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NOTES

Corporate Law—THE BUSINESS JUDGMENT RULE IMPOSES PROCEDURAL REQUIREMENTS ON CORPORATE DIRECTORS—*Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985)

In a decision that elicited intense criticism from the nation's boardrooms, the Delaware Supreme Court recently limited the protection available to corporate directors under the Business Judgment Rule. In *Smith v. Van Gorkom*¹ (the *Trans Union Case*) the court reversed the Delaware Court of Chancery and found the directors of Trans Union Corporation personally liable to the corporation's shareholders for breaching the duty of reasonable care. The purpose of this Note is to review the Business Judgment Rule, analyze the court's opinion in the *Trans Union Case*, and assess the criticism the decision has generated.

I. THE BUSINESS JUDGMENT RULE

The Business Judgment Rule is a judicially developed principle of corporate governance that has evolved into a fundamental part of American corporate law over the last 150 years.² Although courts and commentators have articulated a variety of formulations of the rule, defensive use of the Business Judgment Rule has developed largely for two reasons:³ first, to protect officers and directors from personal liability for misjudgments made in the good faith performance of their corporate duties,⁴ and second, out of recognition that judges are not business experts qualified to evaluate complex commercial transactions.⁵ The rule thus operates to

1. 488 A.2d 858, 864, 893 (Del. 1985).

2. Cf. Arsh, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979). It appears the Business Judgment Rule originated in 1829. See *Percy v. Millaudon*, 8 Mart. (n.s.) 68 (La. 1829); *Godbold v. Branch Bank*, 11 Ala. 191 (1847).

3. See Block & Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata?*, 37 BUS. LAW. 27, 32 (1981); Veasey & Manning, *Codified Standard—Safe Harbor or Uncharted Reef?*, 35 BUS. LAW. 919 (1980); Arsh & Hinsey, *Codified Standard—Same Harbor but Charted Channel: A Response*, 35 BUS. LAW. 947 (1980).

4. Block & Prussin, *supra* note 3, at 32.

5. Block & Prussin, *supra* note 3, at 33; *Davis v. Louisville Gas & Elec. Co.*, 142 A. 654, 659 (Del. Ch. 1928) (questions of corporate policy and business management are best resolved outside of courtrooms).

limit the scope of judicial review regarding the merits of most business decisions.⁶

Under the Business Judgment Rule, directors are presumed to have acted with loyalty, good faith, and due care in their decision-making functions.⁷ The Business Judgment Rule does not preclude judicial inquiry into corporate decision-making in all cases, however. The good faith presumption may be rebutted by evidence of fraud⁸ or actions compromising a director's duty of care or loyalty.⁹

Judicial inquiry into the scope of a director's duty of care is limited to determining whether he made a reasonable effort to obtain all necessary information for a particular decision.¹⁰ The Business Judgment Rule protects the director only when the challenged decision was based on adequate information.¹¹ The court will not evaluate the relative weight accorded various potential alternatives so long as the information was obtained and available for consideration.¹²

The Business Judgment Rule may also be invoked when a director's duty of loyalty is questioned.¹³ For a director to avail himself of the rule's protection requires that his actions be motivated by a desire to benefit the corporation.¹⁴ Alternatively, concomitant individual and corporate gain will not render the Business Judgment Rule inapplicable if a good faith corporate purpose also exists.¹⁵ However, where a director has a substantial personal interest in a corporate transaction, the presumption of loyalty ceases.¹⁶ If personal interest is shown, the director must demonstrate that the transaction is intrinsically fair to the corporation.¹⁷

6. See, e.g., *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979). The Business Judgment Rule "bars judicial inquiry into actions of corporate directors taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes." *Id.*; *Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971).

7. See, e.g., *Panter v. Marshall Field & Co.*, 646 F.2d 271, 293 (7th Cir. 1981); *Sinclair Oil Corp. v. Levin*, 280 A.2d 717, 720 (Del. 1971).

8. See, e.g., *Gimbel v. Signal Cos.*, 316 A.2d 599 (Del. Ch.), *aff'd per curiam*, 316 A.2d 619 (Del. 1974).

9. *Auerbach*, 393 N.E.2d at 999-1000; *Sinclair*, 280 A.2d at 720.

10. See, e.g., *Thomas v. Kempner*, 398 A.2d 320, 323-4 (Del. Ch. 1979).

11. *Lutz v. Boas*, 171 A.2d 381, 396 (Del. Ch. 1961).

12. *Stern v. Lucy Webb Hayes Nat'l Training School for Deaconesses & Missionaries*, 381 F. Supp. 1003, 1013-14 (D.C. 1974).

13. *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939).

14. *Gall v. Exxon Corp.*, 418 F. Supp. 508, 515 (S.D.N.Y. 1976).

15. *Hawes v. Oakland*, 104 U.S. 450 (1881).

16. See *Arsht*, *supra* note 2, at 115; *Guth*, 5 A.2d at 510.

17. *Guth*, 5 A.2d at 511; *Tanzer v. International Gen. Indus.*, 402 A.2d 382, 386 (Del. Ch. 1979).

