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Theriot v. Bourg: The Demise of the Business Judgment Rule in Louisiana?

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I. INTRODUCTION

In most jurisdictions, the business judgment rule protects the directors and officers of corporations from liability for informed business decisions made in good faith. Until recently, the prevailing perception was that the same held true in Louisiana, but this is not so clear anymore. In *Theriot v. Bourg*,[1] the First Circuit Court of Appeal of Louisiana considered what standard to apply to the liability of directors and officers of corporations for business decisions. *Held*, the standard for imposing liability on corporate officers and directors for their business decisions is simple, rather than gross negligence. Although this holding may be defensible from a purely textual standpoint, it fails to recognize how the business judgment rule has affected the traditional understanding of the statutory text. As a result, *Theriot* has changed a fundamental rule of corporate governance in Louisiana. If the decision is followed, Louisiana courts will no longer be precluded from second-guessing the business decisions of a corporation's officers and directors. The decision may impact the willingness of people to serve on the boards of Louisiana corporations, as well as the ability of these boards to make the bold entrepreneurial decisions necessary for business success.

II. THE CASE: *THERIOT V. BOURG*

Theriot v. Bourg concerned a shareholder's derivative action brought by two minority directors of a closely-held corporation against five majority directors and a subsidiary of the corporation. Harry Bourg founded the Harry Bourg Corporation ("HBC") in 1955. After his death, each of his children or their heirs had a seat on the board of directors and shared equally in the ownership of the company's stock. From its inception, HBC primarily collected revenue from mineral leases granted on the 17,000 acres of land it owned.[2]

However, in May of 1988, anticipating decreases in oil and gas revenues, the board of directors of HBC voted to diversify by funding a subsidiary called Bourg Mariculture, Inc. ("BMI"). Three of the majority directors were elected officers of BMI. The purpose of this subsidiary was to engage in an industry new to Louisiana, redfish farming. After obtaining one of a limited number of permits from the Louisiana Wildlife and Fisheries Department, the president of BMI developed and patented an innovative method of raising redfish in modified container barges.[3]

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1. 691 So. 2d 213 (La. App. 1st Cir.), *writ denied*, 696 So. 2d 1008 (1997).
2. *Id.* at 216.
3. *Id.* at 217.

BMI purchased the initial batch of redfish in November 1988 and raised them until May 1989, when some unknown person released them from the barges. In mid-1990, BMI placed a second group of fish in the barges. Although some of these fish were sold, an operational problem with the feeding system destroyed the remainder.[4]

At that time, BMI's president independently entered the redfish raising industry through his company called 4-C Ranch. The board of HBC agreed that BMI would advance 4-C Ranch $358,000 for its next batch of fish. However, before they could be delivered to BMI, Hurricane Andrew destroyed the fish in August of 1992. BMI made no further attempt to raise fish.[5]

The plaintiffs' claim was predicated upon the initial decision of the defendants to diversify HBC's assets by entering into the mariculture business through BMI in 1988. Also at issue were many of the decisions concerning the redfish operation made by the board of HBC and by the officers of BMI from 1988 to 1992.[6]

The jury found that the defendants had breached their fiduciary duty to HBC under Louisiana Revised Statutes 12:91[7] which resulted in damages to HBC in the sum of $5,798,441. The defendants appealed this judgment based upon the jury instructions given by the trial court and the sufficiency of the jury's verdict. The defendants claimed that the trial court incorrectly instructed the jury that the standard imposed on corporate directors by Section 91 required a finding of only simple negligence instead of gross negligence.[8] They also alleged that the court "failed to emphasize the overwhelming importance of the Business Judgment Rule and completely negated the impact of the rule by overemphasizing inapplicable and minor exceptions to the rule."[9] Finally, they claimed that the jury "failed to properly apply the Business Judgment Rule."[10] The First Circuit Court of Appeal of Louisiana affirmed the trial court's ruling, stating that the standard of care was simple, rather than gross negligence.[11] The Louisiana Supreme Court denied writs on the case in a five to one vote.[12]

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4. *Id.*
5. *Id.*
6. *Id.*
7. Section 91 of the Louisiana Business Corporation Law reads:

> Officers and directors shall be deemed to stand in a fiduciary relation to the corporation and its shareholders, and shall discharge the duties of their respective positions in good faith, and with that diligence, care, judgment and skill which ordinarily prudent men would exercise under similar circumstances in like positions. Nothing herein contained shall derogate from any indemnification authorized by R.S. 12:83.

8. *Theriot*, 691 So. 2d at 221.
9. *Id.* at 218.
10. *Id.* at 224.
11. *Id.* at 214.
12. Theriot v. Bourg, 691 So. 2d 213 (La. App. 1st Cir.), *writ denied*, 696 So. 2d 1008 (1997).

