/* We continue with part 4 of 8 of the Model Business Corporations Act. */

(2) a majority vote of a committee consisting of two or more independent directors appointed by majority vote of independent directors present at a meeting of the board of directors, whether or not such independent directors constituted a quorum.

(c) None of the following shall by itself cause a director to be considered not independent for purposes of this section:

(1) the nomination or election of the director by persons who are defendants in the derivative proceeding or against whom action is demanded;

(2) the naming of the director as a defendant in the derivative proceeding or as a person against whom action is demanded or

(3) the approval by the director of the act being challenged in the derivative proceeding or demand if the act resulted in no personal benefit to the director.

(d) If a derivative proceeding is commenced after a determination has been made rejecting a demand by a shareholder, the complaint shall allege with particularity facts establishing either (1) that a majority of the board of directors did not consist of independent directors at the time the determination was made or (2) that the requirements of subsection (a) have not been met.

(e) If a majority of the board of directors does not consist of independent directors at the time the determination is made, the corporation shall have the burden of proving that the requirements of subsection (a) have been met. If a majority of the board of directors consists of independent directors at the time the determination is made, the plaintiff shall have the burden of proving that the requirements of subsection (a) have not been met.

(f) The court may appoint a panel of one or more independent persons upon motion by the corporation to make a determination whether the maintenance of the derivative proceeding is in the best interests of the corporation. In such case, the plaintiff shall have the burden of proving that the requirements of subsection (a) have not been met.

/* Interestingly enough the Court is allowed to enforce democracy within the corporation. */

Official Comment.

1. The Persons Making the Determination

Section 7.44(b) prescribes the persons by whom the determination in subsection (a) may be made. The subsection provides that the determination may be made by a majority vote of independent directors if there is a quorum of independent directors, or by a committee of independent directors. These provisions parallel the mechanics for determining entitlement to indemnification in section 8.55 of the Model Act except that clause (2) provides that the committee of independent directors shall be appointed by a vote of the independent directors only, rather than the entire board. In this respect this clause is an exception to section 8.25 of the Model Act which requires the approval of at least a majority of all the directors in office to create a committee and appoint members. This approach has been taken to respond to the criticism expressed in a few cases that special litigation committees suffer from a structural bias because of their appointment by vote of non-independent directors. See Hasan v. CleveTrust Realty Investors, 729 F.2d 372, 37677 (6th Cir.1984).

The decisions which have examined the qualifications of directors making the determination have required that they be both "disinterested" in the sense of not having a personal interest in the transaction being challenged as opposed to a benefit which devolves upon the corporation or all shareholders generally, and "independent" in the sense of not being influenced in favor of the defendants by reason of personal or other relationships. See, e.g., Aronson v. Lewis, 473 A.2d 805, 812-16 (Del.1984). Only the word "independent" has been used in section 7.44(b) because it is believed that this word necessarily also includes the requirement that a person have no interest in the transaction. The concept of an independent director is not intended to be limited to non-officer or "outside" directors but may in appropriate circumstances include directors who are also officers.

Many of the special litigation committees involved in the reported cases consisted of directors who were elected after the alleged wrongful acts by the directors who were named as defendants in the action. Subsection (c)(1) makes it clear that the participation of non-independent directors or shareholders in the nomination or election of a new director shall not prevent the new director from being considered independent. This sentence therefore rejects the concept that the mere appointment of new directors by the non-independent directors makes the new directors not independent in making the necessary determination because of an inherent structural bias. Clauses (2) and (3) also confirm the decisions by a number of courts that the mere fact that a director has been named as a defendant or approved the action being challenged does not cause the director to be considered not independent. See Aronson v. Lewis, 473 A.2d 805, 816 (Del.1984); Lewis v. Graves. 701 F.2d 245 (2d Cir.1983). It is believed that a court will be able to assess any actual bias in deciding whether the director is independent without any presumption arising out of the method of the director's appointment, the mere naming of the director as a defendant or the director's approval of the act where the director received no personal benefit from the transaction.

2. Standard to Be Applied

Section 7.44(a) requires that the determination be made by the appropriate persons in good faith after conducting a reasonable inquiry upon which their conclusions are based. The word "inquiry" rather than "investigation" has been used to make it clear that the scope of the inquiry will depend upon the issues raised and the knowledge of the group making the determination with respect to the issues. In some cases, the issues may be so simple or the knowledge of the group so extensive that little additional inquiry is required. In other cases, the group may need to engage counsel and other professionals to make an investigation and assist the group in its evaluation of the issues.