Recognizing the opportunity for greater liability protection, corporate directors have made offensive use of the Business Judgment Rule to shield themselves from shareholder derivative suits.¹⁸ Generally, offensive use of the rule is made by board appointment of special litigation committees comprised of disinterested and independent directors.¹⁹ These committees investigate allegations in shareholder derivative suits and determine whether maintenance of the action is in the best interests of the corporation.²⁰ These committees generally have the authority to dismiss the action upon determination that the suit is contrary to the interests of the corporation.²¹

Two viewpoints have emerged as to the propriety of special litigation committees. The traditional approach, consistent with the rationale of the Business Judgment Rule, accords great weight to the decision of the disinterested directors and generally limits judicial inquiry to evaluating the disinterested independence of committee members.²² A more revolutionary view, marking an erosion of the Business Judgment Rule, recognizes that a so-called disinterested special litigation committee is actually a subset of the board. Therefore, to some extent, the independent directors will sympathize with their colleagues and, thus, not be truly disinterested.²³ More skeptical courts extend considerably less deference to the decision of the committees.

The weight accorded special litigation committees' decisions, and indeed the Business Judgment Rule in general, are issues of state law. An individual state's resolution of these issues will effectively determine the extent to which it becomes actively involved in corporate governance. The *Trans Union Case* is significant because, given Delaware's status as one of the nation's leading corporate states, the Delaware Supreme Court's treatment of the Busi-

18. See Block & Prussin, *supra* note 3, at 38.

19. This practice was introduced in *Gall* and discussed in Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261, 271 (1981).

20. *Gall*, 418 F. Supp. at 514.

21. *Id.*

22. See, e.g., Auerbach, 393 N.E.2d at 996; Morris & Henry, *The Aftermath of Zapata Corp. v. Maldonado: What Is Left of the Business Judgment Rule?* 88 DICK. L. REV. 411, 417 (1984).

23. See *Zapata Corp. v. Maldonado*, 430 A.2d 779, 787 (Del. 1981); Block & Prussin, *supra* note 3, at 55. DEL. CODE ANN. tit. 8, § 141(c) (1974), allows a board to delegate all of its authority to a committee.

ness Judgment Rule may have an influence felt far beyond that state's borders.

II. FACTUAL BACKGROUND

Trans Union's shareholders brought a class action against Marmon Group, Inc., seeking rescission of a cash-out merger of Trans Union into New T Company, a wholly owned subsidiary of Marmon, which was controlled by the Pritzker family.²⁴ In the alternative, the shareholders sought damages against the Trans Union directors personally.²⁵ The Delaware Court of Chancery summarily dismissed the suit, finding "(1) that the Board of Directors had acted in an informed manner so as to be entitled to protection [under the] business judgment rule . . . and (2) that the shareholder vote approving the merger should not be set aside because the stockholders had been 'fairly informed' by the Board" prior to the formal vote on the merger.²⁶ The Delaware Supreme Court reversed the court of chancery, rejecting its factual and legal conclusions. The directors were held personally liable for the fair value of the shareholders' stock.²⁷

Trans Union was a diversified, publicly traded holding company with annual cash flows of hundreds of millions of dollars.²⁸ However, the company had accumulated substantial investment tax credits and was unable to produce sufficient taxable income to take advantage of them.²⁹ As an alternative to Trans Union's practice of offsetting its credits by acquiring small income-producing companies, Donald Romans, Chief Financial Officer of Trans Union, suggested a leveraged buy out.³⁰ He and Bruce Chelberg, President and Chief Operating Officer of Trans Union, informed the Board that they had performed a preliminary study by "running the numbers" of a potential leveraged buy out at fifty and sixty dollars per share. They found that it would be easy to work a deal at fifty dollars but very difficult at sixty dollars.³¹ At this time, Jerome Van Gorkom, Trans Union's Chairman and Chief Executive Of-

24. *Smith v. Van Gorkom*, 488 A.2d 858, 863 (Del. 1985) [hereinafter cited as *The Trans Union Case*]. A cash-out or leveraged buy out is typically a friendly merger arrangement where the buyer uses the assets of the target corporation as collateral to finance the purchase.

25. *Id.* at 863.

26. *Id.* at 864.

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.* at 865.

31. *Id.*

ficer, stated that he would be willing to take fifty-five dollars for his seventy-five thousand shares, but he vetoed a leveraged buy out by management because of a potential conflict of interest.³²

Intrigued by the prospect of a buy out, Van Gorkom unilaterally decided to meet with corporate takeover specialist Jay Pritzker.³³ Van Gorkom presented to Pritzker a purchase proposal of fifty-five dollars per share,³⁴ purportedly reserving the right to accept a better offer. Pritzker agreed, upon the condition that he be able to purchase one million shares of Trans Union stock at market price. If an "auction contest" developed and Trans Union sold to a higher bidder, then the profit Pritzker would make on those shares would be his fee for being a "stalking horse."³⁵ On Thursday, September 18, Pritzker tendered a cash-out merger offer of fifty-five dollars a share but insisted the Trans Union Board act on the proposal within three days.³⁶ On Friday, September 19, Van Gorkom retained James Brennan, an attorney, to advise Trans Union of the legal aspects of the merger. Van Gorkom called a meeting of senior management for Saturday, September 20, to be followed immediately by a special meeting of the Board.³⁷ The Pritzker offer was received negatively at the senior management meeting. Romans, the Chief Operating Officer, announced that he had done a second study, finding the appropriate price range for a leveraged buy out to be between fifty-five and sixty-five dollars.³⁸ Van Gorkom neither saw Romans' study nor requested that it be made available for the Board meeting.³⁹

32. *Id.* The court found it noteworthy that Van Gorkom, an officer of Trans Union for 24 years, its Chief Executive Officer for more than 17 years, and Chairman of the Board for 2 years, was approaching the mandatory retirement age of 65. *Id.* at 866.

