LIMITING DIRECTOR'S LIABILITY: THE CASE FOR A MORE BALANCED APPROACH—THE CORPORATE GOVERNANCE PROJECT ALTERNATIVE

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One of the most topical issues among both corporate practitioners and state legislators during these past three years has concerned the desirability of amending state corporation statutes to enable limitations on corporate directors' liability for breach of the duty of care.

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Twenty-five or more states have effected some change to their respective state corporation laws in this respect; many others have considered, or will be considering, similar amendments. These legislative initiatives have been triggered principally by concern that corporations were finding it difficult to attract and retain qualified directors and because directors were exposed, with respect to transactions where one or more shareholders might contend that the directors failed to exercise due care, to potential personal liability both disproportionately large and rather unpredictable. While the enacted and proposed amendments include a variety of elements, including provisions regarding both the appropriate standard of conduct for directors and


3. Among the other states which have considered or may be considering some further revision of their corporation laws are Alabama, California, Colorado, Idaho, Illinois, Maine, Mississippi, Nebraska, Oregon, and Washington. A list of the various bills introduced in the 1987 sessions of the legislatures in these states is on file in the office of the Western New England Law Review.

4. Some states have specified in their corporation laws an expanded list of factors which shall be considered by the Board of Directors in adopting or rejecting a particular corporate action. Thus, for example, the Connecticut Stock Corporation Act now provides as follows:

For purposes of [the sections relating to corporate combinations or acquisitions], a director of a corporation which has a class of voting stock registered pursuant to section 12 of the Securities Exchange Act of 1934, as the same has been or hereafter may be amended from time to time, in addition to complying with the provisions of [Section 33-313(d)], shall consider, in determining what he reasonably believes to be in the best interests of the corporation, (1) the long-term as
the circumstances under which indemnification by the corporation may be permitted, the central feature often has been a statutory provision enabling either a limitation on, or the elimination of, corporate directors' liability for breach of the duty of care. It is these specific legislative responses which are the principal focus of this commentary. The analysis which follows includes five parts: first, a review of the three principal statutory alternatives which have been enacted with respect to limitation of directors' liability; second, the alternative ap-

well as the short-term interests of the corporation, (2) the interests of the shareholders, long-term as well as short-term, including the possibility that those interests may be best served by the continued independence of the corporation, (3) the interests of the corporation's employees, customers, creditors and suppliers, and (4) community and societal considerations including those of any community in which any office or other facility of the corporation is located. A director may also in his discretion consider any other factors he reasonably considers appropriate in determining what he reasonably believes to be in the best interests of the corporation. A person who performs his duties in accordance with this subsection shall be deemed to have no liability by reason of being or having been a director of the corporation.

CONN. GEN. STAT. ANN. § 33-313(e) (1988), as amended by 1988 Conn. Acts 350 (Reg. Sess.). It is somewhat unclear just what legal effect was intended by this specification of factors to be considered. On one hand, the revision notes that factors other than the interests of shareholders, i.e. employees, customers, creditors, local community, shall be taken into account in determining what is in the best interests of the corporation. In addition, the last sentence states that a person who "performs his duties in accordance with this subsection shall be deemed to have no liability . . . ." Id. Yet, a director presumably still has to show care and prudence in evaluating these considerations. Connecticut's approach further is novel in that the enumerated standards apparently apply only to publicly-held companies whose securities are registered under the Securities Exchange Act of 1934. No provision is made for the standards to be considered by directors of smaller, closely-held corporations. For a thoughtful criticism of statutory standards which includes consideration of the interests of persons or groups other than shareholders, see Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819, 848-65 (1981).


In general, these statutes apply only to individuals acting in the capacity of director, and not to other corporation officials.

proach proposed by the ALI's Corporate Governance Project;\textsuperscript{6} third, a discussion of the various arguments in support of some action to limit or eliminate directors' liability; fourth, a consideration of some of the problems or concerns which have been raised regarding these new statutory alternatives; and finally, a concluding recommendation regarding this observer's preferred course of action.

I. \textbf{Principal Statutory Approaches Being Utilized}

Three distinct statutory patterns addressing the problem of directors' liability have emerged. The predominant approach (which, for purposes of this article, we will refer to as the "Delaware approach") has been amendment of the state corporation law to authorize a corporation to adopt a specific amendment to its certificate of incorporation to limit or eliminate directors' liability.\textsuperscript{7} Under this approach, a corporation simply is authorized to amend its certificate of incorporation

\textsuperscript{6} PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.17 at 25-26 (Tent. Draft No. 7, April 10, 1987) [hereinafter Corporate Governance Project, T.D. 7].

\textsuperscript{7} Section 102(b)(7) of title 8 of the Delaware Code provides as follows:

\begin{quote}
(b) In addition to the matters required to be set forth in the certificate of incorporation . . . the certificate of incorporation may also contain any or all of the following matters:

(7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit ...
\end{quote}


It may be noted that under the Delaware approach, the limitation or elimination of personal liability applies only to a breach of the duty of care. A director still may be liable for money damages regarding any breach of the duty of loyalty, e.g., with respect to corporate transactions in which the director may have a material personal interest. While the scope and significance of this exception is not considered further in this article, one can refer to various other commentators for discussions of that subject. See, e.g., Linsley, supra note 1, at 535-68; Lee, supra note 1, at 273; and Gelb, supra note 1, at 38-43.
in the conventional manner—i.e., upon approval of both the board of directors and the shareholders—to achieve the desired result. 8

A second approach, adopted to date by a much smaller number of states (hereinafter the "Indiana approach"), is to amend the applicable corporation law flatly to provide that, absent willful misconduct or recklessness, corporate directors have no liability for any breach of a duty of care. 9 In this instance, the limitation or elimination of liability is automatically effective upon the enactment of the statutory change without the necessity for any action by individual corporations or their shareholders.

The third approach is that being pursued by Virginia—namely, to specify a statutory cap on the maximum liability to which directors (and officers) may be subject. 10 Under the Virginia corporation law amendments, a corporate official's maximum liability generally is the greater of: (1) $100,000.00 or (2) the amount of cash compensation received by the officer or director from the corporation during the


9. The Indiana approach operates in mandatory fashion to relieve directors of liability, absent willful misconduct, as follows:

A director is not liable for any action taken as a director, or any failure to take any action, unless:
   (1) the director has breached or failed to perform the duties of the director's office in compliance with this section; and
   (2) the breach or failure to perform constitutes willful misconduct or recklessness.


A variation on this approach is that followed by Connecticut where a director is deemed not liable if he or she considers the various standards set out in the revised corporation law. See supra note 4 and discussion therein as to the effect of such language.

