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WHAT HAPPENED IN DELAWARE CORPORATE LAW AND
GOVERNANCE FROM 1992–2004?

A RETROSPECTIVE ON SOME KEY DEVELOPMENTS

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INTRODUCTION	1401
A. <i>History</i>	1402
B. <i>Summary of Themes</i>	1404
C. <i>Scope of This Article</i>	1407
I. CORPORATE GOVERNANCE	1410
A. <i>Models of Corporate Governance</i>	1410
B. <i>Standards of Conduct</i>	1416
C. <i>Standards of Review</i>	1420
1. The Business Judgment Rule	1421
2. Other Standard of Review Issues	1428
a. <i>Levels of scrutiny</i>	1428
b. <i>Vicinity of insolvency</i>	1429
c. <i>Exculpation and section 102(b)(7)</i>	1432
D. <i>Evolving Expectations</i>	1436
II. GOOD FAITH	1439
III. MERGERS: DEAL PROTECTION MEASURES.....	1454
A. <i>Background</i>	1454
B. <i>Omnicare</i>	1458
C. <i>Contract Rights</i>	1462
IV. DERIVATIVE SUITS.....	1465
A. <i>General Clarification of Demand</i>	1466
B. <i>The Use of Section 220 Demands</i>	1466
C. <i>The Direct/Derivative Dichotomy</i>	1468
D. <i>Director Independence</i>	1470
V. INDEPENDENCE IN OTHER CONTEXTS	1471
VII. DISCLOSURE ISSUES.....	1473
VIII. CORPORATE OPPORTUNITY.....	1477
IX. CONTROLLING STOCKHOLDERS	1478
A. <i>The Intersection of Fiduciary Duty and Stockholder Rights</i>	1478
B. <i>“Going Private” Transactions</i>	1482
X. APPRAISAL AND VALUATION.....	1486
XI. A LOOK INTO THE FUTURE.....	1495
A. <i>Is Delaware Law Changing?</i>	1495
B. <i>Federalism v. Federalization</i>	1503
C. <i>Best Practices</i>	1506
CONCLUSION	1508
APPENDIX	1509

Dean Robert Clark; Jason Comer, Esquire; Gabriel Ewing, Esquire; Professor Lawrence A. Hamermesh; Tarik J. Haskins, Esquire; Stephen Radin, Esquire; Professor Edward B. Rock; Professor Hillary Sale; and the Honorable Leo E. Strine, Jr. The author, however, takes full responsibility for all errors and analytical flaws. Moreover, the views expressed in this Article are purely my own. They do not necessarily reflect the views of my former judicial colleagues, my current colleagues at Weil, Gotshal & Manges, or the clients of the firm. Some of the ideas discussed in this Article reflect those expressed in some of my previous speeches and articles. A selection of those are cited throughout this Article.

INTRODUCTION

This Article is a glimpse via the rear-view mirror at some of the corporate law and governance developments, including the corporate jurisprudence of the Delaware Supreme Court, during my twelve-year term as Chief Justice of Delaware, which began in April of 1992 and ended in May of 2004. I call this Article a “glimpse” because this project has turned out to be broader than I originally envisaged.

In fact, my original concept was to write about the Delaware Supreme Court corporate cases during that period. But that idea turned out to be both too large and too small. It was too large in the sense that there were too many subjects covered, even by the relatively small number of Supreme Court cases. It was too small in the sense that many interesting corporate law and corporate governance topics that formed the environment of that period were not part of the Supreme Court’s jurisprudence.

In the final analysis, the breadth and depth necessary to do justice to a complete jurisprudential retrospective is not practicable in a single law review article. First, the breadth: the reader will see that some of the important cases are not discussed exhaustively; some not at all. Next, the depth: the depth of analysis required to scrutinize the holding and language of the Supreme Court in each case—and their implications—is simply not practicable in an article.

During this period there were important developments in “Corporate America.” The 2001–2002 scandals, typified by Enron and WorldCom, which were not Delaware corporations, came to define what was wrong with corporate governance generally. These events are aberrations and did not define Delaware corporate jurisprudence.

Rather, Delaware corporate jurisprudence is authoritatively framed, in part, by a discrete number of decisions of the Delaware Supreme Court. It is also framed, in part, by a plethora of Delaware Court of Chancery decisions, many of them excellent examples of jurisprudence. If one looks at the entire landscape of the decisions of both courts over the 1992–2004 period, one can tease out themes and trends that have little or nothing to do with the 2001–2002 scandals and the resulting activity at a national level, including the Sarbanes-Oxley Act,¹ SEC rulemaking, and listing requirements of the Self-Regulatory Organizations (SROs), like the New York Stock Exchange (NYSE). To be sure, the federal regulatory landscape is changing,

¹ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, 29 U.S.C.).

and these changes will play out extensively in the years ahead. Some ripple effects of the federal dimension may influence Delaware jurisprudence going forward. Now, however, we can look at where the law has been and where it is presently. Then we can make some educated guesses about what may happen in the years ahead.

A. History

Eight years ago, Delaware celebrated the 100th anniversary of its current Constitution of 1897. That constitution provides two major regimes that are relevant here: it authorized legislation creating a general corporation law, and it revamped the judicial selection process.² The judicial selection process, which has been in effect and has remained essentially unchanged since then, provides for twelve-year terms for each Supreme Court justice and trial judge,³ appointment by the governor⁴ (today from a merit-selected list recommended by a bipartisan commission),⁵ and confirmation by the state senate.⁶ It also provides for a bipartisan judiciary.⁷

The constitutional requirement of a bipartisan judiciary is unique to Delaware. It mandates that in each court individually and in all Delaware constitutional courts collectively there may not be more than a bare majority of one major political party.⁸ This system has served well to provide Delaware with an independent and depoliticized judiciary and has led, in my opinion, to Delaware's international attractiveness as the incorporation domicile of choice.

Shortly after the adoption of the 1897 constitution, the Delaware legislature adopted a general corporation law that generally mirrored

² DEL. CONST. art. IX, § 1; *see also* A. Gilchrist Sparks, III & Donna L. Culver, *Corporations—Article IX*, in THE DELAWARE CONSTITUTION OF 1897, at 157, 159-62 (Randy J. Holland et al. eds., 1997) (discussing the changes to the constitution that allowed for the enactment of a general corporation law).

³ DEL. CONST. art. IV, § 3.

⁴ *Id.*

⁵ This is a result of executive orders of a succession of governors, beginning over twenty-five years ago with Governor Pete du Pont. *See* Del. Exec. Order No. 4, 4:8 Del. Reg. R. 1202, 1310 (Feb. 1, 2001) (noting, in 2001, that this had been the practice for over twenty years).

⁶ DEL. CONST. art. IV, § 3.

⁷ *Id.*

⁸ *Id.*; *see also* Joseph T. Walsh & Thomas J. Fitzpatrick, Jr., *Judiciary—Article IV*, in THE DELAWARE CONSTITUTION OF 1897, *supra* note 2, at 121, 134-35 (describing the "political balance" requirement).

New Jersey's.⁹ Many large national firms had incorporated in New Jersey, but in the early part of the twentieth century, New Jersey engaged in a strong regulatory and taxation regime affecting corporations. In part as a reaction to that regime, a major migration of corporate charters from New Jersey to Delaware occurred.¹⁰

There followed eight or nine decades of extensive litigation in Delaware of disputes involving internal corporate affairs.¹¹ That litigation resulted in the body of Delaware judge-made law that shaped Delaware history and the landscape of corporation law in the United States. The Delaware Court of Chancery and Delaware Supreme Court have established a reputation for their extensive business expertise and swift decision making, have amassed a vast amount of rich case law, and have earned international respect. In 2005, for the fourth year in a row, Delaware was rated first in the nation among judicial systems for efficiency and fairness in civil litigation by a Harris Poll conducted for the United States Chamber of Commerce.¹²

As of February 19, 2004, Delaware had over 615,000 business entities, including about 275,000 domestic corporations.¹³ Nearly sixty percent of the Fortune 500 companies and nearly the same proportion of those listed on the New York Stock Exchange are Delaware corporations.¹⁴ In addition, seventy percent of initial public offerings in 2004 on the New York Stock Exchange, the American Stock Exchange, and the NASDAQ were Delaware corporations.¹⁵

⁹ See Maurice A. Hartnett, III, *Delaware's Charters and Prior Constitutions*, in THE DELAWARE CONSTITUTION OF 1897, *supra* note 2, at 21, 38 (noting the enactment of the Delaware General Corporation Law in 1899); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 609 (2003) (stating that Delaware "copied" New Jersey's corporate laws in order to encourage incorporation in Delaware).

¹⁰ See Roe, *supra* note 9, at 609-10 (recounting the history of the competition for incorporation between New Jersey and Delaware in the early twentieth century).

¹¹ Cf. William T. Quillen et al., *Trustees of Equity: The Judges of the Delaware Court of Chancery*, in THE DELAWARE BAR IN THE TWENTIETH CENTURY 393, 398 (Helen L. Winslow et al. eds., 1994) ("The most dramatic change during Chancellor [Charles] Curtis' term [from 1909–1921] was the advent of major corporate litigation."); *id.* at 404 ("The first half of the 1980s brought . . . a flood of corporate litigation.")

¹² See HARRIS INTERACTIVE, INC., 2005 U.S. CHAMBER OF COMMERCE STATE LIABILITY SYSTEMS RANKING STUDY 40 (Mar. 8, 2005), at <http://www.instituteforlegalreform.org/harris/pdf/HarrisPoll2005-FullReport.pdf> (ranking Delaware first in 2005 and noting that Delaware was also ranked first in its 2002, 2003, and 2004 studies).

¹³ Telephone Interview with Richard J. Geisenberger, Assistant Secretary of State of Delaware (Mar. 7, 2005).

¹⁴ *Id.*

¹⁵ *Id.*

B. *Summary of Themes*

Delaware corporate jurisprudence is shaped both by Supreme Court and Chancery Court decisions. In the years from 1992 to 2004, there were only slightly more than eighty Supreme Court decisions in the corporate area, including full opinions and orders. Concepts of corporate governance are shaped not only by these courts' jurisprudence, but also through academic discourse and counseling on best practices.

The Delaware Supreme Court decisions during these twelve years clarified some areas of the corporate law and left others shrouded in ambiguity. Most of the decisions were sound and advanced the law in a meaningful direction. Others are the subject of valid criticism.

Beyond the Supreme Court jurisprudence during this period is the overlay of Chancery decisions and other corporate governance developments. My central focus, after looking back over this twelve-year landscape, is to observe that it was a period of significant development. This period was somewhat like the mid-1980s in that regard. But it was different, because the earlier era was characterized by the hostile takeover phenomenon, culminating in the watershed year of 1985 when four major cases shaped the takeover jurisprudence for years to come.¹⁶

During my twelve-year term as Chief Justice, the developments were not as sharply focused as the takeover period of the mid-1980s. But if I had to characterize in one sentence my observation of the 1992–2004 period, it would bring to mind Dickens's phrase about "the best of times . . . [and] the worst of times."¹⁷ It was a rational period of some clarification and some residual ambiguity in Delaware jurisprudence, in a national atmosphere of tumultuous upheaval and a voluntary quest for best practices by many corporations. As a consequence, some of the subthemes I have observed in reexamining the corporate jurisprudence of this period are as follows:

- Corporate governance, with its emphasis on board structure and process, has emerged as the predominant focus of directors, their counselors, and courts.
- Delaware judges have had a substantial role in shaping best practices in corporate governance.

¹⁶ See *infra* Part III.A (discussing the impact of *Unocal*, *Van Gorkom*, *Moran*, and *Revlon*).

¹⁷ CHARLES DICKENS, *A TALE OF TWO CITIES* 1 (London, Oxford University Press 1859).

- Standards of conduct for directors are defined by Delaware statutory law and judge-made articulations of fiduciary duties. The expectations for director conduct evolve over time as business mores evolve, with courts applying the evolving expectations in a common law process in deciding the proper standard of review to apply in specific circumstances.
- The evolution of expectations means the directors themselves, as well as the courts, must focus on genuine processes, not mere rote, “check the box” drills.
- Courts should not second-guess the business decisions of directors, and the Delaware courts have not done so. There has been no change in Delaware law of the time-honored business judgment rule, which remains alive and well.
- The fact that judicial review by Delaware courts of director conduct has resulted in some findings of wrongdoing and liability is primarily a function of intensified judicial focus on process and improved pleading by plaintiffs’ lawyers.
- Improved pleading by plaintiffs’ lawyers has, in turn, been influenced by court decisions in this period. For example, one significant development has been the Delaware courts’ strong suggestions that plaintiffs’ lawyers employ a books and records demand before bringing a derivative suit.
- Two examples of areas of directors’ increased concern are the emergence of “good faith” as an issue and the question of whether directors are held to a uniform standard or varying standards, according to individual expertise and experience. The cases have not authoritatively resolved those concerns, but directors’ exposure to liability has not been ratcheted up significantly.
- In order to understand the various levels of review, one must focus continuously on the fact that the business judgment rule does not allow a judicial determination of whether a business decision was objectively *reasonable*; the rule is a rebuttable presumption that the decision was reached by a careful, good faith process and that the result was *rational*.
- The standards of review in takeover cases and other areas outside the ordinary business judgment rule and the di-

rectors' oversight responsibility continue to be complex and in some instances difficult to apply.

- As a result, deal making and deal protection devices continue to present a challenge for creative lawyering. But it is not an unworkable challenge.
- The dénouement of this twelve-year period in our jurisprudence is the courts' deepened reliance on independent directors and an expectation that directors will act thoughtfully and in good faith.
- The goal is to promote good governance and avoid the need (or the temptation) for courts and regulators to second-guess directors.
- By encouraging sound structures and processes, good disclosure, and fair elections, the courts can continue to afford directors wide discretion, because sound practices of internal corporate governance limit the potential for abuse.
- Going forward, the Delaware judiciary will continue to face difficult corporate law disputes that I expect the courts will handle well and continue the clarification trend.

These subthemes cannot be summarized by some overarching "sound bite," but it is fair to alert the reader to four recurring and dominant notions that characterize this period in Delaware corporate jurisprudence:

- Process matters.
- Procedure matters: many opinions turn on the procedural posture of the case. To the extent that the Supreme Court has reversed Chancery dismissals of cases with prejudice at the pleading stage, the Supreme Court establishes a precedent based on well-pleaded but sometimes extreme allegations. This may facilitate the development of an important genre of Delaware decision making. That is, an opinion that raises questions or teaches without imposing liability may provide guidance to the corporate world to conform to best practices without the downside of actually imposing personal liability.
- Board governance is key, at least as an aspiration and sometimes with legal consequences.

- In addition, speeches and articles by Delaware judges are often helpful in guiding boards and their counsel in the direction of best practices.

Common law decision making may raise some jurisprudential difficulties because most Chancery decisions are not appealed. That may mean that some, perhaps many, burning issues of corporate law do now always make it to the Supreme Court in either a timely manner or, more commonly, in a posture that squarely poses the issue. It remains for history to judge whether the Supreme Court was able to strike the balance between (a) respecting the norms of common law decision making (i.e., deciding only the case before the court) and (b) the need to bring clarity to the corporate law and to give authoritative views on controversial issues.

C. Scope of This Article

This project begins with the selection of the universe of Delaware Supreme Court corporate cases from 1992 to 2004. The Supreme Court's annual 700-plus case docket generally includes comparatively few corporate cases. In fact, there were only about eighty-four corporate cases during those twelve years, depending upon how one defines what constitutes a corporate case. The appendix to this article lists those cases in reverse chronological order.¹⁸

The reader will note that most of the decisions are unanimous. It is debatable whether the court's goal of speaking with one voice is a worthy one.¹⁹ One could argue that more split decisions would have

¹⁸ According to an analysis by Ashley Altschuler, Esquire, one of my former law clerks and presently an associate at Weil, Gotshal & Manges, I sat on about 3500 panels (three-justice or en banc) from 1992 until 2004, which included a wide variety of civil, corporate, criminal, and constitutional cases. Of those, I authored 350 opinions and orders including full majority opinions, three concurring opinions, and, fortunately, only two dissenting opinions. One dissent was a search and seizure case, *Quarles v. State*, 696 A.2d 1334 (Del. 1997), and the other was *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003), which is discussed extensively in Part III.B.

¹⁹ See David A. Skeel, Jr., *The Unanimity Norm in Delaware Corporate Law*, 83 VA. L. REV. 127, 129 (1997) ("The Delaware supreme court . . . rarely issues separate opinions."); see also Randy J. Holland & David A. Skeel, Jr., *Deciding Cases Without Controversy*, 5 DEL. L. REV. 115, 118 (2002) ("The Delaware Supreme Court, which has long been recognized as the definitive authority on corporate law, rarely issues separate opinions. Even on deeply controversial issues, Delaware's justices almost invariably speak with a single voice." (footnotes omitted)); Adam D. Feldman, Comment, *A Divided Court in More Ways Than One: The Supreme Court of Delaware and Its Distinctive Model for Judicial Efficacy, 1997–2003*, 67 ALB. L. REV. 849, 852-55 (2004) (proposing explanations for the Delaware "unanimity norm").

resulted in sharper focus and more clarity. Although I disagree with that view, I hope it is now a moot point. One step the court did take during my term was having more en banc cases with oral argument, and fewer important decisions emanating from three-justice panels.²⁰

The Court of Chancery makes much of our corporate law. The judges of that court perform prolifically and promptly in an extraordinary manner on the ground, daily, as the world's most respected business trial court. My estimate is that the heavy caseload of that court consists of about 75% corporate or business cases, with the remainder being other equally important equity cases. About 85% to 90% of the court's final judgments in corporate cases are never appealed. The low rate of appeal is due to several factors, including the extraordinarily high international respect for the expertise of that court; the fact that those judgments are mostly correct; the fact that they are usually affirmed on appeal anyway; the fact that many cases are decided by interlocutory order (on an injunction, for example); and the practical reality that business must move on from the answer provided by the Court of Chancery.²¹ This phenomenon is a high tribute to that court and is the chief reason that Delaware is the prevailing corporate domicile of choice.

The Delaware Supreme Court, of course, has the last word in corporate jurisprudence. As Justice Jackson said of the United States Supreme Court in a famous concurring opinion: "We are not final because we are infallible, but we are infallible only because we are final."²² The Delaware Supreme Court is certainly "infallible" in the sense that it is the final word in corporate law. It is the last word in

²⁰ About two-thirds of the Supreme Court's cases are decided by three-justice panels without oral argument. Very few corporate cases fall in this category. For many years, some important cases, including corporate cases, were decided by three-justice panels after oral argument. That practice changed during my term—for the better, in my view. The Supreme Court's 2003 amendments to its Internal Operating Procedures now express an expectation that most cases that meet the criteria for oral argument (importance, novelty, etc.) will be worthy of being heard en banc ab initio so that the court will be heard as speaking with one voice. The procedure also avoids the inefficiency and expense of two oral arguments if the three-justice panel decides that there should be a later, en banc oral argument. It applies to all "important" cases, not just corporate cases. See DEL. SUP. CT. INTERNAL OPERATING P. V(4) (listing some criteria used to decide whether oral argument will be heard in a case); DEL. SUP. CT. INTERNAL OPERATING P. VII ("The Motion Justice or the Chief Justice may order any matter meeting the criteria for oral argument set forth in IOP V(4) to be determined by the Court *en Banc* upon the briefs or upon oral argument.").

²¹ See E. Norman Veasey, *Counseling Directors in the New Corporate Culture*, 59 BUS. LAW. 1447, 1448-49 (2004) (praising the Court of Chancery).

²² *Brown v. Allen*, 344 U.S. 443, 540 (1953) (Jackson, J., concurring).

each particular case presented to it, and it sets forth the authoritative precedent governing future cases. Perhaps, however, it is not always *doctrinally* infallible—no court ever is.

This Article offers some perspective on what has occurred in Delaware corporate jurisprudence over the past twelve years, for better or for worse. To turn on its head Mark Antony’s famous speech in Shakespeare’s *Julius Caesar*, I come to praise the court, not to bury it.²³ In praising it, however, I will not shy away from mentioning some of its doctrinal critics and some valid criticism. But, as I have said at the outset: (a) one needs to look beyond the universe of Supreme Court cases to the larger environment of corporate law and governance; and (b) this single Article cannot explore the many doctrinal issues presented in the cases decided in this twelve-year period. Whether it is because of the inherent complexity of some issues or imprecise articulation in some of the decisions, there are doctrinal anomalies and conundrums that should be explored—if at all—in a full-length book.

Of course, when critiquing the case law and forming an opinion about whether our jurisprudence has set forth the ideal set of standards of review, or otherwise questioning whether a particular decision was the “right” one, it is important to bear in mind the doctrine of stare decisis. Over the years, the court has occasionally overruled, at least in part, some prior precedent.²⁴ This has happened sometimes without explicit reference to the doctrine of stare decisis. In *Account v. Hilton Hotels Corp.*,²⁵ however, the court in 2001 reaffirmed the basic law validating stockholder rights plans (“poison pills”) established in

²³ See WILLIAM SHAKESPEARE, *JULIUS CAESAR* act 3, sc. 2 (“I come to bury Caesar, not to praise him.”).

²⁴ See, e.g., *Brehm v. Eisner*, 746 A.2d 244, 253-54 (Del. 2000) (holding that the Supreme Court undertakes de novo review of a decision of the Court of Chancery dismissing a derivative action under Delaware Chancery Court Rule 23.1, and overruling *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), and its progeny, but only to the extent that they express an abuse of discretion scope of review); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703-04 (Del. 1983) (holding that minority stockholders’ remedy in a cash-out merger is appraisal, and overruling *Lynch v. Vickers Energy Corp.*, 429 A.2d 497 (Del. 1981), “to the extent that it purports to limit a stockholder’s monetary relief to a specific damage formula” (internal citation omitted)); *id.* at 704 (overruling the business purpose rule as announced in *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977), and its progeny); see also *Beattie v. Beattie*, 630 A.2d 1096, 1101 (Del. 1993) (abrogating the doctrine of interspousal immunity as “a relic from the common law that is no longer a viable concept and no longer meets the needs of modern society”).