33. *Id.*

34. *Id.* Prior to the meeting, Van Gorkom instructed Trans Union's controller, without consulting the Board or senior management, "to calculate the feasibility of a leveraged buy-out at an assumed price per share of \$55." The record revealed no competent evidence that \$55 represented the per share intrinsic value of Trans Union. *Id.*

35. *Id.* Originally, Pritzker reserved the right to purchase 1,750,000 shares, but later negotiations settled on 1,000,000 shares.

36. *Id.* at 867.

37. *Id.*

38. *Id.* at 867-68. In fact Chelberg, and Peterson the controller, were the only officers to support the proposal. Romans objected to the price as being too low and argued the proposal was a "lock-up" and amounted to 'an agreed merger as opposed to an offer.' He further suggested that inadequate consideration was given to the tax consequences of a cash-out deal on low-basis stockholders, and that the provisions of the agreement prohibiting bid solicitations and the furnishing of inside information to other bidders would inhibit potential offers. *Id.*

39. *Id.* at 867-69. Attorney Brennan had a copy of the proposed merger agreement, but

At the Board meeting, Van Gorkom gave a twenty-minute oral presentation of the Pritzker proposal but failed to mention how the fifty-five dollar purchase price had been reached.⁴⁰ Regarding the fairness of the price, Van Gorkom took the position that a ninety-day market test would validate the Board's approval of the fifty-five dollar price.⁴¹ At the end of the two-hour meeting, the Board approved the agreement sight unseen, purportedly subject to two exceptions to which Pritzker later agreed.⁴² Subsequently, the company issued a press release announcing that both the merger agreement and the Pritzker proposal would be submitted for a shareholder vote if a better offer was not received prior to February 1, 1981.⁴³ Solomon Brothers, retained by Trans Union to solicit additional offers for the company, produced only one serious customer, who later declined to make a final offer.⁴⁴ On February 10, the merger agreement was approved by the shareholders.⁴⁵

III. ANALYSIS

The principal holding in the *Trans Union Case* was narrow. The court held that the Board's September 20 decision approving the proposed cash-out merger "was not the product of an informed business judgment."⁴⁶ In so holding, the court found adequate evi-

copies were not available for the directors. However, as chief financial officer, Romans attended the board meeting and informed the Board of his second study. *Id.*

40. *Id.* at 868. Van Gorkom never disclosed that he suggested the \$55 price to Pritzker, that it was not negotiated, or "the methodology by which he alone . . . arrived at the \$55 figure." *Id.*

41. *Id.* Van Gorkom urged the Board to decide not whether \$55 per share was the highest price the market would bear, but instead whether it was a fair price which should be submitted to the shareholders for acceptance or rejection. The court noted, however, that "a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement." *Id.* at 873. DEL. CODE ANN. tit. 8, § 251(b) (1974), provides that directors must adopt a resolution which approves a detailed merger agreement prior to the agreement being submitted to the shareholders.

42. The *Trans Union Case*, 488 A.2d at 869. The Board claimed to have made its acceptance of the agreement contingent on two items: that Trans Union would be free to accept any better offer made while the market test was going on, and that Trans Union's proprietary information could be shared with other bidders. These conditions were not reflected in the Board's minutes. *Id.*

43. *Id.* at 870.

44. *Id.* at 870. General Electric Credit Corp. negotiated with Trans Union but refused to make a final offer because of the existing merger agreement with Pritzker. *Id.*

45. *Id.* Some 69.9% of the outstanding shares were voted in favor of the merger, 7.25% were voted against, and 22.85% were not voted. *Id.*

46. *Id.* at 864. The court further held that the Board's subsequent amendments of the merger agreement and other attempted curative actions had no effect, and "that the Board did not deal with complete candor with the stockholders by failing to disclose all material

dence that the directors had not availed themselves of all the information reasonably necessary to make an informed decision. Thus, the presumption of reasonable care was overcome.⁴⁷

The court noted that there were no allegations of fraud, bad faith, or self-dealing against the directors, and it therefore presumed the decision was made in good faith.⁴⁸ The directors' loyalties were not in question; the case rested solely on the duty of care. The court also affirmed the applicable standard of care: whether the directors were grossly negligent in failing to reach an informed decision.⁴⁹

Initially, the Trans Union directors argued that their actions between September 20 and the shareholders' vote four months later should be considered in determining whether an informed decision had been made.⁵⁰ The court rejected this post hoc approach and instead evaluated the degree of information available to, and possessed by, the directors on September 20, the date of the actual decision.⁵¹ In what appears to be an exceptionally accommodating approach, the court examined the possible curative effects of the directors' post-September 20 actions.⁵² To evaluate the level of information available after the actual decision had been made would allow the fortuity of subsequent information or circumstances to absolve the directors of an otherwise clear violation of their fiduciary duty.

