CORPORATIONS—DIRECTORS WHO APPROVE SALE OF CORPORATION WITHOUT SUFFICIENT DELIBERATION NOT ENTITLED TO PROTECTION AFFORDED BY BUSINESS JUDGMENT RULE—*Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

Traditionally, the business judgment rule has afforded corporate directors considerable protection in making business decisions.[1] Courts have generally taken a highly deferential approach in their analysis of decisions made by a corporate board of directors whenever the business judgment rule is raised as a defense.[2] Recently, however, there has been a growing trend for the judiciary to take a more active role in reviewing the business decisions of corporate boards.[3] Indicative of this movement is the Delaware Supreme Court's decision in *Smith v. Van Gorkom*.[4] In *Van Gorkom*, the court denied the directors the protection of the business judgment rule and held that they acted in a "grossly negligent" manner by approving the sale of the corporation after only two hours of consideration.[5]

Trans Union Corporation (Trans Union) was a publicly traded holding company[6] incorporated under the laws of Delaware.[7] Despite Trans Union's annual cash flow[8] of several hun-

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1 This note focuses primarily on the Delaware courts' treatment of the business judgment rule.

2 *See, e.g.*, Sinclair Oil Co. v. Levien, 280 A.2d 717 (Del. 1971); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970); Warshaw v. Calhoun, 43 Del. Ch. 148, 221 A.2d 487 (Del. 1966); Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964); Smith v. Pritzker, No. 6342 (Del. Ch. July 6, 1982), *rev'd sub nom.* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Muschel v. Western Union Corp., 310 A.2d 904 (Del. Ch. 1973); Kelly v. Bell, 254 A.2d 62 (Del. Ch. 1969), *aff'd*, 266 A.2d 878 (Del. 1970); Porges v. Vadsco Sales Corp., 27 Del. Ch. 127, 32 A.2d 148 (1943); Karasik v. Pacific E. Corp., 21 Del. Ch. 81, 180 A. 604 (1935); Mitchell v. Highland-Western Glass Co., 19 Del. Ch. 326, 167 A. 831 (1933); Cole v. National Cash Credit Ass'n, 18 Del. Ch. 47, 156 A. 183 (1931); Robinson v. Pittsburgh Oil Ref. Corp., 14 Del. Ch. 193, 126 A. 46 (1924).

3 *See, e.g.*, Aronson v. Lewis, 473 A.2d 805 (Del. 1984); Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981); *see also* Burks v. Lasker, 441 U.S. 471 (1979) (disinterested investment company directors must serve as "independent check" on management); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S. 2d 920 (1979) (court may examine disinterested independence of special litigation committee of board of directors).

4 488 A.2d 858 (Del. 1985).

5 *Id.* at 884, 888.

6 A holding company is defined as "[a] company that confines its activities to owning stock in, and supervising management of, other companies." BLACK'S LAW DICTIONARY 658 (5th ed. 1979).

7 *Van Gorkom*, 488 A.2d at 864.

8 Cash flow is "[t]he cash generated from the property. It is different than net

dred million dollars, it was unable to generate "sufficient taxable income to offset increasingly large investment tax credits (ITCs)."[9] Consequently, on August 27, 1980, Trans Union's chairman and chief executive officer, Jerome W. Van Gorkom, met with Trans Union's senior management[10] in an effort to find a permanent solution to the tax credit problem.[11] Among the alternatives considered was a leveraged buy out[12] by management.[13] Fearing a possible conflict of interest for the members of management, however, Van Gorkom subsequently vetoed the idea of a leveraged buy out.[14]

In early September, Van Gorkom approached Jay A. Pritzker, a corporate takeover specialist, with an offer to sell Trans Union to Pritzker's company, Marmon Group, Inc. (Marmon).[15] Van Gorkom arrived at a price of $55 per share for the company based solely upon figures used by Trans Union's controller to assess the feasibility of a leveraged buy out.[16] During the week beginning September 15, 1980, Pritzker and Van Gorkom entered into further negotiations concerning the proposed sale of Trans Union to Marmon.[17] These discussions concluded with Pritzker's offer to purchase Trans Union on

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income; cash flow looks to the amount of cash left after all payments are made, whether they are tax deductible or not. Cash receipts minus disbursements. . .for a given period." BLACK'S LAW DICTIONARY 196 (5th ed. 1979).

9 *Van Gorkom*, 488 A.2d at 864.

10 Trans Union's senior management included the following people: Donald Romans, the corporation's chief financial officer; Carl Peterson, the controller; Bruce S. Chelberg, the president and chief operating officer; William Browder, the vice president; and William Moore, the corporate general counsel. *Id.* at 865-67.

11 *Van Gorkom*, 488 A.2d at 865. The problem arose from the fact that Trans Union's rail car leasing division was taking large accelerated depreciation deductions on its assets, thus decreasing the available taxable income. *Id.* at 864. Without sufficient taxable income, the ITCs would go unused. *See id.*

12 A leveraged buy out is defined as

> [t]he purchase of assets or stocks of a privately owned company or a public company or a subsidiary of these companies, in which the purchaser uses a significant amount of debt and very little equity capital. This is accomplished by utilizing the purchased assets for collateral and the acquired earnings stream to amortize the debt.

J. BERENYI, THE MODERN AMERICAN BUSINESS DICTIONARY 158 (1982).

13 *Van Gorkom*, 488 A.2d at 865. Until this time, Trans Union had relied upon a program of acquiring small companies in order to increase available taxable income and thus offset available ITCs. *Id.* Van Gorkom, however, did not consider this a permanent solution to the problem. *Id.*

14 *Van Gorkom*, 488 A.2d at 865.

15 *Id.* at 866-67. Marmon was owned by Pritzker and his brother. *See id.* at 864.

16 *Id.* at 866.

17 *See id.* at 867.

September 18th at $55 per share.[18] The terms of that offer included a demand by Pritzker that he receive an option to purchase 1,000,000 shares of newly issued Trans Union stock at market price.[19] In addition, the offer was made contingent upon Trans Union's board of directors acting within three days.[20]

Two days later, on September 20th, Van Gorkom disclosed the terms of the merger to the members of Trans Union's senior management, but he failed to furnish them with a copy of the agreement.[21] The majority of the members of senior management objected to the merger proposal.[22] Despite senior management's reaction, Van Gorkom presented the proposal to the board of directors,[23] urging them to let the shareholders make the ultimate determination as to the fairness of Pritzker's offer.[24]

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18 *See id.*

19 *Id.* at 866-67. Pritzker would be free to sell those shares to a higher bidder. *Id.* at 866.

20 *Id.* at 867.

21 *Id.* At this meeting, Donald Romans, Trans Union's chief financial officer, disclosed that his department had conducted a second study on the price needed for a successful leveraged buyout. *Id.* This study revealed that the price of Trans Union stock ranged from $55 to $65 per share. *Id.* This report, however, was not made available to the members of management present at the meeting. *Id.*

22 *Id.* Romans objected, arguing that the proposal essentially "amounted to 'an agreed merger as opposed to an offer.' " *Id.* at 868. Romans's argument was based on the fact that "the agreement to sell Pritzker one million newly-issued shares at market price would inhibit other offers, as would the prohibitions against soliciting bids and furnishing inside information to other bidders." *Id.* at 867-68. The only two members of senior management who supported the proposal were Bruce S. Chelberg and Carl Peterson. *Id.* at 867.

23 *Id.* at 868. All but one of the members of the board were present at the meeting. *Id.* Director O'Boyle was absent due to illness. *Id.* The board of directors consisted of five "inside" directors and five "outside" directors. *Id.* Generally, all members of the board were well-educated and had a vast amount of business experience. *Id.* The "inside" directors were defendants Bonser, O'Boyle, Browder, Chelberg, and Van Gorkom. *Id.* At the time of the proposed merger, these members had been collectively employed by Trans Union for 116 years and had served on the Trans Union board for a combined total of 68 years. *Id.* at 894 (McNeilly, J., dissenting). The "outside" directors included defendants Wallis, Johnson, Lanterman, Morgan, and Reneker. *Id.* at 868. Dr. Wallis was "a professor of economics at Yale University, dean of the graduate school of business at the University of Chicago, and Chancellor of the University of Rochester." *Id.* at 894 (McNeilly, J., dissenting). He had served as a member of Trans Union's board since 1962, as well as serving on a number of other major corporate boards. *Id.* The other four "outside" directors were all chief executive officers of major corporations. *Id.*

24 *Id.* at 868. The court summarized Van Gorkom's presentation of the terms of the merger as follows:

> Pritzker would pay $55 in cash for all outstanding shares of Trans Union stock upon completion of which Trans Union would be merged into New T Company, a subsidiary wholly-owned by Pritzker and formed to implement the merger; for a period of 90 days, Trans Union could re-

Van Gorkom also asked Donald Romans, Trans Union's chief financial officer, to disclose the results of a study conducted by Trans Union's financial department in connection with the possibility of a leveraged buy out.[25] Romans emphasized the fact that the study was merely a step in the direction of determining the value of Trans Union and was in no way meant to be viewed as a valuation study.[26] Trans Union's president, Bruce S. Chelberg, concluded the meeting by advising the other board members that he supported Van Gorkom's representations as well as the merger itself.[27]

After two hours of discussion, the directors voted to approve the proposed merger agreement.[28] That evening, Van Gorkom and Pritzker executed the agreement at a social function.[29] The following Monday, September 22nd, Trans Union issued a press release announcing the merger.[30] In response to this announcement, many key members of Trans Union's management

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> ceive, but could not actively solicit, competing offers; the offer had to be acted on by the next evening, Sunday, September 21; Trans Union could only furnish to competing bidders published information, and not proprietary information; the offer was subject to Pritzker obtaining the necessary financing by October 10, 1980; if the financing contingency were met or waived by Pritzker, Trans Union was required to sell to Pritzker one million newly-issued shares of Trans Union at $38 per share.

Id.

25 *Id.* at 869. The study was made for the purpose of determining the minimum price per share that would justify a leveraged buy out by management. *Id.*

26 *Id.* Romans's statement as to the nature of this study was consistent with his initial objection to the proposed merger. *See supra* note 22 and accompanying text.