III. THE DUTY OF CARE

A. Jurisprudential Development of the Duty of Care

The directors and officers of a corporation may be liable to the corporation and its shareholders for breaching a duty to exercise reasonable care in the management of the corporation's affairs.[13] This duty of care developed well before states began to promulgate it in statutes. In fact, it has its origins in the common law of trusts and agency of England.[14] In *Charitable Corp. v. Sutton*,[15] decided over two hundred and fifty years ago, an English court presented this following "remarkably modern formulation"[16] of the duty: "[b]y accepting of a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence. . . ."[17] The court found the directors of a corporation personally liable for failing to follow the loan procedures of the corporation in making unsecured loans to fellow directors, acts which constituted gross negligence according to the court.[18] These concepts of fidelity and reasonable diligence are still the foundations of the fiduciary duty of corporate directors today.

The early American cases applied this duty to bank officers and directors. Remarkably, the first time an American appellate court reviewed the decisions of bank directors was in a Louisiana Supreme Court case, *Percy v. Millaudon*,[19] which held that corporate directors are required to practice ordinary care in the exercise of their duties. The case involved liability for losses resulting from defalcations by the bank's president and treasurer. Analogizing bank directors to agents, the court stated that in some situations they will be required to exercise:

> the utmost diligence . . . (and will be) . . . responsible for the slightest neglect. There are others, where the duties imposed are presumed to call for nothing more than ordinary care and attention, and where the exercise of that degree of care suffices.
>
> The directors of banks from the nature of their undertaking, fall within the class last mentioned, while in the discharge of their ordinary duties.[20]

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13. La. R.S. 12:91 (1968).

14. Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 Del. J. Corp. L. 971, 973 (1994).

15. 26 Eng. Rep. 642 (Ch. 1742).

16. Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 Tex. L. Rev. 591, 593 n.7 (1983).

17. *Sutton*, 26 Eng. Rep. at 645.

18. *Id.* at 644-45.

19. 8 Mart. (n.s.) 68 (La. 1829).

20. *Id.* at 74-75.

This language is strikingly similar to the current statutory duty imposed to act as the "ordinarily prudent man."[21] Throughout the nineteenth-century, the Louisiana Supreme Court continued to analogize the duty owed by corporate directors to an agency relationship, as done in *Sutton*.[22]

Later American courts extended the concept to include the directors of non-banking corporations. The Rhode Island Supreme Court expressed its formulation of the duty in *Hodges v. New England Screw Co.*[23] In *Hodges*, the corporate directors of the New England Screw Company were sued for an ultra vires purchase of stock in another corporation. In a succinct analysis, the court recognized the violation of the corporate charter, but refused to find personal liability, stating:

> The question then will be, was such violation the result of mistake as to their powers, and if so, did they fall into this mistake from want of proper care, such care as a man of ordinary prudence practices in his own affairs. For, if the mistake be such as with proper care might have been avoided, they ought to be liable. If, on the other hand, the mistake be such as the directors might well make, notwithstanding the exercise of proper care, and if they acted in good faith and for the benefit of the Screw Company, they ought not to be liable.[24]

Finding that the directors had exercised proper care, the court dismissed the claim against them.

In an oft-cited case, the United States Supreme Court pronounced in *Briggs v. Spaulding*[25] that directors should be held to a duty to act with the care that "ordinarily prudent and diligent men would exercise under similar circumstances." Thereafter, American courts, following *Briggs*, nearly universally defined the duty of care required of corporate directors in terms of the conduct of a reasonable and prudent man.[26]

B. Statutory Duty of Care

In Louisiana, the applicable duty of care is now provided by Louisiana Revised Statutes 12:91, which reads:

> Officers and directors shall be deemed to stand in a fiduciary relation to the corporation and its shareholders, and shall discharge the duties of

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21. La. R.S. 12:91 (1968).

22. *See Raymond v. Palmer*, 35 La. Ann. 276, 277 (La. 1883), where the court in dealing with a mismanagement claim against directors of a bank stated, "Officers and directors are mandataries of the corporation, and, as such, they are liable to their principal for breaches of the duties assumed by them."

23. 1 R.I. 312 (R.I. 1850).

24. *Id.* at 346.

25. 141 U.S. 132, 152, 11 S. Ct. 924, 931 (1891).

26. Horsey, *supra* note 14, at 974.

> their respective positions in good faith, and with that diligence, care, judgment and skill which ordinary prudent men would exercise under similar circumstances in like positions. Nothing herein contained shall derogate from any indemnification authorized by R.S. 12:83.

