the insurance crisis, the adoption of new indemnification statutes by various states, and the measures adopted by corporations to cope with the insurance crisis).

105. See Romano, *What Went Wrong?*, *supra* note 104, at 1-2.

106. See, e.g., English, *supra* note 42, at 2.

107. See Balotti & Gentile, *supra* note 104, at 6-9.

108. See, e.g., *Secretary Edgar's Business Corporation Act Advisory Committee on Proposed Changes Regarding Director and Officer Liability Requests Comments*, ISBA CORP. & SEC., Oct. 1986, at 1.

109. The legislative intent behind Section 102(b)(7) of the Delaware Code is stated explicitly in the legislative synopsis to the statute. The synopsis states in pertinent part that section 102(b)(7) is a "legislative response to recent changes in the market for directors' liability insurance" which have "threatened the quality and stability of the governance of Delaware corporations because directors have become unwilling . . . to serve without the protection which such insurance provides and . . . may be deterred by the unavailability of such insurance from making entrepreneurial decisions." Synopsis to DEL. CODE ANN. tit. 8, § 102(b)(7), *reprinted in* Pease, *supra* note 4,

III.: THE DELAWARE DIRECTOR LIABILITY STATUTE

A. Delaware's Section 102(b)(7)

In 1985, the Delaware State Bar Association formed a committee to propose measures to alleviate the director liability crisis and to counteract the perception that serving on a corporate board of directors exposed directors to enormous liability.¹¹⁰ After studying several possible approaches to the problem,¹¹¹ the committee drafted an amendment to Section 102 of the Delaware General Corporation Act.¹¹² The amendment, hereinafter referred to as Section 102(b)(7), would enable Delaware corporations to include in their certificate of incorporation, either initially or by amendment, a provision which would eliminate or limit director liability for breach of the fiduciary duty of care.¹¹³ The Council of the Corporate Law Section of the Delaware State Bar Association proposed the amendment, which was approved by section members on May 14, 1986.¹¹⁴ The bill was introduced and passed by both the House and Senate

app. at 101-02. The synopsis concludes that section 102(b)(7) is intended "to allow Delaware corporations to provide substitute protection . . . to their directors and to limit director liability under certain circumstances." *Id.*

110. Groessl, *supra* note 85, at 429 (describing the formation of the Delaware State Bar Association committee to develop a response to the director liability crisis).

111. The committee first considered a bill that would approach the problem by greatly expanding the power of Delaware corporations to provide indemnification for their directors and officers. Groessl, *supra* note 85, at 429.

112. Ultimately, the committee drafted the bill which became section 102(b)(7), because they considered it to be a "more direct approach" to the problem which would "fit well within the traditional enabling character of section 102." Groessl, *supra* note 85, at 430-31.

113. The statute amends Article 8 of the Delaware General Corporation Act and provides in pertinent part as follows:

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters: . . .

(7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director

(i) For any breach of the director's duty of loyalty to the corporation or its stockholders,

(ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law,

(iii) under § 174 of this title; or

(iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. All references in this paragraph to a director shall also be deemed to refer to a member of the governing body of a corporation which is not authorized to issue capital stock.

DEL. CODE ANN., tit. 8, § 102(b)(7)(1986).

114. Pease, *supra* note 4, at 90.

and signed into law within three days.¹¹⁵ The new provision became effective on July 1, 1986.¹¹⁶

115. Groessl, *supra* note 85, at 441 n.190.

116. *Id.* Since Delaware adopted section 102(b)(7), 35 other states have enacted statutes which follow the Delaware "permissive" charter option model, enabling corporations to include a director liability provision in their articles of incorporation. The following director liability statutes are similar in form to Section 102(b)(7): ALASKA STAT. § 10.06.480 (1990); ARIZ. REV. STAT. ANN. § 10-54(A)(9)(1990); ARK. CODE ANN. § 4-27-202(B)(3) (Michie Supp. 1987); CAL. CORP. CODE §§ 204(a)(10), 204.5 (West Supp. 1990); COLO. REV. STAT. ANN. § 7-3-101(1)(u) (West Supp. 1989); GA. CODE ANN. § 14-2-202(b)(4) (Michie 1989); HAW. REV. STAT. § 415-48.5 (Supp. 1989); IDAHO CODE § 30-1-54(2) (Supp. 1989); IOWA CODE ANN. § 490.832 (Special Pamphlet 1990); KAN. STAT. ANN. § 17-6002(b)(8) (1988); KY. REV. STAT. ANN. § 271B-2-020(2)(d) (Baldwin 1989); LA. REV. STAT. ANN. § 12:24(4) (Supp. 1991); MD. CORPS. & ASSNS' CODE ANN. §§ 2-104(b)(8), 405.2 (Supp. 1990); MASS. GEN. L. ch. 156B, § 13(b)(1-1/2) (Supp. 1990); MICH. STAT. ANN. § 21.200(209)(c) (Callaghan 1990); MICH. COMP. LAWS ANN. § 450.1209(c) (1990); MINN. STAT. ANN. § 302A.251(4) (West Supp. 1989-90); MONT. CODE ANN. § 35-1-202(2)(a)(v)(2) (1989); NEB. REV. STAT. § 21-2035(2) (Supp. 1988); NEV. REV. STAT. § 78.037 (Supp. 1989); N.H. REV. STAT. ANN. § 293-A:54(I-a) (Supp. 1989); N.J. REV. STAT. § 14A:2-7(3) (Supp. 1990); N.M. STAT. ANN. § 53-12-2(E) (Michie Supp. 1989); N.Y. BUS. CORP. LAW § 402(b) (McKinney Supp. 1990); OKLA. STAT. ANN. tit. 18, § 1006(B)(7) (West Supp. 1990); OR. REV. STAT. § 60.047(2)(c)(1988); PA. CONS. STAT. ANN. § 8364 (Purdon Supp. 1990) R.I. GEN. LAWS § 7-1.1-48(6) (Supp. 1989); S.D. CODIFIED LAWS ANN. § 47-2-58.8 (Supp. 1990); TENN. CODE ANN. § 48-12-102(b)(3) (1988); TEX. REV. CIV. STAT. ANN. art. 1302-7.06(B) (Vernon Supp. 1990); UTAH CODE ANN. § 16-10-49.1. (Supp. 1990); WASH. REV. CODE § 23B-02-020(5)(i)- § 23B-08-320 (Supp. 1990); WYO. STAT. § 17-16-834 (1989). MARK A. SARGENT, D&O LIABILITY HANDBOOK: LAW - SAMPLE DOCUMENTS - FORMS xiii-xxiv (1991-92) [hereinafter SARGENT, HANDBOOK].

