Zapata Corp. v. Maldonado: “Steering a Middle Course” May Spell Deep Water for Business Judgment Application in Shareholder Derivative Suits

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Abstract

In an attempt to strike a balance between the rights of an individual shareholder in his efforts to protect the corporation, and the rights of the board of directors to control the litigation in which the corporation is involved, the Supreme Court of Delaware, in Zapata Corp. v. Maldonado," developed a new set of game plans for shareholder derivative suits.

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In an attempt to strike a balance between the rights of an individual shareholder in his efforts to protect the corporation, and the rights of the board of directors to control the litigation in which the corporation is involved, the Supreme Court of Delaware, in Zapata Corp. v. Maldonado, developed a new set of game plans for shareholder derivative suits. While Zapata is important because of its impact on procedural elements of shareholder derivative actions, what makes it so noteworthy is the impact it may have on future applications of the business judgment rule in such actions.

This comment will focus on the three cases that set the framework for the Zapata decision. They are: Maldonado v. Flynn [Maldonado I], Maldonado v. Flynn [Maldonado II], and Maher v. Zapata Corporation. All three cases arose from similar transactions by the Zapata board of directors, and in each the court faced a common issue: whether the board of directors could compel dismissal of a shareholder's derivative suit after an independent committee, appointed by the board, determined that the suit was not in the best interest of Zapata Corporation. In analyzing the courts' decisions, this comment will survey general principles governing shareholder derivative actions, and consider the business judgment rule as it pertains to such actions.

The Trilogy - A Review of the Related Cases

In 1970, the board of directors of Zapata Corporation, a Delaware...
firm, approved a stock option plan for certain officers and directors of the corporation. The options were to be exercised during five installment periods from 1971 to 1974. Under the plan eligible officers and directors could exercise their options to purchase Zapata's common stock at $12.15 per share. Zapata Corporation stockholders approved the stock option plan in 1971.\(^7\)

In 1974, the board of directors voted to accelerate the last option date from July 14, 1974, to July 2, 1974.\(^8\) At that time most of Zapata's directors were eligible to participate in the 1970 stock option plan.\(^9\) By accelerating the date, the option holders expected to reduce their anticipated tax liability.\(^10\) Therefore, on July 2, eligible participants exercised their final option.\(^11\)

William Maldonado, a Zapata stockholder, initiated a shareholder's derivative suit in the Delaware Court of Chancery in June of 1975.\(^12\) He alleged ten corporate officers and directors breached their fiduciary duty by accelerating the option date. This "deprived Zapata of a federal tax deduction in an amount equal to that saved by the optionees. This occurred because the options were exercised [early], when the price of Zapata stock was $18.8125, rather than on July 14, 1974, when the price of Zapata stock was [approximately] $24.50."\(^13\)

In 1977, Maldonado brought a second shareholder's derivative suit in the United States District Court for the Southern District of New York,\(^14\) against nine of Zapata's past and current directors for alleged

\(^7\) 413 A.2d at 1254.

\(^8\) Id.

\(^9\) Id.

\(^10\) Vice Chancellor Hartnett in his opinion explained:

This was so because the amount of capital gain for federal income tax purposes to the optionees would have been an amount equal to the difference between the $12.15 option price and the price on the date of the exercise of the option: $18-19 if the options were exercised prior to the tender offer announcement or nearly $25 if the options were exercised immediately after the announcement.

Id. at 1254.

\(^11\) Id.

\(^12\) Maldonado I, 413 A.2d 1251.

\(^13\) Id. at 1255.

violations of the Securities and Exchange Act of 1934. Finding Maldonado had failed to state a cause of action, the district court dismissed his complaint but granted him leave to amend. Maldonado appealed the decision, and the Court of Appeals for the Second Circuit remanded the case. He then filed an amended complaint in the district court. A third shareholder's derivative suit was filed against Zapata by John F. Maher and other stockholders in the United States District Court for the Southern District of Texas, also alleging violations of the Securities and Exchange Act of 1934 by several Zapata board members.

Four of the defendant directors had left Zapata's board by June of 1979. To fill those vacancies, the remaining directors appointed two new directors from outside the corporation. After the appointment, the board created an Independent Investigation Committee authorized to investigate the claims asserted in [the three suits] and to take any course of action it deemed appropriate in view of its findings.