27 *Van Gorkom*, 488 A.2d at 869. Chelberg, Trans Union's president, "testified that he 'participated to make sure that the Board members collectively were clear on the details of the agreement or offer from Pritzker.' " *Id.*

28 *Id.* The board later claimed to have made its acceptance conditional upon Trans Union's right to "share its proprietary information with any other potential bidders" and accept any better offer made during the 90 day market test period. *Id.* Although these two conditions were disputed at trial, it was uncontroverted that the board failed to reserve the right to pursue other offers. *Id.*

29 *Id.* Neither Van Gorkom nor any other board member read the agreement prior to its execution. *Id.*

30 *Id.* The press release stated that Trans Union had entered into a definitive agreement to merge with Pritzker's corporation at an agreed upon price of $55 per share. *Id.* at 881. The press release also stated that the merger was subject to stockholder approval at a special meeting and that Pritzker reserved the right to revoke the offer if he could not obtain proper financing for the merger. *Id.* at 881-82. In additon, the press release announced a related transaction in which Pritzker was given the option to purchase 1,000,000 newly-issued shares of Trans Union stock at just above market price. *Id.* Finally, the release stated that completion of the transaction was subject to the preparation and distribution of a definitive proxy statement and any necessary governmental approval. *Id.*

threatened to resign.[31] In an attempt to placate those members, Pritzker offered to modify the agreement in return for their promise to remain with the company for at least six months after the merger.[32] The primary modifications were as follows: (1) the agreement would be amended to permit Trans Union to solicit competing offers through January, 1981, and (2) the shareholders' meeting would take place on February 10, 1981 instead of in early January.[33] The purpose of the first amendment was to allow for a three-month "market test" period to ascertain the fairness of Pritzker's offer.[34] Pacified by these proposals, the directors voted on October 8th to approve the amendments even though they would not be drafted until two days later.[35]

On October 9th, Pritzker moved to limit the proposed market test by informing Trans Union that he had completed the necessary financing arrangements.[36] This action, he alleged, bound both parties to a firm purchase and sale agreement.[37] In addition, Pritzker publicly announced the exercise of his option to purchase 1,000,000 shares of Trans Union at just above the going market price.[38] A second press release was issued shortly thereafter, announcing that Pritzker had obtained the financing necessary to consummate the merger and that he had purchased the 1,000,000 shares of Trans Union stock.[39] This press release also stated that Trans Union was now permitted to solicit other merger offers.[40] If a more favorable offer were not received by February 10, 1981, Pritzker's proposed merger would then be submitted for shareholder approval.[41]

Van Gorkom received the amendments to the agreement on October 10th.[42] Although the amendments were at variance with his understanding of their terms, Van Gorkom signed the documents on behalf of the board.[43] The other members of the board

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31 *Id.* at 869.
32 *Id.*
33 *Id.*
34 *See id.*
35 *Id.* at 882-83.
36 *Id.* at 883.
37 *Id.*
38 *Id.*
39 *Id.* at 870, 883.
40 *Id.* at 870.
41 *Id.*
42 *Id.*
43 *See id.* at 883. Van Gorkom believed that the amendments gave Trans Union an unqualified right to solicit other offers as well as an absolute right to withdraw from the Pritzker merger. *See id.* at 882-83. In actuality, the October 10th amend-

did not formally approve the amendments, however, until almost two months later.[44]

In the three months that followed, Trans Union was offered for sale in the open market for the purpose of assessing the adequacy of Pritzker's offer.[45] The only firm offer Trans Union received was from the investment firm of Kohlberg, Kravis, Roberts & Co. (KKR).[46] The transaction with KKR was never completed, however, primarily because Trans Union's rail car leasing operation, a member of the group KKR was supposed to purchase, withdrew from the agreement.[47] Consequently, Van Gorkom deemed it unnecessary to disclose the existence of the KKR proposal at the board meeting scheduled later that day.[48] General Electric Credit Corporation (GE) also expressed interest in purchasing Trans Union at a higher offering price than that tendered by Pritzker, but GE terminated its advances when Pritzker refused to extend the February 10, 1981 deadline for negotiations.[49]

On January 21st, management sent out its proxy statements for the February 10th shareholders' meeting.[50] The board met again on January 26th and voted to approve the Pritzker

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ments severely limited Trans Union's right to solicit other offers and to withdraw from the Pritzker merger. *See id.* at 870, 883. The court noted:

> Under the October 10 amendments, a better *offer* was no longer sufficient to permit Trans Union's withdrawal. Trans Union was now permitted to terminate the Pritzker Agreement and abandon the merger only if, prior to February 10, 1981, Trans Union had either consummated a merger (or sale of assets) with a third party or had entered into a "definitive" merger agreement more favorable than Pritzker's and for a greater consideration—subject only to stockholder approval.

Id. at 883.

44 *Id.*

45 *Id.* at 870. The idea underlying the market test was that it would establish the adequacy of Pritzker's offer through a comparison with other offers. *See id.*

46 *Id.* at 884. KKR made its offer in early December. *Id.*

47 *Id.* at 885. Throughout the negotiations with KKR, Van Gorkom expressed his disapproval of their offer. *Id.* at 884-85. Because of conditions contained in KKR's offer, Van Gorkom did not view the offer as firm. *Id.* Claiming it would chill other offers, he refused to publicize KKR's proposal. *Id.* at 885. Interestingly, the court observed that Van Gorkom's unwillingness to publicize the KKR transaction was "inconsistent" with his previous "espousal of the September 22 press release following Trans Union's acceptance of Pritzker's proposal." *Id.* at 885 n.27. Although Van Gorkom denied responsibility for the withdrawal of the railroad leasing operation, he spoke with the chief officer of that operation prior to KKR's decision to revoke its offer. *Id.* at 885.

48 *Id.*

49 *Id.*

50 *Id.* at 870.

merger.[51] The board also voted to mail out a supplement to the original proxy statements, which purportedly set forth all previously undisclosed information concerning the merger.[52] Finally, on February 10th, an overwhelming majority of Trans Union's stockholders voted to approve the Pritzker merger.[53]

Prior to the shareholders' approval of the transaction, Alden Smith, a shareholder of Trans Union, petitioned to enjoin the merger.[54] On February 3, 1981, the trial court denied Smith's motion for a preliminary injunction.[55] Thereafter, Smith was joined by John W. Gosselin, and the two instituted a class action on behalf of the shareholders of Trans Union, seeking a rescission of the merger or, in the alternative, damages from the board of directors of Trans Union.[56] In an unreported opinion, the Delaware Court of Chancery held for the board.[57] On appeal, the Supreme Court of Delaware reversed and held that by approving the sale of Trans Union, the directors had acted in an uninformed manner and were not entitled to the protection of the business judgment rule.[58]

The origin of the business judgment rule can be traced to the early nineteenth century.[59] The rule developed at common law based on a belief that people of intellect and prudence would not serve as corporate directors if they were potentially liable for

51 *Id.*

52 *Id.*

53 *Id.*

54 *Id.* at 864 n.1, 870.

55 *Id.* at 864 n.1.

56 *Id.* at 863, 864 n.1.

57 *See* Smith v. Pritzker, No. 6342, slip op. at 15 (Del. Ch. July 6, 1982), *rev'd sub nom.* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

58 *Van Gorkom*, 488 A.2d at 864, 888.

59 One of the earliest American statements of the business judgment rule can be found in an 1829 Louisiana Supreme Court case, Percy v. Millaudon, 8 Mart. (n.s.) 68 (La. 1829). That case involved a suit brought by the shareholders of a bank against the bank's directors, seeking to hold the directors liable for losses resulting from defalcations by the bank's president and cashier. *Id.* at 68. In reaching the conclusion that the directors should not be held liable for mere good faith errors in judgment, the court stated:

> The test of responsibility therefore should be, not the certainty of wisdom in others, but the possession of ordinary knowledge; and by shewing [sic] that the error of the agent is of so gross a kind, that a man of common sense, and ordinary attention, would not have fallen into it. The rule which fixes responsibility, because men of unerring sagacity are supposed to exist, and would have been found by the principal, appears to us essentially erroneous.

Id. at 78.

mere errors in judgment.[60] One of the earliest Delaware cases to espouse the principles upon which the business judgment rule is predicated was *Robinson v. Pittsburgh Oil Refining Corp.*[61]

In *Robinson*, the directors of the Pittsburgh Oil Refining Corporation offered for sale all of the corporation's assets.[62] The directors received a number of bids, two of which they ultimately considered.[63] Although the two bids differed by almost $20,000, the directors of Pittsburgh Oil accepted the lower bid.[64] The plaintiff, a minority shareholder, instituted suit against the corporate directors, seeking a preliminary injunction to restrain the sale of the corporate assets.[65] The plaintiff alleged that acceptance of the lower bid constituted a total disregard of the corporation's best interests.[66]

In denying the preliminary injunction, the court articulated the founding principles of what would later become known as the business judgment rule.[67] At the outset, the court recognized that "the first essential requirement" for a transaction of this nature is shareholder consent.[68] It noted that since there was no evidence to suggest the shareholders had acted in bad faith, it

60 *See* Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 97 (1979); *see also* Godbold v. Branch Bank, 11 Ala. 191, 199 (1847) (prudent man would not accept directorship if liable for errors in judgment); Percy v. Millaudon, 8 Mart. (n.s.) 68, 78 (La. 1829) (no person would serve as corporate director if required to exercise perfect wisdom).

61 14 Del. Ch. 193, 126 A. 46 (1924).

62 *Id.* at 195, 126 A. at 46.

63 *See id.* at 195-96, 126 A. at 47.

64 *Id.* at 197, 126 A. at 47. The first bid was made by the Hood Trading Company and amounted to $487,946.67. *Id.* at 196, 126 A. at 47. This would have resulted in a distribution dividend upon dissolution of $4.706 per share. *Id.* The second bid was submitted by Poe & Davies and one of their associates, Joseph Kennedy. *Id.* This bid was for $466,650, which worked out to a distribution dividend upon dissolution of $4.50 per share. *Id.* In addition, the two bids differed in another respect. *See id.* at 195-96, 126 A. at 47. Hood was to pay $274,235 in cash for a portion of Pittsburgh Oil's assets. *Id.* at 195, 126 A. at 47. Other assets having a net value of $213,711.67 were to be retained by the corporation. *Id.* at 195-96, 126 A. at 47. Pittsburgh Oil would also retain all of its liabilities. *Id.* at 195, 126 A. at 47. On the other hand, Poe & Davies offered to pay $466,650 in cash for all of the assets of Pittsburgh Oil subject to all liabilities. *Id.* at 196, 126 A. at 47. Finally, the two bids contained different plans for the capital structure of the new corporation that was to take control of the assets purchased. *Id.* at 195-96, 126 A. at 47.