Other states have taken an approach which differs from the Delaware model. Instead of enacting permissive legislation, these states have changed their statutory standards of a director's duty of care or their standards of culpability for breach of the duty of care. See EDWARD BRODSKY & H. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES § 2.05 at 18-20 (1986). The effect of such statutory changes is to make directors' liability protection mandatory. SARGENT, HANDBOOK, *supra* at 12-1 (describing Indiana liability limitation as "self-executing," i.e., the limitation applies automatically, without a vote of shareholders and the corporation may not "opt out of the limitation"). See also Romano, *Corporate Governance, supra* note 104 at 1160 (describing the Indiana statute lowering directors' standard of care as applying "automatically to all firms" incorporated in the state, without giving shareholders of Indiana firms the option of retaining liability for director negligence). As examples of other states' laws, see VA. CODE ANN. § 13.1-690(A) (Michie 1989) (holding directors to their "good faith judgment of the best interests of the corporation," rather than "the care of an ordinarily prudent person"); IND. CODE ANN. § 23-1-35-1(e) (Burns 1989) (retaining the requirement that a director act with the care of an ordinarily prudent person but requiring proof of willful misconduct or recklessness to find a director personally liable for a breach of the duty of care); ME. REV. STAT. ANN. tit. 13, § 716 A (West Supp. 1989) (limiting personal liability unless the director acted dishonestly or not in the "reasonable belief that the action was in or not opposed to the best interests of the corporation or its shareholders"); FLA. STAT. ANN. § 607.0831 (West Supp. 1991) (director will not be held liable for monetary damages in a stockholders' derivative action unless the breach of the duty of care constitutes "conscious disregard for the best interest of the corporation, or willful misconduct"); OHIO REV. CODE ANN. § 1701.59(D) (Page Supp. 1989) (requiring proof by clear and convincing evidence that the director's act or omis-

Section 102(b)(7) permits a corporation to include in its certificate of incorporation a provision eliminating or limiting a director's personal liability to the corporation or its stockholders for monetary damages for breach of the director's duty of care.¹¹⁷ Section 102(b)(7) states explicitly that protection under the statute does not extend to a breach of "the director's duty of loyalty," nor to "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law."¹¹⁸ Nor can the corporation protect a director from liability "for any transaction from which the director derived an improper personal benefit."¹¹⁹

Besides limiting section 102(b)(7) protection to breaches of the directors' duty of care section 102(b)(7) may extend only to monetary damages, not to equitable remedies such as injunction or rescission.¹²⁰ Protection under section 102(b)(7) is also limited to shareholder class action or derivative suits.¹²¹ Thus, it does not eliminate the possibility of monetary damages in actions brought by third parties.¹²²

Section 102(b)(7) applies only to directors.¹²³ It does not provide protection for "officers, employees, or agents of a corporation."¹²⁴ Also, it applies solely to directors acting in their capacity as directors.¹²⁵ Thus, if a person is both legal counsel to a corporation and a director, she is not protected against liability for acts or omissions in her capacity as legal counsel, but only for acts or omis-

sion was "undertaken with reckless disregard for the best interests of the corporation").

117. See *supra* note 109 for a discussion of the legislative intent behind DEL. CODE ANN. tit. 8, § 102(b)(7) (1986).

118. Synopsis to DEL. CODE ANN. tit. 8, § 102(b)((7), *reprinted in* Pease, *supra* note 4, app. at 101-02.

119. *Id.*

120. *Id.* Although equitable remedies may be effective in the context of proxy disputes, elections to the board of directors, removal of directors, or resignation of directors, equitable remedies are only meaningful if stockholders are aware of corporate actions before they have been completed. Balotti & Gentile, *supra* note 104, at 16. Thus, as a practical matter, the unavailability of monetary damages may leave stockholders with "no effective remedy for injury occasioned by the directors' action." *Id.*

121. Balotti & Gentile, *supra* note 104, at 12.

122. *Id.*

123. *Id.* Unlike section 102(b)(7), director liability statutes in several states *do* extend protection against personal liability for monetary damages to officers of the corporation. See KY. REV. STAT. ANN. § 271B.2-020(1)(d) (Baldwin 1989); LA. REV. STAT. ANN. § 12:24(4) (West Supp. 1991); MD. CORPS. & ASSNS' CODE ANN., §§ 2-104(b)(8) and 405.2 (Supp. 1990); NEV. REV. STAT. § 78.037 (Supp. 1989); N.J. REV. STAT. ANN. § 14A:2-7(3) (Supp. 1990) as cited in BRODSKY & ADAMSKI, *supra* note 116, at n.1 (Cum. Supp. 1991).

124. Balotti & Gentile, *supra* note 104, at 12.

125. *Id.*

sions in her capacity as a director.¹²⁶

The enactment of section 102(b)(7) did not automatically protect directors of Delaware corporations because section 102(b)(7) is merely an enabling statute.¹²⁷ Thus, section 102(b)(7) does not mandate that a corporation institute director liability protection.¹²⁸ Rather, it permits a corporation to include a limitation on director liability in its articles of incorporation, either *ab initio* or by amendment.¹²⁹ Moreover, a board of directors that decides to amend the corporation's certificate of incorporation to include a director liability provision must submit the proposed amendment to a vote of the shareholders.¹³⁰

126. *Id.* (describing section 102(b)(7) as not permitting elimination or limitation of monetary damages for officers, employees, or agents of the corporation). See also Brennan, *supra* note 53, at 322 (discussing section 102(b)(7) as applicable only to directors, thus covering director-officers only when they are acting in their capacity as directors).

127. An "enabling" statute permits persons, corporations, or agencies "to do what before they could not;" it confers new powers. BLACK'S LAW DICTIONARY 526 (6th ed. 1990).

128. By contrast, some states have enacted statutes which changed the standard of care required of corporate directors. See *supra* note 116 for a discussion of statutes which limit the liability of directors of *all* domestic corporations, as opposed to statutes which simply *permit* the state's corporations to protect their directors by adopting a director liability provision.

