DIRECTOR AND OFFICER LIABILITY:
STATE LEGISLATIVE REACTION TO
SMITH V. VAN GORKOM

INTRODUCTION

Since the landmark case of Smith v. Van Gorkom, director liability has become a significant concern for states that are considered corporate meccas. State legislatures have sought to lessen the impact of Van Gorkom by enacting legislation aimed at lessening or eliminating director liability for certain conduct. In view of this legislative activity, this Comment discusses the Van Gorkom decision and its effects on the traditional business judgment rule defense. This Comment then examines the various types of statutory enactments being promulgated by state legislatures in an effort to lessen the impact that Van Gorkom has had on director liability. Next, specific statutes enacted by Delaware and Arizona are reviewed. Finally, this Comment concludes with a discussion of actions that corporate boards can and should take to avoid or at least minimize director liability.

THE BUSINESS JUDGMENT RULE

The Business Judgment Rule is a judicial principle of corporate law that has developed over a significant number of years. This Rule evolved as a means of protecting directors and officers from personal liability for errors in judgment, as well as identifying the deference paid to business experts by judges unqualified to evaluate complicated commercial transactions. The Rule creates a presumption that the directors act with due care and good faith toward the corporation, and that the directors or officers use due care when making their decisions.

The Business Judgment Rule is inapplicable if directors or officers are deemed to have a conflict of interest; if such conflict exists, the director must, under some circumstances, demonstrate according

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1. 488 A.2d 858 (Del. 1985).
2. See infra notes 6-31 and accompanying text.
3. See infra notes 32-72 and accompanying text.
4. See infra notes 73-103 and accompanying text.
5. See infra notes 104-23 and accompanying text.
7. Id.
8. Id. at 110.
to the duty of loyalty that the transaction is intrinsically fair to the corporation. However, the typical corporate transaction involves a director making a decision which is absent self-dealing and which will affect the future well-being of the corporation. Thus, the director need only utilize due care when making such decisions.

The Business Judgment Rule is a directors' primary shield from liability when a court's inquiry focuses on the due care standard. However, Van Gorkom has significantly increased the level of scrutiny that a court utilizes when reviewing the directors' decision-making process. As a result, the business judgment doctrine will no longer be invoked to uphold directors' decisions without courts reviewing certain fundamental aspects of the transaction, especially if the transaction involves a fundamental corporate change.

**SMITH V. VAN GORKOM**

In *Smith v. Van Gorkom*, the Delaware Supreme Court held that when the board of directors of Trans Union approved a cash-out merger, the decision was "not the product of an informed business judgment." The court announced that it no longer would immediately defer to the business judgment of corporate boards when making decisions absent fraud, bad faith, or self-dealing.

Van Gorkom, Trans Union's chairman and chief executive officer, met with a takeover specialist, Jay Pritzker. Van Gorkom had previously vetoed a leveraged buy-out proposed by management at a price between $50 and $60. Van Gorkom, however, intrigued with the idea of a sale, presented to Pritzker a proposal to sell the company at $55 per share. Pritzker thereafter tendered a cash-out merger at $55 per share and required the Trans Union board to act on his proposal within three days.

On September 20, Van Gorkom called a special meeting of the
board and gave a twenty-minute oral presentation of the Pritzker proposal.\textsuperscript{20} He failed, however, to inform the board as to the valuation methodology utilized to obtain the $55 figure, and at the end of a two-hour meeting, the board approved the agreement without having even seen the purchase documents.\textsuperscript{21} The merger was approved by the shareholders, and thereafter a class action lawsuit was brought by minority shareholders seeking rescission of the merger or, in the alternative, damages against the board of directors.\textsuperscript{22}

The Delaware Supreme Court held that the directors had not made an informed business decision and failed to avail themselves of information which was reasonably necessary in making such a decision.\textsuperscript{23} There were no allegations of fraud, bad faith, or self-dealing; therefore, the court's analysis focused on the directors' duty of care rather than the duty of loyalty and its intrinsic fairness standard.\textsuperscript{24} Typically, the Business Judgment Rule would be the applicable defense and the court would defer to the directors' judgment in making the decision to sell the company.\textsuperscript{25} However, the court found that the directors were grossly negligent in failing to reach an informed decision.\textsuperscript{26}

