THE DUTIES AND LIABILITIES OF AN IOWA CORPORATE DIRECTOR

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I. INTRODUCTION

The topics covered in this Article—the basic statutory and fiduciary duties of a director of an Iowa corporation—are among the most important in corporate practice. A director who violates these duties can be held liable for any resulting damages, and, when appropriate, for punitive damages as well.[1] The Article describes the corporate director's duties as defined by the Iowa Business Corporation Act (IBCA)[2] and Iowa case law, and the claims and defenses that typically arise when a party asserts that the director has breached these duties. All pertinent IBCA provisions and the most significant modern Iowa Supreme Court decisions regarding director duties are included.[3]

Yet, the coverage provided here is by no means comprehensive. There is no way it can be. The duties and liabilities of a corporate director are the product of a complex set of interrelationships among statutes, court decisions, and in some cases, provisions in the corporation's own articles of incorporation or bylaws. The subject has been considered in scores of treatises and articles, many of which might be useful in analyzing a particular question of director duty or liability when it arises.[4] This Article's goal is more modest. It provides an overview of Iowa law as it pertains to the most common problems in the area.

The Article divides its discussion of the duties of an Iowa corporate director into two broad categories: duties of care and duties of loyalty.[5] It separately discusses two important legal doctrines that may limit a director's

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1. Iowa decisions have imposed both compensatory and exemplary damages on corporate directors who breached fiduciary duties. *See* Midwest Mgmt. Corp. v. Stephens, 353 N.W.2d 76 (Iowa 1984); Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639 (Iowa 1979); Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517 (Iowa 1974); Holden v. Constr. Mach. Co., 202 N.W.2d 348 (Iowa 1972); Charles v. Epperson & Co., 137 N.W.2d 605 (Iowa 1965).

2. IOWA CODE §§ 490.101-.1705 (2001); *see* 1989 Iowa Acts 502 (repealing IOWA CODE ch. 496A and enacting IOWA CODE ch. 490).

3. This Article focuses on the duties of directors of corporations organized under the IBCA because the IBCA governs the overwhelming majority of Iowa corporations. IOWA CODE § 490.1701. Directors of corporations organized under other Iowa laws, such as banks and insurance companies, generally will have the same obligations as those described in the Article. *See, e.g., id.* § 524.604 (listing duties and responsibilities of bank directors). This Article does *not*, however, cover the special obligations of corporate directors under the federal and state securities laws.

4. Any bibliography would be necessarily incomplete. The following sources are a helpful starting point for research in this area: ABA COMM. ON CORP. LAWS, CORPORATE DIRECTOR'S GUIDEBOOK (2d ed. 1994); NAT'L ASS'N OF CORPORATE DIRS., A PRACTICAL GUIDE FOR CORPORATE DIRECTORS (1996); Melvin A. Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437 (1993); Robert W. Hamilton, *Corporate Governance in America 1950-2000: Major Changes but Uncertain Benefits*, 25 J. CORP. L. 349 (1999); Bayless Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477 (1984). For articles directed to the Iowa statutes and case law, see Edgar F. Hansell et al., *Duties of the Board of Directors Under the Iowa Business Corporation Act*, 40 DRAKE L. REV. 687 (1991) [hereinafter Hansell et al., *Duties*] and Edgar F. Hansell et al., *Director Liability Under Iowa Law—Duties and Protection*, 13 J. CORP. L. 369 (1987).

5. *See infra* Parts III, V.

liability exposure for certain breaches of the duty of care—the Iowa business judgment rule and corporate charter limitations of director liability.[6]

As will be seen, the Iowa statutes and cases that define a corporate director's duties and liabilities are consistent in most respects with those of leading corporate law jurisdictions. In a few areas, like business judgment rule jurisprudence, Iowa law may be somewhat behind the curve. In others, Iowa's unique rules concerning special litigation committees of directors, for example, Iowa law represents novel, if not widely-accepted, corporate law thinking.

The Article offers interpretational guidance on a few director duty questions that the Iowa courts have not yet addressed. It also suggests modest changes in doctrine on several director duty topics that the Iowa courts have covered in prior decisions. The primary purpose of the Article is not critique, however. Rather, the Article endeavors to present, in a comprehensive and doctrinally cohesive fashion, the Iowa statutes and cases that define a corporate director's duties and liabilities. Thus, the pages that follow are more in the nature of a primer for Iowa directors, for the lawyers who advise them, and for Iowa courts that adjudicate director liability issues.

II. THE IOWA DIRECTOR AS FIDUCIARY AND SOURCES OF LAW DEFINING THE DIRECTOR'S DUTIES

A. *Agent or Fiduciary?*

Corporate directors are not, strictly speaking, agents of the corporation or its shareholders.[7] Agency is a hierarchical relationship in which the agent is subservient to the principal.[8] Corporate directors in Iowa and other American jurisdictions do not take orders from shareholders or from any other constituency in the corporation. Rather, the board of directors is empowered by statute to manage the corporation largely free from any restrictions or right of intervention by others.[9] Thus, most commentators agree that the position of a corporate director is sui generis.[10]

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6. *See infra* Parts IV, VI.

7. Nonetheless, directors are often described as such. *See, e.g.*, Hansell et al., *Duties*, *supra* note 4, at 689 ("The directors of a corporation are agents for the corporation and its stockholders." (citing IOWA CODE § 490.850(2) (1991))).

8. *See* RESTATEMENT (SECOND) OF AGENCY § 1 (1958) (describing the agency relationship as one in which the agent acts subject to the principal's control and consent).

9. For example, IBCA § 490.801 requires that an Iowa corporation's powers be "exercised by or under the authority of" the board of directors and that "the business and affairs of the corporation [be] managed under the [board's] direction . . . ." IOWA CODE § 490.801(2) (2001). This management scheme may be varied by corporations with fifty or fewer shareholders, but only if the corporation's articles of incorporation so provide. *Id.* § 490.801(3). Corporations organized

But one of the hallmarks of American law is that permissive corporation codes like the IBCA are supplemented by fiduciary duties that constrain a corporate director's discretion.[11] So it is with the management prerogatives of an Iowa corporate director. While the director is subject to few statutory constraints, the Iowa courts have repeatedly held that a director is a trustee or quasi-trustee who owes fiduciary duties to the corporation and its shareholders.[12]

B. *Judicial Decisions Defining the Director's Duties*

Of course, a director's status as a fiduciary does not necessarily define the director's obligations. To paraphrase Justice Felix Frankfurter, the director's fiduciary status only begins the inquiry.[13] The heart of a director's fiduciary obligations lies in the types of *conduct* the law requires that the director engage

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under other Iowa laws give similar broad management authority to the board of directors. *See, e.g.*, *id.* § 524.601 (describing the powers of boards of directors of state banking corporations).

10. This Latin phrase means "unique" or "of its own kind." BLACK'S LAW DICTIONARY 1448 (7th ed. 1999). As summarized by the drafters of the Model Business Corporation Act:

> Legal writers have developed various theories as to the status of directors and the source of their powers: (1) the agency theory (all powers reside in the shareholders who have delegated certain powers to the directors as their agents); (2) the concession theory (the powers of directors are derived from the state, which authorizes them to perform certain functions, so that this power does not flow from the shareholders); (3) the Platonic guardian theory (the board is an aristocracy or group of overseers created by statutory enactment); and (4) the sui generis theory (directors are not agents; they are fiduciaries whose duties run to the corporation but their relationship with the corporation is sui generis since they are not trustees). Of these various theories, the first has been generally rejected, and probably most commentators today would agree that the fourth most accurately describes the modern role of directors.

MODEL BUS. CORP. ACT ANN. § 8.01 cmt. (1985 & Supp. 1997).

11. *See* John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1619 (1989) ("[W]hat is most mandatory in corporate law is not the specific substantive content of any rule, but rather the institution of judicial oversight.").

12. *See, e.g.*, Holden v. Constr. Mach. Co., 202 N.W.2d 348, 358 (Iowa 1972) ("[D]irectors of a corporate entity . . . occupy a fiduciary duty . . . to the corporation and its stockholders."); Shildberg Rock Prods. Co. v. Brooks, 140 N.W.2d 132, 136 (Iowa 1966) ("[D]irectors of a corporation are trustees or quasi-trustees of the corporate assets and occupy a fiduciary relation to the corporation and its stockholders."); Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d 174, 216 (Iowa 1952) ("[D]irectors of a corporation . . . are the trustees or quasi trustees . . . of the property of the corporation for the company and its stockholders.").

13. SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943) ("But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?").

in, or refrain from engaging in, in order to fulfill the director's duties as a fiduciary.

Several IBCA provisions address this issue,[14] but the Iowa courts are also important regulators in this area. As will be seen, judicial decisions shape fiduciary duties not only through statutory interpretation but also through special judicial review principles applicable only to the conduct of fiduciaries. In Iowa, the courts have defined the fiduciary duties of directors in a relatively small body of reported decisions, most frequently in the context of derivative litigation. Because the court acts as fact finder in such equitable proceedings,[15] and review on appeal is de novo,[16] the appellate courts have enjoyed considerable flexibility in shaping these rules.

What policies or objectives guide, or ought to guide, the Iowa courts in this regard? Scholars disagree. The traditional view is that fiduciary duties are an automatic, open-ended, and flexible judicial constraint on director discretion to be applied on a case-by-case basis. Courts impose these limitations on directors because the welfare of the corporation, and indirectly the shareholders, rests in the hands of the directors.[17] In other words, fiduciary duties are a by-product of the directors' power over corporate affairs and should be applied by courts as necessary to remedy or prevent misuse of that power. There is some support in Iowa case law for this position.[18]

The competing view, from contemporary law and economics scholarship, is that fiduciary duties are gap-filler terms in what is, in essence, a contractual relationship between the shareholders of a corporation and the corporation's

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14. *See infra* Part II.C.

15. Weltzin v. Nail, 618 N.W.2d 293, 302-03 (Iowa 2000) (holding Iowa does not recognize a right to a jury trial in a derivative suit).

16. Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639, 645 (Iowa 1979) (holding derivative suits are reviewed de novo on appeal).

17. *See* Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403, 1407-08 (1985) (describing trust and agency law roots of corporate fiduciary duties); *see also* Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795, 809-14 (1983) (describing the relationship between the fiduciary and the entrustor and the duties this relationship imposes).

18. *See, e.g.*, Linge v. Ralston Purina Co., 293 N.W.2d 191, 194 (Iowa 1980) (concluding that majority shareholders of Iowa corporations owe fiduciary duties to minority shareholders because "[b]y being in a position to manage corporate affairs through control of the board of directors, a majority shareholder is in the same relationship to minority shareholders as the directors themselves"). The Iowa Supreme Court has invoked similar reasoning to justify the fiduciary duties of an agent in the principal-agent relationship, that is, fiduciary duties operate as a judicial check on the agent's power to affect the principal's welfare. *See, e.g.*, Condon Auto Sales & Serv. v. Crick, 604 N.W.2d 587, 599 (Iowa 1999) (indicating employer claims against employees alleging unfair competition and self-dealing are often styled as breach of fiduciary duty claims because "a principal-agent relationship gives rise to a fiduciary duty of loyalty, and an employer-employee relationship can be closely associated with a principal-agent relationship").

management. In this view, courts should impose as fiduciary duties only those for which the parties bargained, or for which the parties would have bargained had they addressed the issue.[19] Iowa case law also provides some support for this position.[20]

Does it matter which view of fiduciary duties animates the court in a particular case? It might. The traditional view produces fiduciary duties in the form of aspirational standards that are intentionally open-ended and perhaps nonwaiveable.[21] A contractual explanation of fiduciary duties, on the other hand, tends to produce duties that are narrow, bright-line rules, duties that corporate participants may always vary by agreement.[22] Advocates or courts wishing to expand the scope of fiduciary duties will often find support for that position in the traditional view. Those seeking to restrict the scope of fiduciary duties will often be able to justify such outcomes using contract based theories.

That is not to say that the courts are unbounded by statutory constraints when defining the responsibilities of a corporate director. The IBCA, like most modern corporation codes, now directly addresses certain aspects of the director's duties. The following section summarizes the most important provisions of the IBCA that create or qualify obligations for a corporate director.

C. *Statutory Provisions Defining the Director's Duties*

IBCA section 490.801 requires that an Iowa corporation's powers be "exercised by or under the authority of" the board of directors and that "the business and affairs of the corporation [be] managed under the [board's] direction . . . ."[23] IBCA section 490.830 describes the standards of conduct directors must observe when discharging these management functions.[24] A director must perform his duties on the board or on any of its committees: (1) "[i]n good faith;" (2) "[i]n a manner the director reasonably believes to be in the best interests of the corporation;" and (3) "[w]ith the care an ordinarily prudent

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19. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 92-93 (1991) (stating that fiduciary duties should not trump actual contracts).

20. *See, e.g.*, Whalen v. Connelly, 545 N.W.2d 284, 292 (Iowa 1996) (holding the general partner of a Delaware limited partnership operating in Iowa did not breach fiduciary duties to a limited partner when the general partner's conduct was authorized by the partnership agreement).

21. *See generally* Brudney, *supra* note 17, at 1406-10 (recognizing the role that judicially fashioned fiduciary principles play in determining corporate managerial decisions).

22. *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 19, at 90-93 (stating that contracts can be written so narrowly as to remove the need for traditional fiduciary duties).

23. IOWA CODE § 490.801(2) (2001).

24. *Id.* § 490.830(1).

person in a like position would exercise under similar circumstances."[25] A director is entitled to rely on information provided by others, so long as the director "reasonably believes" the information to be reliable.[26]

Parts III, IV, and V of the Article explore the implications of these statutory requirements for directors as fiduciaries. The Article concentrates on these requirements because few other IBCA provisions are relevant to this inquiry. Several other parts of the IBCA impose affirmative obligations or liability risks on corporate directors, but these statutes are generally very limited in scope.[27] Part VI of the Article will also consider IBCA provisions that provide directors with defenses, liability limitations, and similar rights.[28] However, these statutory protections are best understood if one first considers the claims and liability risks they are intended to counter. The Article now turns to those issues.

III. THE IOWA DIRECTOR'S DUTY OF CARE

Almost all of the reported appellate cases in Iowa relating to a corporate director's duties concern misconduct that violates the director's duty of loyalty, for example, the misappropriation of corporate assets or self-dealing.[29] That is not to say there is no Iowa law imposing a duty of care on corporate directors. To the contrary, the IBCA expressly includes such duties for directors.[30] Moreover, courts in other jurisdictions have interpreted similar, if not identical, statutory rules when defining the corporate director's duty of care. The Iowa courts will likely look to these precedents for guidance, and most of this Part is devoted to them. Such Iowa case law authorities as exist are reviewed in considerable detail along with relevant IBCA provisions.

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25. *Id.*

26. *Id.* § 490.830(2).

27. For example, various parts of the IBCA require an active management role by the board of directors in specific contexts, such as issuing stock, declaring dividends, and approving extraordinary transactions. *Id.* §§ 490.621, .640, .1003. IBCA § 490.833 imposes liability on directors for approval of unlawful corporate distributions in certain circumstances. *Id.* § 490.833.

28. As explained in Part V, IBCA § 490.831 provides a qualified defense in certain conflict of interest situations that may have been a violation of the director's duty of loyalty at common law. *Id.* § 490.831. As explained in Part VI, the corporation may, under IBCA § 490.832, exculpate directors from certain monetary damage claims arising out of a breach of the duty of care. *Id.* § 490.832. Finally, IBCA §§ 490.850 through 490.858 permit, and in some instances require, the corporation to indemnify or insure a director against certain liability claims. *Id.* §§ 490.850-.858.

29. *See infra* Part V.

30. IOWA CODE § 490.830.

A. *Substantive Obligations*

As noted in Part II, IBCA section 490.801 vests exclusive management control over the corporation in its board of directors: "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 . . . ."[31] The directors have a corresponding obligation to discharge that management function. This duty to manage is sometimes described as the substantive component of a director's duty of care.[32]

1. *Two Models of Management*

To understand the nature of a director's responsibilities in this regard, it is important to remember that section 490.801 allows the board of directors to manage the corporation in a manner that best suits its situation.[33] Section 490.801 provides that corporate powers may be exercised "by" the board of directors directly.[34] But section 490.801 also authorizes the board of directors to exercise corporate powers indirectly, by appointing officers, agents, and employees who will carry out the corporation's functions "under the authority" of the board.[35] When the latter course is followed, the board's primary substantive management obligation is one of monitoring and oversight.[36]

Directors of closely held corporations typically follow the first management pattern outlined above. In such corporations, most if not all directors will be shareholders and will also actively participate in the

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31. IOWA CODE § 490.801(2). Corporations organized under other Iowa laws give similar broad authority to the board of directors. *See, e.g.*, *id.* § 524.601 (detailing powers of boards of directors of state banking corporations). For-profit business corporations with fifty or fewer shareholders may vary the statutory management scheme if the corporation's articles of incorporation so provide. *Id.* § 490.801(3). Traditionally, however, very few corporations have taken advantage of similar opportunities to opt out of the default corporate management rules. Dennis Karjala, *A Second Look at Special Close Corporation Legislation*, 58 TEX. L. REV. 1207, 1266 n.236 (1980).

32. *See* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(a) cmt. b, at 145 (1994) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE] ("Courts have often used the word 'duty' to refer to . . . powers and tasks [of a director] as well as to the standard of care under which performance of a director . . . is to be judged.").