129. See *supra* note 113 for the text of § 102(b)(7).

130. See *supra* note 113 for the text of § 102(b)(7). A corporation may amend its certificate of incorporation by submitting a proposed amendment to a vote of its stockholders at an annual meeting of the corporation or at a special meeting of stockholders. Balotti & Gentile, *supra* note 104, at 21. Alternatively, a corporation may seek approval by written consent of its stockholders under Rule 14-(c)(5) of the Securities Exchange Act of 1934 which was incorporated into Delaware law as section 228 of the General Corporation Law. Balotti & Gentile, *supra* note 104, at 22 & n.60. Balotti and Gentile also observe that director liability provisions may either be written in a form which tracks the statute or in a broader form which limits liability "to the fullest extent permitted by law." *Id.* at 20. They note that amendments which track or mirror the statute are "highly likely" to "withstand judicial scrutiny" and "could require less stringent disclosure in a proxy or registration statement." *Id.* The advantage of the broader formulation is that it automatically incorporates broader protection which may be provided by future legislation. *Id.* at 20-21. If future legislation reduces the protection available under a § 102(b)(7) provision, the reduction would automatically become effective too. *Id.* at 21.

Balotti and Gentile also note that many corporations which have adopted an amendment under § 102(b)(7) have included a provision intended to reduce director uncertainty concerning possible future stockholder action which might reduce the protection provided under the provision. *Id.* at 21. Thus many initial § 102(b)(7) amendments include the following provision: "Any repeal or modification of the foregoing paragraph shall not adversely affect any right or protection of a Director of the Corporation existing hereunder with respect to any act or omission occurring prior to or at the time of such repeal or modification." *Id.* A corporation which is newly incorporating will, of course, not submit a liability provision to a vote of shareholders. Linsley, *supra* note 85, at 533 n.22. In such an instance the provision will be disclosed in the corporation's prospectus. *Id.* The situation is not so clear-cut in the case of a corporation which is reincorporating in Delaware. *Id.* However, since reincorporations are usually

Despite the procedural hurdles to securing protection for directors, Delaware corporations responded enthusiastically to the new director liability statute.¹³¹ Not only did Delaware corporations indicate that they would propose director liability amendments to their stockholders, but many non-Delaware corporations suggested that they might seek reincorporation in Delaware to take advantage of the director liability protection offered by section 102(b)(7).¹³²

Other states responded to section 102(b)(7) by passing similar measures, many of them identical to the Delaware statute.¹³³ In the year following passage of section 102(b)(7), fifteen states passed director liability statutes.¹³⁴ By 1991, forty-one states had adopted statutes intended to protect directors from liability for monetary damages.¹³⁵ Illinois, however, has not yet adopted a director liability statute, despite the efforts of the Illinois corporate bar to en-

the result of a merger, a shareholder vote on the merger itself will provide shareholders the opportunity to vote on whether the articles of incorporation shall include a director liability provision. *Id.*

131. Balotti and Gentile note that 75% of the Delaware corporations that responded to a survey conducted by the American Society of Corporate Secretaries indicated that they intended to seek shareholder approval to adopt liability-limiting amendments of the type permitted by Section 102(b)(7). Balotti & Gentile, *supra* note 104, at 5 n.1, citing 1 Corp. Counsel Weekly (BNA) No. 48, at 1 (Dec. 10, 1986).

132. The reported reason for the move was that Delaware afforded greater protection to directors than did Illinois. Groessl, *supra* note 85, at 444 n.214. For example, Stone Container Corporation, which was originally incorporated in Illinois in 1945, reincorporated in Delaware in 1987. FIRST CHICAGO GUIDE: A SCHOLL CORPORATE GUIDE 192 (Scholl Communications, Inc. ed., 1991). See also Pease, *supra* note 4, at 95 (reporting that 7,400 companies incorporated in Delaware in the three months following the effective date of the director liability statute; a state official attributed the large number to the availability of § 102(b)(7) protection for directors).

133. See James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1210 (1988) (discussing the following states which have adopted charter option statutes modelled on § 102(b)(7): Arizona, California, Colorado, Georgia, Idaho, Iowa, Kansas, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, North Carolina, Oklahoma, Oregon, Rhode Island, South Dakota, Texas, Utah, Washington, and Wyoming).

134. *Id.* at 1246-53 (showing that the following 15 states had passed director liability statutes by 1987: Arizona, Arkansas, Colorado, Idaho, Kansas, Montana, Nevada, New Jersey, New Mexico, North Carolina, Oregon, Rhode Island, Tennessee, Utah, and Wyoming).

135. The following 40 states have enacted some type of director liability statute: Arizona, Arkansas, California, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming). SARGENT, HANDBOOK, *supra* note 116, at xiii-xxiv. Alaska has also enacted a director liability statute. BRODSKY & ADAMSKI, *supra* note 116, § 205 (1986 & Cum. Supp. 1991).

courage such a measure.¹³⁶

B. *The Illinois General Assembly's Rejection of Director Liability Protection*

In 1986, the Illinois corporate bar was aware of the director liability crisis.¹³⁷ They were also aware of the Delaware Legislature's attempt to solve the problem by passing section 102(b)(7).¹³⁸ In September, 1986, the Corporate and Securities Section of the Illinois State Bar Association formed a Task Force to study the issue of director and officer liability and to recommend action.¹³⁹ In December, 1986, the Task Force proposed an amendment to the Illinois Business Corporation Act which was identical to Delaware's section 102(b)(7).¹⁴⁰ Senator Vince Demuzio introduced the bill in the Illinois Senate as Senate Bill 1214 in April, 1987. The Senate passed the measure in May.¹⁴¹ However, the bill died in the Illinois

136. See *infra* notes 137-153 and accompanying text for a discussion of the abortive attempt to pass a director liability statute in Illinois.

137. See English, *supra* note 142, at 3 (describing director liability statutes enacted or under consideration in Delaware, Indiana, Missouri and New York in 1986).

138. The fact that director liability was the focus of the September, October, and December issues of the Illinois State Bar Association's newsletter for the Section on Corporation and Securities Law demonstrates the Illinois corporate bar's concern about the director liability crisis. Similarly, the fact that the text of the Delaware statute was printed in its entirety in the September issue demonstrates the Illinois corporate bar's awareness of the Delaware director liability statute. Michael W. Hansen, *New Delaware Statutory Provisions Permitting Limitations on Directors' Liability*, 32 ISBA CORP. & SEC., Sept. 1986, at 4, 4.

139. See *Secretary Edgar's Business Corporation Act Advisory Committee*, *supra* note 108, at 1.

140. Thomas N. Jersild, *Deliberations and Recommendations of the Task Force on Director and Officer Liability to the Secretary of State's Corporation Act Advisory Committee*, 32 ISBA CORP. & SEC., Dec. 1986, at 3.

