Notre Dame Law Review

Volume 56 | Issue 5 Article 10

6-1-1981

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IV. Corporate Governance Generally

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I. Introduction

In a Symposium concerned with corporate accountability and governance, one's attention naturally gravitates to the myriad of issues that have been discussed in this setting in recent years.[1] Yet, it is curious that, within this context, little attention has focused on the unduly broad application of certain judicial principles by a number of courts that permit boards of directors and management improperly to employ a relatively large number of procedures to insulate their actions from successful shareholder challenge.

This subject strikes at the very heart of corporate governance. Although shareholders may care, for example, about having independent directors on their boards or having the opportunity to present shareholder proposals,[2] these interests are relatively minute when compared to their ability to bring suit either individually or on behalf of the corporation when management has perpetrated an alleged wrong. Yet it is in the context of shareholder challenges to management actions that the courts have enunciated several principles which, if construed too broadly, serve as a subterfuge allowing recalcitrant management to rationalize and defend its otherwise illegal conduct. The principles permitting management to avoid shareholder scrutiny include the inveterate business judgment rule, the *Burks v. Lasker*[3] special litigation committee scenario, certain limi-

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1 *See, e.g.*, Curzan & Pelesh, *Revitalizing Corporate Democracy: Control of Investment Managers' Voting on Social Responsibility Proxy Issues*, 93 HARV. L. REV. 670 (1980); Epstein, *Societal, Managerial, and Legal Perspectives on Corporate Social Responsibility—Product and Process*, 30 HASTINGS L.J. 1287 (1979); Ferrara & Steinberg, *The Role of Inside Counsel in the Corporate Accountability Process*, 4 CORP. L. REV. 3 (1981); Hetherington, *When the Sleeper Wakes: Reflections on Corporate Governance and Shareholder Rights*, 8 HOFSTRA L. REV. 183 (1979); Jones, *Corporate Governance: Who Controls the Large Corporation?*, 30 HASTINGS L.J. 1261 (1979); Mace, *Directors: Myth and Reality—Ten Years Later*, 32 RUTGERS L. REV. 293 (1979); Schwartz, *Response: Some Thoughts on the Directors' Evolving Role*, 30 HASTINGS L.J. 1405 (1979); Small, *The Evolving Role of the Director in Corporate Governance*, 30 HASTINGS L.J. 1353 (1979); Stevenson, *The Corporation as a Political Institution*, 8 HOFSTRA L. REV. 39 (1979); Werner, *Management, Stock Market and Corporate Reform: Berle and Means Reconsidered*, 77 COLUM. L. REV. 388 (1977); Williams, *Corporate Accountability and the Lawyer's Role*, 34 BUS. LAW. 7 (1978).

2 *See, e.g.*, Securities Exchange Act Release No. 16356 (Nov. 23, 1979); Securities Exchange Act Release No. 15384 (Dec. 6, 1978); Securities Act Release No. 6003 (Dec. 4, 1978). *But see* Kripke, *The SEC, Corporate Governance and the Real Issues*, 36 BUS. LAW. 173 (1981).

3 441 U.S. 471 (1979).

tations on the *Goldberg v. Meridor*[4] rationale, the true purpose cases, and the somewhat related disclosure of antisocial, unethical or unlawful policies rationale. The above list, although by no means exhaustive,[5] will serve as the benchmark for this article.

Before delving into these areas, however, a caveat is in order. The author is not urging that the foregoing principles be abrogated. As the Supreme Court has noted, strike suits in this context are sometimes feared with good reason.[6] Mechanisms are undoubtedly required to combat vexatious and unfounded shareholder litigation.[7] Further, corporations are "managed under the direction of" their boards of directors.[8] As such, courts should normally respect, although not necessarily acquiesce in, directors' exercise of independent judgment.[9] Nevertheless, if these principles are construed too broadly, they provide recalcitrant management with potent weapons to insulate its otherwise illegal actions from successful shareholder attack.

II. Judicial Principles That Insulate Management's Actions

A. *The Business Judgment Rule*

Few principles are as sacred or as deep-rooted in corporate law as the business judgment rule. The rule generally provides that corporate officers and directors, absent self-dealing or other personal interest,[10] shall be shielded from

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4 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

5 For example, another such principle is the transactional causation requirement, described by one authority as follows:

> [W]hen a complaint alleges that the election of directors pursuant to allegedly deficient proxy materials results in a continuation of allegedly improper and undisclosed business practices, several courts have held that the subsequent acts are too remote from the election to provide the requisite causal nexus between the proxy solicitation and the alleged damage.

Block & Barton, *The Business Judgment Rule as Applied to Stockholder Proxy Derivative Suits Under the Securities Exchange Act*, 8 SEC. REG. L.J. 99, 115 (1980). *See, e.g.*, Nemo v. Allen, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,765 (S.D.N.Y. 1979); Herman v. Beretta, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,574 (S.D.N.Y. 1978); *In re* Tenneco Securities Litigation, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,492 (S.D. Tex. 1978); Lewis v. Elam, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,013 (S.D.N.Y. 1977); Levy v. Johnson, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,899 (S.D.N.Y. 1977). *But see* Weisberg v. Coastal States Gas Corp., 609 F.2d 650 (2d Cir. 1979), *cert. denied*, 100 S. Ct. 1600 (1980); Maldonado v. Flynn, 597 F.2d 789 (2d Cir. 1979).

6 *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975):

> [I]n the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment. The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit.

Id. at 740 (citations omitted).

7 Arguably, the courts may reduce the likelihood of vexatious litigation by such measures as requiring plaintiffs to post security for expenses, requiring judicial review of derivative settlements, and granting summary judgment motions. A number of states require the posting of security for expenses. *See, e.g.*, CAL. CORP. CODE § 800(d) (West 1980); N.J. STAT. ANN. § 14A:3-6(3) (West Supp. 1980); N.Y. BUS. CORP. LAW § 627 (McKinney Supp. 1979); MODEL BUS. CORP. ACT § 49 (1979).