33. IOWA CODE § 490.801(2).

34. *Id.*

35. *Id.*

36. Regardless of the extent to which the board has delegated its power to others, the IBCA requires active participation by the board for certain management decisions, such as issuance of shares, declaration of dividends, and approval of extraordinary transactions. *Id.* §§ 490.621, .640, .1003.

corporation's day-to-day business as officers, agents, and employees. When directors are thus involved in corporate affairs, few issues will arise concerning any breach of the substantive duty of care. Indeed, the most common breach of fiduciary duty for directors in this context is a claim that they have overstepped their management prerogatives, favoring majority shareholders to the disadvantage of minority shareholders.[37]

The larger the corporation, the more likely directors are to discharge their management obligations indirectly, as supervisors rather than as active participants. Indeed, in public corporations, a majority of board members are typically outside directors—persons not employed full time by the corporation.[38] For such directors, indeed for any director who does not participate in corporate affairs on a daily basis, the primary obligation is to provide direction and oversight to officers, employees, and other agents of the corporation who carry out the management function on behalf of the directors.[39] As Professor Bayless Manning has explained, in most large-scale corporate enterprises these latter groups are the de facto managers of the business and set most of the agenda to which the board of directors must respond.[40] Thus, the board's substantive duty of care generally requires passive monitoring and oversight rather than active decision making and hands-on management.

Professor Manning notes two important exceptions to the passive management role for directors whose principal task is monitoring and oversight.[41] First, the directors must ensure not only that a functioning corporate management team is in place, but also that information systems exist that enable the board to monitor the performance of that team.[42] Second, the directors must take action to

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37. *See generally* F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS (2d ed. 1997) (discussing the relationship between majority shareholder-directors and minority shareholders).

38. ROBERT CHARLES CLARK, CORPORATE LAW 107 (1986).

39. *Id.* at 107-08 (discussing the supervisory and advisory role of boards of directors).

40. *See generally* Manning, *supra* note 4, at 1484 (noting what the board discusses is generally determined by management or "the corporation's automatic built-in secular equivalent of an ecclesiastical calendar").

41. *Id.*

42. *Id.* Professor Manning writes:

> [N]o board can deny the existence of a built-in paramount responsibility with regard to what may be called the organic or structural integrity of the company. This organic integrity is essentially made up of two elements. A company must have a *functioning management* in place and operating at all times. A board can itself see that this is done. And a company must have an *internal information system* in place that is generally suitable for an enterprise of the company's character to keep the management informed about what is going on and particularly to provide the accounting data on which to base financial statements. . . . As to these two organic

protect the corporation's interest if there are credible signs that corporate management is not performing its job.[43]

2. *Liability for Failure to Discharge Substantive Management Obligations*

Decisions from other jurisdictions generally follow the pattern outlined by Professor Manning. It has long been recognized that directors may be liable for breach of fiduciary duty where they fail to discharge their substantive obligation to manage the corporation. Typically, these claims arise where directors fail to detect or prevent misconduct by subordinate corporate managers and such misconduct harms the corporation.[44] But these cases generally impose liability on directors only in the face of a "sustained or systematic failure" to exercise oversight.[45] Indeed, cases holding directors liable for neglect of their management duties usually involve a complete abdication of the directors' functions as in the famous case of *Francis v. United Jersey Bank*.[46] These decisions thus support Professor Manning's view that the law authorizes directors to play a largely passive role of oversight and monitoring in the corporate management structure.[47]

> elements of the enterprise, the directors may not wait for the management to bring issues to their attention.

Id.

43. *Id.* at 1484-85. Professor Manning also writes:

> [N]o director or group of directors may choose to ignore credible signals of serious trouble in the company. . . . There will usually be a wide range of possible actions which a director could reasonably take to pursue such a matter and thereby fulfill his obligation as a director; but he cannot simply do nothing. Execution of this responsibility of a director will be episodic and, typically, infrequent, but the responsibility itself is ongoing and present every day.

Id.

44. *See, e.g.*, Bates v. Dresser, 251 U.S. 524, 526 (1920) (discussing the liability of bank directors for losses caused by a bank employee's theft); Briggs v. Spaulding, 141 U.S. 132, 138 (1891) (examining whether bank directors are liable for the president's inappropriate actions resulting in losses).

45. Delaware's Chancellor William Allen so characterized the case law in his famous decision, In re *Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 971 (Del. Ch. 1996). *See also* MODEL BUS. CORP. ACT ANN. § 8.31(a)(2)(iv) (1985 & Supp. 1998/99).

46. Francis v. United Jersey Bank, 432 A.2d 814 (N.J. 1981). The director in *Francis* was the mother of the principal director-officers. *Id.* at 818. She was held liable for their wrongful diversions of corporate funds because she made no effort to discharge her responsibilities as director and, if she had, she readily would have discovered the wrongdoing. *Id.* at 825-26; *cf.* Gen. Films, Inc. v. Sanco Gen. Mfg. Corp., 379 A.2d 1042, 1043-44 (N.J. Super. 1977) (holding a director who took little action to discharge responsibilities was not liable when wrongdoing by others was an isolated transaction spanning a brief period of time which had many earmarks of a legitimate transaction).

47. Manning, *supra* note 4, at 1484-85.

Recent decisions also confirm Manning's assertion that directors have limited but continuing obligations to ensure that adequate information systems are in place that will enable the board to oversee and monitor corporate affairs. For example, in the public corporation context, there has been considerable debate about whether directors have an obligation to set up information and reporting systems within the corporation that are sufficient to detect criminal conduct or other legal violations by subordinates.[48] Chancellor William Allen, Delaware's most prominent corporate jurist before his recent retirement, addressed this question in In re *Caremark International Inc. Derivative Litigation*[49] and found that such a duty exists.[50]

Information and reporting systems should be present, Allen concluded, "that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance."[51] He reasoned that such systems are a necessary predicate for any board that is to fulfill its statutory supervisory and monitoring role.[52]

3. *The* Rowen *Decision*

The sole Iowa Supreme Court decision relating to this topic, *Rowen v. Le Mars Mutual Insurance Co.*,[53] addressed the substantive management obligations of a corporate director, but only indirectly. The *Rowen* plaintiffs were policyholders of Le Mars Mutual Insurance Company (Le Mars).[54] They objected when Alesch, a director of Le Mars, agreed to resign from its board and persuaded a majority of the remaining board members to do the same.[55] Plaintiffs contended that the purpose of these resignations was to facilitate

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48. *Id.* at 1479-80.

49. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

50. *Id.* at 970.

51. *Id.*

52. *Id.* Chancellor Allen distinguished *Graham v. Allis Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963), an earlier Delaware Supreme Court decision that seemed to negate a board's duty to monitor the corporation's compliance with law. In Allen's view, *Graham* stands for the more limited proposition that "absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf." *Id.* at 969. Nonetheless, Allen articulated a protective liability standard for directors faced with a claim for failure to implement a monitoring system sufficient to detect wrongdoing by subordinates. Such directors are liable, he stated, only for an "utter failure to attempt to assure a reasonable information and reporting system exists." *Id.* at 971.

53. Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639 (Iowa 1979).

54. *Id.* at 644.

55. *Id.* at 649.

Alesch's sale of his own insurance agency to Iowa Mutual Insurance Company (Iowa Mutual), a competitor of Le Mars, at a price that included a premium for transfer of control of Le Mars to Iowa Mutual.[56] The court agreed, finding the control premium to be the property of Le Mars and holding Alesch liable for its repayment.[57]

The substantive duty of care issues in *Rowen* arose in connection with plaintiffs' claims that the other directors of Le Mars and the directors of Iowa Mutual were also liable for Alesch's misconduct.[58] While agreeing that all of these parties potentially shared responsibility for the plaintiffs' losses, the Iowa Supreme Court drew important distinctions among them.

First, the court refused to impose liability on the outside directors of Iowa Mutual who were not aware of the connection between their company's purchase of Alesch's agency and the improper transfer of control of Le Mars.[59] The court noted these directors could properly rely on the inside directors—those working fulltime for Iowa Mutual—until they had reason to suspect some impropriety.[60] Second, and equally important, the court reached a different conclusion concerning the outside directors of Le Mars.[61] The court held Alesch's request for en masse board resignations at the same time he sold his own insurance agency should have alerted those directors that such resignations were improper and thus a breach of their fiduciary duties to Le Mars.[62]

The distinctions drawn in *Rowen* are worth noting because they echo those suggested above by Professor Manning. Indeed, the Iowa court quoted lengthy passages from treatises and articles that describe the limited role of outside directors—those who are not full-time employees of the corporation—in much the same fashion as Professor Manning.[63] The court's exoneration of the outside directors of Iowa Mutual implicitly acknowledged that such directors play more of a passive monitoring and oversight function than one of active management, and that an outside director may generally rely on corporate insiders to transact

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56. *Id.* at 650.

57. *Id.* at 650-51.

58. *Id.* at 651. The plaintiffs' theory with respect to the Iowa Mutual directors—persons who owed no fiduciary duties to Le Mars—was that such persons were liable as co-conspirators, or aiders and abettors, in connection with Alesch's breach of his fiduciary duty to Le Mars. *Id.* (citing Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d 174, 217 (Iowa 1952)).

59. *Id.* at 652.

60. *Id.* at 652-53.

61. *Id.* at 654.

62. *Id.* at 653-54.

63. *Id.* at 652 (quoting WILLIAM F. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS 25 (3d ed. 1978); Noyes E. Leech & Robert H. Mundheim, *The Outside Director of the Publicly Held Corporation*, 31 BUS. LAW. 1799 (1976)).

day-to-day business.[64] However, the court's imposition of liability on the Le Mars directors—both inside and outside directors—makes clear that when circumstances arise that should trigger suspicion on the part of any directors, those directors must investigate further.[65] Liability may attach if they fail to do so.[66]

B. *Standard of Care Obligations*

1. *The Statutory Framework*

Recall that IBCA section 490.830 requires that a director meet certain standards of performance.[67] A director must discharge his duties on the board or on any of its committees: (1) "[i]n good faith;" (2) "[i]n a manner the director reasonably believes to be in the best interests of the corporation;" and (3) "[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances."[68] A director is entitled to rely on information or reports provided by others in the performance of his duties so long as the director "reasonably believes" such information or reports to be reliable.[69]

If it is shown that a director has *not* met these standards, the director is exposed to liability.[70] Section 490.830 states this proposition in the negative: "A director is not liable for any action taken as a director, or any failure to take any action, if the director performed the duties of the director's office in compliance with this section . . . ."[71] Plaintiffs must, of course, prove that the director's

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64. *Id.* at 653.
65. *Id.* at 653-54.
66. *Id.* at 654.
67. IOWA CODE § 490.830 (2001).
68. *Id.* § 490.830(1).
69. *Id.* § 490.830(2). Specifically, IBCA § 490.830(2) states that, unless the director has such knowledge as would cause reliance to be "unwarranted," the director is

> entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data . . . prepared or presented by any of the following: (a) One or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented; (b) Legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence; or (c) A committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

Id.

70. *Id.* § 490.830(4).
71. *Id.*

failure to comply with the standard of conduct required by section 490.830 harmed the corporation and the extent of that harm.[72]

2. *Standard of Care Obligations Within the Statutory Framework*

The statute's good faith requirement[73] and its requirement that directors reasonably believe that their actions advance "the best interests of the corporation"[74] are best understood as a part of the director's duty of loyalty to the corporation.[75] Focusing on the remaining elements of the statute, one is left with the requirement that a director exercise "the care an ordinarily prudent person in a like position would [use] under similar circumstances,"[76] and the corollary proposition that a director may rely on information provided by others when the director "reasonably believes [them] to be reliable."[77]

With the exception of a decision or two relating to the business judgment rule, this language is virtually the only Iowa law that imposes a standard of care on directors. What does this language mean? It purports to require a director to exercise what amounts to reasonable care—the familiar negligence standard of tort law. In this respect the standard of care for a director appears comparable to,

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72. Hansell et al., *Duties*, *supra* note 4, at 698. There are Iowa decisions that require defendant directors to prove that they have discharged their duties to the corporation. *See, e.g.*, Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639, 647 (Iowa 1979). However, such burden shifting should occur only when plaintiffs' claims present duty of loyalty issues or the business judgment rule otherwise does not apply. *See* discussion *infra* Parts IV, V. Most of these decisions can be explained on that basis.

In any event, the IBCA may soon be amended to clarify that the plaintiff bears the burden of proof on duty of care claims. The latest version of the ABA's Model Business Corporation Act so provides, MODEL BUS. CORP. ACT ANN. § 8.30 (1985 & Supp. 1998/99), and a proposal has been introduced in the 2002 legislative session that would make that provision, and several other recent revisions of the Model Act, part of the IBCA. *See* S.S.B. 3163 § 37, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (adding new Iowa Code § 490.831 clarifying, inter alia, that the plaintiff has the burden of proof when suing a director for breach of duty); H.S.B. 682 § 37, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (adding new Iowa Code § 490.831 clarifying, inter alia, that the plaintiff has the burden of proof when suing a director for breach of duty). *See also Report Concerning Proposed Amendments to the Iowa Business Corporation Act* 6-7, BUS. L. SEC. OF THE IOWA STATE BAR ASS'N & BUS. L. COUNCIL OF THE IOWA STATE BAR ASS'N, (September 2001) (copy on file with author) [hereinafter For Profit Corporation Report].

73. IOWA CODE § 490.830(1)(a).

74. *Id.* § 490.830(1)(c).

75. *See infra* Part V. These two requirements are also relevant to the director's duty of care insofar as both are predicates for availability of the business judgment rule. *See infra* Part IV.B.

76. IOWA CODE § 490.830(1)(b).

77. *Id.* § 490.830(2). Section 490.830(3) provides, "A director is not acting in good faith if the director has knowledge concerning the matter in question that makes reliance . . . unwarranted." *Id.* § 490.830(3).

if not derived from, the standard that applies in agency law, which generally requires agents to exercise "reasonable care and skill" in the performance of their duties.[78]

However, the official comment to Model Business Corporation Act section 8.30, an identically worded provision to the Iowa statute, counsels some caution in this regard.[79] The comment states, for example, that the "ordinarily prudent person" formulation used in the statute, as contrasted with the "ordinarily prudent businessperson," is intended to make clear that no special expertise is required for service as a corporate director.[80] A director's education, experience, and position in the corporation are, of course, relevant considerations under the "like position" and "similar circumstances" qualifications to the ordinarily prudent person standard. But these qualifications also require consideration of the particular situation of the corporation and director in question, and are intended to preclude second-guessing based on hindsight.[81]

Professor Manning aptly observes that an after-the-fact assessment of the performance of a board of directors is much more problematic than such an assessment of, say, a car driver who has had an accident:

> The situation with regard to the directors of corporations is totally different. There is no agreed upon roster of functions of a director, analogous to driving the car. We do not have any common standard or experience as to what directors do; and what they do varies from company to company, from situation to situation, and from time to time.

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78. *See generally* RESTATEMENT (SECOND) OF AGENCY § 379 (1958).

79. MODEL BUS. CORP. ACT ANN. § 8.30 cmt. (1985 & Supp. 1998/99). The reader should note that the Model Business Corporation Act drafters amended § 8.30 in 1998. *See* Historical Background, MODEL BUS. CORP. ACT ANN. § 8.30. Unless otherwise indicated, citations in this Article are to the text and official comment of § 8.30 in effect when Iowa adopted the IBCA in 1989.

80. *See id.* (remarking that 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").

81. *Id.*

> 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 or she were a director of the particular corporation . . . . 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 on such factors as the size, complexity, urgency, and location of activities carried on by the 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 that director's compliance with the standard of care.

Id.

> Abandoning all effort to state what directors do, the present law simply announces that they must do it "carefully," like a prudent person. But . . . we have no external measuring rod for assessing how the directors should do it (whatever "it" is). There is no common experience among courts or juries as to how "it" is normally done, and therefore should be done.[82]

The upshot of Professor Manning's criticism is that courts should exercise great caution when evaluating a director's compliance with the reasonable care standard that section 490.830 apparently imposes.[83] Unlike negligence assessments in most litigation contexts, it will be difficult to identify any uniform standard of conduct against which the director's conduct can be fairly judged.[84]

The reported cases suggest that courts have heeded this warning. Indeed, while the law in most jurisdictions imposes a reasonable care standard on directors, few decisions purport to hold directors liable for a mere failure to exercise such care.[85] Certainly no Iowa cases predicate director liability on that basis. In order to understand the apparent disconnect between the standards of reasonable care that section 490.830 provides and the more generous liability standards applied by the courts one must take into account the business judgment rule. The Article now turns to that subject.

IV. THE DIRECTOR'S DUTY OF CARE AND THE BUSINESS JUDGMENT RULE IN IOWA

The goal of this Part—an explication of the business judgment rule—is not an easy task. As some commentators have noted, the relationship between the

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82. Manning, *supra* note 4, at 1493-94.

83. *Id. See also* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(a) cmts. c, e, f, h.

84. IBCA § 490.830(2), which expressly authorizes directors to rely on information provided by others in discharging their duties as directors, raises issues similar to those just discussed. As a predicate to reliance on such information, for example, a report from the corporation's counsel, auditor, or a board committee, § 490.830(2) requires that directors first exercise "reasonable care" to satisfy themselves that the persons providing the information are reliable. IOWA CODE § 490.830(2) (2001). While there are no Iowa cases on point, the Delaware Supreme Court has stated that the director's obligations in this regard should be evaluated under a gross negligence standard. *See, e.g.*, Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) ("[U]nder the business judgment rule director liability is predicated upon concepts of gross negligence."). To the extent that reliance on others is an inevitable reality in large corporations in which the board necessarily delegates most of its management functions, such deference may be appropriate.