141. Senator Vince DeMuzio, the assistant majority leader, introduced Senate Bill 1214 on April 10, 1987. LEGIS. SYNOPSIS & DIG., *supra* note 1 at 268. It was assigned to the Committee on Finance and Credit Regulations. *Id.* The committee recommended passage on May 7 by a vote of 12-1. *Id.* The Senate passed the bill on May 22, 1987 by a vote of 58-0. *Id.* The bill arrived in the House of Representatives on May 26, where it was sponsored by Representative John Dunn. *Id.* It was placed on the House calendar for first reading on May 28. *Id.* The bill was assigned to the Judiciary Committee, then placed on the Interim Study Calendar on June 12. *Id.* Representative Dunn described the status of a bill in interim study as "in a coma, on life support with the committee's hand on the plug." Telephone Interview with John Dunn, Illinois State Representative, 101st Dist. (Apr. 9, 1992) [hereinafter Dunn Interview]. Representative Dunn held two public hearings on Senate Bill 1214 in November, 1987, and sought opinions on Senate Bill 1214 from several law professors. Dunn Interview, *supra*. The bill never had a second reading in the House and on May 4, 1988, it was tabled pursuant to House Rule 26D. LEGIS. SYNOPSIS & DIG., *supra*, note 1 at 268. Representative Dunn attributed the death of the bill to "failure to pursue it in committee." Dunn Interview, *supra*.

House of Representatives the following year.¹⁴²

The Illinois House rejected the director liability amendment primarily because House members viewed the amendment as a measure that took a remedy away from shareholders.¹⁴³ "Populist" legislators, who were in the majority in the House, saw the amendment as a way for corporate directors to "get off the hook" for their negligent actions.¹⁴⁴ More specifically, the House members who opposed Senate Bill 1214 believed that the amendment would shield corporate directors from liability for acts which constituted gross negligence.¹⁴⁵

In addition to philosophical reasons for opposing a director liability statute, the Illinois General Assembly, unlike the Delaware Legislature, had no economic incentive to pass the director liability amendment.¹⁴⁶ In Delaware, franchise taxes paid by corporations incorporated in Delaware are a major source of state revenue.¹⁴⁷ In

142. LEGIS. SYNOPSIS & DIG., *supra* note 1, at 268.

143. Telephone Interview with Thomas Jersild, a partner at Mayer, Brown & Platt in Chicago and the chairman of the Task Force on Directors' and Officers' Liability organized by the Corporate and Securities Law Section of the Illinois State Bar Association (Mar. 12, 1992) [hereinafter Jersild Interview].

144. Jersild Interview, *supra* note 143.

145. Representative Dunn and the members of the Judiciary Committee were very aware of *Van Gorkom*. Dunn Interview, *supra* note 141. Representative Dunn believed that Senate Bill 1214, which he knew was identical to Delaware's § 102(b)(7) director liability provision, would excuse directors for gross negligence. *Id.* Representative Dunn opposed Senate Bill 1214 because he believed the release from liability was too broad. *Id.* In reaching this conclusion, Representative Dunn relied on the opinions of several law professors. *Id.* See, e.g., Letter from Charles W. Murdock, Professor, Loyola University of Chicago School of Law, to John Dunn, Illinois State Representative, 101st Dist. (Oct. 26, 1987) (on file with Note author) (describing Senate Bill 1214 as exculpating directors for "conduct which amounts to gross negligence or recklessness" and proposing an amendment to the bill which would specifically exclude from protection acts which constituted gross negligence or recklessness); Letter from William H. Painter, Theodore Rinehart Professor of Law, The George Washington University, to John Dunn, Illinois State Representative, 101st Dist. (Sept. 8, 1987) (on file with Note author) (describing Senate Bill 1214 as permitting shareholders to exculpate both inside and outside directors from personal liability for monetary damages for "acts of negligence, gross negligence, or even recklessness" and arguing that members of the Task Force which drafted the bill were "unreceptive to the protection of shareholder interests"); Letter from William J. Davey, Associate Professor of Law, University of Illinois at Urbana-Champaign, to John Dunn, Illinois State Representative, 101st Dist. (Sept. 11, 1987) (on file with Note author) (describing director liability statutes as a response to *Van Gorkom* and arguing that Senate Bill 1214 "establishes an unacceptably low standard by which directors' conduct is judged" because the proposed amendment "would immunize directors for their grossly negligent, and perhaps even reckless, failure to inform themselves before making a decision").

146. Jersild Interview, *supra* note 143.

147. See Seligman, *A Brief History*, *supra* note 33, at 282-83 (describing the importance of the franchise tax to the state of Delaware and observing that in 1971, corporation franchise taxes and related corporate income accounted for 23% of Delaware's total state revenue collections).

Illinois, however, franchise and license fees are not linked to incorporation in the state.¹⁴⁸ Instead, Illinois franchise and license fees are based on the corporation's economic activity in Illinois.¹⁴⁹ As a result, all corporations operating in Illinois are required to pay franchise and license fees at the same rate, regardless of the state in which they are incorporated. Therefore, Illinois legislators were not motivated to pass a director liability amendment by the fear that failure to protect directors would reduce the state's franchise tax and license fee income.¹⁵⁰

Major corporations operating in Illinois did not actively campaign in favor of director liability protection.¹⁵¹ They had no incentive to lobby because most of them are not incorporated in Illinois.¹⁵² They are incorporated in Delaware.¹⁵³ As Delaware corporations, they already enjoyed the benefit of Delaware's section 102(b)(7) protection and therefore, had no reason to lobby in favor of a similar amendment in Illinois.

Resistance to the Delaware statutory model was not confined to Illinois. Many commentators, critical of Delaware's traditionally "pro-management" corporate law, view section 102(b)(7) unfavorably.¹⁵⁴ Some see the passage of the statute less than one week after it was introduced as evidence of the Delaware Legislature's uninformed deference to the corporate bar.¹⁵⁵ Others regard the move

148. See ILL. REV. STAT. ch. 32, para. 15.20 - 15.75 (1991). Although license and franchise fees for domestic and foreign corporations are set forth in separate sections of article 15, the provisions are virtually identical. See *id.*

149. *Id.*

150. Jersild Interview, *supra* note 143.

151. Jersild Interview, *supra* note 143; Telephone Interview with Charles W. Murdock, Professor, Loyola University of Chicago School of Law (Apr. 14, 1992) [hereinafter Murdock Interview] (discussing public hearings on Senate Bill 1214 and stating that the only two major Illinois corporations that testified in favor of the bill were Abbott Laboratories and W. W. Grainger, Inc., which are both incorporated in Illinois).