8 *See Corporate Director's Handbook*, 33 BUS. LAW. 1591, 1606-07 (1978).

9 *See generally* United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261 (1977); Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259 (3d Cir. 1979); Genzer v. Cunningham, 498 F. Supp. 682 (E.D. Mich. 1980); Abella v. Universal Leaf Tobacco, Inc., 495 F. Supp. 713 (E.D. Va. 1980); Zapata Corp. v. Maldonado, ___ A.2d ___ (Del. 1981).

10 As one commentator stated:

> [W]here a director or controlling stockholder has a material personal interest in the outcome of a transaction or is engaged in self-dealing, it will fall to that individual to prove that the trans-

liability for harm to the corporation resulting from their decisions if such decisions "lie within the powers of the corporation and the authority of management and were reasonably made in good faith and with loyalty and due care."[11] At least three strong policy considerations support this rule. First, if management were liable for mere good faith errors in judgment, few capable individuals would be willing to incur the financial and emotional risks of serving in such roles.[12] Second, courts are generally ill equipped to evaluate business judgments.[13] Finally, management has the expertise to discharge the responsibility of making such determinations.[14]

Because of these policy considerations, the business judgment rule is desirable if our society's economy is to function efficiently. Like any rule of general application, however, it can be construed so expansively that virtually any management action may be deemed reasonably made in good faith. For example, it is beyond peradventure that members of management should premise their decisions on what is in the corporation's best interests, rather than on preserving their jobs or status.[15] It thus arguably appears that, once the complainant demonstrates that retention of control was a motive in management's decision, the presumption of the rule should be rebutted and the burden should shift to management to justify the fairness of the transaction. Nonetheless, the Third and Seventh Circuits, in construing Delaware law, both recently held that the presumption is rebutted only where management's "sole or primary purpose" is to retain control.[16] Such a holding unduly expands the business judgment rule

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> action he or she authorized is intrinsically fair to the corporation and its stockholders. Otherwise stated, where such a personal interest or self-dealing is shown to exist, a presumption of overreaching arises that can be overcome only by proof of intrinsic fairness. This has been denominated as the intrinsic fairness rule.

Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 115-16 (1979) (citations omitted). *See* Lewis v. S.L.&E, Inc., 629 F.2d 764, 769 (2d Cir. 1980); Blake v. National Research Assocs., Inc., 466 F.2d 570, 572 (4th Cir. 1972); Trans World Airlines, Inc. v. Summa Corp., 374 A.2d 5, 9 (Del. Ch. 1977).

11 Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96, 101 (1980). For other definitions of the rule, see 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1039 (rev. perm. ed. 1975); Arsht, *supra* note 10, at 111-12. For recent applications of the rule, see Panter v. Marshall Field & Co., [Current] FED. SEC. L. REP. (CCH) ¶ 97,929 (7th Cir. Apr. 2, 1981); Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980).

12 *See Corporate Director's Guidebook, supra* note 8, at 1603-04, 1615.

13 *See* Auerbach v. Bennett, 47 N.Y.2d 619, 629, 393 N.E.2d 994, 1000, 419 N.Y.S.2d 920, 926 (1979).

14 *Id.*

15 *See, e.g.*, Commonwealth Oil Refining Co. v. Tesoro Petroleum Corp., 394 F. Supp. 267, 273-74 (S.D.N.Y. 1975). *See also* Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977):

> "While technically not trustees [corporate directors] stand in a fiduciary relationship to the corporation and its stockholders. . . . This rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale."

Id. at 977, *quoting* Guth v. Loft, Inc., 5 A.2d 503, 510 (1939).

16 Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981). In Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), the court asserted that by the very nature of corporate life "a director has a certain amount of self-interest in everything he does." *Id.* at 292. To alleviate this conflict, "the rule . . . postulat[es] that if actions are arguably taken for the benefit of the corporation, then the directors are presumed to have been exercising their sound business judgment rather than responding to any personal motivations." *Id.* The court concluded that

> under Delaware law, at a minimum, the plaintiff must make a showing that the sole or primary motive of the defendant was to retain control. If he makes a showing sufficient to survive the directed verdict, the burden then shifts to the defendant to show that the transaction in question had a valid corporate business purpose.

Id. at 293, *relying on* Petty v. Pentech Papers, Inc., 347 A.2d 140, 143 (Del. Ch. 1975); Cheff v. Mathes, 41 and, as the dissents argued in the above cases, does not comport with other Delaware decisions.[17] Under such an expansive interpretation, management given the benefit of hindsight and the advice of expert counsel can practically always set forth some rational and proper purpose to explain its conduct. At the very least, once the complainant presents a prima facie case that control was a motive, management, in order to be entitled to the rule's presumption, should be required to come forward with evidence showing that a primary purpose underlying its conduct was to benefit the corporation.

The business judgment rule also receives excessively broad application in the tender offer setting. A number of courts have indicated that a target company's management may take certain actions to defeat a hostile tender offer if in its good faith judgment the offer is not in the corporation's best interests.[18] Target managements have consequently engaged in a wide variety of defensive tactics to thwart takeover bids, such as announcing an unprecedented dividend increase, entering a defensive merger with a "white knight," or acquiring another corporation.[19] To shareholders denied the opportunity to tender their shares at a substantial premium, the courts' unduly broad application of the business judgment rule appears inherently unfair. Under such an interpretation, "[r]egardless of the tactic employed, management can easily manufacture a 'legitimate' corporate purpose for its action, even when it employed the tactic solely to perpetuate its own status."[20] Such a consequence seems practically assured when management

Del. Ch. 494, 199 A.2d 548 (1964); Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405 (1962). *But see* Treadway Cos. v. Care Corp., 638 F.2d 357, 382 (2d Cir. 1980) (under New Jersey law, "[o]nce a plaintiff demonstrates that a director had an interest in the transaction at issue, the burden shifts to the defendant to prove that the transaction was fair and reasonable to the corporation"). *See generally* Gruenbaum, *Defensive Tactics and the Business Judgment Rule*, 4 CORP. L. REV. 263 (1981); Comment, *Buying Out Insurgent Shareholders With Corporate Funds*, 70 YALE L.J. 308 (1960).

