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Community Effects as a Factor in Corporate Decisions Under Pennsylvania's New Business Corporation Law: Objective Evidence of a Subjective Process

I. INTRODUCTION

The Pennsylvania Legislature enacted a new Business Corporation Law (hereinafter BCL) on November 16, 1988, which took effect October 1, 1989.¹ The sections of the new BCL governing the standard of conduct for corporate directors are a re-enactment of 42 PA. CONS. STAT. ANN. §§ 8363 - 8365.² Included in these sections is a protective feature which allows corporate directors to take into account the effect an act of the corporation will have upon a community when making corporate decisions.³ It is probable that a shareholder suit against a director alleging improper conduct in business decision making will be met with a defense claiming that the decision resulted from the consideration of a community effect. This comment proposes that an objective standard of evidence be employed to test the existence and consideration of such a community effect when this factor is used to defend against a shareholder suit alleging breach of duty by a corporate director.

The statute allowing corporate directors to consider community effects was enacted in 1983;⁴ at that time Pennsylvania joined a small number of states which, by statute, allow corporate officials to consider factors beyond shareholders' financial interests when making business decisions.⁵

1. Pa. Act No. 1988-177; codified in Title 15 PA. CONS. STAT. ANN. § (Purdon Supp. 1990). Effective date of legislation appears in § 304 of Act 1988-177.

2. Pa. Act No. 1988-177, Source Notes, Purdon's Pa. Legislative Service, No. 8, March 1989, p. 1522.

3. 42 PA. CONS. STAT. ANN. § 8363(b)(Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 511(b)(Purdon Supp. 1990).

4. Pa. History of Senate Bills, 1983-84, at A-146. SB 1144, in its final form, was passed by the house on December 13, 1983, concurred in by the Senate on December 14, 1983 and approved by the Governor on December 23, 1983. *Id.* The section was originally codified at 15 PA. CONS. STAT. ANN. § 1408 (B) (Purdon Supp. 1984); it has been recodified twice: 42 PA. CONS. STAT. ANN. § 8363(b)(Purdon Supp. 1987) and finally at 15 PA. CONS. STAT. ANN. § 511(b)(Purdon Supp. 1990).

5. Maine, Minnesota and Ohio also allow a corporate director to consider the "community" or "societal" impact of a corporate decision. *See*, OHIO REV. CODE ANN. §

II. THE TRADITIONAL STANDARD

The traditional rule governing corporate decision making was stated forcefully in *Dodge v. Ford Motor Co.*⁶: "A business corporation is organized and carried on primarily for the profit of the stockholders."⁷ In 1952, the Pennsylvania Supreme Court acknowledged this limitation on the discretion of corporate directors.⁸ Exceptions to this narrow scope of allowable corporate goals did exist; for example, corporate philanthropy was allowed⁹ and close corporations were often treated in a less strict manner than publicly held corporations.¹⁰ In 1985, the Federal District Court for the Eastern District of Pennsylvania, when construing Pennsylvania law in *Enterra Corporation v. SGS Associates*,¹¹ held that management might properly consider the interests of suppliers, customers, lenders and the stability of the company as well as shareholder interests.¹² However, no mention was made of considering the effect of corporate action upon a community.

Proponents of the narrow scope of interests which can be considered when making business decisions argue that broader concerns lead to inefficient and arbitrary decision making.¹³ This view "ignores the reality that other constituencies both share the risk and are vital to the success of corporate activity."¹⁴ In Pennsylvania, the proponents of the broader view have prevailed, as evidenced by the legislation in question.

Pennsylvania follows the business judgment rule, by which a court will not question the judgment employed in making a busi-

1701.59(E)(Page Supp. 1988); ME. REV. STAT. ANN., Title 13-A § 716(West Supp. 1989); MINN. STAT. ANN. § 302A.251(West Supp. 1990). Missouri allows directors to consider such a factor in the context of an attempted acquisition of the corporation. See, MO. ANN. STAT. § 351.347(Vernon Supp. 1990).

6. 204 Mich. 459, 170 N.W. 668 (1919).

7. *Id.* at 507, 170 N.W. at 684.