85. *See* Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099-1100 (1968) (concluding that almost no reported cases impose liability on directors for failure to exercise reasonable care where the directors' conduct is untainted by self-dealing).

duty of care and the business judgment rule is notoriously imprecise.[86] Perhaps more troubling, from an Iowa law perspective, is the absence of any significant case law treatment of the business judgment rule in Iowa. As will be explained, the sole modern Iowa Supreme Court decision purporting to apply the business judgment rule, *Hanrahan v. Kruidenier*,[87] departs in some important respects from the most widely accepted versions of the doctrine.

A. *Early Iowa Cases*

The earliest evidence of the business judgment rule in Iowa appears in decisions that do not invoke the rule by name. In 1936, for example, the Iowa Supreme Court stated in *Independent Order of Foresters v. Scott*:[88] "[S]tockholders will not be permitted to displace [officers' and directors'] corporate authority and control by substituting therefor the policy, and control of the courts, except in plain cases of such fraud or maladministration as works manifest oppression or wrong to them."[89] Eight years later, in *Wolf v. Lutheran Mutual Life Insurance Co.*,[90] the court refused to enjoin efforts to amend the articles of incorporation of an insurance company over the opposition of some of its members, stating that "courts [will not] control or interfere in the internal management or policy of a corporation except in cases of fraud, bad faith, breach of trust, gross mismanagement or ultra vires acts."[91] Finally, in *Natale v. Sisters of Mercy*,[92] the court refused to enjoin a hospital from revoking a physician's staff privileges, quoting with approval the following proposition from *Fletcher Cyclopedia of Private Corporations*:

> 'It is a well known rule of law that questions of policy of management are left solely to the honest decisions of officers and directors of a corporation, and the court is without authority to substitute its judgment for the judgment of the board of directors; the board is the business manager of the corporation, and as long as it acts in good faith its orders are not reviewable by the courts.'[93]

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86. *See* Robert W. Hamilton, *Reliance and Liability Standards for Outside Directors*, 24 WAKE FOREST L. REV. 5, 22-23 (1989).
87. Hanrahan v. Kruidenier, 473 N.W.2d 184 (Iowa 1991).
88. Indep. Order of Foresters v. Scott, 272 N.W. 68 (Iowa 1936).
89. *Id.* at 74. The statement is dicta, however, because the court immediately thereafter describes it as "a correct abstract statement of law which has no application to the situation here." *Id.*
90. Wolf v. Lutheran Mut. Life Ins. Co., 18 N.W.2d 804 (Iowa 1945).
91. *Id.* at 809.
92. Natale v. Sisters of Mercy, 52 N.W.2d 701 (Iowa 1952).
93. *Id.* at 709 (quoting 2 FLETCHER CYCLOPEDIA OF PRIVATE CORP. § 505).

All of these statements by the Iowa Supreme Court reflect judicial deference to business decisions by corporate directors. This deference is the heart of the business judgment rule. It is the reason many contend that, despite statutory reasonable care standards, a director is not subject to liability for mere failure to exercise reasonable care. But if reasonable care is not the measure of director liability, what is? It is difficult to tell from the language used above. Indeed, the American Law Institute's characterization of American decisions applying the business judgment rule fits these Iowa cases fairly well: "Confusion with respect to the business judgment rule has been created by the numerous varying formulations of the rule and the fact that courts have often stated the rule incompletely or with elliptical shorthand references."[94]

B. *Contemporary American Standards*

Debate continues about what type or level of judicial review the business judgment rule entails and whether a business judgment rule of any sort can be articulated.[95] Nonetheless, modern American decisions, including some Iowa cases, reflect several common denominators that are generally considered to constitute the business judgment rule applicable to corporate directors today.

1. *The Director Action Requirement*

Courts generally hold that the business judgment rule protects only decisions or other actions taken by a director.[96] Put differently, the rule does not protect the director from claims based on inattention to duty. Thus, a director who has failed to monitor and oversee subordinate managers, resulting in losses to the corporation, cannot invoke the protections of the business judgment rule.[97] Such a failure, one might argue, is a breach of the director's substantive duty to manage the corporation, not a breach of the duty to manage with requisite care.

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94. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c) cmt. a, at 178.

95. *See generally* FRANKLIN A. GEVURTZ, CORPORATION LAW § 4.1.2 (2000) (stating that the drafters of the 1984 revision of the Model Business Corporation Act wanted to include the rule but could not properly define it).

96. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c) & cmt. c, at 139, 174 (commenting that the director "who makes a business judgment" fulfills the duty of care if certain requirements are satisfied); *see also* Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984) ("[T]he business judgment rule operates only in the context of director action."), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

97. *See, e.g.*, Francis v. United Jersey Bank, 432 A.2d 814, 822 (N.J. 1981) (stating that directors have a duty to maintain familiarity with business operations).

The Iowa Supreme Court's imposition of liability on certain director defendants in *Rowen* can be understood as an application of this principle.[98] Although the court did not expressly require director action as a prerequisite of the business judgment rule, it did hold the outside directors of Le Mars liable for what amounted to nonfeasance.[99] The court stated that these particular defendants "failed to discharge their duties as directors when even the most ordinary diligence on their part would have prevented the surrender of their corporation to Iowa Mutual."[100]

This action versus inaction distinction provides guidance in understanding the business judgment rule, but it should be applied with caution. As noted by both courts and commentators, the line between a director's neglect of duty and a conscious decision by the director to take no action is imprecise at best.[101]

2. *The Good Faith Requirement*

Courts also generally hold the business judgment rule applies only when the director acts in "good faith."[102] What constitutes good faith is subject to debate, of course, but it is generally understood as an honest intention on the part of the director to act in the corporation's best interests.[103] The older Iowa cases all included this requirement,[104] and it clearly remains a predicate for business judgment rule protection in Iowa.[105]

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98. Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639 (Iowa 1979); *see supra* Part III.A.3.

99. Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d at 654.

100. *Id.*

101. *See* Aronson v. Lewis, 473 A.2d at 813 ("[U]nder applicable principles, a conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment."); *see also* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c) cmt. c, at 175 ("[W]hether there has been a conscious decision or inexcusable inattentiveness may, at times, not be readily discernible and may present close evidentiary questions."); Manning, *supra* note 4, at 1485-86 ("In the long run, any workable formulation of the director's standard of attention must take into account the setting of the board's work agenda, and in so doing: 'must recognize that the protection of the principle of the business judgment rule must have equal application to things not done by the board as well as to things done by the board . . . .'").

102. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c) cmt. c, at 139, 174 (director who "makes a business judgment in good faith" fulfills the duty of care if certain requirements are satisfied); *see also* Aronson v. Lewis, 473 A.2d at 812.

103. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(a), (c) & cmt. d, at 138-39. One can also draw this inference from IBCA § 490.830(3), which provides that a director "is not acting in good faith if the director has knowledge concerning the matter in question that makes reliance . . . unwarranted." IOWA CODE § 490.830(3) (2001).

104. *See supra* Part IV.A.

105. *See* Hanrahan v. Kruidenier, 473 N.W.2d 184, 186 (Iowa 1991); *see also* Davies v. Dooley, No. 00-0639, 2001 WL 539609, at *7 (Iowa Ct. App. May 23, 2001).

3. *The Disinterest Requirement*

Courts likewise refuse to apply the business judgment rule when the director's conduct advances the director's own self-interest or the interest of any party *other than* the corporation.[106] Such situations involve a potential violation of the director's duty of loyalty, making deferential review of the director's conduct under business judgment rule standards inappropriate.[107] The Iowa courts have repeatedly invoked this predicate to business judgment rule protection, declining to apply the rule when the plaintiff alleges violations of the director's duty of loyalty.[108]

4. *Other Requirements for Business Judgment Rule Protection*

So far this Article has identified at least three requirements for application of the business judgment rule: the director must have made (1) a business judgment, (2) in good faith, and (3) without conflict of interest. What more does the law require? Here, the decisions of the courts diverge, but one can identify at least three patterns in the cases.

a. *The Business Judgment Rule Requires Nothing More.* One view is that the business judgment rule requires nothing more of directors. In other words, when the foregoing predicates are established, the business judgment rule requires a conclusion that the director has discharged the duty of care.[109] The older Iowa cases quoted in Part IV.A perhaps come close to this version of the business judgment rule, but no modern Iowa decisions endorse it.

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106. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c)(1), (3), at 139 (providing that the business judgment rule protects a director who "is not interested in the subject of the business judgment" and who "rationally believes that the business judgment is in the best interests of the corporation").

107. As will be explained in Part V, when a director's compliance with the duty of loyalty is in issue, the director is generally required to establish the fairness of the director's conduct to the interests of the corporation.

108. *See* Cookies Food Prods., Inc. v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 447, 453 (Iowa 1988) ("[T]he business judgment rule governs only where a director is shown not to have a self-interest in the transaction at issue."); Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709, 715-16 (Iowa 1983) ("[I]t would not be possible for the business judgment rule to be invoked at the instance of a board of directors if the majority of the board are alleged to be involved in the self-dealing."); *see also* Davies v. Dooley, 2001 WL 539609, at *7.

109. See GEVURTZ, *supra* note 95, § 4.1.2(c), at 282-84, for a discussion of *Kamin v. American Express Co.*, 383 N.Y.S.2d 807, 815 (Sup. Ct. 1976), in which the court's review of a challenged business decision focused on the subjective motivations for the decision, rather than on the objective reasonableness of the judgment. Under this interpretation, "the result of the business judgment rule is to effectively abolish the duty of care for any situation in which the plaintiff challenges an action by the board." GEVURTZ, *supra* note 95, § 4.1.2(c), at 284.

b. *The Business Judgment Rule Requires a Gross Negligence or Recklessness Standard.* Other courts seem to apply the business judgment rule as a gross negligence or similarly liberal liability standard. Under this version of the business judgment rule, if the foregoing predicates are satisfied, plaintiffs cannot prevail unless they establish more than a reasonable care violation on the part of the director.[110] The plaintiff must show gross negligence by the director or other conduct that approaches recklessness.[111] Iowa cases provide no direct support for application of the business judgment rule as a gross negligence or recklessness standard.

c. *The Business Judgment Rule Requires a Process-Based Standard of Review.* Perhaps the most widely accepted version of the business judgment rule, that endorsed by the American Law Institute in its *Principles of Corporate Governance*, confines judicial review of director decisions primarily to matters of process rather than substance.[112] Under this view, the business judgment rule will protect directors once the predicates listed above are established, but only if the directors followed an adequate decisional process before taking the challenged action.

Section 4.01(c) of the *Principles of Corporate Governance* states the requirements for business judgment rule protection under the process-based approach.[113] A director satisfies the duty of care when the director makes a "business judgment in good faith" and "is not interested in the subject of the business judgment" so long as the director: (1) "is informed with respect to the subject of the business judgment to the extent the director . . . reasonably believes to be appropriate under the circumstances;" and (2) "rationally believes that the business judgment is in the best interests of the corporation."[114] The business judgment rule applied in Delaware has been described in similar terms.[115] In

110. *See id.* § 4.1.2(d), at 285-86 (stating that "gross negligence entails some worse level of dereliction than ordinary negligence").

111. *Id.* § 4.1.2(d), at 284 (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

112. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c), at 139.

113. *Id.*

114. *Id.*

115. *See, e.g.*, Samuel Arsht, *Fiduciary Responsibilities of Directors, Officers and Key Employees*, 4 DEL. J. CORP. L. 652, 660 (1979).

> [T]he Business Judgment Rule is that a transaction which involves . . . no personal interest of the directors will not be enjoined for misconduct of directors, and the directors who authorize such transactions will not be held personally liable for resultant damages unless the record discloses at least one of three circumstances or conditions: (1) that the directors did not exercise due care to ascertain the relevance of the available facts before voting to authorize the transaction; or (2) that the directors voted to authorize the transaction even though they could not have reasonably believed the transaction to be for the best interest of the corporation; or

essence, this version of the business judgment rule protects directors from liability so long as their decisional processes are worthy of respect from both objective and subjective perspectives.

The requirement that the director be informed when making a business judgment is primarily an objective standard. It is perhaps best illustrated by the Delaware Supreme Court's famous, or infamous, decision in *Smith v. Van Gorkom*.[116] The *Van Gorkom* court held the directors were not protected by the business judgment rule when they approved a merger transaction at a two hour meeting, following a twenty minute oral presentation by the company's chief executive officer, and without reading the merger agreement or inquiring into the basis for the merger price.[117] The court reasoned that although the directors acted in good faith, without conflict of interest, and in an effort to further a valid corporate objective, the business judgment rule did not apply because the directors were not adequately informed.[118]

The further requirement that the director "rationally believe" that the action taken "is in the best interests of the corporation" is primarily a subjective standard.[119] It overlaps considerably with the business judgment rule's predicate requirements of good faith and lack of conflict of interest on the part of the director. But something more is required. While directors are free to determine whether a proposed course of action furthers corporate interests, their beliefs in that regard must be at least rational. Thus, the court's review of the merits of any director decision remains one step removed from the substance of the decision itself. It should be focused on the director's "rational belief," vel non, with respect to the merits of that decision, thus leaving the director significant latitude in determining the appropriateness of a proposed course of action.[120]

The New York case, *Litwin v. Allen*,[121] is often cited as an example of this outer limit constraint on director behavior.[122] The *Litwin* court found the directors liable for approval of a debenture agreement that appeared to expose the corporation to excessive risks without any offsetting reward—a decision

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(3) that in some other way the directors' authorization of the transaction was not in good faith.

Id.

116. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

117. *Id.* at 868-69, 874.

118. *Id.* at 875-76.

119. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c) & cmt. f, at 139, 179.

120. *Id.*

121. Litwin v. Allen, 25 N.Y.S.2d 667 (Sup. Ct. 1940).

122. GEVURTZ, *supra* note 95, § 4.1.2 (b), at 286 ("[T]o put the matter crudely, the court thought this was an extraordinarily stupid agreement for the board to make.").

approaching irrationality.[123] The fact that such decisions are quite rare confirms that courts generally defer to directors on the issue of rational business purpose.[124]

Procedurally, the process-oriented business judgment rule is often described as a presumption that the director has discharged the duty of care.[125] As used here, the "presumption" label does not entail special evidentiary standards, but simply means that the plaintiff bears the burden of establishing that one of the predicates for business judgment rule protection is missing—bad faith, conflict of interest, inadequate information, no rational business purpose.[126] If the plaintiff persuades the court that the business judgment rule is unavailable, the director can avoid liability only by proving that the director's conduct was fair to the corporation—a burden of proof generally applied when the director's compliance with the duty of loyalty is in issue.[127]

C. *Contemporary Iowa Standards: The* Hanrahan *Decision*

The best indication of where Iowa falls along the foregoing spectrum of standards comes from the Iowa Supreme Court's application of the business judgment rule in *Hanrahan v. Kruidenier*.[128] Indeed, *Hanrahan* is virtually the only modern decision that purports to apply Iowa business judgment rule standards of review to director action.[129]

The director decisions at issue in *Hanrahan* were made in connection with the liquidation of the corporation that sold the *Des Moines Register* to a new

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123. Litwin v. Allen, 25 N.Y.S.2d. at 737. Some scholars argue that the decision challenged in *Litwin* was a sound one, and that the court failed to grasp that fact. *See* Patricia A. McCoy, *The Notional Business Judgment Rule in Banking*, 44 CATH. U. L. REV. 1031, 1038-40 (1995) (challenging the soundness of *Litwin* on its facts).

124. *See infra* Part V.A.

125. *See, e.g.*, Grobow v. Perot, 539 A.2d 180, 187 (Del. 1988), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

126. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(d), at 139 (stating that in order to challenge a director's conduct a complainant must prove a breach of the duty of care).

127. For example, when the court in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), determined that the business judgment rule did not protect directors who approved a merger transaction, the court remanded the case for trial on the issue of whether the corporation's shareholders had received a fair price for their shares in the merger. *Id.* at 893.

128. Hanrahan v. Kruidenier, 473 N.W.2d 184 (Iowa 1991).

129. *See id. Cf.* Whalen v. Connelly, 593 N.W.2d 147, 153-54 (Iowa 1999) (applying the business judgment rule as defined by Delaware law in the context of a dispute involving a limited partnership organized in Delaware operating in Iowa); Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709, 711-13 (Iowa 1983) (noting the existence of the business judgment rule but not directly applying it; addressing instead the power of corporate directors to appoint special litigation committees).

owner.[130] The complaining shareholders objected to the board's approval of various charitable donations of corporate property and to an employee compensation plan the board implemented to retain certain employees during the transition.[131] The directors claimed that the business judgment rule protected both of these decisions.[132]

The Iowa Supreme Court concluded that the business judgment rule protected the charitable donations, but did not apply to the directors' adoption of the employee compensation plan because it involved potential conflicts of interest on the part of certain directors.[133] This latter conclusion by the *Hanrahan* court was unquestionably correct. Indeed, the court's holding in this regard is consistent with one of the generally accepted predicate requirements for application of the business judgment rule—the director must not be interested in the subject of the business judgment.[134] Interested directors bear the burden of proving their conduct was fair to the corporation—a burden the *Hanrahan* court held was satisfied by the directors affected by the compensation plan.[135]

More troubling is the *Hanrahan* court's characterization of the business judgment rule itself, which the court held protected the directors' corporate donation decisions: "The business judgment rule, universally applied as a part of corporate law, has long been codified in Iowa. *It now appears in Iowa Code section 490.830 (1991)*."[136] According to the court, this statute "sets precise metes and bounds for judicial interference."[137]

Recall that IBCA section 490.830 requires that a director discharge the director's duties: (1) "[i]n good faith;" (2) "[i]n a manner the director reasonably believes to be in the best interests of the corporation;" and (3) "[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances."[138] There is little difficulty in reconciling the business judgment

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130. Hanrahan v. Kruidenier, 473 N.W.2d at 185-86.