17 *See* Panter v. Marshall Field & Co., [Current] FED. SEC. L. REP. (CCH) ¶ 97,929, at 90,746 (7th Cir. Apr. 2, 1981) (Cudahy, J., dissenting); Johnson v. Trueblood, 629 F.2d 287, 301 (3d Cir. 1980) (Rosenn, J., dissenting). In his dissent in *Johnson*, Judge Rosenn stated:

> Unlike the majority, I believe that under Delaware law, once plaintiff has shown that the desire to retain control was a motive in the particular business decision under challenge, the burden is then on the defendant to move forward with evidence justifying the transaction as primarily in the corporation's best interests.

Id. at 301, *relying on* Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548, 554 (1964); Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405, 409 (1962). *See also* Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980); Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690 (2d Cir. 1980).

18 *See, e.g.*, Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981); Crouse-Hinds Company v. InterNorth, Inc., 634 F.2d 690 (2d Cir. 1980); Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980); Berman v. Gerber Products Co., 454 F. Supp. 1310 (W.D. Mich. 1978). For commentary taking this position, see Fleischer, *Business Judgment Rule Protects Takeover Targets*, Legal Times (Wash.) Apr. 14, 1980, at 15; Herzel, Schmidt, & Davis, *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 CORP. L. REV. 107 (1980); Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979); Steinbrink, *Management's Response to the Takeover Attempt*, 28 CASE W. RES. L. REV. 882 (1978).

19 *See* cases cited note 18 *supra*; Humana, Inc. v. American Medicorp, Inc., [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,286 (S.D.N.Y. Jan. 5, 1978); Applied Digital Data Sys., Inc. v. Milgo Elec. Corp., 425 F. Supp. 1145 (S.D.N.Y. 1977); Royal Indus., Inc. v. Monogram Indus., Inc., [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863 (C.D. Cal. Nov. 29, 1976).

20 Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901, 926 (1979). *See generally* Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981) (Cudahy, J., concurring in part and dissenting in part). Judge Cudahy stated:

> Unfortunately, the majority here has moved one giant step closer to shredding whatever constraints still remain upon the ability of corporate directors to place self-interest before shareholder interest in resisting a hostile tender offer for control of the corporation. There is abundant evidence in this case to go to the jury on the state claims for breach of fiduciary duty. I emphatically disagree that the business judgment rule should clothe directors, battling blindly to fend off a threat to their control, with an almost irrebuttable presumption of sound business

utilizes expert counsel and investment bankers to lay a foundation for and to structure its anti-takeover actions.

To avoid this perverse result, courts should at the very least inquire whether the principal objective of management's actions was to benefit the subject corporation or to impede the tender offer.[21] One significant (although by no means determinative) consideration should be whether the decision to oppose the takeover bid and to engage in defensive maneuvers was made primarily by disinterested directors or by those directors whose very livelihood and economic interests depended on the continued separate existence of the subject corporation.[22]

B. *The* Burks v. Lasker *Special Litigation Committee Scenario*

A relatively new defensive strategy in response to a shareholders' derivative suit against members of a corporation's board of directors is for the corporation's board to appoint a special litigation committee composed of disinterested nondefendant directors. The extent to which such a committee can rely on the business judgment rule in terminating such suits is highly controversial and has been the subject of increasing scrutiny by both the courts[23] and commentators.[24] Further, it is important to keep in mind that the application of the business judg-

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> judgment, prevailing over everything but the elusive hobgoblins of fraud, bad faith or abuse of discretion.

Id. at 299. Judge Cudahy asserted that "[t]his case announces to stockholders (if they did not know it before) that they are on their own and may expect little consideration and less enlightenment from their board of directors when a tender offeror appears to challenge the directors for control." *Id.* at 312. Accordingly, "only the submission to jury verdict of cases like this one can restore confidence in our system of corporate governance." *Id.*

21 *See, e.g.*, Klaus v. Hi-Shear Corp., 528 F.2d 225, 233 (9th Cir. 1975); Royal Indus., Inc. v. Monogram Indus., Inc., [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,863, at 91,136 (C.D. Cal. Nov. 24, 1976).

22 *See* Gelfond & Sebastian, *Reevaluating the Duties of Target Management in a Hostile Tender Offer*, 60 B.U.L. REV. 403, 472 (1980); Williams, *Role of Directors in Takeover Offers*, 13 REV. SEC. REG. 963 (1980). *See also* Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981), where Judge Cudahy stated:

> Directors of a New York Stock Exchange-listed company are, at the very least, "interested" in their own positions of power, prestige and prominence (and in their not inconsequential perquisites). They are "interested" in defending against outside attack the management which they have, in fact, installed or maintained in power—"their" management (to which, in many cases, they owe their directorships). And they are "interested" in maintaining the public reputation of their own leadership and stewardship against the claims of "raiders" who say that they can do better. Thus, regardless of their technical "independence," directors of a target corporation are in a very special position, where the slavish application of the majority's version of the good faith presumption is particularly disturbing.

Id. at 300-01 (Cudahy, J., concurring in part and dissenting in part). Moreover, it should be recognized that management will often be able to influence outside directors. *See* Mite Corp. v. Dixon, 633 F.2d 486, 494-95 (7th Cir. 1980), *prob. jur. noted*, 49 U.S.L.W. 3824 (May 4, 1981).