65 *Id.* at 197, 126 A. at 47.

66 *Id.* The plaintiff's claim was based upon § 64a of Delaware's General Corporation Law, which provided that corporate directors have a duty, when selling all of a corporation's assets, to act expediently and in the best interests of the corporation. *See id.*

67 *See id.* at 199, 126 A. at 48.

68 *Id.*

was proper to infer that the directors had likewise acted without bad faith.[69] The court reasoned, therefore, that the law presumes that directors act with a bona fide regard for the best interests of the corporation.[70]

The court then observed that the preliminary injunction would not issue if the terms and conditions of the sale itself did not indicate that the bargain was so unfair as to constitute fraud.[71] After thoroughly analyzing the terms of the sale in light of this presumption,[72] the court concluded that the directors' acceptance of the lower bid was not so unreasonable as to be removed from "the exercise of honest and sound business judgment."[73] Accordingly, the preliminary injunction was denied.[74]

In *Cole v. National Cash Credit Association*,[75] the Delaware Court of Chancery applied a similar analysis in upholding the directors' decision to proceed with a stock-for-stock merger.[76] *Cole* involved a minority shareholder's action, which sought to enjoin the proposed merger.[77] The basis of the complaint was that the value of the shareholders' preferred stock exceeded the value of the stock

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69 *Id.* The court characterized the defendant directors as the shareholders' "friendly representatives on the board." *Id.*

70 *Id.*

71 *Id.* at 199-200, 126 A. at 48.

72 *See id.* at 200-04, 126 A. at 48-50.

73 *Id.* at 202, 126 A. at 49. The court reasoned that although there was a difference of approximately $21,000 on the face of the two bids, this was not the only difference between the two bids. *See id.* at 200-01, 126 A. at 49. In addition, the court noted that there existed other terms that effectively lowered the difference between the two bids to only about $5000. *Id.* at 201, 126 A. at 49; *see supra* note 58. The court observed that if the only difference between the two bids consisted of the $21,000 face disparity, acceptance of the lower bid would clearly have constituted fraud. *Id.* at 200, 126 A. at 49.

74 *Id.* at 205, 126 A. at 51; *cf.* Allied Chem. & Dye Corp. v. Steel & Tube Co. of Am., 14 Del. Ch. 1, 120 A. 486 (1923). *Allied Chemical* was factually similar to *Robinson* except for two principal features. *Robinson*, 14 Del. Ch. at 197, 126 A. at 47. First, in *Allied Chemical* there was majority control of the stock, which did not exist in *Robinson*. *Id.* Second, *Allied Chemical* involved personal interest on the part of the directors. *Id.* Because of this personal interest, the *Allied Chemical* court refused to afford the directors the protection of the presumption that they acted in good faith. *See Allied Chemical*, 14 Del. Ch. at 24, 120 A. at 496. Therefore, the court granted the preliminary injunction. *Id.* at 25, 120 A. at 497.

75 18 Del. Ch. 47, 156 A. 183 (1931).

76 *See id.* at 64, 156 A. at 190. National Cash Credit Association, the defendant, was to merge into the Franklin Plan Corporation, the surviving company. *Id.* at 49, 156 A. at 184.

77 *Id.* Actually, *Cole* involved two separate actions, each seeking to enjoin the proposed merger. *Id.* The other action was brought by the Journal Square Bank Building Company, a creditor of the defendant. *Id.* at 50, 156 A. at 185.

offered in exchange by the surviving corporation.[78] The plaintiffs asserted that this constituted a fraud against the shareholders.[79]

In its opinion, the court first noted that the complaint was framed in terms of constructive fraud, rather than actual fraud.[80] The court stated that because a board's decision to accept a particular price is discretionary, a claim of fraud will not be justified by a trivial difference in the value of the stock exchanged.[81] Rather, the court opined that the disparity in value must be so great that the board's acceptance of the exchange constituted a conscious abuse of discretion.[82] The *Cole* court reasoned that absent a showing of such abuse of discretion, the board's decision was presumed to have been made in good faith.[83] Concluding that the evidence was insufficient to overcome the presumption that the directors acted in good faith, the court rejected the plaintiff's petition for a preliminary injunction.[84]

While *Cole* and *Robinson* focused upon the presence or absence of good faith on the part of corporate directors,[85] these courts failed to address the affirmative duties of a director under the business judgment rule. In *Mitchell v. Highland-Western Glass Co.*,[86] a Delaware chancery court first recognized that the business judgment rule invests directors with certain affirmative duties incident to their status.[87]

Mitchell involved a derivative suit by minority shareholders seeking to enjoin a proposed sale of all the assets of the defendant corporation.[88] One of the plaintiffs' principal contentions was

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78 *Id.* at 49, 156 A. at 184.

79 *Id.* at 56, 156 A. at 187. The stock valuation problem was based on an alleged prejudicial undervaluation of the assets of the National Cash Credit Association and an overvaluation of those of the Franklin Plan Corporation. *Id.* at 56-57, 156 A. at 187.

80 *Id.*, 156 A. at 187.

81 *Id.* at 58, 156 A. at 188.

82 *See id.* The court observed that this is necessarily so because "otherwise [the judicial system] would be choked with applications of recalcitrant stockholders." *Id.* (quoting Donald v. American Smelting & Ref. Co., 61 N.J. Eq. 458, 463, 48 A. 786, 788 (Ch.), *rev'd on other grounds*, 62 N.J. Eq. 729, 48 A. 771 (N.J. 1901)).

83 *Id.*

84 *Id.* at 64, 156 A. at 190.

85 *See id.* at 58, 156 A. at 188; *Robinson*, 14 Del. Ch. at 199, 126 A. at 48.

86 19 Del. Ch. 326, 167 A. 831 (1933).

87 *See id.* at 329-30, 167 A. at 833.

88 *Id.* at 326, 167 A. at 832. The gravamen of the complaint was that the defendant received inadequate consideration for the assets sold. *Id.* After the original complaint was filed, the sale was consummated, and the plaintiffs amended their complaint, seeking a return to the status quo or equivalent relief. *Id.* at 326-27, 167 A. at 832.

that the officers and directors of the defendant corporation failed to examine the purchasing corporation's books, as well as their own records.[89] The plaintiffs argued that they were thereby deprived of the benefit of the directors' informed judgment in deciding to sell the assets of the corporation.[90] The plaintiffs maintained, therefore, that the directors' decision was not in the best interests of the corporation.[91] The court rejected this assertion and found that the directors had examined the books of the purchasing corporation.[92] Nevertheless, the court implicitly recognized that in addition to acting in good faith, corporate directors must make an informed and intelligent decision under the business judgment rule.[93]

The requirements that directors act in good faith and in an informed manner were the determinative factors in subsequent decisions upholding the business judgment of directors.[94] For example, in the 1964 decision of *Cheff v. Mathes*,[95] the Delaware Supreme Court upheld the directors' decision to repurchase corporate stock primarily because there was no showing that the directors had acted with an improper motive.[96] The transaction at issue in *Cheff* was the repurchase of corporate stock in response to a hostile takeover attempt.[97]

Early in 1957, Arnold Maremont, well-known in corporate liquidation activities, began purchasing stock of the Holland Furnace Company (Holland).[98] In August, 1957, Maremont demanded that he be named to Holland's board of directors because he controlled approximately 100,000 shares of Holland stock.[99] Because of Maremont's threat to alter substantially the operating procedures of Holland, his demand was refused.[100]

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89 *Id.* at 329, 167 A. at 833.

90 *Id.*

91 *Id.* The plaintiffs argued that by failing to examine the books of either the purchaser or the seller, the directors were uninformed as to the value of both the purchaser's stock and the seller's stock and thus could not determine whether the exchange was a fair one. *See id.*

92 *Id.* at 329-30, 167 A. at 833.

93 *See id.*

94 *See, e.g.*, Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964); Muschel v. Western Union Corp., 310 A.2d 904 (Del. Ch. 1973).

95 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964).

96 *Id.* at 508, 199 A.2d at 556.

97 *Id.* at 496-97, 199 A.2d at 549-51.

98 *Id.* at 499, 199 A.2d at 551. Holland Furnace Company was a Delaware corporation that was publicly traded on the New York Stock Exchange. *Id.* at 497, 499, 199 A.2d at 550, 551.

99 *Id.* at 500, 199 A.2d at 551.

100 *Id.* At a meeting with P.T. Cheff, chief executive officer of Holland,

Fearing a takeover of Holland by Maremont, Holland's board of directors authorized the corporation to purchase the company's stock.[101] Unable to effect the takeover, Maremont offered to sell his stock back to Holland at a premium.[102] Holland accepted and consummated the deal with company funds.[103] The plaintiffs, minority shareholders of Holland, then instituted a shareholders' derivative suit against Holland's board of directors.[104] In their suit, the shareholders alleged that the repurchase of Holland stock was motivated by an improper desire to ensure the continued control of Holland by its incumbent directors.[105]

The trial court accepted the shareholders' assertion and found the directors liable.[106] On appeal, the Supreme Court of Delaware reversed.[107] After a cursory review of the evidence before it, the supreme court observed that in the absence of an improper motive, the directors' decision to purchase the company stock "was a matter of business judgment."[108] The court

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Maremont expressed his desire to liquidate Holland or substantially alter its sales force. *Id.*

101 *Id.* at 501, 199 A.2d at 552.

102 *See id.*

103 *Id.* at 502, 199 A.2d at 552-53. Maremont's company sold 155,000 shares of stock to Holland at $14.40 per share, which was higher than the going market price. *Id.*

104 *Id.*, 199 A.2d at 553.

