Note: The Personal Liability of Directors in Florida: Whose Corporation is it Anyway?*

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Abstract

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KEYWORDS: directors, liability, personal
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I. INTRODUCTION

During the 1980's a serious crisis developed in the insurance industry which threatened to expose corporate directors to personal liability.¹ In addition, in 1985, the Delaware Supreme Court decided in Smith v. Van Gorkom that directors who failed to adequately inform themselves of corporate matters were grossly negligent, and therefore would be held personally liable for their uninformed decisions.² The decision has been viewed as one of the worst in the history of corporate law, and one which will adversely affect the quality of directors who serve on corporate boards.³

In keeping with the flurry in almost every state to amend their corporate acts in response to the crisis in the Director and Officer insurance industry and the Smith v. Van Gorkom decision, in 1987 the Florida Legislature made sweeping changes to the Florida General Corporation Act.⁴ Specifically, the Legislature added a new statute relating to the personal liability of directors for decisions which they

* The author would like to thank Professor Marilyn Cane for her suggestion of the title and her assistance generally.

1. A number of commentators have written about the crisis in the director and officer liability insurance industry. See, e.g., Block, Barton & Garfield, Advising Directors on the D & O Insurance Crisis, 14 SEC. REG. L.J. 130 (1985); Note, New York's Response to the Director and Officer Liability Crisis: A Need to Reexamine the Importance of D & O Insurance, 54 BROOKLYN L. REV. 1305 (1989).
2. 488 A.2d 858 (Del. 1985).
make in their capacity as directors. Rather than follow the lead of the Delaware Legislature, which allowed corporations to limit or eliminate liability of directors in their charters, the Florida Legislature took a different approach. The lawmakers decided to grant directors immunity from personal liability for money damages in respect to "any statement, vote, decision, or failure to act, regarding corporate management or policy," unless there is a breach of duty by the director and the breach constitutes one of five circumstances. Whereas the Delaware amendment sought to protect informed shareholders by giving them the choice of deciding whether or not to relieve their directors of liability, the Florida Legislature took choice out of the hands of the shareholder. In effect, the Florida statute relieves directors of accountability for their actions except in the most grievous circumstances, and indeed, reduces the rights of shareholders.

The 1987 amendment had two stated legislative purposes. The first was to reduce the concerns of directors to the possibility of being personally liable for damages arising out of decisions they make in their capacity as directors. The second was to define more clearly the standard of care owed to the corporation and the shareholders by the director. In order to satisfy the stated legislative purpose of making directors' jobs less worrisome, and to attract high calibre directors, the legislature also modified the provisions with regard to indemnification. These provisions were altered to increase the circumstances in which directors may be indemnified where they are found liable for acts taken on behalf of the corporation.

The approach of the Florida Legislature in amending its corporation statute has been described as "[t]he most radical legislative approach to director liability [as it directly alters] the standard of liability necessary to recover money damages from directors." Moreover, one commentator noted that the 1987 amendment so dilutes a share-

5. Fla. Stat. § 607.0831 (1989). This amendment will be referred to in this paper as "the 1987 amendment."
7. § 607.0831; See infra Part II
9. Id. at § 1(2). Quoted in full infra Part II.
10. The indemnification provisions can be found at § 607.0850. The new provisions are at §§ 607.0850(2) and (7).
holder's right of action against a director for money damages that its constitutionality may be in doubt.\textsuperscript{12} Whereas some thirty five states have already amended their corporation acts to provide for a lower standard of culpability, only five other states have enacted such obviously pro-director legislation similar to Florida.\textsuperscript{13}

The 1987 amendment has the effect of reducing the concerns which directors have regarding their personal liability, but other questions remain. The statute clarifies the appropriate standard of care owed by the director to the corporation and its shareholders only in so far as it generally eliminates liability for monetary damages. However, directors must continue to be concerned with the standard of care since they may still be restrained from action by injunction or their actions may be subject to rescission by the court.\textsuperscript{14} Nevertheless, because the burden on the shareholder seeking to obtain equitable relief is so great, directors probably have no real need to be concerned. This Note considers the present state of the law relating to liability of directors in Florida, and considers whether the new legislative changes can or will have the intended effect. Part II analyzes the legislative changes, describes in detail the provisions of section 607.0831 and considers how the new provisions differ from the state of the law prior to 1987. Part III examines the policy considerations in determining the parameters of director liability, and focuses particularly on the part that the director and officer liability insurance industry played in effecting the legislative change. Part IV considers what effect, if any, the statutory changes can or will have on corporations and their directors, and concludes that thus far, the positive effects anticipated by the legislature have not occurred.

\textsuperscript{12} See McGuigan, \textit{Legislative Developments in Director's Liability Ch. 87-245}, FlA. B.J. 41, 43 (1987)(discussing the constitutionality of the 1987 amendment and concluding that it is probably constitutional).