23 *See, e.g.*, Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980); Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979), *cert. denied*, 101 S. Ct. 206 (1980); Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Genzer v. Cunningham, 498 F. Supp. 682 (E.D. Mich. 1980); Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980); Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980); Siegal v. Merrick, 84 F.R.D. 106 (S.D.N.Y. 1979); Lewis v. Adams, No. 77-266C (N.D. Okla. Nov. 15, 1979); Zapata Corp. v. Maldonado, __ A.2d __ (Del. 1981); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

24 *See, e.g.*, Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261 (1981). Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96 (1980); Gammon, *Derivative Suits*, 12 REV. SEC. REG. 887 (1979); Steinberg, *The Use of Special Litigation Committees to Terminate Shareholder Derivative Suits*, 35 U. MIAMI L. REV. 1 (1980); Comment, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600 (1980).

ment rule in this context "is an expansion of the traditional rule."[25]

In the seminal case of *Burks v. Lasker*,[26] the Supreme Court found two questions to be dispositive in determining whether federal court dismissal of shareholder derivative suits against board members is proper: (1) whether the applicable state law permits the disinterested directors to terminate shareholder derivative suits against fellow directors, and (2) whether such a state rule is consistent with the policies underlying the federal securities laws.[27] Of course, if dismissal is sought in state court, the only determination is whether relevant state law authorizes such dismissal.[28]

Subsequent to *Burks*, a number of federal and state courts have addressed this subject with varying results. As a generalization, at one end of the spectrum are decisions that construe state law so as to permit dismissal in any type of action, including those premised on self-dealing by defendant directors,[29] and that decline to recognize any federal policy as conflicting with such interpretation of state law.[30] A number of these decisions place the burden upon the shareholder to show that the special litigation committee was biased.[31] At the other end of the spectrum are decisions that construe state law so as to preclude dismissal in apparently all situations.[32] The middle position generally is occupied by those courts that assess the special litigation committee's independence and good faith, the reasonableness of the committee's decision, the type of conduct alleged to have been involved, and the presence of any strong federal policies.[33]

It should be stressed that courts in the first group above provide management with practically free reign to terminate shareholder derivative suits against directors.[34] Toward this end, management frequently appoints nondefendant disinterested directors to the special litigation committee and retains outside counsel of unimpeachable integrity. After hearing witnesses and examining documentary evidence, the committee, with the special counsel's concurrence, normally issues a comprehensive report concluding that the corporation's best interests would not be served by the suit due to its improbability of success, its exorbitant cost, and its tendency to disrupt company business, and lower employee morale. Relying on the committee's report, the corporation seeks to dis-

25 Genzer v. Cunningham, 498 F. Supp. 682, 689 (E.D. Mich. 1980).

26 441 U.S. 471 (1979).

27 *Id.* at 480, 486.

28 *See, e.g.*, Zapata Corp. v. Maldonado, __ A.2d __ (Del. 1981); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

29 *See, e.g.*, Gaines v. Haughton, [Current] FED. SEC. L. REP. (CCH) ¶ 98,000 (9th Cir. May 18, 1981); Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979); Abramowitz v. Posner, [Current] FED. SEC. L. REP. (CCH) ¶ 97,921 (S.D.N.Y. Mar. 25, 1981); Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980).

30 *See* note 29 *supra*.

31 *See, e.g.*, Lewis v. Anderson, 615 F.2d at 783; Auerbach v. Bennett, 47 N.Y.2d at 633-35, 393 N.E.2d at 1002-03, 419 N.Y.S.2d at 928-29; Falkenberg v. Baldwin, SEC. REG. & L. REP. (BNA) No. 545, A-14 (N.Y. Sup. Ct. Mar. 3, 1980).

32 *See, e.g.*, Abella v. Universal Leaf Tobacco, Inc., 495 F. Supp. 713 (E.D. Va. 1980); Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980); Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980), *reversed and remanded*, — A.2d — (Del. 1981).

33 *See, e.g.*, Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980); Abbey v. Control Data Corp., 603 F.2d 778 (8th Cir. 1979), *cert. denied*, 444 U.S. 1017 (1980); Cramer v. General Tel. & Elecs. Corp., 582 F.2d 259 (3d Cir. 1979); Genzer v. Cunningham, 498 F. Supp. 682 (E.D. Mich. 1980); Zapata Corp. v. Maldonado, __ A.2d __ (Del. 1981) (court should (1) inquire into independence and good faith of committee and bases supporting its conclusions and (2) apply its own independent business judgment).

34 *See generally* Steinberg, *The Use of Special Litigation Committees to Terminate Shareholder Derivative Suits*, 35 U. MIAMI L. REV. 1 (1980).

miss the complaint.[35] With the burden of proof on the shareholders, these courts find an additional basis upon which to grant the motion.[36]

This is not to imply that special litigation committee investigations are necessarily shams. These committees and their special counsel may ferret out vexatious litigation as well as nonfrivolous actions that are not in the corporation's best interests. Nonetheless, the apparent pressure on committee members to discount the corporation's interests when fellow directors are sued should lead a court to scrutinize the type of conduct (*e.g.*, corporate mismanagement as opposed to self-dealing) alleged to have occurred and the reasonableness of the committee's determination.[37] Further, because the defendant directors selected the members of the committee, the appearance (and perhaps the presence) of impropriety and unfairness to the shareholders should place the burden of establishing the committee's independence upon the movant.[38] In this regard, to help ensure that the committee members were not subject to the defendants' influence and had exercised independent judgment on the corporation's behalf, any prior contacts or relationships between committee members and defendants should be rigorously examined.[39]

C. *Certain Limitations on the* Goldberg v. Meridor *Rationale*

In *Santa Fe Industries, Inc. v. Green*,[40] the Supreme Court held that section 10(b) and rule 10b-5 did not reach breaches of fiduciary duty not involving deception or manipulation.[41] One argument advanced by the plaintiff-shareholders in that case was that the majority shareholder's failure to provide them with advance notice of an impending merger constituted a material nondisclosure. In what has become a most important footnote fourteen, the Court rejected this contention, reasoning that the plaintiffs had not indicated how they might have acted differently had they received such prior notice: "Indeed, they accept the conclusion of both courts below that under Delaware law they could not have enjoined the merger because an appraisal proceeding is their sole remedy in the Delaware courts for any alleged unfairness in the terms of the merger."[42] Accordingly, the Court concluded that the failure to provide advance notice was

35 *See* note 23 *supra*; Bishop, *Derivative Suits Against Bank Directors: New Problems, New Strategies*, 97 BANKING L.J. 158 (1980); Steinberg, *supra* note 34, at 1-2.