²⁵ 780 A.2d 245 (Del. 2001).

*Moran v. Household International, Inc.*²⁶ in 1985 and did dilate somewhat on the doctrine of stare decisis:

Although this Court has not had occasion in the recent past to elaborate on the doctrine of *stare decisis*, it is well established in Delaware jurisprudence. Once a point of law has been settled by decision of this Court, “it forms a precedent which is not afterwards to be departed from or lightly overruled or set aside . . . and [it] should be followed except for urgent reasons and upon clear manifestation of error.” The need for stability and continuity in the law and respect for court precedent are the principles upon which the doctrine of *stare decisis* is founded. In determining whether *stare decisis* applies, this Court should examine whether there is: “a judicial opinion by the [C]ourt, on a point of law, expressed in a final decision.” The doctrine of *stare decisis* operates to fix a specific legal result to facts in a pending case based on a judicial precedent directed to identical or similar facts in a previous case in the same court or one higher in the judicial hierarchy.²⁷

The importance of stare decisis is further highlighted by the Delaware courts’ role in defining the corporation law and in preserving stability and predictability in corporate jurisprudence. Courts should tread carefully when setting out on a new jurisprudential path and should avoid freely overturning precedents once established. Thus, academic criticism of a court’s decisions may be more effective when tailored toward limiting the reach of decisions instead of calling for their overturn the moment they are released from the gate. The 2003 case of *Omnicare, Inc. v. NCS Healthcare, Inc.*,²⁸ which is discussed extensively below,²⁹ offers a good example.

I. CORPORATE GOVERNANCE

A. *Models of Corporate Governance*

A review of the law governing corporations should begin with consideration of the policies behind the law as well as certain extralegal principles controlling and influencing the actions of corporations and their constituents. What do we mean when we use the term “corpo-

²⁶ 500 A.2d 1346 (Del. 1985).

²⁷ *Account*, 780 A.2d at 248 (alterations in original) (citations omitted); cf. *Gannett Co. v. Kanaga*, 750 A.2d 1174, 1181-82 (Del. 2000) (citing with approval the U.S. Supreme Court’s discussion of the doctrine of stare decisis in *Planned Parenthood of Southeastern Pennsylvania v. Casey*, 505 U.S. 833, 854-69 (1992), and analogizing that doctrine with the law of the case issue presented in *Gannett*).

²⁸ 818 A.2d 914 (Del. 2003).

²⁹ See *infra* Part III.B for a discussion of *Omnicare*.

rate governance”? A number of definitions have emerged since that term became prominent in the United States during the 1980s. In its broadest sense it is used to define the structure, relationships, norms, control mechanisms, and objectives of the corporate enterprise.³⁰ The objectives of the firm are to benefit stockholders by attracting capital, performing efficiently and profitably, and complying with the law.

What we are addressing here as corporate law is the law governing the internal affairs of corporations—that is, state law, often Delaware law. Corporate law is related to—but is not perfectly coextensive with—corporate governance. Enabling acts, such as the Delaware General Corporation Law (DGCL), are part of the corporate law. They create only a skeletal framework, however.

The “flesh and blood” of corporate law is judge-made. It is the common law formulation of principles of fiduciary duties articulated on a case-by-case basis. But, in addition to these fiduciary principles, a variety of other norms, expectations, and aspirational standards influence the structure, relationships, control mechanisms, and objectives of corporations.

At least one respected corporate scholar has observed that Delaware’s common law process, which places case law at the forefront of corporate law, is the functional equivalent of judicial legislation. Professor Jill Fisch of Fordham Law School has concluded:

Although the Delaware statute provides general guidelines about corporate formalities such as the scheduling of annual meetings and the required components of a corporate charter, the statute does not deal with the fiduciary principles that provide the foundation of corporate law and allow, under appropriate circumstances, judicial scrutiny of corporate decisionmaking

. . . .

³⁰ Professor Hillary Sale offers one definition:

The term “corporate governance” is widely used to refer to the balance of power between officers, directors, and shareholders. Academics often discuss it in the context of regulating communications and combating agency costs where corporate officers and directors have the power to control the company, but the owners are diverse and largely inactive shareholders. Good corporate governance, then, allows for a balance between what officers and directors do and what shareholders desire. The term implies that managers have the proper incentives to work on behalf of shareholders and that shareholders are properly informed about the activities of managers.

Hillary A. Sale, *Delaware’s Good Faith*, 89 CORNELL L. REV. 456, 460 (2004) (footnote omitted).

... Delaware's judicial lawmaking ... has a number of atypical characteristics that cause it to resemble the legislative process.³¹

Because Delaware fiduciary duty law is judge-made, it is "far from clear and predictable" and therefore "demonstrates a degree of indeterminacy," in Professor Fisch's words.³² But importantly, any indeterminacy found in the fiduciary law does not outweigh the benefits produced by judicial lawmaking. Professor Fisch observes that "Delaware lawmaking offers Delaware corporations a variety of benefits, including flexibility, responsiveness, insulation from undue political influence, and transparency."³³ I agree both that it is indeterminate and that this indeterminacy is good.

In fact, criticism of Delaware fiduciary duty law because it is indeterminate is misplaced or disingenuous. A flexible or indeterminate regime, such as we have had in Delaware, is distinct from a rigid codification system that prevails in many systems outside the United States.³⁴ That is part of the genius of our law.³⁵ Life in the boardroom is not black and white; directors and officers make decisions in shades of gray all the time. A "clear" law, in the sense of one that is codified, is simply not realistic, in my view. There can be no viable corporate

³¹ Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1074-75 (2000) (footnotes omitted). Even if the Delaware common law process resembles the legislative process in some ways, the Delaware courts do exercise restraint to avoid creating judicial legislation. See, e.g., *Williams v. Geier*, 671 A.2d 1368, 1385 (Del. 1996) ("If we were to engraft here an exception to the statutory structure and authority in order to accommodate Williams' objection to this result, we would be engaging in impermissible judicial legislation."); *Nixon v. Blackwell*, 626 A.2d 1366, 1377 (Del. 1993) ("If such corporate practices were necessarily to require equal treatment for non-employee stockholders, that would be a matter for legislative determination in Delaware. There is no such legislation to that effect. If we were to adopt such a rule, our decision would border on judicial legislation.").

³² Fisch, *supra* note 31, at 1063. But see Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1017 (1997) (arguing that "despite the fact-specific, narrative quality of Delaware opinions, over time they yield reasonably determinate guidelines").

³³ Fisch, *supra* note 31, at 1064.

³⁴ See E. Norman Veasey, *The Judiciary's Contribution to the Reform of Corporate Governance*, 4 J. CORP. L. STUD. 225, 239-40 (2004) (comparing the American corporate law regime with the systems in the U.K. and the E.U.).

³⁵ See ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW I* (1993) ("The genius of American corporate law is in its federalist organization Firms . . . can particularize their charters under a state code, as well as seek the state whose code best matches their needs so as to minimize their cost of doing business."); E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW. 393, 393 (1997) ("[T]he 'genius of American corporate law' is its state-oriented federalism and its flexible self-governance").

governance regime that is founded on a “one size fits all” notion. Fiduciary law is based on equitable principles. Thus, it is both inherently and usefully indeterminate, because it allows business practices and expectations to evolve, and enables courts to review compliance with those evolving practices and expectations.

The judicial articulation of fiduciary duty law in Delaware is constantly evolving and has developed over about eight or nine decades. It is the quintessential application of the common law process.³⁶ Directors are fiduciaries, duty-bound to protect and advance the best interests of the corporation. When those interests conflict—or may conflict—with the personal interests of the fiduciaries, the fiduciaries’ interests must be sublimated to those of the corporation. The evolution of fiduciary principles occurs not only because courts must decide only the cases before them,³⁷ but also because business norms and mores change over time. Thus, concepts like “good faith” may acquire more defined content and doctrinal status over time as cases emerge addressing new business dynamics.³⁸

Delaware’s corporate law—in its judge-made mode—also provides advantages over a codified model to both stockholders and managers because of its balance and flexibility. Indeed, Delaware’s emphasis on responsible corporate governance practices as a standard of conduct is intended to promote good decision making by directors, thereby obviating the specter of judicial second-guessing. Good governance practices permit the time-honored business judgment rule regime to operate with integrity by checking self-interest and sloth while permitting valuable and prudent risk taking. Consequently, there is no discernible movement in Delaware to develop a codified model, even while the Delaware legislature improves and clarifies the DGCL nearly every year, with the expert input of the Delaware Bar.³⁹

³⁶ See Randy J. Holland, *Law, Politics and the Judiciary: Statutory Enactments and the Common Law*, DEL. LAW., Fall 2003, at 22 (describing the relationship and interactive development of judicial common law and legislative statutes).

³⁷ See *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 51 (Del. 1994) (“It is the nature of the judicial process that we decide only the case before us . . .”).

³⁸ See Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 30 DEL. J. CORP. L. (forthcoming 2005) (manuscript at 14) (“[A] general duty of good faith facilitates the development of specific new fiduciary obligations outside the scope of lack of care and lack of pecuniary self-interest in response to changing norms, conceptions, and practices.”).

³⁹ See E. Norman Veasey, *Law and Fact in Judicial Review of Corporate Transactions*, 10 U. MIAMI BUS. L. REV. 1, 3-4 (2002) (discussing the “overarching global debate” over whether corporate laws should be mandatory or enabling).

Delaware corporate law is characterized by the constant effort not only to improve the statutory law but also to improve corporate jurisprudence. That effort expressly embraces the need for flexibility and stability, without rigidity.⁴⁰ The goal in Delaware jurisprudence and legislation is similar to what the Toyota company has taken as its model. That model is *kaizen*, which I understand to mean “continuous improvement.”⁴¹ *Kaizen* comes to the fore here not only through the continuous improvement in the statutes and the articulation of judge-made law but also in the best practices of corporate governance that are being implemented every day by the directors and officers themselves—often encouraged by court dicta and speeches of judges and regulators.⁴²

In a 1992 speech in Delaware at the celebration of the 200th anniversary of the Delaware Court of Chancery, the Chief Justice of the United States, William H. Rehnquist, commented on the success of Delaware courts in crafting good corporate law:

Corporate lawyers across the United States have praised the expertise of the Court of Chancery, noting that since the turn of the century, it has handed down thousands of opinions interpreting virtually every provision of Delaware’s corporate law statute. No other state court can make such a claim. As one scholar has observed, “[t]he economies of scale created by the high volume of corporate litigation in Delaware contribute to an efficient and expert court system and bar.”⁴³

As I see it, there are seven normal expectations that a stockholder should have of a board of directors. Although others may apply in some situations, the stockholders expect at least that (i) the stock-

⁴⁰ See *Williams v. Geier*, 671 A.2d 1368, 1385 n.36 (Del. 1996) (“Directors and investors must be able to rely on the stability and absence of judicial interference with the State’s statutory prescriptions.”).

⁴¹ See John Gapper, *The Straight Route to Success*, FIN. TIMES, Sept. 23, 2004, at 17 (defining *kaizen* and describing its importance to Toyota’s innovation).

⁴² See, e.g., E. Norman Veasey, *Musings on the Dynamics of Corporate Governance Issues, Director Liability Concerns, Corporate Control Transactions, Ethics, and Federalism*, 152 U. PA. L. REV. 1007, 1014 (2003) (“Although, as judges, we give speeches and write articles raising academic issues and exhorting directors to adopt best practices, we do not reach out and make *ex cathedra* pronouncements on reformulating our jurisprudence or forecasting how certain fact situations should be decided.”); Thomas A. Roberts et al., *Director Liability Warnings from Delaware*, BUS. & SEC. LITIGATOR, Feb. 2003, at 1, available at [http://www.weil.com/wgm/cwgmhomep.nsf/Files/BSLFeb03/\\$file/BSLFeb03.pdf](http://www.weil.com/wgm/cwgmhomep.nsf/Files/BSLFeb03/$file/BSLFeb03.pdf) (citing judicial speeches as signaling the court’s focus on corporate governance issues).

⁴³ William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 BUS. LAW. 351, 354 (1992) (alteration in original).

holders will have a right to cast a meaningful vote for the members of the board of directors and have a right to vote on fundamental structural changes, such as mergers; (ii) the board of directors will actually *direct* and monitor the management of the company, including strategic business plans and fundamental structural changes; (iii) the board will see to the hiring of competent and honest business managers; (iv) the board will understand the business of the firm and develop and monitor a business plan and will monitor the managers as they carry out the business plan and the operations of the company; (v) when making a business decision, the board will develop a reasonable understanding of the transaction and act in good faith, on an informed basis, and with a rational business purpose; (vi) the board will carry out its basic fiduciary duties with honesty, care, good faith, and loyalty; and (vii) the board will take good faith steps to make sure the company complies with the law.

Stockholders also have expectations of the courts that are overseeing the stockholders' expectations of the board. Stockholders look to courts to enforce fiduciary duties in highly textured fact situations by applying the general principles that underlie the relationship between the investors and the board of directors.

As I see it, the courts have at least seven key obligations. They are (i) be clear; (ii) be prompt; (iii) be balanced; (iv) have a coherent rationale; (v) render decisions that are stable in the overall continuum; (vi) be intellectually honest; and (vii) properly limit the function of the court.

Stability, the fifth obligation stated above, is a stated goal of Delaware Supreme Court jurisprudence. In the 1996 case of *Williams v. Geier*, for example, the court stated:

In addition to the specter of impermissible judicial legislation, the relief requested by [the stockholder-plaintiff], if granted, would introduce an undesirable degree of uncertainty into the corporation law. Directors and investors must be able to rely on the stability and absence of judicial interference with the State's statutory prescriptions [A]bsent a showing of inequitable conduct on the part of the board, compliance with the applicable corporate governance regime (be it statute or bylaw) will generally shield corporate action from judicial interference.⁴⁴

⁴⁴ 671 A.2d at 1385 n.36 (citations omitted); *see also* *Nixon v. Blackwell*, 626 A.2d 1366, 1380-81 (Del. 1993) (arguing that predictable decisions are required for fair contract enforcement); *Am. Hardware Corp. v. Savage Arms Corp.*, 136 A.2d 690, 693 (Del. 1957) (warning that undue court interference would "import serious confusion and uncertainty into corporate procedure").

Note, however, the venerable Delaware jurisprudential doctrine that conduct that may be legally authorized may nevertheless be actionable as inequitable.⁴⁵

The tension between deference to director flexibility in decision making and the need for judicial oversight is often a defining tension.⁴⁶ The complexity of the issues and the variety of highly textured fact situations require a delicate balance in fiduciary duty jurisprudence.⁴⁷

B. Standards of Conduct

As Professor Mel Eisenberg has written,⁴⁸ and as the Model Business Corporation Act (MBCA) reflects,⁴⁹ standards of conduct are distinct from standards of review. Standards of conduct include conduct that is required of directors and aspirations for what is expected of directors.⁵⁰ Standards of review, on the other hand, govern whether directors will be held liable or a transaction set aside as a result of particular action or inaction.⁵¹ This distinction is implied in Delaware jurisprudence and it is developed in speeches and articles,⁵² but is not

⁴⁵ See *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437, 439 (Del. 1971) (“[I]nequitable action does not become permissible simply because it is legally possible.”); *Hollinger Int’l, Inc. v. Black*, 844 A.2d 1022, 1078 (Del. Ch. 2004) (same, quoting *Schnell*).

⁴⁶ See Veasey, *supra* note 35, at 402 (describing the role of independent decision making and judicial oversight in corporate governance).

⁴⁷ E. Norman Veasey, *An Economic Rationale for Judicial Decisionmaking in Corporate Law*, 53 BUS. LAW. 681, 682, 694-95 (1998).

⁴⁸ Melvin A. Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437 (1993).

⁴⁹ MODEL BUS. CORP. ACT (MBCA) §§ 8.30-31 (2002).

⁵⁰ See Eisenberg, *supra* note 48, at 437 (“A *standard of conduct* states how an actor should conduct a given activity or play a given role.”). In the context of professional counseling of boards of directors, I have found the 2004 version of the *Corporate Director’s Guidebook* to be a very helpful framework in the quest for best practices. ABA COMM. ON CORPORATE LAWS, CORPORATE DIRECTOR’S GUIDEBOOK (4th ed. 2004). The Guidebook was produced by the Committee on Corporate Laws of the American Bar Association’s Section of Business Law, which I am now privileged to chair.

⁵¹ See Eisenberg, *supra* note 48, at 437 (“A *standard of review* states the test a court should apply when it reviews an actor’s conduct to determine whether to impose liability or grant injunctive relief.”); Veasey, *supra* note 21, at 1453 n.29 (noting the distinction between standards of conduct and standards of review).

⁵² Former Chancellor William Allen, Justice (then-Vice Chancellor) Jack Jacobs, and Vice Chancellor Leo Strine have ventured another useful definition:

A judicial standard of review is a value-laden analytical instrument that reflects fundamental policy judgments. In corporate law, a judicial standard of review is a verbal expression that describes the task a court performs in determining

well developed in the cases. Nevertheless, it is clear that the standard of review is not perfectly coextensive with the standard of conduct.

When considering standards of conduct one begins with the duties and responsibilities of directors. Directors must direct the management of the corporation. They also have a vital oversight role in monitoring management without micromanaging operations. They must carry out their responsibilities in accordance with principles of fiduciary duty. Although the business judgment rule is a standard of review, these duties are embodied in the rule itself. That is, directors are expected to act—indeed are presumed to act, unless the presumption is rebutted—“on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.”⁵³

Although Delaware is not a Model Act state, it is sometimes helpful to learn from the articulation of the corporate law in the MBCA. The MBCA is followed in varying forms by a majority of states, and it is kept up to date by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association.⁵⁴ Section 8.30 of the MBCA articulates the standards of conduct for directors in a manner that I believe is generally consistent with Delaware jurisprudence.⁵⁵

whether action by corporate directors violated their fiduciary duty. Thus, in essential respects, the standard of review defines the freedom of action (or, if you will, deference in the form of freedom from intrusion) that will be accorded to the persons who are subject to its reach.

William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1295 (2001); *see also id.* (“There exists a close, but not perfect, relationship, between the standard by which courts measure director liability (the ‘standard of review’) and the standard of behavior that we normatively expect of directors (the ‘standard of conduct’).”).

⁵³ This quotation is taken from the oft-quoted 1984 Supreme Court decision in *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). Whether good faith is a stand-alone fiduciary duty—along with the duties of care and loyalty—is a point of some debate. This point will be developed later in this Article, *see infra* Part II.

⁵⁴ *Introduction to MODEL BUS. CORP. ACT ANN.*, at xxvii (1998); *see also* ABA Comm. on Corp. Laws, *Changes in the Model Business Corporation Act—Proposed Amendments Relating to Chapters 1, 7, and 8*, 60 BUS. LAW. 341, 341 (2004) (proposing amendments to the MBCA).

⁵⁵ It provides in subsections (a) and (b) as follows:

§ 8.30. STANDARDS OF CONDUCT FOR DIRECTORS

(a) Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director *reasonably believes* to be in the best interests of the corporation.

(b) The members of the board of directors or a committee of the board, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with

When discharging their duties, directors shall properly inform themselves and act in good faith. In *Aronson*, the court stated:

[Additionally], to invoke the rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties. While the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence.⁵⁶

The basic responsibilities of the board of directors stem from the operative Delaware statute, which requires that "the business and affairs of . . . [the] corporation . . . be managed by or under the direction of the board of directors."⁵⁷ The noun "direction," like the verb "to direct," is defined in the dictionary as a proactive concept, implicating strategic control and goal orientation. The very plain and forceful dictionary meaning of the noun "direction" is "guidance or supervision of action, conduct, or operations, . . . something that is imposed as authoritative instruction or bidding . . . an explicit instruction."⁵⁸ The meaning of the verb "to direct" is equally clear:

[T]o cause to turn, move, or point undeviatingly or to follow a straight course with a particular destination or object in view; to dispatch, aim, or guide [usually] along a fixed path . . . to show or point out the way . . . to regulate the activities or course of . . . to guide and supervise . . . to carry

the care that a person in a like position would reasonably believe appropriate under similar circumstances.

MODEL BUS. CORP. ACT § 8.30(a)-(b) (emphasis added). Note that Delaware does not use the "reasonably believes" test. Rather, Delaware case law rests on the test of "honestly believes." There is a difference. Compare 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, 930-42 (1980) (comparing the MBCA's reasonableness test with the rationality test under Delaware law), with S. Samuel Arshat & Joseph Hinsey IV, *Codified Standard—Same Harbor but Charted Channel: A Response*, 35 BUS. LAW. 947 (1980) (arguing that the reasonableness standard would not alter the business judgment rule). Consider also section 4.01 of the ALI's *Principles of Corporate Governance*, which states a "rationally believes" test. Subsection (b) of section 8.30 of the MBCA, in describing the duty of care, is an echo of a similar phrase in *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963), that "directors of a corporation . . . are bound to use that amount of care which ordinarily careful and prudent [persons] would use in similar circumstances." Additionally, subsections (c), (d), and (e) of section 8.30 of the MBCA are reliance sections, consistent with title 8, section 141(e) of the Delaware Code.

⁵⁶ 473 A.2d at 812 (footnote omitted).

⁵⁷ DEL. CODE ANN. tit. 8, § 141(a) (2001).

⁵⁸ WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 650 (3d ed. 2002).

out the organizing, energizing, and supervising of [especially] in an authoritative capacity⁵⁹

The root “direct” in this statutory mandate has two components: (1) to determine policy in their decision making function and (2) to guide and supervise in the oversight function. Thus, directors are not merely the group that hires and fires the CEO and is expected simply to advise management. They must be proactive in directing the management.