\textsuperscript{14} McGuigan, \textit{supra} note 12, at 42.
II. THE 1987 AMENDMENT

In making the "radical" amendment to the Florida Corporation Act, the Legislature found

that the service of qualified persons on the governing boards of corporations, . . . is in the public interest and that within reasonable limitations, such persons should be permitted to perform without undue concern for the possibility of litigation arising from the discharge of their duties as policy makers. The Legislature further finds that the case law of the state does not adequately delineate the liability of those serving on governing boards, and that such delineations through the clarification of the appropriate standard of care due an individual and a corporation by a member of a governing board is essential in encouraging the continued service of qualified persons on such governing boards.15

In the Staff Analysis of the House of Representatives, Committee on the Judiciary, it was noted that Florida case law had not yet defined the "parameters of liability of a director of a corporation . . . in this state."16 The House Analysis went on to find that the state of the law was such that it was foreseeable that a director could be held personally liable where he failed to take "all reasonable and necessary precautions to ensure that any action [which] he took as a director would not result in damage to another."17 Under these circumstances, the committee recommended that the law should be changed to define more clearly the standards to which directors should be held.18 The Senate Committee pinpointed two main reasons why the need for the change arose: the need to make the position of director attractive in order to encourage corporations to incorporate in Florida; and the difficulty of obtaining director and officer liability insurance.19

This part examines the provisions of the 1987 amendment. A discussion of the state of the law regarding the personal liability of directors in 1987 puts in context the reason the position of director may have been unattractive at that time.

17. Id.
18. For the proposals of the House Committee see id. at 2-5.
19. See FLA. SENATE, STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT at 7-8 (1987) [hereinafter SENATE ANALYSIS].
A. *The Provisions of the 1987 Amendment*

Section 607.0831 of the Florida Statutes eliminates director liability for monetary damages except in five defined circumstances. Rather than outlining the standards by which directors should be guided, the statute virtually eliminates director liability for monetary damages, and restates the law regarding the acts for which director liability may still attach. Furthermore, the statute requires a two-step test before liability may be established. The first and threshold requirement is that the director must have breached or failed to perform his duties as a director. The second step is that the breach must also constitute: 1) a violation of criminal law, unless the director had reasonable cause to believe that his act was lawful or no reasonable cause to believe it was unlawful; or 2) a transaction from which the director derived a personal benefit; or 3) the director has voted or assented to an unlawful distribution and is liable pursuant to section 607.0834; or 4) conscious disregard for the best interest of the corporation, or wilful misconduct in any derivative action or other action by or against the corporation; or 5) recklessness or any act or omission which was committed in bad faith or with malicious purpose or in a manner exhibiting wanton and wilful disregard of human rights, safety, or property.

The first step of the 1987 amendment neither changes nor clarifies the standard of care of directors as it refers to duties which it does not define. However, the real meat of the statute is the second step, for even if the court finds a breach of duty, it must still find one of the five violations for any liability for monetary damages to attach. The five exceptions encompass such improper conduct, "so clearly without any societal benefit," that under no circumstances should society validate it.

B. *The Duties of Directors*

Since the 1987 amendment does not define the "duties" which the director must breach in order to attract liability, the common law duties of care and loyalty, and the standards as previously codified under

21. § 607.0831(1)(a).
22. § 607.0831(1).
23. § 607.0830 outlines general standards in codifying the business judgment rule. See also infra Part II, section C.
sections 607.0830 and 607.0832 must be examined to determine whether there has been a breach of duty.

Historically, courts have wrestled with the type of duty owed by directors to the corporations they serve. The Florida Supreme Court noted in 1932 that "[w]hile directors of a corporation may not be in the strict sense trustees, it is well established by the decisions that they occupy a quasi-fiduciary relation to the corporation and its stockholders." The present state of the law is that directors owe the twin duties of care and loyalty to the shareholders and the corporation in managing and administering the corporation's property, assets and affairs. Directors must act with fidelity and in good faith when discharging their functions.

In discharging his duties, a director must act with ordinary care and skill. Even though the director may delegate his authority in the active management of the business to officers, he must still exercise reasonable supervision. Directors have a "continuing obligation to keep informed about the activities of the corporation," and if they do not, they cannot set up a defense of lack of knowledge needed to exercise the requisite degree of care. Indeed, "[a] director is not an ornament, but an essential component of corporate governance. Consequently, a director cannot protect himself behind a paper shield bearing the motto 'dummy director.'" The director owes a duty to the shareholders to exercise "supervision and control over the policies and practices of the corporation."