The board of directors argued that their decision was an informed one, based primarily upon the premium the shareholders of Trans Union received for their stock and the collective experience and sophistication of the board members making the decision.\textsuperscript{27} However, the court held that the premium paid, while important, was insufficient by itself to properly evaluate the fairness of any offer.\textsuperscript{28} In response to the collective experience and business sophistication argument, the court held that the directors breached their duty to the company, regardless of their experience, when they relied almost completely upon the premium offer as justification for their decision.\textsuperscript{29} Ultimately, the court held that the Business Judgment Rule afforded no protection for directors who make "unintelligent or

\begin{itemize}
\item\textsuperscript{20} Id. at 867-68.
\item\textsuperscript{21} Id. at 868, 869.
\item\textsuperscript{22} Id. at 870, 863-64.
\item\textsuperscript{23} Id. at 874.
\item\textsuperscript{24} Id. at 872-73.
\item\textsuperscript{26} Van Gorkom, 488 A.2d at 873.
\item\textsuperscript{27} Id. at 875. The defendants also argued that a market test period was performed and that they had relied on legal advice that they would be sued if they did not take the deal. Id.
\item\textsuperscript{28} Id. The $55 per share offer was a premium of approximately $17 per share.
\item\textsuperscript{29} Id. at 880. The offer included a 90-day market test to determine whether there were higher bids available; the court found this market test to be inadequate to offset the board's overall negligence. Id. at 879-80.
\end{itemize}
unadvised judgment[s]." Thus, Van Gorkom has heralded the end of the "reflexive deference" that courts have traditionally paid to board room decisions.\textsuperscript{31}

LEGISLATIVE REACTION

The predictability of courtroom deference to director decisions ended with Smith v. Van Gorkom.\textsuperscript{32} Carriers that provide liability insurance for directors and officers had to take a new look at their position subsequent to this decision.\textsuperscript{33} As a result, insurance premiums soared to record levels and carried increased deductibles, reduced limits, expanded exclusions and more narrow definitions.\textsuperscript{34} Outside directors began to resign from boards rather than serve with what they considered inadequate protection from liability for basic corporate decisions.\textsuperscript{35} As a response to the dwindling availability of directors and officer liability insurance, virtually every state legislature has taken some action in an effort to reduce the potential liability created by Van Gorkom.\textsuperscript{36}

One author has identified seven basic forms of legislative response to the director-liability issue: (1) charter-option statutes; (2) self-executing statutes; (3) cap-on-money damages statutes; (4) expanded-indemnifiability statutes; (5) expansion of nonexclusivity statutes; (6) nonstockholder-constituency statutes; (7) alternative-sources-of-reimbursement statutes.\textsuperscript{37}

By far the most utilized form of statutory limitation of director liability has been the charter-option statute.\textsuperscript{38} After Delaware enacted a charter-option statute, thirty other states adopted similar legislation.\textsuperscript{39} Typically, the charter-option statute authorizes a corporation to adopt in its articles various provisions which eliminate or limit the personal liability of directors for monetary damages and

\textsuperscript{30} Id. at 872.

\textsuperscript{31} Hanks, Evaluating Recent State Legislation on Director and Officer Reliability Limitation and Indemnification, 43 BUS. LAW. 1207, 1209 (1988).

\textsuperscript{32} See Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

\textsuperscript{33} Hanks, 43 BUS. LAW. at 1209.

\textsuperscript{34} Id. The author noted that according to The Wall Street Journal, premiums increased by over 360% in one year. Id.

\textsuperscript{35} Id. Inside directors are officers of the corporation and cannot resign in order to avoid liability.

\textsuperscript{36} Id. at 1209-10.

\textsuperscript{37} Id. at 1210-31.

\textsuperscript{38} Id. at 1210.

\textsuperscript{39} Id. at 1210. States that have adopted charter-option statutes are: Arizona, Arkansas, California, Colorado, Delaware, Georgia, Idaho, Iowa, Kansas, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Washington and Wyoming. Id. at 1254.
for breaches of fiduciary duties. There are, however, exceptions to the limitation or elimination of liability. Therefore, based upon the typical language presented by charter-option statutes, shareholders, rather than the legislature, have the right to decide to what extent they will reduce or eliminate a duty-of-care breach as a cause of action for monetary damages. The charter-option statutes only apply to money damage suits and do not prevent actions for injunctions or rescission. Therefore, the statutes will not operate to prevent a suit to enjoin directors from voting either to sell or merge their company.