105 *Id.*

106 *Id.* at 503, 199 A.2d at 553. The trial court observed that the majority of the board believed that the only option available to defeat the hostile takeover attempt was the purchase of Maremont's stock. *See id.* Those directors were therefore exonerated from liability. *Id.* The court, however, imposed liability on the four directors who had been aware of the existence of another potential purchaser. *Id.* The trial judge reasoned that the directors' knowledge of the existence of this alternative evidenced an improper desire to insure continued control of Holland. *See id.*

107 *Id.* at 508, 199 A.2d at 557.

108 *Id.*, 199 A.2d at 556. In reaching its conclusion that the directors were justified in purchasing Holland's stock with company funds, the court stated:

> The *unrebutted* testimony before the court indicated: (1) Maremont had deceived Cheff as to his original intentions, since his open market purchases were contemporaneous with his disclaimer of interest in Holland; (2) Maremont had given Cheff some reason to believe that he intended to eliminate the retail sales force of Holland; (3) Maremont demanded a place on the board; (4) Maremont substantially increased his purchases after having been refused a place on the board; (5) the directors had good reason to believe that unrest among key employees had been engendered by the Maremont threat; (6) the board had received advice from Dun and Bradstreet indicating the past liquidation or quick sale activities of [Maremont's company]; (7) the board had received professional advice from the firm of Merril Lynch, Fenner & Beane, who recommended that the purchase from [Maremont's company] be carried out; (8) the board had received competent advice that

therefore concluded that the directors should not be held personally liable.[109]

In *Muschel v. Western Union Corp.*,[110] a 1973 decision, a Delaware chancery court engaged in analysis[111] similar to that applied forty years earlier in *Mitchell*. The court's decision focused on both the good faith of the directors and their duty to make an informed judgment.[112] In *Muschel*, Regrem, Inc., a wholly-owned subsidiary of Western Union, sought to merge into National Sharedata Corporation (National).[113] National was to survive the merger as a wholly-owned subsidiary of Western Union.[114] As part of this transaction, Western Union was to issue shares of its common stock to the existing National shareholders at an agreeable exchange ratio.[115] Upon learning of this plan, the plaintiffs, minority shareholders of Western Union, petitioned for a preliminary injunction against the proposed merger.[116] The plaintiffs contended that the directors did not receive all material information relevant to the proposed merger and hence could not have made an informed business judgment in approving the merger.[117] In addition, they contended that Western Union had agreed to pay an excessive price for National.[118]

Initially, the court noted that the business judgment rule was the standard to be applied to this merger decision.[119] Under this rule, the plaintiffs had the burden of establishing fraud, either

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> the corporation was over-capitalized; (9) . . . Cheff had made informal personal investigations from contacts in the business and financial community and had reported to the board of the alleged poor reputation of Maremont.

Id. at 507, 199 A.2d at 556.

109 *Id.* at 509, 199 A.2d at 556-57.

110 310 A.2d 904 (Del. Ch. 1973).

111 *See id.* at 908-09.

112 *See id.* at 908.

113 *Id.* at 905.

114 *Id.*

115 *Id.* at 905-06. Western Union was to issue 880,000 shares of its common stock in exchange for 2,278,727 of National's common stock. *Id.* Thus, the agreed upon exchange ratio was 0.387 shares of Western Union for each share of National. *Id.* at 906.

116 *Id.*

117 *Id.* The plaintiffs contended that the board was not informed that National often issued stock options and warrants to potential customers as an incentive to enter into long-term contracts. *Id.* at 908. Additionally, the plaintiffs maintained that the board was not informed that a certain projection of National's revenues was substantially inflated. *Id.* A different projection prepared for National's officers presented a gloomier financial picture. *See id.*

118 *Id.* at 906.

119 *Id.* at 908.

actual or constructive, on the part of the directors.[120] The *Muschel* court stated that when an alleged fraud is based on a "discriminatory undervaluation or overvaluation of corporate assets," the disparity in valuation must be so great as to show "a conscious abuse of discretion" and not merely "an honest error of judgment."[121] The court further reasoned that the business judgment rule affords corporate directors wide discretion in making decisions relating to the matter of corporate valuation.[122] In addition, the court noted that the business judgment rule protects a board's decision from reproach if it "can be attributed to any rational business purpose."[123] Finally, the court stated that it would not substitute its own business judgment for that of the directors.[124]

Proceeding with its analysis in light of these considerations, the *Muschel* court rejected the plaintiffs' contention that the board lacked material facts in making its decision to merge the companies.[125] The court stated that there was evidence in the record indicating that the allegedly material facts were actually nonmaterial; thus, disclosure to the board was unnecessary.[126] Similarly, the court rejected the plaintiffs' allegation that the projection of National's revenues presented to Western Union's board reflected a better financial position than a similar projection prepared for National's officers.[127] The court reasoned that the projection offered to the board represented National's potential financial position after the proposed merger, while the other report was intended to be a projection for National prior to the proposed merger.[128] The *Muschel* court therefore concluded that the directors had acted in an informed manner and were entitled to the protection of the business judgment rule.[129]

Despite the apparent deference of the Delaware courts to the

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120 *Id.*

121 *Id.* (citing *Cole*, 18 Del. Ch. at 57, 156 A. at 187).

122 *Id.*

123 *Id.* (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

124 *See id.*

125 *Id.* at 908-09.

126 *Id.* In rejecting the plaintiffs' contention that the board was not advised of National's practice of issuing stock options and warrants to prospective customers, the court noted that only two options were exercised by National's customers. *Id.* at 908. The remainder of the options expired before they were exercised. *Id.*

127 *Id.* at 909.

128 *Id.*

129 *Id.* Because of its conclusion that the directors' decision was within the business judgment rule, the court found it unnecessary to question the price Western Union had agreed to pay for National. *See id.*

business judgment of directors, the Delaware chancery court in *Gimbel v. Signal Companies*[130] acknowledged that the business judgment rule does not "irrevocably [shield] the decisions of corporate directors from challenge."[131] In *Gimbel*, the court enjoined a corporation's sale of stock in its wholly-owned subsidiary because the price offered was grossly inadequate.[132] The transaction challenged arose when Signal Companies, Inc. (Signal) agreed to sell all of the outstanding capital stock of one of its wholly-owned subsidiaries to Burmah Oil Inc. (Burmah).[133]

In October and November of 1973, Burmah and Signal entered into preliminary negotiations concerning Burmah's possible purchase of some or all of the subsidiary's properties.[134] On December 18, 1973, Burmah made a formal purchase offer to Signal, which was conditioned upon Signal's acceptance on or before December 21, 1973.[135] A special meeting of Signal's board of directors was called on December 21st, and after only a few hours' consideration, the board voted to approve the transaction.[136] The plaintiff, a minority shareholder of Signal, instituted a derivative action seeking to enjoin the sale.[137] The plaintiff claimed that the sale price was "wholly inadequate" and that the directors had acted hastily in approving the sale.[138]

The *Gimbel* court first noted that the business judgment rule provides a presumption that directors act in good faith and in the best interests of the corporation.[139] In addition, the court stated that directors' "decisions will not be disturbed if they can be at-

130 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).

131 *Id.* at 609.

132 *See id.* at 618.

133 *Id.* at 601.

134 *Id.* at 612. In October, 1973, representatives of Burmah approached the president of Signal and indicated that Burmah was interested in acquiring the assets of the subsidiary for approximately $400 million. *Id.* Discussions continued throughout November, but the possible transaction was not revealed to Signal's board of directors until December 21, 1973. *Id.*

135 *Id.*

136 *Id.* The directors were given 36 hours' notice of this meeting, and the outside directors received no notice of the meeting's purpose. *Id.* Three of the outside directors were informed about the proposed sale for the first time at this meeting. *Id.* The meeting "resulted in the approval of a transaction of over $480,000,000 and possibly one of the largest private cash sales ever to take place." *Id.*

137 *Id.* at 601.

138 *Id.* at 604. The complaint also alleged self-interest and personal motivation on the part of certain directors. *Id.* The court quickly disposed of this allegation by noting that nothing in the record justified a finding that the directors were improperly motivated. *Id.*

139 *Id.* at 608-09 (citing *Robinson*, 14 Del. Ch. at 199, 126 A. at 48).

tributed to any rational business purpose."[140] The court recognized, however, that the business judgment rule is not an irrebuttable presumption.[141]

Proceeding in light of these principles, the court addressed the threshold question of whether the directors acted "with informed reasonable deliberation" by approving the sale.[142] In answering this question in the affirmative, the court considered all of the evidence before it in an exhaustive and detailed manner.[143] The court analyzed several factors, including the events leading up to the offer in December,[144] the directors' conduct at the special board meeting of December 21st,[145] the experience and expertise of the directors,[146] and the overall situation of Signal prior to the sale.[147] The court ultimately concluded that these factors were insufficient to raise "a reasonable probability that the plaintiff will be able to pierce the 'business judgment' standard."[148]

The *Gimbel* court then observed that the primary issue in the case was whether there was a gross disparity between the price paid for Signal's subsidiary and its true value.[149] After a close examination of the evidence relating to the issue of value,[150] the court concluded that further investigation into the fair value of the subsidiary was warranted.[151] The court therefore granted the preliminary injunction.[152]

Seven years after the *Gimbel* decision, in the seminal case of

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140 *Id.* at 609 (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

141 *Id.* (citing Marks v. Wolfson, 41 Del. Ch. 115, 123, 188 A.2d 680, 685 (1963)).

142 *Id.* at 611. The court characterized this part of the case as "those allegations whereby the plaintiff seeks to hurdle the protections of the business judgment rule." *Id.*

143 *See id.* at 611-15.

144 *Id.* at 611-12.

145 *Id.* at 612-13.

146 *Id.* at 613.

147 *Id.* at 613-14.

148 *Id.* at 615.

149 *Id.* Although the court concluded that the directors' *actions* were proper, it noted that a "method which produces a dollar result which appears perhaps to be shocking is significant." *Id.*

150 *See id.* at 615-17.