10. The charter options open to Virginia corporations are as follows:

A. In any proceeding brought by or in the right of a corporation or brought by or on behalf of shareholders of the corporation, the damages assessed against an officer or director arising out of a single transaction, occurrence or course of conduct shall not exceed the lesser of:
   1. The monetary amount ... specified in the articles of incorporation or, if approved by the shareholders, in the bylaws as a limitation on ... the liability of the officer or director; or
   2. The greater of (i) $100,000 or (ii) the amount of cash compensation received by the officer or director from the corporation during the twelve months immediately preceding the act or omission for which liability was imposed.

B. The liability of an officer or director shall not be limited as provided in this section if the officer or director engaged in willful misconduct or a knowing violation of the criminal law or of any federal or state securities law, including, without limitation, any claim of unlawful insider trading or manipulation of the market for any security.

VA. CODE ANN. § 13.1-692.1 (Supp. 1988). For a further discussion of these provisions, see King, supra note 1, at 129.
twelve months immediately preceding the act or omission for which liability is imposed.\textsuperscript{11} This cap is effective as to Virginia corporations without any further action by either a corporation's board of directors or shareholders (although the amount of the cap can be reduced, but not increased, by appropriate amendment of the corporation's charter documents).

Each of these alternatives typically is proposed together with various other corporation law revisions. Thus, a state interested in taking action to protect directors not only might modify its corporation law to permit a corporation to adopt the requisite amendment to its certificate of incorporation limiting liability, but also might adopt provisions which will broaden the scope of permissible indemnification or set forth a wider range of standards and interests which the directors properly may consider in taking action.\textsuperscript{12}

The practical effect of all three of these approaches generally has been to eliminate accountability by corporate directors for any monetary liability for breach of the duty of care. The Indiana approach achieves this result directly, by amending the corporation law to bar any director liability absent willful misconduct or recklessness. The Delaware and Virginia statutory approaches theoretically leave room for corporations to adopt amendments to their certificates of incorporation providing a cap on the maximum liability of corporate officials, thus retaining a minimal level of residual financial exposure for those officials. However, most corporations which have put forth an amendment for shareholder consideration have proposed total elimination of financial liability.\textsuperscript{13}

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\textsuperscript{11} VA. CODE ANN. § 13.1-692.1 (Supp. 1988). For text of this provision, see \textit{supra} note 10. The effect of the statutory provision is to cap outside directors' liability at $100,000.00 while inside directors (i.e., corporate officers) can have a somewhat greater financial exposure, depending upon the level of their annual compensation from the corporation.

\textsuperscript{12} For a discussion of some factors appearing in recently enacted statutes to be considered by directors in reaching corporate decisions, see \textit{supra} notes 4 and 5 and accompanying text.

\textsuperscript{13} The one notable exception which has come to the author's attention is Emhart Corporation, a Virginia corporation which adopted a charter amendment limiting directors' and officers' liability to $100,000.00. See \textit{Emhart Corporation, Proxy Statement} 46-50, C-1 to C-5 (March 24, 1988). Otherwise, the various corporations of which the author is aware have sought charter amendments eliminating all monetary liability on the part of directors for breach of the duty of care. See, \textit{e.g.}, the proxy statements of the following publicly-held corporations: \textit{MDU Resources Group, Inc., Proxy Statement} at 1-3, A-1 (March 6, 1987) (Delaware corp.); \textit{RJR Nabisco, Proxy Statement} 12-16, A-1, B-1 (March 19, 1987) (Delaware corp.); \textit{Hartford National Corporation, Proxy Statement} 21-23, 25 (April 15, 1987) (Delaware corp.); \textit{Oklahoma Gas and Electric Company, Proxy Statement} 15-25, A-1 to A-4 (April 4, 1988)
\end{quote}
II. THE ALI APPROACH

The Corporate Governance Project's proposed legislative solution differs from the three statutory approaches noted above in that the former is premised on the assumption that, "as a matter of public policy, some residual prospect of liability for due care violations should be retained."14 Under the Corporate Governance Project approach set forth in its proposed section 7.17, the potential for financial liability could be reduced, but never eliminated.

That section would measure a corporate official's maximum liability for a violation of the duty of care generally by the compensation received by the particular director or officer for serving the corporation during the year of the alleged violation.15 While certain more


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15. The proposed section provides as follows:

§ 7.17 Limitation on Damages for Certain Violations of the Duty of Care
(a) If a failure by a director [§ 1.08] or an officer [§ 1.22] to meet the standard of conduct specified in § 4.01 did not
   (1) involve a knowing and culpable violation of law by the director or officer; or
   (2) enable the director or officer, or an associate [§ 1.02], to receive a benefit that was improper under Part V; or
   (3) show a conscious disregard for the duty of the director or officer to the corporation under circumstances in which the director or officer was aware that his conduct or omission created an unjustified risk of serious injury to the corporation; or
   (4) constitute a sustained and unexcused pattern of inattention that amounted to an abdication of the defendant's duty to the corporation, damages for the violation should be limited to an amount that is not disproportionate to the compensation received by the director or officer for serving the corporation during the year of the violation.
(b) A limitation on damages complying with § 7.17(a) may be implemented by
   (1) an enabling statute that authorizes the inclusion of a limitation on damages in a corporation's certificate of incorporation; or
   (2) a provision in a certificate of incorporation that is adopted by a vote of disinterested shareholders [§ 1.11] after appropriate disclosure concerning the provision.
(c) Any limitation on damages set forth in the corporation's certificate of incorporation

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(Oklahoma corp.); FLEET/NORSTAR FINANCIAL GROUP, INC., PROXY STATEMENT 23-27, B-1, C-1 (April 7, 1988) (Rhode Island corp.); and SARA LEE CORPORATION, PROXY STATEMENT 15-17 (September 22, 1988) (Maryland corp.). (All of the above proxy statements are on file at the office of the Western New England Law Review.) See also Note, The Limitation of Directors' Liability, supra note 1, at 446 n.187.
egregious violations of the duty of care still would be subject to full
financial liability for whatever damages proximately flowed from those
violations,\(^\text{16}\) under section 7.17 as proposed, most violations would re­
quire no more than restitution by the corporate official of the compen­
sation earned for services to the corporation during the period in
question.\(^\text{17}\)

The position reflected in the Corporate Governance Project draft
obviously is a middle ground between the traditional tort liability prin­
ciple of full liability for whatever damages proximately flow from a
breach of duty and the contract principle that shareholders should be
free to adopt whatever rules shall be applicable to their corporation
(including even an elimination of all liability for breaches of duty). While accepting many of the considerations discussed in the following
section which support limitation of liability,\(^\text{18}\) the draft commentary to
section 7.17 borrows a concept from the Uniform Commercial Code to
justify its rejection of a pure “freedom of contract” view which would
legitimate the elimination of all liability. The commentary notes that
section “7.17 is premised on the belief that there should be a minimum
boundary in order that the risk of liability not be so low that the duty
of care, as expressed in [section] 4.01, ‘fail of its essential purpose,’ ”\(^\text{19}\)
i.e., to assure that corporate officials generally do act on behalf of the
corporation in an appropriate manner. Section 7.17 thus implicitly
rejects the argument that corporate officials should be subject to no
financial liability because injunctive and other non-monetary remedies
still available to shareholders will assure appropriate conduct by those
officials.\(^\text{20}\)

\(^{16}\) See id. § 7.17(a)(1)-(4).

