Corporate Officers and The Business Judgment Rule: A Reply to Professor Johnson

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Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson

By Lawrence A. Hamermesh1 and A. Gilchrist Sparks III2

I. INTRODUCTION

At the outset of a 1992 article on the subject, we observed that "[t]he precise nature of the duties and liabilities of corporate officers who are not directors is a topic that has received little attention from courts and commentators."3 The relevant legal landscape has changed little since 1992: a few more judges and commentators have weighed in on the subject,4 but the topic remains relatively unexplored.

Given our interest in the subject, we therefore welcomed the recent effort by Professor Lyman PQ. Johnson to study the matter of judicial review of the conduct of non-director officers.5 For the reasons set forth below, we ultimately and respectfully disagree with Professor Johnson to the extent that he is urging that the business judgment rule should not extend to non-director officers. We continue to believe that the policy rationales underlying the development and application of the business judgment rule to corporate directors similarly justify application of the rule to non-director officers, at least with respect to their exercise of discretionary delegated authority.

It is not entirely clear that Professor Johnson's claim is absolutely contrary to our view. He states as his thesis that the business judgment rule "does not and should not be extended to corporate officers in the same broad manner in which it is applied to directors."6 With similar circumspection, Johnson concludes his article with the assertion that "stockholders and directors . . . expect adherence to basic fiduciary standards, without undeserved refuge in the business judgment rule."7 We do not quarrel with either of these limited assertions: even in our 1992

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4. See infra notes 20–25.
6. Johnson, supra note 5, at 440 (emphasis added).
7. Id. at 469 (emphasis added).
article, we acknowledged that the business judgment rule should not apply to 
conduct of officers outside the scope of their delegated authority, and that the 
rule, as Professor Johnson says, should therefore not apply as broadly to officers 
as to directors; and we certainly do not argue that the business judgment rule 
should afford any "undeserved refuge" for officers.

Nevertheless, the liability scheme that Professor Johnson appears to advocate—
in which officers are to be held liable for ordinary negligence—is one that we 
believe is contrary to both established law and sound policy. Our analysis under-
lying that belief is set forth below, and proceeds along the following path. We 
begin with an inventory of the many and important points on which we agree 
with Professor Johnson. Next, we briefly review pertinent post-1992 develop-
ments in case law and secondary authority. Third, we present a critique of Pro-
fessor Johnson's treatment of the policy justifications for the business judgment 
rule, and conclude that he has unduly discounted their application to corporate 
officers. Finally, and with those policy justifications in mind, we re-examine the 
appropriate scope of application of the business judgment rule to the conduct of 
corporate officers.

II. IMPORTANCE OF THE ISSUE AND PERTINENT POLICY 
CONSIDERATIONS

Professor Johnson has ably articulated the importance of defining the legal 
standards governing liability of non-director officers for misconduct that injures 
the corporation. As he points out, non-director officers were prominent, if not 
notorious, actors in recent corporate scandals involving Enron and WorldCom, and Delaware has recently amended its jurisdictional statutes to permit service of 
process on senior corporate officers, as well as directors, of Delaware corporations 
who are sued on claims of breach of fiduciary duty to the corporation. The 
recent and highly publicized derivative proceedings involving Walt Disney's hiring 
and firing of Michael Ovitz have also shone a spotlight on the distinct role of 
corporate officers.

8. 1992 Article, supra note 3, at 234. 
9. Johnson, supra note 5, at 441. 
10. See, e.g., Kurt Eichenwald, U.S. Indicts 11 Former Enron Executives, N.Y. TIMES, May 2, 2003, 
at C1 (reporting the indictment of Enron officers Andrew Fastow, Ben Glisan and others); Mark 
Hamblett, Two Ex-WorldCom Executives Indicted for Securities Fraud Prosecutors Allege Sullivan and 
Yates Hid Billions From Auditors, N.Y.L.J., Aug. 29, 2002, at 1 (reporting the indictment of Scott Sullivan 
and Buford Yates, Jr., former chief financial officer and controller, respectively, of WorldCom). 
11. DEL. CODE ANN., tit. 10, § 3114 (2003); see General Assembly Approves 2003 Amendments 
requirements for independent director representation on public company boards of directors, it is 
likely that fewer senior officers will also serve as directors. Therefore, had Section 3114 not been 
amended, the ability to obtain personal jurisdiction in Delaware over some of the most significant 
participants in corporate governance would have been impaired."). 
Sep. 10, 2004) (reviewing the fiduciary duties attaching to Michael Ovitz from the time he became 
an officer until his subsequent election as a director).
Despite the obvious importance of officers in corporate governance, and as Professor Johnson correctly observes, the standard of liability for non-director officers remains relatively unexplored in the case law, and nothing in the Delaware cases since 1992 has undermined our earlier assertion that Delaware law is somewhat underdeveloped in this regard. In contrast, there is widespread consensus among courts and commentators, including both us and Professor Johnson, on the policy justifications for the deferential judicial treatment of directors under the business judgment rule.