15. Id.
16. Id. at 1034. Maldonado's initial filing alleged that defendants (1) violated § 10(b) of the Act [Securities and Exchange Act of 1934], 15 U.S.C. § 78j(b) and Rule 10b-5 by modifying the stock option plan without obtaining stockholders' approval, resulting in certain directors using inside information to gain substantial personal benefits at the Corporation's expense, and (2) violated § 14(a) of the Act, 15 U.S.C. § 78n(a) and Rule 14a-9 thereunder by making statements in proxy solicitations issued to the shareholders by the Corporation in 1975, 1976, and 1977, for the election of directors of the Corporation that were materially misleading with respect to the earlier modification of the stock option plan and the directors' exercise of their options thereunder.

Maldonado v. Flynn, 597 F.2d 789 (2d Cir. 1979).

17. Id.

18. Maldonado II, 485 F. Supp. at 277. "The amended complaint [sought] to nullify the elections of directors from 1975-1979; an injunction against further misleading proxy statements; and to recover from the defendants on behalf of Zapata damages allegedly flowing from the issuance of the claimed deceptive proxy materials." Id.

19. Id. at 349.
20. Id. at 349.
21. 430 A.2d at 781.
22. Id. at 781.
23. 413 A.2d at 1255.
24. Id.
This committee was composed exclusively of the two new directors. 25

After conducting its investigation “the Committee concluded, in September, 1979, that each action should have [been] dismissed forthwith as their continued maintenance [was] inimical to the Company’s best interest. . . .” 26 Accordingly, the Committee “instructed Counsel for Zapata to seek dismissal of all the pending suits.” 27 The following January, on remand, the District Court for the Southern District of New York granted Zapata’s motion for summary judgment dismissing the *Maldonado II* action. 28 The basis for the decision, district court Judge Edward Weinfeld stated, was “that the Committee, composed of independent and disinterested directors, conducted a proper review of the matters before it, considered a variety of factors and reached, in good faith, a business judgment that the action was not in the best interest of Zapata.” 29 Maldonado appealed to the Second Circuit Court of Appeals. 30

Zapata’s attorneys were not as successful in opposing Maldonado’s state action, *Maldonado I*. The Delaware Court of Chancery ruled that “nothing in [the business judgment rule] grants any independent power to a corporation board of directors to terminate a derivative suit.” 31 As a result, the Court of Chancery denied Zapata’s motion to dismiss the suit. 32 Zapata filed an interlocutory appeal with the Supreme Court of Delaware which was accepted for review in *Zapata Corporation v. Maldonado*. 33 Before the appeal was accepted, however, the chancery court applied the holding of the New York federal district court in *Maldonado II* and dismissed *Maldonado I* on *res judicata* principles. 34 The *Maldonado I* dismissal was contingent upon the Second Circuit’s affirmance of the district court’s decision in *Maldonado II*. 35

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25. *Id.*
26. 430 A.2d at 781.
27. 413 A.2d at 1255.
29. *Id.* at 286-87.
30. 430 A.2d 779.
31. 413 A.2d at 1257.
32. *Id.*
33. 430 A.2d 779.
35. *Id.*
ware Supreme Court in Zapata stated, “the Second Circuit Appeal was ordered stayed . . . pending this Court’s resolution of the appeal from April 19th Court of Chancery order denying dismissal and summary judgment.”

In Maher, Zapata filed a motion to dismiss which the Texas federal district court denied in a decision similar to that in Maldonado I. The federal district court in Maher held that the business judgment rule did not grant a committee authority to compel dismissal of a shareholder derivative suit in situations in which no demand is made on the board of directors to initiate an action.

Courts in various jurisdictions have distinguished those situations where the shareholder is required to demand that the corporate board file suit, from those situations when the shareholder is excused from making such a demand prior to initiating a derivative suit. The distinctions between “demand” and “no demand” conditions significantly impact on the procedures and guidelines which are employed in a suit. In the Zapata trilogy none of the plaintiffs demanded the board of directors to file suit against any of the defendants, prior to initiating his individual action. The board’s own interest in the subject matter of the litigation would have made demand futile.

The central issue interwoven among each of the three cases was whether the independent committee had the power to compel dismissal of the shareholder derivative actions, especially when many of the directors who appointed the committee were named defendants. Each court had to deal with questions about the interpretation and application of the business judgment rule; this led to divergent results in Maldonado I and II.