\(^{17}\) Corporate Governance Project, T.D. 7, supra note 6, at 25-26.

\(^{18}\) See infra notes 21-30 and accompanying text.

\(^{19}\) Corporate Governance Project, T.D. 7, supra note 6, at 31. See also id. at 37-38.

\(^{20}\) Id. at 32-33.
III. PRINCIPAL FACTORS CONTRIBUTING TO THE NEED FOR LIMITATION ON LIABILITY

How is it that the statutory approaches referenced at the outset have come to command so much interest and attention? A variety of factors have stirred the consciousness of corporate practitioners and legislators. These include difficulties faced by corporations in attracting and retaining qualified directors, increased costs of obtaining appropriate insurance coverage for corporate officials, potential chilling of entrepreneurial behavior, and the perceived need by individual states to keep their corporation laws competitive with those in other jurisdictions.

The factor cited most often in support of legislation limiting or eliminating monetary liability for directors has been the claim that corporations have found it increasingly difficult to attract and/or retain qualified directors, due to the potential liability exposure such individuals otherwise face. This claim actually can be broken down further into two related issues—first, that various state court decisions interpreting directors' duty of care have increased the financial risks for individuals who serve as directors, particularly outside directors who have a very limited financial stake in the corporation; and second, that director and officer insurance coverage ("D & O insurance") has become prohibitively expensive and, in some cases, unavailable. While there appears to be little hard data to indicate whether more corporate officials actually are being found liable for breach of the

21. Baum, The Job Nobody Wants, BUS. WK. Sept. 8, 1986, at 56; Lerner & Burke, Protecting Directors in Tender Offer Contests and Leveraged Buyouts, in DIRECTORS' AND OFFICERS' LIABILITY AND THE INSURANCE CRISIS 232 (Georgetown University Law Center comp. 1987) (material on file at the office of the Western New England Law Review); Touche Ross, ISSUES FACING U.S. CORPORATE DIRECTORS 2, 5 (Dec. 1986) (over one-third of 1,100 directors of publicly-held corporations surveyed indicated they had considered resignation due to increased liabilities to which exposed (on file at the office of the Western New England Law Review)). One commentator identifies at least seventeen publicly-held companies who specifically suffered director resignations. See Hanks, State Legislative Responses, supra note 1, at 24 n.6. See also Note, The Limitation of Directors' Liability, supra note 1, at 413.

22. Block, supra note 1, at 131 n.5; Baum, supra note 21, at 56; Lewin, Director Insurance Drying Up, N.Y. Times, Mar. 7, 1986, at D1, col. 2; Ipsen, The Crisis in Directors and Officers Insurance, 19 INST. INVESTORS 231 (Aug. 1985); Hilder, Risky Business: Liability Insurance is Difficult to Find Now for Directors, Officers, Wall St. J., July 10, 1985, at 1; Foley, Insurance Against Director & Officer Liability, in DIRECTORS’ AND OFFICERS’ LIABILITY AND THE INSURANCE CRISIS 8-5 to 8-6 (Georgetown University Law Center comp. 1987) (showing a decline in available coverage for D & O carriers from $347 million at January 1, 1984, to $110 million at November 1, 1986); Boundas, Negotiating the D&O Insurance Contract, in DIRECTORS’ AND OFFICERS’ LIABILITY AND THE INSURANCE CRISIS 320-24 (Georgetown University Law Center comp. 1987).
duty of care via shareholder derivative actions than in the past, there is no question that the number of such lawsuits filed has increased dramatically\(^{23}\) and that the average expenses involved in defending those lawsuits also have increased significantly.\(^{24}\) In addition, there clearly was a period from 1984 through 1987 during which the premium charges for D & O insurance escalated very rapidly.\(^{25}\) The net effect of these developments has been to generate myriad reports of either individuals choosing to resign as directors when adequate coverage could not be obtained or of corporations having difficulty recruiting qualified individuals willing to serve as directors.\(^{26}\)

The principal factor resulting in these consequences, arising in the recent era of large mergers and acquisitions, is the potential for disproportionately large and somewhat unpredictable damages theoretically being attributable to directors' failure to observe due care. While the nature of directors' functions and responsibilities may not be much different from what shareholders expected of them fifteen or twenty years ago, the magnitude of the transactions on which directors must pass has changed dramatically. In the 1960s, for example, a shareholder might have challenged a board of directors' decision not to undertake a particular business opportunity which allegedly deprived the corporation of the opportunity to earn several hundred thousand dollars a year.\(^{27}\) In the celebrated recent Smith v. Van Gorkom case,\(^{28}\) on

\(^{23}\) Stone, Aetna Offers Added Protection to Corporate Directors, Hartford Courant, Feb. 24, 1988, at F-1 (from 1970 to 1985, number of lawsuits seeking more than $1 million in damages from corporate officers and directors increased from 2 to in excess of 500).

\(^{24}\) Id.

\(^{25}\) In some instances, premium increases were as high as 1,000 %. Boundas, supra note 22, at 320.

\(^{26}\) While the indemnification statutes in most states are intended to enable reimbursement to directors or officers of expenses associated with defending a lawsuit, those provisions sometimes will offer no help, either because the corporate official does not meet the standards of conduct set forth in the statute or because the corporation may be financially unable or unwilling (e.g., due to a change in corporate control) to provide the requested indemnification. Olson, The D & O Insurance Gap: Strategies for Coping, Legal Times, Mar. 3, 1986, at 25, col. 1; Note, Statutory and Non-Statutory Responses, supra note 1, at 192-93.

Similarly, D & O insurance coverage, even though authorized by most statutes, may be limited due to prohibitive cost, see supra note 25, or because of specific exclusions or deductibles provided in the particular D & O policy. See, e.g., Johnston & Gassman, Directors and Officers Liability Insurance—The Standard Insurance Contract, in DIRECTORS' AND OFFICERS' LIABILITY AND THE INSURANCE CRISIS 292-97 (Georgetown University Law Center comp. 1987).