The predecessor statute to Louisiana Revised Statutes 12:91 was nearly identical to the present one. It, in turn, was very similar to a 1928 statute, which contained the first Louisiana statutory standard of care[27] that was taken nearly verbatim from the Model Business Corporation Act of 1928.[28] Louisiana Revised Statutes 12:91 is similar to the statutory standard of care found in many other states and the Revised Model Business Corporation Act[29] and the American Law Institute's Corporate Governance Project.[30]

C. *Behavior That Constitutes a Breach of This Duty*

Although directors and officers clearly have a fiduciary duty to their corporations, the type of behavior required to breach this duty is unclear. As in tort law, this "ordinarily prudent man" standard for directors is difficult to define. What amounts to ordinary care or a lack of it depends on the facts of the particular case.[31] The existence of a breach of the duty is determined by a number of factors. These include the duties imposed by a corporation's charter, the good or bad faith of the directors' conduct, the officers' or directors' actual or imputed knowledge of corporate affairs, the residence of the officer or

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27. 1928 La. Acts No. 250, § 36.
28. Model Bus. Corp. Act § 33 (1928).
29. The Revised Model Bus. Corp. Act § 8.30(a) (1984) states:

> A director shall discharge his duties as a director, including his duties as a member of a committee:
> (1) in good faith;
> (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
> (3) in a manner he reasonably believes to be in the best interests of the corporation.

30. The American Law Institute's Principles of Corporate Governance § 4.01(a) states:

> (a) A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. . . .
> (1) The duty in Subsection (a) includes the obligation to make, or cause to be made an inquiry when, but only when, the circumstances would alert a reasonable director or officer to the need therefor. The extent of such inquiry shall be such as the director or officer reasonably believes to be necessary . . . .

31. 3A William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Private Corporations § 1035 (perm. ed. 1986).

director, the time of the alleged breach, and any personal gains of the directors or officers.[32]

Commentators disagree about the level of care required by the "ordinarily prudent person" standard.[33] Because of this ambiguity, one commentator remarked that the statute has "left the courts only a nebulous guide."[34] Although the statute makes no reference to the concepts of ordinary or gross negligence, courts have turned to these standards to determine what the language means.[35] An early commentator, noting the varying interpretations given to the statute, wrote:

> In determining the degree of care which directors and officers must exercise, courts have run the gamut, from the rigorous requirement that such officers must exercise the care which the ordinary prudent man would "use in his own business," to the view that they are to be held [liable] only in case of "gross negligence."[36]

"Ordinarily prudent man" seems to imply that the same level of care is required as in an ordinary negligence case, i.e. simple negligence. One scholar agrees, arguing that three-fourths of jurisdictions interpret the "ordinary prudent man" standard to require only a showing of simple negligence.[37] On the other hand, another author disputes this, stating that in practice the standard is one of gross negligence.[38]

In *Theriot*, the first circuit held that the Louisiana Revised Statutes 12:91 provides for a simple negligence standard in Louisiana.[39] This result conflicts with *Louisiana World Exposition v. Federal Insurance Co.*,[40] where the United States Fifth Circuit Court of Appeals, interpreting Louisiana jurisprudence, found that the standard was gross negligence.

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32. James R. Pettway, Comment, *Duty of Corporate Officers and Directors in Louisiana*, 29 La. L. Rev. 691, 692-93 (1969). *See also* Commercial Germania Trust & Sav. Bank v. Jurgens, 64 So. 703 (1914); Semple v. Frisco Land Co., 50 So. 619 (1909); Bourdette v. Sieward, 31 So. 630 (1902); Trisconi v. Winship, 43 La. Ann. 45, 9 So. 29 (1891); Pontchartrain R.R. Co. v. Paulding, 11 La. 41 (1837); Percy v. Millaudon, 8 Mart (n.s.) 68 (La. 1829); and Faurie v. Millaudon, 3 Mart (n.s.) 476 (La. 1825).

33. E. Norman Veasey & William E. Manning, *Codified Standard—Safe Harbor or Uncharted Reef? An Analysis of the Model Act Standard of Care Compared with Delaware Law*, 35 Bus. Law. 919, 926 (1980).

34. Pettway, *supra* note 32, at 692.

35. Louisiana World Expo. v. Fed. Ins. Co., 864 F.2d 1147, 1149 (5th Cir. 1989).

36. Dale E. Bennett, *The Louisiana Business Corporation Act of 1928*, 2 La. L. Rev. 597, 640 (1940).

37. Veasey & Manning, *supra* note 33, at 926 n.31.

38. Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 Yale L.J. 1078, 1101 (1968).

39. *Theriot*, 691 So. 2d at 222.

40. 864 F.2d 1147 (5th Cir. 1989).

Adding to the confusion is *Dupuy v. Riley*,[41] where the Fourth Circuit Court of Appeal, without explicitly saying it was doing so, seemingly applied a simple negligence standard. However, it could be argued that the court actually employed a gross negligence standard in making its ruling. In *Dupuy*, an officer of a corporation was sued for signing checks that the majority shareholder used to misappropriate a considerable sum of money. Although the court found that the officer had not conspired with the majority shareholder, it still found her personally liable. Because the misappropriation was obvious and long-standing, it can be argued that the officer's conduct was grossly negligent. In addition, the corporation's manager had inquired about the checks, and the officer failed to respond to this inquiry.