The directors argued that their decision was informed, based on

facts . . . before securing the stockholders' approval of the merger." *Id.*

47. *Id.* at 893. "In the specific context of a proposed merger . . . a director has the duty under [DEL. CODE ANN. tit. 8, § 251(b) (1974)], along with his fellow directors, to act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders." *Id.* The court also held that the Board failed to disclose to Trans Union's shareholders all material information which a reasonable shareholder would deem necessary to consider when deciding on the Pritzker offer. *Id.* DEL. CODE ANN. tit. 8, § 251 (1974) is the Delaware long-form merger statute.

48. The Trans Union Case, 488 A.2d at 873. The court stated, however, that questions of motive were irrelevant when examining directors' actions under a duty of care analysis. *Id.*

49. *Id.* The Delaware Supreme Court had recently held in *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), that the duty of care under the Business Judgment Rule is based upon the standard of gross negligence.

50. The Trans Union Case, 488 A.2d at 873-74. During this period the Board, among other actions, employed Salomon Brothers to solicit other offers and amended the merger agreement so as to allow Trans Union to run a market test. *Id.* at 878. The Delaware Court of Chancery had considered the actions taken during this four-month period between the approval of the merger agreement and the shareholders' notification in determining that the directors had reached an informed decision. *Id.* at 874.

51. *Id.* at 874.

52. *Id.* at 881.

four factors: (1) the magnitude of the premium between the market value of the stock and Pritzker's offer, (2) an amendment of the September 20 agreement to allow a "market test" period, (3) the collective experience and corporate sophistication of the Board's directors, and (4) reliance on legal advice that rejection of the proposal could lead to a suit against the directors.⁵³ These reasons were deemed insufficient to demonstrate that the Board's decision was informed.

In addressing the first argument, the court acknowledged that a premium paid for stock may be one reason to recommend a merger but, by itself, is insufficient to evaluate properly the fairness of an offer.⁵⁴ This was especially true in Trans Union's situation because the Board was aware that the market had historically undervalued Trans Union's stock.⁵⁵ The Board stated in the proxy statement that the common stock did not reflect the "inherent" value of the company.⁵⁶ Thus, by its own admission, the Board thought it was inappropriate to rely on the market price as an accurate indicator of Trans Union's value.⁵⁷ Yet with no other information designed to value the corporation, the Board agreed to sell Trans Union. Furthermore, it was not disputed that the price paid for publicly traded stock is typically a measure of the value of a minority interest in the corporation.⁵⁸ The Board apparently did not take into consideration the fact that the sale of an entire corporation or of a controlling interest in one generally yields a greater value than the cumulative price per share.⁵⁹ The court also rejected the directors' assertions that they were protected under Delaware law because they had relied in good faith on Van Gorkom's "report" to the Board on the substance of the Pritzker proposal.⁶⁰ Although "re-

53. *Id.* at 875.

54. *Id.* The market price of Trans Union stock on the date of the agreement was approximately \$38 per share. Thus, the offer by Pritzker constituted a premium of \$17 per share. *Id.*

55. *Id.* at 876.

56. *Id.* It was stated in the proxy statement that earnings were "excellent" but that this would probably not be reflected in future stock prices because in the past the market price had not reflected the inherent value of Trans Union. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.* at 875. DEL. CODE ANN. tit. 8, § 141(e) (1974), provides:

A member of the board of directors of any corporation organized under this chapter . . . shall, in the performance of his duties, be fully protected in relying in good faith upon the books of account or reports made to the corporation by any of its officers . . . or in relying in good faith upon other records of the corporation.

port" under the Delaware Code has been liberally construed to include presentations by corporate officers,⁶¹ the court found Van Gorkom to have been uninformed about the basic provisions "of the very document" he discussed.⁶² Because the "report" was not pertinent to the valuation of the corporation, the court characterized the directors' acceptance of Van Gorkom's presentation as "blind reliance" rather than good faith.⁶³ Had the directors made reasonable inquiry of Van Gorkom, the inadequacy of the proposal would have been apparent.⁶⁴ In a portion of the opinion that has received much criticism,⁶⁵ the court noted that the directors did not call for an outside valuation study or fairness opinion of Trans Union.⁶⁶ Although the court clearly stated that an outside valuation study was not necessary, nor an investment banker's opinion required, as a matter of law,⁶⁷ the decision was hastily labeled an "Investment Banker's Relief Act."⁶⁸ Although the Trans Union Board had Solomon Brothers on retainer, its merger and acquisition specialist, who was based in Chicago and familiar with Trans Union's affairs, was not consulted.⁶⁹ The complete failure of the Board to in any way objectively verify the fifty-five dollar price offered by Pritzker compelled the court's finding that the Board's decision was insufficiently informed to qualify for protection under the Business Judgment Rule.