The duty of loyalty prohibits faithlessness and self dealing, includ-

25. See, e.g., Charitable Corp. v. Sutton, 26 Eng. Rep. 642, 645 (1742) (the court found that directors were trustees and required them to act "with fidelity and due diligence"); see also Note, An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule, 40 Vand. L. Rev. 605 (1987) (for a more detailed discussion of the history of the duty of directors).
30. See id.
32. Id.
33. Id. at , 432 A.2d at 823 (citing Campbell, 62 N.J.Eq. at 415, 50 A. 120).
34. Id. at , 432 A.2d at 824.
ing fraud and bad faith. The duty is based on the rationale that the director, by virtue of his office, owes allegiance to the corporation and therefore the best interest of the corporation must prevail over his own.\textsuperscript{35} However, a director is not absolutely precluded from entering into transactions in which he may be personally interested and which arise as a result of his relationship with the corporation.\textsuperscript{36} At common law, transactions between a corporate director and an outsider which resulted from the director's office were voidable without regard to the fairness of the transaction.\textsuperscript{37} The Florida statute now provides that the transaction is not void or voidable if the relationship is disclosed or is known to the directors or the shareholders.\textsuperscript{38}

C. \textit{The Business Judgment Rule}

The business judgment rule is a policy of judicial restraint, which recognizes that directors are more qualified than judges to make business decisions.\textsuperscript{39} The rule provides that, for matters that the law vests in the board, the board has wide discretion and a court will not generally substitute its judgment for that of the directors.\textsuperscript{40} Thus, absent any wrong doing, the court will generally not scrutinize the decisions of a board to determine the merits of its decision.\textsuperscript{41} Traditionally, directors have always been protected by the "business judgment rule."\textsuperscript{42} A director who acted with care and loyalty was not subject to any personal liability.\textsuperscript{43}

The rule is rooted in the notion that in exchange for the confidence and trust which shareholders place in them, directors must act in good faith, and "in accepting the office they impliedly undertake to give the enterprise the benefit of their best care and judgment, and to exercise

\begin{itemize}
  \item \textsuperscript{35} Animashaun, \textit{supra} note 3, at 350.
  \item \textsuperscript{36} See \textit{e.g.}, Procacci v. Soloman 317 So. 2d 467 (Fla. 4th Dist. Ct. App. 1975)(director who purchased corporation's property from bank, after corporation defaulted on promissory note, found not liable for breach of fiduciary duty).
  \item \textsuperscript{37} See Animashaun, \textit{supra} note 3, at 350.
  \item \textsuperscript{38} § 607.0832.
  \item \textsuperscript{39} See, \textit{e.g.}, International Ins. Co. v. Johns, 874 F.2d 1447, 1458 & n.20 (11th Cir. 1989) (applying Florida law, and reviewing decisions involving the business judgment rule).
  \item \textsuperscript{40} \textit{Id.}
  \item \textsuperscript{41} \textit{Id.}
  \item \textsuperscript{42} \textit{Id.} at 1458-59.
  \item \textsuperscript{43} \textit{Id.}
\end{itemize}
the powers conferred solely in the interest of the corporation." Indeed, equity has always held them liable as trustees.

However, courts have not allowed directors to shelter behind the business judgment rule where directors have acted in bad faith, without due care, abused their discretion, or participated in a transaction in which they were interested. The rule has been characterized as having five elements, which courts generally examined before "second guessing" the decision of the board. The decision must be a business decision, the board should be disinterested, have acted with due care, in good faith and even if it satisfies all the other elements, must still not have abused its discretion. Courts have been reluctant to find liability unless the decision could not be attributed to any rational business purpose, or there was abuse of discretion.

The burden lay on the person alleging breach of duty to overcome the presumption of due care, good faith and disinterestedness. Only if he did, then the burden shifted to the director to show the contrary. In any event, the plaintiff also had to establish causation and damage.

In Florida, even prior to the 1987 amendment, the business judgment rule had been codified as the duty of care provision. An individual who performs duties as a director, in good faith and in the best interests of the corporation, with such care as an ordinarily prudent person in like position would exercise under similar circumstances, is relieved from liability. However, under this general provision, similar to that in Delaware and many other states, it was left to the court to define and apply the phrase "such care as an ordinarily prudent person in like position".

Florida courts have long relied on Delaware corporate law for guidance in deciding cases involving corporation law, and "to establish

44. *Orlando Orange Groves Co.*, 107 Fla. at 314, 144 So. at 677 (quoting 7 R.C.L. 456, 457).
45. *Id.*, 144 So. at 677.
47. *Id.*
48. *Id.*
49. *International Ins. Co.*, 874 F.2d at 1461.
50. *See Van Gorkom*, 488 A.2d at 872.
51. *See, e.g.*, *id.* (Delaware Supreme Court remanding the matter to the trial court for a hearing to determine the damage sustained).
52. § 607.0830. The Legislature did not change this section in any way after the 1987 amendment.
53. *Id.*
their own corporate doctrines." In Aronson v. Lewis, the Delaware Supreme Court decided that in making a business decision, directors would be protected by the business judgment rule only in so far as the decision was informed. Furthermore, the standard for determining whether the decision was informed was one of "gross negligence."