The typical exceptions to the charter-option statutes are: (1) breach of the directors' duty of loyalty to the corporation; (2) acts or omissions done not in good faith; (3) intentional misconduct; (4) a knowing violation of law; (5) unlawful distributions or dividends; and (6) transactions whereby a director derived improper personal benefits. The exception for a breach of the duty of loyalty will necessarily focus increased attention and create litigation on the issue of the duty of loyalty when the Business Judgment Rule does not immunize a director's decision which involves self-dealing or conflicts of interest. Thus, director decisions which involve self-interest or suspect loyalties are not protected by the charter-option statutes.

Self-executing statutes have been adopted by Indiana, Ohio, Florida, Wisconsin and Maine. These statutes differ from charter-option statutes in that the legislatures have established that directors are liable only if they breach duties of statutorily defined standards of care. The statutes establish the standard by which the director's or officer's conduct is judged, and therefore the directors are liable only if they fail to meet these specific standards. A typical statute is the Florida provision which states that a director "is not personally liable for monetary damages to the corporation or any other person for any statement, vote, decision, or failure to act, regarding corpo-

40. Id. at 1210-11.
41. Id. at 1211-12.
42. Id. at 1210-11.
43. Id. at 1215.
44. Id. at 1215-16.
45. Id. at 1211-12.
46. See id. at 1212.
47. Id. at 1212-13. It is important to note that several states have omitted from their charter-option statutes the duty-of-loyalty exception. They are: California, Georgia, Maryland, Nebraska, Nevada, New Mexico, New York, North Carolina, Pennsylvania, Virginia and Washington. Id. at 1213.
48. Id. at 1216.
49. Id.
50. Id.
rate management or policy."\textsuperscript{51}

As another response to the issue of director liability some state statutes directly limit the amount of money damages available to shareholders or derivatively, to the corporation.\textsuperscript{52} In Virginia, damages are limited to $100,000 or the amount of compensation received by the officer or director during the preceding twelve months.\textsuperscript{53} These cap-on-money damages statutes do not apply to willful misconduct or knowing violations of state or federal law.\textsuperscript{54}

Some states have enacted expanded-indemnifiability statutes which give additional rights to corporations to indemnify directors for settlements made in adverse judgments.\textsuperscript{55} Prior to the expansion of these statutes, the typical provision would indemnify the director or officer against expenses in the case of successful lawsuits, but only permit indemnification in unsuccessful suits if ordered by a court.\textsuperscript{56} The expanded variety of indemnification statutes eliminates the distinction between third party and derivative suits and permits indemnification for directors who meet certain statutory standards without requiring court approval.\textsuperscript{57} For example, the Wisconsin statute requires indemnification for directors or officers against liabilities in any proceeding unless the director breaches a statutorily defined duty owed to the corporation.\textsuperscript{58}

Twenty-nine states have also included nonexclusivity provisions in their corporate statutes.\textsuperscript{59} These provisions allow corporations to give rights to directors other than indemnification. The typical statute states simply that the statutory indemnification provided elsewhere by the corporate statute is not deemed to be exclusive and that additional indemnification may be provided by agreement or other-

\textsuperscript{51} FLA. STAT. ANN. § 607.1645(1) (West Supp. 1989).
\textsuperscript{52} Hanks, 43 BUS. LAW. at 1219-21.
\textsuperscript{54} Id.
\textsuperscript{55} Hanks, 43 BUS. LAW. at 1221-23. States with expanded-indemnifiability statutes are: Arizona, Arkansas, California, Delaware, Florida, Georgia, Indiana, Kansas, Louisiana, Maine, Maryland, Michigan, Minnesota, Missouri, Nevada, New York, North Carolina, Utah, Wisconsin and Wyoming. \textit{Id.} at 1254.
\textsuperscript{56} \textit{Id.} at 1221.
\textsuperscript{57} \textit{Id.}
\textsuperscript{58} \textit{Id.} at 1222. Such statutorily-defined standards are: willful failure to deal fairly with the corporation when conflict of interest exists; criminal activity; improper personal profit; and willful misconduct. WIS. STAT. ANN. §§ 186.044, 048 (West Supp. 1987).
The reason for the addition of these nonexclusivity provisions is that prior case law had interpreted the statutory indemnification protections as being the exclusive protection for directors. Some states provide express limits for the nonexclusivity provision within their statutes. Additionally, there may be exceptions for willful or intentional misconduct. However, because this latter exception applies only to indemnification, the nonexclusivity statute will apparently allow for advancement of expenses.