Even though the acts of negligence in *Dupuy* were of the non-decision-making variety, the case does make it clear that an argument exists for the application of a simple negligence standard. Nevertheless, since *Dupuy* did not involve the decisions of a corporate director concerning the corporation, it should not have influenced the *Theriot* decision.

However, an inquiry into the correct standard is not necessary in cases involving decisions made by the directors and officers. In fact, the duty applied by courts is intimately linked to, and limited by, the business judgment rule.[42] As one writer has stated,

> In many instances . . . the question of the exact parameters of the duty of care is rendered moot because of the application of the business judgment rule: so long as a decision of the directors has a rational basis, and was made in good faith and for what they honestly believed to be in the best interest of the shareholders, it will not be reviewed by a court.[43]

Thus, the use of the "ordinary prudent man" standard is misleading. A federal district court noted the importance was not in "the technical labels given to the standard of care, but to the latitude afforded to directors in their decisions."[44]

IV. THE BUSINESS JUDGMENT RULE

A. Generally

The business judgment rule has existed in corporate law since the 1820's.[45] One treatise has defined it, stating:

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41. 557 So. 2d 703, 709 (La. App. 4th Cir. 1990).

42. Charles Hansen, *The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule, A Commentary*, 41 Bus. Law. 1237, 1238 (1986).

43. Wendell H. Holmes, *The Revised Model Business Corporation Act and Corporate Law Reform in Mississippi: Part One*, 56 Miss. L.J. 165, 191 (1986).

44. Federal Sav. & Loan Ins. Corp. v. Shelton, 789 F. Supp. 1360, 1366 (E.D. La. 1992).

45. S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 Hofstra L. Rev. 93, 97 (1979).

> If in the course of management, directors arrive at a decision within the corporation's powers (*intra vires*) and their authority, for which there is a reasonable basis, and they act in good faith, as the result of their independent discretion and judgment, and uninfluenced by any consideration other than what they honestly believe to be the best interests of the corporation, a court will not interfere with the internal management and substitute its judgment for that of the directors to enjoin or set aside the transaction or to surcharge the directors for any resulting loss.[46]

Simply put, "directors ought not be liable for honest mistakes of judgment or unpopular business decisions."[47] The American Law Institute's Corporate Governance Project has promulgated a statutory expression of the rule.[48] Yet another well-stated formulation of the rule is found in *Cramer v. General Telephone & Electronics Corp.*,[49] which states that "[a]bsent bad faith or some other corrupt motive, directors are normally not liable to the corporation for mistakes of judgment . . . ."

The duty of care and the business judgment rule are "two distinct, but interrelated concepts."[50] While the duty of care applies to all the actions of the directors and officers, the business judgment rule applies strictly in the decision-making context. Some commentators believe the business judgment rule has been too broadly interpreted. "Although the doctrine began as an adjunct to duty of care standards designed to protect directors' decisions against hindsight evaluation when appropriate diligence had been exercised, the doctrine has enveloped the primary inquiry."[51] One writer doubted whether a viable shareholder action against directors still existed save for cases of fraud, self-interest, disloyalty, or the disclosure concerns of securities law.

Thus, a consequence of this doctrine is the guarantee of a limitation of liability of directors and officers who in good faith and with reasonable diligence commit errors in judgment. Undoubtedly, the rule has proven to be a powerful defense against claims by shareholders for losses resulting from injurious

46. Harry G. Henn and John R. Alexander, Law of Corporations § 242 (3d ed. 1983).
47. Arsht, *supra* note 45, at 96.
48. ALI's Principles of Corporate Governance § 4.01(c):

(c) A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer:
(1) is not interested [§ 1.23] in the subject of the business judgment;
(2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
(3) rationally believes that the business judgment is in the best interests of the corporation.

49. 582 F.2d 259, 274 (3d Cir. 1978).
50. Holmes, *supra* note 43, at 189.
51. Cohn, *supra* note 16, at 594.

decisions.[52] Since the cases where directors are found liable for their good-faith decisions are so rare, one commentator compared searching for cases that imposed liability to searching for "a very small number of needles in a very large haystack"[53] and another has called the inquiry a "relatively fruitless search."[54]

B. *Application*

The application of the business judgment rule is an examination of the *decision-making process*, not of the *decision* itself. One writer summarizing its application, stated, "[w]hile it is agreed . . . that the directors must meet a kind of negligence standard for the decision-making process, it is the author's strong belief that any hint that such a standard be applied to the substance of the decision must be negated."[55] He continued, "The key point is that a director's legal duty of care cannot be measured by result. It should be measured only by process: Was the director careful to be informed?"[56]