Because of these variations in interpretation and application of Delaware corporate law, the proper framework (and no doubt, urgency) for resolution of the issues existed. The Supreme Court of Delaware acknowledged and resolved them in Zapata: it set new guidelines for Delaware courts to use in ruling on a corporation’s motion to

36. 430 A.2d at 781.
38. Id. at 348.
39. The distinctions between demand and no demand are discussed in text at 198-200, infra.
40. 430 A.2d at 781.
dismiss a derivative suit where demand has been excused. However, because of the resulting impact the Zapata decision may have on application of the business judgment rule in shareholder derivative suits, the holding in Zapata most probably was not what some knowledgeable commentators had anticipated.\(^{41}\)

**Shareholder Derivative Actions**

A corporation is a unique entity providing investors an opportunity to share in business ownership and profits, while minimizing an investor's financial exposure and involvement in the day to day management of the firm.\(^{42}\) Management functions traditionally are delegated to the directors of the corporation after their election to the board by the stockholders. This separation between ownership and management is not without pitfalls. The stockholder, "having surrendered individual control over his investment for the opportunity of corporate profit, . . . entrusts his fortunes to a board of directors who may well invest poorly, or worse, engage in self dealing."\(^{43}\)

The problems created by this separation between ownership and management become more apparent when a minority stockholder has serious and well-founded concerns with the quality and/or integrity of the board's management decisions. A director or an officer of a corporation has a fiduciary duty to that business.\(^{44}\) A breach of that duty gives rise to a cause of action by the corporation against that director or officer.\(^{45}\) Similarly, the corporation may have claims against third persons for wrongs unrelated to corporate management.\(^{46}\) Whether internally or externally created, the result of the injury is damage to the value of the corporation and, correspondingly, diminution in value of

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41. See discussion on commentators in text at 206, infra.
42. For a discussion of the attributes of the corporation entity as compared with other business structures, see H. Henn, Handbook of the Law of Corporations ch. 2 (West 2d ed. 1970).
44. Steinberg, The Use of Special Litigation Committees to Terminate Shareholder Derivative Suits, 35 U. of Miami L. Rev. 1, 3 (1980); Henn, supra note 42, at 457-58.
45. Henn, supra note 42, at 95.
46. Id. at 740.
shareholders' interests." However, since it is the corporation that directly suffers from the loss, it is the corporation that has a direct cause of action - not the individual stockholder. Generally, the individual stockholder lacks sufficient voting strength to directly influence board decisions to file suit or compel the ouster of an errant director. Lacking the ability to force the corporation to sue in its own behalf, the stockholder may be doomed to watch his investment dwindle, or perhaps gush, away.

When the corporation has a valid claim which it refuses to litigate, the individual stockholder theoretically has no legal remedy. In the past, the stockholder was considered to be without standing to initiate a suit on behalf of the corporation. Seeing the minority shareholder in this dilemma, equity courts developed the shareholder's derivative action. They found this right to bring the suit derived from ownership of an equitable or beneficial interest in the corporation and the corporation's failure to initiate a suit on its own behalf. "In legal effect a stockholder's [derivative] suit is one by the corporation conducted by the stockholder as its representative. The stockholder is only a nominal plaintiff, the corporation being the real party in interest." In essence, the shareholder is a catalyst for the corporation to take action against one of its own officers or a third party, if either is endangering the corporation and its board of directors has not taken action.

The threshold question to be determined in most shareholder derivative actions is whether the right to sue on behalf of the corporation has vested in the shareholder. As a rule, state statutes regulate shareholder derivative suits. Typically, these statutes require the stockholder, *inter alia*, to have "contemporaneous ownership of shares in order to maintain the suit . . ." and that the plaintiff "allege his efforts

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47. 13 *FLETCHER CYC. CORP.* § 5941.1 (Callaghan Rev. per. ed. 1980).
48. *Id.* § 5944.
49. *Id.*
50. *Id.*
51. *Id.* § 5940.
52. *Id.* § 5941.
53. *Id.* § 5939. The corporation "enters the litigation as a nominal party defendant because of its failure to enforce the claim in its own rights." *HENN, supra* note 42, at 777.
54. *FLETCHER, supra* note 47.
to obtain relief within the corporation before bringing his suit.\textsuperscript{55}

Delaware's Chancery Court Rules are in harmony with these requirements.\textsuperscript{56} The courts in Delaware have construed the chancery court rules as creating two different types of shareholder derivative actions: those where a demand to initiate suit must be made on the corporate board,\textsuperscript{57} and those where the demand requirement is excused.\textsuperscript{58}