131. *Id.* at 186-88.

132. *Id.* at 186.

133. *Id.* at 187-88.

134. *See supra* Part IV.B.3.

135. *See* Hanrahan v. Kruidenier, 473 N.W.2d at 188. The *Hanrahan* court imposed this burden only on the directors who were interested in the compensation plan. *Id.* The remaining directors were protected by the business judgment rule. *Id.* at 188 n.5. Because the interested directors proved that the compensation plan was fair, the court did not reach the issue of what burdens of proof, if any, applied to the remaining directors. *Id.*

136. *Id.* at 186 (emphasis added). The statement is, in fact, dicta, because the corporation at issue in *Hanrahan* was governed by IOWA CODE ch. 496—the predecessor to the IBCA. *Id.* at 186 n.3. The court made a similar statement in *Miller v. Register & Tribune Syndicate, Inc.*, 336 N.W.2d 709 (Iowa 1983): "In its broad sense, [the business judgment rule] merely establishes a standard of care to which directors are held in corporate decision making." *Id.* at 712.

137. Hanrahan v. Kruidenier, 473 N.W.2d at 186.

138. IOWA CODE § 490.830(1) (2001).

rule with the first and second of these three elements, but the third raises some important questions.

As to the first, courts universally agree that business judgment rule protection is unavailable when a director's conduct evidences bad faith such as a dishonest or pretextual motive.[139] As to the second, courts likewise agree that there is no business judgment rule protection for a director whose conduct advances his own self-interest rather than that of the corporation.[140] The second element of IBCA section 490.830 goes a bit further than this, requiring that directors "reasonably believe" their conduct to be in the corporation's best interests.[141] However, the process-oriented versions of the business judgment rule include a similar requirement: Directors must "rationally believe" their conduct to be in the corporation's best interest before the business judgment rule will apply.[142]

The prong of IBCA section 490.830 that potentially conflicts with the business judgment rule is its requirement that the director act "[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances."[143] The *Hanrahan* court apparently read this part of the statute to mean that a director decision must be "reasonably prudent" before the business judgment rule will protect it.[144] Does this mean the business judgment rule applies to a director decision in Iowa only if the court finds the decision substantively reasonable?

It is difficult to tell from the *Hanrahan* decision. The court concluded that the business judgment rule protected the charitable donations approved by the board, but did so only after reviewing the directors' justifications for approving the donations and finding them to be persuasive.[145] Thus, apparently the court concluded that the plaintiffs had failed to establish that the challenged gifts were unreasonable.[146] If this view of the case is correct, then the Iowa business judgment rule does not prevent a court from evaluating the substance of any

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139. *See supra* Part IV.B.2.

140. *See supra* Part IV.B.3.

141. IOWA CODE § 490.830(1)(c).

142. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c), at 139. While a reasonable belief standard suggests more stringent requirements than a rational belief standard, there is likely no difference in practice. As explained in Part V.A, there is little evidence in the case law that any American courts second-guess directors on the issue of how to define the corporation's best interests.

143. IOWA CODE § 490.830(1).

144. Hanrahan v. Kruidenier, 473 N.W.2d 184, 186 (Iowa 1991) ("When directors act in good faith in making a business decision, *when the decision is reasonably prudent*, and when the directors believe it to be in the corporate interest, there can be no liability.") (emphasis added).

145. *Id.* at 186-88.

146. *See id.*

director's decision that may later be challenged as unreasonable.[147] The plaintiff merely bears the burden of proving it unreasonable in that regard.

Perhaps the *Hanrahan* court did not intend this result. Indeed, the court acknowledged that the business judgment rule prevents courts from second-guessing directors' decisions.[148] But if Iowa's version of the business judgment rule is to accomplish that objective, courts should not review directors' decisions for substantive reasonableness. Instead, courts can better accommodate the ordinarily prudent person requirement of section 490.830 and the business judgment rule by treating that requirement as applicable only to *the process* by which a director makes a decision. Recall that this is the approach to the business judgment rule proposed by the American Law Institute and applied in leading corporate law jurisdictions such as Delaware.[149]

Under a process-oriented version of the business judgment rule, the *Hanrahan* court appropriately determined that the directors approved the challenged corporate donations in good faith and with the best interests of the corporation in mind.[150] But the court should then have limited its inquiry to whether the directors, when making the decisions, were properly "informed."[151] So long as the directors decided the matter based upon adequate information, the business judgment rule would then protect their decision.[152] While the outcome of the case would likely have been the same as under the *Hanrahan* court's approach, a more limited inquiry would have better accommodated the management prerogatives of the defendant directors.

Nothing in IBCA section 490.830, which the *Hanrahan* court characterized as a "codification" of the business judgment rule,[153] necessarily forecloses

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147. The Iowa Court of Appeals recently so characterized the business judgment rule, citing *Hanrahan*. *See* Davies v. Dooley, No. 00-0639, 2001 WL 539609, at *6 (Iowa Ct. App. May 23, 2001) ("If directors act in good faith in making a business decision, and the decision is reasonably prudent, and the directors believe it to be in the corporate interest, there can be no liability.").

148. Hanrahan v. Kruidenier, 473 N.W.2d at 186 ("The purpose of the rule is to severely limit second-guessing of business decisions which have been made by those whom the corporation has chosen to make them."). While the court might have been more expansive concerning these policy goals, *see, e.g.*, Joy v. North, 692 F.2d 880 (2d Cir. 1982), few would quarrel with this statement.

149. *See supra* Part IV.B.4.c.

150. Hanrahan v. Kruidenier, 473 N.W.2d at 189.

151. *See supra* Part IV.B.4.c. There is a line of cases in Delaware and in other jurisdictions that subjects charitable donation decisions to a reasonableness review on the theory that such gifts may be inconsistent with the corporate profit objective. *See, e.g.*, Theodora Holding Corp. v. Henderson, 257 A.2d 398, 405 (Del. Ch. 1969). However, the *Hanrahan* court did not purport to be following such precedents. Hanrahan v. Kruidenier, 473 N.W.2d at 189.

152. *See supra* Part IV.B.4.c.

153. Hanrahan v. Kruidenier, 472 N.W.2d at 186.

judicial development of the Iowa business judgment rule along the lines recommended above.[154] Indeed, the drafters of the Model Business Corporation Act expressly caution that section 490.830 was not intended to foreclose deferential standards of judicial review under the business judgment rule.[155] Thus, if the Iowa Supreme Court wants to treat section 490.830 as a codification of the business judgment rule,[156] the court should read the statute to require a decision-making *process* worthy of judicial respect rather than substantively reasonable decisions. So construed, an Iowa director would be immune from liability for decisions made honestly, with a view towards advancing the corporation's best interests, and on the basis of adequate information. The Iowa business judgment rule would then be equivalent to its counterparts in leading corporate law jurisdictions.

It remains to be seen whether the Iowa Supreme Court will further develop its business judgment rule jurisprudence along these lines. If the court does not, the legislature may do it for them. As of this writing, the Iowa legislature is considering proposed amendments to the IBCA that would incorporate many recent changes to the Model Business Corporation Act.[157] While not codifying the business judgment rule as such, the proposed amendments include Model Act section 8.31, which uses tests similar to those proposed above as the measure of director liability for business judgments.[158]

D. *The Director's Duty of Care and the Business Judgment Rule: Special Situations*

One of the reasons the business judgment rule has been the product of judicial development rather than statutory formulation is that the concept must be sufficiently malleable to accommodate a wide variety of circumstances. Several

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154. IOWA CODE § 490.830 (1991).

155. The official comment to § 8.30 of the Model Business Corporation Act states: "The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts." MODEL BUS. CORP. ACT ANN. § 8.30 cmt. (Supp. 1998/99). In view of that continuing judicial development, § 490.830 "does not try to codify the business judgment rule or to delineate the differences between that defensive rule and the section's standards of director conduct" set forth in § 490.830. *Id.* That is a task left to the courts and possibly to later revisions of this Model Act.

156. *See* Hanrahan v. Kruidenier, 473 N.W.2d at 186 (noting the business judgment rule is codified at IOWA CODE § 490.830 (1991)).

157. *See* S.S.B. 3163 § 37, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (adding new Iowa Code § 490.831 tracking Model Business Corporation Act § 8.31 language); H.S.B. 682 § 37, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (adding new Iowa Code § 490.831 tracking Model Business Corporation Act § 8.31 language); *see also* For Profit Corporation Report, *supra* note 72, at 6-7.

158. *See* MODEL BUS. CORP. ACT ANN. § 8.31 cmt.

special situations in which directors may attempt to invoke the rule therefore deserve special comment.

1. *Ultra Vires Transactions; Illegal Transactions; Corporate Waste*

Courts have often stated that the business judgment rule does not protect actions of directors that are ultra vires—acts that exceed the powers of the corporation.[159] Some courts similarly withhold business judgment rule protection from decisions of directors that constitute knowing violations of law.[160] Finally, it is sometimes said that the business judgment rule does not protect a transaction approved by directors that can be characterized as a "no-win deal," irrational, or a waste of corporate assets.[161] How can one reconcile such positions with a version of the business judgment rule that concerns itself with the process rather than the merits of director decisions?

Perhaps the best answer is that one must view such business judgment rule exceptions as specific applications of the rule's prerequisites that directors must act in good faith and with a reasonable, or at least rational, belief that their actions advance the best interests of the corporation. While these good faith tests may well be subjective standards,[162] they require that directors act with some minimal level of rationality insofar as corporate welfare is concerned. When directors disregard express limits on corporate powers, knowingly violate the law, or "'authorize an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration,'"[163] there is concrete evidence of bad faith.[164] It could

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159. *See, e.g.*, Wolf v. Lutheran Mut. Life Ins. Co., 18 N.W.2d 804, 809 (Iowa 1945) (noting this exception but finding it inapplicable to the facts presented).

160. *See, e.g.*, Miller v. Am. Tel. & Tel. Co., 507 F.2d 759, 762 (3d Cir. 1974) (stating that the business judgment rule does not apply to illegal acts).

161. *Litwin v. Allen*, 25 N.Y.S.2d 667 (Sup. Ct. 1940), discussed in Part IV.B.4.c, has been so characterized. *See* Jay v. North, 692 F.2d 880, 886 (2d Cir. 1982) (citing *Litwin* for the proposition that "no-win decisions" fall outside the scope of the business judgment rule).

162. *See* MODEL BUS. CORP. ACT ANN. § 8.51 cmt. (characterizing the MBCA's good faith requirements as subjective); *see also* Davies v. Dooley, No. 00-0639, 2001 WL 539609, at *6 (Iowa Ct. App. May 23, 2001) (characterizing the requirement that a director act in a manner he reasonably believes to be in the best interests of the corporation as a subjective standard).

163. The quoted phrase is the one Delaware courts used to identify corporate waste. *In re* Walt Disney Co. Derivative Litig., 731 A.2d 342, 362 (Del. Ch. 1998) (quoting Glazer v. Zapat Corp., 658 A.2d 176, 183 (Del. Ch. 1993), *aff'd in part, rev'd in part sub nom.*, Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (identifying corporate waste).

164. *See, e.g.*, Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 129-30 (1979) ("Bad faith may preclude application of the business judgment defense where directors knowingly violate a statute or comparable expression of public policy, even if such a violation is undertaken in the corporation's best interests."); *see also, e.g.*, *In re* RJR Nabisco, Inc. Shareholders Litig., 1989 WL 7036, at *22 n.13 ("As I conceptualize the matter, such limited

also be said that no director could reasonably believe such action to be in the corporation's best interests.[165] In any event, interpreting the business judgment rule to forbid the narrow categories of conduct listed above at best minimally intrudes into a director's discretion.

2. *Demand Futility in Derivative Litigation and Disposition of Litigation by Special Committees*

An inherent conflict of interest is present for directors who are asserted to be liable to the corporation in derivative litigation. Because of their personal liability exposure in such cases, the business judgment rule arguably has no application to any management decisions directors make respecting the corporation's claims against them. On the other hand, the corporation is the real party in interest in derivative litigation, and whether the corporation should seek to enforce a derivative claim is arguably a business decision best left to corporate management. Not surprisingly, then, the courts must strike a delicate balance when applying the business judgment rule in this context. With one notable Iowa exception,[166] most of the pertinent case law has arisen in Delaware and is summarized here only briefly.

a. *Demand Futility.* Corporate law generally requires a plaintiff shareholder to make demand for action by the board of directors before filing a derivative suit.[167] Derivative plaintiffs who make demands on the board of directors do so at their peril, however. Some courts treat the demand as an acknowledgment by plaintiff that the board is disinterested and independent, and that the board may therefore properly exercise its business judgment concerning

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substantive review as the [business judgment] rule contemplates (i.e., is the judgment under review 'egregious' or 'irrational' or 'so beyond reason,' etc.) really is a way of inferring bad faith.").

165. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 4.01(c) cmt. f, at 180. The comment quoted the following summary of Delaware case law from S. Samuel Arsht & Joseph Hinsey IV, *Codified Standard—Same Harbor but Charted Channel: A Response*, 35 BUS. LAW. 947, 959 (1980):

> [A] court will interfere with the discretion vested in the board of directors upon a finding that the judgment of the directors was arbitrary, resulted from a reckless disregard of the corporation's and its stockholders' best interests, or is simply so removed from the realm of reason that it cannot be sustained.

Id.

166. *See* Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709 (Iowa 1983).

167. For example, IBCA § 490.740(2) requires that a complaint in a derivative suit "allege with particularity the demand made, if any, to obtain action by the board of directors and either that the demand was refused or ignored or why the complainant did not make the demand." IOWA CODE § 490.740(2) (2001).

the derivative claim, including settling or dismissing it.[168] To avoid this risk, most derivative plaintiffs contend that because the claim they bring alleges wrongdoing on the part of one or more of the directors who would respond to the demand, demand need not be made.[169] In other words, plaintiffs contend that demand is excused as "futile" because the claim is not a subject upon which the directors are qualified to exercise their business judgment.[170]

But how is the court to determine whether this is true? Should demand be excused as futile whenever the plaintiff names a majority of the corporation's directors as defendants in the derivative suit? If so, it would be fairly easy to skirt the demand requirement by creative pleading. Should futility hinge on whether the plaintiff alleges that a majority of directors approved the transaction that is the subject of the derivative claim? Or should the plaintiff be required to plead more serious improprieties on the part of directors?[171] The Iowa Supreme Court has not addressed these questions in any detail. In two decisions, both involving allegations that the defendant directors engaged in self-dealing and similarly improper conduct, the court concluded that demand was excused as "a vain and useless thing."[172] Whether demand would have been excused in the face of less serious allegations is unclear.

To the extent the Iowa courts look to Delaware for guidance on these issues, they will find that the test for demand futility applied there is generally difficult for the derivative plaintiff to satisfy. A Delaware court is required to determine whether the "particularized facts" alleged in plaintiff's petition create a reasonable doubt that a majority of the corporation's directors: (1) are not disinterested and independent with respect to the derivative claim, or (2) did not validly exercise their business judgment in approving the challenged transaction.[173] One set of commentators summarizes this test as follows:

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168. This is the rule in Delaware. *See* Spiegel v. Buntrock, 571 A.2d 767, 775-77 (Del. 1990) ("The effect of a demand is to place control of the derivative litigation in the hands of the board of directors."). As a result, the grounds upon which a Delaware derivative plaintiff may challenge the board's refusal of demand are quite limited. *Id.* at 777; *see also* Whalen v. Connelly, 593 N.W.2d 147, 153-56 (Iowa 1999) (discussing the application of this rule to an Iowa limited partner's derivative claims against the general partner of a Delaware limited partnership).

169. *See, e.g.*, Spiegel v. Buntrock, 571 A.2d at 769, 774 (claiming that demand to the board "would have been a futile gesture").

170. *See* John C. Coffee, Jr., *New Myths and Old Realities: The American Law Institute Faces the Derivative Action*, 48 BUS. LAW. 1407, 1414 (1993).

171. *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 814-15 (Del. 1984) (formulating a "more balanced" test for demand futility), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000); *see also* MODEL BUS. CORP. ACT § 7.44 (Supp. 1998/99) (proposing statutory standards that address this issue).

172. Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517, 523 (Iowa 1974); Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d 174, 217 (Iowa 1952).

173. Aronson v. Lewis, 473 A.2d at 814.

> [D]emand will almost always be required unless a majority of the Board is so directly self-interested in the challenged transaction that there is serious doubt that the business judgment rule would protect that transaction. Self-interest, for these purposes, is defined in terms of direct financial interest in the challenged transaction: the fact that a majority of directors voted to approve the transaction—and are therefore named as defendants in the action—does not constitute the requisite self-interest and will not excuse demand.[174]

The two reported Iowa cases that have excused demand as futile would apparently have satisfied these high standards.[175] It remains to be seen, however, whether the Iowa Supreme Court will limit the demand futility category in this manner in the future. At least some doubt exists on this score, given that the court in *Miller v. Register & Tribune Syndicate, Inc.*[176] pointedly refused to adopt the Delaware approach on a related question concerning special litigation committees.[177]

b. *Special Litigation Committees*. The special litigation committee device emerged as a potent weapon against derivative litigation in the mid-1970s.[178] In its most common form, a special litigation committee consists of directors who are not named as defendants in the subject derivative claim or who otherwise

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174. Dennis J. Block & H. Adam Prussin, *Termination of Derivative Suits Against Directors on Business Judgment Grounds: From* Zapata *to* Aronson, 39 BUS. LAW. 1503, 1505-06 (1984).