The phrase "in good faith" modifies both the determination and the inquiry. The test, which is also included in sections 8.30 (general standards of conduct for directors) and 8.51 (authority to indemnify), is a subjective one, meaning "honestly or in an honest manner." The Corporate Director's Guidebook, 33 Bus.Law. 1595, 1601 (1978). As stated in Abella v. Universal Leaf Tobacco Co., 546 F.Supp. 795, 800 (E.D.Va.1982), "the inquiry intended by this phrase goes to the spirit and sincerity with which the investigation was conducted, rather than the reasonableness of its procedures or basis for conclusions."

The phrase "upon which its conclusions are based" requires that the inquiry and the conclusions follow logically. This provision authorizes the court to examine the determination to ensure that it has some support in the findings of the inquiry. The burden of convincing the court about this issue lies with whichever party has the burden under section 7.44(e). This phrase does not require the persons making the determination to prepare a written report that sets forth their determination and the bases therefor, since circumstances will vary as to the need for such a report. There may, however, be many instances where good corporate practice will commend such a procedure.

Section 7.44 is not intended to modify the general standards of conduct for directors set forth in section 8.30 of the Model Act, but rather to make those standards somewhat more explicit in the derivative proceeding context. In this regard, the independent directors making the determination would be entitled to rely on information and reports from other persons in accordance with section 8.30(b).

Section 7.44 is similar in several respects and differs in certain other respects from the law as it has developed in Delaware and been followed in a number of other states. Under the Delaware cases, the role of the court in reviewing the board's determination varies depending upon whether the plaintiff is in a demand required or demand excused situation. Demand is excused only if the plaintiff pleads particularized facts that create a reasonable doubt that a majority of directors at the time demand would be made are independent or disinterested, or alternatively, that the challenged transaction was the product of a valid exercise of business judgment by the approving board. Aronson v. Lewis, 473 A.2d 805, 814 (Del.1984); Pogostin v. Rice, 480 A.2d 619, 624 (Del.1984). If the plaintiff fails to make either of these two showings, demand is required. Since the Aronson requirements are difficult to satisfy, the plaintiff normally must make demand on the board.

In the unusual case where the plaintiff's demand is excused under either of the Aronson tests, the plaintiff has standing to bring the derivative suit. If the corporation seeks to reassert its right to control the litigation. the corporation will form a special litigation committee to determine if the litigation is in the best interests of the corporation. If the corporation files a motion to dismiss the litigation based upon the recommendation of the special committee, Delaware law requires the corporation to bear the burden of proving the independence of the committee, the reasonableness of its investigation, and the reasonableness of the bases of its decision reflected in the motion. Zapata Corp. v. Maldonado, 430 A.2d 779 (Del.1981). Zapata also permits the court a discretionary second step to review the special committee's decision by invoking the court's "independent business judgment." Id. at 789.

In the usual scenario where demand is not excused, the shareholder must demand that the board take action and the Zapata principles do not apply. The board or special committee of independent directors decides whether the corporation should take the action the shareholder requests or respond in some other way. As in the case of all board decisions, the board's response to the shareholder's demand is presumptively protected by the traditional business judgment rule. Allison v. General Motors Corp., 604 F.Supp. 1106, 1122 (D.Del.1985). As a result, the shareholder in filing suit bears the normal burden of creating by particularized pleadings a reasonable doubt that the board's response to the demand was wrongful. Levine v. Smith, C.A. No. 8833, n. 5 (Del.Ch. Nov. 27, 1989) (available on LEXIS). The plaintiff must allege with particularity a lack of good faith, care, independence or disinterestedness by the directors in responding to the demand.

In contrast to Delaware's approach, some jurisdictions have adopted uniform tests to judge both demand required and demand excused situations. For example, in New York judicial review is always limited to an analysis of the independence and good faith of the board or committee and the reasonableness of its investigation; the court does not examine the reasonableness of the bases for the board's decision, nor does the court have the discretionary authority to use its independent business judgment. Auerbach v. Bennett, 47 N.Y.2d 619, 63-34, 419 N.Y.S.2d 920 92-29, 393 N.E.2d 994, 10024)3 (1979). In contrast, the North Carolina Supreme Court has interpreted that state's statutory provisions on derivative actions as requiring the application of the Zapata criteria in both demand required and demand excused cases. Alford v. Shaw, [320 N.C. 465], 358 S.E.2d 323, 327 (1987).

Since section 7.42 requires demand in all cases, the distinction between demand excused and demand required cases does not apply. Subsections (d) and (e) of section 7.44 carry forward the distinction, however, by establishing pleading rules and allocating the burden of proof depending on whether there is a majority of independent directors. Subsection (d), like Delaware law, assigns the plaintiff the threshold burden of alleging facts establishing that a majority of the board is not independent. If there is an independent majority, the burden remains with the plaintiff to plead and establish that the requirements of section 7.44(a) have not been met. If there is no independent majority the burden is on the corporation on the issues delineated in section 7.44(a). In this case, the corporation must prove both the independence of the decisionmakers and the propriety of the inquiry and determination.