Fourteen states have adopted nonstockholder-constituency statutes. The primary rationale for these statutes is to allow directors, when considering the best interests of the corporation, to consider the corporation's employees, customers, suppliers, creditors, the community in which it is located, and the long-term interests of the corporation and its shareholders. A director of a corporation incorporated in a state having a nonshareholder-constituency statute may consider nonshareholder interests when making board decisions. However, the necessary caveat is that such interests must be in connection with the best interests of the corporation. Thus, it will not be inappropriate for boards to consider community concerns when making decisions such as the sale of the entity.

Under alternative-sources-of-reimbursement statutes, corporations may provide reimbursement from sources other than conventional insurance. Examples of such sources are: letters of credit, captive insurance subsidiaries, trust funds, association captives formed by industry groups, sureties and guaranties. A typical statute is that enacted in Ohio, which authorizes a corporation to have director and officer insurance, as well as "similar protection, including but not limited to trust funds, letters of credit, or self-insurance." Thus, the shareholders usually will retain the "economic risk of the director's misconduct" because the funds are typically pro-

60. DEL. CODE ANN. tit. 8, § 145(f) (Supp. 1988).
61. Hanks, 43 BUS. LAW. at 1224-25.
62. Id. at 1224.
63. Id. at 1225.
64. Id.
65. Id. at 1227. The states are: Arizona, Idaho, Illinois, Indiana, Kentucky, Maine, Minnesota, Missouri, Nebraska, New Mexico, New York, Ohio, Pennsylvania and Wisconsin. Id. at 1254.
67. Hanks, 43 BUS. LAW. at 1227. It is interesting to note that Arizona's statute provides that directors "shall" consider such other constituencies. See infra notes 103-04 and accompanying text.
68. Hanks, 43 BUS. LAW. at 1227.
69. Id. at 1230.
70. Id.
vided from corporate self-insurance.\textsuperscript{72}

DELAWARE AND ARIZONA DIRECTOR LIABILITY STATUTES

Delaware was the originator of the charter-option statute.\textsuperscript{73} In addition, Delaware has enacted expanded-indemnifiability and expanded-nonexclusivity provisions.\textsuperscript{74} The principal language of the Delaware charter option statute provides that a corporation's articles may contain any or all:

1. provisions which limit or eliminate personal liability of directors for money damages;
2. but that such provisions do not eliminate or limit liability when the duty of loyalty, acts not in good faith, or when improper personal benefits are involved.\textsuperscript{75}

The Delaware statute therefore expressly prohibits any limitation on liability for breach of a director's duty of loyalty, acts not in good faith, acts which involve intentional misconduct, or acts which involve improper personal benefit.\textsuperscript{76} The charter option provision applies only to directors and not to officers.\textsuperscript{77} In addition, the statute has no effect on equitable relief, allowing rescission or injunctions for breaches of any fiduciary duty.\textsuperscript{78}

The result brought about by the Delaware statute may have an impact on the method by which courts analyze the distinction between the duty of due care and the duty of loyalty. Once a court characterizes the issue as involving a duty of due care, the Delaware statute (provided the shareholders have voted to include such language in their charter) will operate to relieve directors of money

\textsuperscript{72} Hanks, 43 Bus. Law. at 1231.
\textsuperscript{73} Id. at 1210. Del. Code Ann. tit. 8, § 102(b)(7) (Supp. 1988).
\textsuperscript{74} Del. Code Ann. tit. 8, § 145(b), (f) (Supp. 1988).
\textsuperscript{75} Id. § 102(b)(7) (Supp. 1988). The Delaware statute provides:

(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 [the section dealing with conflict of interest]; or (iv) for any transaction from which the director derived an improper personal benefit.

\textsuperscript{76} Id.
\textsuperscript{77} Id.
\textsuperscript{78} Id.
damage liability for violations of the duty of due care. However, if
the court characterizes the issue as one involving a duty of loyalty,
the Delaware statute specifically excludes such conduct from nonli-
ability. Therefore, the court will settle the question of the applica-
ability of the charter-option statute based upon its initial
determination of which duty is involved.