175. *See* Holi-Rest, Inc. v. Treloar, 217 N.W.2d at 523; Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d at 217.

176. Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709 (Iowa 1983).

177. *Id.* at 712, 714. As of this writing, the Iowa legislature is considering proposals for the 2002 legislative session that would expand the IBCA's regulation of derivative litigation. *See* S.S.B. 3163 §§ 23-30, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (adding several sections that increase IBCA regulation of derivative suits); H.S.B. 682 §§ 23-30, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (adding several sections that increase IBCA regulation of derivative suits); *see also* For Profit Corporation Report, *supra* note 72, at 2-4 (proposing adoption of MODEL BUS. CORP. ACT §§ 7.41-.44 (Supp. 1998/99)). These proposals include a so-called universal demand requirement that applies in all derivative cases, without any futility exception. *See* S.S.B. 3163 § 25; H.S.B. 682 § 25. The proposals would allow a derivative plaintiff to attack a board or a board committee's decision to reject the demand, but only on limited grounds. S.S.B. 3163 § 27; H.S.B. 682 § 27. The plaintiff would be required to allege with particularity facts establishing either that the board or board committee that rejected the demand was not independent or that the rejection was not made in good faith after reasonable inquiry. S.S.B. 3163 § 27; H.S.B. 682 § 27. Generally speaking, these grounds are the same ones that the courts have identified as pertinent to inquiries by special litigation committees.

178. Richard C. Brown, *Shareholder Derivative Litigation and the Special Litigation Committee*, 43 U. PITT. L. REV. 601, 616 (1982).

face no serious risk of liability in the litigation: that is, nominal defendants.[179] The board of directors empowers the committee to investigate the asserted claim, and to refuse demand or continue the lawsuit in a case where demand is not excused as futile, or to dismiss, settle, or continue the lawsuit in the corporation's best interests, in a case where demand is excused as futile.[180] Supporters of this device reason that statutory corporate law confers broad managerial power on corporate directors, including the power "to initiate, or to refrain from entering, litigation."[181] Critics contend that special litigation committees improperly short-circuit the derivative remedy because such committees almost always recommend that demand be refused or, in a demand-excused case, that the suit be dropped or settled for nominal consideration.[182]

The business judgment rule is implicated when a court is asked to approve or withhold approval of a special litigation committee's disposition of the corporation's claims in derivative litigation.[183] As summarized by the Iowa Supreme Court in *Miller*:

> Elements commonly required to be shown in the use of the business judgment rule in derivative actions include: (1) whether the special litigation committee appointed by the board of directors is endowed with the requisite corporate power to bind the corporation to its recommendation of dismissal; and (2) whether it has been demonstrated that the special litigation committee was disinterested, independent, acted in good faith, and that the bases for its conclusions were sufficient based upon reasonable investigative techniques.[184]

Miller involved only the first of these issues and adopted a somewhat unique position concerning the power of a board of directors to appoint special litigation committees.[185]

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179. *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 781 (Del. 1981) (noting Zapata formed an "Independent Investigation Committee" composed of two recently-hired directors who were not defendants in the derivative action).

180. *See* Brown, *supra* note 178, at 601.

181. *See, e.g.*, Zapata Corp. v. Maldonado, 430 A.2d at 782 (noting "[d]irectors of Delaware corporations derive their managerial decision making power" from Delaware statutory law).

182. *See* George W. Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U. L. REV. 96, 105-09 (1980) (discussing how the use of special litigation committees by corporations may bring about "the demise of the derivative suit"); *see also* Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d at 716 (discussing criticisms of special litigation committees).

183. Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d at 711-12.

184. *Id.* at 712.

185. *Id.*

Most courts that have considered the question allow the board of directors to delegate to a special litigation committee the board's power to exercise business judgment concerning derivative litigation, even when a majority of the board members who make the appointment are personally interested in its outcome.[186] The *Miller* court disagreed with this position, endorsing concerns expressed by many commentators that special litigation committee members are subject to "structural bias" influences, even if they have no personal stake in the litigation.[187] The court concurred with these commentators "that it is unrealistic to assume that the members of [special litigation] committees are free from personal, financial, or moral influences which flow from the directors who appoint them."[188]

The *Miller* court therefore adopted a "prophylactic rule" that "directors of Iowa corporations . . . may not confer upon a special committee . . . the power to bind the corporation as to its conduct of [derivative] litigation."[189] A board that wishes to invoke the special litigation committee device should instead, the court stated, "apply to the court for appointment of a 'special panel' to make an investigation and report on the pursuit or dismissal of a stockholder derivative action, which panel may be invested for these purposes with the powers of the board of directors."[190] Although no case has yet been presented, the Iowa Supreme Court would presumably review the recommendations of any such committee under deferential business judgment rule standards.[191]

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186. *See, e.g.*, Gall v. Exxon Corp., 418 F. Supp. 508, 519-20 (S.D.N.Y. 1976) (declining to consider the interests of special litigation committee members until after discovery); Zapata Corp. v. Maldonado, 430 A.2d at 786 ("We do not think that the interest taint of the board majority is per se a legal bar to the delegation of the board's power to an independent committee composed of disinterested board members.").

187. Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d at 716, 718.

188. *Id.* at 716.

189. *Id.* at 718. The court thereby answered in the negative the following question that was certified to it by the United States District Court for the Southern District of Iowa:

> Under the law of the State of Iowa, may the Board of Directors of a corporation . . . acting through directors who are named defendants in a derivative action brought by a minority shareholder on behalf of the corporation, (1) appoint a Special Litigation Committee composed of two directors who were not serving as directors at the time of the incidents in question, and (2) confer upon such committee the power to (a) investigate the merits of such derivative action, (b) determine in good faith whether, in its business judgment, the best interest of the corporation would be served by the prosecution, dismissal or settlement of such action, and (c) bind the corporation to its decision?

Id. at 711, 718.

190. *Id.* at 718.

191. *See id.* at 712 (discussing the standards of review that have been applied by the courts of New York and Delaware).

As of this writing, the Iowa legislature is considering proposals that add to the IBCA new statutory provisions relating to derivative actions.[192] These new provisions would reverse *Miller*'s ban on internally appointed special litigation committees but would permit judicial review of the committee's independence on specified grounds, as well as the good faith and adequacy of the committee's investigation.[193]

3. *Mergers, Takeovers, and Other Corporate Control Transactions*

Courts in some jurisdictions, most notably Delaware, have considerably refined the business judgment rule as it applies to director decisions pertaining to transfer of control of the corporation. A complete review of this jurisprudence is not possible here.[194] Suffice it to say that various special considerations have prompted refinement of the business judgment rule in this context. These considerations include, for example, the potential for conflicts of interest when directors approve measures to deter or resist hostile takeovers,[195] and directors' limited need for discretion once they have decided that the corporation is for sale.[196] When and if Iowa corporations litigate similar issues, one might plausibly expect the Iowa Supreme Court to follow Delaware's lead regarding application of the business judgment rule in these special contexts.

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192. *See supra* note 177.

193. *See* S.S.B. 3163 § 27, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (authorizing internal appointment of special litigation committees and providing grounds for judicial review of committee recommendations); H.S.B. 682 § 27, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (authorizing internal appointment of special litigation committees and providing grounds for judicial review of committee recommendations); *see also* For Profit Corporation Report, *supra* note 72, at 3-4 (proposing adoption of MODEL BUS. CORP. ACT § 7.44 (Supp. 1998/99)).

194. For an introductory "cook's tour" of the relevant Delaware case law as of the early 1990s, see John C. Coffee, Jr., *Defining 'Sale' Is Paramount Concern*, NAT'L L.J. Nov. 8, 1993, at 18.

195. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55 (Del. 1985) (mandating that when implementing poison pills or other devices that may deter hostile takeover bids, a Delaware corporation's board must demonstrate "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the defensive mechanism adopted was "reasonable in relation to the threat posed").

196. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985) (holding once the corporation is for sale or its breakup is inevitable, the duty of the board changes from "the preservation of [the] corporate entity to the maximization of the company's value at a sale for the stockholders' benefit").

V. THE IOWA DIRECTOR'S DUTY OF LOYALTY

A. *The Duty of Loyalty: The Basics*

Although there is no IBCA definition of a director's duty of loyalty, this aspect of the director's fiduciary obligation is captured in the command of section 490.830 that the director act in "good faith" and in a manner the director "reasonably believes to be in the best interests of the corporation."[197] Put otherwise, directors must always be honest in their dealings with the corporation[198] and cannot, while serving as directors, advance their own self-interests or the interests of any party *other than* the corporation.[199]

Like the director's duty of care, the duty of loyalty derives from fiduciary obligations long recognized in the law of agency.[200] Specifically, the duty reflects agents' obligation to "act solely for the benefit of the principal in all matters connected with [their] agency."[201] Justice Cardozo would add that the duty of loyalty reflects standards of honesty and good faith that are considerably more inflexible than "the morals of the market place."[202] As the Iowa Supreme Court summarized in *Des Moines Bank & Trust Co. v. George M. Bechtel & Co.*:[203]

> [Directors] occupy a fiduciary relation to the corporation on which relation the stockholders may rely. The corporate entity and the stockholders, in particular, may presume that these trustees will perform their duties with the diligence, honesty and the utmost good faith, inherent and implicit in their functions. They are not required to be ever on their guard and watchful lest those trustees misapply, destroy, embezzle, steal the corporate assets, or defraud them.[204]

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197. IOWA CODE § 490.830(1)(a), (c) (2001). Interestingly, while the IBCA nowhere specifically purports to define the duty of loyalty, it expressly prohibits a corporation from exculpating directors from any breach of the duty. *See id.* § 490.832.

198. *See* Hansell et al., *Duties, supra* note 4, at 691-92 ("The Iowa courts discussing a director's fiduciary obligation of loyalty to the corporation have focused on the director's obligation to act in the best interests of the corporation and its shareholders with respect to 'matters affecting the general well being of the corporation.'" (quoting Midwest Mgmt. Corp. v. Stephens, 353 N.W.2d 76, 80 (Iowa 1984))).

199. *Id.* at 692.

200. *See* RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

201. *Id.*

202. *See* Meinhard v. Salmon, 164 N.E. 545, 546-48 (N.Y. 1928). In contrast to the high standards of conduct required by the duty of loyalty, the marketplace generally condones any conduct in the interests of competition short of outright misrepresentation or fraud. *Id.*

203. Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d 174 (Iowa 1952).

204. *Id.* at 216.

One of the most important characteristics of the director's duty of loyalty is its sweeping breadth. The Iowa Supreme Court has characterized the duty as an open-ended principle requiring the director to act in the best interests of the corporation in all "'matters affecting [its] general well-being.'"[205] The duty of loyalty prohibits not only misappropriation of corporate assets,[206] but also more subtle misdeeds, like conflict of interest transactions,[207] competition with the corporation,[208] or taking a corporate business opportunity without the corporation's consent.[209] Indeed, the duty of loyalty may in some instances impose on the director a duty of disclosure to the corporation and its shareholders.[210] Perhaps Dean Robert Clark summarized it best when he wrote: "The overwhelming majority of particular rules, doctrines, and cases in corporate law are simply an explication of th[e] duty [of loyalty] or of the procedural rules and institutional arrangements involved in implementing it."[211]

Parts V.C through V.F explore the most important limitations that Iowa law imposes on a corporate directors as a result of their duty of loyalty to act in the best interests of the corporation. As a preliminary matter, one must define the corporation's interests for this purpose.

B. *Defining the Best Interests of the Corporation*

The duty of loyalty's general command that the director advance the corporation's best interests presupposes that those interests can be readily identified.[212] But that is not necessarily the case. One of the longest running

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205. Midwest Mgmt. Corp. v. Stephens, 353 N.W.2d 76, 80 (Iowa 1984) (quoting Yerke v. Batman, 376 N.E.2d 1211, 1214 (Ind. Ct. App. 1978)).

206. *See, e.g.*, Holden v. Constr. Mach. Co., 202 N.W.2d 348, 360 (Iowa 1972) (holding a director accountable for breach of his duty of loyalty when the director appropriated corporate funds for his own personal use).

207. *See, e.g.*, Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517, 525 (Iowa 1974) (finding a director having an interest in a transaction with the corporation liable for breach of fiduciary duty for failing to follow statutory safeguards).

208. *See, e.g.*, Midwest Janitorial Supply Corp. v. Greenwood, 629 N.W.2d 371, 375 (Iowa 2001) (stating that there is a breach of fiduciary duty when a director sets up a directly competing business while still a director of one corporation, but permitting a director contemplating resignation to make preparations for a competing business before leaving).

209. *See, e.g.*, Shildberg Rock Prods. Co. v. Brooks, 140 N.W.2d 132, 137 (Iowa 1966) (stating that the corporate opportunity doctrine, which prohibits the taking of a corporate opportunity without the corporation's consent, is part of "the cardinal rule of individual loyalty on the part of fiduciaries").

210. *See, e.g.*, Midwest Mgmt. Corp. v. Stephens, 353 N.W.2d at 80 (finding that the defendant's fiduciary duty to the corporation included a "duty to disclose information to those who have a right to know the facts").

211. CLARK, *supra* note 38, at 34.

212. *See* RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

debates in American corporate law is whether the corporate interest is synonymous with the interest of shareholders alone, or whether it also includes the interests of other corporate constituencies, like creditors, employees, suppliers, customers, and the community in which the corporation operates.[213] Resolving the debate is important, at least to the extent that shareholder interests compete with the interests of these nonshareholder constituencies of the corporation.

1. *Shareholders as the Primary Corporate Constituency*

The answer traditionally given is that the director should define the corporation's interests from the perspective of shareholders. As stated in the famous case of *Dodge v. Ford Motor Co.*:[214]

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders to devote them to other purposes. . . . [N]o one will contend that, if the avowed purpose of the defendant directors was to sacrifice the interests of shareholders, it would not be the duty of the courts to interfere.[215]

Nearly eighty years later, the American Law Institute expressed a similar view when defining the "objective and conduct of the corporation" in its *Principles of Corporate Governance*: "[A] corporation . . . should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain."[216]

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213. Professor E. Merrick Dodd and Professor Adolf A. Berle debated this issue in a series of classic law review articles in the 1930s. Dodd argued that business corporations had a social service as well as a profit making function. E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932). Berle contended that a focus on shareholder interests was necessary to restrict management's discretion. Adolph A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); Adolph A. Berle, *For Whom Corporate Managers* are *Trustees*: *A Note*, 45 HARV. L. REV. 1365 (1932). This debate is surveyed in Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964). For a more recent continuation of the debate, see A. A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33 (1991).

214. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

215. *Id.* at 684.

216. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 2.01(a), at 55.

2. *The Long-Run "End-Run" for Other Corporate Constituencies*

Nonetheless, American corporate law recognizes some important exceptions to this general rule. For example, section 2.01 of the *Principles of Corporate Governance* qualifies the corporate profit-making objective in the following respects: (1) a corporation must act within the boundaries of the law; (2) a corporation may take into account ethical considerations appropriate to responsible conduct of business; and (3) a corporation may devote a reasonable amount of resources to charitable causes.[217]

Of course, none of these exceptions, two of which are permissive rather than mandatory, are necessarily inconsistent with a corporate profit objective.[218] Indeed, they can often be reconciled with such an objective if one defines profitability from a long- rather than a short-run perspective. This development in corporate law—a recognition that directors are required to maximize a corporation's profits in the long-run—has afforded directors much of the tremendous discretion they have enjoyed during the better part of the past century.

Accordingly, in *Shlensky v. Wrigley*,[219] the equally famous counterpart to *Dodge v. Ford Motor Co.*,[220] the court dismissed shareholder derivative claims against the board of directors of the corporation that owned the Chicago Cubs.[221] The shareholder contended that the board had wrongfully refused to install lights in Wrigley Field, adversely affecting attendance at Cubs' games and reducing corporate profits.[222] The shareholder argued that the board's motivation for this course of conduct was improper.[223] At worst, he claimed, the board was acquiescing in the controlling shareholder's personal preference for daytime baseball.[224] At best, the board preferred the interests of neighbors of the stadium, who opposed night baseball, to the shareholders' interests in profits.[225] Either way, the duty of loyalty was implicated.

The *Wrigley* court dismissed the claims, accepting the board's implausible assertion that the corporation would enhance shareholder profits in the long-run by foregoing night baseball games at home because such a move would enhance the quality of the neighborhood where Wrigley Field was located, and hence, the

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217. *Id.* § 2.01(b), at 55.
218 *See id.*
219. Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968).
220. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).
221. Shlensky v. Wrigley, 237 N.E.2d at 777, 781.
222. *Id.* at 777-78.
223. *Id.* at 778.
224. *Id.*
225. *Id.*

value of the corporation's stadium property.[226] Whatever the merits of the *Wrigley* decision itself, it is now generally accepted that directors do not violate their duties of loyalty by managing the corporation in a way that benefits nonshareholder constituents, so long as their goals are to enhance corporate profits in the long-run.[227]

3. *Statutory Authority to Consider Nonshareholder Constituencies' Interests*

Of course, the long-run view of corporate interests does not resolve all potential conflicts between shareholders and other corporate constituencies. Arguably, if the corporation is to be sold, the only proper objective for directors is to maximize the potential sales price to be paid to the corporation's shareholders. The rationale for this position is that there is not necessarily any long-run for the corporation when the corporation's directors decide to sell the company.[228] Thus, the Delaware courts hold that when a corporation is in *Revlon* mode—the corporation is for sale or its breakup is inevitable[229]—the discretion of the board of directors is limited to that of auctioneers charged with obtaining the best possible price for the shareholders.[230]

To counter possible limitations on directors' discretion in this context, and to thereby increase the likelihood that corporations will be able to resist hostile acquisition proposals from out-of-state rivals, Iowa and many other states have approved the use of various weapons to deter such proposals. This arsenal includes poison pill plans, control share acquisition laws, and so-called

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226. *Id.* at 780-81.