Subsections (d) and (e) of section 7.44 thus follow the first Aronson standard in allocating the burden of proof depending on whether the majority of the board is independent. The Committee decided, however, not to adopt the second Aronson standard for excusing demand (and thus shifting the burden to the corporation) based on whether the decision of the board that decided the challenged transaction is protected by the business judgment rule. The Committee believes that the only appropriate concern in the context of derivative litigation is whether the board considering the demand has a disabling conflict.

See Starrels v. First Nat'l Bank, 870 F.2d 1168, 1172-76 (7th Cir.1989) (Easterbrook, J., concurring).

Thus, the burden of proving that the requirements of 7.44(a) have not been met will remain with the plaintiff in several situations. First, in subsection)b)(1), the burden of proof will generally remain with the plaintiff since the subsection requires a quorum of independent directors and a quorum is normally a majority. See 8.24. The burden will also remain with the plaintiff if there is a majority of independent directors which appoints the committee under subsection (b)(2). Under section 7.44(f), the burden of proof also remains with the plaintiff in the case of a determination by a panel appointed by the court.

The burden of proof will shift to the corporation, however, where a majority of directors is not independent, and the determination is made by the group specified in subsection (b)(2). It can be argued that, if the directors making the determination under subsection (b)(2) are independent and have been delegated full responsibility for making the decision, the composition of the entire board is irrelevant. This argument is buttressed by the section's method of appointing the group specified in subsection (b)(2) since subsection (b)(2) departs from the general method of appointing committees and allows only independent directors, rather than a majority of the entire board, to appoint the committee which will make the determination. Nevertheless, despite the argument that the composition of the board is irrelevant in these circumstances, the Committee adopted the provisions of subsections (b)(2) and e) of section 7.44 to respond to concerns of structural bias.

Finally, section 7.44 does not authorize the court to review the reasonableness of the determination. As discussed above, the phrase in section 7.44(a) "upon which its conclusions are based" limits judicial review to whether the determination has some support in the findings of the inquiry.

3. Pleading

Former section 7.40(b) provided that the complaint in a derivative proceeding must allege with particularity whether demand has been made on the board of directors and the board's response or why demand was excused. This requirement is similar to rule 23.1 of the Federal Rules of Civil Procedure. Since demand is now required in all cases, this provision is no longer necessary.

Subsection (d) sets forth a modified pleading rule to cover the typical situation where plaintiff makes demand on the board, the board rejects that demand. and the plaintiff commences an action. In that scenario, in order to state a cause of action, subsection (d) requires the complaint to allege facts with particularity demonstrating either (1) that no majority of independent directors exists or (2) why the determination does not meet the standards in subsection (a). Discovery is available to the plaintiff only after the plaintiff has successfully stated a cause of action by making either of these two showings.

7.45 Discontinuance or Settlement

A derivative proceeding may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interests of the corporation's shareholders or a class of shareholders, the court shall direct that notice be given to the shareholders affected.

Official Comment.

Unlike the statutes of some states, section 7.45 does not address the issue of which party should bear the cost of giving this notice. That is a matter left to the discretion of the court reviewing the proposed settlement.

7.46 Payment of Expenses

On termination of the derivative proceeding the court may:

(1) order the corporation to pay the plaintiff's reasonable expenses including counsel fees) incurred in the proceeding if it finds that the proceeding has resulted in a substantial benefit to the corporation;

(2) order the plaintiff to pay any defendant's reasonable expenses (including counsel fees) incurred in defending the proceeding if it finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose; or

(3) order a party to pay an opposing party's reasonable expenses (including counsel fees) incurred because of the filing of a pleading, motion or other paper, if it finds that the pleading, motion or other paper was not well grounded in fact, after reasonable inquiry, or warranted by existing law or a good faith argument for the extension, modification or reversal of existing law and was interposed for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

7.47 Applicability to Foreign Corporations

In any derivative proceeding in the right of a foreign corporation, the matters covered by this subchapter shall be governed by the laws of the jurisdiction of incorporation of the foreign corporation except for sections 7.43, 7.45, and 7.46.

Chapter 8

DIRECTORS AND OFFICERS

Subchapter A

Board of Directors

8.01 Requirement for and Duties of Board of Directors

(a) Except as provided in subsection (c), each corporation must have a board of directors.

(b) All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation.

(c) A corporation having 50 or fewer shareholders may dispense with or limit the authority of a board of directors by describing in its articles of incorporation who will perform some or all of the duties of a board of directors.

/* In extremely small corporations, it may make more sense for the shareholders to run the corporation's affiars themselves. */

8.02 Qualifications of Directors

The articles of incorporation or bylaws may prescribe qualifications for directors. A director need not be a resident of this state or a shareholder of the corporation unless the articles of incorporation or bylaws so prescribe.