8. *Moore v. Keystone Macaroni Manufacturing Co.*, 370 Pa. 172, 87 A.2d 295, 29 A.L.R. 2d 1256 (1952). Wherein the Court stated that a Board of Directors cannot authorize a corporate act which they believe is in the best interests of the corporation when no quid pro quo results. To allow this type of activity by the directors would open the door to dissipation of corporate assets in violation of the shareholders rights. *Id.*, 87 A.2d at 297-98.

9. 15 P.S. § 1302(16)(Purdon 1967), now recodified at 15 PA. CONS. STAT. ANN. § 1502(a)(9)(Purdon Supp. 1990).

10. *Chambers v. Beaver-Advance Corporation*, 392 Pa. 481, 140 A.2d 808 (1958).

11. 600 F.Supp. 678 (E.D. Pa. 1985).

12. *Id.* at 687.

13. Lipton, M., *Corporate Governance in the age of Finance Corporatism*, 136 U. PA. L. REV. 1, 36-37 (1986), and authorities cited therein.

14. *Id.*

ness decision.¹⁵ Only when there is evidence that a corporate act was arbitrary or done in bad faith will a Pennsylvania court intervene in the internal management decisions of a corporation.¹⁶ While courts will not examine the business decision itself, they have examined the underpinnings of that decision, inquiring as to the diligence,¹⁷ potential for bias,¹⁸ and compliance with fiduciary duty with which that decision is made.¹⁹ Courts of other jurisdictions have inquired as to the reasonableness of the decision to insure that directors have acted diligently.²⁰

It is clear that the business judgment rule protects the director in exercising his judgment; it is also clear that a director has a duty to be diligent and loyal to the corporation in the exercise of that judgment. In Pennsylvania, a breach of those duties subjects a director to personal liability.²¹ Now that the legislature has broadened the scope of interests which enter into business decisions, the question to be decided is whether this broadening will be considered part of the exercise of judgment protected by the business judgment rule, or an underpinning, similar to diligence, which the courts will scrutinize.

III. LEGISLATIVE HISTORY OF THE STATUTE

The provision allowing corporate directors to consider community effects was first enacted as part of an anti-takeover statute in 1983.²² Senate Bill 1144 was rushed through the General Assembly in response to corporate acquisitions occurring at that time in Pennsylvania.²³ Consequently, most of the debate centered on the

15. *Selheimer v. Manganese Corporation of America*, 423 Pa. 563, 224 A.2d 634 (1966). *Pincus v. Mutual Assurance Co.*, 4 Pa. D.&C. 3d 71 (Phila. Cty. 1976), *aff'd*, 251 Pa. Super. 626, 381 A.2d 913 (1978).

16. *Hopkins v. Union Canvas Goods Co.*, 104 Pa. Super. 264, 158 A. 301 (1932). *MacAleer v. Sun Oil Co.*, 280 Pa. Super. 148, 421 A.2d 449 (1980).

17. *Hunt v. Aufderheide*, 330 Pa. 362, 199 A. 345 (1938). *Otis & Co. v. Pennsylvania R. Co.*, 61 F. Supp. 905 (E.D. Pa. 1945), *aff'd*, 155 F.2d 522 (3d Cir. 1946).

18. *Lewis v. Curtis*, 671 F.2d 779 (3d Cir. 1982), *cert. denied*, 459 U.S. 880 (1982).

19. *Id.*

20. *Cramer v. General Telephone & Electric Corporation*, 582 F.2d 259 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129 (1979); *Miller v. American Telephone & Telegraph Co.*, 507 F.2d 759 (3d Cir. 1974); both applying New York law.

21. *Hill v. Hill*, 279 Pa. Super. 154, 420 A.2d 1078 (1980). *See also*, 15 PA. CONS. STAT. ANN. § 512 (Purdon Supp. 1990).