This distinction is most critical when examining takeover trans-
actions. Management may enact defensive tactics which make a take-
over more difficult. The issue is therefore raised, at least with
respect to the application of the Delaware charter amendment stat-
ute, whether such defensive tactics fall within the duty of loyalty or,
in the alternative, within the duty of due care. Presumably, if the
court were to hold that such decisions fall within the duty of loyalty,
given the inherent self-interest in management and directors in re-
taining their positions, the charter-option statute may not apply. Sev-
eral states have avoided the potential problem of distinguishing
between the duties by eliminating the duty of loyalty exception from
their respective statutes.

The Delaware expanded indemnifiability and nonexclusivity pro-
visions are codified in section 145 of the Delaware corporate stat-
utes. The indemnifiability section provides that the corporation

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79. Id. § 102(b)(7)(i).
80. The Delaware Supreme Court has, in Unocal Corp. v. Mesa Petroleum Co.,
493 A.2d 946 (Del. 1985) and subsequent decisions, established a modified business
judgment rule to determine the propriety of takeover defenses. Under this modified
test the board of directors must first prove that a specific threat to the corporation's
policy and effectiveness exists and second, that the defensive measure was reasonable
in relation to the threat perceived. If the answer to this dual inquiry is yes, then the
modified business judgment rule is utilized by the court in its analysis and serves to
protect the actions taken by the board in defending its corporation. Id. at 955-56.
81. See supra note 47.
82. See supra note 74 and accompanying text. According to DEL. CODE ANN. tit. 8,
§ 145(b):
A corporation may indemnify any person who was or is a party or is
threatened to be made a party to any threatened, pending or completed action
or suit by or in the right of the corporation to procure a judgment in his favor
by reason of the fact that he is or was a director, officer, employee or agent of
the corporation, or is or was serving at the request of the corporation as a di-
rector, officer, employee or agent of another corporation, partnership, joint
venture, trust or other enterprise against expenses (including attorneys' fees)
actually and reasonably incurred by him in connection with the defense or
settlement of such action or suit if he acted in good faith and in a manner he
reasonably believed to be in or not opposed to the best interests of the corpo-
ration and except that no indemnification shall be made in respect of any
claim, issue or matter as to which such person shall have been adjudged to be
liable to the corporation unless and only to the extent that the Court of Chanc-
cery or the court in which such action or suit was brought shall determine
upon application that, despite the adjudication of liability but in view of all
the circumstances of the case, such person is fairly and reasonably entitled to
indemnity for such expenses which the Court of Chancery or such other court
shall deem proper.
may indemnify directors or officers (or any other person) against judgments and attorney's fees if the party acted in good faith and if that person wins the lawsuit. The corporation may only indemnify parties adjudged liable if approved by a court.

Therefore, the corporation may indemnify a director or officer for expenses and attorney fees provided that the director or officer acted in good faith and, in addition, that he reasonably believed the actions to be in the best interests of the corporation. However, the statute specifically excludes indemnification if the director or officer has been adjudged to be liable (to the corporation in a derivative suit), unless the court determines that the person is reasonably entitled to such indemnity. This statute, while expanded from the previous Delaware indemnity provision, is not as broad as other states' indemnification statutes which permit indemnification in the event the director or officer meets a statutorily-defined standard of conduct. This indemnifiability is provided regardless of whether the director or officer is adjudged liable.

Delaware, in addition to its indemnification statute, provides in section 145 that statutory indemnification is not deemed to be exclusive of other rights of persons who look for indemnification from the corporation. The Delaware statute provides that the corporation may enact bylaws or other forms of agreements to indemnify directors or officers. Unlike other states, Delaware does not provide an express limit for this nonexclusivity provision. One author notes that it is likely that a court would add its own public policy limit to this provision. Therefore, it may be that the outer limit of the Delaware nonexclusivity provision is not as broad as it appears. It is also noteworthy that Delaware corporate statutes provide this nonexclusivity provision for the advancement of expenses, as does the general indemnification statute.