36 *See* note 31 *supra*.

37 *See* notes 32-33 *supra*. As the *Cramer* court stated:

> [W]e do not think that the business judgment of the directors should be totally insulated from judicial review. In order for the directors' judgment to merit judicial deference, that judgment must have been made in good faith and independently of any influence of those persons suspected of wrongdoing. In addition, where the shareholder contends that the directors' judgment is so unwise or unreasonable as to fall outside the permissible bounds of the directors' sound discretion, a court should, we think, be able to conduct its own analysis of the reasonableness of that business judgment.

582 F.2d at 275. *See* Steinberg, *supra* note 34, at 28 (when the directors' alleged actions involve conflicts of interests, fraud, or self-dealing, dismissal may not be proper). In such situations, a court "should, when appropriate, give special consideration to matters of law and public policy in addition to the corporation's best interests." Zapata Corp. v. Maldonado, __ A.2d __, __ (Del. 1981).

38 *See, e.g.*, Genzer v. Cunningham, 498 F. Supp. 682, 693 (E.D. Mich. 1980); Gyrnberg v. Farmer, [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,683, at 98,586 (D. Col. Oct. 8, 1980); Zapata Corp. v. Maldonado, __ A.2d __ (Del. 1981).

39 *See* Steinberg, *supra* note 34, at 25-26.

40 430 U.S. 462 (1977).

41 *Id.* at 473-74.

42 *Id.* at 474 n.14.

not a material nondisclosure within the meaning of section 10(b) and rule 10b-5.[43]

Significantly, however, after *Santa Fe*, the Delaware Supreme Court in *Singer v. Magnovox Co.*[44] held that appraisal is not a minority shareholder's sole remedy, stating that a long-form merger "made for the sole purpose of freezing out minority shareholders, is an abuse of the corporate process; and . . . states a cause of action for violation of a fiduciary duty."[45] Moreover, the court concluded that even if a valid business purpose were shown, the transaction must be scrutinized for its entire fairness.[46] Subsequent Delaware cases have reaffirmed and extended *Singer*'s principles.[47] Decisions of other state courts, although not strictly in adherence with *Singer*,[48] also recognize that appraisal is not a minority shareholder's exclusive remedy when the merger has not been consummated.[49]

Based on these decisions and on *Santa Fe's* footnote fourteen, the Second,

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43 *Id.* The Court's decision was widely viewed by commentators as sharply curtailing the scope of section 10(b). *See, e.g.*, Campbell, Santa Fe Industries, Inc. v. Green: *An Analysis Two Years Later*, 30 MAINE L. REV. 187 (1979); Jacobs, *Rule 10b-5 and Self Dealing by Corporate Fiduciaries: An Analysis*, 48 U. CIN. L. REV. 643 (1979); Ratner, *"Federal Corporation Law" Before and After* Santa Fe Industries v. Green, in NINTH ANNUAL INSTITUTE ON SECURITIES REGULATION—CORPORATE TRANSCRIPT SERIES 305, 322 (Fleischer, Lipton & Vandegrift eds. 1978); Note, *Suits for Breach of Fiduciary Duty Under Rule 10b-5 After* Santa Fe Industries, Inc. v. Green, 91 HARV. L. REV. 1874 (1978).

44 380 A.2d 969 (Del. 1977).

45 *Id.* at 980.

46 The court stated:

> On the contrary, the fiduciary obligation of the majority to the minority stockholders remains and proof of a purpose, other than such freeze-out, without more, will not necessarily discharge it. In such case the Court will scrutinize the circumstances for compliance with the *Sterling* rule of *"entire fairness"* and, if it finds a violation thereof, will grant such relief as equity may require.

Id.

47 As stated by the author:

> *Singer* was the harbinger of a new era in Delaware. Subsequent Delaware cases have confirmed and extended the viability of *Singer*'s principles. From these decisions, a number of general principles can be proffered: a majority shareholder's fiduciary duty is not fulfilled simply by relegating the minority stockholders to their statutory appraisal remedy; majority shareholders cannot effect a merger solely for the purpose of eliminating the minority; such a merger must be for a proper purpose and must be entirely fair to the minority; a merger made primarily to advance the business purpose of a majority stockholder is proper so long as it has a bona fide purpose and is entirely fair to the minority; and where a complaint alleges that the purpose of the merger was to eliminate minority shareholders, such a complaint may often be immune from a motion to dismiss. The foregoing principles are applicable to short-form as well as long-form mergers.

Ferrara & Steinberg, *A Reappraisal of* Santa Fe: *Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263, 278-80 (1980), *citing* Roland Int'l Corp. v. Najjar, 407 A.2d 1032 (Del. 1979); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977); Young v. Valhi, Inc., 382 A.2d 1372 (Del. Ch. 1978); Kemp v. Angel, 381 A.2d 241 (Del. Ch. 1977). *See also* Weinberger v. UOP, Inc., 426 A.2d 1333 (Del. Ch. 1981). For additional discussion of *Singer*, see Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978); Rothschild, *Going Private*, Singer, *and Rule 13e-3: What Are the Standards for Fiduciaries?*, 7 SEC. REG. L.J. 195 (1979); Comment, *Delaware Reverses Its Trend in Going Private Transactions: The Forgotten Majority*, 11 LOY. L.A. L. REV. 567 (1978); Comment, Singer v. Magnovox *and Cash Take-Out Mergers*, 64 VA. L. REV. 1101 (1978).

48 *See, e.g., In re* Jones & Laughlin Steel Corp., 488 Pa. 524, 412 A.2d 1099 (1980) (state legislature intended that appraisal statute serve as sole postmerger remedy); Gabhart v. Gabhart, 267 Ind. 370, 370 N.E.2d 345 (1977) (adopting only the first prong of *Singer*). *But see* Perl v. IU Int'l Corp., 607 P.2d 1036 (Hawaii 1980) (following *Singer*). *See generally* Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969) (as interpreted by the Hawaii Supreme Court, "[a]lthough *Ahmanson* did not involve a merger, it appears clear from the language of the opinion that the California Supreme Court would apply the fiduciary duty of good faith and inherent fairness to such a situation." 607 P.2d at 1047 n.12).