22. Act 1983-92, P.L. 395, Laws of Pennsylvania, 1983, Acts and Miscellaneous Actions, at 395-99.

23. Pa. Legislative Journal, Senate, 1983, at 1430-31, 1436-37. *See remarks of Senator Zemprelli and the interrogation of Senator Fisher by Senator Zemprelli. Id.*

potential problems and benefits of the provisions regulating transactions involving changes in corporate control.²⁴

Senator Fisher directly addressed the increase in decision making factors, remarking that it was a codification of existing law which was meant to benefit shareholders as well as the members of the enumerated classes, i.e., employees, suppliers, customers, and communities.²⁵ It is worth noting that Senator Fisher's statement was offered in answer to Senator Zemprelli's remark that the bill could protect poor management rather than benefitting shareholders.²⁶ Other legislators commenting on Senate Bill 1144 emphasized the need for effective anti-takeover protection and did not elaborate on the provision in question.²⁷

The House amended Senate Bill 1144 to extend the change of corporate control protections to subsidiaries.²⁸ No mention is made in the House discussion of the community effects provision. When the Senate considered the House amendment, concern was again expressed that the bill should not benefit management at the expense of the shareholders.²⁹ Ultimately the bill was passed in its present form by an overwhelming majority.³⁰

In allowing corporate directors the freedom to consider additional factors when making business decisions the General Assembly did not provide statutory direction as to how the propriety of such consideration would be measured in a court proceeding. What little history exists indicates a legislative intent to benefit shareholders as well as the other corporate constituencies, not an intent to protect poor corporate management. An objective standard of evidence helps insure that the statute will operate to benefit the classes the legislature sought to protect.

24. *Id.* at 1430-37.

25. *Id.* at 1434. Senator Fisher's statement emphasized that the statute was meant to codify judicial interpretations of similar laws of other states to remove any doubt that such actions were proper under Pennsylvania law. The consideration of such interests was meant to benefit the corporation and shareholders as well as the other interests listed in the statute. *Id.*

26. *Id.* Senator Fisher's remarks appear at 1432-36. Senator Zemprelli's expression of concern appears at 1430 and 1432. Senator Zemprelli apparently found the provisions applicable if a change of corporate control occurred objectionable, however, the community effects provision could also operate to protect poor management. *Id.*

27. *Id.* at 1431. Remarks of Senators Bell and Fumo. *Id.*

28. Pa. Legislative Journal, House, 1983 at 2129-30.

29. Pa. Legislative Journal, Senate, 1983 at 1523-24. The remarks of Senator Zemprelli. After consistently expressing reservations, Senator Zemprelli voted in favor of the bill. *Id.*

30. Pa. History of Senate Bills, 1983-84 at A-146. The amended version passed by the House by a vote of 192 to 3; the Senate concurred by a vote of 48 to 2. *Id.*

The 1986 statute which repealed, re-enacted and recodified the section allowing a corporate director to factor community effects into the business decision making process also created a new standard by which to judge the conduct of corporate directors.³¹ The new standard substantially raises the burden on a shareholder attempting to have personal liability imposed on a director by requiring the challenged conduct to "constitute self-dealing, willful misconduct or recklessness."³² The legislative history of this bill deals mostly with the standard of conduct and does not directly address the question of community effects. However, some of the concerns raised in discussing the standard of conduct are equally applicable to the community effects question.

House Bill 2072 had been unanimously passed by the House on June 25, 1986; the Senate adopted amendments to the bill and unanimously passed the amended version on September 30, 1986.³³ The first week of October was the occasion of substantial debate in the House regarding the Senate amendments. Mr. Manderino, the House Majority Leader, proposed amendments requiring the more lenient standard to be adopted by shareholder vote and removing corporate officers from the class of individuals protected by that standard.³⁴

Especially pertinent to the community effects question is the amendment requiring a shareholder vote before the more lenient standard goes into effect. The discussion of the proposed amendment centered on preserving the control of shareholders over the corporate directors.³⁵ Similarly here, requiring objective evidence that a director has taken into account a factor such as community effects, which is not directly related to the interests of the shareholders, furthers the purpose of providing the shareholders with a measure of control over the directors they elect. Accountability is preserved by not allowing the erection of a complete shield for the directors against a shareholder action by a mere invocation of "community effects" to justify any challenged business decision.

The legislative history of the amendment removing officers from the class protected by the lenient standard also supports the re-

31. 42 PA. CONS. STAT. ANN. § 8364 (Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 512 (Purdon Supp. 1990).