III. POST-1992 CASE LAW AND SECONDARY AUTHORITIES

We address later Professor Johnson’s welcome invitation to consider these policy justifications in evaluating the proper scope of application of the business judgment rule to the conduct of officers. Before embarking upon that task, however, we comment briefly on some of the legal authorities bearing on the question.

To begin with, it is important to clarify what we mean when we refer to the business judgment rule. Professor Johnson urges that the business judgment rule protects only director judgments based upon reasonable care in ascertaining pertinent facts—apparently leaving ordinary negligence as a basis for a claim against directors for breach of the duty of care. As we use the term, however, the busi-
ness judgment rule includes a strongly deferential standard of care. Hence, Delaware case law has long applied a “gross negligence” standard of care to corporate directors, in addition to the rational basis deference afforded to director action.\textsuperscript{17} While Professor Johnson has argued in an earlier article against this standard,\textsuperscript{18} he acknowledges that it is one embraced by the courts, at least in Delaware.\textsuperscript{19}

Returning to the question of application of the business judgment rule to non-director officers, the claim that this rule does not apply to corporate officers faces the formidable, if not insuperable, obstacle of rejection by thoughtful deliberative processes, including those of the American Law Institute and the ABA Committee on Corporate Laws. After publication of our 1992 article, both of those bodies affirmed that the business judgment rule should protect officer conduct in appropriate circumstances.\textsuperscript{20} In the case of the Committee on Corporate Laws, that affirmation came despite recognition that the case law on the issue was both “limited” and “muddled,”\textsuperscript{21} thereby implying that the Committee was expressing a considered policy judgment rather than simply a rote recitation of judicial pronouncements. Whether or not that Committee or the American Law Institute sufficiently explained the rationale for their policy conclusions, those two bodies have unmistakably made considered determinations to support application of the business judgment rule to officers in at least some circumstances, and those determinations surely merit at least some respect.\textsuperscript{22}

Professor Johnson challenges these determinations primarily by questioning the quality of the case law on which they rely. That is surely a fair form of advocacy, but it cannot be comforting to him that the cases decided since 1992, however sparse or insufficiently reasoned they may be, are virtually unanimous in their willingness to apply the business judgment rule to officers. Since we wrote on the

\textsuperscript{17} Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000) (summarizing the business judgment rule as follows: “directors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.” (emphasis added)); Aronson v. Lewis, 475 A.2d 805, 812 (Del. 1984) (“under the business judgment rule director liability is predicated upon concepts of gross negligence.”).


\textsuperscript{19} Id.

\textsuperscript{20} 1 American Law Institute, Principles of Corporate Governance: Analysis and Recommendations (1994) ("ALI Principles") § 4.01 cmt. a (“Sound public policy points in the direction of holding officers to the same duty of care and business judgment standards as directors, as does the little case authority that exists on the applicability of the business judgment standard to officers, and the views of most commentators support this position.”); ABA Comm. on Corporate Laws, Changes in the Model Business Corporation Act Pertaining to the Standards of Conduct for Officers; Inspection Rights and Notices—Final Adoption, 54 Bus. Law. 1229, 1231 (1999) (“the business judgment rule will normally apply to decisions within an officer's discretionary authority.”).

\textsuperscript{21} Id. at 1230.