Arizona has enacted charter-option, expanded-indemnifiability, expanded-nonexclusivity, alternative-reimbursement, and nonstockholder-constituency provisions in its corporate statutes. The Aria...
zona charter-option statute is very similar to Delaware and other
state statutes. This statute makes the enactment of the provision
the responsibility of the shareholders by requiring the provision be
affirmatively voted upon. In addition, the statute does not apply to
a breach of the directors' duty of loyalty, acts not in good faith, trans-
actions involving improper personal benefits, or when conflicts of in-
terest arise. The statute applies only to monetary damages and is
therefore not effective against rescissionary or injunctive requests for
relief.

The Arizona corporate statutes provide for expanded indemnifi-
cation of directors and officers. This expanded-indemnification

provides:

9. If the liability of directors is limited or eliminated, 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. No provision in the articles may eliminate or limit the liability of a di-
rector for any of the following:
(a) Any breach of the director's duty of loyalty to the corporation or its
shareholders.
(b) Acts or omissions which are not in good faith or which involve inten-
tional misconduct or a knowing violation of law.
(c) Authorizing the unlawful payment of a dividend or other distribution
on the corporation's capital stock or the unlawful purchase of its capital
stock.
(d) Any transaction from which the director derived an improper personal
benefit.
(e) A violation of § 10-041 [which relates to directors' conflicts of interest].

94. Id. Any amendment to the corporation's articles of incorporation must be ap-
proved by the shareholders pursuant to ARIZ. REV. STAT. ANN. § 10-059 (1977).

95. Id.

96. Id. 

97. ARIZ. REV. STAT. ANN. § 10-005(B) (Supp. 1988). This statute provides:
A corporation shall have power to indemnify any person who was or is a party or
is threatened to be made a party to any threatened, pending or completed
action or suit by or in the right of the corporation to procure a judgment in its
favor by reason of the fact that he is or was a director, officer, employee or
agent of the corporation, or is or was serving at the request of the corporation
as a director, officer, employee or agent of another corporation, partnership,
joint venture, trust or other enterprise against expenses, including attorneys' fees, but excluding judgments and fines, and, except as hereinafter set forth, amounts paid in settlement, actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted, or failed to act, in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation and except that no indem-
nification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless
and only to the extent that the court in which such action or suit was brought
shall determine upon application that, despite the adjudication of liability but
in view of all circumstances of the case, such person is fairly and reasonably
entitled to indemnity for such expenses which such court shall deem proper.

The court in which any such action or suit was brought may determine upon
statute is essentially the same as its Delaware counterpart.

The Arizona statutes also provide a nonexclusivity provision in which the indemnification offered in the expanded-indemnifiability section is not deemed to be exclusive of any other rights which may be provided by other means. This statute provides that statutorily-provided indemnification is not the exclusive benefit which a corporation may provide. Thus, the corporation may in effect enact any agreement providing the directors or officers with indemnification.

The primary distinction between the Arizona and Delaware nonexclusivity provisions is the use of the words “and other benefits” by Arizona in place of the “advancement of expenses” language adopted by Delaware. One author has noted that the impact of this different language “arguably includes alternative sources of reimbursement, as opposed to simply advancement of expenses” and thereby further expands the nonexclusivity theory of altering director liability in Arizona.

Arizona specifically provides for the authorization by a corporation of alternative means of reimbursement for director liability. This alternative reimbursement statute provides that a corporation may provide insurance for directors, officers or employees against liability irrespective of whether the corporation would have the power to do so under other provisions of the statute. Thus, even if a person is liable for the conduct in issue, the corporation may nonetheless

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application that, in view of all circumstances of the case, indemnity for amounts paid in settlement is proper and may order indemnity for the amounts so paid in settlement and for the expenses, including attorneys' fees, actually and reasonably paid in connection with such application, to the extent the court deems proper.

Id.

98. ARIZ. REV. STAT. ANN. § 10-005(F) (Supp. 1988). Subsection (F) provides: The indemnification and other benefits provided by this section or otherwise provided by law shall not be deemed exclusive of any other rights to which those benefited may be entitled under bylaw, agreement, vote of shareholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office.

Id.

99. Id.

100. Hanks, 43 BUS. LAW. at 1226.

101. ARIZ. REV. STAT. ANN. § 10-005(G),(H) (Supp. 1988). This section provides:

G. A corporation shall have the power to purchase and maintain insurance on behalf of or insure or cause to be insured any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liability under the provisions of this section. As used in this subsection, “insurance” includes retrospectively rated and self-insured programs.