227. As former Chancellor William Allen summarized it:

> There is a utility in this long-term/short-term device. Though employment of this distinction is subject to obvious manipulation, it can nevertheless resolve the tension between . . . differing conceptions of the corporation in a way that offers the possibility of some judicial protection to shareholders, while affording substantial room to the multi-constituency, social entity conception to operate. With this distinction, judicial review of particular decisions is available under the fiduciary duty standard. But corporate directors are also afforded very considerable latitude to deal with all groups or institutions having an interest in, or who are affected by, the corporation. The long-term/short-term distinction preserves the form of the stockholders oriented property theory, while permitting, in fact, a considerable degree of behavior consistent with a view that sees public corporations as owing social responsibilities to all affected by their operation.

William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 273 (1992).

228. *See id.* at 275.

229. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176-79 (Del. 1986).

230. *Id.* at 182.

stakeholder constituency statutes.[231] The latter generally provide directors with extra flexibility in defining the *corporation's* best interests in response to an acquisition proposal, flexibility that permits consideration of nonshareholder interests.[232]

For example, IBCA section 490.1108 authorizes "[a] director, in determining what is in the best interest of the corporation when considering a tender offer or proposal of acquisition," to consider the "effects of the action on the corporation's employees, suppliers, creditors, and customers," and on "communities in which the corporation operates," as well as the "long-term [and] . . . short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation."[233] If the board determines, "on the basis of the community interest factors," that a takeover "is not in the best interests of the corporation, it may reject the proposal or offer."[234] In that case, the board "has no obligation to facilitate, to remove any barriers to, or to refrain from impeding, the proposal or offer."[235]

The statute further provides that:

> Consideration of any or all of the community interest factors is not a violation of the business judgment rule or of any duty of the director to the shareholders, or a group of shareholders, *even if* the director reasonably determines that a community interest factor or factors outweigh the financial or other benefits to the corporation or a shareholder or group of shareholders.[236]

Thus, IBCA section 490.1108 means more than that directors must legitimatize their consideration of nonshareholder interest by a theory of maximization of corporate profits in the long-run, an interpretation that some have proffered for constituency statutes.[237] The Iowa director can, in the acquisition context at least,

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231. *See* IOWA CODE §§ 490.624A, .1108, .1110.

232. *See* Symposium, *Corporate Malaise—Stakeholder Statutes: Cause or Cure?*, 21 STETSON L. REV. 1, 1 (1991); *see also* David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 248 (1991) (discussing how new directors' duty statutes allow management to consider the impact of its decisions on nonshareholder interests and in some cases choose a course of action inconsistent with shareholders' interests); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 579-80 (1992) (discussing the purposes behind N.Y. BUS. CORP. LAW § 717(b) (McKinney Supp. 1991)); Sommer, *supra* note 213, at 35.

233. IOWA CODE § 490.1108(1).

234. *Id.* § 490.1108(2).

235. *Id.*

236. *Id.* (emphasis added).

237. *See* James J. Hanks, Jr., *Playing With Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97, 108 (1991).

allow the interests of other corporate constituencies to *trump* the interests of shareholders.[238]

Since relatively few Iowa corporations are the subject of hostile acquisition proposals, it remains to be seen whether the Iowa constituency statute will have much impact.[239] The only other jurisdictions whose constituency laws reach so far are Indiana and Pennsylvania.[240] Some have suggested that these states' statutes will deter investment in corporations chartered there because share discounts will develop for what are essentially takeover-proof corporations.[241] Indeed, although the Iowa and Indiana laws are as yet untested in the courtroom, the Pennsylvania law became famous, or infamous, when it proved instrumental in the defeat of a recent hostile takeover bid.[242]

Aside from the takeover context, however, the flexibility directors enjoy in defining the corporation's best interests from the long-run profit perspective enables them to avoid any serious duty of loyalty problems relating to the competing interests of various corporate constituencies. That same flexibility does not apply in the context of a personal conflict of interest between the director and the corporation. The Article now turns to these more traditional duty of loyalty problems.

C. *Misappropriation of Corporate Property*

Perhaps the most straightforward application of the duty of loyalty is to transactions in which the director misappropriates corporate property. Such conduct obviously violates the requirement that directors advance the corporation's best interests rather than their own. Thus, directors of Iowa corporations have been held liable for stealing, embezzling, or misappropriating corporate property in a wide variety of contexts. An apparent common

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238. *See id.*

239. In 1995, there was a hostile takeover bid for Younkers, Inc., a company headquartered in Des Moines, Iowa. *See* Carson Pirie Scott & Co. v. Gould, No. CIV.A.14359, 1995 WL 419980, at *1 (Del. Ch. July 12, 1995). However, since Younkers, Inc. was incorporated in Delaware, the Iowa constituency law did not apply. *Id.* at *2.

240. *See* IND. CODE. ANN. § 23-1-35-1(f) (Michie 1999); 15 PA. CONS. STAT. ANN. § 1715(a) (West 1995).

241. *See generally* R. Cammon Turner, *Shareholders vs. the World: Revlon Duties and State Constituency Statutes*, BUS. L. TODAY Jan.-Feb. 1999, at 32, 33 (characterizing constituency statutes as obstacles to corporate growth strategies such as mergers).

242. *See id.* at 34 (characterizing *Norfolk S Corp. v. Conrail Inc.*, C.A. No. 96-CV-7167 (E.D. Pa. Nov. 19, 1996), and the Pennsylvania constituency statute as "a major controversial leap away from traditional corporate governance law").

denominator, at least in the more recent decisions, is that a director who engages in such conduct may be liable for exemplary damages.[243]

First National Bank of Council Bluffs v. One Craig Place, Ltd.[244] illustrates well the negative judicial response to directors who steal from their corporate principal. Persons who were promoters and directors of a corporation arranged to pay for their shares with proceeds of a loan the corporation obtained from a bank.[245] Other stockholders guaranteed the corporation's obligation, unaware of how the loan proceeds were being applied.[246] Not only were the promoter-directors held liable to the corporation for this conduct, but the court also negated the liability of the corporation and loan guarantors in view of the lender's knowing participation in the promoter-directors' breach of fiduciary duty.[247]

Holden v. Construction Machinery Co.[248] sustained a duty of loyalty claim against a majority shareholder-director who first caused his corporation to buy stock in another enterprise, then assumed ownership of that stock without compensating the corporation.[249] A majority shareholder-director was held liable on a similar basis in *Holi-Rest, Inc. v. Treloar*[250] after he treated corporate assets as his own, to the exclusion of the interest of the corporation's minority shareholder.[251]

Many other examples of theft or misappropriation of corporate property can be found in the cases.[252] Perhaps the most interesting of these is *Rowen v. Le*

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243. *See, e.g.*, Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517, 525-26 (Iowa 1974) (holding director who misappropriated corporate property liable for exemplary damages); Charles v. Epperson & Co., Inc., 137 N.W.2d 605, 618 (Iowa 1965) (holding director who misappropriated corporate property liable for exemplary damages).

244. First Nat'l Bank of Council Bluffs v. One Craig Place, Ltd., 303 N.W.2d 688 (Iowa 1981).

245. *Id.* at 690.

246. *Id.* at 691.

247. *Id.* at 697-700.

248. Holden v. Constr. Mach. Co., 202 N.W.2d 348 (Iowa 1972).

249. *Id.* at 351, 367.

250. Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517 (Iowa 1974).

251. *Id.* at 519-20, 525.

252. *See, e.g.*, Charles v. Epperson & Co., 137 N.W.2d 605, 608-16 (Iowa 1965) (alleging conversion of company property, misappropriation of corporate funds for personal use, sale of corporate property, conflict of interest in entering into a contract with the corporation, and failure to collect or secure payments due to the corporation); Des Moines Bank & Trust Co. v. George M. Bechtel & Co., 51 N.W.2d 174, 180 (Iowa 1952) (alleging conspiracy in violation of fiduciary duty and misappropriation of approximately $700,000); First Nat'l Bank of Waterloo v. Fireproof Storage Bldg. Co., 202 N.W. 14, 16 (Iowa 1925) (alleging mismanagement through payments and lending of corporate funds); Interstate Inv. & Dev. Co. v. Webster, 177 N.W. 554, 554-55 (Iowa 1920) (involving withdrawal of corporate stock and spending of corporate funds without authorization and with no benefit to the corporation); Schoening v. Schwenk, 84 N.W. 916, 916 (Iowa 1901) (involving directors' disbursements of corporate funds for personal expenses).

Mars Mutual Insurance Co.,[253] discussed in Part III.[254] The misappropriation condemned in *Rowen* was the directors' de facto sale of control of a mutual insurance company in exchange for a premium paid to the company's dominant director.[255] The court concluded that while directors may accept control premiums when they also transfer to buyers a majority of the stock of the corporation for which they are directors, their directorships, as such, cannot be sold.[256] The rationale for this rule, the court stated, is "'undisputable: persons enjoying management control hold it on behalf of the corporation's stockholders, and therefore may not regard it as their own personal property to dispose of as they wish.'"[257]

D. *Self-Dealing*

A more subtle duty of loyalty violation is possible when directors are interested in the subject matter of a transaction involving their corporation.[258] Such a conflict of interest may be obvious, as when a director sells property to the director's corporation.[259] Other conflicts of interest may be more obscure, as when a director's relative or a business associated with the director deals with the corporation as an adverse party.[260] These and similar situations are generally labeled as self-dealing transactions by a corporate director.[261]

Because, at some level, a director stands on "both sides of the deal" in such transactions, the director faces a conflict of interest.[262] The director cannot necessarily be expected to exercise independent judgment concerning the transaction, let alone to discharge the obligation to act in the corporation's best interests in connection with it.[263] As a result, the courts refuse to apply the business judgment rule to self-dealing transactions and generally impose more

253. Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639 (Iowa 1979).

254. *See supra* Part III.A.3.

255. Rowen v. Le Mars Mut. Ins. Co. of Iowa, 282 N.W.2d at 649.

256. *See id.* at 649-50 (stating that the director could not profit from the transaction, regardless of his motive).

257. *Id.* at 651 (quoting Essex Universal Corp. v. Yates, 305 F.2d 572, 575 (2d Cir. 1962)).

258. *See* CLARK, *supra* note 38, at 141 (stating that fiduciary duty prohibits fiduciaries, in some contexts, from maintaining a state of affairs in which they have a conflict of interest).

259. *Id.* at 142-43.

260. *Id.*

261. *Id.*

262. *Id.* at 147.

263. *Id.* at 150.

stringent standards of review.[264] It is somewhat difficult to precisely describe these standards, however, because the law has undergone considerable evolution.

1. *Common Law Standards*

According to a seminal article by Professor Harold Marsh, courts traditionally held self-dealing transactions to be either void or voidable at the option of the corporation if any shareholder objected.[265] Whether such a rigid prophylactic rule was ever widely applied by other jurisdictions,[266] it is doubtful that such an approach has ever prevailed in Iowa.[267] The Iowa courts appear instead to have required a director with a conflict of interest "to make a full disclosure and obtain the consent of all concerned," and "to establish the good faith, honesty and fairness of the transaction."[268] Many Iowa decisions support this approach.[269]

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264. *See, e.g.*, Cookies Food Prods., Inc. v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 447, 453 (Iowa 1988) ("When self-dealing is demonstrated, 'the duty of loyalty supercedes the duty of care, and the burden shifts to the director[] to prove that the transaction was fair and reasonable to the corporation'" (quoting Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 265 (2d Cir. 1984) (citation omitted))); Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709, 715-16 (Iowa 1983) ("[I]t would not be possible for the business judgment rule to be invoked at the instance of a board of directors if the majority of the board are alleged to be involved in self-dealing."); *accord* Davies v. Dooley, No. 00-0639, 2001 WL 539609, at *7 (Iowa Ct. App. May 23, 2001) ("[T]he business judgment rule only applies to challenges which do not allege self-dealing on the part of [a director].").

265. Harold Marsh, Jr., *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 36-37 (1966). A representative case is *Munson v. Syracuse, Geneva & Corning Ry. Co.*, 8 N.E. 355, 358 (N.Y. 1886), in which the court held a director's self-dealing transaction was "repugnant to the great rule of law which invalidates all contracts made by a trustee or fiduciary, in which he is personally interested, at the election of the party he represents." *Id.*

266. Professor Norwood P. Beveridge, Jr. has recently challenged Professor Marsh's characterization of the traditional judicial approach to self-dealing transactions. Norwood P. Beveridge, Jr., *The Corporate Fiduciary's Duty of Loyalty: Understanding the Self-Interested Director Transaction*, 41 DEPAUL L. REV. 655, 659 (1992).

267. *See* Schildberg Rock Prods. Co. v. Brooks, 140 N.W.2d 132, 136 (Iowa 1966) (involving claims against corporate fiduciaries who took business opportunities from the corporation, and stating in dicta that "an act by the fiduciary in which personal interest and duty conflict is voidable at the option of the beneficiary"). However, the court did not actually apply that rule when deciding the case. *See id.*

268. Charles v. Epperson & Co., 137 N.W.2d 605, 608 (Iowa 1965) (citing First Trust & Sav. Bank v. Iowa-Wisconsin Bridge Co., 98 F.2d 416, 425 (8th Cir. 1938)).

269. *Compare* Ontjes v. MacNider, 5 N.W.2d 860, 869 (Iowa 1942) (finding for directors on most issues using the disclosure and consent approach); Kurtz v. Oxborrow, 4 N.W.2d 857, 858 (Iowa 1942) (finding for director using the disclosure and consent approach); *In re* Estate of Evans, 232 N.W. 72, 77 (Iowa 1931) (finding for director); Gunn v. Gould Balance Valve Co., 218 N.W. 895 (Iowa 1928) (finding for director); Wabash Ry. Co. v. Iowa & Southwestern Ry. Co., 202 N.W. 595, 601 (Iowa 1925) (finding for directors); Iowa Drug Co. v. Souers, 117 N.W. 300 (Iowa 1908) (finding for president); Stetson v. N. Inv. Co., 73 N.W. 869 (Iowa 1898) (finding for

A number of arguments support this standard of review for self-dealing transactions, at least as compared to a strict prohibition of all such conduct. The most common contention is that in some cases the best interests of the corporation may be furthered by transactions with directors.[270] Whether that is true or not, some conflict of interest transactions, like compensation of directors, appear inevitable, making an absolute prohibition on self-dealing unrealistic.[271]

2. *Statutory Standards*

The more relaxed approach to self-dealing transactions made its way into statutory corporate law in the early 1930s and has been widely adopted by the states, including Iowa.[272] Such directives are not exactly safe harbors for self-dealing transactions, however. Indeed, these laws often make the law of director self-dealing somewhat more complex because they clarify some issues, but leave others unanswered.

Consider the current Iowa statute, IBCA section 490.831.[273] Section 490.831 provides that a self-dealing transaction by a director is not void or voidable solely because of the director's interest if one of the following is true: (1) the material facts relating to the director's conflict were disclosed to, or known by, the board or a board committee, and the board or committee authorized, approved, or ratified the transaction; (2) those same facts were disclosed to, or known by, the shareholders entitled to vote, and the shareholders authorized, approved, or ratified the transaction; or (3) the transaction was fair to the corporation.[274]

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director); Garrett v. Burlington Plow Co., 29 N.W. 395 (Iowa 1886) (finding for director); Farmers' & Merchs.' Bank of Lineville v. Wasson, 48 Iowa 336 (1878) (finding for director); Buell v. Buckingham & Co., 16 Iowa 28 (1864) (finding for director), *with* Atlas Coal Co. v. Jones, 61 N.W.2d 663, 668 (Iowa 1954) (finding against directors using the disclosure and consent approach); Gord v. Iowana Farms Milk Co., 60 N.W.2d 820, 831 (Iowa 1953) (finding against directors using the disclosure and consent approach); Hallam v. Indianola Hotel Co., 9 N.W. 111 (Iowa 1881) (finding against director using disclosure and consent approach); Blair Town Lot & Land Co. v. Walker, 50 Iowa 376 (1879) (finding against director). For federal court discussion affecting Iowa regarding the same issue, see Liken v. Shaffer, 141 F.2d 877, 880 (8th Cir. 1944) (finding a breach of fiduciary duty when directors purchased land from the corporation without disclosure to, or the consent of, the stockholders); Wyman v. Bowman, 127 F. 257, 274 (8th Cir. 1904) (stating that contracts between directors or officers and the corporation are voidable at the option of creditors, stockholders, or the corporation itself when the contract is unfair).

270. GEVURTZ, *supra* note 95, § 4.2.1, at 323.

271. *Id.*

272. *Id.* § 4.2.1, at 324. Iowa amended its corporations code to include such a provision in 1970. Act of April 2, 1970, ch. 1239, 1970 Iowa Acts 313, at 316 (amending IOWA CODE § 496A.34).

273. IOWA CODE § 490.831 (2001).

274. *Id.* § 490.831(1).