Generally a demand is considered to be a condition precedent to a shareholder's right to initiate a derivative suit.\textsuperscript{59} The purpose of the demand is to give "the management of the corporation an opportunity to consider the merits of the dispute and to determine in the interests of the corporation and the shareholders whether it might be disposed of without the expense and delay of litigation."\textsuperscript{60}

There are a number of perfectly legitimate reasons why a board of directors, or an independent investigation committee acting in its stead, may find it undesirable to litigate corporate claims. The probability of success in trial, a cost-benefit analysis of the suit, and the effect on a company's image and its employees' morale are factors bearing on a decision to litigate.\textsuperscript{61}

There may be instances when, after proper demand, the board agrees to litigate.\textsuperscript{62} This decision would obviate the need for a share-

\textsuperscript{55} Id.
\textsuperscript{56} DEL. CODE ANN. Chancery Court Rules § 23.1 (1980). This rule provides:
In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an incorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall allege that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and the reasons for his failure to obtain the action or for not making the effort.
\textsuperscript{57} See generally 413 A.2d 1262.
\textsuperscript{58} See generally 430 A.2d 779.
\textsuperscript{59} FLETCHER, supra note 47, § 4961.
\textsuperscript{60} Id. § 4963.
\textsuperscript{62} See HENN supra note 42, § 361.
holder's derivative suit because the corporation would be pursuing the action under its own appellation. There are also situations in which a demand has been made properly, and the board refuses to file suit; however, rather than resisting the individual's efforts to initiate a derivative action, the board gives some type of assistance to the stockholder. In Sohland v. Baker, a Delaware case, a board refused to file suit, but it financially assisted the stockholder in retaining counsel in order that he could initiate a derivative suit. Assuming the board's refusal to initiate suit rests on an "independen[t], good faith and reasonable investigation" of the shareholder's allegations, the shareholder's right to initiate the derivative action terminates. The shareholder may still be able to initiate the suit if he meets the burden of showing that these good faith elements are lacking. This is a difficult burden to meet since the court will presume the existence of good faith on the part of the board of directors. The board of director's decisions in demand situations are protected under the business judgment rule.

Generally, a shareholder is excused from making a demand if it would be futile; however, "the complainant normally must demonstrate that the directors are either controlled by the alleged wrongdoer, interested in the challenged transaction to a degree which impairs their business judgment, or are participants in the alleged wrong." This was the type of situation encountered in each of the Zapata cases: the named defendants/directors constituted a majority of the corporate board.

Recently, the common practice of corporate boards has been to appoint an independent committee to investigate the need or desire for initiating litigation after demand has been made. Similarly, in those

63. Id. at 750.
64. See id. § 361.
65. 141 A. 277 (Del. 1927).
66. See 430 A.2d at 783 discussing Sohland.
67. Id. at 787.
68. Id. at 784.
69. Id.
70. For discussion, see text at 200 infra.
71. See generally Steinberg, supra note 44.
73. Steinberg, supra note 44.
cases where demand is excused, and a derivative suit has been filed, the board appoints a committee to determine whether the suit is in the best interest of the corporation. Typically, the committee finds the suit is not in the corporation’s best interest, and, accordingly, seeks to have the suit dismissed. This was the committee’s recommendation in the Zapata case.

Courts are faced with a dilemma in these no demand situations when the corporation seeks to have the suit dismissed. If the board determines that the suit is not in the best interest of the corporation, should a minority shareholder override that determination and be able to maintain the suit on the corporation’s behalf? There is a presumption that the board of directors and the independent committee have acted in good faith on behalf of the corporation. Therefore, courts have been reluctant to overrule decisions of the board of directors based on their business judgment unless the board or the committee fails to meet the good faith criteria. The courts in both Maldonado I and Maher determined that the board did not have the authority to terminate demand excused derivative suits under the business judgment rule.

It is appropriate, in this context, to examine the business judgment rule.