32. 42 PA. CONS. STAT. ANN. § 8364(a)(2) (Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 512(a)(2) (Purdon Supp. 1990).

33. Pa. History of House Bills, 1986, at A-292.

34. Pa. Legislative Journal, House, 1986, at 2036-40.

35. *Id.*, at 2036-44.

quirement of objective evidence. This amendment was the more hotly contested of the two.³⁶ Here rather than centering on protecting shareholder control, the discussion focused on assuring that the shareholders would have a recovery from a corporate officer personally for malfeasance and nonfeasance, rather than being forced to recover from the corporation, in effect a recovery from themselves.³⁷

Requiring objective evidence of the existence of a true community effect and a valid consideration of that effect by the directors also furthers the purpose of assuring shareholders the recovery from the responsible party personally, because objective evidence is more susceptible to contradiction and challenge. Objective evidence helps insure the legitimacy of the defense if it is raised. The directors are covered by a standard requiring recklessness or willful misconduct before personal liability attaches.³⁸ Where no valid community effect exists or where the directors have failed to act in a diligent, reasonable manner in evaluating that effect, their conduct could be construed as reckless in that they disregarded shareholder interests.³⁹ Therefore, requiring objective evidence of a community effects factor serves to give proper effect to the recklessness standard adopted for directors by allowing shareholders some assurance that reckless decision making will not be protected by a bald claim that community factors dictated the challenged decision.

The legislative history of the new BCL does not directly address the re-enacted sections in question. However, the legislative purpose discussed in that history also supports an objective rather than subjective standard of evidence. The driving force behind the

36. *Id.*, at 2036-53. This amendment was initially defeated but was later passed upon reconsideration. *Id.*

37. *Id.*, at 2040, remarks of Mr. Manderino. *Id.*

38. 42 PA. CONS. STAT. ANN. § 8364(a)(2) (Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 512(a)(2) (Purdon Supp. 1990).

39. Recklessness has been defined as: "Rashness; heedlessness; wanton conduct. The state of mind accompanying an act, which either pays no regard to its probably or possibly injurious consequences, or which, though foreseeing such consequences, persists in spite of such knowledge." BLACK'S LAW DICTIONARY, 5th Ed., p. 1142. Pennsylvania Courts define it similarly: Recklessness implies conscious appreciation of the probable extent of danger or risk incident to a contemplated action. *Reilly v. City of Philadelphia*, 328 Pa.563, 568, 195 A. 897, 900 (1938). Willful misconduct conveys a like . . . meaning: willful misconduct means that the actor desired to bring about the result that followed or at least that he was aware that it was substantially certain to ensue. *Goss v. Baltimore Ohio Co.*, 355 F.2d 649, 651(3d. Cir. 1966), citing *Evans v. Philadelphia Transportation Co.*, 418 Pa. 567, 573-74, 212 A.2d 440, 443 (1965).

new BCL was a desire to provide corporations with defensive mechanisms against hostile takeovers.⁴⁰ While the legislation does in fact reduce some rights of shareholders by, for example, "reconfirming and expanding the abolition of the doctrine of *de facto* mergers",⁴¹ the thrust of the legislation in general was to protect corporations from hostile takeovers, not to insulate directors totally from liability when shareholders challenge their decisions. Shareholder actions are not the type of activity which the new BCL was meant to protect against.

IV. OTHER AREAS WHERE OBJECTIVE EVIDENCE IS USED TO SHOW SUBJECTIVE STATE OF MIND

The process of making a business decision is a very subjective one. The director's education, experience, intuition and a host of other individual traits are part of that process. Directors are free to employ those traits to assign weights to the various factors bearing on the decision; however, they are not free to decide which factors are to be considered. Pennsylvania has limited those factors by statute. Therefore, an inquiry into which factors did, in fact, impact a decision is appropriate.