Van Gorkom, decided by the Delaware Supreme Court one year later, "shocked the corporate world" by deciding that the directors of Trans Union Corporation had been "grossly negligent" in approving a cash-out merger proposal after a short meeting, and would not be protected by the business judgment rule. The board's decision was made at a special board meeting called by Jerome W. Van Gorkom, Trans Union's Chairman and Chief Executive Officer, who did not inform the directors of the purpose of the meeting. In fact, senior management learned of the proposal approximately one hour before the meeting. Apart from Van Gorkom's twenty minute presentation at the meeting, the directors had no other substantive information about the merger. It appears that none of the directors had read the merger agreement prior to signing. The court held that the directors did not adequately inform themselves as to Van Gorkom's role in the transaction and as to how he arrived at the decision to force the sale and set the price of the shares. In addition, they were not informed as to the value of the corporation. The court found the directors "grossly negligent in approving the 'sale' of the Company upon two hours' consideration, without prior notice, and without the

54. *International Ins. Co.*, 874 F.2d at 1459 n.22.
56. *See, e.g.*, id. at 812 & n.6; *Van Gorkom*, 488 A.2d at 873. Indeed, Florida courts have long held that directors who acted with gross negligence, causing waste to the corporation's assets, could not seek shelter behind the business judgment rule; *see Skinner*, 103 Fla. at 716, 138 So. at 771 (citations omitted). Since 1985, Florida courts have extended the standard even further. In Cottle v. Storer Comm., Inc., 849 F.2d 570, 577 (11th Cir. 1988), the United States Court of Appeals, applying Florida law, held that the plaintiff must prove gross inadequacy of price in order to overcome the business judgment rule.
57. 488 A.2d 858.
58. *Id.* at 874; *see also* Radin, *supra* note 3, at 707.
60. *Id.*
61. *See id.* at 868-69.
62. *See id.* at 868 & n.7.
63. *Id.* at 874.
64. *Id.*
exigency of a crisis or an emergency."

Many viewed the Van Gorkom decision as the courts having opened the door to exposing directors to personal liability for their actions. Based on the facts of the case, the view in the insurance industry and within the business community was that the standard of care required of a director was now much higher, and indeed almost impossible to achieve.

In actions involving monetary damages, the 1987 amendment, in effect requires the courts to apply the business judgment rule only as a first step to determine whether a duty has been breached. For even if the director breached a duty, he will not be liable for damages unless the court finds that the breaching act falls into one of the five exceptions.

D. The Five Exceptions

Under the first exception, the director’s breach or failure to perform his duty must constitute

[a] violation of the criminal law, unless the director had reasonable cause to believe his conduct was lawful or had no reasonable cause to believe his conduct was unlawful. A judgment or other final adjudication against a director in any criminal proceeding for a violation of the criminal law estops the director from contesting the fact that his breach or failure to perform, constitutes a violation of the criminal law; but does not estop him from establishing that he had reasonable cause to believe that his conduct was lawful or had no reasonable cause to believe that his conduct was unlawful.

This exception does not create new law, because as part of their duty of care, directors have traditionally had a duty to act lawfully. According to the ALI Principles of corporate governance, a director violates his duty of care and good faith if he “knowingly” causes the corporation to violate the law. To eliminate problems which have

65. Id.
66. See supra note 3.
67. Id.
68. § 607.0831(1)(a).
69. § 607.0831(1)(b).
70. § 607.0831(1)(b)(1).
arisen over the interpretation of the word "knowingly," the Florida Legislature chose instead to define it as "having reasonable cause to believe."72 Undoubtedly, litigation will still arise as to the meaning of "reasonable cause," since inevitably, directors will attempt to further insulate themselves from liability by claiming that they did not believe that their actions were criminal.

Under the second exception, the director’s breach or failure to perform must constitute "[a] transaction from which the director derived an improper personal benefit, either directly or indirectly."73 The statute goes on to define an “improper personal benefit.” The director is deemed not to derive an improper personal benefit if: a) the transaction and the nature of the benefit were not prohibited by federal or state law;74 b) the transaction was known or disclosed to the all directors and /or shareholders;75 and c) the transaction was fair and reasonable to the corporation.76 The statute also does not rule out the possibility of other circumstances under which the benefit may be deemed to be improper.77

In this second exception the Legislature addressed the director’s duty of loyalty. The exception must be viewed in conjunction with section 607.0832, which outlines the standards for directors in situations where there may be a conflict of interest.78 Although, section 607.0832 deals primarily with the enforceability of the contract, it is interesting to note that it may be possible for the contract to be unenforceable because of a conflict of interest under section 607.0832, but for the director not to be liable under section 607.0831(1)(b)(2).

This second exception only alludes to that aspect of the duty which requires the director to act in the corporation’s best interest and to refrain from self-interested behavior. Other aspects of the duty of loyalty such as fraud or bad faith are not addressed in this exception. In addition, the definition of “improper” does not include a benefit to the director’s family or financial associates.79 Consequently, although this ex-

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72. See § 607.0831(1)(b)(1).
73. § 607.0831(1)(b)(2).
74. § 607.831(3).
75. § 607.831(3)(a),(b).
76. § 607.831(3)(c).
77. § 607.0831(5).
78. § 607.0832 does not address the issue of director liability.
79. See Gelb, supra note 71, at 40, for a discussion of the merits of including members of the director’s family and his associates in determining whether he has an interest in the transaction.
ception saves some liability for breach of duty of loyalty, it relieves the
director of much responsibility.

