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Conclusion

Despite recent responses designed to combat the increased liability exposure of directors and officers, the personal risks for corporate insiders remain significant. With corporations operating in an ever-complex regulatory maze,¹ there has been an increased focus on corporate accountability.² The difficulty in resolving director and officer liability issues, however, arises in balancing the need to punish misguided fiduciaries with the need to protect aggressive managers who take good faith risks to produce increased corporate profits.³ While long-range solutions to this balancing problem are essential, directors and officers should pursue short-term tactics to reduce their risk of personal liability.

Because it is relatively easy to allege that an individual has breached a fiduciary duty, a director or officer may become embroiled in a lawsuit without actually doing anything "wrong." Consequently, all directors and officers should attempt to reduce their exposure to liability. In particular, corporate insiders should understand that certain decisions are especially susceptible to litigation and, therefore, more likely to result in personal liability. Courts are more inclined to second-guess management decisions that impact on shareholders' "ownership" rights.⁴ For example, if a board of directors approves a cashout merger plan that undervalues the shareholders' stock, a court may be more inclined to find the directors personally liable.⁵ In this instance, management's de-

1. See Perkins, *Avoiding Director Liability*, HARV. BUS. REV., May-June 1986, at 8, 8 (stating that "[t]he Foreign Corrupt Practices Act, environmental laws and regulations, comprehensive disclosure requirements for corporate securities transactions, and banking regulations — covering everything from insider loans to foreign exchange transactions — are all examples of the tighter legal requirements for which boards are now responsible").

2. Johnston, *Corporate Indemnification and Liability Insurance for Directors and Officers*, 33 BUS. LAW. 1993, 1993 (1978) (indicating that "[t]here is a growing awareness that the power of corporations and corporate managers carries with it certain responsibilities, both to shareholders and to the public").

3. *Id.* at 1993-94.

4. Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 BUS. LAW. 1, 5 (1985). The author indicates that management decisions generally concern two types of issues: "enterprise" issues and "ownership claim" issues. An example of an enterprise issue is a management decision to expand the corporation's business operation. An example of an ownership claim issue is a management decision to exchange a block of common stock for an asset of questionable value.

5. See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985); see also *supra* *Recent*

cision has severed the shareholders from their investment and caused them to suffer a loss in their role as "owners" of stock.⁶ In contrast, a decision by the board of directors to enter a new product market that eventually turns sour is unlikely to result in liability. Although shareholders may suffer a loss on their investment because of the board's decision, the loss is incurred in the shareholders' capacity as investors.⁷ Consequently, management should exercise greater caution on decisions that directly affect the shareholders' "ownership" interests—decisions concerning, for example, stock issuance, redemption, cashout, or merger.⁸

In addition, management should establish clear job descriptions and decisionmaking procedures. Liability frequently attaches if a corporate insider acts outside the scope of the insider's duties or neglects an area of responsibility for which the insider is accountable. Written job descriptions for directors and officers ensure that managers are apprised of their responsibilities, both individually and in relation to the management operation as a whole.⁹ Similarly, the functions of various board committees and their members should be delineated clearly.

In order to avoid liability, corporate managers also should be prepared adequately before each business meeting. This requires directors and officers to read all appropriate reports and digest the information contained therein. In *Smith v. Van Gorkom*¹⁰ the Delaware Supreme Court concluded that the board of directors acted in a grossly negligent manner by approving amendments to a merger proposal without familiarizing themselves with the contents of the documents.¹¹ To encourage corporate directors and officers to do their homework, minutes of previous meetings and a clearly delineated agenda of future meetings should be timely distributed to each board member.

Corporate managers should conduct their meetings in a busi-

Developments (Special Project) notes 48-86 and accompanying text.

6. Manning, *supra* note 4, at 5-6. The author analogizes this situation to one in which an individual receives a letter proclaiming, "This will inform you that I have just sold your house. Check is enclosed."

7. *Id.* at 5.

8. *Id.* at 6.

9. Curtner, *Ensuring D&O Loss Control, Risk Mgmt.*, Oct. 1986, at 42, 44.

10. 488 A.2d 858 (Del. 1985).

11. In particular, the court noted that Mr. Van Gorkom, Trans Union's chief executive officer, countersigned the merger agreement without reviewing the documents to determine if they were consistent with the authority previously granted him by the board. In addition, the court concluded that neither Mr. Van Gorkom nor any other member of the board read the documents before executing the merger agreement. *Id.* at 879.

nesslike and unbiased fashion. Thus, the board of directors should follow corporate formalities, including keeping minutes of all board and committee meetings, in conducting their meetings. The mere appearance of conducting corporate matters in an unbusinesslike and less than serious manner may support a finding that a fiduciary did not exercise due care.¹² In addition, corporate managers should ask tough questions at their meetings. Corporate records indicating that questions have been asked and satisfactorily answered is a positive factor in demonstrating that directors and officers exercised due care.¹³ Conversely, records indicating that no questions were asked may indicate that corporate insiders were not sufficiently informed to make a valid business judgment.¹⁴ Finally, questions frequently will help avoid serious errors in judgment by enabling directors and officers to consider every alternative to a given proposal.¹⁵

Corporate managers should keep a complete record of all documents essential to the organization, including relevant financial, legal, and personnel records, as well as individual director and officer files. Effective documentation makes it easier to refute or defend allegations of wrongdoing because a corporate defendant can demonstrate more readily what action was taken, when it was taken, why it was taken, and by whom it was taken.¹⁶ Failure to maintain an evidentiary trail of the corporate decisionmaking process can be fatal.¹⁷ Corporations should improve existing documentation procedures and establish a records retention policy to guarantee that important documents are not thrown out prematurely.¹⁸

12. See *Smith v. Van Gorkom*, 488 A.2d 858, 879 (Del. 1985) (indicating that the chief executive officer signed the merger agreement at a social function he was hosting).

13. Perkins, *supra* note 1, at 12.

14. In *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), the Delaware Supreme Court adjudged the Trans Union directors grossly negligent in approving a merger, observing that: The Board did not request its Chief Financial Officer, Romans, to make any valuation study or review of the proposal to determine the adequacy of \$55 per share for sale of the Company No director sought any further information from Romans. No director asked him why he put \$55 at the bottom of his range. No director asked Romans for any details as to his study, the reasons why it had been undertaken or its depth. No director asked to see the study

Id. at 877.

15. See Perkins, *supra* note 1, at 12.

16. See Curtner, *supra* note 9, at 43.

17. See *Smith v. Van Gorkom*, 488 A.2d 858, 878 (Del. 1985) (imposing liability in situation in which the merger agreement was not produced by the defendants).

18. Curtner, *supra* note 9, at 43. The author recommends that most files should be kept for three to seven years. In addition, the author urges corporate managers to be careful in writing memos that become part of the documentation effort. Because of liberal discovery

Finally, directors and officers should make effective use of corporate legal counsel. Each organization faces unique legal concerns and, therefore, should consult independent counsel to determine what the law requires with respect to the individual duties of management as directors and officers and with respect to the legal responsibilities of the organization as a whole.¹⁹ Legal counsel can clarify the issues to which the business judgment rule might apply and determine which issues might raise legal implications that would prevent the rule from operating fully.²⁰ The use of counsel in this fashion will ensure that corporate managers understand both their legal responsibilities and their legal exposure.

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rules, the author argues that a plaintiff's counsel can obtain almost all written materials. As a result, corporate insiders should not assume that internal memos always will be held confidential and, therefore, should avoid writing what the author refers to as "stupid memos." *Id.* at 43-44.

19. *Id.* at 44.

20. Perkins, *supra* note 1, at 14.

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