There are two tests to determine whether or not the process of decision-making meets the standard of care. The first is whether the directors reasonably researched and ascertained the relevant information and law necessary for the decision.[57] The second is whether the deliberations of the board were reasonable.[58] *Smith v. Van Gorkom*[59] synthesized these two tests into one rule: directors must take appropriate steps to become informed before a decision. The Delaware Supreme Court held in *Aronson v. Lewis*[60] that the standard for measuring this process is gross negligence. "Thus, the due care standard in corporate law is applied to the decision-making process and not to its result."[61]

The business judgment rule acts as a qualification on the statutory duty of care. The business judgment rule renders moot the debate about whether the standard of care is simple or gross negligence. For "so long as a decision of the directors has a rational basis, and was made in good faith and for what they honestly believed to be in the best interests of the shareholders, [the substance of the decision] will not be reviewed by the court."[62]

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52. Krishnan Chittur, *The Corporate Director's Standard of Care: Past, Present, and Future*, 10 Del. J. Corp. L. 505, 507 (1985).
53. Bishop, *supra* note 38, at 1099.
54. Hansen, *supra* note 42, at 1245.
55. *Id.* at 1239.
56. *Id.*
57. *Id.* at 1241.
58. *Id.*
59. 488 A.2d 858, 873 (Del. 1985).
60. 473 A.2d 805, 812 (Del. 1984).
61. Hansen, *supra* note 42, at 1241.
62. Holmes, *supra* note 43, at 191.

C. Policies

The justification of the business judgment rule is based upon "the fundamental premises" underlying the rule that humans are, by nature, fallible and not able to please stockholders at all times.[63] "The first premise recognizes human nature, the second the need to foster both business and judicial economy by not allowing every corporate transaction to be subject to judicial review at the request of a disagreeing stockholder."[64] One commentator states that it is the "foundation stone" of modern corporate law that "there must be a minimum of interference by the courts in internal corporate affairs."[65] Courts should be hesitant to second-guess the decisions of directors with the benefit of hindsight. This, coupled with a desire for judicial economy, provides sufficient justification for the rule.

If courts question and hold corporate directors personally liable for the substance of their decisions, few people will serve as directors.[66] This type of discouragement could severely impact the quality of people on corporate boards. Without qualified people, in theory, the decisions of the boards will become less and less productive. It can be argued that without the protection that the business judgment rule gives directors, the quality of their decisions will decline, rather than improve.

The final, and perhaps most compelling, justification for the rule is the realization that decisions in the corporate world often involve an inherent element of risk.[67] "[I]mposing a kind of trustee mentality based upon the 'ordinarily prudent person' test will tend to eliminate those bold entrepreneurial decisions that have resulted in major economic benefit."[68] Throughout the history of business, the decisions involving highest amounts of risk have had the highest returns. Arguably, without the business judgment rule, most of these risky decisions will not be made. For directors, the cost of making such decisions would greatly outweigh the benefits. As a result, innovation will be stifled.

D. The Business Judgment Rule: In Louisiana

Along with being the first American case to establish the duty of care, *Percy v. Millaudon*[69] has been cited as the "earliest American expression" of the

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63. Arsht, *supra* note 45, at 95.
64. *Id.*
65. Hansen, *supra* note 42, at 1239.
66. *Id.*
67. Arsht, *supra* note 45, at 100.
68. Hansen, *supra* note 42, at 1239.
69. 8 Mart (n.s.) at 68 (La. 1829).

business judgment rule.[70] The Louisiana Supreme Court, in a "discourse as relevant today as it was"[71] then, articulated the rule,

> [W]e are of the opinion that on the occurrence of difficulties, in the exercise of [ordinary duties], which offer only a choice of measures, the adoption of a course from which loss ensues cannot make the agent responsible . . . . The test of responsibility therefore should be . . . the possession of ordinary knowledge; and by shewing [sic] that the error of the agent is of so gross a kind, that a man of common sense, and ordinary attention, would not have fallen into it.[72]

In *Watkins v. North American Land & Timber Co.*,[73] the court again recognized the application of this rule in Louisiana. *Watkins* concerned an action by a stockholder in a corporation to have a sale of land by the officers rescinded for lesion beyond moiety.[74] The plaintiff alleged that the officers sold the land for one-seventh of its value, an act that constituted "gross mismanagement" by the officers.[75] Recognizing that "[t]he reluctance of the courts to interfere at the instance of a stockholder, or of a minority of the stockholders, with the affairs of a private corporation is very pronounced," the court then stated that:

> Other decisions emphasize the principle that the courts of equity cannot undertake the management of all private corporations in this country; that in the absence of usurpation, of fraud, or of gross negligence, they will not interfere, but will allow the majority to rule, and leave dissatisfied stockholders to redress their grievance through ordinary corporate methods . . . . *Individual stockholders cannot question in judicial proceedings the corporate acts of directors, if the same are within the powers of the corporation, and in furtherance of its purposes, are not unlawful or against good morals, and are done in good faith and in the exercise of an honest judgment* . . . . To hold otherwise would be to substitute the judgment and discretion of others in place of those determined on by the scheme of incorporation.[76]

Thus, the court wholeheartedly adopted the business judgment rule, along with its exceptions.