\(^{27}\) See, for example, the celebrated derivative action brought in the case of Shlensky v. Wrigley, 95 Ill. App. 2d 173, 237 N.E.2d 776 (1968), which probably involved a damage claim of less than $1 million. While the plaintiff alleged that the failure to install lights (in order to enable night baseball games) resulted in the loss of substantial additional revenues,
the other hand, the damages allegedly attributable to the directors' failure to sufficiently inquire regarding the acquisition proposed by their chief executive officer probably were in the vicinity of $65,000,000.00; the eventual settlement in that case was approximately $23,500,000.00.29

A more fundamental argument put forward by proponents of one or more of the foregoing statutory alternatives is that the mere existence of potential liability for a director seriously discourages entrepreneurial decisiveness. To put it another way, faced with any possibility of personal financial liability as a result of shareholder litigation, directors will be reluctant to authorize or engage in corporate transactions perceived to involve more than ordinary risk.30 Classic economic doctrine holds that the greatest potential for reward usually

28. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). In that case, Van Gorkom, the chief executive officer of Trans Union Corporation, negotiated an agreement for the sale of the corporation via a merger to the Pritzker family at the price of $55.00 per share. The Delaware Supreme Court found that the Board of Directors did not reach an informed business judgment in approving that transaction. Specifically, the court found that the directors (1) did not adequately inform themselves as to Van Gorkom's role in initiating the transaction and establishing the per share purchase price; (2) did not obtain sufficient information to enable them to reach an informed judgment on the fairness of the $55.00 per share price; and (3) failed to act with informed reasonable deliberation in approving the Pritzker merger proposal. Id. at 874-80.

29. The case actually was remanded for a determination of the actual damages, to be measured by the difference between the fair market value of the Trans Union shares and the merger transaction price of $55.00 per share. Id. at 893. Assuming that the fair market value was at least $60.00 per share (a value within the range suggested by the chief financial officer's internal projections, id. at 867), the directors' aggregate liability would have approached $66 million, based upon the 13,357,758 shares outstanding at the time. Id. at 864 n.3.

The litigation subsequently was settled, apparently for a total of $23.5 million, $10 million of which came from the D & O insurance carrier (that amount being the policy limit) and the balance from the acquirer. Block, supra note 1, at 136 n.28.

30. The commentary to section 7.17 of the Corporate Governance Project analyzes this consideration in the following manner:

[E]conomic logic suggests that a ceiling [on financial liability] would reduce the pressures on directors to act in an unduly risk-averse manner. Realistically, the risk of liability for due care violations tends to be one-sided: directors can be held liable for excessively risky acts or decisions, but not, as a practical matter, for excessively cautious ones. Given the frequently nominal investment of directors in their corporation's stock, a substantial risk of liability for negligence might lead risk-averse directors to opt for more hesitant policies than shareholders desire (particularly to the extent that shareholders hold reasonably diversified portfolios and so are substantially protected against any firm-specific risk). . . .

Corporate Governance Project, T.D. 7, supra note 6, at 31.
lies with those business decisions involving greater risk. 31 Thus, if corporate officials are chilled from undertaking corporate transactions posing greater risk because of potential shareholder derivative action, the corporation and its shareholders, having foregone those business endeavors with the greatest profit potential, will be the losers in the long run. A related concern shared by many corporate practitioners is that the protection historically available to directors making decisions involving investment and business risks under the so-called business judgment rule also has been eroded significantly.32.

Finally, some corporate practitioners and state officials urge the adoption of one of these alternatives merely to keep their state competitive with other state jurisdictions which already have done so. The concern expressed is that corporations presently domiciled in their states may elect to reincorporate in a state which has adopted more protective provisions for its domestic corporations.33

How valid are all these concerns? It certainly is true that some corporations have found it somewhat more difficult to locate persons to serve as directors.34 However, whether this is solely or even principally attributable to the increased liability risks perceived to be associated with such service is open to question. There is some evidence that directors' changing perceptions of their functions and responsibilities have increased the time commitment that those persons feel is required, with the result that any given individual accepts fewer directorship positions than in the past.35 Similarly, while D & O premiums have increased significantly, it is not clear what factors actually are most responsible for those increases—a greater frequency of shareholder derivative actions, increased legal costs of defense, monetarily higher judgments, or poor actuarial judgments in earlier times.36 In

33. Testimony offered before the state legislatures invariably includes reference to the necessity to retain domestic corporations and the jobs for which those corporations account. See, e.g., Woodward, How Much Indiana's Anti-Takeover Law Cost Shareholders, Wall St. J., May 5, 1988, at 32, col. 8; Murphy, Dread of Hostile Takeovers Leads to Compromise Legislation This Session, Hartford Courant, May 10, 1988 at C1, col. 1.
34. See supra note 21 and accompanying text.
35. Melloan, A Good Director is Getting Harder to Find, Wall St. J., Feb. 9, 1988, at 39, col. 3.
36. Boundas, supra note 22, at 320-24; Lee, supra note 1, at 254 nn.73 & 74.
any event, notwithstanding the recent escalation in premium costs, ade­quate liability coverage generally appears to be available presently for most corporations and their officers and directors.37

The claim that entrepreneurial decision-making will be unduly discouraged assumes that the corporation law, both as written and as interpreted by the courts, leaves corporate officials without any meaningful protection with respect to corporate decisions involving risk. That proposition, like the Player Queen in Hamlet, "doth protest too much."38 The generally prevailing statutory or case law standards for director action—that directors should act in good faith and in the best interests of the corporation with the care of a reasonable person in like circumstances39—do not themselves prohibit transactions which may involve both greater risk and greater reward potential.40 Moreover, the burden of proving that the directors' approval of a particular transaction was not in the best interests of the corporation falls on the challenging shareholder.41 Most importantly, the business judgment rule, in fact, remains intact, i.e., that directors' evaluations of the business aspects of a particular transaction, including the potential risks and rewards, will not be second-guessed by a court, absent any implications of self-dealing or conflicts of interest on the part of the directors.42 None of the celebrated cases often referenced by practitioners actually threaten that basic doctrine. Smith v. Van Gorkom, for exam­

38. W. SHAKESPEARE, HAMLET 129 (Bell Pub. Co., Inc. 1958) (Lady Gertrude commenting on the comments of the Player Queen).
39. The duty of care is spelled out in the Revised Model Business Corporation Act as follows:

[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(a) (1984).
40. The language referring to a director "in a like position" and "under similar circumstances" was intended to recognize that certain transactions may involve greater risks and that the nature and extent of the director's responsibilities thus may vary. Id., official comment at 222. See also The Corporate Director's Guidebook, 32 BUS. LAW. 5, 15 (1976).
41. Schwartz & Bauman, The Developing Business Judgment Rule, Georgetown Conference, supra note 21, at 1, 20. See also Puma v. Marriott, 283 A.2d 693, 695 (Del. Ch. 1971); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); HENN & ALEXANDER, LAWS OF CORPORATIONS § 234, at 625 (3d ed. 1983). Section 4.01(d) of the Corporate Governance Project expressly adopts that position: "A person challenging the conduct of a director or officer under this Section has the burden of proving a breach of duty of care . . . and the burden of proving that the breach was the legal cause of damage suffered by the corporation." Tentative Draft 4 § 4.01(d) (1985).
ple, is not a holding which authorizes a court to second-guess a considered decision by the board of directors; it rather is only a finding that the process for reviewing, questioning, and evaluating a proposed transaction must bring all the relevant information before the directors so that they can make an appropriate decision.\(^{43}\) While one thus can conclude that directors need not be chilled in their decision-making regarding transactions involving greater risks, that does not necessarily remove the issue. To the extent that persons serving as directors perceive, even if incorrectly, that their decisions may be second-guessed and liability imposed, they still may act in a risk-aversive manner. Fortunately, as will be noted shortly, that possible effect can be minimized, if not substantially eliminated, by providing a defined limit as to those directors' liability which, as a result of D & O insurance and otherwise, they may be willing to bear.