152. Of the major corporations headquartered in Illinois, 25 are incorporated in Illinois, 184 are incorporated in Delaware, and 17 are incorporated in states other than Illinois and Delaware. Tabulation by Note author of data in FIRST CHICAGO GUIDE: A SCHOLL CORPORATE GUIDE (Scholl Communications, Inc. ed., 1991). Among the Delaware-incorporated corporations, 12 *reincorporated* in Delaware after the adoption of § 102(b)(7) in 1986. *Id.* Two of the reincorporating firms were originally incorporated in states other than Illinois. *Id.* Ten of the reincorporating firms were originally incorporated in Illinois. *Id.* A total of 18 of the 25 largest corporations headquartered in Illinois are incorporated in Delaware. *Id.* They include Caterpillar, Inc.; UAL Corporation; Motorola, Inc.; Ameritech Corporation, CNA Financial Corporation; Baxter International, Inc.; and Archer-Daniels-Midland Co. *Id.*

153. *Id.*

154. See, e.g., Lee, *supra* note 65, at 272-73 (suggesting that section 102(b)(7) "opens the floodgates" to the use of puppet directors who will allow management to abuse shareholders' interests).

155. See Groessl, *supra* note 85, at 441 n.190 (describing the Delaware legislature as being composed of "mostly blue collar" legislators and concluding that

to place statutory limits on directors' liability as another instance of Delaware's willingness to adopt any pro-management measure that will enhance its attractiveness as a state of incorporation, thus protecting the tax revenues and franchise fees which flow into the state each year.¹⁵⁶

While most commentators concede that states are justified in taking action to insure that qualified outside directors will continue to serve on corporate boards, many regard the measure adopted by Delaware as overly generous to directors, at the expense of shareholders.¹⁵⁷ They view the shareholder approval requirement as meaningless, arguing that most shareholders will simply approve the proposed amendments "without meaningful bargaining or consent."¹⁵⁸ Opponents of the measure argue that the approval requirement is inherently flawed because shareholders will not recognize that approval of a liability limitation amendment constitutes a waiver of their right to bring an action for damages if the directors fail to exercise their duty of care.¹⁵⁹ However, critics of section 102(b)(7) have based their objections on the text of the statute, rather than on a judicial interpretation of the statute. In 1991, more than five years after the Delaware Legislature enacted section 102(b)(7), the Delaware Supreme Court interpreted the meaning of director liability protection under the Delaware statute.

the swift enactment of § 102(b)(7) was the result of the Delaware legislature's "great deference to the Delaware corporate bar"; see also Brennan, *supra* note 53, at 324 (describing an interest group theory that the enactment of § 102(b)(7) should be seen simply as a victory for the interest group "which had the lowest start-up costs to lobby effectively" for the measure; that interest group was the Delaware bar).

156. See Blank, *supra* note 32, at 134 (describing § 102(b)(7) as "another mechanism to lure businesses to incorporate in Delaware," thus assuring Delaware "of continued high income from corporate taxes and fees").

157. See Brennan, *supra* note 53, at 324 (describing § 102(b)(7) as vindicating the argument of those who regard Delaware as leading a "race to the bottom" because the director liability provision "favors management over shareholders" by providing "a disincentive for directors to act in a way which maximizes shareholder welfare").

158. See Gelb, *supra* note 83, at 30 (describing the notion of shareholder choice as "somewhat illusory" because the approval process does not allow for "meaningful bargaining or consent," except in corporations in which boards proposing a § 102(b)(7) provision are concerned "about the attitudes of institutional or other large investors").

159. See Blank, *supra* note 32, at 132 (discussing the probability that shareholders will not "comprehend the consequences of their waiver" because the proposal to adopt a director liability provision will be presented in a one-sided manner, because shareholders may not understand the implications of the provision, or because shareholders may simply approve the proposal without reading it); see also Whited, *supra* note 85, at 512 (discussing the likelihood that shareholders, not understanding the import of the proposed director liability provision, will approve it without realizing that they are waiving protection of their interests by reducing their rights to sue directors in derivative actions).

IV: SECTION 102(b)(7) AS INTERPRETED BY IN RE DATAPRODUCTS SHAREHOLDERS' LITIGATION¹⁶⁰

While the Delaware statute reduced uncertainty and anxiety among prospective outside directors, the question of whether the statute as written seriously limits the rights of shareholders can only be evaluated after judicial interpretation of the statute. *In re Dataproducts Shareholders' Litigation* was the first case to test section 102(b)(7), Delaware's director liability protection statute.¹⁶¹ *Dataproducts* was a class action suit brought by shareholders seeking monetary damages against the directors for alleged breaches of duty in connection with the merger of Dataproducts Corporation with a subsidiary of Hitachi Koki Co., Ltd. and Nissei Sangya, Ltd. (hereinafter jointly referred to as "Hitachi").¹⁶²

The shareholders presented two claims against the Dataproducts directors.¹⁶³ First, they alleged that the directors breached their duty to oversee management.¹⁶⁴ The shareholders claimed that, as a result of the directors' lax supervision, management manipulated the timing of the merger announcement so as to unfairly cap the price offered to shareholders for the tender of their Dataproducts stock.¹⁶⁵ Second, the shareholders charged that the directors breached their duty of candor by misdisclosing, and failing to disclose, material facts in the merger materials in order to induce shareholders to tender their shares at Hitachi's \$10 per share price.¹⁶⁶

In both claims, the shareholders charged the directors with acts "that were 'not in good faith' and that constituted 'intentional

160. *In re Dataproducts Shareholders' Litigation*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,227 (Del. Ch. Aug. 22, 1991).

161. *Id.* at 91,178.

162. *Id.* at 91,180.

163. *Id.* at 91,181.

164. *Id.*

165. *Id.* The shareholders charged the Dataproducts directors with failing to oversee the activities of management. *Id.* at 91,179. The shareholders alleged that the directors' failure of oversight allowed management to manipulate the timing of the merger announcement so as to disadvantage the shareholders. *Id.* at 91,180. Hitachi announced its \$10 per share tender offer on April 16, 1990. *Id.* at 91,181. Three weeks after Hitachi's announcement, Dataproducts announced fourth quarter earnings that were better than anticipated. *Id.* The plaintiff shareholders argued that management deliberately manipulated the timing of the two announcements, making sure that the \$10 per share offer was announced before the better-than-expected earnings. *Id.* at 91,182. The shareholders contended that announcing the tender offer first put the shareholders at a disadvantage in obtaining the highest possible price for their shares, *i.e.*, had management announced the earnings first, the announcement could have resulted in a rise in the price of Dataproducts stock which could, in turn, have resulted in a higher price per share tender offer. *Id.*

166. *In re Dataproducts*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,182.

misconduct.'"¹⁶⁷ However, the defendants contended that even if the directors were properly charged with breach of their fiduciary duty, the shareholders' allegations were "legally insufficient because they amount at best to negligence, for which the directors are exempted from damage liability by Dataproducts' certificate of incorporation."¹⁶⁸