Courts use objective evidence to determine the true subjective intent of an actor in a number of other situations. In the contract area, the subjective intent of a party to the contract is determined by that party's objective manifestations.⁴² Pennsylvania courts can look at the surrounding circumstances, the object of the contract and other extraneous objective evidence, as well as the personal conduct of the contracting parties to determine intent.⁴³ Due to the difficulty of ascertaining a person's intent, a court will adopt the most reasonable and practical interpretation of the parties' conduct, which is objective evidence of that intent, when intent is at issue in a contract case.⁴⁴

Similarly, courts rely on objective evidence to determine subjective state of mind in the criminal area. Conduct of the actor and the surrounding circumstances can be examined to determine

40. Pa. Legislative Journal, Senate, 1988, at 1671-72.

41. Pa. Act No. 1988-177, Headnote, Purdon's Pa. Legislative Service, No. 8, March, 1989, p.1211.

42. *Ingrassia Construction Co. v. Walsh*, 337 Pa. Super. 58, 486 A.2d 478 (1984). *Mellon Bank NA v. Aetna Business Credit, Inc.*, 619 F.2d 1001 (3d Cir. 1980).

43. *In Re Carter*, 390 Pa. 365, 134 A.2d 908 (1957). *Ziff v. H. Daroff & Sons*, 357 Pa. 326, 53 A.2d 729 (1947). *Hindman v. Farren*, 353 Pa. 33, 44 A.2d 241 (1945).

44. *Walton v. Philadelphia National Bank*, 376 Pa. Super. 329, 545 A.2d 1383 (1988).

whether the necessary criminal intent is present.⁴⁵ If a defense based on a lack of criminal intent is to be successful, the actor's belief in facts which exculpate the act must be *bona fide* and reasonable.⁴⁶ A court can attribute that which a reasonable man would have known to the actor.⁴⁷

Objective evidence is also used to measure a subjective decision in domicile cases. Where an individual has residences in two or more states he can choose which residence will be his home, and so choose in which state he will be domiciled.⁴⁸ In Pennsylvania, courts will examine the person's conduct to determine which residence has, in fact, truly been chosen as the principal home despite any self-serving statements of subjective intent the person makes.⁴⁹

In the corporate area, courts in other states have treated the business judgment rule as a presumption that a corporate director, in making a business decision, acted on an informed basis, in good faith and with the belief that the act was in the best interests of the corporation.⁵⁰ Courts have examined objective evidence when determining if a director was truly acting on an informed basis.⁵¹ Here, where the list of what constitutes the best interests of the corporation has been expanded, a court should examine objective evidence to determine whether an appropriate interest actually exists and was considered.

V. STATUTORY CONSTRUCTION ACT

The Pennsylvania Statutory Construction Act (hereinafter the Act) further supports the adoption of a objective standard of evidence. The Act applies to every statute enacted on or after September 1, 1937;⁵² the rules set forth therein govern statutory construction unless application of those rules "would result in a construction inconsistent with the manifest intent of the General Assembly."⁵³ Construction of the new BCL is clearly controlled by the Act.

45. *Commonwealth v. Walzack*, 468 Pa. 210, 360 A. 2d 914 (1976); *Commonwealth v. Wright*, 289 Pa. Super. 399, 433 A.2d 511 (1981).

46. *Commonwealth v. Compel*, 236 Pa. Super. 404, 344 A.2d 701 (1975).

47. *Commonwealth v. McFarland*, 226 Pa. Super. 138, 308 A.2d 126 (1973).

48. *In Re Dorrance's Estate*, 309 Pa. 151, 163 A. 303 (1932).

49. *Id.*

50. *Smith v. Van Gorkum*, 488 A.2d 858 (Del. 1985), *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

51. *Id.*

52. 1 PA. CONS. STAT. ANN. § 1502(a)(1)(i) (Purdon Supp. 1989).

53. 1 PA. CONS. STAT. ANN. § 1901 (Purdon Supp. 1989).