\textsuperscript{22} We take further comfort in the fact that distinguished individual commentators, along with the American Law Institute and the Committee on Corporate Laws, also espouse the view we have expressed. Stephen M. Bainbridge, \textit{Corporation Law And Economics} § 6.4 at 285–286 (2002); Charles Hansen, \textit{The Business Judgment Rule: Is There Any Doubt It Applies to Officers?}, LXX Corp. No. 17 (Aspen 1999). And apart from Professor Johnson's recent writing, we have found no other scholarly writing in support of his position.
subject in 1992, in fact, no court has stated that the business judgment rule does not apply to officers, and quite a number of opinions have held that it does. In seeking support for his contrary view, Professor Johnson cites Brown v. United Cerebral Palsy, Inc. and Shields v. Cape Fox Corp. Neither opinion, however, offers him much support. Indeed, the Brown opinion actually corroborates the position we have taken: while purporting to hold that a corporate officer is liable to the corporation for damages arising from negligence, the court in Brown goes on to clarify that if the officer's action involves “discretionary activity,” liability must be premised upon action that is “negligent in the sense that it had no rational basis.” Restating the standard of liability in a way that also closely tracks the typical formulation of the business judgment rule, the court explained that “[t]he concept of negligence, . . . when dealing with the propriety of discretionary decisions, involves an area in which mistakes are not negligent unless no reasonable person would have made them (i.e., they were unconscionable).” This identification of “unconscionable” conduct as the standard for care-based liability strongly resembles the weak “gross negligence” standard of liability under the business judgment rule, and places the Brown case squarely in line with prevailing authority.

That leaves Shields v. Cape Fox as the lone post-1992 source of case support for Professor Johnson's view of the law. Little can be said about this cursory opinion, except that its treatment of corporate law surely does not inspire great respect, given its casual (and stunningly incorrect) pronunciation that “liability under the business judgment rule does not differ appreciably from negligence liability.” More to the point, the holding on which Professor Johnson relies sustains a jury instruction to which the defendants had made no objection in the trial court, and could therefore only have been a basis for reversal if it had been “plain error.” The Alaska Supreme Court sustained the jury instruction solely by citing the Restatement (Second) of Agency, and (undoubtedly because of a failure of counsel to call attention to it) without engaging in the slightest discussion of (a) the


27. Id.

28. Shields, 42 P.3d at 1092.

29. The trial court had instructed the jury that a manager would be liable to the corporation for "failure to exercise reasonable skill and ordinary care and diligence." Id. at 1091.

30. Id.

business judgment rule, (b) the fact that one of the defendants was a corporate officer as opposed to an ordinary employee, or (c) the existing case law and other authorities (including the ALI Principles and our 1992 article) indicating that officers are protected by the business judgment rule from liability for discretionary decisions made within the scope of their delegated authority.

In short, there can be little dispute at this point that the application of the business judgment rule to officer action involving their delegated discretionary authority is well established in the case law. We acknowledge, however, that the Delaware Supreme Court has not definitely weighed in on the debate, and that the cases do not thoroughly or clearly articulate the rationales for applying the rule to officers. We therefore believe that our most useful contribution to the debate at this point will be to demonstrate why, in light of the policies underlying the business judgment rule, the legal conclusion expressed with near unanimity in the case law is correct.

IV. THE POLICY JUSTIFICATIONS OF THE BUSINESS JUDGMENT RULE AS APPLIED TO OFFICERS

We generally agree with Professor Johnson's inventory of the policy justifications for the business judgment rule, and will not review the authorities he capably assembles in his effort to document that inventory. What we seek to accomplish, rather, is to show that those justifications actually demonstrate why it is ordinarily appropriate to apply the business judgment rule to officers, at least in the absence of any contractual modification of the standard of liability.

A. ENCOURAGING OFFICERS TO ACCEPT BUSINESS RISKS

As Professor Johnson points out, a principal justification for the business judgment rule is to encourage directors to serve and cause the corporation to take on business risks. Indeed, he rightly acknowledges that "stockholders seek the same optimizing stance toward risky corporate investment opportunities from officers as they do from directors." He then correctly notes that director liability for lack of care would discourage risk taking "because their relatively small stockholdings and lack of incentive compensation give them little of the 'upside' gains on investment projects." Why, then, does this risk-encouragement policy justification for the business judgment rule not also apply to officers?

The answer says Professor Johnson, is that officers have greater incentive-based compensation than directors, and "stand to reap substantial rewards for taking appropriate risks." We find this answer unpersuasive for two principal reasons.