In a subsequent case, the supreme court employed business judgment rule language in affirming the trial court's dismissal of plaintiff's suit. In *Reliance*

70. Arsht, *supra* note 45, at 97.
71. *Id.*
72. 8 Mart. (n.s.) at 78 (La. 1829).
73. 31 So. 683 (La. 1902).
74. The sale of an immovable may be rescinded for lesion when the price is less than one half of the fair market value of the immovable. *See* La. Civ. Code art. 2589.
75. *Watkins*, 31 So. at 685.
76. *Id.* at 686-87 (emphasis added by court).

Homestead Association v. Nelson,[77] a case involving the president of a homestead association who allegedly made an erroneous payment, the court stated, "it is a well-recognized rule, by both the federal and state courts, that an executive officer of a corporation cannot be held liable for errors of judgment, where he acts with reasonable care, without corrupt intent, and in good faith, unless his acts are unlawful per se or ultra vires." This language undoubtedly expresses the Louisiana Supreme Court's acceptance of the business judgment rule as a qualification on the duty of care.

V. ANALYSIS: THE *THERIOT* DECISION

In *Theriot v. Bourg*,[78] the Louisiana First Circuit Court of Appeal seemingly ignored the history of application of the business judgment rule in Louisiana by upholding the trial court's finding of liability on the part of the majority directors.[79] The first circuit held that the standard of care applicable to the directors and officers of a corporation was simple, rather than gross negligence. Assuming for a moment that this aspect of the court's holding was correct, the court's decision remains inadequate, having given no consideration to the business judgment rule's qualification of this standard of care.

To reach its conclusions, the *Theriot* court relied heavily on its second *Pool v. Pool*[80] decision (*Pool II*). However, the court first acknowledged the language of its first *Pool v. Pool*[81] case (*Pool I*) which stated that:

> Directors are not liable for mere errors of judgment on their part where they act in good faith. They are only required to exercise reasonable care and diligence and act in good faith. But they are liable for willful neglect of duty, gross negligence or other fraudulent breach of trust.[82]

The defendants argued that this language mandated the use of a gross negligence standard. After first stating that the language was dicta, and thus not dispositive of the issue, the court then reasoned that the defendants had misinterpreted the language.

The court found that gross negligence was simply an example of the type of behavior that would result in liability for the board of directors. The court noted that, "In *Pool[I]* we stated that gross negligence would result in liability, rather than liability must be predicated on a finding of gross liability as asserted by the appellants."[83] It seems unlikely that the *Pool I* court was merely presenting some examples of behavior that would result in liability in its statement, "[b]ut

77. 154 So. 734 (La. 1934).
78. 691 So. 2d 213 (La. App. 1st Cir.), *writ denied*, 696 So. 2d 1008 (1997).
79. *Id.* at 216.
80. 22 So. 2d 131 (La. App. 1st Cir. 1945).
81. 16 So. 2d 132 (La. App. 1st Cir. 1943).
82. *Id.* at 135.
83. *Theriot*, 691 So. 2d at 222.

they are liable for willful neglect of duty, gross negligence or other fraudulent breach of trust."[84] The *Pool I* court would not have listed the more obvious examples of behavior that would cause liability while omitting the more questionable behavior such as simple negligence. The *Theriot* court's interpretation of its *Pool I* decision simply fails to make sense.

In *Theriot*, the first circuit failed to recognize the language as a reformulation of the business judgment rule. As stated before, the *Cramer* court's wording of the rule was, "Absent bad faith or some other corrupt motive, directors are normally not liable for mistakes of judgment."[85] This language is strikingly similar to, "directors are not liable for mere errors of judgment on their part where they act in good faith."[86] By ignoring the *Pool I* court's application of the business judgment rule, the court in *Theriot* was able to hold the majority directors personally liable under a simple negligence standard. The court quoted the following passage: "[D]irectors [are] only required to exercise reasonable diligence and act in good faith and with that judgment and discretion which ordinarily prudent men exercise under similar circumstances."[87] While this language is no doubt a correct statement of the duty, it must be interpreted in light of the business judgment rule.