Under the third exception, the director’s breach or failure to per-
form must constitute a circumstance whereby the director votes or as-
serts to a distribution of dividends in violation of section 607.06401 or
the articles of incorporation.\textsuperscript{80} The statute merely reiterates the direc-
tor’s liability for unlawful distributions which had previously been stat-
tutorily established. The intent of the provision is to continue to protect
the creditors of the corporation against directors who may want to re-
ward shareholders for their investments before creditors are satisfied.\textsuperscript{81}

Under the fourth exception, the director’s breach or failure to per-
form must constitute “[i]n a proceeding by or in the right of the corpo-
ration to procure a judgement in its favor or by or in the right of a
shareholder, conscious disregard for the best interest of the corporation,
or wilful misconduct.”\textsuperscript{82} Once more the legislature tried to preserve the
duty of loyalty to some extent. In a derivative action, this exception
puts the onus on the director to act with good faith. However, the
words “conscious” and “wilful” indicate that the standard of care re-
quired is relatively low and a level of behavior bordering on outra-
geousness is probably what is required for liability to be established.

The fifth and final exception requires that the director’s breach or
failure to perform constitute, “in a proceeding by or in the right of
someone other than the corporation or a shareholder, recklessness or an
act or omission which was committed in bad faith or with malicious
purpose or in a manner exhibiting wanton and wilful disregard of
human rights, safety or property.”\textsuperscript{83} The section goes on to define
“recklessness” as “the action, or omission to act, in conscious disregard
of a risk,” and which the director knew or should have known because
it was obvious, would be so great as to probably cause harm.\textsuperscript{84} This
exception refers to actions brought by third parties. The standard es-
blished by the section is even lower than in the previous section.
Criminal intent may have to be established in order to find a director
liable under this exception.

\textsuperscript{80} § 607.0831(1)(b)(3). § 607.06401 provides the circumstances under which
the board may authorize distributions to shareholders. See \textsc{Fla. Stat.} § 607.0640
(1989) and § 607.08401 (Supp. 1990). The restrictions are mainly out of concern for
creditors. See also \textit{Changes}, supra note 11, at 702.

\textsuperscript{81} See Changes, supra note 11, at 702.

\textsuperscript{82} § 607.0831(1)(b)(4).

\textsuperscript{83} § 607.0831(1)(b)(5).

\textsuperscript{84} § 607.0831(2).
Florida courts have not yet had an opportunity to examine the provisions of the 1987 amendment. Indeed, the exceptions require such exceptional misconduct by directors that it is unlikely that litigation is forthcoming. However, a re-examination of the Van Gorkom case in the light of the 1987 amendment is instructive.

Delaware Supreme Court Justice Andrew G.T. Moore, a member of the Van Gorkom court, stated that the case "doesn't stand for new law. The court was just applying old law to egregious facts." Some commentators have concluded that "absent egregious conduct," the court has not changed its traditional application of the business judgment rule's presumption that director's conduct is informed and taken in good faith. The Delaware court found the board to have been grossly negligent because it approved a multi-million dollar takeover in a two hour board meeting without regard to proper reports or investigation. However, if the action had taken place where current Florida law was applicable, the directors would have escaped liability because their actions did not fall into any of the five exceptions.

The 1987 amendment defines egregious conduct under the five exceptions, and basically requires the courts to go beyond the business judgment rule in order to find director liability in circumstances in which monetary damages are claimed. Apart from these few exceptional circumstances, the legislature has limited the power of the courts to deal with the director who has abused his discretion. The legislature has also stymied the right of the owners of the corporation to decide how culpable their directors should be.

III. THE LEGISLATURE'S CONCERNS

In amending the corporation act, the Senate believed that the new provisions in themselves would give directors an incentive to serve on boards, since they would serve free from the worry of personal ruin.

85. There are no reported cases which have called upon the courts to determine whether the action falls within the amendment.
87. Id. at 720.
88. In contrast, under present Delaware law, the directors would have escaped liability only if Trans Union had amended its certificate of incorporation to include a provision relieving directors of liability. The issue of who controls the votes of shareholders' which are necessary for an amendment of this nature is beyond the scope of this article.
and secure in the knowledge that they would likely be indemnified by the corporation for any liability which may be determined against them. Further, it anticipated that Florida would benefit as it would remain an attractive place for corporations to incorporate.

This part reviews the state of the director and officer liability insurance industry, particularly from the standpoint of directors. It also examines whether the indemnification provisions of the corporation act, together with the 1987 amendment can achieve the legislature's stated objective.

A. Director and Officer Liability Insurance

It is indisputable that a crisis exists, and has existed since the early 1980's, in the director and officer insurance industry. The practice of corporations insuring their directors against personal liability incurred for their corporate actions is quickly disappearing. On the one hand, premiums have become exorbitant, and on the other, some insurance companies are no longer issuing such policies. Corporate directors must now face the reality of potential personal liability for simple errors in judgment.