32. Johnson, supra note 5, at 455–457.
33. Id. at 456.
34. Id. at 458.
35. Id. at 458 (citing Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996)).
36. See BAINBRIDGE, supra note 22, at 286 ("because officers "are likely to be even more risk averse than directors, ... insulation from liability may be necessary to encourage optimal levels of risk-taking by officers.").
37. Johnson, supra note 5, at 459.
First, it establishes at most a difference of degree, not kind: directors as well as officers receive incentive compensation, in several forms. Second, and more importantly, the scope of potential negligence-based liability for officers is enormous in comparison to any but the most generous incentive compensation packages: even at the median $3 million level, CEO compensation (let alone presumably lesser compensation for more junior officers) is trivially small in relation to corporate harm potentially arising from officer neglect. And at least under Delaware law, officers cannot even enjoy the damages insulation afforded to directors under exculpatory charter provisions.

Professor Johnson responds to this concern about disproportionate and risk-deterring officer damages liability by suggesting that negligence-based officer liability will not be excessive, because officers will have the benefit of the corporation's director and officer liability insurance if and when the board of directors resolves to bring suit against them for lack of care. In this respect, Professor Johnson's error is factual: director and officer liability insurance policies uniformly include an "insured v. insured" exclusion, denying coverage where the corporation itself initiates the claim against the officer.

38. See, e.g., Joann S. Lublin, More Work, More Pay: Directors are taking on greater responsibility these days; And despite shareholder skittishness, they're getting bigger paychecks as well, WALL ST. J., Feb. 24, 2003 (reporting average director compensation of $152,000 at 200 large U.S. companies, and increasing reliance on cash and restricted stock instead of stock options); Rachel Emma Silverman, GE Makes Changes in Board Policy, WALL ST. J., Nov. 8, 2002 (reporting General Electric's decision to use deferred stock grants in lieu of options as 60% of director compensation); Tod Perry, Incentive Compensation for Outside Directors and CEO Turnover (July 1999), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=236033 (reporting a study of director compensation from 1992 to 1995, concluding that "not only are more firms using incentive-based compensation for directors, but incentive-based pay has also become a more substantial portion of director pay").

39. Consider, for example, the $140 million in claimed excessive compensation to Michael Ovitz currently at issue in the Walt Disney derivative litigation. It is easy to think of examples of far larger harms that have been the subject of claims of managerial neglect. See, e.g., In re Caremark International Inc. Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996) (action seeking recovery of $250 million in losses); Saito v. McCall, C.A. No. 17132-NC, 2004 WL 3029876 (Del. Ch. Dec. 20, 2004) (claim of officer and director liability for accounting fraud in connection with $14 billion acquisition); In re Enron Corp., Final Report of Neil Batson, supra note 13. Professor Johnson implicitly acknowledges the problem of disproportionate liability by his support for "limitations on damages" that would "spare[] officers the draconian exposure to monetary claims that could induce a decision maker to be, if only at the margin, overly risk averse." Johnson, supra note 5, at 468.

40. Under Section 102(b)(7) of the Delaware General Corporation Law, directors—but not officers—may be relieved of monetary damages liability for breach of the duty of care. Some states permit such exculpation to extend to officers as well as directors, but that approach is a minority one. See, e.g., LA. REV. STAT. ANN. § 12:24(C)(4) (2004); MD. CODE ANN. CORPS. & ASS'NS § 2-405.2 (2004); N.J. STAT. ANN. § 14A:2-7(k)(3) (2004).