The Delaware Chancery Court dismissed both charges of the plaintiff's complaint.¹⁶⁹ The court found that neither count of the complaint alleged facts that even inferentially suggested that the directors acted in bad faith.¹⁷⁰ Nor did the court find any contention that any of the directors realized, or even sought, any personal benefit at the expense of the shareholders.¹⁷¹ Because the plaintiffs failed to show either bad faith or intentional misconduct, and because their claims were "equally consistent with director gross negligence," the court held that the claims were precluded by Dataproducts' director protection clause which exculpated directors from liability "for acts amounting to gross negligence."¹⁷²

Dataproducts thus affirms the validity of section 102(b)(7) and demonstrates that the Delaware Chancery Court will accord corporate directors broad protection under a section 102(b)(7) provision. The burden on shareholder plaintiffs will be a heavy one: the complaint must allege facts with sufficient particularity to support a claim of breach of one of the fiduciary duties that is not accorded section 102(b)(7) protection.¹⁷³ Plaintiffs not meeting this burden can expect the court to dismiss their claims as legally insufficient, following the *Dataproducts* precedent.

By contrast, the Trans-Union shareholders who won \$23.5 million in damages in *Van Gorkom* had only to show that the directors

167. *Id.* at 91,183. Since the Dataproducts directors were protected by a section 102(b)(7) provision, they could only be held liable for monetary damages for acts which the statute specifically excluded from protection. Section 102(b)(7) does not protect directors against liability for acts which are not in good faith or which involve intentional misconduct. See *supra* notes 118-26 and accompanying text for a discussion of acts which are not protected under a section 102(b)(7) provision.

168. The director liability provision adopted by Dataproducts as Article 15 of its certificate of incorporation exactly tracked the language of section 102(b)(7). *In re Dataproducts*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,182-83.

169. *Id.* at 91,183.

170. *Id.*

171. *Id.*

172. *Id.* The court found that the effect of Dataproducts' directory liability provision "was to exculpate the directors from liability for monetary damages for acts amounting to gross negligence." *Id.* Consequently, "the directors cannot be held liable for monetary damages except for (*inter alia*) acts amounting to a breach of their duty of loyalty, or involving intentional misconduct, a knowing violation of law, or an improper personal benefit." *Id.*

173. *Id.*

were grossly negligent.¹⁷⁴ Now, the *Dataproducts* court has established that corporations adopting a provision tracking section 102(b)(7) can expect to protect directors from liability for monetary damages even for actions constituting gross negligence. Had such protection been available to the Trans-Union directors sued in *Van Gorkom*, they would not have been liable for monetary damages. Thus, if the Delaware Legislature's intent in enacting section 102(b)(7) was to prevent future *Van Gorkom* decisions, *Dataproducts* suggests that their purpose has been accomplished. Indeed, section 102(b)(7), as interpreted by the *Dataproducts* court, provides greater protection for corporate directors than the business judgment rule, inasmuch as it prevents acts constituting gross negligence from resulting in personal liability for monetary damages.¹⁷⁵ A plaintiff who claims that directors have breached their fiduciary duty of care will, therefore, be required to allege with particularity facts which establish that the directors acted recklessly.¹⁷⁶

From a procedural point of view, a section 102(b)(7) provision will also prove more advantageous to corporate directors than the business judgment rule. Few plaintiffs will be able to survive a motion for dismissal based on insufficient pleadings.¹⁷⁷ Defendant corporate directors will, therefore, avoid discovery and trial. To avoid dismissal, plaintiffs will be required to allege with particularity

174. The court found that the directors' actions in *Van Gorkom* constituted gross negligence. *Smith v. Van Gorkom*, 488 A.2d 858, 881 (Del. 1985); see also *supra* notes 90-94 and accompanying text. Under the *Dataproducts* court's interpretation of a director liability provision adopted pursuant to section 102(b)(7), directors cannot be held liable for monetary damages for acts amounting to gross negligence, unless their acts also constitute a breach of loyalty or involve intentional misconduct, knowing violation of law or improper personal benefit. *In re Dataproducts*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,183. In *Van Gorkom*, the court found only a violation of the duty of care. *Van Gorkom*, 488 A.2d at 872-873; see also text accompanying notes 95-97, *supra*.

175. In *Van Gorkom*, the court found that the directors had been grossly negligent and therefore were not entitled to protection under the business judgment rule. *Van Gorkom*, 488 A.2d at 888. As a result, the court held the directors liable for \$23.5 million in damages. *Id.* at 893.

176. The *Dataproducts* court established that a § 102(b)(7) provision exculpates directors "from liability for monetary damages for acts amounting to gross negligence." *In re Dataproducts*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,183. Therefore, a plaintiff who alleges that directors breached their duty of care, as opposed to their duty of loyalty, must show that the directors' acts amounted to more than gross negligence, *i.e.*, a plaintiff must show that the director's acts were reckless. *Id.*

177. Plaintiffs who allege a breach of the directors' duty of care will have to allege that the directors acted recklessly. See *id.*; see also Paul Vizcarrondo, Jr. & Theodore N. Mirvis, *Court OK's Director Exculpation*, NAT'L L. J., Dec. 16, 1991, at 23 (describing *Dataproducts* as an illustration of the effectiveness of a § 102(b)(7) provision in "cut[ting] off litigation against directors at the pleading stage" and observing that terminating a lawsuit before discovery benefits directors at the expense of shareholder plaintiffs).

facts which establish recklessness in breach of the directors' duty of care, a violation of the duty of care which constitutes intentional misconduct, or a violation of the directors' duty of loyalty.¹⁷⁸

Of course, the greater the protection a section 102(b)(7) provision affords corporate directors, the greater the disadvantage it represents for shareholders who seek monetary damages from directors for breach of their fiduciary duties. Short of actions which constitute recklessness, section 102(b)(7) provisions render directors immune from claims for monetary damages for breach of the duty of care.¹⁷⁹ Although shareholders who seek equitable remedies such as injunction will be unaffected by a section 102(b)(7) provision,¹⁸⁰ the statute has all but eliminated shareholder actions for monetary damages as a means for shareholders to exert control over corporations.