49 *See* note 48 *supra*; Ferrara & Steinberg, *supra* note 47, at 281; Steinberg, *State Court Decisions After Santa Fe*, 9 SEC. REG. L.J. 85 (1981).

Third, Fifth, Seventh and Ninth Circuits have generally held that, where there has been a material nondisclosure that would have enabled the shareholder to seek injunctive relief in a state court to prevent the consummation of a transaction, such nondisclosure constitutes "deception" within the meaning of section 10(b).[50] The leading case adhering to this rationale is the Second Circuit's decision in *Goldberg v. Meridor*.[51]

There are, however, a number of limitations to the *Goldberg* rationale. For example, management is under no obligation to disclose to shareholders its own breaches of fiduciary duty. As the Third Circuit stated, to hold otherwise "would clearly circumvent the Supreme Court's holding in *Santa Fe*."[52] Another limitation is that where a particular matter does not require shareholder approval, full disclosure to a disinterested board of directors is deemed equivalent to full disclosure to the shareholders. Stated differently, the disinterested directors' knowledge is attributed to the corporation, thereby precluding a finding of deception.[53] This limitation generally seems well-founded, since directors are elected to consider such matters.[54] However, if the term "disinterested" is defined too broadly, recalcitrant management will be able to undermine the *Goldberg* rationale in instances where shareholder approval is not required.

Accordingly, a director should not be deemed "disinterested" merely because he lacks a financial stake in the subject transaction.[55] Other disabilities, such as conflicts of interest, the design of "entrenchment," and the perpetration of improper influence by control persons, should also disqualify a director.[56] The presence of any such disability should be held to impair the director's ability to exercise independent judgment on the corporation's behalf, and should give rise to a requirement that management obtain shareholder approval of the transaction after full disclosure.[57]

Further, some courts have construed the term "disinterested" broadly to in-

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50 *See* Healey v. Catalyst Recovery, Inc., 616 F.2d 641 (3d Cir. 1980); Alabama Farm Bureau Mut. Cas. Co. v. American Fidelity Life Ins. Co., 606 F.2d 602 (5th Cir. 1979), *cert. denied*, 101 S. Ct. 77 (1980); Kidwell *ex rel.* Penfold v. Meikle, 597 F.2d 1273 (9th Cir. 1979); Goldberg v. Meridor, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978); Wright v. Heizer Corp., 560 F.2d 237 (7th Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978). A question that remains open is whether a shareholder must show not only that he could have brought suit in state court but also that he would have prevailed in the state court action. The courts are deeply split on this issue. *See* Ferrara & Steinberg, *supra* note 47, at 291-94.

51 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978). The Second Circuit subsequently reaffirmed the *Goldberg* rationale in IIT v. Cornfeld, 619 F.2d 909, 917 (2d Cir. 1980).

52 Biesenbach v. Guenther, 588 F.2d 400, 402 (3d Cir. 1978). The court further reasoned:

> *Santa Fe* made clear that absent deception, misrepresentation, or nondisclosure a breach of fiduciary duty does not violate the statute or Rule. . . . In effect, appellants are stating that the failure to disclose the breach of fiduciary duty is a misrepresentation sufficient to constitute a violation of the Act. We refuse to adopt this approach which would clearly circumvent the Supreme Court's holding in *Santa Fe*.

Id.

53 Maldonado v. Flynn, 597 F.2d 789, 795 (2d Cir. 1979) (since the amendments modifying the stock option plan were "validly enacted by a vote of disinterested board members who had been fully informed of all material facts, their knowledge was attributable to the Corporation and no 'deception' occurred within the meaning of Rule 10b-5"). *See also* Kaplan v. Bennett, 465 F. Supp. 555, 565-66 (S.D.N.Y. 1979).

54 *See* notes 8-9 *supra* and accompanying text.

55 *See* Tyco Labs., Inc. v. Kimball, 444 F. Supp. 292 (E.D. Pa. 1977); Falkenberg v. Baldwin, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,086 (S.D.N.Y. 1977).

56 *See* Maldonado v. Flynn, 597 F.2d 789, 795 (2d Cir. 1979); Kaplan v. Bennett, 465 F. Supp. 555, 565 (S.D.N.Y. 1979); Goldberger v. Baker, 442 F. Supp. 659, 665 (S.D.N.Y. 1977).

57 *See* Ferrara & Steinberg, *supra* note 47, at 290.

clude directors who have other substantial contacts with the corporation, such as serving as outside counsel, as a major supplier, or having some other present or previous similar association.[58] This construction of "disinterested" leaves open the door for management to appoint such persons to the board and to delegate to them the decisionmaking functions whenever management is interested, such as in regard to particular remuneration benefits, and the determination is not relegated to the shareholders.[59] In such a situation, "[t]ruly independent actions by either the lawyer or the supplier might well signify a substantial reduction in income."[60] Yet, by labelling such persons "disinterested," the courts forever foreclose shareholders from challenging the propriety of these transactions. Such a broad construction is contrary both to the federal disclosure policy underlying the *Goldberg* rationale and to the maintenance of corporate accountability.

D. *True Purpose Cases*

The true purpose cases stand for the proposition that the securities laws require objective disclosure rather than subjective revelation.[61] Nearly twenty-five years ago, Judge Rifkind posed the following question, then answered it in the negative: "Assuming that data are supplied, is the proxy statement nevertheless false if it omits a confession of selfish motive?"[62] As one authority has remarked: "It is not necessary to say, 'this is a grossly unfair transaction in which the board of directors is overreaching the minority shareholders.' You just have to give them the facts."[63] Or, as the Third Circuit put it: "[T]he unclean heart of a director is not actionable, whether or not it is disclosed, unless the impurities are

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58 *See* Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981); Maldonado v. Flynn, 597 F.2d 789, 794 (2d Cir. 1979).