41. Johnson, supra note 5, at 468.

42. See, e.g., 2 WILLIAM E. KNEPPER and DAN A. BAILEY, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 25.09 (Matthew Bender 2004); Level 3 Communications, Inc. v. Federal Insurance Co., 168 F.3d 956, 958 (7th Cir. 1999) (a purpose of the "insured on insured" exclusion "is to exclude coverage . . . [of] suits in which a corporation sues its officers or directors in an effort to recoup the consequences of their business mistakes"); Township of Center v. First Mercury Syndicate, Inc., 117 F.3d 115, 119 (3d Cir. 1997); Murray v. The Loewen Group, 133 F. Supp. 2d 1110, 1117 (E.D. Wls. 2001) ("Insured v. Insured' exclusions are standard in director and officer insurance policies."). To be sure, that exclusion does not ordinarily preclude coverage in shareholder derivative actions, but the pre-suit demand requirement applicable to such actions will ordinarily bar negligence claims against officers who are not directors.
Professor Johnson also suggests that if excessive and disproportionate officer liability for negligence were thought to unduly deter valuable risk-taking, corporations could simply "agree to eliminate (or place a cap on) the money damages that could be recovered from an officer for breaching the duty of care . . . ." There is a perverse quality to this sort of argument: it could just as easily justify a default rule of strict liability of officers for their mistakes, on the theory that such a debilitating rule could be overcome by private agreement. Instead, the correct default rule should be the one that is most likely to reflect the collective (but unexpressed) best interests of the corporation and its stockholders. And in our view, the default rule that best satisfies this test is the business judgment rule, with its strong protection for risk initiation by corporate officers, and its elimination of incentives for officers to incur excessive precaution costs. A default rule that requires corporations and their officers to achieve such benefits only by means of negotiated agreements will only increase transaction costs associated with the retention of corporate officers.

Ultimately, and apart from his point about officer compensation, Professor Johnson asserts flatly that officers "should face greater risks" and "should be held to the same standard of care as are all other persons who serve as agents of companies . . . ." The bases for this normative assertion are somewhat imprecise and impressionistic: Professor Johnson explains that officers work full time, have better access to information than directors, influence many people's lives, and enjoy high status. None of these considerations, however, adequately explains why liability for ordinary negligence would discourage valuable risk-taking by officers any less than such liability would discourage valuable risk-taking by directors. Full time work and better information, which go hand in hand, may if anything make it difficult for an officer to claim ignorance or reliance on others as a defense, thereby accentuating, rather than reducing, a reluctance to take risks in the face of a negligence-based liability rule. Professor Johnson does not explain how influence or high status (even assuming that officers enjoy greater "influence" or "status" than directors) eliminates the deterrent to valuable risk-taking by corporate officers that is created by a negligence-based standard of liability. In any event, and at least where an officer is simply attempting to implement board policy and exercise delegated corporate authority, imposing a more demanding standard of liability upon officers than upon directors seems unfair in that it would shift to officers the burden of legal liability for risk-taking activity that the directors themselves encouraged.

43. Johnson, supra note 5, at 467.

44. MELVIN A. EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 78 (8th ed. unab., Foundation 2000) (law should establish "good rules that the parties probably would have agreed to if they had addressed the issue," and not establish "bad rules that the [parties] can contract around.").

45. Johnson, supra note 5, at 460 (emphasis in original).

46. Id.

47. ALI PRINCIPLES, supra note 20, § 4.01, cmt. a ("full-time officers will generally be expected to be more familiar with the affairs of a corporation than outside directors.").
In the end, Professor Johnson appears to be arguing that an ordinary care liability standard will not dry up the supply of corporate officers, given generally high compensation and status. But the issue is not whether people will serve as corporate officers; the issue is whether, once serving, officers will be unduly cautious in their business conduct if faced with liability for lack of ordinary care. As previously noted, a negligence standard for officer liability will almost certainly discourage officers from choosing and implementing relatively risky but valuable corporate decisions. The corollary consequence of such a standard, moreover, is the prospect that to avoid liability for merely a negligent breach of the duty of care, officers will engage in unnecessary investigations and obtain unnecessary second and third opinions, thereby causing the corporation to incur excessive precaution costs. Neither of these results is beneficial to corporations or their stockholders, and they both underscore the utility of applying the business judgment rule to officers as well as to directors.

B. LIMITATIONS ON JUDICIAL COMPETENCE TO EVALUATE BUSINESS CONDUCT

As Professor Johnson points out, judicial deference to director decisions is also based significantly on the courts' recognition of their limited ability to evaluate and attach liability to complex business judgments. He rightly acknowledges that there is a "strong case" that this justification for the business judgment rule "supports judicial deference to officer decisions" as well. The risk of hindsight bias applies with at least equal force to officer decisions, which, perhaps even more than director decisions, arise in complex, fluid situations in which courts and juries suffer from what Professor Johnson aptly describes as "cognitive limitations and informational disadvantage."