The Business Judgment Rule

“It is well settled that the management of a corporation is en-

74. Id.
75. Id.
76. 430 A.2d at 785.
77. Id. at 784.
78. 413 A.2d at 1257. 490 F. Supp. at 348.
79. The “business judgment” rule has been restated by one author as:
A corporation transaction that involves no self-dealings by, or other personal interest of, the directors who authorized the transaction will not be enjoined or set aside for the directors’ failure to satisfy the standards that govern a director’s performance of his or her duties, and directors who authorized the transaction will not be held personally liable for resultant damages, unless:
(1) the directors did not exercise due care to ascertain the relevant and available facts before voting to authorize the transaction; or
(2) the directors voted to authorize the transaction even though they
trusted to its board of directors, and that business judgments made by
the board are not subject to review unless they are made in bad
faith."  This concept has evolved into the business judgment rule
which has provided legal practitioners and scholars fertile ground for
debating whether the rule provides a corporation's board of directors
with only a shield or with a sword as well.  If the business judgment
rule is only protective, it merely shields the board from liability arising
out of inefficient, albeit, good faith decisions. However, if the board has
the authority to initiate legal actions based on its business judgment,
the rule becomes a sword as well.

The business judgment rule presumes that a board of directors, in
good faith, considers the best interests of the corporation when reach-
ing management decisions.  As the court in Zapata noted, the business
judgment rule was a judicial creation in Delaware "to give recognition
and deference to directors' business expertise when exercising their
managerial power under § 141(a)" of the Delaware Code.

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80. 490 F. Supp. at 351.
82. HENN, supra note 42, at 483.
83. 430 A.2d at 782. The court noted the applicable text of Del. Code Ann. tit.
8, § 141(a) (1980) to be:
The business and affairs of every corporation organized under this
chapter shall be managed by or under the direction of a board of directors,
except as may be otherwise provided in this chapter or in its certificate of
incorporation. If any such provision is made in the certificate of incorpor-
ation, the powers and duties conferred or imposed upon the board of direc-
tors by this chapter shall be exercised or performed to such extent and by
such person or persons as shall be provided in the certificate of incorporation.
It follows that if the board of directors has the power to manage the corporation and the authority to appoint an independent committee to act in its behalf, then when the committee makes its good faith business decision regarding suit on behalf of the corporation, its decision as a business judgment should be honored by the courts.

Thus, the shield versus sword debate becomes particularly significant in the context of shareholder derivative actions. In those instances where demand is required prior to commencing the derivative suit, courts have been reluctant to challenge board refusal to sue on the corporation's behalf. As noted earlier, the shareholder's right to sue derivatively terminates once demand has been made and properly refused. Here the board's decision is conspicuously sheltered by the business judgment rule.

However, in those situations where demand is excused, a question arises as to whether the board can compel dismissal of the derivative suit. Initially, the court in *Maldonado II* said yes, and held "that the Committee had the authority under the 'business judgment' rule, to require the termination of the derivative action." The court in *Zapata* however, rejecting the logic of *Maldonado II*, held the rule should not impede derivative actions where demand on the board was excused.

**Zapata Corp. v. Maldonado: The Balance Tips for the Shareholder**

The court in *Zapata* addressed a novel issue: whether an independent committee, appointed by the board of directors, had the power to compel dismissal of a shareholder derivative suit when no demand had been made on the board to initiate an action. To answer this question,

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84. 430 A.2d 786.
85. *Id.*
86. *Id.* at 779.
87. *Id.* at 784.
88. *See* text at 199, *supra*.
89. The rule applies to directors and officers alike. *Arsht, supra* note 81, at 111.
90. 430 A.2d at 781.
91. *See generally* 430 A.2d 779 and discussion in 202-07 *infra*.
92. In the major case of *Burks v. Lasker*, 441 U.S. 471 (1979), the Supreme Court held...
the court examined, separately, three inherent components:

The continuing right of a stockholder to maintain a derivative suit; the corporate power under Delaware law of an authorized board committee to cause dismissal of litigation instituted for the benefit of the corporation; and the role of the Court of Chancery [of Delaware] in resolving conflicts between the stockholder and the committee.93

Ultimately the court focused "on the power to speak for the corporation as to whether the lawsuit should be continued or terminated."94 The court stated that "disputes pertaining to control of the suit arise in two contexts."95 These contexts are: first, where a stockholder properly demands the board to initiate suit, the board refuses, and the stockholder claims the board's decision was wrongful; and second, where the stockholder initiates a derivative suit without first making a demand because such demand would be futile.96

In determining whether the individual stockholder had an individual right to maintain the suit, the court firmly distinguished the demand required from the demand excused circumstance evidenced in Zapata.97

"[W]here demand is properly excused, the stockholder does possess the ability to initiate the action on his corporation's behalf."98 But, while acknowledging the shareholder's right to initiate, the court noted that this right did not necessarily translate into shareholder power to exclusively control the corporation's "right throughout the litigation."99

Court, in developing a two prong test to be applied to similar questions arising in shareholder derivative actions, held that state law was determinative as to whether a committee has the power to compel dismissal of an action. See also Zolezzi, Director Good Faith Marches On: A California Analysis of Director Termination of Shareholder Derivative Suits Under Burks v. Lasker, 32 HASTINGS L.J. 519 (1980).

