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Fiduciary Duties of Directors Considering Strategic Alternatives

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Fiduciary Duties of Directors Considering Strategic Alternatives

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Directors' Fiduciary Duties: The Business Judgment Rule

The Business Judgment Rule

Generally, acts of directors of a Delaware corporation are reviewed under the business judgment rule

- Presumption that in making a business decision, directors acted:
 - On an informed basis
 - In good faith
 - In the honest belief that action taken was in best interests of the corporation
- Under business judgment rule, courts afford directors broad deference in exercise of business judgment and “will not substitute their judgment for that of the board if the latter’s decision can be attributed to *any rational business purpose*”
- Does not apply unless board observes its *duty of care* and *duty of loyalty*

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Duty of Care

Duty of Care Basics

- Duty of care requires that a business judgment be an *informed* judgment
- In analyzing duty of care, courts primarily focus on *decision-making process* engaged in by board, and less on actual results
- Crucial that directors give thoughtful consideration to what methods of inquiry and sources of information are practical and useful in circumstances
- Issues material to board’s ultimate decision must be identified, considered and dealt with
- Whatever decision a board makes, the board will be required, in the event of court review, to display an informed and reasonable basis for the decision

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Duty of Care: Best Practices

In assessing information, directors must proceed with a critical eye

- Always feel free to **ask questions** of meeting participants
- Actively **participate** in decision-making process
- Establish **adequate record** of deliberations

Actions that will help directors meet duty of care

- Be **fully informed** as to developments that frame proposed course of action
- Thoroughly **review** background facts and circumstances before taking action
- Engage in **full and extensive discussions** with each other and independent legal and financial advisors
- Receive **full and candid evaluation** of proposal's strengths and weaknesses, as well as strengths and weaknesses of alternative courses of action
- Review **relevant documentation** (or accurate summaries thereof)
- Critically **examine** available information
- Take **sufficient time** to **evaluate** proposed course of action in deliberate manner

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Duty of Loyalty

Duty of loyalty is often expressed in terms of **good faith** and **independence** to the corporation and its stockholders

Good Faith

- Belief that action taken is in best interests of corporation and its stockholders
- Can be demonstrated by documentation of directors' business purposes or stockholder-oriented reasons for their decisions
- Extreme set of facts would seem to be required to sustain a claim for disloyalty based on theory that directors were deliberately disregarding their duties

Independence

- Directors cannot have a personal financial interest in matter or certain relationships that would affect directors' judgment in a manner adverse to corporation

Directors need to be mindful of **potential conflicts**

- Disclose conflicts to board
- Conflicted directors may want to abstain from vote and, in some cases, not participate in deliberations

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