Nevertheless, while Professor Johnson suggests a willingness to extend judicial deference to the substance of officer decisions—as to which, he says, "the business judgment rule rightly precludes inquiry"—he asserts that officers have a "duty of ordinary care in preparing for, making, and carrying out the business decision." We disagree with that assertion, however, for several reasons. First, as discussed above, our view is that the business judgment rule does encompass a relaxed standard of judicial review of care. Second, judicial evaluation of care in "preparing for, making and carrying out" a business decision presents the same

48. See Donald Langevoort, The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability, 89 GEO. L.J. 797, 818 (2001); see also infra note 61 and accompanying text, discussing the likelihood that officers will cause more of their decisions to be made at the level of the board of directors—a precaution cost that is particularly burdensome in an environment in which boards of directors are called upon to perform an increasingly demanding monitoring role.
49. Johnson, supra note 5, at 456.
50. Id. at 463.
51. Id. at 462.
52. Id. at 463.
53. Id.
54. See supra notes 16–19 and accompanying text.
problems of hindsight bias and institutional comparative disadvantage that would apply if courts were called upon to evaluate the substantive soundness of business decisions. If concerns about hindsight bias and institutional competence warrant application of business judgment rule deference to director action, they equally justify such deference to the action of corporate officers.

There is one further aspect of the institutional limitations of the judicial system that counsels against adopting different standards of liability for directors and officers for lack of care. In shareholder derivative proceedings asserting that a breach of the duty of care has resulted in significant corporate harm, it should be common to find both directors and officers named as defendants. Indeed, it should be common to find defendants who are both directors and officers, and whose role in the matters complained of involved acts or omissions in both of those capacities. And further, at a time when there is increasing recognition and encouragement of officer disclosure of significant corporate information to superiors and, perhaps, to the board of directors, it should be common to find that major corporate harms are the product of a complex web of communication among directors and officers. The institutional problem for judicial review in these circumstances is this: given the typical involvement of both directors and officers, and the typical overlap of roles and communications, it is likely to be fiendishly complex for a court, let alone a jury, to sort out when and where any given defendant is acting (or failing to act) in a distinct capacity as a director or officer.

Thrown into this mix, the introduction of a negligence standard of liability for officers would make the task of the trier of fact painfully more complex and uncertain, exacerbating the risks of hindsight bias and threatening to deprive director action of the protection to which it should be entitled under the business judgment rule.

C. Preserving the Board's Governance Role

The third policy rationale for the business judgment rule is its role in “centralizing corporate authority in the board.” Professor Johnson claims that this rationale does not support application of the rule to officers; he argues, in fact, that it supports the opposite view. We respectfully disagree.

Professor Johnson maintains that business judgment rule deference to officer decisions would actually undermine the authority of the board of directors, by

55. See, e.g., Saito v. McCall, supra note 39 (defendants in derivative action premised on accounting oversight failures included directors as well as the corporation’s chief financial officer and controller).

56. As most recently amended, section 8.42(b)(1) of the Model Business Corporation Act defines the duty of a corporate officer to include the obligation “to inform the superior officer to whom, or the board of directors or the committee thereof to which, the officer reports of information about the affairs of the corporation known to the officer, within the scope of the officer’s functions, and known to the officer to be material to such superior officer, board or committee; . . . .” ABA Comm. on Corporate Laws, Changes in the Model Business Corporation Act—Amendments Relating to Chapters 1, 7, 8 and 14, 60 Bus. Law. 943 (2005); see also Donald C. Langevoort, Agency Law Inside the Corporation: Problems of Candor and Knowledge, 71 U. Cin. L. Rev. 1187 (2003).

withholding deference from a board's decision to assert negligence claims against corporate officers. Our disagreement with Professor Johnson does not challenge his support for judicial deference to a board determination to sue an officer. A board's decision whether or not to sue an officer for neglect should ordinarily be protected by the business judgment rule in a stockholder action challenging that decision as a breach of the directors' duty of care. But that judicial deference has nothing to do with the articulation of the legal principles that should govern the corporation's underlying claim against the officer. Those governing legal principles are not for the board to decide as a matter of its business judgment; they are a matter of law, subject to variation only by agreement with the officer. Establishing a default rule of officer liability for ordinary negligence would, as Professor Johnson correctly notes, simply "alter the balance of power in favor of the board in fashioning an appropriate intra-firm sanction or advantageous severance arrangement." The board's authority to determine how to respond to a finding of officer neglect would be the same, and would be entitled to the same judicial deference, regardless of what default rule were selected to determine officer liability for lack of care.