93. 430 A.2d at 782.
94. Id.
95. Id. at 784.
96. Id.
97. The court's discussion regarding "demand required" situations was dicta, however, it will be very persuasive in future decisions.
98. 430 A.2d at 784.
99. Id. at 785.
The court reasoned "that such an inflexible rule would recognize the interest of one person or group to the exclusion of all others within the corporate entity."\(^{100}\) The court recognized that "[e]ven when demand is excusable, circumstances may arise when continuation of the litigation would not be in the corporation's best interests."\(^{101}\) Therefore, the court reasoned that if there was not "a permissible procedure under § 141(a) by which a corporation [could] rid itself of detrimental litigation . . . a single stockholder in an extreme case might control the destiny of the entire corporation."\(^{102}\)

After acknowledging the dangers of allowing a sole stockholder to control derivative litigation, the court addressed the question of whether the independent committee had the authority to seek termination of the suit. The court in Zapata held that the power of the board to appoint an independent committee to act in its stead is found in the Delaware statutes.\(^{103}\) Therefore, since the committee received its authority from the board, the committee "would have the power to move for dismissal or summary judgment if the entire board did."\(^{104}\) The court further noted that although a majority of Zapata's board members were tainted by self-interest, this was not "a legal bar to the delegation of board power to an independent committee composed of disinterested board members."\(^{105}\)

The court held that in both demand required and demand excused circumstances, the board retained power "to make decisions regarding corporate litigation."\(^{106}\) Thus, the committee had the authority to seek termination of the suit.

While reaffirming the committee's legal power, the Zapata court nevertheless usurped board power to defeat the derivative suit and expressly changed the game plans for suits in demand excused situations. By its promulgation of new guidelines the Delaware Supreme Court appears to have given minority shareholders a distinct advantage in such suits.

\(^{100}\) Id.
\(^{101}\) Id.
\(^{102}\) Id. See applicable text of statute at note 83, supra.
\(^{103}\) 430 A.2d at 785.
\(^{104}\) Id.
\(^{105}\) Id. at 786.
\(^{106}\) Id.
As currently outlined by the Zapata court, the requirements for the corporation's pretrial motion to dismiss include submitting “a thorough written record of the investigation and its findings and recommendations. . . . Under appropriate court supervision, akin to proceedings on summary judgment, each side should have an opportunity to make a record on the motion.”\textsuperscript{107} The moving party, \textit{i.e.}, the corporation, then will have the burden of showing “that there is no genuine issue as to any material fact and that the moving party is entitled to dismiss as a matter of law.”\textsuperscript{108}

The more important advantage Zapata gives shareholders is a two-step test which Delaware courts will be required to apply to that motion. In the first step, “the court should inquire into the independence and good faith of the committee and the bases supporting [the committee’s] conclusions.”\textsuperscript{109} The independence and good faith elements are totally consistent with prior criteria established for reviewing the propriety of a corporation’s decisions. However, requiring the court to review the bases of the committee’s decision creates a new dimension of inquiry into the committee’s good faith.\textsuperscript{110}

Prior to Zapata, the decisions of a board of directors, under the business judgment rule, were given a presumption of good faith, independence and reasonableness.\textsuperscript{111} The burden to prove otherwise was on the shareholder who brought suit. The Zapata court now places on the board the burden of proving the existence of those elements. As the court stated, “[t]he corporation should have the burden of proving independence, good faith and reasonableness.”\textsuperscript{112} The court noted that “[i]ts] approach [was] consistent with the Delaware approach to 'interested director' transactions, where the directors, once the transaction is attacked, have the burden of establishing its 'intrinsic fairness' to a court's careful scrutiny.”\textsuperscript{113}

\begin{itemize}
  \item \textsuperscript{107} 430 A.2d at 788.
  \item \textsuperscript{108} \textit{Id}.
  \item \textsuperscript{109} \textit{Id}.
  \item \textsuperscript{110} The court may now question the reasoning for the decision of the board of directors or its independent committee, not just whether the decision was reached independently and in good faith. \textit{See} 430 A.2d at 789.
  \item \textsuperscript{111} 430 at A.2d at 782.
  \item \textsuperscript{112} \textit{Id} at 788.
  \item \textsuperscript{113} \textit{Id} at 788-89.
\end{itemize}
The second step mandates “[the] trial court [to] determine, applying its own independent business judgment, whether the motion should be granted. This means, of course, that instances could arise where a committee can establish its independence and sound bases for its good faith decisions and still have the corporation’s motion denied.”  114