59 *See* 597 F.2d at 793-95 (amendments modifying stock option plan that inured to direct benefit of recipient-directors).

60 Ferrara & Steinberg, *supra* note 47, at 290.

In *Maldonado*, however, the Second Circuit concluded that a director who was a partner in a law firm that received substantial fees from the subject corporation was "disinterested." The court reasoned:

> [T]o label . . . [counsel] an 'interested' director for purposes of Rule 10b-5 because of his relationship as the company's legal counsel would be to open the door to an unworkable standard for determining whether there has been deception practiced upon the corporation. . . . [W]e cannot assume that a counsel-director acts for reasons that are against the corporation's interest, as distinguished from the private interests of its officers.

597 F.2d at 794.

For articles discussing *Santa Fe* and its progeny see, *e.g.*, Block & Schwarzfeld, *Corporate Mismanagement and Breach of Fiduciary Duty After* Santa Fe v. Green, 2 CORP. L. REV. 91 (1979); Campbell, Santa Fe Industries, Inc. v. Green: *An Analysis Two Years Later*, 30 ME. L. REV. 187 (1979); Ferrara & Steinberg, *A Reappraisal of* Santa Fe: *Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980); Jacobs, *Rule 10b-5 and Self Dealing By Corporate Fiduciaries: An Analysis*, 48 CIN. L. REV. 643 (1979); Note, *Suits for Breach of Fiduciary Duty Under Rule 10b-5 After* Santa Fe Industries, Inc. v. Green, 91 HARV. L. REV. 1874 (1978); Note, Goldberg v. Meridor: *The Second Circuit's Resurrection of Rule 10b-5 Liability for Breaches of Corporate Fiduciary Duties to Minority Shareholders*, 64 VA. L. REV. 765 (1978).

61 *See, e.g.*, Selk v. St. Paul Ammonia Products, Inc., 597 F.2d 635, 639 (8th Cir. 1979) (failure to disclose that purpose of merger was to freeze-out minority shareholders not actionable under sections 10(b) and 14(a)); O'Brien v. Continental Illinois Nat'l Bank & Trust Co., 593 F.2d 54, 60 (7th Cir. 1979) (failure to reveal that investment advice was self-serving not actionable under section 10(b)); Gluck v. Agemian, [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,582, at 98,090 (S.D.N.Y. 1980) ("disclosure of subjective motive is not required under the federal securities laws"); Hundahl v. United Benefit Life Ins. Co., 465 F. Supp. 1349, 1364 (N.D. Tex. 1979) (failure to disclose breach of fiduciary duty or scheme to undervalue company not actionable under section 10(b)).

62 Doyle v. Milton, 73 F. Supp. 281, 286 (S.D.N.Y. 1947).

63 Ratner, *supra* note 43, at 322.

translated into actionable deeds or omissions both objective and external."[64] Thus, management is under no obligation to describe a particular matter in pejorative terms[65] or to disclose its true purpose or motivation.[66]

The problem in this context principally occurs when management undertakes a course of conduct designed to maintain its own control. Although corporate control is acknowledged to be of universal interest to incumbent management,[67] when management embarks on a program or adopts a policy for the purpose of perpetuating its control, the nondisclosure of such purpose can ultimately harm the corporation and its shareholders. Recognizing this fact, the Fifth Circuit recently found actionable under section 10(b) an allegation that management had failed to disclose that it "had embarked on a program of maintaining control at the cost of inflating stock prices."[68] Further, the Second Circuit has implied that when management's design hinges upon so-called "entrenchment," rather than its obvious interest in company control, then disclosure of such design will be required.[69]

As a general proposition, if these true purpose cases are construed too broadly, management can undertake practically any course of action to perpetuate its control and never be required to disclose its ultimate design. For example, in order to maintain control, management may decide that the corporation should remain an independent entity. To this end, management may embark on a stock repurchase program for the purpose of raising stock prices to deter potential acquirors, may enter other lines of business to pose antitrust obstacles for potential bidders, and may seek shareholder approval for adoption of a number of anti-takeover amendments to further solidify its position.[70] Yet, under a broad true purpose construction, management is under no obligation to disclose that it has engaged in these actions in order to perpetuate its control.

On the other hand, it is contrary to management's self-interest to reveal its intent in such a context and, with the advice of counsel, legitimate business reasons can be formulated to justify the action taken. The same beneficial disclosure result, however, can usually be achieved by requiring that the *effect* of the action be disclosed. Thus, in each of the examples above, management should be required to disclose that the effect of its action is to solidify management's control and to render hostile takeover bids less probable and, if made, less likely to succeed.[71] If such disclosure is made, the shareholder generally will receive all the

64 Biesenbach v. Guenther, 588 F.2d 400, 402 (3d Cir. 1978).

65 *See* Goldberg v. Meridor, 567 F.2d 209, 218 n.8 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

66 *See* notes 62-65 *supra* and accompanying text.

67 *See* Rodman v. The Grant Foundation, 608 F.2d 64, 71 (2d Cir. 1979).

68 Alabama Farm Bureau Mut. Cas. Co., Inc. v. American Fidelity Life Ins. Co., 606 F.2d 602, 614 (5th Cir. 1979), *cert. denied*, 101 S. Ct. 77 (1980).

69 Rodman v. The Grant Foundation, 608 F.2d at 71. *See also* Vaughn v. Teledyne, Inc., 628 F.2d 1214, 1221 (9th Cir. 1980) ("Corporate officials are under no duty to disclose their precise motive or purpose for engaging in a particular course of corporate action, so long as the motive is not manipulative or deceptive and the nature and scope of any stock transactions are adequately disclosed to those involved."); Steinberg, *Fiduciary Duties and Disclosure Obligations in Proxy and Tender Contests for Corporate Control*, 30 EMORY L.J. — (1981). *See also* SEC v. C & R Clothiers, Inc., [1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,650 (D.D.C. 1980) (consent).