8.03 Number and Election of Directors

(a) A board of directors must consist of one or more individuals, with the number specified in or fixed in accordance with the articles of incorporation or bylaws.

(b) If a board of directors has power to fix or change the number of directors, the board may increase or decrease by 30 percent or less the number of directors last approved by the shareholders, but only the shareholders may increase or decrease by more than 30 percent the number of directors last approved by the shareholders.

(c) The articles of incorporation or bylaws may establish a variable range for the size of the board of directors by fixing a minimum and maximum number of directors. If a variable range is established, the number of directors may be fixed or changed from time to time, within the minimum and maximum, by the shareholders or the board of directors. After shares are issued, only the shareholders may change the range for the size of the board or change from a fixed to a variable-range size board or vice versa.

(d) Directors are elected at the first annual shareholders' meeting and at each annual meeting thereafter unless their terms are staggered under section 8.06.

8.04 Election of Directors by Certain Classes of Shareholders

If the articles of incorporation authorize dividing the shares into classes, the articles may also authorize the election of all or a specified number of directors by the holders of one or more authorized classes of shares. A class (or classes) of shares entitled to elect one or more directors is a separate voting group for purposes of the election of directors.

Official Comment

Section 8.04 makes explicit that the articles of incorporation may provide that a specified number (or all) of the directors may be elected by the holders of one or more classes of shares. This approach is widely used in closely held corporations to effect an agreed upon allocation of control, for example, to ensure minority representation on the board of directors by issuing to that minority a class of shares entitled to elect one or more directors. A class (or classes) of shares entitled to elect separately one or more directors constitutes a separate voting group for purposes of the election of directors; within each voting group directors are elected by a plurality of votes and quorum and voting requirements must be separately met by each voting group. See sections 7.25, 7.26, and 7.28.

8.05 Terms of Directors Generally

(a) The terms of the initial directors of a corporation expire at the first shareholders' meeting at which directors are elected.

(b) The terms of all other directors expire at the next annual shareholders' meeting following their election unless their terms are staggered under section 8.06.

(c) A decrease in the number of directors does not shorten an incumbent director's term.

(d) The term of a director elected to fill a vacancy expires at the next shareholders' meeting at which directors are elected.

(e) Despite the expiration of a director's term, he continues to serve until his successor is elected and qualifies or until there is a decrease in the number of directors.

8.06 Staggered Terms for Directors

If there are nine or more directors, the articles of incorporation may provide for staggering their terms by dividing the total number of directors into two or three groups, with each group containing one half or one-third of the total, as near as may be. In that event, the terms of directors in the first group expire at the first annual shareholders' meeting after their election, the terms of the second group expire at the second annual shareholders' meeting after their election, and the terms of the third group, if any, expire at the third annual shareholders' meeting after their election. At each annual shareholders' meeting held thereafter, directors shall be chosen for a term of two years or three years, as the case may be, to succeed those whose terms expire.

8.07 Resignation of Directors

(a) A director may resign at any time by delivering written notice to the board of directors, its chairman, or to the corporation.

(b) A resignation is effective when the notice is delivered unless the notice specifies a later effective date.

8.08 Removal of Directors by Shareholders

(a) The shareholders may remove one or more directors with or without cause unless the articles of incorporation provide that directors may be removed only for cause.

(b) If a director is elected by a voting group of shareholders, only the shareholders of that voting group may participate in the vote to remove him.

(c) If cumulative voting is authorized, a director may not be removed if the number of votes sufficient to elect him under cumulative voting is voted against his removal. If cumulative voting is not authorized, a director may be removed only if the number of votes cast to remove him exceeds the number of votes cast not to remove him.

(d) A director may be removed by the shareholders only at a meeting called for the purpose of removing him and the meeting notice must state that the purpose, or one of the purposes, of the meeting is removal of the director.

8.09 Removal of Directors by Judicial Proceeding

(a) The [name or describe] court of the county where a corporation's principal office (or, if none in this state, its registered office) is located may remove a director of the corporation from office in a proceeding commenced either by the corporation or by its shareholders holding at least 10 percent of the outstanding shares of any class if the court finds that (1) the director engaged in fraudulent or dishonest conduct, or gross abuse of authority or discretion, with respect to the corporation and (2) removal is in the best interest of the corporation.

(b) The court that removes a director may bar the director from reelection for a period prescribed by the court.

(c) If shareholders commence a proceeding under subsection (a), they shall make the corporation a party defendant.

Official Comment

Section 8.09 authorizes the removal of a director who is found in a judicial proceeding to have engaged in fraudulent or dishonest conduct or gross abuse of office. For example, a judicial proceeding (as contrasted with removal under section 8.08) may be necessary or appropriate in the following situations:

1) In a closely held corporation, the director charged with misconduct is elected by voting group or cumulative voting, and the shareholders with power to prevent his removal exercise that power despite the existence of fraudulent or dishonest conduct. The classic example is where the director charged with misconduct himself possesses sufficient votes to prevent his own removal and exercises his voting power to that end.