The marketplace is developing the expectation—that is, an extralegal standard of conduct—that directors will engage in best practices. This expectation is, for now, primarily an aspirational standard of conduct. Failure to adhere to the standard of conduct reflected in the aspirational standards of best practices may not necessarily result in liability, as the Delaware Supreme Court made clear in *Brehm v. Eisner*:⁶⁰

This is a case about whether there should be personal liability of the directors of a Delaware corporation to the corporation for lack of due care in the decisionmaking process and for waste of corporate assets. This case is not about the failure of the directors to establish and carry out ideal corporate governance practices.

All good corporate governance practices include compliance with statutory law and case law establishing fiduciary duties. But the law of corporate fiduciary duties and remedies for violation of those duties are distinct from the aspirational goals of ideal corporate governance practices. Aspirational ideals of good corporate governance practices for boards of directors that go beyond the minimal legal requirements of the corporation law are highly desirable, often tend to benefit stockholders, sometimes reduce litigation and can usually help directors avoid liability. But they are not required by the corporation law and do not define standards of liability.⁶¹

The interesting conundrum, going forward, is whether or not certain aspirations of best practices will become the norm. If they do, it will become necessary to consider the extent to which the failure to adhere to certain norms will become liability-producing acts or omissions.⁶²

I would note, as a matter of prudent counseling, that it is arguable—but not settled—that board conduct may be measured not only by the evolving expectations of directors in the context of Delaware

⁵⁹ *Id.*

⁶⁰ 746 A.2d 244 (Del. 2000).

⁶¹ *Id.* at 255-56.

⁶² *See infra* Part I.D.

common law fiduciary duty, but also by other standards. The Sarbanes-Oxley Act,⁶³ the Rules of the Securities and Exchange Commission (SEC), and the listing requirements of self regulatory organizations (SROs) such as the New York Stock Exchange (NYSE) may become relevant in state courts. Even though there is no express private right of action in the federal legislation or the SRO requirements, when and if these reforms are presented in a Delaware court as governing a board's conduct, adherence to these reforms may be relevant. Thus, adherence to these requirements would be advisable as a best practice, whether or not expressly required as a matter of state fiduciary duty law. Chancellor Chandler and Vice Chancellor Strine have, in fact, written an article suggesting, in part, that state courts, particularly Delaware courts, may be seeing Sarbanes-Oxley and other "2002 Reforms" issues.⁶⁴

C. Standards of Review

The standards of review determine whether a director may be held liable or a transaction set aside when the standards of conduct are not met.⁶⁵ We begin with the business judgment rule.

⁶³ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, 29 U.S.C.).

⁶⁴ William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 957 (2003).

⁶⁵ In fact, section 8.31 of the MBCA sets forth the standards of liability under that act, which has been adopted by a majority of states. While the MBCA does not apply in Delaware, this provision is a helpful reference. It provides, in pertinent part:

§ 8.31 STANDARDS OF LIABILITY FOR DIRECTORS

(a) A director shall not be liable . . . unless the party asserting liability in a proceeding establishes that:

. . . .

(2) the challenged conduct consisted or was the result of:

(i) action not in good faith; or

(ii) a decision

(A) which the director did not reasonably believe to be in the best interests of the corporation, or

(B) as to which the director was not informed to an extent the director reasonably believed appropriate in the circumstances; or

(iii) a lack of objectivity due to the director's familial, financial or business relationship with, or a lack of independence due to the director's domination or control by, another person having a material interest in the challenged conduct.

. . . .

(iv) a sustained failure of the director to devote attention to ongoing oversight of the business and affairs of the corporation . . .

1. The Business Judgment Rule

The conduct of directors of Delaware corporations in their decision making role continues to be reviewed under the business judgment rule, which is alive and well in Delaware corporate jurisprudence. Because of the mandate that directors manage or direct the management of the business and affairs of the corporation, the focus of the business judgment rule remains on the process that directors use in reaching their decisions.⁶⁶ The business judgment rule will normally protect the decisions of a board of directors reached by a careful, good faith process.⁶⁷ The rule itself has been restated numerous times. In *Brehm v. Eisner* the Supreme Court provided the following formulation:

The business judgment rule has been well formulated by *Aronson* and other cases. *See, e.g., Aronson*, 473 A.2d at 812 (“It is a presumption that in making a business decision the directors . . . acted on an informed basis, in good faith and in the honest belief that the action taken was in the

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- (v) receipt of a financial benefit to which the director was not entitled or any other breach of the director’s duties to deal fairly with the corporation and its shareholders that is actionable under applicable law.
 - (b) The party seeking to hold the director liable:
 - (1) for money damages, shall also have the burden of establishing that:
 - (i) harm to the corporation or its shareholders has been suffered, and
 - (ii) the harm suffered was proximately caused by the director’s challenged conduct

MODEL BUS. CORP. ACT § 8.31.

⁶⁶ *See, e.g., R. Franklin Balotti & James J. Hanks, Jr., Rejudging the Business Judgment Rule*, 48 BUS. LAW. 1337, 1344 (1993). Balotti and Hanks point out:

It is in the effort to impose liability for *decisions*—as opposed to *process*—that plaintiffs’ efforts to hold directors liable for money damages have encountered the greatest difficulty A different rubric, however, should be employed to determine whether to impose liability for a judgment that later turns out to be erroneous than for an act that was not performed properly. Thus, the deference given to the judgments of the directors—i.e., the substantive aspect of the business judgment rule—prohibits courts from overturning judgments of the directors.

Id.

⁶⁷ *See Brehm v. Eisner*, 746 A.2d 244, 264 n.66 (Del. 2000) (explaining the deference courts give a director’s decision). In *Brazen v. Bell Atlantic Corp.*, the court explained:

The business judgment rule is a presumption that directors are acting independently, in good faith and with due care in making a business decision. It applies when that decision is questioned and the analysis is primarily a process inquiry. Courts give deference to directors’ decisions reached by a proper process, and do not apply an objective reasonableness test in such a case to examine the wisdom of the decision itself.

695 A.2d 43, 49 (Del. 1997) (footnotes omitted).

best interests of the corporation.”). Thus, directors’ decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.⁶⁸

In a recent article, Professor Stephen Bainbridge speaks favorably of the foregoing articulation of the rule and equates the business judgment rule to a species of abstention doctrine.⁶⁹

This approach is consistent with the Delaware doctrine that the rule is a presumption that courts will not interfere with, or second-guess, decision making by directors. This is true unless the presumption is rebutted or unless a more exacting standard of review, such as entire fairness, applies because of the nature of the transaction before the court.⁷⁰ The business judgment rule applies not only to protect the decision (transactional justification) but also to protect directors from personal liability. Sometimes the standard of review for transactional justification purposes may diverge from the standard of review for personal liability purposes. For example, when the business judgment rule does not apply to protect directors because they did not act on an informed basis, they may be protected by a provision in the corporate charter exonerating them from liability,⁷¹ while the transaction they approved may nevertheless be set aside due to their violation of the duty of care.

The business judgment rule functions to protect the policies underlying corporate law, including maximization of stockholder value. Stockholders benefit from a profitable company—one that can attract capital and one that has ever-expanding earnings and earning potential. Stockholders expect a board that is not risk averse. They also want a board that knows the business, and is smart, honest, and hard-working. Probably (and usually), they want a good percentage of the board to be independent.

It is very much in the stockholders’ interest that the law not encourage directors to be risk averse. Some opportunities offer the prospect of great profit at the risk of very substantial loss, while the al-

⁶⁸ *Brehm*, 746 A.2d at 264 n.66.

⁶⁹ See Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 91 n.45 (2004) (noting that in *Brehm* the “Delaware Supreme Court articulated a strongly abstention-oriented version of the business judgment rule”).

⁷⁰ See *infra* Part I.C.2 for a discussion of standard of review issues.

⁷¹ For discussion of Delaware General Corporation Law section 102(b)(7) provisions and their implications, see *infra* Part I.C.2.c.

ternatives offer less risk of loss but also less potential profit. A diversified investor often is willing to invest in seemingly risky alternatives that may result in loss because, for example, the losses in some stocks will, over time, be offset by even greater gains in others or be ameliorated by the stability of debt instruments.

Judge Frank Easterbrook and Professor Dan Fischel, two brilliant theorists of the Chicago school of thought, have captured well the policy rationale that supports the notion that courts must continually strive to stay out of business decisions and to keep the business judgment rule alive and well, as I believe the Delaware courts have done. Consider the following passages:

Behind the business judgment rule lies recognition that investors' wealth would be lower if managers' decisions were routinely subjected to strict judicial review.

. . . .

. . . How can the court know whether a poor outcome of a business decision is attributable to poor management (inputs) or to the many other things that affect firms?

A decision is good to the extent it has a high *expected* value, although it may also have a high variance. To observe that things turned out poorly *ex post*, perhaps because of competitors' reactions, or regulations, or changes in interest rates, or consumers' fickleness, is not to know that the decision was wrong *ex ante*. Only after learning all of the possible outcomes, and the probability attached to each, could the court determine the wisdom of the decision at the time it was made. Occasionally the decision will be a howler, making inquiry easy. More often it will be hard to reconstruct possible outcomes. Businesses rarely encounter "sure things." Often managers must act now and learn later; delay for more study may be the *worst* decision; the market will decide whether the decision was good. Competition pares away the unsuccessful choices. Only in retrospect, observing which decisions were fruitful and which were not, can we say which was best. Yet because failure does not show that the decision was inferior when made, a court lacks the information to decide.

Costs of decision *ex post* will be highest precisely when it was also most difficult to contract *ex ante*. So when claims are made on the basis of the fiduciary principle—as opposed to a specific contract—courts are likely to lack essential tools of decision. This means that *ex post* settling up in markets has a comparative advantage over courts at enforcing the fiduciary principle *except* in the case of startling gaffes and large, one-shot, self-

interested transactions. It should be no surprise, then, to learn that the business judgment rule confines courts to exactly these rare cases.⁷²

Substantial academic literature has discussed the concept of “hindsight bias,” the human tendency to view decisions as having been obviously poor ones *after* having learned that the outcome was poor.⁷³ Hindsight bias is a hot topic in behavioral law and economics, as well as in the empirical work of certain psychologists and sociologists. Psychological research on hindsight bias strongly suggests the wisdom of the traditional Delaware approach, with its emphasis on protecting the substance of business judgments from after-the-fact scrutiny and condemnation, while allowing critiques based on disloyalty, lack of adequate process, and the like.⁷⁴ There is also some risk that hindsight bias will color our assessments of what an acceptably good process would have been or would have produced. Fortunately, this risk is mitigated in Delaware by the reality that certain kinds of processes—like use of special committees of independent directors who clearly have exclusive power to hire relevant advisors—can become customary and easily imitated, once they are widely thought to be good. This problem sometimes arises (or is perceived to arise) under some of the federal securities laws. Witness the pressure on the WorldCom and Enron directors to contribute part of the proposed settlements from their own personal assets.⁷⁵ To be sure, these cases are aberrations. Nevertheless, directors should take heed of them, but not panic.

Investor interests will be advanced if corporate directors and managers honestly assess risk and reward, cost and benefit. In their strategic vision, directors should pursue with integrity the highest available risk-adjusted returns that exceed the corporation’s cost of capital.

⁷² FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 93, 98-99 (1991).

⁷³ See, e.g., DAVID G. MYERS, *INTUITION: ITS POWERS AND PERILS* 89-93 (2002) (introducing the phenomenon of hindsight bias).

⁷⁴ See Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 574 (1998) (observing that the law “must tolerate biased assessments of liability or create some form of immunity for potential defendants,” and discussing the business judgment rule as an example).

⁷⁵ E. Norman Veasey, *A Perspective on Liability Risks to Directors*, DIRECTORS MONTHLY, Feb. 2005, at 1. *But cf. In re Worldcom, Inc. Secs. Litig.*, 02 Civ. 3288 (DLC), 2005 U.S. Dist. LEXIS 1805, at *32-33, *49-51 (S.D.N.Y. Feb. 9, 2005) (rejecting proposed settlement by proportionately liable defendants while deep-pocket, jointly and severally liable defendants remain in the case; and suggesting that this result likely gives less protection for outside directors than was intended by the drafters of the Private Securities Litigation Reform Act of 1995).

But directors may tend to be risk averse if they must assume a substantial degree of exposure to personal risk relating to ex post claims of liability for any resulting corporate loss occasioned by a business decision gone bad. They need not worry under Delaware law about mistakes of judgment—even “stupid” ones. They should not worry about liability if they exercise loyalty to the good faith pursuit of the best interests of the corporation.

Certain cases have given some pause to directors, practitioners, and academics, however. For example, in *Cede & Co. v. Technicolor, Inc.*,⁷⁶ the plaintiffs challenged a cash-out merger on grounds of fraud and breach of fiduciary duty, among other things.⁷⁷ The Court of Chancery had held that the directors could not be liable for a breach of the duty of care unless the plaintiffs could prove that the corporation was harmed by the directors’ lack of care.⁷⁸ That is, Chancellor Allen assumed for purposes of his decision that the directors had breached their duty of care,⁷⁹ but also applied a “no harm, no foul” type of analysis. He reasoned that there should not be liability unless the wrong caused an injury, which he apparently concluded it had not.⁸⁰

The Supreme Court reversed, holding that the directors had breached their duty of care and that the transaction, therefore, was subject to entire fairness review.⁸¹ The court observed that “[t]o require proof of injury as a component of the proof necessary to rebut the business judgment presumption would be to convert the burden shifting process from a threshold determination of the appropriate

⁷⁶ 634 A.2d 345 (Del. 1993).

⁷⁷ *Id.* at 349.

⁷⁸ *See id.* at 350-51 (“The Chancellor has erroneously imposed on Cinerama, for purposes of rebutting the rule, a burden of proof of board lack of due care which is unprecedented.”).

⁷⁹ Specifically, Chancellor Allen “entertain[ed] grave doubts” about whether the directors had met their duty of care, but he concluded that he need not decide the issue. *Cinerama, Inc. v. Technicolor, Inc.*, No. 8358, 1991 Del. Ch. LEXIS 105, at *8-9 (Del. Ch. June 21, 1991).

⁸⁰ *See id.* at *56-57 (“[I]n an arm’s-length, third party merger proof of a breach of the board’s duty of due care [does not] itself entitle[] plaintiff to judgment. Rather, in such a case . . . plaintiff bears the burden to establish that the negligence shown was the proximate cause of some injury to it . . .”). Chancellor Allen cited Learned Hand’s venerable decision in *Barnes v. Andrews*, 298 F. 614 (S.D.N.Y. 1924). The Delaware Supreme Court concluded that *Barnes* was inapposite. *See Cede*, 634 A.2d at 370 (stating that “[w]hile *Barnes* may still be ‘good law,’ *Barnes*, a tort action, does not control a claim for breach of fiduciary duty . . . [t]he tort principles of *Barnes* have no place in a business judgment rule standard of review analysis”).

⁸¹ *Cede*, 634 A.2d at 367.

standard of review to a dispositive adjudication on the merits.”⁸² The court held that a “breach of the duty of care, without any requirement of proof of injury, is sufficient to rebut the business judgment rule”⁸³ and remanded the case to the Court of Chancery for review of the challenged transaction under the entire fairness standard.⁸⁴

Commentators have criticized this decision (sometimes called *Cede* and sometimes called *Technicolor*) on a number of points. Professor Lyman Johnson has stated that it conflates the *duty* of care (a standard of conduct) and the *judicial determination* whether directors will be liable for that breach (a standard of review).⁸⁵ He has also suggested that *Cede*’s holding that the entire fairness standard applies when the business judgment rule is rebutted by directors’ breach of the duty of care was unprecedented.⁸⁶ Indeed, before the *Cede* decision entire fairness had not seemed to be the most fitting vehicle for addressing a breach of the duty of care. Entire fairness, which incorporates elements of fair dealing and fair price, is traditionally tied to situations involving self-dealing—in other words, *loyalty* cases.⁸⁷

Professor Stephen Bainbridge has suggested that this decision injects a more substantive component into the business judgment rule, moving the rule away from its traditional role as a doctrine of judicial

⁸² *Id.* at 371.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ See Lyman Johnson, *Rethinking Judicial Review of Director Care*, 24 DEL. J. CORP. L. 787, 803 (1999) (“The *Cede* court not only rhetorically *subsumed* care (a pervasive duty) under the business judgment rule (a specialized judicial review policy), but also wrongly *correlated* the duty of due care with the informedness element of the business judgment rule.”).

⁸⁶ See *id.* at 799 (“[N]one of the authority cited in [*Cede*] supports the novel proposition that, in a duty of care case, a director must carry the burden of proving the entire fairness of a challenged transaction. The court is far too careless and cavalier about this vital point.” (footnote omitted)).

⁸⁷ Bud Roth explains:

Entire fairness review is a doctrine historically used to scrutinize a transaction in which a member of the board (or other fiduciary) has a conflict of interest. Such claims normally involve accusations that a director engaged in self-dealing or personally profited from a transaction in a manner not shared with shareholders generally. Never before *Technicolor* had the Supreme Court employed the entire fairness standard of review to examine a transaction that the trial court had expressly found was approved in good faith and untainted by self-dealing.

Bud Roth, *Entire Fairness Review for a “Pure” Breach of the Duty of Care: Sensible Approach or Technicolor Flop?*, 3 DEL. L. REV. 145, 161 (2000) (footnotes omitted).

abstention.⁸⁸ His analysis is based, in part, on the court’s conclusion that “Cinerama clearly met its burden of proof for the purpose of rebutting the rule’s presumption by showing that the defendant directors of Technicolor failed to inform themselves fully concerning all material information reasonably available prior to approving the merger agreement.”⁸⁹ Bainbridge observes:

In so holding, the Supreme Court effectively rejected any conception of the business judgment rule as a doctrine of judicial abstention. The analysis began innocuously enough, with a fairly standard statement of the board of directors’ authority to manage the business and affairs of the corporation. The court immediately went off the rails, however, by describing the business judgment rule as being intended “to preclude a court from imposing itself *unreasonably* on the business and affairs of a corporation.” Contrast that formulation to *Van Gorkom*’s statement that the rule is intended to “protect and promote the full and free exercise of the managerial power granted to Delaware directors.” The contrast between these formulations is quite striking, with more than semantic implications. *Technicolor*’s formulation suggests far less judicial deference to the board than does that of *Van Gorkom*.

To be sure, the *Technicolor* court described the business judgment rule as “a powerful presumption” against judicial interference with board decision making. Immediately thereafter, however, the court proceeded to eviscerate that presumption:

Thus, a shareholder plaintiff challenging a board decision has the burden at the outset to rebut the rule’s presumption. To rebut the rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the triads of their fiduciary duty—good faith, loyalty or due care. If a shareholder plaintiff fails to meet this evidentiary burden, the business judgment rule attaches to protect corporate officers and directors and the decisions they make, and our courts will not second-guess these business judgments. If the rule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the “entire fairness” of the transaction to the shareholder plaintiff.

Notice how the court puts the cart before the horse. Directors who violate their duty of care do not get the protections of the business judgment rule; indeed, the rule is rebutted by a showing that the direc-

⁸⁸ See Bainbridge, *supra* note 69, at 87 (“[*Cede*] illustrates the modern trend towards treating the business judgment rule as a substantive doctrine, expressing the scope of director liability, and permitting courts some room to examine the substantive merits of the board’s decision.”).

⁸⁹ *Cede*, 634 A.2d at 371.

tors violated their fiduciary duty of “due care.” This is exactly backwards. As we shall see, the abstention doctrine approach to the rule prevents plaintiff[s] from litigating that very issue. Put another way, the whole point of the business judgment rule is to prevent courts from even asking the question: did the board breach its duty of care?⁹⁰

The *Cede v. Technicolor* decision, though anomalous doctrinally, may not make a big practical difference, because personal liability of directors solely for due care violations has largely become moot by reason of section 102(b)(7) of the DGCL.⁹¹

2. Other Standard of Review Issues

a. *Levels of scrutiny*

The standards of review include various gradations of judicial scrutiny. If the business judgment rule applies, courts will not second-guess directors or even question whether a business decision is “reasonable.” But the takeover era of the 1980s, culminating in the watershed year of 1985, led to more and increasingly complicated standards of review. For example, the Delaware Supreme Court has set forth differing review mechanisms to be applied in various contexts. The various forms of enhanced scrutiny range from testing the reasonableness and proportionality of the directors’ resistance to a takeover under the *Unocal*⁹² standard, to the “entire fairness” test under *Weinberger*,⁹³ to the “best price on sale of control” standard under *Revlon*⁹⁴ and *QVC*,⁹⁵ to the “compelling justification” standard for interference with a stockholder vote under *Blasius*⁹⁶ and *Liquid Audio*.⁹⁷

⁹⁰ Bainbridge, *supra* note 69, at 93-95 (footnotes omitted).

⁹¹ See *infra* Part I.C.2.c. The conduct at issue in the *Cede* case took place in 1982-1983, before the 1986 enactment of section 102(b)(7).

⁹² *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985); see also *Unitrin Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1372 (Del. 1995). The *Unitrin* gloss on *Unocal* is discussed *infra* Part III.A.

⁹³ See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) (holding that in a transaction involving conflicted insiders, those who are conflicted have the burden to satisfy the court that the transaction is entirely fair to stockholders or the corporation, both as to fair price and fair process).

⁹⁴ *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1985).

⁹⁵ *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 43 (Del. 1994).

⁹⁶ *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988).

⁹⁷ *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1128 (Del. 2003).

This phenomenon has been criticized by some scholars as creating a regime that is too complex.⁹⁸ It is not practicable in this Article to analyze, rationalize, or offer a restatement of these complex levels of review. That job would, indeed, need to be a complete article itself or part of a book.

b. *Vicinity of insolvency*

There is a very challenging issue of whether (and to what extent) directors, in making their business decisions when the corporation is in the vicinity of insolvency, may be required to consider the interests of creditors—a different constituency from that to which their duties normally extend, namely stockholders.⁹⁹ In his opinion in *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*,¹⁰⁰ then-Chancellor Allen stated that “[a]t least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise.”¹⁰¹ The Chancellor then provided, in his famous footnote fifty-five, an example of how the possibility of insolvency can alter the incentives facing directors in their decision making processes.¹⁰² Thus,

⁹⁸ See Allen et al., *supra* note 52, at 1292-93, 1317-21 (criticizing the increasing number of standards of review in Delaware corporate law, and suggesting a mid-course correction that would leave only three standards of review). *But cf.* Lawrence A. Cunningham & Charles M. Yablon, *Delaware Fiduciary Duty Law After QVC and Technicolor: A Unified Standard (and the End of Revlon Duties?)*, 49 BUS. LAW. 1593, 1594 (1994) (analyzing *QVC* and *Technicolor* “as part of a movement in Delaware fiduciary law toward a single, more unified standard, and away from doctrinal fragmentation”).