The Board's second argument suggested that the market test, whereby Trans Union could receive other offers for a specified period of time, was a condition of the September 20 agreement. The Board contended that the decision was not impulsive or uninformed and that the marketplace conclusively established that the price was reasonable.⁷⁰ However, the facts on record offered little support for these arguments.⁷¹ Van Gorkom admitted having never read the merger agreement and stated he was relying on his under-

61. *Cheff v. Mathes*, 199 A.2d 548, 556 (Del. 1964).

62. *The Trans Union Case*, 488 A.2d at 875.

63. *Id.*

64. *Id.* at 875.

65. *See infra* note 106.

66. *The Trans Union Case*, 488 A.2d at 876.

67. *See infra* text accompanying note 117.

68. *But see* Manning, *Reflections and Practical Tips on Life in the Boardroom after Van Gorkom*, 41 BUS. LAW. 1, 3 (1985). "[I]t is an overstatement to consider the *Van Gorkom* case as the Investment Bankers' Relief Act of 1985" *Id.*

69. *The Trans Union Case*, 488 A.2d at 877-78.

70. *Id.* at 878.

71. *Id.* There was no showing that the merger agreement or any amendment to it permitted a public auction with Trans Union going to the highest bidder. *Id.*

standing that corporate directors have an inherent right, based on their fiduciary duty, to accept a better offer.⁷² Van Gorkom further conceded that the agreement barred Trans Union from actively soliciting other offers or furnishing nonpublic information about Trans Union to other interested parties.⁷³ Although the shareholders requested that the directors produce the merger agreement for evidentiary purposes, the directors, without explanation, failed to do so.⁷⁴ Likewise, the directors failed to call James Brennan, Trans Union's outside attorney, for verification of the agreement's contents.⁷⁵

The Board's contention that the sale price was validated as reasonable by the market was unpersuasive because the press release issued by the Board on September 22 stated that Trans Union had entered into "definitive agreements" with Pritzker and failed to mention any right to accept higher offers. These factors would have effectively precluded other offers.⁷⁶ Furthermore, the press release was accompanied by a public announcement that Pritzker had been granted an option to purchase one million shares of Trans Union, further diminishing potential interest in the company.⁷⁷

The Board's third and probably most persuasive argument was that the collective experience and business sophistication of the directors warranted the conclusion that the decision to sell was informed and reasonable. The court acknowledged the exceptional backgrounds of the "inside" and "outside" directors of Trans Union,⁷⁸ but determined that the defendants' "unfounded reliance" on the premium and market test undermined their argument.⁷⁹ Notably, the court did not criticize the substantive decision made by the Board; rather the court found that the procedure

72. *Id.* at 879.

73. *Id.* at 878.

74. *Id.* The court stated that the defendants' failure to produce the original merger agreement warranted the inference that the document authorized Trans Union to receive competitive proposals. *Id.*

75. *Id.* at 879.

76. *Id.*

77. *Id.* at 879-80. Another corporation interested in purchasing Trans Union would have to pay at least \$17 million more because of the option given to Pritzker.

78. *Id.* at 880 n.21. The court noted in detail the impressive backgrounds of both the "inside" and "outside" directors. The inside directors collectively had 116 years of employment with Trans Union and 68 years on the Board of Directors. The outside directors were eminent businessmen with 50 years combined experience as directors of Trans Union. *Id.*

79. *Id.* at 880.

used, or lack of procedure, precluded the board from reaching an informed judgment.⁸⁰

In their final argument, the directors contended that they relied on their attorney's legal advice that Delaware law did not require a fairness opinion or an outside valuation prior to sale.⁸¹ The court acknowledged the correctness of the legal advice but found it irrelevant to the issue of whether the decision to sell was informed.⁸² The sole concern regarding the Business Judgment Rule was whether the directors adequately informed themselves of the value of Trans Union prior to their decision to sell the corporation.⁸³

The Delaware Supreme Court found a complete lack of merit in the justifications offered by the directors. The court held the directors personally liable for a breach of their fiduciary duty of reasonable care.⁸⁴ Approval of the sale of a publicly held multimillion dollar corporation based on an undocumented twenty-minute oral presentation, in the absence of exigency cannot, in the most permissive interpretation of the fiduciary duty of care, be considered an informed business decision.

IV. A RESPONSE TO THE CRITICISM

Criticism of the *Trans Union Case* has been largely premised upon the misperception that the Delaware Supreme Court departed from traditional Business Judgment Rule principles.⁸⁵ Although the decision appears to be the first case turning "solely on the basis of the Board's decision-making processes,"⁸⁶ it is actually a clarification of the existing due care requirement rather than an erosion of the rule's protection.⁸⁷ Considering the many inconsistent formulations of the rule in prior case law, misconceptions sur-

80. *Id.* at 881; accord *Gimbel v. Signal Cos.*, 316 A.2d 599, 599 (Del. Ch.), *aff'd per curiam*, 316 A.2d 619 (Del. 1974).

81. *The Trans Union Case*, 488 A.2d at 880.

82. *Id.* at 881.