Legislative intent controls the construction of a statute under the Act.⁵⁴ When determining legislative intent a court can consider the following: the former law upon the same subject,⁵⁵ the objective to be attained⁵⁶ or the mischief to be remedied,⁵⁷ as well as other matters.⁵⁸ Additionally, a court may presume "that the General Assembly intends to favor the public interest as against any private interest."⁵⁹ Statutes are to be liberally construed to effect their objects and promote justice.⁶⁰

Requiring an objective standard of evidence to prove a defense based upon 15 PA. CONS. STAT. ANN. § 511(b) follows the above enumerated rules of construction. Former law in this area indicated a great reluctance to allow corporate directors total freedom as to which goals were proper objects of corporate activity;⁶¹ an objective standard serves this purpose. The new BCL was enacted to remedy the susceptibility of Pennsylvania corporations to hostile takeovers;⁶² an objective standard does not prevent effectuation of this remedy. Nor does an objective standard prevent attainment of the legislative objective;⁶³ community effects may still be factored into the corporate decision. In fact, an objective standard may further the legislative objective by insuring that an in depth examination of those effects by directors attempting to conform their decision making activities to that standard.

A subjective standard would favor the private interest of directors by easing their burden when proving a defense based upon 15 PA. CONS. STAT. ANN. § 511(b). While it is in the public interest to have the effects of a corporate act upon the community at large considered by the directors, it is also in the public interest to have some degree of accountability on the part of those directors and to provide aggrieved shareholders with some viable means of redress personally against those directors for misconduct. An objective standard of evidence favors these public interests over the private interests as required by the Act.

54. 1 PA. CONS. STAT. ANN. § 1921 (Purdon Supp. 1989).

55. 1 PA. CONS. STAT. ANN. § 1921(c)(5) (Purdon Supp. 1989).

56. 1 PA. CONS. STAT. ANN. § 1921(c)(4) (Purdon Supp. 1989).

57. 1 PA. CONS. STAT. ANN. § 1921(c)(3) (Purdon Supp. 1989).

58. 1 PA. CONS. STAT. ANN. § 1921(c) (Purdon Supp. 1989).

59. 1 PA. CONS. STAT. ANN. § 1922(5) (Purdon Supp. 1989).

60. 1 PA. CONS. STAT. ANN. § 1928(c) (Purdon Supp. 1989).

61. *See supra*, notes 6-10, and accompanying text.

62. *See supra*, notes 29-30, and accompanying text.

63. *See text of 42 PA. CONS. STAT. ANN. § 8363(b)* (Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 511(b) (Purdon Supp. 1990).

An objective standard of evidence is not a liberal construction of the statute. However, by preventing the erection of an impenetrable shield to shareholder actions against directors based upon improper decision making, it does promote justice by holding directors liable for their misconduct.

Further support for an objective standard of evidence to measure § 511(b) defenses is found in the provisions of the Act requiring a statute to be construed so as to give effect to all its provisions,⁶⁴ and requiring related statutes to be construed in *pari materia*.⁶⁵

Section 511 contains two other subsections.⁶⁶ The first defines the directors' fiduciary duties, including a duty of reasonable inquiry, skill and diligence.⁶⁷ The final subsection creates a presumption that actions by the directors are in the best interests of the corporation; however, this presumption only arises in the absence of any breach of the duties outlined in § 511(a).⁶⁸

An objective standard of evidence gives effect to both of these subsections. It facilitates measurement of the directors' performance by the fiduciary standard stated in § 511(a). It does not deny effect to the presumption created by § 511(c), rather it examines the breach of fiduciary duty which must be absent before the presumption arises.

The subchapter of the new BCL containing § 511 also contains two other sections dealing with the personal liability of directors⁶⁹ and indemnification of directors by the corporation.⁷⁰ The Act requires these sections to be construed together.⁷¹

An objective standard for § 511(b) complements the requirements for personal liability outlined in § 512. Personal liability arises if the director breaches his fiduciary duty.⁷² An objective standard facilitates measurement of any breach of this duty be-

64. 1 PA. CONS. STAT. ANN. § 1921(a) (Purdon Supp. 1989).

65. 1 PA. CONS. STAT. ANN. § 1932 (Purdon Supp. 1989).

66. 42 PA. CONS. STAT. ANN. § 8363 (Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 511 (Purdon Supp. 1990).

67. 42 PA. CONS. STAT. ANN. § 8363(a) (Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 511(a) (Purdon Supp. 1990).