(2) In a publicly held corporation, the director charged with misconduct declines to resign, though urged to do so, and because of the large number of widely scattered shareholders, a special shareholders' meeting can be held only after a period of delay and at considerable expense.

A shareholder who owns less than 10 percent of the outstanding shares of the corporation may bring suit derivatively in the name of the corporation under this section upon compliance with the requirements of section 7.40. A shareholder who owns at least 10 percent of the outstanding shares of the corporation may maintain suit in his own name and in his own right without compliance with section 7.40. The corporation, however, must be made a party to the proceeding. See section 8.09(c).

The purpose of section 8.09 is to permit the prompt and efficient elimination of dishonest directors. It is not intended to permit judicial resolution of internal corporate struggles for control except in those cases in which a court finds that the director has been guilty of wrongful conduct of the type described.

8.10 Vacancy on Board

(a) Unless the articles of incorporation provide otherwise, if a vacancy occurs on a board of directors, including a vacancy resulting from an increase in the number of directors:

(1) the shareholders may fill the vacancy;

(2) the board of directors may fill the vacancy; or

(3) if the directors remaining in office constitute fewer than a quorum of the board, they may fill the vacancy by the affirmative vote of a majority of all the directors remaining in office.

(b) If the vacant office was held by a director elected by a voting group of shareholders, only the holders of shares of that voting group are entitled to vote to fill the vacancy if it is filled by the shareholders.

(c) A vacancy that will occur at a specific later date (by reason of a resignation effective at a later date under section 8.07(b) or otherwise) may be filled before the vacancy occurs but the new director may not take office until the vacancy occurs.

Official Comment

Section 8.10(a)(3) allows the directors remaining in office to fill vacancies even though they are fewer than a quorum. The test for the exercise of this power is whether the directors remaining in office are fewer than a quorum, not whether the directors seeking to act are fewer than a quorum. For example, on a board of six directors where a quorum is four, if there are two vacancies, they may not be filled under section 8.10(a)(3) at a "meeting" attended by only three directors. Even though the three directors are fewer than a quorum, section 8.10(a)(3) is not applicable because the number of directors remaining in office-four-is not fewer than a quorum.

8.11 Compensation of Directors

Unless the articles of incorporation or bylaws provide otherwise, the board of directors may fix the compensation of directors.

Subchapter B

Meetings and Action of the Board

8.20 Meetings

(a) The board of directors may hold regular or special meetings in or out of this state.

(b) Unless the articles of incorporation or bylaws provide otherwise, the board of directors may permit any or all directors to participate in a regular or special meeting by, or conduct the meeting through the use of, any means of communication by which all directors participating may simultaneously hear each other during the meeting. A director participating in a meeting by this means is deemed to be present in person at the meeting.

8.21 Action Without Meeting

(a) Unless the articles of incorporation or bylaws provide otherwise, action required or permitted by this Act to be taken at a board of directors' meeting may be taken without a meeting if the action is taken by all members of the board. The action must be evidenced by one or more written consents describing the action taken, signed by each director, and included in the minutes or filed with the corporate records reflecting the action taken.

(b) Action taken under this section is effective when the last director signs the consent, unless the consent specifies a different effective date.

(c) A consent signed under this section has the effect of a meeting vote and may be described as such in any document.

Official Comment

The power of the board of directors to act unanimously without a meeting is based on the pragmatic consideration that in many situations a formal meeting is a waste of time. For example, in a closely held corporation there will often be informal discussion by the manager-owners of the venture before a decision is made. And, of course, if there is only a single director (as is permitted by section 8.03), a written consent is the natural method of signifying director action. Consent may be signified on one or more documents if desirable.

In publicly held corporations, formal meetings of the board of directors may be appropriate for many actions. But there will always be situations where prompt action is necessary and the decision noncontroversial, so that approval without a formal meeting may be appropriate.

Under section 8.21 the requirement of unanimous consent precludes the possibility of stifling or ignoring opposing argument. A director opposed to an action that is proposed to be taken by unanimous consent, or uncertain about the desirability of that action, may compel the holding of a directors meeting to discuss the matter simply by withholding his consent.

8.22 Notice of Meeting

(a) Unless the articles of incorporation or bylaws provide otherwise, regular meetings of the board of directors may be held without notice of the date, time, place, or purpose of the meeting.

(b) Unless the articles of incorporation or bylaws provide for a longer or shorter period, special meetings of the board of directors must be preceded by at least two days' notice of the date, time, and place of the meeting. The notice need not describe the purpose of the special meeting unless required by the articles of incorporation or bylaws.