83. *Id.* The court agreed that outside valuation studies and fairness opinions were not required by law; however, the court found that, in the absence of outside studies, the Board did not have sufficient information as to the intrinsic value of Trans Union on which to base an informed business judgment. *Id.*

84. *Id.* at 893.

85. See Schwartz & Wiles, *Business Judgment Rule Clarified by Del.'s Trans Union Decision*, NAT'L L.J., July 8, 1985, at 1, 42.

86. *Id.* at 44.

87. *The Trans Union Case* decision does not undermine *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963), where the court stated that "directors are entitled to rely on the honesty and integrity of their subordinates until something occurs to put them on suspicion."

rounding the actual requirements of the Business Judgment Rule are understandable.⁸⁸

Until recently, the focal point of the Business Judgment Rule has been on the substantive fairness of directors' decisions.⁸⁹ In such determinations, the rule was assumed to attach with equal force to all directors' decisions,⁹⁰ thus limiting the court's inquiry to whether the business judgment was so grossly negligent as to warrant piercing the rule's considerable protection. In this context, the rule and its underlying justifications are at their strongest.⁹¹ However, when the focus is shifted to the procedural due care exercised by directors in acquiring the information necessary for an informed decision, it appears the justifications for the rule are diminished.⁹² While it is undoubtedly sound policy to provide protection from judicial second-guessing as to a board's substantive decisions, it seems less defensible to protect boards when they fail to use reasonable care in gathering all pertinent information prior to decision-making. This rationale applies with even greater force when the decision involves a fundamental change in the corporation.

Acquiring information for business decisions is expensive.⁹³ Naturally, then, the amount invested in information should vary with the importance and potential impact of the decision.⁹⁴ A criticism of the *Trans Union Case*, and of any decision going against those seeking the protection of the Business Judgment Rule, is that the court is substituting its determination of the adequacy of information for that of more qualified professional directors.⁹⁵ While this concern is generally valid, fear of judicial second-guessing is not an appropriate criticism of the *Trans Union Case*. Confronted with competing interests of corporate autonomy and the state's respon-

88. Schwartz & Wiles, *supra* note 85, at 44.

89. Manning, *supra* note 68, at 4. "The *Van Gorkom* opinion can be fitted . . . into the . . . business judgment rule jurisprudence, with its emphasis not on the merits of the decision made by the directors but on the process by which the decision was made." *Id.*

90. See Manning, *supra* note 68, at 5. "The literature on the business judgment rule accords no significance to the character of the particular issue being decided by the directors. Judicial and law review discussions take it for granted that the business judgment rule applies uniformly to all decisions by the board." *Id.*

91. It is in this area that directors' experience and business intuition should be given the widest latitude.

92. In the gamble for profits, hindsight will demonstrate some decisions to be improvident; however, as a social policy the risk of loss becomes intolerably high when the gamble is not based on adequate information.

93. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437, 1441 (1985).

94. *Id.*

95. *Id.*

sibility for corporate governance, the court in the *Trans Union Case* rendered a traditional Delaware business-friendly definition of the Business Judgment Rule.⁹⁶ The rule provides an across-the-board presumption that directors are fully informed prior to making a decision; gross negligence is required to overcome that presumption.⁹⁷ It is difficult to imagine how the court could have fashioned a more promanagement formulation of the rule.⁹⁸ If the *Trans Union Case* is open to any criticism from a rule-of-law standpoint, it is that the decision is a continuation of Delaware's "race to the bottom" corporate policy.⁹⁹

Unfortunately, the egregious factual circumstances in the *Trans Union Case* preclude safe prophecies about the willingness of Delaware courts to hold directors liable for inadequately informed decisions. While the holding ostensibly provides a gross negligence standard of review for directors' judgments, it also may demonstrate a willingness to engage in heightened judicial scrutiny of decisions involving fundamental corporate change. Just as the rela-

96. Delaware has been soundly criticized both judicially and legislatively for creating an environment extremely favorable to corporations. See generally Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

97. The *Trans Union Case*, 488 A.2d at 873.

98. Concern about the lack of uniformity in the State governance of corporations has led to various proposals to federalize corporation law. Establishing the appropriate due care requirement has been a major obstacle in these proposals. It appears, however, the standard generally proposed is one of negligence as opposed to the gross negligence standard applied in the *Trans Union Case*.

The American Law Institute Corporate Governance Project has articulated the following formulation:

§ 4.01 Duty of Care of Directors and Officers; the Business Judgment Rule.

(d) A director or officer does not violate his duty under this Section with respect to the consequences of a business judgment if he:

(1) was informed with respect to the subject of the business judgment to the extent he reasonably believed to be appropriate under the circumstances; (2) was not interested [§ 1.15] in the subject of the business judgment and made the judgment in good faith; and (3) had a rational basis for believing that the business judgment was in the best interests of the corporation.

A.L.I. PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, Tentative Draft No. 3 (Apr. 13, 1984) (footnotes omitted).

The Model Business Corporation Act sets the following standard:

§ 8.30(a) A director shall discharge his duties as a director including his duties as a member of a committee:

(1) in good faith
(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
(3) in a manner he reasonably believes to be in the best interests of the corporation.

REVISED MODEL BUSINESS CORP. ACT § 8.30 (1984).