As for the United States Fifth Circuit Court of Appeals holding in *Louisiana World Exposition v. Federal Insurance Co.*,[88] the *Theriot* court simply stated, "[W] e are not persuaded by this federal jurisprudence . . . ." Interestingly, although the Louisiana Supreme Court seemed unimpressed by the Fifth Circuit's jurisprudence, the Delaware Supreme Court has been more attentive, citing *Mansfield Harwood Lumber Co. v. Johnson*[89] on which *Louisiana World Exposition* had relied.[90]

Finally, after claiming to have "thoroughly" searched for cases requiring gross negligence to support personal liability for corporate directors and officers, the court relied on a plain language argument. "For reasons stated above, we . . . find that the applicable standard is that which is set forth by the plain language of LSA-R.S. 12:91."[91] Again, this would be a valid argument if the language of the statute was "clear and unambiguous."[92] As stated above, there is much scholarly debate as to what type of behavior constitutes a breach of the corporate directors' fiduciary duty.

In addition, at the time that the statute was written, the business judgment rule was a firmly accepted jurisprudential creation. The promulgators of the

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84. 16 So. 2d at 135.
85. 582 F.2d 259, 274 (3d Cir. 1978).
86. *Pool*, 16 So. 2d at 135.
87. Pool v. Pool, 22 So. 2d 131, 133 (La. App. 1st Cir. 1945).
88. 864 F.2d 1147 (5th Cir. 1989).
89. 263 F.2d 748 (5th Cir. 1959).
90. Lynch v. Vickers Energy Corporation, 429 A.2d 497 (Del. 1981).
91. *Theriot*, 691 So. 2d at 222.
92. *See* La. Civ. Code art. 9.

statute knew it existed; therefore, the statute should be interpreted in light of this fact. As the Louisiana Supreme Court has previously stated, "it is more likely that the legislative approval and codification of a broad, general jurisprudential principle carries with it approval of, or acquiescence in, contemporaneously developed auxiliary rules used by the courts to implement the principle, unless there is a contrary principle."[93]

Because of the first circuit's failure to apply or even acknowledge the business judgment rule, it questioned the substance of the decisions of the board of directors instead of the process of decision-making. As discussed above, Louisiana courts should apply the standard of care to the directors' process of informing themselves before making the decision, not to the substance of the decision itself.[94]

Even under the incorrect analysis employed by the court in the *Theriot* case, the result reached still seems unfair. Three of the defendants were in their seventies or eighties, and none of the majority directors had completed college or had any formal education in running a business.[95] The defendants relied on their attorney, their geologist, an environmental expert, and the owner of a redfish raising business in Mississippi in deciding to create BMI.[96] The reasonable reliance of directors on the advice of experts is allowed under statute.[97] Stating that none of these experts had any experience in the fish raising business in *Louisiana*, the first circuit held that the defendants' reliance on their advice was unreasonable.

The court did note that the president of BMI spent considerable time with the owner of a Mississippi redfish farm, viewed his physical plant, and discussed his methods of operation, prior to the board's decision to enter the business.[98] But the court stated that the owner's experience was "limited to operating a relatively new business that provided only part of the function that BMI ultimately undertook" and that his business was located in Mississippi while the

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93. Bergeron v. Bergeron, 492 So. 2d 1193 (La. 1986).
94. Smith v. Van Gorkom, 488 A.2d 858, 885 (Del. 1985).
95. *Theriot*, 691 So. 2d at 224.
96. *Id.*
97. La. R.S. 12:92(E) (1994) states:

A director shall, in the performance of his duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports, or statements presented to the corporation, the board of directors, or any committee thereof by any of the corporation's officers or employees, or by any committee of the board of directors, or by any counsel, appraiser, engineer, including a petroleum reservoir engineer, or independent or certified public accountant selected with reasonable care by the board of directors or any committee thereof or any officer having the authority to make such selection, or by any other person as to matters the director reasonably believes are within such other person's professional or expert competence and which person is selected with reasonable care by the board of directors or any committee thereof or any officer having the authority to make such selection.

98. *Theriot*, 691 So. 2d at 224.

defendant's operation was in Louisiana.[99] The court seemed to be implying that the only reasonable source for expert opinion would have been a Louisiana redfish farmer who used container barges as containment units. However, as the court recognized, the method of raising redfish in modified container barges was a novel technique.[100] In fact, the whole industry of raising redfish was new to Louisiana,[101] and there were no true "experts" in this new field. Restricting the defendants in this way seems somewhat unreasonable and illogical.

The ruling also seems to be applying hindsight scrutiny on the directors' decisions. An evaluation of the short existence of BMI does not reveal a poorly-run business, but simply an unfortunate one. Some unknown person released the initial batch of fish after six months in the cages.[102] The court did not explain how the release of the fish was a consequence of the negligence of the directors. The court did not say that security measures were deficient or that corporate employees were poorly trained. The court apparently assumed that a director's decision to engage in a redfish farming venture was in itself negligent if, somehow, the fish being raised at the farm happened to be accidentally released. Further, BMI did make some money from the second batch of fish before they were destroyed by an operational problem with the feed.[103] Although the directors could theoretically bear some responsibility for this mishap, if, for example, they hired obviously incompetent personnel, a finding of liability can not conceivably be based on the simple fact that losses occurred. Finally, the complete destruction of the barges by Hurricane Andrew cannot be a basis for the directors' negligence.[104] A decision-maker should not be held personally liable for unforeseeable, unpreventable events.