Shareholders derivative claims represent the majority of claims filed against directors of corporations. Indeed there has been an increase in both the number of suits and the severity of such claims. Director and officer claims rose at a rate of fifteen to twenty percent per year over a ten year period from 1977 to 1987. Indeed, directors

89. Senate Analysis, supra note 19, at 7.
90. Id. This prediction has not been borne out since there has been no significant increase in the number of corporations being registered in Florida annually.
91. See supra note 1.
92. A corporation may purchase and maintain insurance on a director in respect of any liability incurred by him. § 607.0850(12).
93. Premiums on director and officer liability policies increased by an average of 506 per cent nationwide in 1986 according to a survey of 256 chairmen of Fortune 1,000 companies by Heidrick & Struggles, a Chicago based executive search firm. See Senate Analysis, supra note 19, at 7.
94. The Department of Insurance identifies nine companies who have rate filings with the department for director and officer insurance. Of these, at least two had no writings in Florida in 1986 and others were very selective in their underwriting. See Senate Analysis, supra note 19, at 7-8.
95. Note, Corporate Directors, supra note 3, at 504.
96. Id.
of public companies have a one in five chance of being sued.98

While ninety percent of the corporations carry director and officer insurance, one third have seen a rise in premiums of over three hundred per cent.99 Premium increases have resulted from large payouts not only in quantity, but also in size. Over a ten year period, the size of claims increased, and the percentage of claims with payments of over one million dollars jumped by seventy three percent.100 Insurance carriers are reluctant to provide adequate director and officer liability insurance at any premium. The risk has become too great.101 Policies that are issued are more restrictive in nature and contain numerous exclusions.102

Many outside directors103 have reevaluated their decisions to serve on boards, while several have resigned or declined appointment where the corporation has failed to provide adequate director and officer liability insurance.104 Three hundred and seventy directors were surveyed by the National Association of Corporate Directors and their responses indicated that one in seven would refuse to sit on any board without insurance protection, and approximately four percent had already resigned from boards without director and officer coverage.105 A 1986 Peat Marwick poll of nearly eight thousand chief executives and directors in the corporate and not-for-profit sectors showed that the problem of providing adequate director and officer coverage was damaging the calibre of management.106 Six in ten reported that this problem affected the way in which they managed their organizations and forty three per cent believed that the situation had reached crisis proportion.107

The corporate legal fiction allows individuals to pool their resources and act as one “person” in conducting commercial activity. Traditionally management of the corporation rests in a board of direc-

98. Senate Analysis, supra note 19, at 8.
99. Id. at 9.
100. Note, New York's Response, supra note 1, at 1308.
101. Block, Barton & Garfield, supra note 1, at 131 & nn.5 & 6.
103. An insider director is one who is also an officer or employee of the corporation. Conversely, an outside director is not an employee.
104. Note, Corporate Directors, supra note 3, at 505 n.73.
105. Senate Analysis, supra note 19, at 8.
107. Id.
tors. However, whereas in the earliest small private corporations the board was usually made up of the shareholders, as corporations grew in size and became more sophisticated, the composition of the board also changed. In order for the corporation to be managed properly, the seats on the board of directors had to be filled by people of reputation, expertise and specialized knowledge. Even so, the modern view is that the board cannot effectively "manage" a corporation. The board can only act in meetings and since in practice meetings are held only a few times a year, the modern board must in effect rely on the officers and executives of the corporation.

Today, the wealth of information that is available on any given topic, and the speed with which it becomes available can make the director's job even more onerous. Fear of liability for not accessing and reading all that is available also acts as a deterrent to busy, yet qualified, persons to serve on corporate boards. The problem corporations face if they are unable to afford or obtain director and officer insurance is in recruiting and retaining a high calibre of director. Confronted with the prospect of risking his financial future for token remuneration, a former or future director prefers to take the safer course of not serving on a corporate board. Ultimately, the lack of qualified directors must create a crisis in the business world. Boards will run less efficiently and certainly, those directors who can be inveigled into taking


109. Florida corporate law still reflects this position, as corporations with 35 or fewer shareholders may provide for no board of directors or may limit the power of the board if it has one. § 607.0801(3).


111. Section 607.0824(3) provides that a vote of the majority taken at a meeting of directors at which a quorum is present, is the act of the board of directors. Directors can act without a meeting only if the action is taken by all the directors. § 607.0821.


113. In discharging his duties, a director may rely on "information, opinions, reports, or statements, including financial statements" which has been prepared by competent employees or officers, experts, accountants, legal counsel and/or committees of the board of which he may not be a member. § 607.0830(2). See also supra Part II.
the positions will act with extreme caution. Directors will be less inclined to take business risks if their personal assets are at stake. Indeed, "the opportunities for 'innovation and creative activities' may be lost." 115

In the light of the foregoing and in order to provide greater protection for directors than the courts are willing to give, in recent years, more than thirty-five states have amended their corporation acts. Most states have taken one of three approaches: 1) the "charter option" approach 2) the "cap on money damages" approach, and 3) the "self-executing" approach. 117