151 *Id.* at 617. After a thorough review of the evidence presented by the expert witnesses on the issue of valuation, the court observed that the conflicting dollar values varied so greatly that there was a substantial probability "that someone may be dead wrong." *Id.* Moreover, the court acknowledged that it was unable to estimate accurately the value of the company. *Id.*

152 *Id.* at 618. It is noteworthy that in granting the preliminary injunction, the court set the required security at $25 million. *Id.* The plaintiffs appealed this

Zapata Corp. v. Maldonado,[153] the Supreme Court of Delaware further evidenced the willingness of Delaware courts to scrutinize a board of directors' exercise of its business judgment. In fact, the *Zapata* court required trial courts to apply their *own* business judgment when reviewing a board's decision to dismiss a shareholder derivative suit.[154]

In *Zapata,* Maldonado instituted a derivative suit against ten officers and directors of the Zapata Corporation, alleging a breach of fiduciary duty.[155] The plaintiff brought the action without first requesting the corporation to do so, as required by Delaware law.[156] Four years after the institution of that action, two outside directors were appointed by the existing board to replace four of the defendant directors who were no longer on the board.[157] These new directors were then appointed as an "Independent Investigation Committee" to determine whether the corporation should pursue the pending shareholder suit filed by Maldonado.[158] The committee ultimately determined that the shareholder's derivative suit was not in the best interests of the company and should therefore be dismissed.[159] The Zapata Corporation then sought dismissal of the action, which the chancery court denied on the basis that the business judgment rule does not authorize the dismissal of shareholder derivative suits.[160] The Supreme Court of Delaware then reversed and held that a committee of independent directors may cause the corporation to file a pretrial application in the court of chancery seeking dismissal of a shareholder's derivative suit.[161]

In reaching its decision, the *Zapata* court articulated a two-step approach to determine the propriety of the committee's decision.[162] Initially, a court should examine "the independence

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amount unsuccessfully on the ground that it was unreasonable. *See* Gimbel v. Signal Cos., 316 A.2d 619 (Del. 1974).

153 430 A.2d 779 (Del. 1981).

154 *See id.* at 789.

155 *Id.* at 780.

156 *Id.* Delaware Court of Chancery rule 23.1 states in part: "The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and the reasons for his failure to obtain the action or for not making the effort." DEL. CH. CT. R. 23.1.

157 *Zapata,* 430 A.2d at 781.

158 *Id.*

159 *Id.*

160 *Id.*

161 *Id.* at 788.

162 *See id.*

and good faith of the committee."[163] If the committee fails this threshold determination, the court should then deny the corporation's motion to dismiss.[164] If the committee is found to have acted independently and in good faith, however, the court should then proceed to the second step of the analysis.[165] In this step, the court should apply its own independent business judgment to determine whether the committee's decision should be upheld.[166]

Although the rule articulated in *Zapata* was limited to corporate directors' decisions to dismiss shareholder derivative suits, the case signaled an increasing trend toward stricter examination of corporate directors' decisions that had previously been protected under the business judgment rule. In the *Van Gorkom* case, the Delaware Supreme Court continued this trend. The court exhaustively reviewed the decision of Trans Union's board of directors to approve Jay Pritzker's merger proposal.[167] In reversing the trial court's ruling that the approval of the merger was an informed decision protected by the business judgment rule,[168] a majority of the *Van Gorkom* court concluded that the directors of Trans Union had breached their fiduciary duty to the sharehold-

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163 *Id.* The court stated: "[T]he corporation should have the burden of proving independence, good faith and a reasonable investigation, rather than presuming independence, good faith and reasonableness." *Id.*

164 *Id.* at 789.

165 *Id.*

166 *Id.* The court explained the rationale for this part of its decision as follows:

> This means, of course, that instances could arise where a committee can establish its independence and sound bases for its good faith decisions and still have the corporation's motion denied. The second step is intended to thwart instances where corporate actions meet the criteria of step one, but the result does not appear to satisfy its spirit, or where corporate actions would simply prematurely terminate a stockholder grievance deserving of further consideration in the corporation's interest. The Court of Chancery of course must carefully consider and weigh how compelling the corporate interest in dismissal is when faced with a non-frivolous lawsuit. The Court of Chancery should, when appropriate, give special consideration to matters of law and public policy in addition to the corporation's best interests.

Id.

167 *See Van Gorkom*, 488 A.2d at 864-70.

168 *See* Smith v. Pritzker, No. 6342, slip op. at 15 (Del. Ch. July 6, 1982), *rev'd sub nom.* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). The court of chancery's judgment was based upon two findings: (1) the directors had acted in an informed manner in deciding to approve the Pritzker merger and thus should be entitled to the protection of the business judgment rule, and (2) the stockholders had been "fairly informed" when they voted to approve the merger and therefore their vote should not be set aside. *Id.* at 13-14.

ers.[169] The court's finding of liability was predicated on both the director's failure to apprise themselves of all relevant information before recommending the proposed merger to the shareholders and their failure to disclose to the shareholders all information material to the proposed merger.[170]

Writing for the majority, Justice Horsey first noted that a director of a corporation serves both the corporation and its shareholders in a fiduciary capacity.[171] As a fiduciary, a director must be informed prior to making any directorial decisions.[172] The court observed that the business judgment rule is a "presumption that in making a business decision, the directors. . .acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[173] According to the *Van Gorkom* majority, however, the business judgment rule does not preclude liability for decisions made in an uninformed or unadvised manner.[174] Qualifying this potential for liability, the court reasoned that "gross negligence is. . .the proper standard for determining whether a business judgment reached by a board of directors was an informed one."[175]

Based upon these standards, the court meticulously analyzed the conduct of Trans Union's directors that led to their approval of the Pritzker merger agreement.[176] The *Van Gorkom* court stated that it would initially determine whether the directors acted in an informed manner at the September 20, 1980 board meeting.[177] A finding that the directors' conduct failed this threshold inquiry would then cause the court to ascertain whether the directors' subsequent actions were sufficient to rectify their prior negligent conduct.[178]

Examining the directors' conduct at the first board meeting, Justice Horsey noted that the directors were wholly unaware of the intrinsic value of Trans Union.[179] The court observed that the trial court's decision that the directors were informed was based

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169 *Van Gorkom*, 488 A.2d at 893.

170 *Id.*

171 *Id.* at 872 (citing Loft, Inc. v. Guth, 23 Del. Ch. 138, 167, 2 A.2d 225, 238 (1938), *aff'd*, 23 Del. Ch. 255, 5 A.2d 503 (Del. 1939)).

172 *Id.* (citing Lutz v. Boas, 39 Del. Ch. 585, 595-96, 171 A.2d 381, 388 (1961)).

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

174 *Id.* (citing *Mitchell*, 19 Del. Ch. at 330, 167 A. at 833).

175 *Id.* at 873 (footnote omitted).

176 *See id.* at 873-88.

177 *Id.* at 874.

178 *Id.*

179 *Id.* at 874, 878.

in part on the fact that Pritzker had offered to pay a substantial premium over the prevailing market price of Trans Union shares.[180] The majority conceded that a significant premium may provide sufficient ground to recommend a merger when assessed in light of information that truly reflects the value of the business being sold.[181] Applying this rationale, the *Van Gorkom* court determined that the market value of Trans Union's stock could not be used as a factor in evaluating the proposed merger because it did not represent an accurate appraisal of the corporation's worth.[182]

The supreme court focused on the fact that the directors had relied entirely upon Van Gorkom's representation that $55 per share was a fair selling price.[183] Justice Horsey observed that the Trans Union board had made no attempt to prepare a valuation study, despite the relative simplicity with which such a study could have been undertaken.[184] Furthermore, the court opined that had the directors questioned either Van Gorkom or Romans concerning the proposed price, they would have discovered that $55 was merely a subjective figure designed to evaluate the merits of a leveraged buy out.[185]

In response to the directors' contention that they had relied upon the legal advice of outside counsel in approving the merger,[186] the *Van Gorkom* majority stated that this defense was inadequate in this factual context.[187] The court reiterated that

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180 *Id.* at 875.

181 *Id.*

182 *Id.* at 875-76. Justice Horsey noted that the market price of Trans Union's stock was "historically depressed" because Trans Union was unable to use its Investment Tax Credits (ITCs). *Id.* In addition, the court observed that there was a conflict between the directors' approval of the transaction and their statements in the proxies sent out to shareholders. *Id.* at 876. The directors relied on the market price of Trans Union stock in approving the merger, while the proxies indicated that the company's "inherent value" was greater than the public trading price. *Id.* Finally, the court pointed out that market price merely represents the value of a single share of stock. *Id.*

183 *See id.* at 877. The court noted that prior to the September 20th meeting, the board had never assessed Trans Union's true value. *See id.*

184 *Id.* at 876-77. Although it recognized that a valuation study or a fairness opinion by independent investment bankers was not required by law, the court reasoned that such a study would have uncovered Trans Union's large cash flow, thus giving the directors a better idea of the company's true worth. *Id.* at 876.

185 *Id.* at 877.

186 *Id.* at 880. Several of the directors testified at trial that James Brennan, outside counsel to Trans Union, had informed them that Delaware law required neither a fairness opinion nor an independent valuation study. *Id.* at 881.

187 *See id.*

the ultimate consideration was whether the directors possessed adequate information regarding the inherent worth of the company to make an informed business judgment.[188] Having concluded that the Trans Union directors had not been so informed, the court rejected the directors' defense that legal counsel had swayed their decision.[189] Although the directors claimed that counsel had warned them of potential lawsuits if they refused Pritzker's merger offer, Justice Horsey reasoned that "mere acknowledgment of this circumstance cannot be rationally translated into a justification for a board permitting itself to be stampeded into a patently unadvised act."[190]

The *Van Gorkom* majority similarly rejected the directors' contention that their merger decision could be validated on the basis of their "collective experience and sophistication."[191] Justice Horsey reasoned that a board's experience and expertise may be outweighed by proof of gross negligence.[192] Moreover, he observed that such experience is irrelevant if the members of the board are not given an opportunity to make an informed decision.[193] After a review of the evidence before it, the *Van Gorkom* majority determined that the directors were grossly negligent in approving the merger after only two hours' consideration.[194] The court therefore concluded that the directors had not acted in an informed manner at the September 20th board meeting, thus failing this threshold inquiry.[195]

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[188] *Id.* The court reasoned that the mere fact that a fairness opinion is not required by law was insufficient to exonerate a director who failed to become informed about the true value of a corporation. *See id.*

[189] *Id.*

[190] *Id.*

[191] *Id.* at 880. The business acumen of the Trans Union directors was a primary factor in the trial court's determination that the directors had acted in an informed manner. *See* Smith v. Pritzker, No. 6342, slip op. at 13 (Del. Ch. July 6, 1982), *rev'd sub nom.* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); *see also supra* note 23 (detailed enumeration of the directors' qualifications and experience).