Leaving aside marginal tax revenues which possibly may be generated from a corporation which is domestically incorporated as opposed to one present only as a foreign corporation, it also is difficult to articulate any sound public policy reasons why states should compete to have the least restrictive or most relaxed corporate law requirements. In the first instance, it is a competition that cannot be finally or conclusively won. Thus, for example, even were the Connecticut or Massachusetts legislatures to decide to make their corporation laws more permissive, nothing precludes Delaware, Indiana, or some other state from enacting even more permissive legislation. Assuming that in such a "race to the bottom,"\(^ {44}\) some state reaches the bottom, what will be the quality of the law? Most likely, it will be a law which affords no significant protections to either the shareholders, creditors, or employees of the corporation. Secondly, there actually are very few (albeit that those few are large and quite influential) corporations domiciled in any given state which seriously would consider reincorporation in another jurisdiction due to the then prevailing corporation law statutes.\(^ {45}\)

\(^{43}\) Smith, 488 A.2d at 889-93.


\(^{45}\) Since most corporate entities doing business in a particular state are subject to service of process, taxation, and corporate filing obligations whether or not domiciled in the state, they generally will find that the benefits of incorporating in a different jurisdiction do not outweigh the costs of doing so. A large corporation with operations and facilities in
Stripping away these layers leaves the common core argument traditionally advanced to legislators for both relaxed corporate law standards and more protective anti-takeover legislation—the need to preserve local jobs. While the preservation of local jobs obviously is an effective argument with which to obtain a legislator’s attention, it simply is a false one—a red herring. Rarely have corporate law standards or requirements prevailing in a particular state had any impact upon plant or business openings or closings.46

Indeed, of all the concerns discussed above, the one which has the most significant basis in fact is the contention that, with the sheer magnitude of many corporate transactions effected in modern times, a corporation and its directors and officers can be subject to unpredictable and unreasonably disproportionate liability. In that circumstance, as the commentary to the Corporate Governance Project’s section 7.17 states, “the traditional principle of law that persons are normally liable for all damages that their actions cause collides with the policy considerations that support a ceiling on financial liability.”47 In attempting to set out a framework within which to fashion a revised statutory scheme, the Corporate Governance Project identifies the following policy reasons which have relevance to the concern over unpredictable and possibly excessive exposure to financial liability:

First and most fundamentally, a ceiling is justified on grounds of fairness, because the potential liability in cases where the ceiling could apply would otherwise be excessive in relation to the nature of the defendant’s culpability and the economic benefits expected from serving the corporation. Second, economic logic suggests that a ceiling would reduce the pressures on directors to act in an unduly risk-averse manner. . . . [Third], such a limitation may serve to reduce the cost of insurance (often borne by the corporation) because the likely exposure of the insurer is reduced. Although the threat of derivative litigation is only one of the determinants of the cost of D&O insurance, which may be more affected by the threat of other liabilities (e.g., securities law liabilities, actions by a bankruptcy

46. The limited data available regarding hostile takeovers do not support a conclusion that more often than not the acquiring company will close several of the acquired company’s facilities or lay off substantial numbers of workers. See Tuerck, The Fallacy of Laws That Stop Takeovers, Boston Globe, Feb. 23, 1988, at 48, col. 3; Woodward, supra note 33.

trustee, and direct federal environmental and anti-discrimination actions), a limitation on due care liability at least contributes to cost reduction and also protects the defendant from the danger that his insurance coverage may be inadequate or that an exception to its coverage may be applicable to his case. . . . [Fourth], it is likely that the duty of care will be implemented by courts more evenly and appropriately when the potential penalties that may result are not perceived as Draconian. 48

Assuming that justification thus exists for pursuing modification of the rules imposing liability on directors, we also need to consider what other problems and concerns may arise when we do so.

IV. PROBLEMS POSED BY ELIMINATION OF ALL FINANCIAL LIABILITY

Perhaps the most fundamental concern posed is the question of the effect on shareholder remedies were directors freed from all financial accountability for breach of the duty of care. What protections or assurances, if any, will shareholders then have that directors will treat

48. Id. at 31-32. It is interesting to note that the reasons urged by Emhart Corporation when it sought shareholder approval of a charter amendment limiting directors' and officers' liability to $100,000.00 are to a similar effect:

The Board of Directors believes that the adoption of the Proposed Article is in the best interests of the stockholders as well as the Corporation. In recent years, there has been an increase in the number and amount of claims brought against directors and officers of corporations. At the same time, the general availability of adequate directors' and officers' liability insurance coverage has been reduced and the cost of the available insurance has escalated dramatically. As a result, certain corporations have experienced significant difficulties in attracting and retaining qualified persons to serve on their boards of directors. In addition, those who do serve may be inhibited by the unavailability of insurance from making business decisions that are in the best interests of the corporation. The Board of Directors has concluded that it is advisable to provide directors and officers with broad protection under the Act (including limiting liability for monetary damages to $100,000) in order to continue to attract and retain capable individuals to serve the Corporation. Further, even without regard to insurance considerations, if the Proposed Article is adopted; the Board believes it will be able more freely to exercise its business judgment because the Proposed Article will reduce the concern as to potential litigation with respect to decisions that the Board must make affecting the future of the Corporation. Finally, the cost of directors' and officers' liability insurance has increased substantially in recent years. The Corporation has historically carried such insurance although it has no legal obligation to do so. Although there can be no assurance that the adoption of the Proposed Article will enable the Corporation more readily to secure directors' and officers' liability insurance at a lower cost, the Board of Directors believes that the Proposed Article may have a favorable impact over the long term on the availability, cost, amount and scope of such insurance coverage. . . .

EMHART CORPORATION, PROXY STATEMENT 48-49 (March 24, 1988).
their interests as significant, let alone paramount? Several responses have been offered. Thus, for example, shareholders theoretically still can bring actions seeking to enjoin a particular corporate transaction as unfair or not in the corporation's best interests. Yet, how likely are such actions to succeed (let alone be attempted) in light of both the business judgment rule and the lack of any incentive among the "private attorney generals" to pursue shareholder litigation?