Section 490.831 is helpful to the extent that it attempts a definition—albeit an open-ended one—of self-dealing transactions.[275] The statute also resolves issues that had divided the courts at common law, such as whether an interested director may be present or vote at meetings to approve a conflict of interest transaction.[276] But what is the meaning of the statute's statement that self-dealing transactions are not void or voidable "solely" because of the director's interest if one of its three criteria are satisfied?[277] Does disinterested shareholder or director approval after disclosure obviate the interested director's need to demonstrate fairness? Will fairness alone satisfy the director's duty of loyalty? Or is some combination of informed disinterested approval and fairness necessary, as older Iowa cases seem to have required?[278]

Courts in other jurisdictions have struggled with these issues. Most have been reluctant to forsake an independent judicial fairness review even when there has been approval or ratification of the transaction by disinterested directors or shareholders pursuant to statutory provisions.[279] Justifications for this position include the potential for logrolling by disinterested directors[280] and the absence of any meaningful participation by shareholders when they are asked to approve such transactions.[281]

The Iowa Supreme Court joined these ranks when it interpreted a law similar in all pertinent respects to section 490.831 in *Cookies Food Products, Inc.*

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275. *See id.* § 490.831. For purposes of the statute, a conflict of interest or self-dealing transaction is one in which a director "has a direct or indirect interest." *Id.* § 490.831(1). "Direct interest" is not defined, but would presumably include any dealings with the corporation by the director or his close relatives. *See id.* An "indirect interest" exists when a business entity in which the director has a material financial interest, is a general partner, is a party to the transaction, or when the party is another entity "of which the director is a director, officer, or trustee . . . and the transaction is or should be considered by the board of directors of the corporation." *Id.* § 490.831(2).

276. *Id.* § 490.831(3). Approval, authorization, or ratification by directors requires the affirmative vote of a majority of the directors or committee members who are disinterested, so long as there are at least two of them. *Id.* A majority of disinterested directors constitutes a quorum. *Id.* § 490.831(4). The interested director can be present and can vote, if a majority approves. *Id.* § 490.831(3).

277. *Id.* § 490.831(1).

278. *See supra* Part V.D.1.

279. *See, e.g.*, Remillard Brick Co. v. Remillard-Dandini Co., 241 P.2d 66, 74-76 (Cal. 1952) ("It would be a shocking concept of corporate morality to hold that because the majority directors or stockholders disclose their purpose and interest, they may strip a corporation of its assets to their financial advantage, and that the minority is without legal redress.").

280. *See* Note, *The Propriety of Judicial Deference to Corporate Boards of Directors*, 96 HARV. L. REV. 1894, 1896-902 (1983) (discussing the likelihood of board conformity).

281. *See* Victor Brudney, *Contract Law and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 611-16, 622-35 (1997).

v. Lakes Warehouse Distributing, Inc.[282] The court held a director must establish the fairness to the corporation of any self-dealing transaction, regardless of prior approval or ratification of the transaction by disinterested parties in accordance with statutory requirements.[283]

The court adopted this view, in part, because statutory approval standards do not directly negate the common law rules they replace—the combined requirement that directors disclose any conflicts of interest, obtain approval by disinterested parties, and establish the fairness of their self-dealing transactions.[284] The court further reasoned that an interpretation requiring only satisfaction of the statutory ratification requirements "would invite those who stand to gain from such transactions to engage in improprieties to obtain consent."[285] The *Cookies* decision illustrates that, when statutory standards do not foreclose judicial oversight of self-dealing problems, courts will be reluctant to abandon their traditional roles as regulators in this area.[286]

Although the *Cookies* court required additional steps beyond statutory approval of self-dealing transactions, it did not regulate such transactions in a highly intrusive manner. For example, although the court required the defendant director to prove the fairness of his self-dealing transactions with the corporation, fairness did not require the director to charge the lowest prices available in the market.[287] Rather, the court evaluated the director's transactions from a more generous "fairness of the bargain" perspective that considered not only the compensation paid to the director, but also the success the corporation achieved as a result of its transactions with him.[288] The court would presumably construe section 490.831 in a similar fashion.

Given that such an interpretation would likely apply, at least two questions linger. First, if disinterested director or shareholder approval under section 490.831 does not obviate fairness review by the court, what is the purpose of these approval options? Second, absent disinterested director or shareholder approval, is fairness review alone sufficient to sustain the transaction?

One possible answer to the first question is that disinterested director or shareholder approval invokes application of a more relaxed fairness standard than

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282. *See* Cookies Food Prods., Inc. v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 447, 452-53 (Iowa 1988) (interpreting IOWA CODE § 496A.34 (1987), the predecessor law to IOWA CODE § 490.831 (2001)).

283. *Id.*

284. *Id.* at 452.

285. *Id.* at 453.

286. *See id.* Whether such continued judicial regulation is appropriate is a matter of considerable debate, as described in Part II.B.

287. *Id.* at 454.

288. *Id.* In the words of one commentator, "the majority felt that sometimes the best proof of value may be in the results." GEVURTZ, *supra* note 95, § 4.2.2, at 329.

might otherwise apply. That is, while such approval alone might not justify deferential review under the business judgment rule, it might be a sufficient basis for the court to eschew a rigorous fairness standard in which all doubts are resolved against the director.[289] Indeed, the fairness standard applied in *Cookies* was arguably closer to a reasonableness test than to a rigorous standard of "entire fairness."[290]

Such an interpretation, in turn, suggests an answer to the second question. Self-dealing transactions by directors are not necessarily void or voidable if they did not obtain disinterested director or shareholder approval in accordance with statutory standards. In such a case, however, the court should require directors to establish that the transaction complied with exacting fairness standards.[291] The court might, for example, require evidence that the director charged the corporation no more, or paid it no less, than market rates for similar products or services.[292]

3. *MBCA Subchapter F*

Subsequent to Iowa's adoption of the Model Business Corporation Act, its drafters revised the Model Act's statutory standards for self-dealing transactions. The revisions replace Model Act section 8.31, upon which IBCA section 490.831 is based, with four more detailed statutes, known collectively as Subchapter F.[293] These new provisions are exceedingly complex and differ in some important respects from both past statutory safe harbor traditions and from other

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289. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 5.02(a)(2)(B), at 209-10 (requiring fairness review when there is no disinterested director approval of conflict of interest transactions; where there is such approval, the court should determine whether the directors "could reasonably have concluded that the transaction was fair to the corporation").

290. *Compare* Cookies Food Prods., Inc. v. Lakes Warehouse Distrib., Inc., 430 N.W.2d at 453 (stating the court "was not convinced that [the director's] fees were . . . unreasonable or exorbitant" simply because other vendors might have charged less, and that the court's fairness analysis should also take into account the director "was the driving force in the corporation's success"), *with* Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997) (finding disinterested shareholder approval of interested director transaction under DEL. GEN. CORP. L. § 144, a statute similar to IOWA CODE § 490.831 (2001), triggers judicial review under a waste standard), *and* Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983) (applying an entire fairness standard when reviewing transactions by parent companies seeking to acquire their majority-owned subsidiaries).

291. *See, e.g.*, Marciano v. Nakash, 535 A.2d 400, 404 (Del. 1987) (substituting fairness review by the court for disinterested director or shareholder approval of conflict of interest transactions under DEL. GEN. CORP. L. § 144).

292. *See* GEVURTZ, *supra* note 95, § 4.2.2, at 326 ("[C]ourts generally compare the value of what the corporation gave up in the transaction versus the value of what it received.").

293. *See* MODEL BUS. CORP. ACT ANN. §§ 8.60-.63 (1985 & Supp. 1998/99). Subchapter F is entitled "Director's Conflicting Interests Transactions" and has four sections: Definitions, Judicial Actions, Directors' Actions, and Shareholders' Actions. *Id.*

contemporary proposals, like the American Law Institute's proposal.[294] For example, Subchapter F provides elaborate bright-line definitions of who is an interested director and of what constitutes a conflict of interest transaction.[295] Its provisions establish a clear disjunctive meaning for the word "or" in the procedural alternatives to judicial fairness review: if disinterested directors or shareholders have approved a self-dealing transaction as required by the statute, the court may not review the transaction for fairness.[296]

Despite the Model Act drafters' best intentions, Subchapter F has not met with legislative success.[297] There are several explanations for this. First, Subchapter F attempts to codify an area of law—open-ended conflict of interest standards—that is not well suited to comprehensive statutory regulation. Thus, the drafters found it necessary to complicate the statutory law of self-dealing by a considerable margin. For example, one must now parse through numerous definitions in an attempt to determine whether a transaction triggers a conflicting interest for a director, or whether other directors or shareholders are eligible to vote on the transaction.[298] And even with all of these bright lines, the Subchapter F standards do not resolve all issues. They apply only to transactions between the corporation and a director or a party related to the director, leaving conflicts of interest arising in connection with nontransactional policy decisions to traditional judicial regulation.[299]

Perhaps more importantly, in a break with centuries of corporate law tradition, Subchapter F endorses procedural protections as a substitute for judicial fairness review of conflict of interest transactions.[300] Some have argued that the reverse should be true; corporate law should be reformed to increase rather than reduce scrutiny of conflict of interest transactions by directors.[301] And even if a reduced judicial role is appropriate, Subchapter F is not likely to produce that result in Iowa. Most Iowa corporations are closely held businesses, and conflicts of interest will often involve major shareholders. In such cases, the corporation

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294. *See generally* Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461 (1992).

295. MODEL BUS. CORP. ACT ANN. § 8.60.

296. *Id.* § 8.61.

297. *See* ROBERT W. HAMILTON, CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES CASES AND MATERIALS 854 (7th ed. 2001) (stating that as of January 1, 1999, only twelve Model Act jurisdictions had adopted Subchapter F).

298. MODEL BUS. CORP. ACT. ANN. §§ 8.60, .62-.63.

299. *Id.* § 8.61.

300. *See supra* Parts V.D.1, .2.

301. *See, e.g.*, Kenneth E. Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 STAN. L. REV. 927, 946-48 (1983) (arguing that corporate law should eliminate due care liability for directors and increase judicial scrutiny of conflict of interest transactions).

may not have qualified directors who may approve the transaction, making judicial review necessary in any event.[302]

Whether due to its unwieldy complexity or the policy choices it represents, as of January 1, 1999, only twelve Model Act jurisdictions have adopted Subchapter F in whole or in part.[303] Reconsideration by the Model Act's drafters appears likely.[304] Simpler statutes like IBCA section 490.831 have achieved far greater acceptance, and remain the law in most states, including Delaware.[305] Nonetheless, proposals are currently pending in the Iowa legislature that would repeal current section 490.831 and enact Subchapter F as part of the IBCA.[306] Given the complexity of these provisions, their break with past tradition, and their limited success in other jurisdictions, the Legislature would be well advised to reject them.

E. *Corporate Opportunities and Competition*

Duty of loyalty problems also frequently arise where a corporate director takes advantage of a business opportunity that is connected in some respect with the corporation's line of business.[307] Similar concerns are presented when the director forms a competing business or prepares for departure to a competing business before resigning from the corporation.[308]

1. *Corporate Opportunity Cases*

Generally speaking, the issue in corporate opportunity cases is whether directors violate their duty of loyalty if they fail to offer a business opportunity to

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302. *See* IOWA CODE § 490.831(3) (2001). Because closely held corporations typically have only a small number of individual shareholders who act as partners, and the shareholders often serve as directors, it is less likely that any directors will be disinterested, and thus qualified to approve a conflict of interest transaction. *See* CLARK, *supra* note 38, at 24-27 (discussing the size of closely held corporations, their similarities to partnerships, and participation of shareholders in their management).

303. HAMILTON, *supra* note 297, at 854.

304. *Id.*

305. *See* GEVURTZ, *supra* note 95, § 4.2.1, at 324 (discussing special statutory provisions dealing with conflict of interest transactions that have been enacted in most states).

306. *See* S.S.B. 3163 §§ 53-56, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (adding Model Act Subchapter F provisions to the IBCA); H.S.B. 682 §§ 53-56, 79th Gen. Assem., Reg. Sess. (Iowa 2002) (adding Model Act Subchapter F provisions to the IBCA); *see also* For Profit Corporation Report, *supra* note 72, at 2.

307. *See, e.g.*, Schildberg Rock Prods. Co. v. Brooks, 140 N.W.2d 132, 137 (Iowa 1966) ("The doctrine 'corporate opportunity' is not new to the law and is but one phase of the cardinal rule of undivided loyalty on the part of fiduciaries.").

308. *See, e.g.*, Midwest Janitorial Supply Corp. v. Greenwood, 629 N.W.2d 371, 375 (Iowa 2001).

the corporation before taking it for themselves.[309] When directors are found to have violated their duty of loyalty by misappropriating such an opportunity "the corporation may elect to claim all of the benefits of the transaction for itself, and the law will impress a trust in favor of the corporation upon the property, interests and profits so acquired."[310] The principal difficulty in these cases is deciding whether the contested business opportunity was a corporate one, triggering duty of loyalty concerns, or instead an opportunity that the director was free to exploit without regard to the corporation's interests.[311]

As summarized recently by an Iowa commentator, American courts have employed at least five different tests for this purpose.[312] These include (1) a fairness test that asks whether "the director took advantage of a corporate opportunity for personal profit when the interest of the corporation called for protection;"[313] (2) an interest or expectancy test that asks "whether the corporation has a legitimate interest, actual or expectant, in the opportunity, and whether the corporation has the financial resources to take advantage of a particular opportunity;"[314] (3) a line of business test that asks "whether a particular opportunity is 'an activity as to which [the corporation] has fundamental knowledge, practical experience and the ability to pursue, which . . . is adaptable to its business having regard for its financial position, and [which is] consonant with its reasonable needs and aspirations for expansion;'"[315] (4) a two step test that "combines the line of business and fairness standards;"[316] and (5) a novel test proposed by the American Law Institute that identifies a corporate opportunity primarily on the basis of how the opportunity came to the director's attention and generally requires the director to first offer such opportunities to the corporation.[317]

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309. GEVURTZ, *supra* note 95, § 4.2.7, at 362.

310. Schildberg Rock Prods. Co. v. Brooks, 140 N.W.2d at 137 (quoting Guth v. Loft, Inc., 5 A.2d 503, 511 (Del. 1939)).

311. GEVURTZ, *supra* note 95, § 4.2.7, at 362.

312. Gordon Fisher, *Knocking the Corporate Opportunity Doctrine*, THE IOWA LAWYER, July 1997, at 8.

[Author's Note: Although the following discussion and notes 312-17 are taken from Gordon Fisher's article, a citation to each original source is provided for reader convenience.]

313. *Id.* at 9 (citing Orsi v. Sunshine Art Studios, Inc., 874 F. Supp. 471, 476 (D. Mass. 1995)).

314. *Id.* at 9-10 (citing Lagarde v. Anniston Lime & Stone Co., 28 So. 199, 201 (Ala. 1900)). "While an interest or expectancy need not be a legal or property right, something more than a 'mere hope or desire' is required." *Id.* at 10 (citing Pioneer Oil & Gas Co. v. Anderson, 151 So. 161, 164 (Miss. 1933)).

315. *Id.* at 10 (quoting Guth v. Loft, Inc., 5 A.2d 503, 514 (Del. 1939)).

316. *Id.* at 10-11 (citing Miller v. Miller, 222 N.W.2d 71, 81 (Minn. 1974)).

317. *Id.* at 11 (citing PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 32, § 5.05).

The Iowa courts have embraced a modified version of the line of business test. As summarized recently by the Iowa Supreme Court in *Lange v. Lange*:[318]

> [I]f there is presented to a corporate . . . director a business opportunity which [1] the corporation is financially able to undertake, [2] is, from its nature, in the line of the corporation's business and is of practical advantage of it, [3] is one in which the corporation has an interest or a reasonable expectancy, and [4] by embracing the opportunity, the self-interest of the . . . director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself.[319]

Commentators have pointed out that various components of this formulation are vague or conceptually difficult to apply.[320] The same can certainly be said for their amalgamation under the Iowa test.

The Iowa Supreme Court had little difficulty applying these standards in *Schildberg Rock Products Co. v. Brooks*,[321] however. The facts of that case were fairly egregious. Individuals serving as officers and directors of a mining corporation entered into a mineral lease covering property that (1) was financially feasible for the corporation to exploit; (2) was located less than two miles from a mine the corporation was actively quarrying; and (3) was under consideration for exploration by the corporation.[322] The court held such circumstances established a violation of the corporate opportunity doctrine.[323]

In *Lange*, the Iowa Supreme Court was receptive to a defense based on the first element of the test set forth there: that no duty of loyalty violation occurs when the director takes an opportunity, however related to the corporation's business, if the corporation itself lacks the financial capacity to do so.[324] The position of the director in *Lange* was further bolstered by evidence that the corporation did not have any plans to take advantage of the opportunity.[325] The

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318. Lange v. Lange, 520 N.W.2d 113 (Iowa 1994).

319. *Id.* at 120 (citation omitted).

320. *See* Fisher, *supra* note 312, at 8 (citing other commentators that describe this formulation as vague or confusing).

321. Schildberg Rock Prods. Co. v. Brooks, 140 N.W.2d 132 (Iowa 1966).

322. *Id.* at 137-39.

323. *Id.* Other Iowa cases have found a breach of fiduciary duty by a director under similar circumstances. *See* Modern Heat & Power Co. v. Bishop Steamotor Corp., 34 N.W.2d 581, 585-86 (Iowa 1948) (evaluating a case in which director acquired tax title to corporate real estate); Bates v. Pabst, 273 N.W. 151, 153 (Iowa 1937) (evaluating a situation in which a bank director was the main purchaser of tax certificates held by the bank).