H. No retrospectively rated or self-insured program under subsection G pro-
insure that conduct and, therefore, exonerate that person from liability. One of the key aspects of the Arizona statute is the authorization for retrospectively-rated and self-insured programs, thereby providing for what is essentially shareholder-backed indemnification of director misconduct.\textsuperscript{102}

Arizona further permits the directors of corporations to specifically consider interests other than those of their shareholders.\textsuperscript{103} This nonshareholder constituency statute provides:

A. In discharging the duties of the position of director, a director, in considering the best interests of the corporation, shall consider the long-term as well as the short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation.\textsuperscript{104}

This statute, unlike several other states' nonshareholder constituency statutes, uses the term "shall" when discussing the constituencies which a director may consider when making decisions. Therefore, not only may a director consider constituencies other than its own shareholders, but the statute technically requires the director to consider both long- and short-term interests of the corporation which may include those interests which are best served by the corporation's continued independence. Thus, at least in the takeover context, the directors are admonished to consider not only the best interests of the shareholders who are receiving a premium for their shares, but also the benefits that may be obtained from the continued independence of the corporation.

Presumably, this language may create doubt as to the propriety of automatically conducting an auction under the rule established by the Delaware Supreme Court in \textit{Revlon, Inc. v. MacAndrews & viding coverage for directors and officers shall include coverage for any of the following:

1. An action based on or attributable to the person gaining in fact any personal profit or advantage to which he was not legally entitled.

2. An action for the return of any remuneration paid to the person without the previous approval of the stockholders which is held by the courts to have been illegal.

3. An action for an accounting of profits in fact made from the purchase or sale by the person of securities of the corporation within the meaning of § 16(b) of the Securities Exchange Act of 1934 and amendments of that act or similar provisions of any statute.

4. An action brought about or contributed to by the dishonesty of the person.

\textit{Id.} \textsuperscript{102.} \textit{Id.} \textsuperscript{103.} \textit{Id.} § 10-1202(A) (Supp. 1988). \textsuperscript{104.} \textit{Id.}
Forbes Holdings, Inc.\textsuperscript{105} The law may develop in Arizona that the directors not only may but must consider other aspects of the transaction, rather than merely focusing on the maximization of shareholder benefits.

DELWARE AND ARIZONA COMPARED

An analysis of the legislation enacted in response to Van Gorkom in Delaware and Arizona shows that there is little distinction between their respective provisions.\textsuperscript{106} Principally, Arizona has the benefit of the nonstockholder-constituency statute, as well as an expanded alternative-reimbursement provision.\textsuperscript{107} The most significant statute affecting this area is the charter-option statute. The Arizona statute is virtually identical to that enacted in Delaware.\textsuperscript{108}

The primary distinction between the two states' provisions is the inclusion in the Arizona corporate statute of the nonshareholder constituency provision.\textsuperscript{109} In the takeover context, directors have traditionally been forced to primarily consider shareholder maximization of wealth or fear lawsuits for a breach of fiduciary duty. In Arizona, directors now have a statutory duty to consider short- and long-term interests of the corporations, including "the continued independence of the corporation."\textsuperscript{110} Thus, directors are free to evaluate facets of a transaction which do not directly benefit shareholders and, perhaps, conclude it best to remain independent.

This provision provides statutory authority for a board to consider the effect that a takeover may have on constituencies other than its shareholders. However, when directing boards to consider such constituencies, the use of the word "shall" rather than "may" in the statute could create, rather than reduce, litigation. Presumably, suits could be initiated against directors on the theory that short- or long-term interests were not considered, thus violating the "shall consider" directive of the statute.

In addition, Arizona's adoption of the alternative-reimbursement provision which states "whether or not the corporation would have the power to indemnify him" may essentially make the corporation

\textsuperscript{105} See supra notes 73-104 and accompanying text.
\textsuperscript{106} See supra notes 99-104 and accompanying text.
\textsuperscript{107} See supra notes 73-80, 91-95 and accompanying text.
\textsuperscript{108} See supra note 103 and accompanying text.
\textsuperscript{109} See supra notes 103-04 and accompanying text.
an insurer of director or officer misconduct.\textsuperscript{111} While there are some exceptions to reimbursable conduct, the overall application of the section will allow shareholders to vote to reimburse officers or directors, whether liable for the infraction or not. Thus, this provision creates a further inducement for the selection of Arizona as the state of incorporation if the primary concern is with director or officer liability.