Alternatively, unhappy shareholders presumably can initiate a proxy contest to replace directors with whom they are dissatisfied. However, the disadvantages confronting would-be challengers, not the least of which is the staggering expense involved, coupled with the uncertainty of the recovery thereof, are many. Not to worry, respond the defenders of liability limitations, unhappy shareholders can register their disapproval by exercising the Wall Street option, by selling their shares. If there were some credible body of evidence suggesting that such actions really have a significant influence on director and officer behavior, one might be willing to accept such a market approach. That evidence is lacking. Moreover, why should a share-

49. Since the Delaware statutory provision and others like it speak only of the elimination of monetary damages or financial liability, injunctive remedies remain available to shareholders troubled by an alleged directors' failure to use appropriate care in acting upon a particular transaction. For text of Delaware statute, see supra note 7. See also Veasey I, supra note 1, at 268 (duty of care has "vitality in remedial contexts other than personal monetary damages"); Hanks, supra note 1, at 25; and Comment, supra note 1, at 1062.

50. See supra notes 41 and 42 and accompanying text; see also Corporate Governance Project, T.D. 7, supra note 6, at 32-33.

51. Under the Securities and Exchange Commission's proxy rules, an unhappy shareholder group can solicit proxies to elect their own slate of candidates to replace the incumbents with whom they are dissatisfied. See 17 C.F.R. §§ 240.14a-6, 14a-7, 14a-9 (1988).

52. It is not unusual in proxy contests involving large publicly-held corporations for the expenses to involve millions of dollars. Thus, for example, in the recent proxy contest between Carl Icahn and the incumbent management of Texaco, the former spent between $5 and $7 million (and the latter presumably more). Wall St. J., June 20, 1988 at 3, col. 1. In a similar vein, the management of Gillette Co. reported that it set aside at least $9 million in the first six months of 1988 in connection with the proxy contest and litigation in which it was engaged with The Coniston Partners. Boston Globe, July 23, 1988, at 12, col. 4. In addition, absent a result other than full success, insurgents may be unable to obtain any reimbursement for the expenses incurred. See, e.g., Rosenfeld v. Fairchild Engine and Airplane Corp., 309 N.Y. 168, 128 N.E.2d 291 (1955).

53. J. LIVINGSTON, THE AMERICAN STOCKHOLDER 60-61, 66-67 (1958). See also Gaines v. Haughton, 645 F.2d 761, 779 (9th Cir. 1981) (noting that, if all other remedies fail, unhappy shareholders "can sell or trade their stock in the offending corporation in favor of an enterprise more compatible with their own personal goals and values"), cert. denied, 454 U.S. 1145 (1982).

54. While corporate managements clearly undertake considerable communication and solicitation with at least the large institutional investors who are current shareholders of a corporation (to obtain their support of either the incumbent directors or pending man-
holder be forced to abandon his property interest in the corporation in order to influence those responsible for directing its affairs?

In addition, even if one were to accept that directors should be held harmless from financial liability in some circumstances, why should not that decision, at a minimum, require an informed determination by shareholders to do so? If shareholders are to part with the right to hold directors accountable for the latter's failure to exercise due care, it should be by an informed and conscious decision-making process.\textsuperscript{55} The Indiana approach seems particularly repugnant because it achieves an elimination of potential director liability without the shareholders of such a domestic corporation having any say or voice.\textsuperscript{56} Similarly, to permit corporate practitioners to insert liability elimination provisions in a certificate of incorporation at the time of formation deprives the future shareholders of that entity from ever considering the choice. The only justifiable approach, whatever limitation of director liability provisions is considered, is to require, first, that those provisions be adopted by affirmative vote of the outstanding shareholders after full and adequate disclosure and, second, that such limitations be periodically reexamined.\textsuperscript{57} Approval by shareholders should be recognized only if the process by which the approval is sought allows for both meaningful articulation of the issues and opportunity for careful reflection.

Another issue yet to be addressed in any of the analysis and discussion of the various statutory approaches concerns the appropriateness of applying liability limitation provisions in the context of closely-held corporations which, after all, constitute the overwhelming number of corporations domiciled in a particular state.\textsuperscript{58} There are

\textsuperscript{55} The commentary to the Corporate Governance Project's T.D. 7 raises the issue of how meaningful is shareholder approval of charter amendments limiting or eliminating director liability:

Given the typical shareholder's lack of awareness of the corporate charter, amendments that frustrate legitimate shareholder expectations may fairly be characterized as contracts of adhesion [i.e., lacking of any opportunity for meaningful bargaining or consent]. . . . As a substitute for actual bargaining, § 7.17(c)(1) specifies a "sunset" provision that requires periodic renewal by shareholders.

Corporate Governance Project, T.D. 7, \textit{supra} note 6, at 41-42.

\textsuperscript{56} For text and discussion of Indiana statute, see \textit{supra} note 9 and accompanying text.

\textsuperscript{57} Corporate Governance Project, T.D. 7, \textit{supra} note 6, at 41-43.

\textsuperscript{58} There are in excess of 3,000,000 corporations in the United States filing corporate tax returns. \textit{U.S. DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1987} at 503, Table 852. Yet only 12,000 to 13,000 of those are publicly traded,
three characteristics of a closely-held corporation which should cause us to consider their situation specially. In the first instance, there is a much greater likelihood that there will be substantial identity between the directors and shareholders of the corporation, i.e., the principal shareholders also will serve as directors. The separate functions and responsibilities usually exercised by persons in those different capacities may well become blurred and indistinguishable. Actions ordinarily performed by the directors may be undertaken by the shareholders or they simply may be undertaken without regard as to the capacity in which the individuals intended to act.

The basic relationship between the participants in a closely-held corporation also is likely to be different from the relationship between directors and shareholders of a large enterprise. In the former, the relationship may be both perceived and conducted more in the nature of a partnership, with higher expectations and trust regarding the conduct of one another. In the latter, there may well be a separation of ownership and control. Moreover, should the relationship turn out less favorably than anticipated, e.g., a particular shareholder's expectations simply are not met, there is far less opportunity for the unhappy shareholder in the closely-held corporation to liquidate his holdings and seek an alternative investment. Means for resale of the shareholder's interest may be severely limited; there is no comparable Wall Street option available as is the case at least for larger corporations whose shares are publicly traded.

V. A MORE BALANCED APPROACH

The discussion in Part III above certainly suggests that some action needs to be taken to address the threat of staggering recoveries against directors of publicly-held companies for breach of the duty of care. On the other hand, the immediately preceding section identifies

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60. Thus, for example, § 8.01(c) of the Revised Model Business Corp. Act authorizes a corporation to operate without a board of directors, i.e., by shareholder action. REVISED MODEL BUSINESS CORP. ACT § 8.01(c) (1984).