Delaware was the first state to enact the "charter option" approach in 1986. This approach allows the shareholders, with some exceptions, to decide whether to adopt a provision in the corporation's charter which eliminates or limits the personal liability of a director for money damages. Several other states have followed Delaware's lead in adopting this approach. 118

The "cap on money damages" approach limits, with some exceptions, the amount of money damages for which a director may be liable. The statute would provide a maximum figure beyond which liability could not extend. 121

The "self-executing" approach, as the name implies, means that the standard of liability is determined by the statute itself. Shareholders have no input into whether liability for monetary damages should attach to their directors in circumstances other than those prescribed by the statute. 123

The Committee on Corporate Laws of the American Bar Association recommends that shareholders should be allowed to decide whether

114. Block, Barton & Garfield, supra note 1, at 131-2.
116. See Changes, supra note 11, at 696.
117. Id.
118. Id.
119. Id. at 696-97.
120. Id. at 698; see also Titus, supra note 3, at 4 n.7 for a discussion concerning the states which followed the Delaware approach.
121. See Titus, supra note 3, at 5. Virginia has placed the cap at $100,000 or the amount of compensation in cash which the director received in the twelve months immediately preceding the act. VA. CODE ANN. § 13.1-692.1(2).
122. Changes, supra note 11, at 698.
123. See id.
to eliminate liability of directors for their conduct, unless "important societal values are at stake."\textsuperscript{124} The Committee therefore recommends that the Model Business Act should adopt the charter option approach.\textsuperscript{125}

The Florida Legislature chose the self executing approach.\textsuperscript{126} Although Florida directors, like directors in every other jurisdiction, owe the corporations they serve and shareholders the fiduciary duties of care and loyalty, they are now statutorily protected regarding decisions they make as directors. As explained in the previous part, a director's liability for monetary damages is completely eliminated unless the action is one which falls into one of the five exceptions. The Florida approach is by far the most radical approach since it eliminates the traditional right of shareholders to decide the manner in which the corporation they own should be run. Taking decision making out of the hands of the shareholder and into the hands of the state is a dangerous precedent and violates the very essence of capitalism.

B. Indemnification Provisions

In addition, in keeping with its decision to give directors as much protection as possible, the Legislature also amended the indemnification provisions in 1987 to increase the circumstances under which a director may be indemnified by the corporation. Three major changes were effected. The first two concern derivative actions. Directors are now entitled to be indemnified for expenses incurred in derivative actions which have been a) settled; and b) in which they have been found liable, if a court of competent jurisdiction determines that it is fair and reasonable so to do.\textsuperscript{127} The third major change was in determining under what circumstances and to what extent the corporation will indemnify a director. The corporation may not indemnify a director whose action constituted one of the exceptions under section 607.0831.\textsuperscript{128}

The present position is that indemnification is available under the statute in four operative categories.\textsuperscript{129} The first is that prior to the

\textsuperscript{124} Id. at 700.
\textsuperscript{125} Id.
\textsuperscript{126} See supra note 13, for other states adopting the Florida approach.
\textsuperscript{127} § 607.0850(2).
\textsuperscript{128} § 607.0850(7).
\textsuperscript{129} Fields, Indemnification of Officers and Directors Under Revised Florida Statute, in Responsibilities and Liabilities of Corporate Directors, Officers
event, the corporation may decide in what circumstances indemnification is allowed by adopting by-laws and executing agreements. Second, after the event, the corporation may elect to indemnify the director, except that it may not indemnify the director in respect of actions which fall under one of four of the five exceptions under section 607.0831. Furthermore, the statute distinguishes between indemnification in derivative and non-derivative actions. Third, a director who successfully defends a suit is unconditionally entitled to expenses to the extent of his success. Finally, a new addition provides that a court of competent jurisdiction may order indemnification even if the director has been unsuccessful, but only if it is fair and reasonable in the circumstances.

The new additions to the statute provide an incentive to directors to settle cases without fear of paying their own out of pocket expenses. However, it is difficult to rationalize why the corporation should reimburse a director for actions he has taken to hurt the corporation in an action brought against him on behalf of the corporation. The policy reasons for adopting such a provision could be only to make the position of director more attractive and to insulate directors further from financial loss as a result of their office.

Viewed in conjunction with the director liability statute, indemnification for expenses is not available if the act constitutes four of the five exceptions. Consequently in an action for money damages which is settled or in which the director is found liable, he may not be reimbursed unless the act falls into the fifth exception - that the director acted recklessly, in bad faith or in a manner exhibiting wanton disregard for life and human safety. In effect the Legislature has made indemnifi-
cation possible in circumstances in which the director should be most culpable. Such a result defies logic, leaving one to conclude that leaving out the fifth exception must have been an oversight by the Legislature.

IV. CONCLUSION

Prior to the 1987 amendment, directors in Florida were not exposed to liability for monetary damages unless they breached their duties to the corporation. Shareholders had some measure of assurance that the directors would act responsibly in making decisions on their behalf, or at least be legally accountable to shareholders for their actions. The 1987 amendment in addition to giving little protection to the shareholder, also does not achieve its stated legislative goal of making the position of director more attractive.