[192] *See Van Gorkom*, 488 A.2d at 880.

[193] *Id.* The majority analogized the *Van Gorkom* case to Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974). *Van Gorkom*, 488 A.2d at 880. In *Gimbel*, the trial court enjoined a corporate board's sale of stock of its wholly-owned subsidiary for an alleged grossly inadequate price. *See Gimbel*, 316 A.2d at 618. The *Van Gorkom* majority reasoned that the *Gimbel* court's decision was "based on a finding that the business judgment rule had been pierced for failure of management to give its board 'the opportunity to make a reasonable and reasoned decision.' " *Van Gorkom*, 488 A.2d at 880 (quoting *Gimbel*, 316 A.2d at 615); *see supra* notes 130-152 and accompanying text (discussion of *Gimbel*).

[194] *See Van Gorkom*, 488 A.2d at 881.

[195] *Id.*

Proceeding to the second prong of its analysis, the court endeavored to determine whether the directors' actions after September 20th were sufficient to rectify their prior negligent conduct.[196] The court first evaluated the directors' conduct from October 8th to October 10th—the period in which amendments to the merger agreement were approved by the board.[197] In concluding that the directors had acted in an uninformed manner during this period, the court relied primarily upon three factors. Initially, the court focused upon the directors' conduct at the October 8th board meeting concerning the approval of the amendments to the merger agreement.[198] Justice Horsey observed that following Van Gorkom's cursory explanation of the content of the proffered amendments, the directors had approved the amendments sight unseen, thereby permitting the agreement "to be amended in a manner [they] had neither authorized nor intended."[199] The court opined that in order for the business judgment rule to absolve the directors from liability, they must demonstrate that they "knew what they were doing, and ensured that their purported action was given effect."[200]

The second factor that Justice Horsey considered was the effect of the October 10th amendments.[201] Although the amendments purported to give Trans Union the right to solicit other offers openly until January 31, 1981, the court concluded that their actual effect was much more limited.[202] The court observed that the October 10th amendments permitted Trans Union to terminate the deal with Pritzker only if it had actually consummated another merger or if it "had entered into a 'definitive' merger agreement more favorable than Pritzker's and for a greater consideration—subject only to stockholder approval."[203] Furthermore, the court noted that the October 10th amendments had in fact reduced the period in which Trans Union could solicit bids.[204] The reason for this was that the October 10th amend-

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196 *Id.*

197 *See id.* at 881-84.

198 *See id.* at 882-83.

199 *Id.* at 884. The actual amendments had not been drafted at the time of the October 8th meeting. *Id.* at 883. Nonetheless, the board approved the amendments and gave Van Gorkom the authority to execute the documents upon receipt of them. *Id.*

200 *Id.* at 883 n.25.

201 *See id.* at 883.

202 *Id.*

203 *Id.*

204 *Id.*

ments required Trans Union to submit its preliminary proxy statements by December 5, 1980 and to mail the statements to the shareholders by January 5, 1981.[205]

The *Van Gorkom* majority then evaluated the effect of the September 22nd and October 9th press releases on the original negligent conduct of the directors.[206] The September 22nd release announced that Trans Union "had entered into definitive agreements to merge with an affiliate of The Marmon Group, Inc."[207] The October 9th release announced that Pritzker had obtained all the necessary financing for the merger and that he intended to exercise his option to purchase 1,000,000 shares of Trans Union stock at just above the market price.[208] The court opined that the effect of these press releases was to deter others interested in merging with Trans Union and to lock Trans Union's board into the Pritzker agreement.[209] Based on these observations, the court concluded that the directors' conduct was as negligent on October 8th as it had been on September 20th.[210]

The *Van Gorkom* court also considered the curative effect of the market test upon which the directors relied to confirm their decision to approve the proposed Pritzker merger.[211] The directors maintained that the existence of the market test period established that they did not act impulsively in reaching their merger decision on September 20th.[212] The directors further contended that the adequacy of Pritzker's offering price was "conclusively established" by the fact that no other offers were received during the market test period.[213] Rejecting both of these arguments, the court noted that there was no evidence indicating that the merger agreement gave the board the unfettered right to put Trans Union up for sale to the highest bidder, nor was there evidence that a public auction of Trans Union had actually

205 *Id.* The October 10th amendments did, however, postpone the shareholder meeting at which the merger proposal was to be submitted for shareholder approval from January 10, 1981 to February 10, 1981. *Id.* at 886 n.29.

206 *See id.* at 881-84.

207 *Id.* at 881-82. The press release made no mention of Trans Union's right to perform a "market test" or the right to withdraw from the Pritzker merger if it received a better offer. *Id.* at 882. In addition, Trans Union failed to make a subsequent announcement that it reserved the right to solicit other offers. *Id.*

208 *Id.* at 883.

209 *See id.* at 884.

210 *Id.* at 883-84.

211 *Id.* at 878.

212 *Id.*

213 *Id.*

occurred.[214]

The court further found it necessary to examine both Van Gorkom's and Pritzker's reactions to the KKR and GE merger proposals.[215] Justice Horsey noted that when Van Gorkom was confronted with KKR's proposal to purchase Trans Union, he reacted in a completely negative manner and refused to acknowledge the legitimacy of the offer.[216] The court noted that KKR consequently withdrew its offer shortly before the Trans Union board meeting that day.[217] In addition, the court observed that GE, Trans Union's only other potential suitor, was deterred from making a firm offer as a result of Pritzker's refusal to extend the February 10th deadline for the stockholders' meeting.[218]

Finally, the *Van Gorkom* majority examined the corrective effects of the January 26, 1981 board meeting.[219] Initially, the court reasoned that, even though all information relevant to the Pritzker merger had then been disclosed to the directors,[220] their

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214 *Id.* In reaching both of these conclusions, the court relied on the following facts, which appeared in the lower court's record: (1) the directors failed to produce the original merger agreement at trial; (2) Van Gorkom testified that the agreement he signed on September 20th prohibited Trans Union from soliciting competing offers and from furnishing additional information to interested parties; (3) the agreement lacked a clause that specifically provided for the right to accept a better offer; and (4) the September 22nd press release failed to mention Trans Union's purported right to solicit other offers or accept higher bids. *See id.* at 878-79.

215 *See id.* at 884-85. For a detailed account of the KKR and GE proposals, see *supra* notes 45-49 and accompanying text.

216 *Van Gorkom*, 488 A.2d at 884-85. Van Gorkom did not view the offer as firm because it was contingent upon obtaining financing of $650 million. *Id.* Henry R. Kravis, a representative of KKR, stated that the financing arrangements were 80% complete. *Id.* at 884.

217 *Id.* at 885. KKR stated that the reason for its retraction was "a sudden decision of the Chief Officer of Trans Union's rail car leasing operation to withdraw from the KKR purchasing group." *Id.* The court posited that the chief officer's decision to withdraw may have been the result of a conversation he had with Van Gorkom prior to the board meeting. *Id.* Van Gorkom, however, denied any such responsibility. *Id.*

218 *Id.* Although GE made a written proposal in mid-January, it was not in the form of an actual offer. *Id.* If Pritzker would extend the February 10th deadline of the stockholders' meeting, GE was willing to make a formal offer of between $2 and $5 per share above Pritzker's offer. *Id.* When Pritzker refused to grant such an extension, GE terminated its proposal. *Id.*

219 *Id.*

220 *Id.* at 886. The following facts were disclosed at the January 26th board meeting: (1) prior to September 20th, no board members or members of senior management, except Chelberg and Peterson, were aware that Van Gorkom had discussed the transaction with Pritzker; (2) Van Gorkom had initially suggested the $55 price to Pritzker; (3) the board had declined to seek an independent fairness opinion; (4) Romans and several other members of senior management had expressed concern at the September 20th meeting that $55 was an inadequate price;

decision to approve the merger once again failed to evidence a reasoned and informed judgment because the directors were mistaken as to their available courses of action.[221] In support of this conclusion, the court relied primarily upon a Delaware statute,[222] which, in the opinion of the court, provided the directors with only two legally viable alternatives.[223] According to the *Van Gorkom* majority, the directors' available courses of action were either to continue to recommend the merger to the stockholders or to rescind the agreement with Pritzker and notify the stockholders that the February 10th meeting was cancelled.[224] Justice Horsey reasoned that the second alternative was not practically available to the directors because it involved the risk that Pritzker might sue for breach of the agreement.[225] The court therefore concluded that the January 26th board meeting had no real curative effects.[226]

The *Van Gorkom* court next addressed the directors' contention that their negligence had been excused by the shareholders'

(5) the financial department of Trans Union had prepared a study indicating that Trans Union had a value of approximately $55 to $65 per share; and (6) Romans was unable to advise the board that $55 was an unfair price. *Id.*

221 *Id.* at 888. The directors contended that at this meeting they had three available alternatives: "(1) to 'continue to recommend' the Pritzker merger; (2) to 'recommend that the stockholders vote against' the Pritzker merger; or (3) to take a noncommittal position on the merger and 'simply leave the decision to [the] shareholders.' " *Id.* at 887-88.

222 *Id.* at 888. The court relied on title 8, § 251 of the Delaware Code, which provides in part:

> The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation. The agreement shall state: (1) the terms and conditions of the merger or consolidation; (2) the mode of carrying the same into effect; (3) the amendments or changes in the certificate of incorporation of the surviving corporation as are desired to be effected by the merger or consolidation, or, if no such amendments or changes are desired, a statement that the certificate of incorporation of [one] of the constituent corporations shall be the certificate of incorporation of the surviving or resulting corporation; (4) the manner of converting the shares of each of the constituent corporations . . . and (5) such other details or provisions as are deemed desirable. . . . The agreement so adopted shall be executed in accordance with § 103 of this title.