⁹⁹ *Cf. Unocal*, 493 A.2d at 955 (stating that, when evaluating a takeover bid, the board may consider the bid’s “effect on the corporate enterprise,” including “the impact on ‘constituencies’ other than shareholders”).

¹⁰⁰ No. 12150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991).

¹⁰¹ *Id.* at *108. But in *Adlerstein v. Wertheimer* the court said:

While it is true that a board of directors of an insolvent corporation or one operating in the vicinity of insolvency has fiduciary duties to creditors and others as well as to its stockholders, it is not true that our law countenances, permits, or requires directors to conduct the affairs of an insolvent corporation in a manner that is inconsistent with principles of fairness or in breach of duties owed to the stockholders.

No. 19101, 2002 Del. Ch. LEXIS 13, at *35 (Del. Ch. Jan. 25, 2002) (footnote omitted).

¹⁰² In that footnote, Chancellor Allen stated:

The directors will recognize that in managing the business affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.

when a corporation is in the vicinity of insolvency—whatever that is—creditors may be considered to be in the pool of residual owners, and therefore become beneficiaries of the fiduciary duties owed to the residual owners. Creditors' inclusion in the pool need not imply that stockholders are thereby excluded, however. Directors will normally have discretion to exercise their business judgment, provided they do so in good faith.

The key here is that directors, in these and all circumstances, must act in the honest belief that they are carrying out the best interests of the corporate entity.¹⁰³ In a recent Chancery decision, *Production Resources Group, LLC v. NCT Group, Inc.*,¹⁰⁴ a creditor of NCT Group sought to have a receiver appointed for NCT under title 8, section 291 of the Delaware Code, and also alleged certain breaches of fiduciary duty.¹⁰⁵ The Court of Chancery largely denied a motion to dismiss the action, allowing the section 291 claims and some of the fiduciary duty claims to proceed. In his decision, Vice Chancellor Strine stated that the plaintiff had sufficiently pleaded:

a suspicious pattern of dealing that raises the legitimate concern that the NCT board *is not pursuing the best interests of NCT's creditors as a class with claims on a pool of insufficient assets*, but engaging in preferential treatment of the company's primary creditor and de facto controlling stockholder (and perhaps of its top officers, who are also directors) without any legitimate basis for the favoritism.¹⁰⁶

I cite *Production Resources* not because it announces anything new. Rather, it reaffirms what, in my view, has always been the law—that directors who make good faith, careful judgments in the honest belief that they are acting in the best interests of the corporation should not fear liability.¹⁰⁷

Credit Lyonnais, 1991 Del. Ch. LEXIS 215, at *108 n.55.

¹⁰³ See *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (“It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”), *overruled on other grounds by* *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

¹⁰⁴ 863 A.2d 772 (Del. Ch. 2004).

¹⁰⁵ *Id.* at 775.

¹⁰⁶ *Id.* at 800 (emphasis added).

¹⁰⁷ A memo from the law firm Wachtell, Lipton, Rosen & Katz supports this position, stating:

In a welcome note of reassurance to directors of financially troubled companies, the Delaware Court of Chancery has held that director exculpation charter provisions adopted under Delaware's § 102(b)(7) protect directors from due care/mismanagement claims brought by creditors who are accorded

As noted, the business judgment rule protects directors who, among other things, make decisions in the honest belief that they are acting in the best interests of the corporation. This may mean that the directors' judgment could shade toward rights of creditors if that course of action comports with the best interests of the corporate entity. Thus, it is important to keep in mind the precise content of this "best interests" concept—that is, to whom this duty is owed and when. Naturally, one often thinks that directors owe this duty to both the corporation and the stockholders. That formulation is harmless in most instances because of the confluence of interests, in that what is good for the corporate entity is usually derivatively good for the stockholders.¹⁰⁸ There are times, of course, when the focus is directly on the interests of stockholders.¹⁰⁹ But, in general, the directors owe fiduciary duties to the *corporation*, not to the stockholders. This provides a doctrinal solution to the incentive problem that is entirely consistent with the emphasis on board governance, namely, that the board's duty is to do what is best for the corporation. This means that, as the corporation slides toward insolvency, the benefits of maximizing the value of the corporation will shift from stockholders to creditors, but, on this view, the duties of the board remain the same. The obvious tension between the interests of creditors and those of stockholders is palpable and a vexing challenge for directors.

standing to pursue fiduciary duty claims when the firm is insolvent. More broadly, the opinion is an important dilation on the same court's often-cited 1991 decision in *Credit Lyonnais* addressing the degree of discretion afforded directors when the firm is in the "zone of insolvency," and makes clear that there is no "new body of creditor's rights law."

....

... Directors' choices remain difficult ones, but under *Production Resources* it is clear that those choices, if made in the good faith exercise of business judgment as to the best interest of the firm itself, ought not give rise to any threat of personal liability at the behest of either stockholders or creditors.

Memorandum from Theodore N. Mirvis et al., *Delaware Speaks to Directors of Troubled Companies* (Dec. 1, 2004) (on file with author) (citation omitted).

¹⁰⁸ *But cf.* *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1036 (Del. 2004) (explaining that the distinction between a direct and a derivative action turns on whether the corporation or the individual stockholders suffered the harm, thus acknowledging that stockholders may suffer harms not affecting the corporation, or vice versa).

¹⁰⁹ See, for example, *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 1994), and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1985), which teach that when there is a sale of control, the directors must seek to attain the best transaction reasonably available for the stockholders because the stockholders are leaving the old corporate entity to the control of others.

The Delaware Supreme Court has never directly addressed the vicinity of insolvency issue, although one case involving the issue was appealed to the court in 2000.¹¹⁰ The court affirmed the case on the basis of the Court of Chancery's opinion and expressly stated that it did not reach the issue of "whether or to what extent directors of a corporation said to be in the so-called 'vicinity of insolvency' owe fiduciary duties to preferred stockholders."¹¹¹ Thus, the questions of what is the "vicinity of insolvency" and how must directors carry out their fiduciary duties in that milieu are areas of future development in the Supreme Court's jurisprudence of fiduciary duties and the business judgment rule. It is certainly an area where directors of troubled companies and their counsel face particular challenges and need expert counseling.

c. *Exculpation and section 102(b)(7)*

As noted, the standard of review for transactional justification purposes may sometimes diverge from the standard of review for personal liability purposes. For example, the court might set aside a transaction if the directors were grossly negligent, but the directors could be shielded from personal liability.¹¹²

In the mid-1980s, the insurance market for directors and officers was very tight, and it was difficult to attract persons willing to serve as directors. As a result, in 1986 the Delaware legislature adopted a statute, section 102(b)(7), that had the effect of permitting stockholders, in the certificate of incorporation, to exonerate directors from personal liability for gross negligence.¹¹³ Although a charter provision enacted under section 102(b)(7) would protect the directors from personal liability for gross negligence, the charter provision would not bar a court from setting aside a transaction that was the product of

¹¹⁰ Kohls v. Kenetech Corp., No. 433, 2002 Del. LEXIS 217, at *1 (Del. Apr. 5, 2002).

¹¹¹ *Id.*

¹¹² Compare Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) (holding directors to be personally liable after the transaction in question was completed, and establishing gross negligence as the test, following dictum of *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)), with *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 273-76 (2d Cir. 1986) (granting a preliminary injunction under New York law enjoining a lock-up option in a takeover battle where directors of the target violated their duty of care, even if the directors were not *grossly* negligent under the standard announced in *Smith v. Van Gorkom*).

¹¹³ DEL. CODE ANN. tit. 8, § 102(b)(7) (2001).

gross negligence. Importantly, section 102(b)(7) does not permit exoneration:

(i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit.¹¹⁴

It must be kept in mind that section 102(b)(7), like the indemnification provisions of section 145 and the reliance provision in section 141(e),¹¹⁵ is designed to have a remedial effect. That is, those provisions are designed to operate like the business judgment rule to protect directors and to encourage qualified persons to act as directors. For example, in the case of *Stifel Financial Corp. v. Cochran*,¹¹⁶ the Supreme Court noted this goal in the indemnification context:

This Court has emphasized that the indemnification statute should be broadly interpreted to further the goals it was enacted to achieve The invariant policy of Delaware legislation on indemnification is to “promote the desirable end that corporate officials will resist what they consider unjustified suits and claims, secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated.” . . . Beyond that, its larger purpose is “to encourage capable [persons] to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve.”¹¹⁷

There has been some debate about how a section 102(b)(7) provision actually operates in litigation to exonerate directors. The bottom line is that derivative due care claims seeking personal liability of directors can normally be dismissed on motion. But the jurisprudential route leading to that result is somewhat tortured. In 1999, in *Emerald Partners v. Berlin*,¹¹⁸ the Supreme Court stated that a director's claim for exculpation from liability under section 102(b)(7) is “in the nature of an affirmative defense.”¹¹⁹ This formulation led to confusion.

Former Chancellor Allen, Vice Chancellor (now Justice) Jacobs, and Vice Chancellor Strine have suggested that treating a section

¹¹⁴ *Id.*

¹¹⁵ See *infra* Part II for discussion of the good faith components of section 145 and section 141(e).

¹¹⁶ 809 A.2d 555 (Del. 2002).

¹¹⁷ *Id.* at 561 (quoting FOLK ON THE DELAWARE GENERAL CORPORATE LAW: FUNDAMENTALS § 145.2 (Edward D. Welch et al. eds., 2001)).

¹¹⁸ 726 A.2d 1215 (Del. 1999).

¹¹⁹ *Id.* at 1223.

102(b)(7) defense as an affirmative defense, as stated in *Emerald Partners*, requires directors to prove that their alleged misconduct did not fall into any of the categories of conduct for which section 102(b)(7) does not provide exculpation, even if the plaintiffs have not alleged those types of breaches.¹²⁰ They propose that it would be wiser to treat section 102(b)(7) as creating a statutory immunity, under which defendants would be automatically exculpated for any duty of care-based claims if the statute applied.¹²¹ This seems sensible to me.

I think that any theoretical awkwardness of the “affirmative defense” concept will not cause ongoing concern in handling section 102(b)(7) cases in view of later jurisprudence. In *Malpiede v. Townson*,¹²² the Supreme Court affirmed the Court of Chancery’s grant of a motion to dismiss the plaintiffs’ due care claims because of the corporation’s 102(b)(7) exculpation provision.¹²³ The Court of Chancery had also dismissed, and the Supreme Court affirmed, the plaintiffs’ duty of loyalty and disclosure violation claims.¹²⁴ Thus, in order to achieve exculpation in *Malpiede*, the directors were not required affirmatively to prove the lack of a breach of loyalty.

The *Malpiede* court elaborated on the 1999 *Emerald Partners* decision by concluding that despite the notion that section 102(b)(7) might be viewed as an affirmative defense, certain language in *Emerald Partners*¹²⁵ permits dismissal of a complaint upon invocation of the corporation’s 102(b)(7) provision if the complaint “unambiguously and solely asserted only a due care claim.”¹²⁶ The court distinguished the 1999 *Emerald Partners* decision on the basis that it had proceeded to trial on matters including the section 102(b)(7) issue, while *Malpiede* involved only pleading issues.¹²⁷ The court noted, however, that despite the description of the exculpatory defense in *Emerald Partners* as an affirmative defense:

¹²⁰ See Allen et al., *supra* note 52, at 1304-05 (“Imposing the burden to establish the exculpation defense upon the directors perversely requires them to disprove all of the duty of *loyalty*-related ‘exceptions’ to the defense, to be relieved of liability for *due care* claims.”).

¹²¹ *Id.* at 1305.

¹²² 780 A.2d 1075 (Del. 2001).

¹²³ *Id.* at 1079.

¹²⁴ *Id.*

¹²⁵ See *Emerald Partners v. Berlin*, 726 A.2d 1215, 1224 (Del. 1999) (“[W]here the factual basis for a claim *solely* implicates a violation of the duty of care, this Court has indicated that the protections of such a charter provision may properly be invoked and applied.”).

¹²⁶ *Malpiede*, 780 A.2d at 1093.

¹²⁷ *Id.* at 1094.

[T]he board is not required to *disprove* claims based on alleged breaches of the duty of loyalty to gain the protection of the provision with respect to due care claims. Rather, proving the existence of a valid exculpatory provision in the corporate charter entitles directors to dismissal of any claims for money damages against them that are based solely on alleged breaches of the board's duty of care.¹²⁸

In 2001, the *Emerald Partners* matter came before the Supreme Court for a third time.¹²⁹ In the third appeal, the court considered “when it is appropriate procedurally to consider the substantive effect of a section 102(b)(7) provision, in a stockholder challenge to a transaction that requires a trial pursuant to the entire fairness standard of judicial review.”¹³⁰ The Supreme Court's 2001 *Emerald Partners* decision noted that the unusual procedural posture there required proof of entire fairness and made clear that it differed from *Malpiede* as follows:

The rationale of *Malpiede* constitutes judicial cognizance of a practical reality: unless there is a violation of the duty of loyalty or the duty of good faith, a trial on the issue of entire fairness is unnecessary because a Section 102(b)(7) provision will exculpate director defendants from paying monetary damages that are exclusively attributable to a violation of the duty of care. The effect of our holding in *Malpiede* is that, in actions against the directors of Delaware corporations with a Section 102(b)(7) charter provision, a shareholder's complaint must allege well-pled facts that, if true, implicate breaches of loyalty or good faith.¹³¹

Of course, there are nuances and doctrinal anomalies here that cannot be analyzed comprehensively and with finality in this glimpse of a retrospective. Indeed, it is probably a fair comment that reading *Malpiede* and the 2001 *Emerald Partners* decision together has “brought some clarity and introduced additional uncertainty.”¹³² Professor Lyman Johnson has written:

The supreme court clearly needs to re-address how the protection of section 102(b)(7) meshes with procedural burdens and existing standards of review. This is important because of judicial efficiency concerns and because burdens and standards of review often are outcome determinative. Apart from that issue, the supreme court should address how the proposed concept of “due loyalty” fits into the existing procedural

¹²⁸ *Id.* at 1095-96 n.70.

¹²⁹ *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001).

¹³⁰ *Id.* at 89-90.

¹³¹ *Id.* at 92 (footnotes omitted).

¹³² Lyman Johnson, *After Enron: Remembering Loyalty Discourse in Corporate Law*, 28 DEL. J. CORP. L. 27, 65 (2003).

scheme and standards of judicial review for addressing alleged fiduciary duty breaches.¹³³

I agree with Professor Johnson to this extent: the jurisprudential path to achieve the remedial effect of section 102(b)(7) is winding. But I do not agree that further clarification should be a high priority for the Supreme Court. I think *Malpiede* is clarification enough.

D. *Evolving Expectations*

As we have seen, the statutory requirements of the DGCL and judge-made principles of fiduciary duty form the standards of conduct of directors. They are expectations that stockholders and courts have concerning director processes. A priori, these evolving expectations may be largely aspirational standards of conduct. But in some circumstances, an egregious failure to adhere to certain evolving expectations could result in liability upon the application of the appropriate standard of review. The phrase “evolving expectations” is not something that one finds explicated in the decisions of the Supreme Court. Rather, it is a shorthand term that I have used in speeches and articles in recent years to help me understand how the focus on director processes has been sharpened over the years.¹³⁴ It does seem obvious to me, nevertheless, that the expectations of director processes—both by stockholders and courts—are dynamic, not static. They continually evolve as business realities and mores change over time. The courts apply the quintessential common law process to those evolving expectations.

In recent years, expectations that boards will implement modern governance norms have been increasing. For example, there is an evolving expectation in the standard of conduct that boards will set up and implement effective law compliance programs. The now-famous *Caremark* decision in 1996 made this principle clear.¹³⁵ Although *Caremark* was a Chancery decision—and the principle announced by the Chancellor was only dictum—the Delaware Supreme Court has

¹³³ *Id.* at 67-68 (footnotes omitted).

¹³⁴ *E.g.*, Veasey, *supra* note 21, at 1451-54; E. Norman Veasey, *Corporate Governance and Ethics in the Post-Enron Worldcom Environment*, 38 WAKE FOREST L. REV. 839, 842 (2003).

¹³⁵ *See In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (describing two contexts in which “director liability for breach of the duty to exercise appropriate attention” may arise, including “from an *unconsidered failure of the board to act* in circumstances in which due attention would, arguably, have prevented the loss”).

cited it¹³⁶ and, indeed, it has taken on a (sometimes controversial or misunderstood) life of its own.¹³⁷

Developing case law outside of the board's decision making processes implicates the oversight responsibility of the board of directors. Strictly speaking, the business judgment rule applies only to business decisions and does not apply in an oversight context.¹³⁸ Nevertheless, directors' decisions about how to set up mechanisms to monitor management involve directorial judgment, and it is the judgment of the directors on which investors rely.

Representative Delaware cases in this area include *Graham v. Allis-Chalmers Manufacturing Co.*¹³⁹ and *Lutz v. Boas*.¹⁴⁰ Both cases were decided in the 1960s, before the 1996 *Caremark* case that shaped the modern understanding of directors' oversight responsibilities. One case found no liability; the other imposed liability.

In *Graham*, directors were held not liable to the corporation in a derivative suit when they failed to prevent junior officials from committing antitrust violations that allegedly damaged the corporation.¹⁴¹ The court held that there was no liability because there were no "red flags" that the directors saw or should have seen.¹⁴² In *Lutz*, directors who virtually abdicated their responsibility through sustained inattention to their duties were held liable for what then-Chancellor Seitz found to be grossly negligent conduct.¹⁴³ The case involved the failure of nonaffiliated (supposedly independent) directors of mutual funds

¹³⁶ See, e.g., *In re Bailey*, 821 A.2d 851, 864 & n.29 (Del. 2003) (citing *Caremark* as an example of a "failure to supervise" claim); *White v. Panic*, 783 A.2d 543, 551 & n.26 (Del. 2001) (same).

¹³⁷ Although *Caremark* is established as a practical matter, represents a fixture in corporate governance, and is the centerpiece around which compliance programs and continuing legal education seminars are set, it has not won universal acclaim. See Charles M. Elson & Christopher J. Gyves, *In Re Caremark: Good Intentions, Unintended Consequences*, 39 WAKE FOREST L. REV. 691, 691-92 (2004) ("Despite sound and lofty intentions, the consequences of *Caremark* have been disappointing . . . an empty triumph of form over substance.").

¹³⁸ See *Aronson v. Lewis*, 473 A.2d 805, 813 (Del. 1984) (explaining that the business judgment rule applies to business decisions and "only in the context of director action").

¹³⁹ 188 A.2d 125 (Del. 1963).

¹⁴⁰ 171 A.2d 381 (Del. Ch. 1961).

¹⁴¹ *Graham*, 188 A.2d at 131.

¹⁴² See *id.* at 130 ("[A]bsent cause for suspicion, there is no duty upon the directors . . . to ferret out wrongdoing which they have no reason to suspect exists.").

¹⁴³ *Lutz*, 171 A.2d at 395-96.

to carry out their oversight responsibility to monitor the fund managers.¹⁴⁴

In the 1996 *Caremark* case, then-Chancellor Allen discussed, in dictum, the potential liability of directors in failing to carry out their oversight responsibilities regarding health care law violations of subordinates:

I am of the view that a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable

. . . .

. . . [I]n my opinion only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system [exists]—will establish the lack of good faith that is a necessary condition to liability. Such a test of liability—lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight—is quite high.¹⁴⁵

Having a modern compliance system is a good, and, modernly, an expected, corporate practice. Although one might not find this notion in the *Graham* case, which was thirty-three years old at the time of *Caremark*, the need for an effective compliance system is not a new idea. In 1980, seventeen years after *Graham* and sixteen years before *Caremark*, I wrote an article with my then-associate William Manning, in which we said that the 1963 *Graham* decision provided only “minimal guidance.” We referred to a 1978 statement of principles of the Business Roundtable of the “core functions” of the board:¹⁴⁶ “Some recent lapses in corporate behavior have emphasized the need for policies and implementing procedures on corporate law compliance. These policies should be designed to promote such compliance on a sustained and systematic basis by all levels of operating management.”¹⁴⁷ We then noted “that the expected role of a director has grown to include the installation of legal compliance systems” and that this change “shows a natural development in the role of an ‘ordi-

¹⁴⁴ *Id.*

¹⁴⁵ *Caremark*, 698 A.2d at 970-71.

¹⁴⁶ Veasey & Manning, *supra* note 55, at 929.

¹⁴⁷ *Id.* (quoting *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation: Statement of the Business Roundtable*, 33 BUS. LAW. 2083, 2101 (1978)).

narily prudent director' since 1963, the year in which *Graham* was decided."¹⁴⁸

Hence, the oversight responsibility is a dynamic one. That is not to say that *Graham* would not be decided the same way today on its particular facts. No doubt, however, some of the language in *Graham* would differ if we looked at its facts through the prism of what is now over forty years of experience.¹⁴⁹

As noted in *Caremark*,¹⁵⁰ the federal sentencing guidelines, which were not in existence in the *Graham* era, give a corporation credit for "an effective program to prevent and detect violations of law," when the program is "reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct."¹⁵¹ These guidelines alone should be sufficient incentive for a board to have a law compliance system as a standard of conduct. Whether application of the standard of review will result in liability may, however, be another matter, depending on all the circumstances.

The evolving expectations for directors may be manifested in considering whether or not directors have acted not only with due care but also in good faith or consistent with principles of loyalty. The legal determination whether directors have acted in accordance with these fiduciary principles may change as extralegal expectations for directorial conduct change. We turn now to consider the role of good faith in Delaware law.

