

Study B-601

July 8, 1996

**First Supplement to Memorandum 96-52****Business Judgment Rule: Revised Draft (Comments of R. Bradbury Clark)**

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Attached to this memorandum is a letter from Brad Clark with technical and substantive drafting suggestions on the business judgment rule draft. If the Commission's decision is to proceed with the codification effort, we will discuss Mr. Clark's substantive comments at the meeting.

Respectfully submitted,

Nathaniel Sterling  
Executive Secretary

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California Law Revision Commission  
4000 Middlefield Road, Suite D-2  
Palo Alto, California 94303-4739

Attention: Nathaniel Sterling, Executive Secretary

Re: July 1996 Staff Draft ("Staff Draft") of  
Discussion Draft re Business Judgment Rule ("BJR")

Ladies and Gentlemen:

I apologize for the lateness of these comments on the Staff Draft in relation to your meeting on July 11: I was away on vacation or otherwise totally committed between late May and late June. Perhaps, however, there will still be time for you to consider the following comments or perhaps the Staff can do so if a discussion draft is prepared for distribution and general comment.

I have the following comments and suggestions, keyed to various pages of the Staff Draft:

1. Cover Page. If the Commission intends to seek comment on whether the BJR should be codified, I would suggest that that be made clear, perhaps by adding the following sentence to the first paragraph: "The Commission also solicits your views as to whether or not the Business Judgment Rule should be codified."

2. Page 2, first paragraph. The second sentence states as a fact that confusion in California law as to the BJR has been a factor in the decision of a number of California corporations to reincorporate in Delaware. I wonder if the Commission actually has substantial objective

evidence to support this statement. If not, I would suggest its deletion.

3. Page 1, third paragraph. The second sentence states that the recommendation does not deal with BJR issues as applied to other entities than business corporations, such as partnerships and nonprofit corporations. I think this is an excellent way to deal with this potential question and suggest that a similar statement be included in the statutory comments themselves where they will be visible and operative if the BJR is codified. The best place would be as an additional comment to Section 320.

4. Pages 4 and 5, "Disinterested Director". The second line of this section and the first line of the first full paragraph on page 5 refer to the ALI Principles as a "draft". Since the ALI Principles are not a draft, it would be better to substitute "Principles" for "draft". Further, in the first full paragraph on page 5, I doubt that the Commission actually would want the ALI Principles relating to the BJR to be "made part of the codification of the Rule". The statement in the second paragraph of the comments to Section 320 (pp. 8-9) express the relationship of the ALI Principles to a codification in California in a more appropriate way and that formulation should probably be used on page 5.

5. Page 8, Section 320(a). I do not think that this section or other sections in proposed Article 2 deal satisfactorily with the situation where a director is "interested" and because of that interest either discloses that interest to the Board or abstains from voting on the matter or both. Unfortunately I have not been able to formulate a solution to this problem, although perhaps it could be handled in the comment in lines 13-18 on page 9 or in a comment to Section 321. The comment would make it clear that if a director has an interest within the meaning of Section 322 in the subject of a business judgment, discloses that interest to the Board and abstains from voting, that director would be entitled to protection of the business judgment rule if a majority of the directors who do vote on the matter satisfy its requirements. Since one or more directors of corporations will inevitably at times be interested in business judgments made by the board, they should not be placed in a separate, more liable class of directors if they make appropriate disclosures and abstain from voting or their vote is not necessary to the outcome of the decision. Otherwise, as I pointed out earlier, their

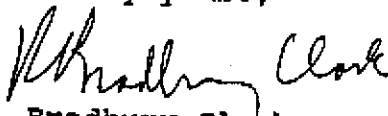
"safe harbor" would be to leave the board, not a desirable result in most cases.

6. Page 9, line 21. I would suggest that this line be rephrased to read "the requirements of this section and, if that burden is sustained, of showing the director's failure to satisfy the requirements of Section 309. See Section 321 (presumption and burden of". As written, this line could suggest that a challenger only has the burden of showing a director's failure to satisfy either one of Section 309 or Section 320. In fact, the question of a director's failure to satisfy the requirements of Section 309 should not arise under the proposed codification unless and until the burden of showing failure to satisfy the requirements of Section 320 has been met. The same change should be made on page 11 in line 13.

7. Page 11, line 41 and page 12, line 2. The phrase "familial relationship" is both vague and probably too broad. Since both "familial relationship" and "associate" are used in clause (3), I would suppose the former means something different than the latter. Just what, though, is troublesome and confusing, since "associate" already includes all of the immediate family of the director. Thus if "familial" relationship is to be given any separate meaning, it must mean family members beyond that group. I would suggest deletion of the phrase in both places. In addition, in lines 41 and 42 of page 11, the phrase "another party" probably is intended to mean "a party other than the corporation" and that phrase should be substituted at that place for "another party".

I was pleased, in looking through the Staff Draft, to note that a good many of the suggestions that I made in my April 3, 1996 letter have been embodied in the new draft and I am pleased at the possibility that my suggestions were helpful. I hope that the comments made in this letter will also be helpful if the Commission decides to distribute the draft and pursue a recommendation for codification of the Business Judgment Rule.

Sincerely yours,

  
R. Bradbury Clark

RBC:bas