Two commentators, Elmer W. Johnson and Robert S. Osborne, 115 felt the decision reached by the lower court in Maldonado I was too harsh in terms of its impact on “second tier 116 business judgment dismissals in cases alleging breach of fiduciary duty.” 117

Johnson and Osborne suggested a middle ground; once the defendant corporation establishes the independence of its special committee, “business judgment rule dismissal of derivative claims should be made available regardless of the nature of the underlying contract.” 118 But the middle ground they sought was a far distance from the landing place of Delaware’s Supreme Court. The court went much further, by permitting the trial court to actually supplant the committee’s business judgment with its own.

The Johnson and Osborne suggestions seem to accord with the theory that power to manage the corporation, and control its litigation, is vested in the directors. If the independence and good faith of the committee’s decisions remain in question after review by the trial court, the court may, appropriately, deny dismissal of the derivative suit.

Allowing the court to delve so deeply into the committee’s decision making process invites judicial overreaching. The court in Zapata acknowledged the danger of such overreaching 119 - but determined the trial court’s “fresh view” into the matter was desirable to properly balance the various interests involved. 120 The court specifically envisioned circumstances in which a dismissal, based solely on the corporation’s

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114. Id. at 789.
115. Johnson & Osborne, supra note 81.
116. The authors refer to the first tier as the original business decision made by the board which creates the controversy, and the second tier as that decision made by the committee as to whether or not to sue for injuries resulting from the first decision. Id. at 64-68.
117. Id. at 68.
118. Id.
119. 430 A.2d at 788.
120. Id.
ability to show good faith and independence, "would simply prema-
turely terminate a stockholder grievance deserving of further considera-
tion in the corporation's interest."\textsuperscript{121}

The court's decision in \textit{Zapata} clearly limits the use of the busi-
ness judgment rule: the rule is, thus, merely a shield in demand exc-
cused derivative suits.\textsuperscript{122} The board of directors, or its committee, may, 
by motion, seek termination of suit if this accords with its business 
judgment. The motion will be honored or denied at the court's 
discretion.

\section*{Conclusion}

There are compelling policy arguments for protecting the minority 
shareholder's right to control a derivative suit when controversies arise 
regarding a board of director's independence or good faith. Similarly, 
there are strong reasons for protecting the rights of the board to direct 
corporate litigation. The shareholder, as an owner of the corporation, 
seeks to maximize his returns and maintain the prestige, goodwill, and 
value of the corporation. The board shares those concerns, but is also 
mindful of the need to maintain autonomy as sole decision-maker of 
the corporation. Because there are often factors considered in business 
decisions which may not directly translate into dollars and cents, the 
board of directors should have the flexibility to make those decisions in 
good faith. Directors should not have the added pressure of finding the 
court in its board room.

The Supreme Court of Delaware, in \textit{Zapata}, was mindful of the 
need to carefully balance the interests of the stockholder and the board 
of directors. The "middle ground" the court struck may ultimately 
prove to be a fair compromise. However, on its surface the decision in 
\textit{Zapata} creates cause for concern of possible judicial overreaching in 
demand excused situations. It is conceivable that the courts, in follow-

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\textbf{Shareholder Derivative Suits} & \textbf{207} \\
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121. \textit{Id.} at 789.

122. The procedures under "demand required" situations in essence remain un-
changed. The board still has the power to refuse to sue when demand is required. \textit{Id.} at 
785. In fact the court buttressed the sanctity of the board's "business judgment" in 
those instances where: 1) demand is required, 2) demand is made, and 3) the board, in 
good faith, reaches a decision not to sue. In those situations the court indicated share-
holders will not have standing to sue. \textit{Id.} at 784.
ing Zapata, will show little reluctance to carry their own business judgment into demand required situations as well. By attempting to clarify the various interpretations surrounding application of the business judgment rule in derivative actions, the Zapata court may have provided Delaware courts with skeleton keys to all of Delaware's board rooms.

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