II. GOOD FAITH

The good faith of directors has long been a part of Delaware law. It has now become a critical issue in the ongoing *Disney* litigation.

¹⁴⁸ See Veasey & Manning, *supra* note 55, at 930 (referring to the *Graham* court's refusal to require the director-defendants to put into effect a "system of watchfulness" before they knew of any misconduct).

¹⁴⁹ For examples of how the evolving expectations of directors in the oversight area have recently been articulated, consider some recent federal and SRO developments. The Sarbanes-Oxley Act, for example, requires management to "establish[] and maintain[] . . . adequate internal control structure[s] and procedure[s]." Sarbanes-Oxley Act of 2002, § 404, Pub. L. No. 107-204, 116 Stat. 745, 789 (2002) (codified in scattered sections of 11, 15, 18, 28, 29 U.S.C.). The New York Stock Exchange requires listed companies to abide by certain "corporate governance standards" and to have an internal audit committee. N.Y. STOCK EXCH., LISTED COMPANY MANUAL §§ 303A.06-.07 (2004), available at <http://www.nyse.com/Frameset.html?displayPage=/listed/1022221393251.html>.

¹⁵⁰ *Caremark*, 698 A.2d at 969.

¹⁵¹ U.S. SENTENCING GUIDELINES MANUAL § 8A1.2, cmt. 3(k) (2001).

There, the amended complaint alleged misconduct by directors and claimed that they did not act in good faith when they approved a lucrative contract for Michael Ovitz as president and then approved his “no-fault” termination fourteen months later at an alleged cost to the company of \$140 million.¹⁵² That complaint survived a motion to dismiss.¹⁵³ In denying the motion to dismiss and permitting the case to go to trial, Chancellor Chandler said:

[The] facts alleged in the new complaint suggest that the defendant directors *consciously and intentionally disregarded their responsibilities*, adopting a “we don’t care about the risks” attitude concerning a material corporate decision. Knowing or deliberate indifference by a director to his or her duty to act faithfully and with appropriate care is conduct, in my opinion, that may not have been taken honestly and in good faith to advance the best interests of the company. Put differently, all of the alleged facts, if true, imply that the defendant directors *knew* that they were making material decisions without adequate information and without adequate deliberation, and that they simply did not care if the decisions caused the corporation and its stockholders to suffer injury or loss. *Viewed in this light, plaintiffs’ new complaint sufficiently alleges a breach of the directors’ obligation to act honestly and in good faith in the corporation’s best interests for a Court to conclude, if the facts are true, that the defendant directors’ conduct fell outside the protection of the business judgment rule.*¹⁵⁴

It must be kept in mind that the *Disney* litigation—as the Supreme Court saw it in *Brehm v. Eisner* in 2000, based on the original and defective set of pleadings—seemed to be primarily a due care case.¹⁵⁵ We remanded, in part because it was not clear whether the directors

¹⁵² See *Brehm v. Eisner*, 746 A.2d 244, 261 (Del. 2000) (“[T]he question here is whether the directors are to be ‘fully protected’ (*i.e.*, not held liable) on the basis that they relied in good faith on a qualified expert under Section 141(e) of the Delaware General Corporation Law.”); *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 278-79 (Del. Ch. 2003) (“[P]laintiffs’ new complaint suggests that the Disney directors failed to exercise *any* business judgment and failed to make *any* good faith attempt to fulfill their fiduciary duties to Disney and its stockholders.”).

¹⁵³ *Disney*, 825 A.2d at 289-90. “Gross negligence” is the standard of review that typically applies to duty of care claims in Delaware. See Allen et al., *supra* note 52, at 1299 (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), as first applying the gross negligence standard to business judgment rule consideration of a claim for breach of the duty of care).

¹⁵⁴ *Disney*, 825 A.2d at 289 (emphasis in final sentence added).

¹⁵⁵ See *Brehm*, 746 A.2d at 255 (“This is a case about whether there should be personal liability of the directors . . . for lack of due care in the decisionmaking process.”). Curiously, potential exoneration of directors under section 102(b)(7) was not discussed in that phase of the case.

could claim the protection of section 141(e).¹⁵⁶ That is, had they “relied in good faith” on an expert in making their two decisions on the Ovitz compensation package?¹⁵⁷

On remand, the case, as repleaded, morphed into a “good faith” case. In 2000 we had not thought of it as a “loyalty” case, there being no allegation of self-dealing. But we suggested that there may be an issue whether the directors could correctly claim that they should be fully protected by relying in good faith on a qualified expert under section 141(e).¹⁵⁸ Large questions now loom, in light of the Chancellor’s 2003 decision: (a) whether self-dealing is an essential element of a violation of the duty of loyalty; and (b) whether good faith is a free-standing fiduciary duty. There is a respected school of thought that a director has violated the duty of loyalty if the act or omission in question is not in good faith in the sense the Chancellor articulated in the 2003 *Disney* decision based on the amended complaint. Thus, a parsing of the protections of section 102(b)(7) and section 141(e) is implicated. The Chancellor’s 2003 decision holds that the allegations, if true, would not protect the directors under section 102(b)(7) because their decisions on the Ovitz matter were not made in good faith.¹⁵⁹ It remains to be seen what facts will be found at trial and whether good faith reliance on a qualified expert under section 141(e) will play a significant part.¹⁶⁰

One must keep in mind that the Chancellor’s decision in *Disney* on the motion to dismiss is the law of the case. That is, it is established, unless the Supreme Court should rule otherwise, that if directors “consciously and intentionally disregarded their responsibilities,”

¹⁵⁶ DEL. CODE ANN. tit. 8, § 141(e) (2001) (providing protection for directors who rely in good faith on, among other things, the advice of experts when making decisions).

¹⁵⁷ See *Brehm*, 746 A.2d at 261 (explaining that “[a]lthough the [lower court] did not expressly predicate its decision on Section 141(e),” the directors are presumptively entitled to its protections); see also discussion *infra* text accompanying note 173.

¹⁵⁸ *Brehm*, 746 A.2d at 261-62; see also *infra* text accompanying notes 280-83.

¹⁵⁹ See *Disney*, 825 A.2d at 286, 289 (holding that acts or omissions not undertaken in good faith “do not fall within the protective ambit of § 102(b)(7)” and that plaintiffs’ complaint “sufficiently alleges a breach of the directors’ obligation to act honestly and in good faith”).

¹⁶⁰ As this Article goes to press, there has been no decision after the *Disney* trial testimony. In fact, the case is being briefed. Oral argument will follow, then the Chancellor’s decision and perhaps an appeal.

they have not acted in good faith and their conduct will not be protected by the business judgment rule or by section 102(b)(7).¹⁶¹

The concept of good faith has been in our jurisprudence for a long time. It forms part of the business judgment rule that applies to the directors' decision-making process, and it is likewise part of the directors' oversight responsibility.

The business judgment rule is the foundation of our corporation law. That rule teaches that courts will not second-guess directors' business decisions and will not interfere with investors' expectation that directors will take honest and prudent business risks to advance the economic well-being of the enterprise. To carry out this entrepreneurial theme that lies at the heart of Delaware jurisprudence, the concept of good faith is an immutable ingredient of the business judgment rule.

Former Chancellor Allen described this theme succinctly and well in several decisions. In the takeover case of *J.P. Stevens & Co.* in 1988, he wrote:

Stated generally, the business judgment rule . . . prevents substantive review of the merits of a business decision made in good faith and with due care. These are, of course, good reasons to minimize such substantive review. . . . “[B]ecause . . . there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with . . . skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith.”

A court may, however, review the substance of a business decision made by an *apparently* well motivated board for the limited purpose of assessing *whether that decision is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.*¹⁶²

In dismissing a derivative suit in 1996 in *Gagliardi v. TriFoods International, Inc.*, he wrote:

[T]o allege that a corporation has suffered a loss as a result of a lawful transaction, within the corporation's powers, authorized by a corporate fiduciary *acting in a good faith pursuit of corporate purposes*, does not state a

¹⁶¹ See, e.g., Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins, No. 202228-NC, 2004 Del. Ch. LEXIS 122, at *36 (Del. Ch. Aug. 24, 2004) (applying the *Disney* “conscious and intentional disregard of their responsibilities” standard in denying a motion to dismiss claims against certain directors in an alleged excessive compensation case).

¹⁶² *In re J.P. Stevens & Co. S'holders Litig.*, 542 A.2d 770, 780 (Del. Ch. 1988) (second emphasis added) (quoting *Solash v. Telex Corp.*, Nos. 9518, 9525, 9528, 1988 WL 3587, at *8 (Del. Ch. Jan. 19, 1988)).

claim for relief against that fiduciary no matter how foolish the investment may appear in retrospect.¹⁶³

In the area of the directors' oversight responsibility (as distinct from the context of business judgment in a board's decision-making role), in my view, former Chancellor Allen's *Caremark* decision is particularly significant:

Indeed, one wonders on what moral basis might shareholders attack a *good faith* business decision of a director as "unreasonable" or "irrational." Where a director *in fact exercises a good faith effort to be informed and to exercise appropriate judgment*, he or she should be deemed to satisfy fully the duty of attention.¹⁶⁴

So, too, has the concept of good faith been imbedded in the DGCL. Three statutes are particularly significant.

Section 141(e), which had been part of the DGCL even before the major 1967 revision, has long provided that a member of the board of directors "shall, in the performance of [the director's] duties, be fully protected in relying in good faith upon [corporate records and reports of management or board committees (other than those on which the directors sit)]."¹⁶⁵ Protection for such good faith reliance now extends to reports of experts "selected with reasonable care by or on behalf of the corporation."¹⁶⁶

Section 145, the indemnification section, was one of the major advancements of the 1967 revision. Subsections (a) and (b) authorize corporations to indemnify directors as well as officers, employees, and agents under certain circumstances. But indemnification is available only if the person to be indemnified "acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation."¹⁶⁷

As noted above, in 1986 Delaware adopted section 102(b)(7) to protect directors from personal liability for gross negligence.¹⁶⁸ That

¹⁶³ 683 A.2d 1049, 1052 (Del. Ch. 1996).

¹⁶⁴ *In re Caremark Int'l Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996).

¹⁶⁵ DEL. CODE ANN. tit. 8, § 141(e) (2001).

¹⁶⁶ *Id.* The 1967 revision was a major overhaul of the DGCL. 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* (2004). Since then there have been many statutory changes, but the changes in this statute have been in the nature of tinkering. *See generally* 2 *id.*

¹⁶⁷ DEL. CODE ANN. tit. 8, § 145(a)-(b) (2001). For the history of the indemnification statute, see 1 BALOTTI & FINKELSTEIN, *supra* note 166, §§ 4.22-4.29.

¹⁶⁸ *See supra* note 112 (citing *Van Gorkom's* "gross negligence" standard).

statute permits a stockholder-approved charter provision that exonerates directors from such liability, but not:

(i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) *for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law*; (iii) under § 174 of [title 8 of the DGCL]; or (iv) for any transaction from which the director derived an improper personal benefit.¹⁶⁹

One can parse each of these three statutes and analyze (or over-analyze) exactly how the words “good faith” are presented. One can also critique the quality of the legislative draftsmanship. For example, in section 102(b)(7) “good faith” is combined in the disjunctive with concepts that “involve intentional misconduct or a knowing violation of law.”¹⁷⁰ Whatever may be the significance of this statutory structure other than arguably poor drafting, a director cannot be exonerated for an “act or omission not in good faith.”¹⁷¹

Indeed, the implications of “good faith” in the section 102(b)(7) context now loom large primarily because of the Chancellor's 2003 *Disney* decision.¹⁷² Whatever happens factually in the *Disney* trial, the Chancellor's “good faith” holding on the allegations of the complaint in denying the motion to dismiss is the law of the case unless reversed or modified by the Supreme Court.

The section 141(e) analysis is part of the reason the Supreme Court remanded the *Disney* case to the Court of Chancery five years ago in *Brehm v. Eisner*. The Supreme Court said:

To survive a Rule 23.1 motion to dismiss in a due care case where an expert has advised the board in its decisionmaking process, the complaint must allege particularized facts (not conclusions) that, if proved, would show, for example, that: (a) the directors did not in fact rely on the expert; (b) their reliance was not in good faith; (c) they did not reasonably believe that the expert's advice was within the expert's professional competence; (d) the expert was not selected with reasonable care by or on behalf of the corporation, and the faulty selection process was attributable to the directors; (e) the subject matter (in this case the cost calculation) that was material and reasonably available was so obvious that the board's failure to consider it was grossly negligent regardless of the expert's advice or lack of advice, or (f) that the decision of the Board was so unconscionable as to constitute waste or fraud. This Complaint

¹⁶⁹ DEL. CODE ANN. tit. 8, § 102(b)(7) (emphasis added).

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 278, 286, 289 (Del. Ch. 2003).

includes no particular allegations of this nature, and therefore it was subject to dismissal as drafted.

....

Plaintiffs will be provided an opportunity to replead on this issue.¹⁷³

The Court of Chancery's recent decision in *In re Emerging Communications, Inc. Shareholders Litigation*¹⁷⁴ is worth mentioning with respect to section 141(e), even though the court did not cite that statute. Some practitioners and directors have become concerned that, as a result of *Emerging Communications*, Delaware jurisprudence is moving toward a generalized heightened standard of liability for directors who have special expertise. I do not share that view.

Emerging Communications was a lengthy decision made after a full and complex trial. The court's many findings centered around the conclusion that the directors had failed to carry their affirmative burden to show that a merger price and the process leading up to it were "entirely fair."¹⁷⁵ The merger price of \$10.25 was far below the value of \$38.05 that the trial judge found to be fair.¹⁷⁶

One of the directors, Salvatore Muoio, was held personally liable not only because he "was in a unique position to know" that the price was unfair, due to his special financial expertise in the relevant business sector, but also because he was found to be not independent.¹⁷⁷ The court stated:

Hence, Muoio possessed a specialized financial expertise, and an ability to understand ECM's intrinsic value, that was unique to the ECM board members Informed by his specialized expertise and knowledge, Muoio conceded that the \$10.25 price was "at the low end of any kind of fair value you would put," and expressed to Goodwin his view that the Special Committee might be able to get up to \$20 per share from Prosser. In these circumstances, it was incumbent upon Muoio, as a fiduciary, to advocate that the board reject the \$10.25 price that the Special Committee was recommending. As a fiduciary knowledgeable of ECM's intrinsic value, Muoio should also have gone on record as voting

¹⁷³ *Brehm v. Eisner*, 746 A.2d 244, 261-62 (Del. 2000) (citations omitted).

¹⁷⁴ No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. May 3, 2004) (Jacobs, J., sitting by designation as Vice Chancellor).

¹⁷⁵ *See id.* at *43-137 (discussing whether the merger price was fair and a product of fair dealing). "Entire fairness" is the standard applicable to mergers involving interested parties. *See Kahn v. Lynch Communication Sys., Inc.*, 638 A.2d 1110, 1116 (Del. 1994) ("Entire fairness remains the proper focus of judicial analysis in examining an interested merger.").

¹⁷⁶ *Emerging Communications*, 2004 Del. Ch. LEXIS 70, at *42.

¹⁷⁷ *Id.* at *143-44.

against the proposed transaction at the \$10.25 per share merger price. Muoio did neither. Instead he joined the other directors in voting, without objection, to approve the transaction.¹⁷⁸

Although the court's statement about Muoio's expertise and special knowledge must be read in light of the fact that he was found to have been not independent, that finding was in another part of the opinion and was not juxtaposed with the court's statements about Muoio's expertise.¹⁷⁹

For some observers, *Emerging Communications* has raised the question whether Delaware courts, in determining liability, will consider—more broadly and generally—a director's qualifications or expertise, as distinct from her factual knowledge unique to a particular transaction. As noted, the court made no explicit reference to section 141(e), but the court's findings square with the idea that, because of his particular expertise and specific knowledge of the inadequacy of the merger price, this director could not have relied in good faith on the expert to secure the protection of section 141(e).¹⁸⁰

It would be a perversity of corporate governance goals, in my view, for the Delaware courts to announce a general rule that a director with special expertise is more exposed to liability than other directors solely because of her *status* as an expert. Rather, the facts and procedural posture should be key. When purporting to rely on another expert in a transaction where a director knows that the expert's opinion is questionable, the director could be at greater risk of liability than other directors. This is not because of the director's *status* as an expert. It is simply that a director with such expertise cannot rely in good faith on another expert's particular opinions under section 141(e). In a similar vein, the SEC made clear that a "financial expert"—expected of audit committees by the Sarbanes-Oxley Act¹⁸¹—is not subject to greater liability exposure simply by virtue of the direc-

¹⁷⁸ *Id.* at *144 (citations omitted).

¹⁷⁹ *See id.* at *125, *128.

¹⁸⁰ See *supra* text accompanying note 166 for an overview of section 141(e)'s provisions. Cf. *In re Worldcom, Inc. Sec. Litig.*, 346 F. Supp. 2d. 628, 672 (S.D.N.Y. 2004) (reviewing a reliance defense under section 11(b)(3)(C) of the Securities Act of 1933, and noting that "reliance on audited financial statements may not be blind. Rather, where 'red flags' regarding the reliability of an audited financial statement emerge, mere reliance on an audit will not be sufficient to ward off liability").

¹⁸¹ The Act does not by its terms require audit committees to have financial experts (ACFEs), but as a practical matter its requirement that any lack of an ACFE must be disclosed and explained will likely work to ensure that most audit committees do include ACFEs. 15 U.S.C. § 7265 (West Supp. 2004).

tor's designation as an expert.¹⁸² That is, or ought to be, the Delaware law as well, in my opinion.

Directors and their counselors should, of course, take heed of *Emerging Communications*. But it is not a clear holding and it is not a Delaware Supreme Court decision. Although we cannot know with certainty how the Supreme Court may decide this issue if it is ever presented to the court, the case could be read as a decision made in the narrow factual context of this particular trial record.¹⁸³ In my view, this decision has not established a new standard of conduct or liability for directors. Rather, it simply applied preexisting principles of law to the particular factual circumstances where the director, after trial, did not show that he relied in good faith on a valuation expert when he had actual knowledge that rendered the other expert's opinion questionable.

Standards of liability for directors should be uniform in the sense that one director should not be more vulnerable to liability than another based on the director's background, as distinct from the director's conduct. Nevertheless, a director who has special expertise is expected to use it for the benefit of all. That is a standard of conduct, not necessarily a standard of liability. Such a director should not be able to rely in good faith—and thereby be protected from liability—if the director knows the expert's view to be erroneous. Whether a director will be found to have that knowledge is a question of fact in each case.

The application of the good faith concept presents a troubling conundrum: should good faith liability review apply to a business decision in a single transaction or set of transactions, as in the *Disney*

¹⁸² See Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, 68 Fed. Reg. 5109, 5117 (Jan. 31, 2003) (to be codified at 17 C.F.R. pts. 228, 229, and 249) ("Our new rule provides that whether a person is, or is not, an audit committee financial expert does not alter his or her duties, obligations or liabilities. We believe this should be the case under federal and state law."). Given the five demanding requirements for designation as an ACFE, see 15 U.S.C. § 7265(b), however, when the facts are reviewed for the ACFE's good faith reliance on a financial opinion, the ACFE may be found liable. Plaintiffs are likely to emphasize, in state or federal litigation, stockholders' reasonable understanding and expectations of the ACFE, whose substantial qualifications have been proclaimed in the corporation's disclosure documents. What plaintiffs emphasize, however, may or may not be what the courts will embrace when liability issues are on the line.

¹⁸³ This case itself is not likely to come before the Supreme Court. Although the decision of the Court of Chancery was released in May, more than six months later no order implementing the decision has been entered. Speculation has it that the case may be settled. Hence, there is not likely to be any appeal.

case? Or should it apply only in the oversight cases of sustained inattention, like *Caremark* or the old New Jersey case of *Francis v. United Jersey Bank*?¹⁸⁴ The directors in *Smith v. Van Gorkom* were found to have acted in good faith in a transaction to sell the company, though they were found to be grossly negligent.¹⁸⁵ When the alleged facts of *Disney* and the facts of *Van Gorkom* are compared, is there a significant difference in the conduct of the two sets of directors? How does one define gross negligence and good faith, and how does one articulate where gross negligence ends and failure to act in good faith begins? Is recklessness or an “I don’t care” attitude the litmus test? Is there such a concept as “severe recklessness”?¹⁸⁶ One should keep in mind that the rule of law in the Chancellor’s *Disney* decision is “intentional and conscious disregard” of known responsibilities.¹⁸⁷ I do not know what the Delaware courts will do when the final chapter is written in this troubling area. All I know is that I will not be on the court to help define and apply the concept of good faith or to distinguish it from gross negligence. At this point, however, the job of wrestling these questions to the ground is beyond one’s attention span for this article.

One dynamic of good faith that continues to play out is the concern of directors and their counselors that directors’ exposure to personal liability has been ratcheted upward from where it was just a few years ago, because of a freshly energized principle of good faith, driving directors’ potential liability through a hole in section 102(b)(7). That is a concern, of course, but if I were a director I would not lose much sleep over it. When all the facts of the *Disney* case are marshaled in the Chancellor’s opinion later this year, there may be some added clarity to the expectations that boards of directors must meet.

There has been much speculation on the likely outcome of the *Disney* trial. I will not join the speculators or prognosticate whether the allegations of the complaint will be borne out. Some commentators are already reading the tea leaves. For example, Lynn Stout has remarked:

¹⁸⁴ 432 A.2d 814 (N.J. 1981). In *United Jersey Bank*, the Supreme Court of New Jersey found that a director’s negligence in attention to the affairs of the business violated her fiduciary duties. *Id.* at 821-26.

¹⁸⁵ 488 A.2d 858, 873 (Del. 1985).

¹⁸⁶ See Sale, *supra* note 30, at 488-94 (analyzing how “egregiousness” might be delineated in the good faith context, including how a concept of “severe recklessness” might fit with other levels of scienter).