68. 42 PA. CONS. STAT. ANN. § 8363(c) (Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 511(c) (Purdon Supp. 1990).

69. 42 PA. CONS. STAT. ANN. § 8364 (Purdon Supp. 1989), now recodified at 15 PA. CONS. STAT. ANN. § 512 (Purdon Supp. 1990).

70. 42 PA. CON. STAT. ANN. § 8365 (Purdon Supp. 1989), now recodified at 15 PA. CON. STAT. ANN. § 513 (Purdon Supp. 1990).

71. See *supra*, note 54 and accompanying text.

72. 15 PA. CONS. STAT. ANN. § 512(a)(1) (Purdon Supp. 1990)

cause objective evidence is more susceptible to challenge and contradiction.

The final section in the subchapter governs indemnification and provides that it is not available if the director has acted recklessly.⁷³ Failure to properly assess a community effect could constitute reckless disregard of the interest of the shareholders.⁷⁴ An objective standard to measure this conduct helps to effectuate the indemnification limitation.

The above reasoning indicates that this type of construction would not be inconsistent with the intent of the General Assembly. Therefore, the rules of construction should be applied to reach such a result.

VI. CONCLUSION

Traditionally, courts have been loathe to question business decisions made by directors because they have been considered beyond the usual scope of judicial expertise.⁷⁵ Pennsylvania courts will not substitute their judgment for that of the directors selected by the shareholders.⁷⁶ However, Pennsylvania courts will examine whether business judgment has been exercised in a reasonably diligent manner.⁷⁷

Decision making is a subjective process. However, the above examples show that a court can appropriately rely on objective evidence to determine subjective intent when required. The inquiry advocated here does not require objective evidence of the propriety of the decision reached; rather, all that would be required is objective evidence of the following elements:

- (1) a valid community effect existed at the time the decision was made;
- (2) the director(s) were aware of the impact the decision would have upon the community;
- (3) the decision is reasonably related to the interest claimed to have been protected.

The first two elements are easily shown and would help to prevent a *post facto* claim of a community effect arising to defend a claim by a shareholder. The final element admittedly comes close to crossing the line into an examination of the propriety of the

73. 15 PA. CONS. STAT. ANN. § 513 (Purdon Supp. 1990).

74. See *supra*, note 28 and accompanying text.

75. *Shlensky v. Wright*, 95 Ill.App.2d 173, 237 N.E.2d 776 (1968).

76. *Hornsby v. Lohmeyer*, 364 Pa. 271, 72 A.2d 294 (1950).

77. *Hunt v. Aufderheide*, 330 Pa. 362, 199 A. 345 (1938). *Otis & Co. v. Pennsylvania R. Co.*, 61 F.Supp. 905 (E.D. Pa. 1945), *aff'd*, 155 F.2d 522 (3d Cir. 1946).

decision itself. However, under the reckless, willful misconduct standard required for personal liability by the statute, the court will already be inquiring as to the reasonableness of a director's conduct. It is but a small step to inquire into the reasonableness of a director's decision as a manifestation of his conduct. The objective standard can further be justified as part of the court's inquiry into the director's diligence.

The Pennsylvania Legislature has adopted the modern view that a corporation has responsibilities beyond those that run to the financial well-being of its shareholders. By this statute, the interests of those who rely upon, and contribute to, the corporation in a manner other than ownership can be considered when decisions which will have dramatic effects upon their lives are made. This is a perceptive step forward which recognizes the inter-relationships of modern economics. However, this step forward for non-ownership constituencies should not remove the accountability of the directors to the corporate owners. A requirement of objective evidence as to the existence and consideration of a valid community effect when making a decision would go a long way towards reminding directors that, while consideration of the interests of others is appropriate, their ultimate responsibility and overriding duty lies with the interests of the corporate shareholders.

An objective standard of evidence is supported by the legislative purpose revealed in the history of the statute. Use of such a standard in other areas of the law to show the subjective intent of a party or actor is proof that such a standard is workable. The Statutory Construction Act supports such a requirement. It should be the standard adopted for proof of any claimed defense arising under 15 PA. CONS. STAT. ANN. § 511(b).

David W. Thomas