DEL. CODE ANN. tit. 8, § 251(b) (1975).

223 *Van Gorkom*, 488 A.2d at 888.

224 *Id.*

225 *Id.* Pritzker's potential suit would be for breach of the September 20th agreement as amended on October 10th. *Id.* Under the October 10th amendment, the board's only legally available way out of the agreement was a more favorable agreement to sell Trans Union to a third party. *Id.*

226 *Id.*

vote to approve the merger.[227] Initially, the court recognized that a board's decision may be sustained, regardless of the defects present in the board's action, if it is approved by a majority vote of fully informed shareholders.[228] Noting that Delaware law required disclosure of all material facts in proxy statements,[229] the majority concluded that the proxies sent to Trans Union's shareholders did not fully inform them of all facts relevant to the Pritzker merger.[230] Hence, the stockholder vote of February 10th did not serve to excuse the directors' uninformed approval of the merger.[231]

In a strong dissenting opinion, Justice McNeilly likened the majority's opinion to "an advocate's closing address to a hostile jury."[232] Justice McNeilly stated that the combined education, experience, and general business acumen of the directors[233] constituted important evidence of their ability to make "on the spot," informed business decisions regarding the affairs of Trans Union.[234] Taking a broad view of the protection the business judgment rule affords corporate directors, Justice McNeilly believed that the rule shielded the decision of Trans Union's directors to recommend the merger to Trans Union's shareholders.[235]

As additional support for his conclusion, Justice McNeilly briefly examined the directors' conduct from July, 1980 until the shareholder meeting in February, 1981.[236] He noted that the directors received a new five-year forecast for Trans Union at the

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227 *See id.* at 889.

228 *Id.*

229 *Id.* at 890.

230 *Id.* The court noted the following deficiencies in the proxy statements sent out by the directors: (1) the directors failed to disclose the fact that they had no reasonable basis for determining the true worth of Trans Union other than the depressed market value; (2) the board's characterization of Romans's report in the supplemental proxy statements sent out; (3) the board's reference to the substantial premium offered was misleading to the shareholders; (4) the board's failure to disclose that Van Gorkom suggested the $55 per share price; (5) the fact that most of the directors were unaware of the potential merger prior to the September 20th board meeting; (6) the fact that the directors had failed to seek an independent fairness study; (7) the fact that several members of management were concerned that $55 was an unfair price; and (8) the fact that Trans Union's chief financial officer had informed the board that he had prepared a study indicating that the company had a value of approximately $55 to $65 per share. *Id.* at 890-92.

231 *Id.* at 893.

232 *Id.* (McNeilly, J., dissenting). Justice McNeilly accused the majority of portraying the Pritzker merger as a "fast shuffle." *Id.* at 894 (McNeilly, J., dissenting).

233 *Id.*; *see supra* note 23 (summary of the directors' credentials).

234 *Id.* at 895 (McNeilly, J., dissenting).

235 *See id.*

236 *Id.* at 895-97 (McNeilly, J., dissenting).

July board meeting.[237] In addition, Justice McNeilly pointed out that at the August board meeting, Van Gorkom presented the directors with a comprehensive study of Trans Union prepared by an outside consulting group.[238] Moreover, the dissent found Van Gorkom's explanation of the terms of the Pritzker agreement at the September 20th meeting totally acceptable.[239] Thus, Justice McNeilly reasoned that the directors were well-informed when they made their decision to recommend the Pritzker merger at the September 20th meeting.[240] Furthermore, the dissent stated that the October 10th amendments established the right of Trans Union to solicit higher bids and permitted unilateral termination of the Pritzker merger agreement by entry into a definitive merger agreement that was more favorable to the stockholders.[241] Justice McNeilly pointed to the results of the market test as an indication of the fairness of the Pritzker agreement.[242] Finally, the dissent noted that both the supplement to

237 *Id.* at 895 (McNeilly, J., dissenting). The five-year forecast was prepared by Trans Union's management and projected an annual income growth of about 20%. *Id.*

238 *Id.* The comprehensive study of Trans Union was prepared by the Boston Consulting Group. *Id.* This study was compiled during an 18 month period and contained a detailed analysis of all aspects of Trans Union, including its subsidiaries. *Id.*

239 *See id.* This was clear from the fact that at the September 20th meeting the directors required the merger proposal to be modified to reflect the fact that the directors could accept a better offer and to require that any potential suitor be given the same information as had been provided Pritzker. *Id.* For support, the dissent pointed to the language in the agreement stating "*that GL and NTC acknowledge that the Board of Directors of TU may have a competing fiduciary obligation to the Stockholders under certain circumstances.*" *Id.* It is noteworthy that the majority pointed to this same language as being clearly insufficient to prove that the directors did in fact amend the merger agreement to include these two provisions. *See id.* at 879; *see also supra* note 214 and accompanying text (noting that the amended agreement lacked a specific description of the right to accept a better offer).

240 *Id.* at 897 (McNeilly, J., dissenting).

241 *Id.* at 895-96 (McNeilly, J., dissenting). Justice McNeilly noted that the investment firm of Salomon Brothers was hired for the purpose of soliciting other offers and did in fact put a great deal of effort into this process. *Id.* at 896 (McNeilly, J., dissenting).

242 *Id.* Although four companies showed some interest in Trans Union, the Justice noted that only KKR actually made an offer to purchase Trans Union. *Id.* at 896 n.1 (McNeilly, J., dissenting). In addition, Justice McNeilly argued that the real reason KKR withdrew its offer was because of problems arising during negotiations with the Reichmans, a Canadian family that was interested in purchasing Trans Union. *Id.* Justice McNeilly also noted that Jack Kruzenga, the member of senior management who would have become chief operating officer of the surviving company, was displeased with the proposed leveraged buy out scheme. *Id.* He maintained that this, not the fact that Van Gorkom spoke with him, caused Kruzenga to withdraw from the KKR purchasing group. *Id.*

the original proxy statement and their conduct at the final board meeting evidenced an informed and reasoned decision on the directors' part.[243] In conclusion, Justice McNeilly stated that he agreed with the majority's analysis of the business judgment rule; however, he objected to their application of the rule to the facts of the *Van Gorkom* case.[244]

While the *Van Gorkom* majority did not expressly articulate a new standard for director liability under the business judgment rule,[245] the court's decision represents a pronounced departure from the traditional approach of Delaware courts whenever the business judgment rule has been raised as a defense.[246] In fact, the *Van Gorkom* decision contrasts sharply with the historically pro-management position of the Delaware courts. Moreover, the *Van Gorkom* court has given a new meaning to what constitutes an informed decision under the business judgment rule. By holding the directors of Trans Union personally liable to the corporation's shareholders, the Supreme Court of Delaware has taken another step into the corporate board room and has signaled a move towards more effective judicial scrutiny of corporate directors' conduct. Unfortunately, the *Van Gorkom* decision may have the practical effect of turning the director's chair into a "hot seat,"[247] which, in turn, could have a crippling effect on the already difficult task of finding competent individuals to serve on corporate boards.[248]

Under the business judgment rule, Delaware courts have generally taken a laissez faire attitude toward the fiduciary role and responsibility of management to its shareholders.[249] The business judgment rule is essentially a salutary principle; it allows

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243 *See id.* at 896-97 (McNeilly, J., dissenting).

244 *Id.* at 897 (McNeilly, J., dissenting). In a separate dissent, Justice Christie summarily voted to affirm the judgment of the court of chancery. *Id.* at 898 (Christie, J., dissenting).

245 The court reaffirmed the view that director liability under the business judgment rule is based upon the concept of gross negligence. *Id.* at 873; *see supra* note 175 and accompanying text.

246 *See supra* note 2 and accompanying text.

247 *See No More Easy Street for Company Directors*, U.S. NEWS & WORLD REP., Mar. 4, 1985, at 95; *see also* Leisner, *Boardroom Jitters: A Landmark Court Decision Upsets Corporate Directors*, BARRON'S, Apr. 22, 1985, at 34; *A Landmark Ruling That Puts Board Members in Peril*, BUS. WK., Mar. 18, 1985, at 56 [hereinafter cited as *Landmark Ruling*].

248 *See Inside Look at Life in the Corporate Board Room*, U.S. NEWS & WORLD REP., Jan. 28, 1985, at 71 [hereinafter cited as *Inside the Corporate Board Room*].

249 Marcus & Walters, *Assault on Managerial Autonomy*, HARV. BUS. REV., Jan.-Feb. 1978, at 57, 58.

for creative thinking and minimizes unwarranted shareholder suits.[250] Although the rule has traditionally been applied to give directors almost unbridled discretion in making corporate decisions, this application of the rule conflicts with the basic principles upon which the rule is grounded. The basic premise of the business judgment rule is that the directors of a corporation stand in a fiduciary relationship with the corporation and its shareholders; this relationship therefore creates the presumption that directors act in good faith and in the best interests of the corporation when making their business decisions.[251] As fiduciaries, corporate directors should be held to a higher standard of care[252] in reaching their professional decisions.

Nevertheless, the business judgment rule has been commonly applied to provide corporate directors with substantial immunity from liability.[253] One oft-quoted statement of the rule has been that a board of directors' decision "will not be disturbed if [it] can be attributed to any rational business purpose."[254] Such a characterization of the rule permits extremely broad discretion on the part of directors and effectively lowers, rather than heightens, the standard of care required of directors. Thus, traditional application of the rule accords directors far more protection than is necessary or warranted.[255]

The court's analysis of the directors' conduct in *Van Gorkom* signals a movement toward closer judicial scrutiny of corporate directors' actions. If followed by other courts, the *Van Gorkom* court's approach should enhance the relationship between corporate directors, the corporation, and its shareholders by requiring directors to act with greater care in arriving at their

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250 *See* Arsht, *supra* note 60, at 95.

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

252 *See generally* G.G. BOGERT & G.T. BOGERT, HANDBOOK OF THE LAW OF TRUSTS 343-46 (5th ed. 1973) (describing general standard of care for fiduciaries).