Moreover, the predictions of dire consequences to corporate directors arising out of Van Gorkom have not materialized, nor have the fears that the courts would lower the standard of culpability for directors. One author's examination of case law in the three years following Van Gorkom has found that "the courts have repeatedly rejected due care allegations in cases in which the challenged board conduct did not approach the level of gross negligence present in Van Gorkom." The study concluded that only six courts found violations of due care within the period, and in all the cases, the conduct approached the level of conduct in the Van Gorkom case. The author concluded that the decisions showed no indication of "a change in the courts' traditional adherence to the business judgment rule's presumption . . . ."

Of particular interest, and perhaps warning, to Florida directors is that in all six cases the parties requested and the court granted injunctive relief after having found a lack of due care. The 1987 amendment did not address the question of injunctive relief, so director liability in that arena remains a question to be determined by consideration of the business judgment rule. However, a plaintiff shareholder will have to anticipate board action in order to stop it by injunction, and in

138. See supra Part II.
139. Id.
140. Radin, supra note 3, at 720.
141. Id. at 720, 754 & n.359.
142. Id.
143. Id. at 755.
144. Injunctive relief may have been the only relief available because of the legislative responses to the Van Gorkom decision.
order to get rescission must prove that the action was so grossly unfair
that it should not be allowed to stand. Ultimately, "as a practical mat-
ter the lack of a monetary damage remedy may deprive stockholders or
the corporation of an effective remedy when the stockholder is unaware
of director action until it is completed." 146

An important question not considered by the Florida Legislature
was the effect that the amendment had on the rights of shareholders.
Incorporation allows investors to pool their resources into one business
entity which hopefully will result in greater returns for the individual in
the long run. In exchange for limited liability, the shareholder gives up
participation in the everyday running of the business to the board of
directors. The fiduciary duties were imposed by the courts to honor the
trust and confidence placed in the directors by the shareholders. 146 The
1987 amendment effectively says to the shareholder in a Florida corpo-
ration that a director may mismanage the corporation without any fear
of sanction except in the most reprehensible circumstances. Directors
may be encouraged to act negligently or even with gross negligence if
there is no fear of legal penalty. 147 While the 1987 amendment pro-
vides protection for the director, it virtually leaves the shareholder out
in the cold. 148

Prior to the 1987 amendment, approximately 90,000 organizations
were incorporated annually in Florida. 149 The statistics presently avail-
able for 1990 indicate that as of November 1990, less than 80,000 in-
corporations had been filed. 150 Although one may argue that the econ-
omy may have had a negative effect on incorporations in Florida,
undoubtedly the stated goal of making Florida a more attractive place
to incorporate has not come to pass.

An interesting view is that the amendment may affect the cost of

145. Gelb, supra note 71, at 32.
146. See Note, Corporate Directors, supra note 3, at 497 n.11.
147. See id. at 513 for a discussion regarding the anticipated reaction of direc-
tors when faced with no legal penalty for their actions.
148. It may be argued that if shareholders can act in time and get past the
procedural hurdles, they are not precluded from seeking injunctive relief against a
board's decision; or that the shareholders may replace unsatisfactory directors by initi-
ating proxy contests. See Titus, supra note 3, at 17. However, proxy contests are ex-
ceedingly expensive and there is no evidence that the price of shares has any effect on
the behavior of directors. See id. at n.52.
149. Senate Analysis, supra note 19, at 8.
150. Statistics given over the telephone from the Division of Corporations.
director and officer insurance by causing rates to fall substantially.\textsuperscript{151} The view is based on the theory that insurance premiums are based on the degree of risk, and that the degree of risk is significantly lowered because of the heightened culpability standard.\textsuperscript{152} Consequently, it is argued, once the insurance industry recognizes the reduced risk, premiums should also fall.\textsuperscript{153} While it is true that the position of director has been made more attractive, whether the amendment has a positive effect on insurance rates will ultimately determine its success viz-a-viz the stated legislative goal.\textsuperscript{154} Furthermore, diluting the voice of shareholders in organizations in which they place their financial well being, while at the same time giving directors free reign, may have negative social and economic effects.

Finally, perhaps if insurance rates fall and the courts interpret the legislation in a manner which favors directors, the "radical" changes in the act may eventually have some "positive" effect on the law or the corporate arena in Florida. However, when weighed against the known effect of diluting the voice of the shareholder in the corporation in which he owns and invests his money by reducing the circumstances in which he may obtain redress for misconduct and mismangement by his fiduciaries, the net effect cannot be positive. Indeed, the actions of the legislature prompts one to ask "whose corporation is it anyway?"

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\begin{footnotesize}
152. \textit{Id.} (citing J. MARKS, \textit{SHARING THE RISK} 109 (1981)).
153. \textit{Id.} at 1350 n.275. In Florida, although data is currently unavailable to determine whether premiums have fallen, statistics from the Supervisor of Insurance indicate that the sums paid out in claims for director and officer liability has fallen significantly since 1987.
154. \textit{Supra} Part II.
\end{footnotesize}