¹⁸⁷ Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins, No. 202228-NC, 2004 Del. Ch. LEXIS 122, at *44-45 & n.56 (Del. Ch. Aug. 24, 2002).

The Disney case is a hard one, due to a basic doctrine of corporate law called the business judgment rule. This rule allows disinterested corporate directors to make foolish, even disastrous, decisions without being second-guessed by courts, so long as their process was reasonable and their decision “informed.” The rule says, in effect, that it is the process, not the outcome, that matters.

This makes sense for several reasons. First, the business world is complex, fluid and risky. Even the most dedicated board will occasionally make decisions that don’t pan out. Second, it can be hard for observers outside a firm—shareholders, judges, or juries—to understand the many factors and considerations that go into a business decision.

The Disney case illustrates the perils of passing judgment from a distance and in hindsight

. . . [I]f the members of Disney’s board are held personally liable, as the lawsuit seeks, it will become more difficult to get good people to serve as directors. . . .

. . . [And] people who serve on boards will become reluctant to take even minor business risks

. . . [I]f the Delaware court decides to hang the Disney directors, it should hang them for process—not for poor results or difficult personalities.¹⁸⁸

Another modern dynamic at work on the issue of good faith involves an intellectual debate concerning whether good faith is a free-standing fiduciary duty, separate from the fiduciary duties of care and loyalty. The confusion regarding whether good faith stands as a separate fiduciary duty can perhaps be traced to the Supreme Court’s *Cede & Co. v. Technicolor, Inc. (Cede II)*¹⁸⁹ decision in 1993. In *Cede II* the court declared that there is a “triad” of fiduciary duties—“good faith, loyalty [and] due care.”¹⁹⁰ The “triad” concept has not been universally embraced. Some members of the judiciary have weighed in on the debate over whether directors owe a triad of duties, suggesting

¹⁸⁸ Lynn A. Stout, Commentary, *Don’t Hang the Disney Board Just Yet*, L.A. TIMES, Nov. 29, 2004, at B9; see also Bruce Orwall & Chad Bray, *Outcome of Ovitz Suit to Affect Liabilities of Corporate Boards*, WALL ST. J., Dec. 15, 2004, at B3 (The decision “will have far-reaching implications for people who serve as corporate directors”).

¹⁸⁹ *Cede II*, 634 A.2d 345 (Del. 1993); see also *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279 (Del. 1989).

¹⁹⁰ *Cede II*, 634 A.2d at 361; see also *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989) (“The burden falls upon the proponent of a claim to rebut the presumption by introducing evidence either of director self-interest, if not self-dealing, or that the directors either lacked good faith or failed to exercise due care.” (citation omitted)).

that there really are only two fiduciary duties—loyalty and care.¹⁹¹ In contrast, other observers have argued that good faith has been and should be viewed as a separate duty.¹⁹²

Late last year in the final gasp of the *Emerald Partners* litigation, a panel of the Supreme Court, in an order affirming the Court of Chancery, cited the Chancellor's decision in the *Disney* case. In affirming then-Vice Chancellor (now Justice) Jacobs's decision holding the merger involved in that case to be entirely fair, Justice Berger wrote for the court in *Emerald Partners*:

The Court of Chancery found several deficiencies in the merger negotiations, and we agree with its comment that “process laxity . . . cannot be condoned . . .” [citing Vice Chancellor Jacobs' opinion]. Indeed, we find that the many process flaws in this case raise serious questions as to the independent directors' good faith, *e.g.*, the independent directors evidenced a “we don't care about the risks” attitude by repeatedly failing to exclude Hall from their deliberative process and by giving Hall continuous direct and prior access to the valuation expert hired to advise the independent directors.¹⁹³

¹⁹¹ See, for example, *Emerald Partners v. Berlin*, in which Justice Jacobs (sitting as a Vice Chancellor) wrote:

Good faith is a fundamental component of the duty of loyalty Confusion about the relationship between the fiduciary duty of loyalty and its good faith component is attributable in part . . . to the way that Section 102(b)(7) is drafted. The structure of Section 102(b)(7) balkanizes the fiduciary duty of loyalty into various fragments, thereby creating unnecessary conceptual confusion.

Emerald Partners v. Berlin, No. 9700, 2003 Del. Ch. LEXIS 42, at *138 n.133 (Del. Ch. Apr. 28, 2003). In *In re Gaylord Container Corp. Shareholders Litigation*, 753 A.2d 462, 475 n.41 (Del. Ch. 2000), Vice Chancellor Strine expressed the view that good faith is a subsidiary component of the duty of loyalty. He also indicated that *Cede II* created the triad by misquoting/changing *Barkan*. *Id.* For another example, see *Guttman v. Huang*:

A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest. . . .

It does no service to our law's clarity to continue to separate the duty of loyalty from its own essence; nor does the recognition that good faith is essential to loyalty demean or subordinate that essential requirement.

Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003).

¹⁹² See, *e.g.*, Eisenberg, *supra* note 38; Sale, *supra* note 30, at 464 (“[T]he Delaware Supreme Court now lists the duty as separate and on par with the other two. . . . This distinction is important. As a separate duty, good faith can attach to situations beyond those invoking loyalty concerns and can grow to address its own category of governance issues.”).

¹⁹³ *Emerald Partners v. Berlin*, No. 295, 2003 Del. LEXIS 639, at *2 (Del. Dec. 23, 2003) (citing the Chancellor's decision in *In re Walt Disney Co. Derivative Litigation*, 825 A.2d 275, 289 (Del. Ch. 2003)). The *Emerald Partners* litigation is so old that three

Does this decision establish any Supreme Court precedent on the issue of good faith?¹⁹⁴ Stay tuned.¹⁹⁵

Is the question whether good faith is subsumed in the duty of loyalty or is a freestanding fiduciary duty along with loyalty and care an important one? Directors who do not act in good faith in the honest belief that they are acting in the best interests of the corporation may be found to be disloyal. Thus, loyalty issues may include not only self-dealing (which is not necessarily implicated in all good faith issues), but also irresponsible, reckless conduct or an “I don’t care” attitude, not involving self-dealing.¹⁹⁶ These latter non-self-dealing actions or failures to act would seem to be disloyal failures to act in good faith and in the best interests of the corporation. Still the question remains whether the good faith standard of review should result in liability for a single transaction or only for a sustained and egregious failure to direct the management of the corporation in good faith.

Whether as an analytical matter acts or omissions not in good faith violate the duty of loyalty and whether good faith conduct is a separate fiduciary duty may be moot points. The question is whether there is a violation of one fiduciary duty or another. Does the correct intellectual pigeonhole matter?

Arguably, it is analytically preferable to treat good faith and loyalty as separate duties, in part because self-dealing is not required for a good faith violation. It is clear, nevertheless, that directors must act in good faith. No one disputes this truism. It is also clear that “acts or omissions not in good faith” cannot be exempted from liability under section 102(b)(7) or indemnified under section 145. Moreover, directors whose purported reliance on experts is not in good faith are not fully protected under section 141(e).

members of the Supreme Court (Veasey, Steele, and Jacobs) were all disqualified by reason of previous involvement.

¹⁹⁴ See Veasey, *supra* note 21, at 1453 (discussing *Disney*, *Emerald Partners*, and *Sarbanes-Oxley* as “evolving expectations of directors”).

¹⁹⁵ This brief order in the *Emerald Partners* case raises another question for continued attention. By emphasizing that the transaction *price* was fair and satisfied “entire fairness,” did the court intend to signal that price trumps process and thereby eviscerate *Weinberger*? See Jennifer Batchelor, *Was the End of Emerald Partners a Gem for the Corporate Bar?*, DEL. L. WKLY., Jan. 14, 2004, at 1 (asking whether the final order in *Emerald Partners* indicates that fair price will trump fair dealing, softening the entire fairness standard).

¹⁹⁶ See *In re Walt Disney Co.*, 825 A.2d at 289 (“Instead, the facts alleged in the new complaint suggest that the defendant directors *consciously and intentionally disregarded their responsibilities*, adopting a ‘we don’t care about the risks’ attitude concerning a material corporate decision.”).

The real issue is understanding the definition, scope, and operational application of the amorphous concept of good faith.¹⁹⁷ Good faith draws much of its content from the directors' subjective state of mind.¹⁹⁸ John Reed and Matt Neiderman have described good faith as follows:

The "good faith" standard, especially in the abdication context . . . acts almost as a bridge between the concepts of due care and loyalty, transforming what might otherwise be deemed certain violations of the former into violations of the latter, even in the absence of an adverse pecuniary interest. Indeed, as noted by the authors of one treatise, the duty of good faith is an "overarching element" of a director's baseline duties of due care and loyalty. Whether a given due care violation presents a question of bad faith and, in some cases, loyalty, appears to depend on the magnitude and/or ongoing nature of the violation. It is the magnitude or ongoing nature of the action(s) or inaction(s) that provides the indicia of what ultimately needs to be proven—i.e., the director's good faith or bad faith motivation ("state of mind").¹⁹⁹

Professor Hillary Sale, who has concluded rather convincingly that good faith is a separate fiduciary duty, has suggested that good faith is defined by the motivations underlying fiduciaries' conduct: "[R]ather than relying on allegations of the fiduciaries' status or conflict, bad faith focuses on the indifference or egregiousness with which fiduciaries approached the substance of the transaction."²⁰⁰

Good faith is not entirely a subjective standard, however. Professor Eisenberg, who also believes that good faith is a separate duty, has explained that good faith consists of both objective and subjective components. For example, he suggests that in order to act in good faith, a director must honestly and sincerely believe that she is acting in the best interests of the corporation, but that such a sincere belief is

¹⁹⁷ Cf. John L. Reed & Matt Neiderman, "Good Faith" and the Ability of Directors to Assert § 102(b)(7) of the Delaware General Corporation Law as a Defense to Claims Alleging Abdication, Lack of Oversight, and Similar Breaches of Fiduciary Duty, 29 DEL. J. CORP. L. 111, 121 (2004) ("As Delaware cases and authorities addressing the meaning of 'good faith' make clear, however, the term cannot be generally defined, but is instead a creature of context.").

¹⁹⁸ See *id.* (referring to the finding in *Citron v. Fairchild Camera & Instrument Corp.*, No. 6085, 1988 Del. Ch. LEXIS 67, at *46-47 (Del. Ch. May 19, 1988), that the board members acted in good faith based on their "subjective state of mind" and proper motivation).

¹⁹⁹ *Id.* at 123 (footnote omitted).

²⁰⁰ Sale, *supra* note 30, at 484; see also *id.* at 488 ("Good faith based liability, then, moves the bar from negligent behavior to deliberately indifferent, egregious, subversive, or knowing behavior, and thereby raises issues related to the motives of the actors." (citation omitted)).

not enough.²⁰¹ In addition, there must be some *objective* basis, in the generally accepted norms applicable to business, for the director's sincere belief that her conduct is in the best interests of the corporation.²⁰²

Professor Edward Rock has offered another explanation for the concept of good faith in Delaware corporate law. Rock suggests that the term “good faith” essentially acts as a placeholder, about which the Delaware courts then “tell stories” to express norms that give content to the highly contextual concept of good faith.²⁰³ Those stories are then disseminated in various ways to the target audience—the directors and officers who must conduct themselves in accordance with the articulated norms.²⁰⁴

Whether good faith is an objective standard, a subjective standard, or a placeholder, it means that directors must not act irrationally, irresponsibly, disingenuously, or so unreasonably that no reasonable director would accept the decision or conduct.²⁰⁵ It demands an honesty of purpose and does not tolerate the disingenuous conduct of a director who appears or claims to act for the corporate good, but who truly does not care for the constituents to whom she owes a fiduciary duty.²⁰⁶

With all the discussion of good faith these days, should directors get out their worry beads? Probably not. Good faith has been in our law for decades and is not a new concept. Thus, it should not now have any more sharp edges than it has always had. It has come to the fore recently as a result of fresh insights into the expected processes of directors in modern times and because of more precise pleading. The new realization is that the 1986 statute, section 102(b)(7), will not

²⁰¹ Eisenberg, *supra* note 38 (manuscript at 16).

²⁰² *Id.* This objective component might more appropriately be understood as a requirement that objective indicators be used, as a matter of evidence, to assess the director's real (i.e., subjective) state of mind. Thus, if a court can discern no rational, objective basis for a director's asserted belief that a decision was in the corporation's best interest, the court can reasonably doubt the sincerity of the asserted belief.

²⁰³ Rock, *supra* note 32, at 1063.

²⁰⁴ *Id.* at 1063-64.

²⁰⁵ See Veasey, *supra* note 21, at 1453 (“Generally speaking, lack of good faith may, in some circumstances, be inferred if a board abdicates its responsibility by not exercising its business judgment or its decision or conduct is irrational, irresponsible, or so beyond reason that no reasonable director would credit the decision or conduct.”).

²⁰⁶ See Veasey, *supra* note 42, at 1009 (“[G]ood faith requires an honesty of purpose and eschews a disingenuous mindset of seeming on the surface to act for the corporate good, but not caring for the well-being of the constituents of the fiduciary.”).

permit exoneration for directors who do not act in good faith. We will just have to see how it plays out in the Delaware Supreme Court.

III. MERGERS: DEAL PROTECTION MEASURES

A. Background

During the 1980s, the Delaware Supreme Court developed a jurisprudence to deal with the extant hostile takeover environment, which seemed to confound the traditional business judgment approach. *Unocal*²⁰⁷ represented the sea change in the takeover jurisprudence of the mid-1980s, although *Van Gorkom*,²⁰⁸ *Moran*,²⁰⁹ and *Revlon*,²¹⁰ all decided in that watershed year, 1985, were also landmark cases that live with us daily, well into the twenty-first century.

The teaching of *Unocal* is that a target board, confronted by a threat to corporate policy and effectiveness, may take action that is reasonable in relation to the threat.²¹¹ Moreover, the burden of going forward with evidence shifts to the board to demonstrate the threat and the reasonableness of the response in proportion to the threat.²¹² The key departure here is that the business judgment rule (which presumes proper process and rationality) has been supplanted in these takeover situations by an objective test of reasonableness—not found in the business judgment rule. This jurisprudential shift, according to the *Unocal* doctrine, is warranted by the “omnipresent specter” of self-interest on the part of the target board in resisting the takeover.²¹³

In 1999, the Supreme Court decision in *Unitrin*²¹⁴ provided a gloss on *Unocal*. That gloss essentially says that when *Unocal* applies, the target board’s defensive actions may not be “coercive” or “preclusive,” and if the board’s actions pass those tests they will be sustained if they were within a range of reasonableness.²¹⁵ I concurred in the *Unitrin* decision in its context, which related to defensive tactics of a target board seeking to forestall a hostile takeover. The problems arose

²⁰⁷ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

²⁰⁸ *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

²⁰⁹ *Moran v. Household Int’l, Inc.*, 500 A.2d 1346 (Del. 1985).

²¹⁰ *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1985).

²¹¹ *See Unocal*, 493 A.2d at 955 (“If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed.”).

²¹² *Id.*

²¹³ *Id.* at 954.

²¹⁴ *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995).

²¹⁵ *Id.* at 1386-87.

later, in my view, when the *Unitrin* concepts of “coercion” and “preclusion” were applied by the court in other contexts, such as provisions designed to protect friendly mergers and acquisitions.

Early in the 1990s, the Supreme Court confronted policy questions on deal protection measures for friendly mergers. Shortly following *Time-Warner*,²¹⁶ which was viewed by many as almost a “just say no” case,²¹⁷ came *Paramount v. QVC*,²¹⁸ in which the court distinguished *Time-Warner*, enjoining measures to protect a change-of-control merger in the face of a higher bid.²¹⁹ In fact, in *QVC* we reached back to embrace Chancellor Allen’s analysis in *Time-Warner* to make it clear that the obligation to secure for the stockholders the best transaction reasonably available attaches on a sale of control and does not also require a break up of the corporation.

In *Time-Warner*, the Chancellor held that there was no change of control in the original stock-for-stock merger between Time and Warner because Time would be owned by a fluid aggregation of unaffiliated stockholders both before and after the merger

. . . Control of both remained in a large, fluid, changeable and changing market.

. . . But here, effectuation of the merger would not have subjected Time shareholders to the risks and consequences of holders of minority shares. This is a reflection of the fact that no control passed to anyone in the transaction contemplated

. . . .

The Paramount defendants have misread the holding of *Time-Warner*. . . .

The Paramount defendants’ position that both a change of control and a break-up are required must be rejected. Such a holding would unduly restrict the application of *Revlon*, is inconsistent with this Court’s decisions in *Barkan* and *Macmillan*, and has no basis in policy.²²⁰

²¹⁶ *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989).

²¹⁷ See Robert B. Thompson, *Shareholders as Grown-Ups: Voting, Selling, and Limits on the Board’s Power to “Just Say No,”* 67 U. CIN. L. REV. 999, 1007-08 (1999) (discussing *Time-Warner*’s impact on corporate takeover jurisprudence).

²¹⁸ *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34 (Del. 1994).

²¹⁹ *Id.* at 46-48.

²²⁰ *Id.* at 46-47 (quoting *Paramount Communications Inc. v. Time Inc.*, Nos. 10866, 10670, and 10935, 1989 WL 79880, at *23 (Del. Ch. July 14, 1989) (emphasis removed)).

The essence of *QVC* was that the directors are required to take reasonable measures—not perfect measures—to seek the best transaction reasonably available for the stockholders when the merger would result in a sale of control.²²¹

The *QVC* decision also made it clear that when a court applies enhanced judicial scrutiny as the standard of review, the court is not imposing on the target board some improbable burden to justify its actions. That is, when a standard of review other than business judgment is held to apply, that holding is not necessarily outcome-determinative. In my opinion, a *Unocal* review is essentially an objective, reasonableness review, as distinct from the minimalist rationality standard of the business judgment rule.²²² Consider this language from *QVC*:

Although an enhanced scrutiny test involves a review of the reasonableness of the substantive merits of a board's actions, a court should not ignore the complexity of the directors' task in a sale of control. There are many business and financial considerations implicated in investigating and selecting the best value reasonably available. The board of directors is the corporate decisionmaking body best equipped to make these judgments. Accordingly, a court applying enhanced judicial scrutiny should be deciding whether the directors made a *reasonable* decision, not a *perfect* decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination. Thus, courts will not substitute their business judgment for that of the directors, but will determine if the directors' decision was, on balance, within a range of reasonableness.²²³

It should be noted that Vice Chancellor Lamb recently breathed new life into this common sense doctrine in his decision in the *MONY Group* litigation.²²⁴

²²¹ See, e.g., *id.* at 49 (“We conclude that the Paramount directors’ process was not reasonable, and the result achieved for the stockholders was not reasonable under the circumstances.”).

²²² Whether or not and the extent to which an entire fairness review is reasonableness-plus, will be discussed in Part IX. Also, one should note section 4.01 of the ALI’s *Principles of Corporate Governance*, which makes a careful distinction between rationality and reasonableness, providing that the former characterizes the business judgment rule analysis.

²²³ *QVC*, 637 A.2d at 45.

²²⁴ See *In re MONY Group, Inc. S’holder Litig.*, 853 A.2d 661, 676-77 (Del. Ch. 2004) (holding that directors did not breach their fiduciary duty because their decisions were within a range of reasonableness).

Time-Warner did not involve a sale of control because public stockholders would continue to be in control. Thus, the court countenanced the notion that, under *Unocal*, the target board could take into account its strategic vision for the future of the firm in such a merger.²²⁵ By contrast, in *QVC* the court concluded that the future strategic vision of the directors of the target board was irrelevant because the merger was not a “merger of equals” but would result in Paramount’s merger partner, Viacom, having unquestioned control in the end—without a control premium for public stockholders. That meant Sumner Redstone, the majority stockholder of Viacom, would have unquestioned control.²²⁶ The Paramount board had not undertaken any negotiations with *QVC*, the other suitor, or done a market check.²²⁷ They had simply, and blindly, locked up the merger with various deal protection measures that shut out *QVC*, the higher bidder.²²⁸

Among the major issues left open by *Paramount v. QVC* were these two: (1) What is a “sale of control”; and (2) under what circumstances will deal protection measures for mergers of equals pass muster? The Court of Chancery was faced with the latter question in several cases in the late 1990s and the early part of this century.²²⁹ These cases never reached the Supreme Court, presumably for the general reasons mentioned above.²³⁰

²²⁵ See *Paramount Communications Inc. v. Time Inc.*, 571 A.2d 1140, 1153-54 (Del. 1989) (explaining that the *Unocal* analysis is flexible enough to allow the directors to consider the long-term, strategic benefits of a transaction and the likelihood that stockholders might misapprehend those benefits).

²²⁶ See *QVC*, 637 A.2d at 43 (“Irrespective of the present Paramount Board’s vision of a long-term strategic alliance with Viacom, the proposed sale of control would provide the new controlling stockholder with the power to alter that vision.”).

²²⁷ *Id.* at 37-41.

²²⁸ The protective measures included a no-shop provision, a termination fee, and a stock option agreement. *Id.*

²²⁹ See generally *ACE Ltd. v. Capital RE Corp.*, 747 A.2d 95 (Del. Ch. 1999) (Strine, V.C.) (considering the validity of a “no-talk” provision in a merger agreement); *In re IXC Communications, Inc., S’holders Litig.*, Nos. 17324, 17334, 1999 Del. Ch. LEXIS 210 (Del. Ch. Oct. 27, 1999) (decision by then-Vice Chancellor, now Chief Justice Steele, crediting a market check and other factors supporting business judgment in deal protection measures); *Phelps Dodge Corp. v. Cyrus Amax Minerals Co.*, No. 17398, 1999 Del. Ch. LEXIS 202 (Del. Ch. Sept. 27, 1999) (Chandler, C.) (considering the validity of “no-talk” and termination fee provisions).

²³⁰ See *supra* text accompanying note 223.