70 *See generally* Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981); Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980); Berman v. Gerber Prod. Co., 454 F. Supp. 1310 (W.D. Mich. 1978); Johnson, *Disclosure in Tender Offer Transactions: The Dice are Still Loaded*, 42 U. PITT. L. REV. 1, 33-34 (1980); Lynch & Steinberg, *supra* note 20, at 928-38.

71 *See* Securities Exchange Act Release No. 15230 (Oct. 1978): "[T]he issuer's proxy material or infor-

information he needs to make an informed decision regarding whether, for example, to sell or retain his stock, to seek the removal of incumbent management, or even to bring suit in state court alleging that management has breached its fiduciary duty.

E. *Disclosure of Antisocial, Unethical, or Unlawful Policies*

A troublesome issue is whether management must disclose, particularly in proxy solicitations for the election of directors, antisocial, unethical or unlawful corporate policies. The rationale supporting nondisclosure is that claims for requiring such disclosures are in fact simply a means by which shareholders can question management's business judgment. To mandate disclosure would open the floodgates for litigious shareholders to bring suit whenever they disagreed with the efficacy or wisdom of management's policies.[72] Moreover, a rule requiring disclosure of such policies is unworkable, since management is unlikely to accuse itself of pursuing antisocial or illegal policies.[73]

Nonetheless, a number of reasonable shareholders would often consider antisocial policies material to their investment and voting decisions, particularly if they have caused significant economic harm. Such information might be important to shareholders in deciding, for example, which directors to vote for or whether to tender stock in a takeover bid setting.[74] Moreover, while many shareholders undeniably wish only to maximize their investments, others seek to invest in companies adhering to ethical, social, and legal norms. Failure to require disclosure on the ground that these shareholders are "unreasonable" or that the information they seek is "immaterial" is inconsistent with fundamental principles of corporate accountability.[75] Further, although courts should be circumspect regarding adoption of principles that would require management to accuse itself

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mation statements should disclose in a prominent place that the overall effect of the proposal is to render more difficult the accomplishment of mergers or the assumption of control by a principal stockholder, and thus to make difficult the removal of management."

72 *See* Amalgamated Clothing and Textile Workers Union, AFL-CIO v. J.P. Stevens & Co., 475 F. Supp. 328 (S.D.N.Y. 1979), *dismissed as moot*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,814 (2d Cir. Jan. 9, 1981): "As to plaintiffs' allegation that [defendant's] labor policy has resulted in significant expenses, management is clearly not required to submit in proxy statements seeking reelection of directors all business judgments whenever it would be possible for shareholders to disagree with their efficacy or wisdom." *Id.* at 331. *See also* Gaines v. Haughton, [Current] FED. SEC. L. REP. (CCH) ¶ 98,000 (9th Cir. May 18, 1981).

73 *Id.* at 332-33. *See* SEC v. Chicago Helicopter Industries, Inc., Civ. No. 79C0469 (N.D. Ill. 1980) ("It is unlikely that the materiality requirement of § 10(b) was ever intended to require management to accuse itself of antisocial behavior."), *discussed in* SEC. REG. & L. REP. (BNA) No. 595, A-4 (Mar. 18, 1981).

74 *See* Brief of the SEC in Amalgamated Clothing and Textile Workers Union, AFL-CIO v. J.P. Stevens & Co., [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,814 (2d Cir. Jan. 9, 1981):

> The Commission submits that the district court erred in concluding that the alleged omissions were non-material as a matter of law because the trier of fact could reasonably conclude, first, that the illegal policy which caused significant economic harm reflected adversely on the way in which Stevens was being managed and, second, that this information would be important to shareholders' decisions about whether to retain Stevens' directors.

75 *See* Natural Resources Defense Council, Inc. v. SEC, 389 F. Supp. 689, 700 (D.D.C. 1974):

> There are many so-called "ethical investors" in this country who want to invest their assets in firms which are concerned about and acting on environmental problems of the nation. This attitude may be based purely on a concern for the environment; but it may also proceed from the recognition that awareness of and sensitivity to environmental problems is the mark of intelligent management. Whatever their motive, this Court is not prepared to say that they are not rational investors and that the information they seek is not material information within the meaning of the securities laws.

of antisocial behavior, to permit nondisclosure on the broad ground that management is not disposed to reveal such policies ignores the fact that, under well established disclosure standards, management must disclose much that is contrary to its interests.[76]

III. Conclusion

This article has focused on a number of judicial principles that, if construed too broadly, serve to insulate recalcitrant management's otherwise illegal actions from successful shareholder challenge. If interpreted properly, these principles advance both the corporation's and shareholders' best interests. If courts are unduly solicitous toward management, however, corporate accountability will needlessly suffer. In this regard, before holding that a particular action taken by management is insulated from challenge by one of these principles, courts should scrutinize the purposes underlying the relevant principle and determine whether applying the principle in that setting would effectuate its purposes. Moreover, the importance of affording shareholders, suing either derivatively or individually, the opportunity for redress should be a relevant consideration in determining whether a particular principle should be applied in a given case. Thus, although courts should apply the business judgment rule and related judicial principles in appropriate situations to shield management's conduct, they should be careful to ensure that their processes are not used as a sword by recalcitrant management to pierce legitimate shareholder interests.

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76 *See, e.g.*, Item 3(f) of Regulation S-K, 17 C.F.R. § 229.20 (1980). *See generally* Brief of the SEC, Amalgamated Clothing and Textile Workers Union v. J.P. Stevens & Co., [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,814 (2d Cir. Jan. 9, 1981):

> [I]t is clear that future plans of a corporation must be disclosed where they are material and *legal*, and there is no basis for concluding that disclosure obligations may be avoided by making future *illegal* plans. The very concept of disclosure may be contrary to human nature, in that management might prefer to conceal all unfavorable information about a company, including such matters as financial losses. Nevertheless, the essence of the federal securities laws, as stated in the preamble to the Securities Act of 1933, is "to provide full and fair disclosure."

Id. (emphasis in original). *See also* Ferrara, Starr & Steinberg, *Disclosure of Information Bearing on Management Integrity and Competency*, 76 NW. U.L. REV. — (1981). Steinberg, *supra* note 69.