99. See Cary, *supra* note 96, at 705.

tive importance of managerial decisions justifies a sliding scale for measuring the duty of information gathering, so the magnitude of the potential effect of board decisions on the corporation may determine the level of scrutiny the court will apply.¹⁰⁰ In particular, the more a decision affects the ownership interests of shareholders, the more willing the court may be to scrutinize the decision.¹⁰¹ A decision to liquidate shareholders' ownership interests, such as that made by the board in the *Trans Union Case*, should require the highest level of predecision information and receive a commensurate level of scrutiny.

The Delaware Supreme Court also has been criticized for its factual findings in the *Trans Union Case*.¹⁰² Rejection of the court of chancery's findings of fact has been described as "arrogance of appellate courts at their worst."¹⁰³ This criticism is neither constructive nor appropriate. While the courts are not in the business of making complex decisions about commercial transactions, and should therefore be hesitant to second-guess decisions of directors, it is well within the court's competence and responsibility to review both the logic and the evidentiary support for factual determinations made by trial courts. In the *Trans Union Case*, the supreme court exercised appropriate judicial restraint in applying the "clearly erroneous" standard of review.¹⁰⁴ After finding the court of chancery's factual determinations were "neither supported by the record nor the product of an orderly and logical deductive process," the court was compelled to reverse.¹⁰⁵ The judicial deference engendered by the Business Judgment Rule does not require appellate courts to accept unsupportable factual findings favorable to corporate directors.

The criticism of the *Trans Union Case* has not been limited to the outcome of the case itself. The paranoia of the business community over the potential effects of the *Trans Union Case* has led to consequences out of proportion to the decision's importance. Among the parade of horrors immediately predicted by the cor-

100. See generally Manning, *supra* note 68, at 5. "It is true that the business judgment rule applies to all directorial decisions. But the criteria within the rule may later be seen to vary as a function of the issue at stake." *Id.* (emphasis omitted).

101. *Id.*

102. See Borden, *First Thoughts on Decision In Delaware on Trans Union*, N.Y.L.J., Feb. 25, 1985, at 1, col. 4.

103. Herzel, Davis & Colling, 'Smith' Brings Whip Down on Directors' Backs, *Legal Times*, May 13, 1985, at 14, col. 4.

104. *The Trans Union Case*, 488 A.2d at 864.

105. *Id.* at 885.

porate Cassandras was an exodus from boardrooms of directors fearful of liability, an increase in the number of insurers unwilling to issue directors' and officers' liability policies, and a chilling effect on managerial risk-taking.¹⁰⁶ Although some of the consequences prophesied have been reflected in recent corporate surveys,¹⁰⁷ this phenomenon is more likely to have been brought on by the misperception of the decision rather than the decision itself. Read in the context of the corporate law decisions immediately preceding and following it, the *Trans Union Case* does not foreshadow a shift in Delaware Business Judgment Rule jurisprudence.¹⁰⁸

Ironically, the *Trans Union Case* may not have been a Business Judgment Rule decision at all. Although couched in traditional due care terms, the broader implication may be that Delaware is unwilling or unready to replace the anachronistic "legal" model¹⁰⁹ of corporate governance with the "actual" model¹¹⁰ which better reflects the corporate reality in modern business society. The legal model, as embodied in the corporate codes of most states, requires that corporations be managed by a board of directors.¹¹¹ While the detached oversight of outside directors¹¹² may be desirable in theory, their ability effectively to direct the corporation is questiona-

106. As these are the very concerns which led to the creation of the Business Judgment Rule, it is obvious that critics of the *Trans Union Case* view the decision as a substantial erosion of the rule. See generally Borden, *supra* note 102; Rovner, *D & O Indemnity: Discrete Contracts Seen as an Option*, Legal Times, Nov. 25, 1986, at 1, col. 3; Manning, *supra* note 68, at 6; Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437 (1985); Blaine, *Liability Looms for firms' boards*, USA Today, Jan. 31, 1986, sec. b, p. 6.

107. See Blaine, *supra* note 106.

108. In two cases decided by the Delaware Supreme Court within 11 months of the *Trans Union Case*, the court found the Business Judgment Rule to protect decisions by directors despite serious questions raised about the propriety of the decisions. See Aronson, 473 A.2d at 805; Pogostin v. Rice, 480 A.2d 619 (1984). In a subsequent case the court held that a board of directors' decision adversely affecting the rights of minority shareholders fell within the rule. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

109. "Legal" model refers to the traditional situation in which directors, as required by corporate codes, manage the corporation.

110. "Actual" model refers to the apparent corporate reality that, notwithstanding the literal requirements of state codes, modern large corporations are managed primarily by corporate officers.

111. For example, the Delaware General Corporation Law states: "The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." DEL. CODE ANN. tit. 8, § 141(a) (1974).