B. Omnicare

In 2003, the Supreme Court faced the deal protection question in an unusual and highly controversial case: *Omnicare v. NCS Healthcare*.²³¹ *Omnicare* was highly controversial not only because it was a rare split (3-2) decision of the usually unanimous Supreme Court,²³² but also because it was surprising that the majority of the Supreme Court reversed a well-reasoned decision of the Court of Chancery.²³³ I dissented in *Omnicare*, and Justice (now Chief Justice) Myron Steele joined in my dissent and filed a separate dissent.

The target board in *Omnicare* had thoroughly shopped the company, which was in financial distress, and seemingly had nowhere to turn but to the deal they made and protected with the merger partner, Genesis. The deal, as protected, was approved in advance of the stockholders' meeting by two controlling stockholders with a clear majority of the voting power. Moreover, the deal included a "force the vote" provision specifically authorized by a recent amendment to the DGCL.²³⁴

As a result of the decision by the majority in *Omnicare*, challenged deal protection measures must be reviewed under *Unocal*²³⁵ and *Unitrin*²³⁶ to determine whether the directors "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed."²³⁷ The deal protection measures must also be "reasonable in relation to the threat posed,"²³⁸ which requires a showing that (1) the measures are neither "coercive"²³⁹ nor "preclusive,"²⁴⁰ and (2) the de-

²³¹ 818 A.2d 914 (Del. 2003).

²³² See *supra* text accompanying notes 19-20 (discussing the Delaware Supreme Court's frequent unanimity).

²³³ *Omnicare*, 818 A.2d at 939.

²³⁴ *Id.* at 918; see also *id.* at 937 & n.80 (explaining that DEL. CODE ANN. tit. 8, § 251(C) (2002) now provides that a merger may be put to a stockholder vote even if the board no longer recommends the merger).

²³⁵ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

²³⁶ *Unitrin Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995).

²³⁷ *Omnicare*, 818 A.2d at 935 (quoting *Unocal*, 493 A.2d at 955).

²³⁸ *Unocal*, 493 A.2d at 955.

²³⁹ "A response is 'coercive' if it is aimed at forcing upon stockholders a management-sponsored alternative to a hostile offer." *Omnicare*, 818 A.2d at 935; *Unitrin*, 651 A.2d at 1387.

²⁴⁰ "A response is 'preclusive' if it deprives stockholders of the right to receive all tender offers or precludes a bidder from seeking control by fundamentally restricting proxy contests or otherwise." *Omnicare*, 818 A.2d at 935; *Unitrin*, 651 A.2d at 1387.

fensive response was “within a ‘range of reasonable responses’ to the threat perceived.”²⁴¹

In *Omnicare*, the majority held that the deal protection measures were invalid and unenforceable.²⁴² The deal protection measures in question were: (1) a provision requiring that the board put the merger to a stockholder vote even if the board no longer recommended the transaction;²⁴³ (2) voting agreements executed by two stockholders (also board members, but voting as stockholders) who held a majority of the voting power of NCS, agreeing to vote in favor of the merger; and (3) the omission of a fiduciary out clause.²⁴⁴ The court held that this combination of deal protection devices was unenforceable, stating:

Although the minority stockholders were not forced to vote for the Genesis merger, they were required to accept it because it was *a fait accompli*. The record reflects that the defensive devices employed by the NCS board are preclusive and coercive in the sense that they accomplished *a fait accompli*. In this case, despite the fact that the NCS board has withdrawn its recommendation for the Genesis transaction and recommended its rejection by the stockholders, the deal protection devices approved by the NCS board operated in concert to have a preclusive and coercive effect. Those tripartite defensive measures—the Section 251(c) provision, the voting agreements, and the absence of an effective fiduciary out clause—made it “mathematically impossible” and “realistically unattainable” for the *Omnicare* transaction or any other proposal to succeed, no matter how superior the proposal.²⁴⁵

The majority found the deal protection measures preclusive, coercive, beyond a reasonable range of responses to the threat of losing the Genesis merger, and, therefore, invalid and unenforceable. The dissent expressed the contrary view: that the board had properly exercised its business judgment.²⁴⁶ Our view was that the business judgment rule, rather than *Unocal*, should have applied, but even under the *Unocal* standard the board’s conduct was reasonable and should have been upheld, as Vice Chancellor Lamb had held. This was particularly true because of the dilemma facing the NCS board in view of

²⁴¹ *Omnicare*, 818 A.2d at 935.

²⁴² *Id.* at 936.

²⁴³ This provision was in accordance with section 251(c) of the Delaware corporate law. DEL. CODE ANN. tit. 8, § 251(c) (2002).

²⁴⁴ *Omnicare*, 818 A.2d at 918.

²⁴⁵ *Id.* at 936.

²⁴⁶ *Id.* at 940-41 (Veasey, C.J., dissenting).

the specter of insolvency.²⁴⁷ We further expressed the hope that later decisions would confine this decision to its facts.²⁴⁸

Omnicare does not preclude the use of deal protection devices in the future, although it raises questions about which deal protection measures will be upheld. The issue thus becomes what types and combinations of deal protection measures will be valid and enforceable after *Omnicare*.²⁴⁹

In the recent case of *Orman v. Cullman*,²⁵⁰ the Chancellor distinguished *Omnicare* and upheld a different set of merger protection devices.²⁵¹ The *Orman* decision addresses a number of issues left open by *Omnicare*, including the application of *Omnicare* to transactions involving a target corporation with a controlling stockholder group.²⁵² *Orman* also suggests the continued viability of certain deal protection devices, at least when used in the right combination and with the right limitations.²⁵³

²⁴⁷ Compare the discussion concerning the vicinity of insolvency, *supra* Part I.C.2.b.

²⁴⁸ See *Omnicare*, 818 A.2d at 946 (Veasey, C.J., dissenting) (“One hopes that the Majority rule announced here will be interpreted narrowly [I]f the holding is confined to these unique facts, negotiations may be able to navigate around this new hazard.”); *id.* at 940 (emphasizing that courts must analyze cases in their factual context); *id.* at 941 (explaining how NCS would not have had any purchaser were it not for the lock-ups); Charles Hanson, *Omnicare v. NCS Healthcare: The Chief Justice Got It Right*, CORP., Oct. 15, 2004, at 5 (noting that the dissent “recognized reality”). Contrast the conduct of the NCS board with that of the Paramount board in *QVC*. See *supra* pp. 1455-57 (discussing *QVC*). The NCS board performed its diligence well, including market testing. Its conduct, sadly, was nevertheless enjoined because of what the Supreme Court found to be an absolute lockup.

²⁴⁹ As Jay Knight predicts:

Future merger agreements will certainly avoid the inclusion of these three provisions. However, the real issue is how much can two companies include in their agreement to add certainty to the deal. Are two out of three provisions acceptable? Maybe a voting agreement and merger agreement with an included fiduciary out clause will survive this new rule.

Jay H. Knight, *Merger Agreements Post-Omnicare*, Inc. v. NCS Healthcare, Inc.: *How the Delaware Supreme Court Pulled the Plug on “Mathematical Lock-Ups,”* 31 N. KY. L. REV. 29, 50 (2004) (footnotes omitted); see also E. Norman Veasey, *Musings from the Center of the Corporate Universe*, 7 DEL. L. REV. 163 (2004).

²⁵⁰ No. 18039, 2004 Del. Ch. LEXIS 150 (Del. Ch. Oct. 20, 2004).

²⁵¹ *Id.* at *31-32.

²⁵² See *id.* at *3 (describing General Cigar’s IPO prospectus notifying prospective investors of a controlling stockholder group).

²⁵³ See *id.* at *35-36 (describing the validity of a fiduciary out, the stockholders’ rights to reject a deal on its merits, and lockup agreements).

Orman was a very unusual case and one that was not particularly well briefed on the plaintiff's side.²⁵⁴ Although it may be interpreted as showing an inclination by the Court of Chancery to find reasonable ways to distinguish *Omnicare*, *Orman* cannot be seen as ushering in a definitive sea change, nor should it be seen as a trailblazing decision; rather, it was decided in a different contextual milieu that was quite unusual, as was *Omnicare*.²⁵⁵

Nevertheless, *Orman* indicates a possible trend toward limiting the majority holding in *Omnicare* to its facts. Whether and how far that trend will continue and what the Delaware Supreme Court itself will do, if given the opportunity, remain to be seen, leaving dealmakers and deal lawyers to proceed with caution.²⁵⁶

It is not practical to offer specific examples of deal protection measures that might survive review after *Omnicare*, but I will suggest some principles that might guide an analysis of whether particular measures will pass muster. First, the courts are likely to limit and not expand the reach of *Omnicare*. I think most objective observers believe that the majority decision was simply wrong. Second, practitioners should not count on the court to overrule the decision—not only because of stare decisis but also because, if the reach of the decision is limited, it will not become necessary or practical for the court to overrule it. Third, corporate jurisprudence should not discourage mergers—they are often good for business and are sometimes necessary. Reasonable deal protection measures are often necessary to achieve a deal. Finally, the Delaware Supreme Court is practical and has expertise in business law.²⁵⁷ A deal protection measure that makes good business sense should pass muster if it allows the board to follow a best practices process. I caution, however, that a disingenuous attempt to use some transparently artificial measure that is too-clever-by-half in

²⁵⁴ For example, the deal in *Orman* involved an eighteen-month lockout, and the preclusion concept adopted by the majority in *Omnicare* was not argued. Also, there apparently was no evidence of coercion in the record.

²⁵⁵ For additional analysis of the impact of the *Orman* decision, see Rod Howard, Norman Veasey & Frederick Green, *Delaware Curbs Omnicare with New Lockup Ruling*, INT'L FIN. L. REV., Dec. 2004, at 19, 19.

²⁵⁶ *Id.* at 21. In the future, I hope that the courts will analyze the equities when addressing deal protection measures. In the *Omnicare* case, the board's actions were authorized by law and were not inequitable, in my view. Equitable principles should intrude on lawful activity only when there is a breach of fiduciary duty. The *Omnicare* majority found an unprecedented legal prohibition through use of the "coercion" and "preclusion" terms of *Unitrin*, which the dissent did not believe were applicable. I cannot figure out and articulate where or how the directors breached a fiduciary duty.

²⁵⁷ Veasey, *supra* note 47.

order to try to get around *Omnicare* in a superficial way while maintaining an ironclad lockup with no realistic wiggle room is inviting trouble.

C. Contract Rights

Omnicare and the deal protection measures challenged in that case also raise questions about the contract rights of third parties in merger transactions. For example, when a court sets about to determine the validity of deal protection measures based on the fiduciary relationship of the target board to the target's stockholders, are the rights of the acquiring company under the merger agreement to be ignored or trumped in all cases by violation of those fiduciary duties?

The court in *QVC* rejected Viacom's argument that it had certain vested contract rights in its merger agreement with Paramount. The court rested its decision on the fact that the Paramount board had adopted the defensive measures in violation of their fiduciary duties.²⁵⁸ Nevertheless, this issue of the tension between third party contract rights and the target board's fiduciary duties remains largely unresolved in the Delaware case law. Professor Paul Regan has stated:

Historically, the judicial impulse in cases challenging the validity of break-up fees, lock-ups and no-shops amidst a proposed change of control transaction has been to protect the interests of the target corporation's stockholders (the "owners") from potential lapses in fidelity by their duly elected directors, without much mention of the favored bidder's contractual interest. Indeed, courts tend to rely almost exclusively on common law fiduciary duty principles as the governing normative standards for resolving such disputes. The contractual interests of the third party acquiror corporation that arise under a merger agreement or similar contract with the selling corporation are seldom evaluated. Consequently, whether such contractual interests warrant any protection invariably turns on whether the court is satisfied that the directors of the selling corporation have fulfilled their fiduciary duties to the stockholders.²⁵⁹

In a very incisive article, Frank Balotti and Gil Sparks have suggested that two competing theoretical frameworks currently cloud this subject in Delaware.²⁶⁰ They propose that under *Van Gorkom*,²⁶¹ at least

²⁵⁸ See *QVC*, 637 A.2d at 50-51 (finding that the "defensive measures were improperly designed to deter potential bidders").

²⁵⁹ Paul L. Regan, *Great Expectations? A Contract Law Analysis for Preclusive Corporate Lock-Ups*, 21 CARDOZO L. REV. 1, 6-7 (1999) (footnotes omitted).

²⁶⁰ R. Franklin Balotti & A. Gilchrist Sparks, III, *Deal Protection Measures and the Merger Recommendation*, 96 NW. U. L. REV. 467 (2002).

in the context of changed circumstances, contract rights are primary and directors will be bound by the terms of the agreement they made, regardless of whether their fiduciary duties would require them to take different actions based on later developments.²⁶² Conversely, they suggest that the decision in *QVC*,²⁶³ which “held that merger provisions which purport to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties are invalid, unenforceable, and vest no contract rights in the merger partner,” places fiduciary duty above contract rights.²⁶⁴

It is not unreasonable to conclude that fiduciary duties should trump supposed contractual rights whenever those duties are sufficiently well defined and established by legal precedent that a merger partner ought to know that it is taking a legal risk by insisting on certain contractual provisions in a given context. The more difficult issue is determining when a particular judicial articulation of fiduciary duties, or of their concrete implications, is *so* new, and represents such a *fundamental* departure from prior formulations, that it would be unreasonable and unfair to apply it against third parties who in good faith obtained contractual rights before the decisions announcing the new rule. But perhaps a contractual provision that treads on established principles of fiduciary duty runs a reasonable risk of being invalidated.

In *Omnicare*, at least, the court need not have chosen between contract rights and fiduciary duty if it had applied the appropriate stan-

²⁶¹ Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

²⁶² Balotti & Sparks explain:

In *Van Gorkom*, the Delaware Supreme Court addressed this issue and appeared to resolve the question squarely in favor of contract rights: A board’s compliance with its fiduciary duties is judged at the time it approves a merger agreement, and a board’s ability to act subsequently in response to post-contracting events is governed by the terms of the merger agreement, not by generalized concepts of fiduciary duty.

Balotti & Sparks, *supra* note 260, at 467-68.

²⁶³ In *QVC*, the Delaware Supreme Court explained:

Viacom argues that it had certain “vested” contract rights with respect to the No-Shop Provision and the Stock Option Agreement. In effect, Viacom’s argument is that the Paramount directors could enter into an agreement in violation of their fiduciary duties and then render Paramount, and ultimately its stockholders, liable for failing to carry out an agreement in violation of those duties. Viacom’s protestations about vested rights are without merit.

QVC, 637 A.2d at 50 (footnote omitted).

²⁶⁴ Balotti & Sparks, *supra* note 260, at 471. Justice Steele cited the Balotti and Sparks article in his dissent in *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 947 n.118 (Del. 2003) (Steele, J., dissenting).

dard of review to the facts of the case. As Balotti and Sparks observe, this tension generally arises because of changed circumstances after a merger agreement is made.²⁶⁵ The dissents in *Omnicare* emphasized the dire circumstances that the NCS board faced and asserted that the board's compliance with its fiduciary duties should be assessed as of the time the board entered the merger agreement with Genesis. In my dissent I emphasized that "[t]he essential fact that must always be remembered is that this agreement and the voting commitments of Outcalt and Shaw concluded a lengthy search and intense negotiation process in the context of insolvency and creditor pressure where no other viable bid had emerged."²⁶⁶ My dissent continued:

It is now known, of course, after the case is over, that the stockholders of NCS will receive substantially more by tendering their shares into the topping bid of Omnicare than they would have received in the Genesis merger, as a result of the post-agreement Omnicare bid and the injunctive relief ordered by the Majority of this Court. Our jurisprudence cannot, however, be seen as turning on such ex post felicitous results. Rather, the NCS board's good faith decision must be subject to a real-time review of the board action before the NCS-Genesis merger agreement was entered into.²⁶⁷

Had the majority taken that approach, they would have found that the board did not breach its fiduciary duties at all, and both fiduciary and contract duties could have been satisfied by proceeding with the Genesis transaction.

Under the approach the majority did take, however, it appears that less protection would be given to contract rights of third parties when operating in the fiduciary context of a merger, though the court did not explicitly address the issue. We must await the next case in

²⁶⁵ See Balotti & Sparks, *supra* note 260, at 467-68 (addressing the tension between contract rights and "the fiduciary duties of directors in responding to post-contracting events," including the board's ability to change its recommendation regarding approval of a merger agreement).

²⁶⁶ *Omnicare*, 818 A.2d at 940 (Veasey, C.J., dissenting).

²⁶⁷ *Id.* Justice Steele's separate dissent reasoned:

Importantly, *Smith v. Van Gorkom*[¹] correctly casts the focus on any court review of board action challenged for alleged breach of the fiduciary duty of care "only upon the basis of the information then reasonably available to the directors and relevant to their decision. . . ." Though criticized particularly for the imposition of personal liability on directors for a breach of the duty of care, *Van Gorkom* still stands for the importance of recognizing the limited circumstances for court intervention and the importance of focusing on the timing of the decision attacked.

Id. at 947 (Steele, J., dissenting) (footnote omitted).

which the court is faced with the tension between contract rights and fiduciary principles to see what framework the court will ultimately employ to resolve the issue.²⁶⁸

IV. DERIVATIVE SUITS

Derivative suits will lie against officers and directors for injury to the corporation they serve. Following the United States Supreme Court's decision in *Shaffer v. Heitner*, invalidating previous sequestration procedure to obtain personal jurisdiction over nonresident defendants,²⁶⁹ the Delaware General Assembly adopted a form of long-arm statute providing in substance that by agreeing to serve as a director of a Delaware corporation, the director subjects herself to personal jurisdiction in the Delaware courts.²⁷⁰ Effective January 1, 2004, the General Assembly amended the statute to authorize in personam jurisdiction over officers as well.²⁷¹ The amendment's purpose was to facilitate jurisdiction over those who may be found to have been the direct cause of injury to the corporation.

During my term, four principal developments emerged in the case law in the area of derivative litigation: (1) a general clarification of the jurisprudence surrounding the demand-excused, demand-required dichotomy; (2) judicial encouragement of the use of a section 220 demand for books and records to aid in framing pleadings when the plaintiff attempts to satisfy the particularity requirements of Chancery Rule 23.1;²⁷² (3) clarification of the law delineating when a suit is derivative and when it is direct; and (4) development of the concept of the independence of a majority of the board for presuit demand purposes. I will address each in turn. The matter of independence has a broader sweep in corporate law than its application to

²⁶⁸ Cf. Regan, *supra* note 259 (proposing a model for, and the policy considerations supporting, the synthesis of contract and fiduciary principles in this context). Nondirector officers owe fiduciary duties to the corporation, but the precise outlines of those duties have not been fully defined in the cases. See Lawrence A. Hamermesh & A. Gilchrist Sparks, III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. (forthcoming 2005) (observing that the "legal landscape" concerning the duties and liabilities of non-director corporate officers has changed little since 1992); A. Gilchrist Sparks, III & Lawrence A. Hamermesh, *Common Law Duties of Non-Director Corporate Officers*, 48 BUS. LAW. 215 (1992) (discussing the duties and liabilities of nondirector corporate officers).

²⁶⁹ 433 U.S. 186 (1977).

²⁷⁰ DEL. CODE ANN. tit. 10, § 3114 (Supp. 2004).

²⁷¹ *Id.*; see also 74 Del. Laws 83 (2003) (amending the statute to include officers).

²⁷² DEL. CT. CH. R. 23.1.

presuit demand in derivative litigation. So, I will touch on independence in this Part and then address it more fully in the next section.

A. General Clarification of Demand

In several cases, including *Rales v. Blasband*,²⁷³ *Grimes v. Donald*,²⁷⁴ *Brehm v. Eisner*,²⁷⁵ and *Malpiede v. Townson*,²⁷⁶ the Supreme Court attempted to explicate pleading requirements and court analysis, balancing the particularity requirement of Rule 23.1 with the desirability of giving the plaintiff her day in court—or at least granting some discovery—if there are inferences from the complaint that make it inappropriate to dismiss a case on a motion to dismiss.

B. The Use of Section 220 Demands

In a plethora of derivative cases, beginning with the 1993 case of *Rales v. Blasband*,²⁷⁷ the Supreme Court and the Court of Chancery have encouraged plaintiffs to use the “tools at hand” and to seek books and records under section 220 of the DGCL²⁷⁸ to improve the specificity of their pleadings.²⁷⁹ Two cases, discussed in greater detail below,²⁸⁰ serve as representative illustrations. *Brehm v. Eisner*, in the first phase of the *Disney* litigation, affirmed the dismissal of a defective initial complaint, but the Supreme Court remanded the case to permit plaintiffs to replead, encouraging them to take advantage of section 220.²⁸¹ After heeding that advice, they framed a pleading that

²⁷³ 634 A.2d 927, 937 (Del. 1993) (excusing demand in breach of fiduciary duty claim by stockholders).

²⁷⁴ 673 A.2d 1207, 1220 (Del. 1996) (affirming dismissal of stockholder derivative complaint involving CEO employment agreements).

²⁷⁵ 746 A.2d 244 (Del. 2000); *see also infra* text accompanying note 281 (discussing this case).

²⁷⁶ 780 A.2d 1075 (Del. 2001); *see id.* at 1101 (affirming dismissal of shareholder fiduciary duty and due care claims).

²⁷⁷ 634 A.2d 927.

²⁷⁸ *See* DEL. CODE ANN. tit. 8, § 220 (2001) (providing a right of inspection of books and records by stockholders).

²⁷⁹ *See* *Beam v. Stewart*, 833 A.2d 961, 981 nn.65-66 (Del. Ch. 2003) (citing numerous cases in which the Delaware Supreme Court and the Court of Chancery have encouraged plaintiffs to use section 220 to improve their pleadings).

²⁸⁰ *See infra* notes 442-48 and accompanying text (discussing the courts’ admonition to plaintiffs to use section 220 to develop the factual basis for their claims and the resulting improvement in the specificity of plaintiffs’ pleadings).