VI. EFFECTS OF THE DECISION

The *Theriot* decision elucidates many of the problems that occur without the protection of the business judgment rule. The rule was designed to remedy the problem of second-guessing by courts with the benefit of hindsight. Interference by the courts with the business decisions of directors of corporations ex post facto is unfair and impractical. If easily subjected to personal liability, competent people will be discouraged from serving on corporate boards. Finally, risk-taking, and with it innovation, will be stifled, when directors, fearing suits for risky decisions that do not work out, take only the safest routes through the corporate maze.

Louisiana does not need this damage to its corporations law. Almost every other jurisdiction in the country recognizes the business judgment rule. Already,

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99. *Id.* at 225.
100. *Id.* at 217.
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.*

Louisiana is viewed as a place unfriendly to businesses, and this decision only makes matters worse. If businesses are discouraged from incorporating here, Louisiana's economy will ultimately feel the repercussions.

Louisiana Revised Statutes 12:24(C)(4) states that the corporation can indemnify its officers and directors for any personal liability imposed because of a breach of their duty of care.[105] A similar statute was developed in the 1980's in Delaware as a response to the *Smith v. Van Gorkom*[106] decision. Statutes of this type now exist in all states, yet all states continue to recognize the business judgment rule. Still, even though many corporations can avoid the problems involved with the *Theriot* decision, it reflects the Louisiana judiciary's attitude toward business. The businesses that will be most effected by this ruling will be the small, unsophisticated corporations which lack the benefit of an experienced corporate counsel.

VII. SOLUTIONS TO THE PROBLEM

As a temporary remedy, corporate attorneys need to ensure that their clients are shielded from personal liability for negligent decisions. The only way to guarantee protection from a *Theriot*-like lawsuit is to advise clients to amend their corporate charters to include the indemnification clause allowed by Section 24 of Louisiana Corporations law. This should provide a sufficient safeguard for the board of directors and officers from personal liability.

For a more long term solution, legislative action is necessary to alleviate the problems created by *Theriot*. In the 1980's, the legislature rectified a similar problem that existed in the banking industry. Because of the savings and loan crisis, the Louisiana Legislature amended the statute that provides the duty of care for officers and directors of banks.[107] That statute now requires a finding of gross negligence to hold a bank director liable for a breach of his duty of care.[108] The same should be done with Louisiana Revised Statutes 12:91; there is no justifiable reason for affording greater protection to the directors of banks than to the directors of other corporations. In addition, the legislative amend-

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105. La. R.S. 12:24(c)(4) (1994).

106. 488 A.2d 858 (Del. 1985).

107. La. R.S. 6:291 (Supp. 1998) which now states:

A. Bank and bank holding company officers and directors shall be deemed to stand in a fiduciary relation to their bank or bank holding company and its stockholders and shall discharge the duties of their respective positions in good faith and with that diligence, care, judgment, and skill as provided in Subsection B of this section . . . .

B. A director or officer of a bank or bank holding company shall not be held personally liable to the corporation or the shareholders thereof for monetary damages unless the director or officer acted in a grossly negligent manner as defined in R.S. 6:2 or engaged in conduct which demonstrates a greater disregard of the duty of care than gross negligence, including intentional tortious conduct or intentional breach of his duty of loyalty.

108. *Id.*

ment to Louisiana Revised Statutes 12:91 should embody the business judgment rule and return the jurisprudence to its pre-*Theriot* state. The ALI's Principles of Corporate Governance section 4.01 provides a good model provision for both the duty of care and the business judgment rule.[109] The following formulation of the business judgment rule is found in Section 4.01(c):

> (c) A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer:
>
> (1) is not interested in the subject of the business judgment;
>
> (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
>
> (3) rationally believes that the business judgment is in the best interests of the corporation . . . .

This model provision is a concise, lucid formulation of the business judgment rule which would help guide Louisiana courts in decisions involving corporate governance and prevent unjust decisions like *Theriot* from occurring in the future.

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109. The duty is contained in ALI's Principles of Corporate Governance § 4.01(a) which states:

> (a) A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. . . .
>
> (1) The duty in Subsection (a) includes the obligation to make, or cause to be made, an inquiry when, but not only when, the circumstances would alert a reasonable director or officer to the need therefor. The extent of such inquiry shall be such as the director or officer reasonably believes to be necessary . . . .