112. "Outside" directors are directors who are unaffiliated with the corporation in any capacity other than as a director.

ble in practice. Directorships of large corporations are often more titular than functional, and those who serve in these part-time positions, frequently do so for numerous corporations.¹¹³ Although generally highly qualified, the only regular contact these directors often have with the corporation is the monthly board meeting; thus, their capacity for actual decision-making is necessarily dependent on information supplied by the corporate officers who are managing the entity's daily operations.¹¹⁴ Furthermore, the compensation of outside directors, who seldom are large stockholders, is not tied to the corporate bottom line, thus limiting the incentive of outside directors to maximize long-term corporate profitability.¹¹⁵ Conversely, senior managers often own a great deal of stock in the firm or have compensation agreements linked to the firm's performance.¹¹⁶ The long-term interests of the corporation and society in general may be more closely aligned with the personal interests of corporate officers. Considering their part-time status, it is questionable whether outside directors truly engage in managerial functions and debatable whether they should.

Regardless of any jurisprudential undercurrents, the *Trans Union Case* remains a coherent explication of a long-existing, fundamental safeguard for corporate management. It is neither a departure from previous Business Judgment Rule holdings nor a harbinger of judicial activism in the corporate sphere.

Concerns that the *Trans Union Case* will amount to an "Investment Banker's Relief Act" ignore the explicit language of the court's opinion. The court specifically stated: "We do not imply that an outside valuation study is essential to support an informed business judgment; nor do we state that fairness opinions by independent investment bankers are required as a matter of law."¹¹⁷ The court further noted that insiders, by virtue of their intimate knowledge of the company's operation, are often in a superior posi-

113. Blaine, *supra* note 106. It is not unusual for a person to serve on the boards of directors of 10 or more large corporations. *Id.*

114. In explaining that inside directors and corporate officers dominate board meetings, Harold Geneen, former Chairman of the Board and Chief Executive Officer of ITT Corp. stated: "Outside board members . . . sit there and listen; then they go . . . home and open the envelopes that contain their fees." Geneen, *Why Directors Can't Protect the Shareholders*, *FORTUNE*, Sept. 17, 1984, at 28.

115. See Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 *J.L. & Econ.* 375, 387-90 (1983).

116. Fischel, *supra* note 106, at 1442.

117. The *Trans Union Case*, 488 A.2d at 876.

tion to evaluate the corporation's worth.¹¹⁸ Recognizing the advantageous position of insiders, the court cited *Cheff v. Mathes*¹¹⁹ for the proposition that directors are fully protected in their good faith reliance on reports by corporate officers.¹²⁰ The court emphasized that Van Gorkom's twenty-minute presentation did not qualify as a "report" so as to justify good faith reliance by the directors.¹²¹ The *Trans Union Case* should not be read to detract from the general rule that directors may rely on inside reports. The ruling may appear economically harsh from the perspective of the directors, but it is doubtful that it will have substantial impact on board decisions whether to seek presale financial analyses. Most multimillion dollar corporations either have an internal mechanism for financial analysis or would obtain an outside opinion as a matter of course.

The reaction to the *Trans Union Case* may itself provide evidence that outside directors play a minor role in corporate governance. The storm of criticism over the decision appears to focus on the issue of certainty: What must directors do to remain within the protective umbrella of the Business Judgment Rule?¹²² Once there is a consensus on the level of the managerial decision-making precautions that are necessary, internal corporate management will ensure the requirements are met. Inasmuch as substantive decisions are virtually immune from attack,¹²³ corporate responsibility to shareholders can be assured only by requiring adequate procedural due care in decision-making.

V. CONCLUSION

For all the outcry in corporate circles, the *Trans Union Case* does not appear to be outside traditional formulations of the Business Judgment Rule. Considering the protection the rule has afforded corporate management over the decades, the criticism leveled at the court's unwillingness to extend the rule further seems highly unjustified. One must wonder if the criticism is directed at the court rather than at the decision itself. Just as a basketball coach may, for tactical reasons, "work the officials" over a close

118. *Id.*

119. 199 A.2d 548 (Del. Ct. 1964).

120. *The Trans Union Case*, 488 A.2d at 876.

121. *Id.* at 875; see *supra* note 60.

122. See generally Manning, *supra* note 68, at 8-14 (establishing a list of director "do's and don'ts" divined from the *Trans Union Case*).

123. *Id.* at 4.

call, the response of corporate managers may be designed to influence as well as to disparage.

"[D]irectors are charged with an unyielding fiduciary duty to the corporation and its shareholders."¹²⁴ To the extent the Business Judgment Rule operates to protect managers from improvident decisions made in good faith or from unfortunate consequences of reasonable decisions, it is a desirable device. However, when reliance on the rule leads to the relaxation of fiduciary conscientiousness, it must yield to the paramount societal interest in shareholder protection. Although created to protect the free exercise of managerial discretion,¹²⁵ the Business Judgment Rule should not be placed on a procrustean bed to cover every fact situation involving managerial decision-making.

The *Trans Union Case* will likely be neither a landmark decision nor have any appreciable effect on traditional Business Judgment Rule jurisprudence. The decision should, however, serve to remind directors that protection under the Business Judgment Rule does not come free. Criticism of the decision, though misguided, should likewise focus public awareness on the fiduciary duties of business leaders.

Contrary to a popular legal maxim, the *Trans Union Case* stands for the proposition that bad facts make good law.

Thomas C. Wagner

124. The *Trans Union Case*, 488 A.2d at 872.

125. *Id.*