On the other hand, a default rule that would place officers at substantially greater risk of care-based liability than the risk faced by directors would impinge upon the board's managerial prerogative, and would therefore frustrate, rather than advance, the policies underlying the business judgment rule. As we pointed out in our 1992 article, such a disparity would simply encourage officers to place more decisions in the hands of the board, and to take fewer, and less risky, initiatives on their own, so as to avoid liability. That effect, however, would substantially impair the ability of the board of directors to delegate its decision-making authority to officers. Management of the corporation would tend to become "top heavy," making service on a board of directors even more time-consuming and costly to the corporation and its stockholders than it has already become.

58. Johnson, supra note 5, at 464 ("If directors make a considered judgment to pursue a breach of fiduciary duty claim against an officer, the rationale of honoring director discretion means that officer conduct should not be deferred to under the auspices of the business judgment rule but, instead, should be scrutinized in accordance with the underlying standard of ordinary care applicable to officers.").

59. An officer surely could, notwithstanding the default rule of business judgment rule protection, agree to be subject to a more demanding standard of liability for lack of care. The more debatable question is whether an officer could, by private agreement with the corporation, obtain immunity from a money damages claim comparable to that available to directors under a charter provision authorized by a statute like Section 102(b)(7) of the Delaware General Corporation Law. Del. Code Ann., tit. 8, § 102(b)(7) (2001).

60. Johnson, supra note 5, at 466.

61. 1992 Article, supra note 3, at 237 ("The Rule's policy of not second-guessing management is imperiled, however, if the Rule's application is withheld from non-director officers. If the officer is deprived of the Rule's protection for delegable decisions, then the corporation has surrendered part of its freedom from judicial interference. The Rule's protection of a board's delegation decision is rendered moot if courts are permitted to interfere with corporate management by subjecting the officer to greater scrutiny. The operation of the Rule should coexist with delegation law, lest courts give with one hand—protecting delegation decisions—while taking with the other by subjecting non-director officers to more liability.").
V. THE APPROPRIATE SCOPE OF APPLICATION OF THE BUSINESS JUDGMENT RULE TO CORPORATE OFFICERS

Our support for applying the business judgment rule to officer conduct is not unlimited. In several important ways, the policies justifying that support implicate limits on the application of the rule to corporate officers. First, an officer should not ordinarily be protected by the business judgment rule with respect to conduct that contravenes policies or directives established by the board of directors or by superior officers implementing board policy. In our view, application of the business judgment rule to officers generally supports the primary authority of the board of directors; the policies underlying that rule, however, do not support its application to an officer who acts in derogation of that board authority. Similarly, and as we previously pointed out, “the concept of an officer as the repository of delegated management authority by the board suggests that the availability of a business judgment rule defense may only be available to a corporate officer when that officer is operating within the scope of the delegated authority.” Again, this limitation on application of the business judgment rule illustrates that the application of the rule to officers should be tailored to give effect to the authority of the board of directors to implement its decisions through delegation of corporate authority to officers. Finally, the business judgment rule should not be available to action by officers that involves a conflict of interest, just as such conflicts ordinarily preclude business judgment rule protection for directors’ conflicting interest transactions.

VI. CONCLUSION

In sum, the policies that have given rise to the application of the business judgment rule to directors apply with equal force to the actions of officers within their delegated discretionary authority. We welcome Professor Johnson’s provocative effort to re-examine the issue thoughtfully, but conclude, contrary to him, that prevailing judicial authority and learned pronouncements on the point have reached the right result.

62. Officers, like agents generally, have a duty of obedience to lawful instructions of the principal (as expressed, in the corporate setting, by the board of directors). See, e.g., Reilly v. Polychrome Corp., 872 F. Supp. 1265, 1268–1269 (S.D.N.Y. 1995) (senior officer’s refusal to comply with president’s directive to report to work warranted termination, despite scope of discretion inherent in the officer’s position).
63. 1992 Article, supra note 3, at 234.
64. See id. at 222.