Section 102(b)(7) was enacted as a means of encouraging qualified persons to accept positions as outside directors of Delaware corporations.¹⁸¹ As the first test of a section 102(b)(7) provision, *Dataproducts* has sent a clear message to corporate directors that the protective shield created by the Delaware Legislature will not be rendered ineffective by the Delaware courts. Moreover, *Dataproducts* provides persuasive precedent for courts in other states whose director liability statutes are modeled on the Delaware statute.¹⁸²

Given the important role outside directors play as representatives of shareholder interests, the Illinois General Assembly should act to remove uncertainty about director liability and thereby assure that qualified persons will agree to serve as outside directors on the boards of Illinois corporations. However, an Illinois director liability statute should provide shareholders more protection than they are afforded under section 102(b)(7) as interpreted in *Dataproducts*. By shielding directors against liability for monetary damages, even when their actions constitute gross negligence, the Delaware court has defeated the purpose of encouraging outside directors to serve on corporate boards. The role of the outside direc-

178. Plaintiffs must allege breach of the duty of loyalty with particularity to show that the allegation is not equally consistent with gross negligence. See *In re Dataproducts*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,183; see also text accompanying notes 170-172 *supra*.

179. See *In Re Dataproducts* at 91,183.

180. Balotti & Gentile, *supra* note 104, at 16.

181. Synopsis to DEL. CODE ANN. tit. 8, § 102(b)(7), *reprinted in* Pease, *supra* note 4, app. at 101-02.

182. Since many states adopted director liability provisions identical to § 102(b)(7), the *Dataproducts* court's interpretation of the protection afforded directors under § 102(b)(7) should provide persuasive precedent in those states. See *supra* note 116 and accompanying text for a discussion of the director liability statutes adopted in other states.

tor is to protect the interests of shareholders. However, this role is rendered virtually meaningless if shareholders have no legal recourse against their representatives except for actions which constitute recklessness. As Section V will show, Illinois can reassure directors and prospective directors that they will not be unreasonably exposed to liability, without sacrificing shareholders' rights to damages against directors whose actions constitute gross negligence. Such a statute will protect directors from unreasonable exposure to liability without eliminating their incentive to exercise the requisite duty of care.

V. A DIRECTOR LIABILITY STATUTE FOR ILLINOIS

Illinois courts have traditionally applied the common law business judgment rule to protect corporate directors against personal liability for their business decisions.¹⁸³ The Illinois First District Appellate Court reaffirmed its adherence to the business judgment rule as recently as March, 1992, in *Stamp v. Touche Ross & Co.*¹⁸⁴ In *Stamp*, the plaintiffs sought \$100 million in damages against eight former outside directors of an insolvent insurance company.¹⁸⁵ The *Stamp* court dismissed the suit, holding that the directors were protected by the business judgment rule because the plaintiffs' complaint did not charge that the directors' acts were fraudulent, illegal, or a result of conflict of interest.¹⁸⁶

In *Stamp*, the court followed Illinois precedent and held that the business judgment rule shielded the directors from liability.¹⁸⁷ Despite the holding in *Stamp*, however, a prospective director cannot be certain that Illinois courts will continue to apply the business judgment rule in the same way in future cases. Delaware courts

183. Charles V. Murdock, *Careless Directors: A New Public Policy for the State of Illinois*, ILL. B.J. 42, 48 (Sept. 1988)(reviewing Illinois Business judgment rule decisions and concluding that Illinois courts "have been exceedingly deferential" to corporate directors).

184. *Stamp v. Touche Ross & Co.*, No. 1-89-3214 (Ill. App. Ct. Mar. 13, 1992).

185. John Flynn Rooney, *Business Judgment Rule Gets Boost From Court*, CHI. DAILY L. BULL., Mar. 17, 1992, at 1.

186. *Id.* See also *Fields v. Sax*, 462 N.E.2d 983, 989 (Ill. App. Ct. 1984) (stating that "absent evidence of bad faith, fraud, illegality, or gross overreaching, courts are not at liberty to interfere with the exercise of business judgment by corporate directors"); *Romanik v. Lurie Home Supply Center, Inc.*, 435 N.E.2d 712, 722 (Ill. App. Ct. 1982) (stating that a director will not be held liable for mere errors of judgment as long as the decision does not involve "fraud, illegality, or conflict of interest"); *Shlensky v. Wrigley*, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (stating that courts should not interfere with directors' decision unless defendants' conduct "at least borders on" fraud, illegality, or conflict of interest).

187. Under Illinois precedent, the court will apply the business judgment rule to shield directors' decisions when plaintiffs fail to rebut the presumption that the directors acted in good faith. See, e.g., *Fields*, 462 N.E.2d at 989; *Romanik*, 435 N.E.2d at 722; *Shlensky*, 237 N.E.2d at 780.

had traditionally applied the business judgment rule, too, until they adopted a stricter test scrutinizing the decision-making process in *Van Gorkom*.¹⁸⁸

To eliminate uncertainty with respect to director liability, the Illinois General Assembly should codify the protection currently afforded directors under the business judgment rule. The Illinois General Assembly should enact a director liability statute modeled on Delaware's section 102(b)(7). However, the Illinois statute should explicitly exclude protection for acts which constitute gross negligence or recklessness.

Although Illinois should not follow Delaware in protecting directors against liability for acts which are grossly negligent, Illinois should follow Delaware in adopting a statute which permits shareholders to vote to include a director liability provision in the corporation's certificate of incorporation.¹⁸⁹ Similarly, Illinois should follow Delaware in excluding from protection acts which constitute a breach of the director's duty of loyalty, acts of intentional misconduct, and acts which violate securities regulations.¹⁹⁰ Finally, like

188. See *supra* note 101 and accompanying text for a discussion of the change in the standard for Delaware courts' application of the business judgment rule.

189. Illinois should enact a statute which allows shareholders to vote on whether the corporation should include a director liability provision in its articles of incorporation because the adoption of a director liability provision constitutes a waiver of shareholders' rights to sue directors for monetary damages for breach of the directors' duty of care. Requiring an affirmative vote of the shareholders for the adoption of a director liability provision also requires that the board of directors inform the shareholders of the consequences of adopting a director liability provision. See Balotti & Gentile, *supra* note 104, at 22 (describing the disclosures the board must make in the proxy statement sent to shareholders when the board seeks shareholder approval of a § 102(b)(7) amendment to the corporation's charter and observing that the board must disclose the fact that adoption of a § 102(b)(7) amendment will bar shareholder suits for monetary damages). Some commentators argue that the shareholder vote requirement is meaningless because shareholders will simply adopt a director liability provision without reading or understanding the proposal and its consequences. See *supra* note 159 and accompanying text for a discussion of these arguments. Nonetheless, shareholders should have the opportunity to cast an informed vote, because eliminating the requirement of a shareholder vote would *guarantee* that shareholders would not be informed that they are waiving certain rights. But see *supra* notes 158-159 and accompanying text for a discussion of commentators who regard voting provisions as meaningless and contend that shareholders will not make informed decisions regarding adoption of director liability provisions.

