

You Should Follow The Business Judgment Rule

I'm David Tate. I am a California litigation attorney: primarily business/corporate, trust, estate, elder abuse, disability/discrimination, and real estate litigation and disputes, including contentious administrations.

I also advise people and businesses on corporate, officer, board and director, audit committee, shareholder, founder, owner, investor, and fiduciary governance and compliance, and responsibilities and rights.

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The Business Judgment Rule

This is a summary discussion about the business judgment rule.

In California a different statutory business judgment rule applies to nonprofits. But as a general matter, these materials also can be followed for nonprofits.

I suggest that governmental entities also adopt and follow these rules as prudent business practices.



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Overview

The business judgment rule provides a director with a defense to personal liability, holding that as a principle of law, a director who satisfies the business judgment rule has satisfied his or her fiduciary duties, including a director who serves on a board committee.

Thus, the business judgment rule provides one standard of care, although other standards may also apply to specific tasks and responsibilities.



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Overview (continued)

The business judgment rule provides a good overall approach for directors and audit committee members to follow, and it simply makes sense.

In some states the business judgment rule is codified by statute while in other states the rule is established by case law. See, for example, Cal. Corp. Code §309 for California corporations, Del. Gen. Corp. Law §141 for Delaware corporations, in addition to relevant case law.



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Business Judgment Rule Requirements

In summary, as a general principle the business judgment rule provides that a director should undertake his or her duties:



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Business Judgment Rule Requirements (continued)

-In good faith, with honesty and without self-dealing, conflict or improper personal benefit (and you should also consider your independence and appearance of independence from the issues, people and organizations that are involved, as situationally appropriate);



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Business Judgment Rule Requirements (continued)

-In a manner that the director reasonably believes to be in the best interests of the corporation and its shareholders; and



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Business Judgment Rule Requirements (continued)

-With the care, including reasonable inquiry, that an ordinarily prudent person in a like position with like expertise would use under similar circumstances.



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Business Judgment Rule Requirements (continued)

Reliance Upon Other People

In the course and scope of performing his or her duties, a director must necessarily obtain information from and rely upon other people.

The director is not involved in the day-to-day operations of the business. The director provides an oversight function.



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Business Judgment Rule Requirements (continued)

Reliance Upon Other People (continued)

Pursuant to the business judgment rule, a 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:



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Business Judgment Rule Requirements (continued)

-Officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the relevant matters;



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Business Judgment Rule Requirements (continued)

-Legal counsel, independent accountants or other persons as to matters that the director reasonably believes are within the person's professional or expert competence; or



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Business Judgment Rule Requirements (continued)

-A committee of the board on which the director does not serve, as to matters within that committee's designated authority, so long as the director acts in good faith, after reasonable inquiry as warranted by the circumstances, and without knowledge that would cause reliance to be unwarranted.



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Business Judgment Rule In **Non-Legal Version**

There are 4 broad overriding guidelines:

1. Act with integrity, honesty, good character, and professionalism, and without self-dealing, self-interest or conflict of interest, and require that of others. And also consider your independence and appearance of independence, as situationally appropriate.
2. Act in the manner that you believe is best for the organization, and require that of others, even if at times it isn't comfortable for you to do so.
3. Be heard and actively involved, speak up, and be counted, with the appropriate "working together" demeanor.
4. Be a leader, by example.



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Business Judgment Rule In **Non-Legal Version** (continued)

The remaining guidelines, numbers 5 through 10 are more specific. Again not in any particular order:

5. Know your responsibilities, and make sure the other people are in agreement about your responsibilities. Some people might refer to this as having a charter, but I believe this guideline requires more detail and understanding than a typical charter. You should also be analyzing and revising or updating your board and committee charters and responsibilities.



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Business Judgment Rule **Non-Legal Version** (continued)

6. Diligently acquire the information that you need so that you can accomplish your responsibilities, by exercising active, timely and inquiring diligence and follow-up, talking with people and acquiring information.



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Business Judgment Rule **Non-Legal Version** (continued)

7. Timely possess and acquire the knowledge and education that you need so that you know your responsibilities and are prepared to perform your responsibilities, address the issues, and act with prudence.



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Business Judgment Rule **Non-Legal Version** (continued)

8. Rely on other people including information provided by other people only if (1) you believe those people are reliable and competent in the areas that they are addressing, (2) your reliance is in good faith, after reasonable inquiry as warranted by the circumstances, and (3) you do not have knowledge that would cause reliance to be unwarranted.

And as a sub-set of number 8, ask the people who you are relying on for information the following question, “What else do you know that I should also know?”



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Business Judgment Rule **Non-Legal Version** (continued)

9. Make diligent informed decisions in keeping with these guidelines, including the difficult decisions.



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Business Judgment Rule **Non-Legal Version** (continued)

10. And for number 10 I have included a suggestion. Take time to reflect on the organization, the board and the board committees, important issues and topics, and how things are going, what needs to happen, and things about which you have questions. Then, communicate the issues, topics and actions that you believe need to be addressed, in keeping with the organization's mission and your responsibilities.

Number 10 also relates to board and committee agenda setting. To whom do you communicate proposed agenda issues and topics? Are your issues and topics given due consideration?



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The Business Judgment Rule – Final Comments

Of course, accomplishing director responsibilities is also a function of the board's overall governance, operations, expertise, functioning and atmosphere of professionalism.

And remember to do annual or more often evaluations of the board and its committees.



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