8.23 Waiver of Notice

(a) A director may waive any notice required by this Act, the articles of incorporation, or bylaws before or after the date and time stated in the notice. Except as provided by subsection (b), the waiver must be in writing, signed by the director entitled to the notice, and filed with the minutes or corporate records.

(b) A director's attendance at or participation in a meeting waives any required notice to him of the meeting unless the director at the beginning of the meeting (or promptly upon his arrival) objects to holding the meeting or transacting business at the meeting and does not thereafter vote for or assent to action taken at the meeting.

8.24 Quorum and Voting

(a) Unless the articles of incorporation or bylaws require a greater number, a quorum of a board of directors consists of:

(1) a majority of the fixed number of directors if the corporation has a fixed board size; or

(2) a majority of the number of directors prescribed, or if no number is prescribed the number in office immediately before the meeting begins, if the corporation has a variable-range size board.

(b) The articles of incorporation or bylaws may authorize a quorum of a board of directors to consist of no fewer than one-third of the fixed or prescribed number of directors determined under subsection (a).

(c) If a quorum is present when a vote is taken, the affirmative vote of a majority of directors present is the act of the board of directors unless the articles of incorporation or bylaws require the vote of a greater number of directors.

(d) A director who is present at a meeting of the board of directors or a committee of the board of directors when corporate action is taken is deemed to have assented to the action taken unless: (1) he objects at the beginning of the meeting (or promptly upon his arrival) to holding it or transacting business at the meeting; (2) his dissent or abstention from the action taken is entered in the minutes of the meeting; or (3) he delivers written notice of his dissent or abstention to the presiding officer of the meeting before its adjournment or to the corporation immediately after adjournment of the meeting. The right of dissent or abstention is not available to a director who votes in favor of the action taken.

8.25 Committees

(a) Unless the articles of incorporation or bylaws provide otherwise, a board of directors may create one or more committees and appoint members of the board of directors to serve on them. Each committee must have two or more members, who serve at the pleasure of the board of directors.

/* Modern larger corporations usually divide all major functions between committees. In fact, the Fortune 500 usually even have a committee which does most of the real work. Acutal operation of the corporation will usually be delegated to an "operating committee." */

(b) The creation of a committee and appointment of members to it must be approved by the greater of (1) a majority of all the directors in office when the action is taken or (2) the number of directors required by the articles of incorporation or bylaws to take action under section 8.24.

(c) Sections 8.20 through 8.24, which govern meetings, action without meetings, notice and waiver of notice, and quorum and voting requirements of the board of directors, apply to committees and their members as well.

(d) To the extent specified by the board of directors or in the articles of incorporation or bylaws, each committee may exercise the authority of the board of directors under section 8.01.

(e) A committee may not, however:

(1) authorize distributions;

(2) approve or propose to shareholders action that this Act requires be approved by shareholders;

(3) fill vacancies on the board of directors or on any of its committees;

(4) amend articles of incorporation pursuant to section 10.02;

(5) adopt, amend, or repeal bylaws;

(6) approve a plan of merger not requiring shareholder approval;

(7) authorize or approve reacquisition of shares, except according to a formula or method prescribed by the board of directors; or

(8) authorize or approve the issuance or sale or contract for sale of shares, or determine the designation and relative rights, preferences, and limitations of a class or series of shares, except that the board of directors may authorize a committee (or a senior executive officer of the corporation) to do so within limits specifically prescribed by the board of directors.

(f) The creation of, delegation of authority to, or action by a committee does not alone constitute compliance by a director with the standards of conduct described in section 8.30.

Official Comment

Section 8.25 makes explicit the common law power of a board of directors to act through committees of directors and specifies the powers of the board of directors that are nondelegable, that is, powers that only the full board of directors may exercise. Section 8.25 deals only with committees of the board of directors exercising the functions of the board of directors; the board of directors or management, independently of section 8.25, may establish nonboard committees composed of directors, employees, or others to deal with corporate powers not required to be exercised by the board of directors.

Section 8.25(b) provides that a committee of the board of directors may be created only by the affirmative vote of a majority of the board of directors then in office, or, if greater, by the number of directors required to take action by the articles of incorporation or the bylaws. This supermajority requirement reflects the importance of the decision to invest board committees with power to act under section 8.25.

Committees of the board of directors are assuming increasingly important roles in the governance of publicly held corporations. See "The Corporate Director's Guidebook," 33 Bus.Law. 1591(1978); "The Overview Committees of the Board of Directors," 35 Bus.Law. 1335 (1980). Executive committees have long provided guidance to management between meetings of the full board of directors. Audit committees also have a long history of performing essential review and control functions on behalf of the board of directors. In recent years nominating and compensation committees, composed primarily or entirely of nonmanagement directors, have also become more widely used by publicly held corporations.