253 *See generally* R. NADER, M. GREEN & J. SELIGMAN, TAMING THE GIANT CORPORATION 102-05 (1976); Cary, *A Proposed Federal Corporate Minimum Standards Act*, 29 BUS. LAW. 1101, 1107-08 (1974). *But see* Arsht, *supra* note 60, at 93, 96 (critics believe "business judgment rule promises more in the way of immunity from liability than in reality it does").

254 Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971); Gimbel v. Signal Cos., 316 A.2d 599, 609 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974); Muschel v. Western Union Corp., 310 A.2d 904 (Del. Ch. 1973).

255 In his article on the business judgment rule, Arsht argues that the primary function of the business judgment rule is to accord directors the same necessary protection that professionals such as doctors or lawyers enjoy under tort law if sued for malpractice. Arsht, *supra* note 60, at 97. If this proposition is correct, then the business judgment rule clearly requires a standard of care more demanding than gross negligence.

professional decisions. Continued application of *Van Gorkom's* heightened level of review may effectuate a desirable balance between the protections afforded to directors under the business judgment rule and the higher standard of care imposed upon directors as fiduciaries.

The result reached by the *Van Gorkom* court is not without its shortcomings. Although gross negligence has long been recognized as the applicable standard for liability under the business judgment rule,[256] Delaware courts historically have challenged the business decisions of directors only upon a showing of fraud, bad faith, or self-dealing.[257] In *Van Gorkom*, there were no allegations of malfeasance or fraudulent motives on the part of the directors.[258] There was, however, a gross disparity between the price actually paid for Trans Union and the perceived fair value of Trans Union at the time of the sale. This disparity was undoubtedly a factor militating in favor of the court's determination that the directors were grossly negligent and therefore personally liable to the plaintiffs.[259] Hence, the *Van Gorkom* court was compelled to apply a somewhat tortured analysis in order to justify a finding of gross negligence. Indicative of this is the fact that both the court of chancery and the *Van Gorkom* dissent addressed the same evidence as the supreme court majority and reached the opposite conclusion.[260]

While the *Van Gorkom* court professed an application of the gross negligence standard to the directors' actions, a close read-

256 *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Other courts have used various phrases to describe the standard by which the exercise of business judgment is governed. *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971) ("fraud or gross overreaching"); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 887 (Del. 1970) ("gross and palpable overreaching"); Allaun v. Consolidated Oil Co., 16 Del. Ch. 318, 325, 147 A. 257, 261 (1929) ("reckless indifference to or deliberate disregard of the. . .stockholders"). In any event, all of these cases indicate that the standard is more demanding than simple negligence. *See supra* notes 175 & 245 and accompanying text.

257 *See, e.g.*, Gottlieb v. Heyden Chem. Corp., 33 Del. Ch. 82, 90 A.2d 660 (Del. 1952); Perrine v. Pennroad Corp., 29 Del. Ch. 531, 47 A.2d 479 (Del. 1946), *cert. denied*, 329 U.S. 808 (1947); Guth v. Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503 (Del. 1939); Robinson v. Pittsburgh Oil Ref. Corp., 14 Del. Ch. 193, 126 A. 46 (1924).

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

259 *Cf.* Gimbel v. Signal Cos., 316 A.2d 599, 609-10 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974) (court analyzed similar evidence, but concluded that the directors made an informed decision in approving the sale of stock of a corporation's wholly-owned subsidiary).

260 *Compare Van Gorkom*, 488 A.2d at 879 *with id.* at 895 (McNeilly, J., dissenting) *and* Smith v. Pritzker, No. 6342, slip op. at 8 (Del. Ch. 1982), *rev'd sub nom.* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

ing of the opinion indicates that the court applied the much stricter standard of simple negligence.[261] By applying this heightened level of review to the evidence before it, the *Van Gorkom* court has clearly established that corporate directors must truly make an informed business judgment to be entitled to the protection of the business judgment rule. Mere good faith on the part of directors will no longer suffice to trigger the rule's protections. Indicative of this attitude is the court's statement that "a director's duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty."[262]

A problem arises, however, in distinguishing an informed business judgment from an intelligent one. The *Van Gorkom* decision may have the adverse effect of encouraging trial judges to apply their own notions of intelligent decison making, rather than determining what is or is not sound business judgment. Furthermore, by implicitly recognizing a new standard of review under the business judgment rule—ordinary negligence—yet failing to expressly articulate it, the *Van Gorkom* decision creates substantial uncertainty as to what is expected under the rule. Such uncertainty may very well have a chilling effect on the "free exercise of. . .managerial power," which is a fundamental objective of the business judgment rule.[263]

Similarly perplexing is the *Van Gorkom* court's perception of the level of disclosure required to render shareholder ratification of a merger valid. While the court acknowleged that informed stockholder ratification of a board's decision will protect that decision from attack,[264] the court's meticulous examination of the proxy statements issued by Trans Union's board of directors evidences that the requisite standard of disclosure is extremely high. In practice, however, proxy statements are general sources of information.[265] If corporate boards are required to disclose everything that *might* be considered material or germane, the proxy statements will become voluminous. The requirement of such a lengthy proxy statement may not only fail to accomplish the desired effect of generating an informed electorate, but may also have the adverse consequence of creating an ignorant body of shareholders.

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261 *See* Kane & Culp, *Boardroom Blues*, BRIEF, Summer 1985, at 24, 26.

262 *Van Gorkom*, 488 A.2d at 872-73.

263 *Id.* at 872; *see Zapata*, 430 A.2d at 782.

264 *See Van Gorkom*, 488 A.2d at 889.

265 *See* Kane & Culp, *supra* note 261, at 26.

Perhaps the most disturbing aspect of *Van Gorkom* is the potential liability that the directors of Trans Union face as a result of this decision. On remand, the court of chancery was instructed to conduct an evidentiary hearing to determine the issue of damages.[266] The *Van Gorkom* court advised the lower court to calculate damages by multiplying the difference between the $55 price actually paid and the fair value of the stock by the number of shares represented by the plaintiffs' class.[267] Allegedly, the fair value of Trans Union exceeded the price actually paid by approximately $200 million.[268] The limit of the directors' liability insurance, however, was merely $10 million.[269] Consequently, the directors' potential personal liability is devastating.[270]

Moreover, the result reached by the *Van Gorkom* court takes on heightened significance when considered in light of the recent surge in the cost of director liability insurance.[271] Many insurance companies are either dropping director liability insurance entirely or are drastically reducing the amount of coverage available

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266 *Van Gorkom*, 488 A.2d at 893.

267 *See id.*

268 *See* Kane & Culp, *supra* note 261, at 25; *Landmark Ruling, supra* note 247, at 57.

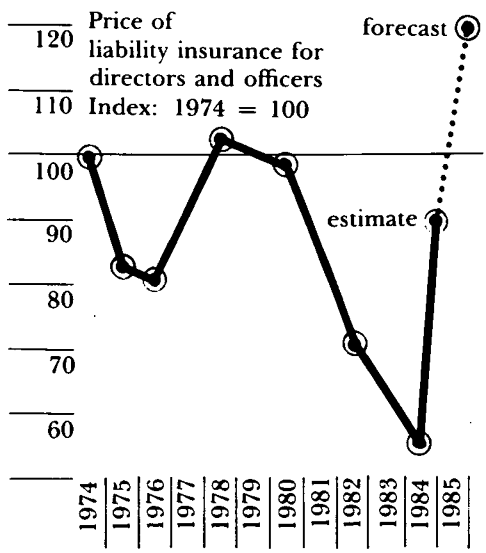
269 Telephone interview with William Prickett, attorney for plaintiffs Alden Smith and John W. Gosselin (Nov. 15, 1985).

270 On October 7, 1985, the parties agreed to settle the case for $23.5 million. Smith v. Van Gorkom, No. 6342 (Del. Ch. Oct. 9, 1985) (available Oct. 15, 1985, on LEXIS, States library, Del. file). Pursuant to the settlement, a fund was established for the benefit of a class of more than 10,000 former stockholders of Trans Union. *Id.* The settlement was approved by the Delaware Court of Chancery on October 9, 1985. *Id.* In addition, the court approved an application for attorneys' fees in the amount of $5.5 million to be paid from the settlement fund. *Id.* This award included fees for plaintiffs' counsel in a related Federal action. *Id.*

271 *See* Newport, *Protecting Directors Suddenly Gets Costly*, FORTUNE, Mar. 18, 1985, at 61. The following graph illustrates the recent surge in the cost of director liability insurance:

to a single corporation.[272] The *Van Gorkom* decision will only aggravate this already volatile market. The difficulty in obtaining insurance at reasonable rates coupled with the potential personal liability of directors as a result of the *Van Gorkom* decision will undoubtedly have a negative effect on any corporation seeking to attract qualified individuals to serve on its board of directors.[273]

Nevertheless, the impact of the *Van Gorkom* decision may be limited, primarily because the court placed excessive emphasis on the directors' failure to determine the intrinsic value of Trans Union before approving the merger.[274] While the court recognized that an outside valuation study is not required under Delaware law,[275] the opinion suggests that procurement of an independent valuation of the company would have exonerated the directors under the business judgment rule.[276] If directors are permitted to avoid liability simply by contacting an investment banker or financial analyst prior to approving a transaction, as many commentators suggest will be the case,[277] the *Van Gorkom*



Source: Wyatt Co.

Id.

[272] *Id.*

[273] *See Inside the Corporate Boardroom*, *supra* note 248, at 71; Kane & Culp, *supra* note 261, at 28.

[274] *See Van Gorkom*, 488 A.2d at 874.

[275] *Id.* at 876, 881.

[276] *See id.* at 875-78.

[277] *See Landmark Ruling*, *supra* note 247, at 57; Leisner, *supra* note 247, at 37.

decision will do nothing in the way of increasing corporate accountability. This is especially true when considered in light of the ease with which a valuation may be obtained.

The *Van Gorkom* decision may prove to be nothing more than a factual aberration in which the Supreme Court of Delaware believed that the directors had taken liberties that the business judgment rule does not afford.[278] Only time and future decisions will determine whether the lower courts in Delaware, as well as in other jurisdictions, are willing to adopt the activist posture so clearly displayed by the *Van Gorkom* court.

James V. Hetzel

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278 *Compare Van Gorkom*, 488 A.2d at 867-69 *with Gimbel*, 316 A.2d at 612-13.