63. Id.
a variety of problems which may be raised by pursuing the statutory alternatives offered to date in response to that threat.

The approach advocated by the Corporate Governance Project, and the one being urged by this author for consideration by state legislators, is based upon a belief that a more reasonable balance between the concerns of directors and the rights of shareholders can be achieved, as opposed to simply insulating directors from all liability for breach of duty of care. That balance can be achieved by providing a statutory cap on liability for corporate officials reasonably related to the economic benefits received by those persons from the corporation they serve. Were that approach to be followed, the state corporation law would provide that the maximum liability which an officer or director would have for breach of the duty of care would be measured by the amount of compensation or fees that person had received from the corporation over a specified period of time.64

Such an approach would offer shareholders a process by which to hold corporate officials accountable when the latters' acts, by virtue of their failure to exercise due care, had caused or allowed injury to the corporation to result. Yet, at the same time, the ceiling limitation would protect those corporate officials from the horrendously disproportionate exposure to liability which presently exists. With specific estimates of the maximum liability to which officers and directors would be exposed then possible, D & O coverage should be more reasonably affordable.65

The specific amount of any such cap obviously is somewhat arbitrary because, in any given instance, the amount of the ceiling will have no direct relationship to the harm suffered by the corporation.66 From the standpoint of restoring a corporation to the position it

64. For a description of how § 7.17 of the Corporate Governance Project would operate, see supra note 15 and accompanying text. The author of Note, The Limitation of Directors' Liability, supra note 1, proposes a similar approach, setting a floor of $100,000.00 for outside directors and the annual compensation received in their officer capacity for inside directors. Id. at 449-51.

65. Corporate Governance Project, T.D. 7, supra note 6, at 31-32.

66. To the extent that the mere existence of a cap in fact influences directors' conduct in a manner which promotes accountability, the arbitrariness of any specific cap amount is less relevant. Measuring the amount of such a cap by reference to the amount of compensation received by the corporate official over an identified period actually is not all that arbitrary. With a restitution-based measure of damages, the party who has acted wrongfully forfeits his or her rights to compensation and whatever profits may have been obtained. The Corporate Governance Project justifies this as consistent with general agency law cases and principles. Id. at 39. Traditional tort liability concepts, on the other hand, would suggest awarding a victorious corporation in a derivative action damages for the full extent of injuries suffered. Id. at 30.
would have been in had a particular transaction not been pursued, this remedy generally will be inadequate. Nevertheless, to the extent that the existence of some residual liability can have an impact in monitoring and influencing directors’ and officers’ conduct, a liability cap would appear worth pursuing. It has been surprising that so few corporate law practitioners have urged this alternative approach in the legislative debates that have occurred to date. Perhaps this is attributable to the fact that most practitioners who represent corporations identify their client as the incumbent management or the board of directors rather than the ultimate owners, the shareholders.

Some commentators suggest that a statutory ceiling approach may be constitutionally infirm. Various liability caps enacted by state legislatures in other contexts have been challenged on the ground that those limitations violate, among other constitutional provisions, the seventh amendment to the Constitution and the comparable state constitutional protections regarding the basic right to a jury trial. This writer believes, however, that a liability cap in the area of officers’ and directors’ liability can withstand a constitutional challenge if appropriately enacted.

While several constitutional law issues have been raised with respect to statutory limitation of damages in a variety of areas, the principal challenge has been the right to a jury trial on the subject of damages. The principal grouping of cases which have questioned the constitutionality of ceilings on liability has dealt with various state legislative efforts to impose caps on malpractice liability or non-economic damages with respect to recognized common law causes of action. Among the more recent decisions invalidating a statutory cap on medical malpractice awards is that in *Boyd v. Bulala*, where Federal District Judge Michael found that the $750,000.00 cap enacted by the Virginia legislature violated the plaintiff’s constitutional right to a jury trial.

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67. It was instructive to this writer to hear one of the principal speakers, a highly regarded corporate practitioner, at the Corporation Law Section’s special program during the Connecticut Bar Association’s 1987 Annual Meeting, claim that corporate lawyers had an obligation to their clients, the members of a corporation’s board of directors, to support the legislative approach offering maximum exculpation from liability, i.e., the Indiana approach. Nothing in the Model Rules of Professional Conduct, however, mandates such a conclusion. See, e.g., Model Rules of Professional Conduct, §§ 1.7, 1.13 (1983).

68. See, e.g., Hanks, supra note 1, at 30; Hazen, supra note 1, at 173.


70. For case citations, see supra note 69.

trial under both the United States and Virginia constitutions. That case is of special interest because of its potential bearing on the statutory cap provision enacted in Virginia with respect to the limitation of directors' liability for breach of the duty of care.  

The plaintiff actually challenged the constitutionality of the malpractice award cap on three independent constitutional law grounds—as a denial of equal protection, as violative of the plaintiff's due process rights, and as violative of the plaintiff's constitutional right to a trial by jury. While Judge Michael held that the statutory cap did not violate the equal protection and due process clauses, he did find that the cap violated the plaintiff's seventh amendment right to a jury trial since, as drafted, the malpractice damages cap "infringes strongly on the fact-finding function of the jury in assessing appropriate damages." A key inquiry thus was whether the determination of damages should be classified as a fundamental jury function. Judge Michael concluded that the assessment of the full measure of damages always had been regarded as within the scope of the jury's basic functions.  

At first blush, all of Judge Michael's reasoning in that case would appear to be equally applicable both to the statutory cap reflected in the Virginia approach and to a ceiling of the type proposed by section 7.17 of the ALI Corporate Governance Project. A shareholder's right to sue for a corporate official's breach of the duty of care has long been recognized. Although the shareholders' derivative action has been categorized as a combination of actions at law and equity, the Supreme Court clearly held in Ross v. Bernhard that plaintiffs in such an action are entitled to the right to a jury trial.

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72. For text and discussion of the Virginia statute, see supra notes 10 and 11 and accompanying text.
74. Id. at 787-88.
75. Id. at 788-89.
76. Id.
77. Id. at 789.
78. Many corporation statutes, in fact, are silent on both the duty of care which a director must exercise and a shareholder's right to sue on behalf of the corporation to enforce such a duty. See, e.g., Conn. Stock Corporation Act, CONN. GEN. STAT. ANN. §§ 33-282 to 418 (West 1987 & Supp. 1988).
80. Id. at 536.
At least two responses can be offered why a statutory limitation in the case of directors' liability should be constitutionally permissible, notwithstanding the *Boyd v. Bulala* analysis. The Reporter responsible for drafting section 7.17 of the Corporate Governance Project cites a variety of additional state court holdings to support his view that "a reasonable limitation on the liability of directors and officers should encounter no serious constitutional obstacle." The limitation proposed in section 7.17 apparently is viewed as a reasonable, rather than an arbitrary, limitation, both because it is directly related to the economic benefits received by whomever may be the particular defendants and because, in shareholder derivative actions, individual shareholders are not seeking direct recovery for serious personal injuries or damages, but rather on behalf of the corporation as an entity.