Section 8.25 establishes the desirable and appropriate role of director committees in light of competing considerations: on the one hand, it seems clear that appropriate board committee action is not only desirable but also is likely to improve the functioning of larger and more diffuse boards of directors; on the other hand, wholesale delegation of authority to a board committee, to the point of abdication of director responsibility as a board of directors, is manifestly inappropriate and undesirable. Overbroad delegation also increases the potential, where the board of directors is divided, for usurpation of basic board functions by means of delegation to a committee dominated by one faction.

Section 8.25(e) prohibits delegation of authority with respect to most mergers, sales of substantially all the assets, amendments to articles of incorporation and voluntary dissolution under section 8.25(e)(2) since these require shareholder action. On the other hand, under section 8.25(e) many actions of a material nature, such as the authorization of long-term debt and capital investment or the pricing of shares, may properly be made the subject of committee delegation.

The statutes of several states make nondelegable certain powers not listed in section 8.25(e) for example, the power to change the principal corporate office, to appoint or remove officers, to fix director compensation, or to remove agents. These are not prohibited by section 8.25(e) since the whole board of directors may reverse or rescind the committee action taken, if it should wish to do so, without undue risk that implementation of the committee action might be irrevocable or irreversible.

Section 8.25(f) makes clear that although the board of directors may delegate to a committee the authority to take action, the designation of the committee, the delegation of authority to it, and action by the committee will not alone constitute compliance by a noncommittee board member with his responsibility under section 8.30. On the other hand, a noncommittee director also will not automatically incur liability should the action of the particular committee fail to meet the standard of care set out in section 8.30. The noncommittee member's liability in these cases will depend upon whether he failed to comply with section 8.30(b)(3). Factors to be considered in this regard will include the care used in the delegation to and supervision over the committee, and the amount of knowledge regarding the particular matter which the noncommittee director has available to him. Care in delegation and supervision include appraisal of the capabilities and diligence of the committee directors in light of the subject and its relative importance and may be facilitated, in the usual case, by review of minutes and receipt of other reports concerning committee activities. The enumeration of these factors is intended to emphasize that directors may not abdicate their responsibilities and secure exoneration from liability simply by delegating authority to board committees. Rather a director against whom liability is asserted based upon acts of a committee of which he is not a member avoids liability if the standards contained in section 8.30 are met.

Section 8.25(f) has no application to a member of the committee itself. The standard applicable to a committee member is set forth in section 8.30(a).

Subchapter C

Standards of Conduct

8.30 General Standards for Directors

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

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner he reasonably believes to be in the best interests of the corporation.

(b) In discharging his duties a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

(1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;

(2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence; or

(3) a committee of the board of directors of which he is not a member if the director reasonably believes the committee merits confidence.

(c) A director is not acting in good faith if he has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section.

Official Comment

Section 8.30 defines the general standard of conduct for directors. It sets forth the standard by focusing on the manner in which the director performs his duties, not the correctness of his decisions. Section 8.30(a) thus requires a director to perform his duties in good faith, with the care of an ordinarily prudent person in a like position and in a manner he believes to be in the best interests of the corporation.

Even before statutory formulations of directors' duty of care, courts sometimes invoked the business judgment rule in determining whether to impose liability in a particular case. In doing so, courts have sometimes used language similar to the standards set forth in section 8.30(a). The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts. In view of that continuing judicial development, section 8.30 does not try to codify the business judgment rule or to delineate the differences, if any, between that rule and the standards of director conduct set forth in this section. That is a task left to the courts and possibly to later revisions of this Model Act.

I. Section 8.30(a)

Section 8.30(a) establishes a general standard of care for all directors. It requires a director to exercise "the care an ordinarily prudent person in a like position would exercise." Some state statutes use the words "diligence," "care," and "skill" to define this duty. E.g., N.C.Gen.Stat.Ann. 55-35 (1975). There is very little authority as to what "skill" and "diligence," as distinguished from "care," can be required or properly expected of corporate directors in the performance of their duties. `Skill," in the sense of technical competence in a particular field, should not be a qualification for the office of director. The concept of "diligence" is sufficiently subsumed within the concept of "care." Accordingly, the words "diligence" and "skill" were omitted from the standard adopted.

Likewise, section 8.30 does not use the term "fiduciary" in the standard for directors' conduct, because that term could be confused with the unique attributes and obligations of a fiduciary imposed by the law of trusts, some of which are not appropriate for directors of a corporation.

Several of the phrases chosen to define the general standard of care in section 8.30(a) deserve specific mention.

(1) The reference to "ordinarily prudent person" embodies long traditions of the common law, in contrast to suggested standards that might call for some undefined degree of expertise, like "ordinarily prudent businessman." The phrase recognizes the need for innovation, essential to profit orientation, and focuses on the basic director attributes of common sense, practical wisdom, and informed judgment.