190. The purpose of enacting a director liability statute should be to guarantee to directors the same protection from liability for monetary damages that the courts have traditionally accorded directors under the business judgment rule. See Murdock, *supra* note 183 at 49 (stating that application of Illinois' business judgment rule provides "adequate protection for conscientious directors" but conceding that providing directors limited assurance against liability might serve a useful purpose). In Illinois, the business judgment rule does not protect directors whose acts constitute a breach of the duty of loyalty, intentional misconduct, or violation of securities laws. See *supra* note 186 and accompanying text for a discussion of the Illinois courts' application of the

Delaware, Illinois should not prevent shareholders from seeking such equitable remedies as injunction and rescission.¹⁹¹

Recognizing the important role played by directors of boards of Illinois not-for-profit corporations, the Illinois General Assembly has already enacted a statute which protects such directors from personal liability for acts which are merely negligent.¹⁹² Directors of business corporations ought to be granted the same certainty. By the same token, the Illinois General Assembly should act to prevent shareholders of Illinois corporations from being placed at a disadvantage in the competition to secure the most qualified persons to serve on their boards of directors.¹⁹³

business judgment rule to protect directors whose actions do not constitute fraud, illegality, or conflict of interest. A director liability provision should not expand the protection of the business judgment rule by immunizing directors from liability for acts not protected under the business judgment rule. See Murdock, *supra* note 183 at 49 (describing exculpation of directors for "mere negligence" as "acceptable" and terming exculpation for gross negligence or recklessness "legislative irresponsibility").

191. The purpose of guaranteeing directors protection against liability for monetary damages is to encourage qualified persons to accept positions as outside directors. See Jersild, *supra* note 140, at 6 (stating that the purpose of an Illinois director liability provision is to encourage "qualified persons to serve as directors and officers of Illinois corporations" and observing that attracting qualified directors will enhance the "quality and stability of the governance of Illinois corporations"). Shareholders whose corporations adopt a director liability provision are, therefore, waiving their rights to seek monetary damages from directors in order to secure qualified outside directors who will serve as monitors of shareholders' interests. See Pease *supra* note 4, at app. C 105-106 (providing Control Data Corporation Proxy Statement which discloses rights which shareholders will waive if they adopt a director liability provision, pursuant to Delaware § 102(b)(7) and urges shareholders to adopt the provision in order to help the company to "attract and retain good outside directors,"). However, adoption of a director liability provision does not eliminate the directors' duty of care. Pease, *supra* note 4, at 91 (stating that adoption of a § 102(b)(7) provision does not eliminate the directors' duty of care and observing that shareholders who adopt a director liability provision can still seek equitable remedies to enforce the directors' duty of care). Nor should it eliminate equitable remedies for breach of the duty of care, since the continued availability of equitable remedies should not discourage qualified persons from accepting positions as outside directors. See, e.g., Jersild, *supra* note 104, at 6 (citing recent litigation in which directors were held liable for "large amounts" in monetary damages for duty of care violations and the unavailability of director and officer liability insurance to pay such damages as the two factors which could deter qualified persons from agreeing to serve as directors).

192. ILL. REV. STAT. ch 32, para. 108.70 (1991). The statute protects directors and officers who serve not-for-profit corporations without compensation. Under the statute, such persons cannot be held liable "for damages resulting from the exercise of judgment or discretion" unless their actions constitute willful or wanton conduct. *Id.*

193. See *supra* notes 69-82 and accompanying text for a discussion of the importance of outside directors as representatives of shareholders' interests.

CONCLUSION

Outside directors can play an important role in protecting the interests of shareholders. However, qualified persons may refuse to serve as outside directors if directors are subject to liability for monetary damages for a breach of their duty of care. *Dataproducts* has shown that the Delaware director liability statute effectively protects directors from liability for monetary damages for duty of care violations. *Dataproducts* has also shown that the Delaware statute goes too far, by protecting directors even when their acts constitute gross negligence. Illinois can avoid this consequence by enacting a director liability statute that explicitly excludes protection for acts which constitute gross negligence or recklessness. Thus, shareholders who adopt the director liability protection provision envisioned in this Note will not be sacrificing a remedy which is currently available to them.¹⁹⁴ Directors' acts which would not be protected under the business judgment rule will not be protected under a director liability statute either.¹⁹⁵ However, by codifying the protection now provided under the business judgment rule, the Illinois General Assembly will eliminate the uncertainty that may cause qualified persons to decline to serve as outside directors.¹⁹⁶ Shareholders and managers of Illinois corporations should have the most capable outside directors available. The Illinois General Assembly should, therefore, assist Illinois corporations and their shareholders by enacting a director liability statute as set forth in the Appendix to this Note.

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194. See *supra* note 53 and accompanying text and notes 184-186 and accompanying text for a discussion of the protection currently afforded directors under the business judgment rule as applied by Illinois courts.

195. See *supra* notes 186-87 for a discussion of the limitations on protection of directors under the Illinois business judgment rule.

196. See *supra* note 85 for a discussion of the uncertainty generated by *Van Gorkom* which led to the director liability crisis and the refusal of qualified persons to serve as outside directors.

APPENDIX

The Illinois General Assembly should enact a director liability statute, similar to Senate Bill 1214, incorporating the following provisions:

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

Section 1. Subparagraph (b)(3) of Section 2.10 of the "Business Corporation Act of 1983," approved January 5, 1984, as amended, is amended by renumbering it as sub-paragraph (b)(4). Section 2. Sub-paragraph (b) of Section 2.10 of the "Business Corporation Act of 1983," approved January 5, 1984, is amended by adding after sub-paragraph (b)(2) thereof a new sub-paragraph (b)(3) reading as follows: (3) A provision eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its shareholders, (ii) for acts or omissions not in good faith or which involve *gross negligence, recklessness*, intentional misconduct, or a knowing violation of law, (iii) under section 8.65 of this title, or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective.¹⁹⁷

197. Emphasis added to indicate amendment to the Senate Bill 1214 proposed by Professor Charles W. Murdock. See Jersild Interview, *supra* note 143 and text accompanying note 143 for a discussion of the Task Force's draft amendment which was introduced in the Illinois Senate as Senate Bill 1214. Professor Murdock proposed the above amendment to the Task Force that drafted the bill. Murdock Interview, *supra* note 151. Professor Murdock proposed the same amendment after the bill was introduced but the Illinois House Judiciary Committee never amended the bill. Letter from Murdock to Representative Dunn, *supra* note 145 and Dunn Interview, *supra* note 141.