While these arguments may be sufficient to dispose of any constitutional law challenge, this author would respond to any prospective challenge by an alternative means—first, by requiring that any statutory cap provision be approved by the requisite vote of the shareholders of that corporation, and, second, by expressly providing in the amendment or the related disclosures furnished to shareholders that such approval represents a decision by the shareholders to waive their right to a jury trial on the full measure of damages otherwise available in the absence of a cap.

The nature of the derivative action which has been the focal point for all the discussion is one dependent totally upon the shareholder status of the persons involved. In other words, no one has a right to bring any action on the corporation's behalf against the officers or directors of the corporation except by having met certain shareholder qualifications.

Furthermore, the corporation law statutes long have provided for


83. As to any recovery in a derivative action being for the benefit only of the corporation, see *Ross*, 396 U.S. at 538; *Koster v. Lumberman's Mut. Casualty Co.*, 330 U.S. 518, 522 (1947).

84. Thus, for example, the Revised Model Business Corporations Act requires that a person bringing a derivative action: (1) be a shareholder at the time of transaction complained of; and (2) make a demand upon the Board of Directors to obtain action (or allege sufficient facts to state why such demand is excused). See REV. MODEL BUSINESS CORP.
shareholder voting on various corporate matters by a certain percentage of the outstanding shares. Typically, so long as the requisite percentage of affirmative votes—either a majority or two-thirds of the voting power represented—is obtained, all shareholders thereafter are bound by that vote. There is nothing preposterous or inconsistent in applying that well-known concept to a shareholder vote to approve a statutory ceiling on the liability of corporate officials. Moreover, if shareholders have the authority to vote to eliminate officer and director liability altogether, as contemplated, for example, under both the Delaware and Virginia approaches, how can they not also approve a statutory ceiling on liability, a lesser reduction of their otherwise recognized right?

Most decisions which have involved a waiver of constitutional rights relate to criminal or other matters involving individual defendants. Nevertheless, the teaching of those cases is that such a waiver is possible, particularly if the waiver is an informed one. An amendment to a publicly-held corporation's certificate of incorporation limiting the amount of damages recoverable in an action for breach of duty of care that has to be submitted to shareholders for action will trigger the production of a proxy statement describing the consequences of adoption or rejection of the amendment. Shareholder approval thus cannot be given without adequate information having been disclosed in advance of the shareholder vote. A similar requirement could be

ACT § 7.40 (1984). Other states add additional requirements, e.g., that the shareholder put up security for expenses. See, e.g., N.Y. BUS. CORP. LAW § 627 (McKinney 1986).


86. The typical effect given to shareholder action which obtains the requisite vote is as expressed in Rev. Model Business Corp. Act § 11.05, which provides as follows:

(a) After a plan of merger . . . is approved by the shareholders . . . the surviving or acquiring corporation shall deliver to the secretary of state for filing articles of merger . . .

(b) Unless a delayed effective date is specified, a merger . . . takes effect when the articles of merger . . . are filed.

REV. MODEL BUSINESS CORP. ACT § 11.05 (1984).

87. At least one judge has disagreed with the concept that the power to deal exhaustively with the whole inherently includes the power to deal with a lesser portion thereof. See Judge Michael's opinion in Boyd v. Bulala, 647 F. Supp. 781, 789-90 (W.D. Va. 1986).

88. See, e.g., the lengthy annotation of cases in Annotations, Withdrawal or Disregard of Waiver of Jury Trial in Civil Action, 64 A.L.R.2d 506 (1959).

89. Id.

90. See Item 19 of Regulation 14A (calling for mandatory disclosure of "the reasons for and the general effect of" any charter or by-law amendment being submitted for shareholder action.) 17 C.F.R. § 240.14a-101 (Schedule 14A, Item 19) (1988).
included in the applicable state corporation statutes with respect to smaller closely-held corporations not subject to the federal proxy rules. In short, it should be possible to structure a required shareholder approval which would avoid any basis for challenge on constitutional law grounds.

**CONCLUSION**

The support urged in this commentary for the Corporate Governance Project’s “middle ground” response is rooted in a belief that it is possible both to afford corporate officials substantial relief from otherwise unreasonable exposure to financial liability and, at the same time, preserve some meaningful accountability for the actions of corporate officials to the shareholders. As noted earlier, a ceiling related to the economic benefits realized by the corporate official will achieve all the desired objectives involved in limiting liability—avoiding disproportionate, excessive or Draconian damages, reducing pressures on corporate officials to act in an unduly risk-averse manner, and reducing the costs of D & O insurance coverage for corporate officials—while at the same time retaining some accountability on the part of corporate officials through the prospect of a minimal residual liability for due care violations. While the deterrent effect of derivative litigation unquestionably will be reduced with a statutory limitation on due care liability, the potential threat of such litigation nevertheless should continue to exert an influence in promoting prudent actions by corporate officials. That residual potential, coupled with the impact of other developments such as the presence on a board of directors of a majority of independent directors, securities disclosure requirements, and the market discipline imposed by the possibility of hostile takeover bids, should assure an adequate minimum level of corporate accountability.

The total elimination of financial liability contemplated by the Indiana approach (and, as a practical matter, the other statutory ap-

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91. Thus, for example, a typical “books and records” provision of a corporation statute (see, for example, CONN. GEN. STAT. ANN. § 33-307 (West 1987)) could be amended by adding something like the following:

Each corporation, other than a corporation subject to Section 14 of the Securities Exchange Act of 1934 as amended, seeking shareholder approval of an amendment to its certificate of corporation with respect to the limitation of liability of directors, corporate officers or agents for breach of duty to the corporation, shall furnish to the applicable shareholders of record a brief statement describing the reason for and general effect of the proposed amendment.

In any given instance, the specific disclosures made by the corporation describing the “general effect” of the proposed cap would include an express statement that approval by shareholders represents a decision to waive rights to a jury trial as to damages.
proaches) swings the pendulum further than necessary to afford corporate officials the basic protection they desire and need. In the absence of any residual financial liability exposure, the duty of care provisions of state corporation law would fail to have any meaningful significance or function. With a remedy for due care violations that measures the maximum exposure by the economic benefits received by the delinquent corporate officials, the applicable duty of care standards of the state corporation law statutes will retain both some credibility and operative deterrent impact.

The state legislatures which either have acted or are considering legislation to absolve directors of all financial exposure—which include Connecticut, Massachusetts and New York in the Northeast—have been persuaded to adopt too extreme a response. It is time for those states to reexamine the issues involved more closely and to address the concerns of both corporate officials and shareholders in a fairer and more balanced manner.