**PLANNING TO MEET THE VAN GORKOM BLUEPRINT FOR INFORMED DECISIONS**

As an alternative to mere reliance upon indemnification and other exculpatory provisions in a state's corporate statute, a board of directors may wish to embark on a more enlightened path: engage in conduct which enables them to pass the blueprint of the Van Gorkom informed business judgment. While one author criticizes Van Gorkom on the basis that it results in unnecessary formalism and increased costs, the decision nevertheless remains a guide for director conduct.\textsuperscript{112} The theory of the Van Gorkom holding was that no matter how great a premium was paid for the stockholders' shares, the board of directors should consider as many factors as are possible to ensure that "its business judgment was an informed one."\textsuperscript{113} Therefore, directors may wish to consider the type of conduct which meets the informed judgment requirements.

To begin with, directors should be given notice and an agenda of all matters to be considered at the proposed meeting.\textsuperscript{114} The agenda and advance notice will assist the director in preparing and being able to review copies of documents or items to be discussed or approved at the meeting.\textsuperscript{115} All necessary financial data should be included in order to properly consider the appropriate decision.\textsuperscript{116}

Next, there should be allowed a sufficient amount of time during and after director meetings to ensure that appropriate deliberation is given to the decision.\textsuperscript{117} This will avoid the appearance of directors merely ratifying a decision which has already been made.

\begin{footnotes}
\item[111] See supra notes 99-101 and accompanying text.
\item[112] Herzel and Katz, Smith v. Van Gorkom: The Business of Judging Business Judgment, 41 BUS. LAW. 1187, 1191-92 (1986). The authors noted that these results would occur due to increased requirements for lawyer's opinions, accounting, and consulting arrangements. \textit{Id}.
\item[113] Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).
\item[114] Wander and Lanznar, Assault on the Boardroom: What Happens When Company Directors are Held Personally Liable for the Board's Decisions, 5 COMPLEAT LAW., Spring 1988, at 9, 12.
\item[115] \textit{Id.} at 12.
\item[116] \textit{Id.}
\item[117] \textit{Id.}
\end{footnotes}
The directors should ask extensive and thoughtful questions of management regarding their plans and proposals, and especially, whether there are alternatives to the proposed actions. In addition, directors should be made aware of the origin of the data being presented and the assumptions upon which such data was prepared. Directors should also inquire as to the source of reports which are presented and upon what assumptions they were based.

As an additional aid in making an informed decision, the board should have separate action committees consisting of noninterested or outside directors. This can take the form of an audit or special committee which meets and independently views proposals made by various parties. Most state's corporate statutes authorize the formation of committees within the board; this may be especially useful in the leveraged buy-out ("LBO") context. In this regard, the board can form a special committee made up of outside or disinterested directors to evaluate the buy-out offer. The use of this special committee can be a valuable tool in the straight takeover context as well.

When management presents its proposal in the form of a LBO, it is usually based upon recommendations from the company's legal and investment advisors. The outside directors (who are taking the lead in representing the company) should obtain their own separate legal and investment advice. In addition, it is best for these outside directors to distance themselves both socially and professionally from the LBO group until the negotiations are concluded.

As a final precaution, a complete record of the directors' actions and deliberations should be recorded into minutes which evidence the board's due diligence involved in the decision. In this way, the board can prepare a record of its exercise of due care.

CONCLUSION

In summary, there may be distinguishing features between various states' corporate statutes regarding director and officer liability issues. While consideration should be given to the opportunities

118. Id. The board should not passively rely on data and conclusions made by interested parties. Id.
120. Id. at 665, 667-68.
121. Id. at 668-81.
122. Id. at 681.
125. See supra notes 73-104 and accompanying text.
that these statutes provide, the best approach is to formulate a more comprehensive plan to protect directors from breach-of-duty liabilities. It is far from clear how courts may interpret exceptions to the application of director liability-limiting statutes, which leaves considerable doubt as to the potential scope of director liability. Thus, the legal practitioner should utilize a two-step approach: be aware of the state's statutory limitations on director liability; but advise the director to follow the *Smith v. Van Gorkom* blueprint for making an informed business judgment.

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