(2) The phrase "in a like position" recognizes that the "care" under consideration is that which would be used by the "ordinarily prudent person if he were a director of the particular corporation.

(3) The combined phrase "in a like position under similar circumstances is intended to recognize that (a) the nature and extent of responsibilities will vary, depending upon such factors as the size, complexity, urgency, and location of activities carried on by the particular corporation, (b) decisions must be made on the basis of the information known to the directors without the benefit of hindsight, and (c) the special background, qualifications, and management responsibilities of a particular director may be relevant in evaluating his compliance with the standard of care. Even though the quoted phrase takes into account the special background, qualifications and management responsibilities of a particular director. it does not excuse a director lacking business experience or particular expertise from exercising the common sense, practical wisdom, and informed judgment of an "ordinarily prudent person.

The process by which a director informs himself will vary but the duty of care requires every director to take steps to become informed about the background facts and circumstances before taking action on the matter at hand. In relying upon the performance by management of delegated or assigned duties pursuant to section 8.01 (including, for example, matters of law and legal compliance), the director may depend upon the presumption of regularity, absent knowledge or notice to the contrary. A director may also rely on information, opinions, reports, and statements prepared or presented by others as set forth in section 8.30(b). Furthermore, a director should not be expected to anticipate the problems which the corporation may face except in those circumstances where something has occurred to make it obvious to the director that the corporation should be addressing a particular problem.

2. Section 8.30(b)

A director complying with the standards expressed in section 8.30(a) is entitled to rely upon information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by the persons or committees described in section 8.30(b). The right to rely under this section applies to the entire range of matters for which the board of directors is responsible. Under section 8.30(c), however, a director so relying must be without knowledge concerning the matter in question that would cause his reliance to be unwarranted. Also inherent in the concept of good faith is the requirement that, in order to be entitled to rely on a report, statement, opinion, or other matter, the director must have read the report or statement in question, or have been present at a meeting at which it was orally presented, or have taken other steps to become generally familiar with its contents. In short, the director must comply with the general standard of care of section 8.30(a) in making a judgment as to the reliability and competence of the source of information upon which he proposes to rely.

Section 8.30(b) permits reliance upon outside advisers, including not only those in the professional disciplines customarily supervised by state authorities, such as lawyers, accountants, and engineers, but also those in other fields involving special experience and skills, such as investment bankers, geologists, management consultants, actuaries, and real estate appraisers. The concept of "expert competence" in section 8.30(b)(2) embraces a wide variety of qualifications and is not limited to the more precise and narrower recognition of experts under the Securities Act of 1933. In this respect section 8.30(b) goes beyond any existing state business corporation act, although several state statutes permit reliance on reports of appraisers selected with reasonable care by the board of directors and deal with the scope and nature of corporate reports and records generally.

Section 8.30(b) permits reliance upon a committee of the board of directors when performing a supervisory or other functions in instances where neither the full board of directors nor the committee takes dispositive action. For example, there may be reliance upon an investigation undertaken by a board committee and reported to the full board of directors, which forms the basis for action by the board of directors itself. Another example is reliance upon a committee of the board of directors, such as a corporate audit committee, with respect to the ongoing role of oversight of the accounting and auditing functions of the corporation.

In conditioning reliance upon reasonable belief that the board committee merits the director's "confidence," section 8.30(b)(3) recognizes a difference between a board committee and an expert. In sections 8.30(b)(1) and (2) the reference is to "competence of an expert," which recognizes the expectation of experience and in most instances technical skills on the part of those upon whom the director may rely. In section 8.30(b)(3), the concept of "confidence" is substituted for "competence" in order to avoid any inference that technical skills are a prerequisite.

3. Section 8.30(c)

Section 8.30(c) expressly prevents a director from "hiding his head in the sand" and relying on information, opinions, reports, or statements when he has actual knowledge which makes reliance unwarranted.

4. Section 8.30(d)

Section 8.30(d) makes clear that the section will apply whether or not affirmative action was in fact taken. If the board of directors or a committee considers an issue (such as a recommendation of independent auditors concerning the corporation's internal accounting controls) and determines not to take action, the determination not to act is protected by section 8.30. Similarly, if the board of directors or committee delegates responsibility for handling a matter to subordinates, the delegation constitutes "action" under section 8.30. Section 8.30(d) applies (assuming its requirements are satisfied) to any conscious consideration of matters involving the affairs of the corporation. It also applies to the determination by the board of directors of which matters to address and which not to address. Section 8.30(d) does not apply only when the director has failed to consider taking action which under the circumstances he is obliged to consider taking.

5. Application to Officers

Section 8.30 generally deals only with directors. Section 8.42 and its Official Comment explain the extent to which the provisions of section 8.30 apply to officers.