324. *See, e.g.*, Lange v. Lange, 520 N.W.2d at 120 (finding no duty of loyalty violation when director of bank holding corporation purchased stock of its subsidiary bank, in part because the corporation "was not financially positioned" to purchase the shares).

325. *Id.* (finding no expectancy interest in additional shares of stock that could have been purchased by bank holding corporation when corporation already owned eighty percent of the

Iowa Supreme Court has also recognized a defense when the corporation makes no complaint when the director takes the business opportunity, thus either implicitly rejecting the opportunity or consenting to the director's conduct.[326]

These case law standards are likely to continue to be the Iowa "law" of corporate opportunity for the foreseeable future. Although the Iowa Supreme Court may one day embrace the American Law Institute approach, as several states have done in recent years, statutory regulation in this area appears unlikely.[327]

2. *Competition with the Corporation*

Generally speaking, agents may not compete with their principals concerning the subject matter of the agency.[328] So, too, corporate directors must refrain from competition with their corporations.[329] Once the fiduciary relation is terminated, as when the director leaves office, the prohibition ends. The director should first make clear to the corporation that the director has resigned, however.[330]

Competition by directors following resignation can give rise to a violation of fiduciary duty if the directors make use of confidential or other proprietary information obtained during their tenure with the corporation.[331] Moreover, the Iowa Supreme Court's recent decision in *Midwest Janitorial Supply Corp. v. Greenwood*[332] suggests that a director who prepares for competition with the corporation before resigning must walk a fine line to avoid liability.[333] The director should refrain from making such preparations on the corporation's time or using the corporation's property and should not communicate with the corporation's vendors or customers.[334] According to the court in *Greenwood*, if

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bank's stock, thus meeting the threshold for favorable tax treatment, and when there was no evidence that corporation planned to acquire more stock).

326. Ontjes v. MacNider, 5 N.W.2d 866, 866-70 (Iowa 1942).

327. *See* Fisher, *supra* note 312, at 12 (citing Maine, Mississippi, Oregon, and Tennessee as jurisdictions adopting the American Law Institute's approach).

328. *See generally* RESTATEMENT (SECOND) OF AGENCY § 393 (1958).

329. *See* Des Moines Terminal Co. v. Des Moines Union Ry. Co., 52 F.2d 616, 625-28 (8th Cir. 1931).

330. *See, e.g.*, Modern Heat & Power Co. v. Bishop Steamotor Corp., 34 N.W.2d 581 (Iowa 1948) (affirming trial court findings that director's conduct was insufficient to establish his resignation, and that the director therefore violated his fiduciary duties by acquiring a tax deed on corporate property).

331. Duane Jones Co. v. Burke, 117 N.E.2d 237, 242-44 (N.Y. 1954) (imposing liability on employees in this situation).

332. Midwest Janitorial Supply Corp. v. Greenwood, 629 N.W.2d 371 (Iowa 2001).

333. *Id.* at 374.

334. *Id.*

directors observe these restrictions they will be liable to the corporation only if it can be shown that their preparations while in office inflicted some additional harm to the corporation "beyond the eventual competition that results from the preparation."[335]

F. *Duties of Disclosure*

The common law of corporations does not require the board of directors to disclose any particular types of information to shareholders on a regular basis.[336] Indeed, such a requirement would be at odds with shareholders' passive role in corporate management. While statutes sometimes mandate narrow exceptions to this pattern,[337] more interesting for purposes of the present discussion are specific disclosure obligations that courts sometimes recognize based on a director's status as a corporate fiduciary.

As already noted, in Iowa and other jurisdictions, common law regulation of self-dealing transactions generally requires that the affected director disclose all pertinent information and obtain disinterested director or shareholder approval of the transaction.[338] Under these judicial standards, disclosure is an integral part of the procedural antidote to the director's conflict of interest.

In addition, courts in many jurisdictions require the board of directors to disclose all pertinent information to shareholders whenever the board seeks shareholder approval of a corporate transaction, like a merger or a sale of all or substantially all corporate assets.[339] This disclosure duty apparently applies whether or not the board solicits shareholder proxies for purposes of the vote.[340] There are as yet no Iowa cases expressly recognizing similar disclosure duties, but one might expect that Iowa courts would follow other jurisdictions in this regard.[341]

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335. *Id.* at 376.

336. *See* GEVURTZ, *supra* note 95, § 3.1.3(c), at 219.

337. For example, IBCA § 490.1621 requires disclosure to shareholders of certain matters relating to director indemnification or issuance of shares on credit. IOWA CODE § 490.1621 (2001). The IBCA also requires a corporation to furnish copies of its annual financial statements at a shareholder's request. *Id.* § 490.1620. While the federal and state securities laws sometimes impose ongoing disclosure obligations, these rules generally impact only a small subset of Iowa corporations.

338. *See supra* Part V.D.1.

339. *See* GEVURTZ, *supra* note 95, § 3.1.3(c), at 218 (citing *Lynch v. Vickers Energy Corp.*, 383 A.2d 278 (Del. 1977), as a prominent example).

340. *Cf.* Berger v. Amana Soc'y, 111 N.W.2d 753 (Iowa 1961) (invalidating amendment to articles of incorporation authorizing stock because directors did not make full and fair disclosure to stockholders of the effect of the proposed amendment).

341. *Id.* (citing Stroud v. Grace, 606 A.2d 75 (Del. 1992)). Whether such a disclosure duty applies to the board in the absence of a request for shareholder action is less clear. *Id.*; *see*

Indeed, the Iowa Supreme Court has made clear that when individual directors seek action by their fellow directors or shareholders concerning corporate business, the directors must generally disclose any information in their possession that is material to the decision. In *Rowen* for example, the corporation's controlling director breached his fiduciary duty when he requested resignations of his fellow directors without disclosing to them that he had sold control of the company to a competitor.[342] The court applied similar reasoning in *Midwest Management Corp. v. Stephens*,[343] finding that a corporate director breached his fiduciary duties when he failed to make truthful disclosures concerning his role, or lack thereof, in a new venture in which the corporation invested.[344]

These decisions fit neatly into more generally applicable principles governing common law fraud claims. While silence is not generally considered to be an actionable misrepresentation for fraud purposes, silence *is* deceptive when there is a duty to speak.[345] A director's fiduciary status may, in an appropriate circumstance, give rise to a duty to speak because a corporate fiduciary must always advance the best interests of the corporation.[346] In the face of such a duty, courts properly require directors to disclose any material information they possess concerning proposed corporate business transactions.[347] As a fiduciary, the director cannot treat the corporation or its representatives as arm's length third parties who must fend for themselves.

The Iowa Supreme Court recently endorsed an analogous position in *Rieff v. Evans*.[348] The *Rieff* court reinstated a derivative suit against directors that the trial court had held was barred by the statute of limitations.[349] The court

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Kahn v. Roberts, No. CIV.A.12324, 1994 WL 70118, at *2 (Del. Ch. Feb. 28, 1994) (holding that directors who decide to voluntarily disclose information pertaining to a corporate transaction have a duty to disclose all material facts even if shareholder approval is unneeded). *But see* Bragger v. Budacz, No. CIV.A.13376, 1994 WL 698609, at *5 (Del. Ch. Dec. 7, 1994) (holding an obligation of full disclosure does not exist if directors do not seek shareholder action).

342. Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d 639, 651 (Iowa 1979).

343. Midwest Mgmt. Corp. v. Stephens, 353 N.W.2d 76 (Iowa 1984).

344. *Id.* at 80.

345. *See, e.g.*, Clark v. McDaniel, 546 N.W.2d 590, 592 (Iowa 1996) (affirming finding of fraud based on silence, and noting that a person with a duty who purposely withholds a fact material to the transaction is in effect misrepresenting the fact).

346. *See supra* Part V.A; *see also* RESTATEMENT (SECOND) OF AGENCY § 381 (1958) (agent must disclose to principal all facts relative to the subject matter of the agency that may be material to any decision the principal must make in connection therewith).

347. *See, e.g.*, Midwest Mgmt. Corp. v. Stephens, 353 N.W.2d at 76 (indicating that a director has a duty to disclose pertinent information concerning a proposed business transaction); Rowen v. Le Mars Mut. Ins. Co., 282 N.W.2d at 649 (requiring a director to disclose material information regarding a proposed corporate business transaction).

348. Rieff v. Evans, 630 N.W.2d 278, 282 (Iowa 2001).

349. *Id.* at 282.

reasoned that a fraudulent concealment tolling exception might apply, stating: "The policyholders allege the defendants had a fiduciary duty to disclose these actions to Mutual's policyholders. In such a case, mere silence may be enough to equal fraudulent concealment."[350]

Some unanswered questions remain. For example, must the plaintiff show scienter—an intent to deceive—on the part of the director when the claim is based on a false disclosure or a failure to disclose in the face of a duty to do so? Such intent must be shown for liability under common law fraud principles, but the Iowa Supreme Court has not yet addressed whether fiduciary duty principles warrant application of more strict liability standards to corporate directors.[351] In any event, there is support in the cases for the proposition that fiduciaries charged with fraudulent nondisclosure bear the burden of proving that they caused no harm, or at least the burden of going forward with evidence on that issue.[352]

VI. Provisions in the Articles of Incorporation Limiting the Liability of Directors

The Delaware Supreme Court's famous, or infamous, decision in *Smith v. Van Gorkom*,[353] which withheld business judgment rule protection and imposed liability on the board of directors of a prominent national corporation, sent shock waves through the American business community in the mid-1980s. The decision prompted resignations on the part of some directors and caused others to decline service as directors.[354] Moreover, the decision came at a time when premiums for director and officer liability (D&O) insurance had become dramatically more expensive.[355] The threat of liability for persons serving on corporate boards suddenly appeared very real.

The resulting crisis, real or imagined, prompted a legislative response.[356] First Indiana, then Delaware, amended their respective corporate codes to authorize corporations to include provisions in their articles of incorporation

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350. *Id.* at 290-91.

351. *See* Linge v. Ralston Purina Co., 293 N.W.2d 191, 195-96 (Iowa 1980) (refusing to decide this question on the ground that the issue was not properly preserved for appellate review). The question also appears to be unresolved in most other jurisdictions. *See* GEVURTZ, *supra* note 95, § 3.1.3(c), at 219.

352. *See, e.g.*, Linge v. Ralston Purina Co., 293 N.W.2d at 195 (recognizing that the existence of a fiduciary duty affects the burden of proof in a fraud case).

353. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

354. *See* James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1209 (1988) [hereinafter Hanks, *Recent Legislation*] (stating that many directors resigned in response to the *Van Gorkom* decision).

355. *See* Hamilton, *supra* note 86, at 28-29 & n.62 (stating that directors were reluctant to serve as a result of *Van Gorkom*, which was decided during a liability insurance crisis).

356. *Id.* at 29.

limiting or eliminating the liability of directors for certain monetary damage claims.[357] Generally speaking, these claims were those arising out of an unintentional breach of the director's fiduciary duty of care.[358] Nearly all states followed suit,[359] with Iowa joining these ranks in 1987.[360] The Iowa director liability law, IBCA section 490.832, is modeled on the Delaware statute and provides as follows:

> The articles of incorporation may contain a provision eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty as director, provided that the provision does not eliminate or limit the liability of a director for a breach of the director's duty of loyalty to the corporation or its shareholders, for acts or omissions not in good faith or which involve the intentional misconduct or a knowing violation of law, for a transaction from which the director derives an improper personal benefit, or under section 490.833. A provision shall not eliminate or limit the liability of a director for an act or omission occurring prior to the date when the provision in the articles of incorporation becomes effective.[361]

While this statute is as yet untested, as are its counterparts in most other jurisdictions, several aspects of it are worth noting. First, the statute operates in a fundamentally different manner than indemnification and D&O insurance—the traditional liability protections for directors. Indemnification does not protect a director from monetary exposure in all circumstances,[362] and D&O insurance protection depends on the coverage provided and on the corporation's ability to purchase it.[363] In contrast, all section 490.832 requires for a director to enjoy protection from monetary damages is that the corporation include language to that effect in its original or amended articles of incorporation.[364] Once included, such a provision either eliminates or limits the directors' liability exposure for

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357. Hanks, *Recent Legislation*, *supra* note 354, at 1209.

358. *Id.* at 1210.

359. *See id.* (stating that forty states had amended their codes).

360. 1987 Iowa Acts 212, § 5 (enacting current IOWA CODE § 490.832 (2001)).

361. IOWA CODE § 490.832 (originally codified as IOWA CODE § 496A.49, then reenacted as part of the IBCA by 1989 Iowa Acts 288, §§ 195, 196). The Delaware law on which the Iowa Code provision is modeled is DEL. CODE ANN. tit. 8, § 102(b) (1988).

362. *See* Hansell et al., *Duties*, *supra* note 4, at 720-21 (stating that directors "shall be indemnified" against reasonable expenses when they "ha[ve] been wholly successful, on the merits or otherwise" in the proceeding) (citing IOWA CODE § 490.852 (1991)).

363. *See* Hanks, *Recent Legislation*, *supra* note 354, at 1207-09 (discussing D&O liability limitation and indemnification).

364. IOWA CODE § 490.832.

monetary damages to a specific dollar amount, depending on the nature of the liability limitation included in the corporate charter.[365]

That is not to say that a director cannot be sued for breach of fiduciary duty if his corporation includes such a provision in its articles. The liability limitation affects only monetary damages exposure, not the director's fiduciary duties themselves. Thus, an action against a director seeking something *other than* monetary damages as a result of the director's breach of those duties, for example, injunctive relief, would still be possible.

Even the monetary liability protections of the statute are limited in some respects. For example, a director is not protected from monetary liability based on any breaches of duty that occurred *before* the liability limitation became effective—before the date the articles of incorporation included the provision.[366]

Perhaps most importantly, the statute expressly excludes protection for monetary damage claims against a director based on the director's failure to act in good faith, breach of the duty of loyalty, intentional misconduct, knowing violations of the law, or violation of the IBCA's limitations on distributions.[367] While the meaning of some of these exclusions is subject to some debate—particularly the good faith and duty of loyalty exceptions—the drafters apparently intended to protect directors only against claims for an unintentional breach of the duty of care, for example, a failure to monitor the corporation or an imprudent business decision.[368] These are claims to which the business judgment rule will generally apply in any event, so that the risk of liability for the director, or the prospect of financial recovery by the corporation, is quite remote.[369] So viewed, the effect of the statute is somewhat less dramatic than might otherwise appear.

It remains to be seen whether plaintiffs will be able to circumvent the protections of section 490.832 by disguising claims that would otherwise be covered by the statute as duty of care matters, for example, by characterizing them as bad faith acts or as violations of the duty of loyalty. The prospects for such efforts are not good. First, the Delaware Supreme Court recently rejected

365. *See* Hansell et al., *Duties*, *supra* note 4, at 722 (stating that most corporations adopt provisions eliminating liability entirely).

366. IOWA CODE § 490.832. Thus, when a director liability limitation is included as an amendment to the articles of incorporation of an existing corporation, the directors are protected with respect to any acts occurring on or after the effective date of the amendment—generally, the date the amendment to the articles of incorporation is filed with the Secretary of State. *Id.* § 490.123(1)(a).

367. *See id.* § 490.832.

368. For a discussion of possible interpretations of the various exclusions in the Iowa statute, see Hansell et al., *Duties*, *supra* note 4, at 715-20.

369. *See generally supra* Part IV.

just such an attempt in *Zirn v. VLI Corp.*,[370] establishing a precedent that other states are likely to follow.[371] In addition, the Iowa legislature is considering amendments to the IBCA that include a provision tightening the exception language in section 490.832.[372]

VII. CONCLUSION

Considering all of the statutes and cases that have been reviewed, one must conclude that for an Iowa director who adheres to the most basic tenets of the fiduciary principle—putting the interests of the corporation ahead of his own—the liability risks are fairly remote. While reform may be appropriate at the margins of Iowa fiduciary law, its statutory and case law principles are largely consistent with those of leading corporate law jurisdictions.

That is not to say there are no liability risks for an Iowa corporate director. The statutes and cases suggest that where there has been sustained inattention to corporate affairs, or any evidence of a conflict of interest or other duty of loyalty problems, the Iowa director faces a serious prospect of liability. This is as it should be. While liability risks should not be so great as to deter individuals from service as a director, the law properly takes such fiduciary responsibilities seriously. The question is always one of balance. So long as Iowa's fiduciary rules for corporate directors continue to recognize the limits of director competence, but remain vigilant concerning issues of loyalty, the compromises struck will likely be workable ones.

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370. Zirn v. VLI Corp., 681 A.2d 1050 (Del. 1996).

371. *See id.* at 1061-62 (holding the disclosure violation at issue merely consisted of a good faith erroneous judgment, thus implicating the duty of care rather than the duty of loyalty).

372. *See* S.S.B. 3163 § 10, 79th Gen. Assem., Reg. Sess. (Iowa 2002); H.S.B. 682 § 10, 79th Gen. Assem., Reg. Sess. (Iowa 2002); *see also* For Profit Corporation Report, *supra* note 72, at 2 (recommending adoption of the latest version of Model Business Corporation Act § 2.02, which includes an exculpatory provision to replace § 490.832). The revised exculpatory provision would read as follows:

> A provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any action taken, or any failure to take action, as a director, except liability for any of the following:
> (1) The amount of a financial benefit received by a director to which the director is not entitled.
> (2) An intentional infliction of harm on the corporation or the shareholders.
> (3) A violation of section 490.833.
> (4) An intentional violation of criminal law.

S.S.B. 3163 § 10; H.S.B 682 § 10.