²⁸¹ *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). This Supreme Court decision in the *Brehm* case held that the original complaint was conclusory, filled with “prolix invective,” but suggested the possibility of process failures and questioned whether the

survived a motion to dismiss where the first complaint had not.²⁸² The Chancellor in his decision duly noted the successful use of section 220.²⁸³

The other illustrative case is *Beam v. Stewart*,²⁸⁴ in which the Supreme Court affirmed the dismissal of a derivative action. The plaintiff attempted to plead that presuit demand should be excused because a majority of the board members of Martha Stewart Living Omnimedia were not independent, solely because they were social friends of Martha Stewart. The Supreme Court held that the plaintiff failed to plead sufficient particularized facts to excuse demand, noting that such failure may have been at least partially based on her failure to take advantage of section 220.²⁸⁵

Other cases during the past twelve years have delineated the extent to which the Court of Chancery should allow plaintiffs to obtain books and records in aid of a derivative claim.²⁸⁶ There are many new

directors relied “in good faith” on an expert under section 141(e). *Id.* at 249, 261-62. *Brehm* was a case that explored traditional concern over alleged process failures, and did not represent a judicial intrusion into business decisions. Though some have suggested otherwise, the opinion was clearly not a reaction to Enron and other scandals of 2001-2002, which occurred long after *Brehm* was decided.

²⁸² *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 280 (Del. Ch. 2003).

²⁸³ In *Disney*, the Chancellor observed:

After the Supreme Court’s remand regarding plaintiffs’ first amended complaint, plaintiffs used the ‘tools at hand,’ a request for books and records as authorized under [section 220], to obtain information about the nature of the Disney Board’s involvement in the decision to hire and, eventually, to terminate Ovitz. Using the information gained from that request, plaintiffs drafted and filed the new complaint, which is the subject of the pending motions. The facts, as alleged in the new complaint, portray a markedly different picture of the corporate processes that resulted in the Ovitz employment agreement than that portrayed in the first amended complaint.

Id. at 279 (footnote omitted).

²⁸⁴ 845 A.2d 1040 (Del. 2004).

²⁸⁵ *Id.* at 1056. The Chancellor in his opinion in *Beam*, and the Supreme Court on appeal, dilated at some length on the value of section 220 and their frustration with plaintiffs who do not use it and later complain that they did not have access to facts to plead with specificity. *Id.* at 1056-57; *see also* *White v. Panic*, 783 A.2d 543, 549 n.15 (Del. 2001) (“We have emphasized on several occasions that stockholder ‘plaintiffs may well have the “tools at hand” to develop the necessary facts for pleading purposes,’ including the inspection of the corporation’s books and records under [section 220].”) (citation omitted); *Beam*, 833 A.2d at 979, 980 n.63, 981-84 & nn.65-66 (citing specific instances where plaintiff could have used section 220).

²⁸⁶ *See, e.g.,* *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113, 118-19 (Del. 2002) (considering the permissible scope of a stockholder’s books and records inspection); *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 569-70 (Del. 1997) (explaining that the Court of Chancery must tailor the scope of the inspection to the “proper purpose” for which the stockholder seeks books and records). For an excellent analy-

and developing cases in this area—both on the use of section 220 in aid of derivative suits and on the scope of section 220. The statute itself has recently been liberalized.²⁸⁷ This is likely to be a continuing area of development in the coming years,²⁸⁸ and this development may lead to changes in boardroom processes, such as increased precision in board meeting records.²⁸⁹

C. *The Direct/Derivative Dichotomy*

My last corporate opinion for the court before retirement from the bench last spring was *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*²⁹⁰ This en banc unanimous opinion was designed to clarify the slippery distinction between a derivative claim and a direct claim. The distinction is of critical importance because a derivative claim requires pre-suit demand on the board or an excusal of demand as futile under Chancery Rule 23.1 and the abundant case law. A direct action, whether individual or class, is not subject to any such requirement.

Delaware jurisprudence had been confused by an amorphous concept that would permit the pleader to assert a direct claim if she could show “special injury.”²⁹¹ In *Tooley*, the court said that its prior jurisprudence should be clarified and cases overruled if necessary to excise the concept of special injury.²⁹² The court did not create a new test for distinguishing between direct and derivative actions, but rather jettisoned the special injury concept and undertook to clarify which of several extant concepts in its jurisprudence should be applied.²⁹³ The court stated the law to be applied in determining

sis of the subject, see Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands*, 26 CARDOZO L. REV. (forthcoming 2005).

²⁸⁷ See Radin, *supra* note 286 (discussing the 2003 amendments to section 220).

²⁸⁸ See *id.* (“The law will continue to evolve, and the pendulum will continue to shift . . . as more and more shareholders test the limits of Section 220 . . . and as courts struggle to craft the proper balance between the rights of minority shareholders . . . and the rights of directors . . .”).

²⁸⁹ See *id.* (discussing the impact of changes in section 220 litigation on boardroom practices).

²⁹⁰ 845 A.2d 1031 (Del. 2004).

²⁹¹ See *id.* at 1035 (describing the special injury test as “not helpful” and “confusing”).

²⁹² See *id.* at 1038 n.21 (describing the court’s use of the special injury test in *In re Tri-Star Pictures, Inc. Litigation*, 634 A.2d 319 (Del. 1993), as a “lapse”).

²⁹³ According to the court:

The special injury concept . . . can be confusing in identifying the nature of the action. The same is true of the proposition . . . that an action cannot be direct if all stockholders are equally affected or unless the stockholder’s injury

whether a particular claim is direct or derivative going forward as follows:

The analysis must be based *solely* on the following questions: Who suffered the alleged harm—the corporation or the suing stockholder individually—and who would receive the benefit of the recovery or other remedy? This simple analysis is well imbedded in our jurisprudence, but some cases have complicated it by injection of the amorphous and confusing concept of “special injury.”

The Chancellor, in the very recent *Agostino* case, correctly points this out and strongly suggests that we should disavow the concept of “special injury.” In a scholarly analysis of this area of the law, he also suggests that the inquiry should be whether the stockholder has demonstrated that he or she has suffered an injury that is not dependent on an injury to the corporation. In the context of a claim for breach of fiduciary duty, the Chancellor articulated the inquiry as follows: “Looking at the body of the complaint and considering the nature of the wrong alleged and the relief requested, has the plaintiff demonstrated that he or she can prevail without showing an injury to the corporation?” We believe that this approach is helpful in analyzing the first prong of the analysis: what person or entity has suffered the alleged harm? The second prong of the analysis should logically follow.²⁹⁴

This holding seems understandable. In some cases the distinction is clear. For example, a corporate waste claim is clearly derivative because it is the corporation’s assets that have allegedly been wasted. A case that turns on a material misstatement in a proxy statement seeking a stockholder vote on a merger is clearly a direct action. But the application of *Tooley* to borderline cases may not be easy. As always, courts will be confronted with applying the requisite inquiries carefully to the facts before them to reach the correct result.

is separate and distinct from that suffered by other stockholders. The proper analysis has been and should remain that stated in *Grimes* [*v. Donald*, 673 A.2d 1207 (Del. 1996)]; *Kramer* [*v. Western Pacific Industries*, 546 A.2d 348 (Del. 1988)] and *Parnes* [*v. Bally Entertainment Corp.*, 722 A.2d 1243 (Del. 1999)]. That is, a court should look to the nature of the wrong and to whom the relief should go. The stockholder’s claimed direct injury must be independent of any alleged injury to the corporation. The stockholder must demonstrate that the duty breached was owed to the stockholder and that he or she can prevail without showing an injury to the corporation.

Id. at 1038-39.

²⁹⁴ *Id.* at 1035-36 (emphasis added) (footnotes omitted).

D. Director Independence

Delaware does not have statutory or case law that imposes a “one-size-fits-all” independence template for all purposes. Characteristically, Delaware deals with board independence contextually, on a case-by-case basis. In *Beam v. Stewart*, the court considered whether members of the Martha Stewart Living Omnimedia board were independent for purposes of presuit demand.²⁹⁵ In analyzing the independence issue, the court noted that the relevant questions are: “[I]ndependent from whom and independent for what purpose?”²⁹⁶

The court answered those questions by holding that friendship and social relationships between the CEO target of the derivative suit and the outside directors did not—standing alone—rebut the presumption of independence for presuit demand purposes.²⁹⁷ In doing so, the court was careful to distinguish Vice Chancellor Strine’s decision in *Oracle*,²⁹⁸ in which he held, in quite a different context, that Stanford University connections between members of a special litigation committee (SLC) of the board and the CEO and other non-independent directors prevented the SLC from carrying its burden of

²⁹⁵ *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1048-52 (Del. 2004).

²⁹⁶ *Id.* at 1049-50 (“Independence is a fact-specific determination made in the context of a particular case. The court must make that determination by answering the inquiries: independent from whom and independent for what purpose?”).

²⁹⁷ The court presented the following description of the relationship necessary to make demand futile:

A variety of motivations, including friendship, may influence the demand futility inquiry. But, to render a director unable to consider demand, a relationship must be of a bias-producing nature. Allegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director’s independence.

Id. at 1050. Some argue that even outside directors cannot be trusted to act independently, since they hold a position as “professional colleague” within the corporate structure. See Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503, 534 (1989) (describing the structural bias argument as a dubious critique of the ability of outside directors to be “neutral on questions of management misbehavior”). The article concludes in the context of derivative litigation:

The structural bias argument asks us to believe that outside directors generally are more willing to risk reputation and future income than they are to risk the social embarrassment of calling a colleague to account. There is no more reason to believe this than there is to believe that independent accountants are easily suborned because they are indifferent to the loss of income from other professional engagements thereby put at risk.

Id. at 535.

²⁹⁸ *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917 (Del. Ch. 2003).

proof of affirmatively showing its independence.²⁹⁹ Significantly, the Stanford connection seemed to have been unearthed in discovery and apparently had not been revealed in the SLC's report.³⁰⁰ The *Beam* court observed that the burden of persuasion and the presumption of independence differ significantly in the demand excusal and SLC contexts.³⁰¹

V. INDEPENDENCE IN OTHER CONTEXTS

So the questions remain: Independent from whom? Independent for what purpose? There were different presumptions, different burdens, and different underlying policies in the independence analysis in the presuit demand context in *Beam* and in the SLC context in *Oracle*. Despite the differences, the Supreme Court was careful to note in *Beam* that it did not need to decide whether a connection such as that found in *Oracle* would have been sufficient to rebut the presumption of independence for purposes of a presuit demand.³⁰² While the inquiries and the underlying policies differ, it remains to be seen whether, based on the same relationships, the outcomes would differ in the two contexts.

One of the most important aspects of director independence relates to the use of committees. *Kahn v. Lynch*³⁰³ and *Kahn v. Tremont*³⁰⁴ stand for the propositions that a special transactional committee: (a) must be truly independent in its conduct and not merely appear to be independent because of the pedigree of its members; and (b) if it is designed to be a surrogate for minority stockholder bargaining with a controlling stockholder, it may shift to the stockholders the burden of proof in an entire fairness context.³⁰⁵ Moreover, in cases like *McMullin v. Beran*³⁰⁶ and *Krasner v. Moffett*³⁰⁷ where the corporations use special transactional committees, the Supreme Court has determined that the

²⁹⁹ *Id.* at 937-48.

³⁰⁰ *Id.* at 929-35.

³⁰¹ *Beam*, 845 A.2d at 1054-55.

³⁰² *Id.* at 1055.

³⁰³ *Kahn v. Lynch Communication Sys., Inc.* 669 A.2d 79 (Del. 1995).

³⁰⁴ *Kahn v. Tremont Corp.*, 694 A.2d 422 (Del. 1997).

³⁰⁵ Consider also Vice Chancellor Strine's opinion in *Oracle*, distinguished in *Beam*, that a special litigation committee requires an even more searching analysis. *Oracle*, 824 A.2d at 939-42; *see also* *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985) (stating that a special litigation committee, especially a one-person committee, must be "like Caesar's wife . . . above reproach")

³⁰⁶ 765 A.2d 910 (Del. 2000).

³⁰⁷ 826 A.2d 277 (Del. 2003).

contextual analysis inherent in the independence determination is normally unsuitable for dismissal under Chancery Rule 12(b)(6).

Today, the matter of director independence is a prevailing theme in corporate governance, if not always in corporate law. The Sarbanes-Oxley Act focuses on audit committee independence, while the New York Stock Exchange and NASDAQ have listing requirements with varying definitions of independence,³⁰⁸ as do organizations such as the Council of Institutional Investors.³⁰⁹ Many corporations have their own definitions. Indeed, there is continuing media scrutiny of the application to particular directors of the expectation that a director whose business or family has economic ties to the corporation is not independent as a general matter.³¹⁰

But for Delaware law purposes, there is no generalization or “one size fits all” analysis. In the *Brehm v. Eisner* case in 2000, the Council of Institutional Investors as amicus curiae invited the Supreme Court to adopt a bright line rule defining what constitutes an independent director. The court declined to do so because such a bright line rule would be antithetical to the Delaware contextual approach.³¹¹ Again, the inquiry should be: independent from whom and independent for what purpose? The result is that Delaware’s independence test may be more or less exacting than other tests, depending on the context.³¹²

³⁰⁸ See N.Y. STOCK EXCH., LISTED COMPANY MANUAL § 303A.02 (2004) (defining “independent director” for purposes of listing on the NYSE), available at <http://www.nyse.com/Frameset.html?displayPage=/about/listed/1022221393251.html> (last accessed Feb. 17, 2005); NASD MANUAL Marketplace Rule 4200(a)(15) (defining “independent director” for NASDAQ listing purposes), available at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=115900635 (last accessed Mar. 27, 2005).

³⁰⁹ See Council of Institutional Investors, *Independent Director Definition*, at http://www.cii.org/dcwasciiweb.nsf/doc/council_indepdirectdef.cm (Mar. 25, 2004) (providing this organization’s definition of independence).

³¹⁰ See, e.g., John R. Emshwiller & Joann S. Lublin, *In Boardrooms, “Independent” Is Debatable*, WALL ST. J., Mar. 3, 2005, at C1 (reviewing corporate filings and suggesting that perhaps some directors who satisfy requirements for independence under NYSE and NASDAQ rules should not be considered independent).

³¹¹ See *Brehm v. Eisner*, 746 A.2d 244, 256 & n.30 (2000) (declining to impose the recommendations of the Council of Institutional Investors because they were not mandated by Delaware law, and because the court’s scope of review was limited to reviewing whether the particularized facts alleged in the complaint suggested a breach of the board’s fiduciary duties); see also *Krasner v. Moffett*, 826 A.2d 277, 286 (Del. 2003) (observing that the “independence of [a] special committee involves a fact-intensive inquiry that varies from case to case”).

³¹² There is a distinction in Delaware law between the concepts of director independence and director interestedness. Under the DGCL, an interested director is one who has a personal interest in the particular corporate matter on which her action is

VII. DISCLOSURE ISSUES

The duty of disclosure requires that in a proxy statement or other writing seeking action by stockholders or putative investors, the corporation must meet disclosure requirements that are generally aligned with federal law.³¹³ In *Stroud v. Grace*, the court stated the “well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board’s control when it seeks stockholder action.”³¹⁴ The court reaffirmed its preference for the materiality standard³¹⁵ over the concept of “candor” that had “crept into” the case law, a concept that the court deemed to be “confusing and imprecise.”³¹⁶

When directors solicit a stockholder vote on a matter, such as a merger, the duty of disclosure under state law is somewhat diffuse. It is usually embodied in judicial decisions, rather than being explicated in a statute.³¹⁷ Disclosure requirements for public corporations are de-

requested. See DEL. CODE ANN. tit. 8, § 144 (relating to contracts or transactions between a corporation and interested directors). Delaware case law uses the concept of independence to define a director who may have family, business, or other relationships with a person with a direct interest in a transaction. See, e.g., *Beam v. Stewart*, 845 A.2d 1040, 1049-50 (Del. 2004) (discussing independence for purposes of presuit demand). In contrast, recent amendments to the MBCA employ the concept of “qualified directors” to embrace concepts of both interestedness and independence. See Comm. on Corp. Laws, *supra* note 54, at 341 (2004) (adding a definition of “qualified director” and amending various sections to replace the interested director or independent director concepts with that of qualified director).

³¹³ In *Zirn v. VLI Corp.*, 621 A.2d 773 (Del. 1993), the court observed:

The requirement that a director disclose to shareholders all material facts bearing upon a merger vote arises under the duties of care and loyalty In *Rosenblatt v. Getty Oil Co.*, [493 A.2d 929, 944 (Del. 1985)], this Court adopted the materiality standard set forth by the United States Supreme Court in *TSC Industries v. Northway*, [426 U.S. 438, 449 (1976)].

Id. at 778.

³¹⁴ *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992). *Stroud* was decided two days after I joined the court, but I obviously did not participate in the case.

³¹⁵ *Id.* at 85 (“The board is not required to disclose all available information. . . . [T]he materiality standard of *TSC Industries v. Northway*, [426 U.S. 438 (1976)], requires disclosure of all facts which would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.” (citations and internal quotation marks omitted)).

³¹⁶ *Id.* at 84.

³¹⁷ See, for example, the notice provision in the statutory merger section of the DGCL:

The agreement . . . shall be submitted to the stockholders . . . at an annual or special meeting for the purpose of acting on the agreement. Due notice of the time, place and purpose of the meeting shall be mailed to each holder of

tailed in the federal securities laws and SEC regulations. There is very little detailed guidance for small corporations.³¹⁸ Perhaps some day the legislature will consider a more detailed disclosure statute.³¹⁹ Until then, the Delaware courts seem to be feeling their way along reasonably well in identifying the parameters of the duties of disclosure when stockholders are asked to vote on proposals.³²⁰

A number of cases during the past twelve years developed the law regarding partial disclosures. In *Arnold v. Society for Savings Bancorp, Inc.*, the court held that even though the materiality standard might not require that a particular category of information be disclosed, “once defendants traveled down the road of partial disclosure of the history leading up to the Merger and used the vague language described, they had an obligation to provide the stockholders with an accurate, full, and fair characterization of those historic events.”³²¹ Then, in *Zirn v. VLI Corp.*, the court again faced the partial disclosure issue and held that directors have a duty to avoid misleading partial disclosures.³²²

stock . . . The notice shall contain a copy of the agreement or a brief summary thereof, as the directors shall deem advisable.

DEL. CODE ANN. tit. 8, § 251(c) (Supp. 2004).

³¹⁸ See, e.g., *Stroud v. Grace*, 606 A.2d 75 (Del. 1992).

³¹⁹ The ABA Committee on Corporate Laws (which I chair) has a task force chaired by Justice Jack Jacobs and Stan Keller, which is considering whether the MBCA should be amended to provide more clarity in various sections where a stockholder vote is required, such as a merger or amending the certificate of incorporation. See, e.g., MODEL BUS. CORP. ACT § 10.03(b) (2004) (requiring the board to submit “the amendment” to stockholders). Although Delaware is not a Model Act state, the Delaware bar’s Corporation Law Section, which drafts legislation for consideration by the Delaware General Assembly, may or may not undertake a similar study or consider any proposed Model Act amendment that may emerge from this study.

³²⁰ See, e.g., *Gilliland v. Motorola, Inc.*, 859 A.2d 80, 82 (Del. Ch. 2004) (holding that in a second-step, short-form merger, fiduciary duty required disclosure of summary financial information beyond the disclosures that would satisfy the statutory mandate).

³²¹ 650 A.2d 1270, 1280 (Del. 1994).

³²² *Zirn v. VLI Corp.*, 681 A.2d 1050, 1056 (Del. 1996); see also *Malone v. Brincat*, 722 A.2d 5, 12 n.31 (Del. 1998) (noting *Zirn*’s holding against misleading partial disclosure, and stating that “[d]irectors are required to provide shareholders with all information that is material to the action being requested and to provide a balanced, truthful account of all matters disclosed in the communications with shareholders”). Consider also the following analysis from *Williams v. Geier*:

Under Delaware law, it is undisputed that when a board of directors is required or elects to seek shareholder action, it is under a duty to disclose fully and fairly pertinent information within the board’s control The board could not couch these disclosures in vague or euphemistic language or in

In *Arnold, Zirn*, and other disclosure cases before 1998, the challenged disclosures had been made in connection with a request for stockholder action of some kind. Another species of the disclosure law now forms part of the directors' fiduciary duties where stockholders are not being asked to vote.

In *Malone v. Brincat*,³²³ the plaintiffs challenged disclosures made in a context other than a request that stockholders vote or take some other action. The case involved the reversal of a grant of a motion to dismiss where the plaintiffs alleged that the corporation and its officers *deliberately* misled existing stockholders by painting a rosy picture of the firm's finances when they *knew the information to be false*, and that the corporation actually was in dire financial straits.³²⁴

Even though the stockholders were not asked to vote, buy, sell, or take other action, the plaintiffs alleged that the disclosures fraudulently lulled the stockholders into a false sense of security that led them to hold on to their stock.³²⁵ Thus, the court faced the issue of whether the fiduciary duty to disclose material information could be implicated in the absence of a request for stockholder action.³²⁶ It held that "directors who knowingly disseminate false information that results in corporate injury or damage to an individual stockholder violate their fiduciary duty, and may be held accountable in a manner appropriate to the circumstances."³²⁷ The court framed the question, however, as implicating the directors' "more general duty of loyalty and good faith" rather than their duty of disclosure.³²⁸

Despite its holding that the dissemination of misinformation alleged by the plaintiffs might support a claim for breach of fiduciary duty, the court also found that the complaint failed to state a direct, derivative, or individual cause of action.³²⁹ The court disagreed "with

terms that would deprive the stockholders of their right to choose. The disclosures must be forthright and clear, and they were in this case.

671 A.2d 1368, 1383 (Del. 1996) (citations and internal quotation marks omitted).

³²³ 722 A.2d 5 (Del. 1998).

³²⁴ See *id.* at 7 ("The complaint alleged that the director defendants intentionally overstated the financial condition of Mercury on repeated occasions throughout a four-year period in disclosures to Mercury's shareholders."); see also *id.* at 8 (quoting the complaint as alleging that "the company has lost all or virtually all of its value (about \$2 billion)").

³²⁵ *Id.*

³²⁶ *Id.* at 9.

³²⁷ *Id.*

³²⁸ *Id.* at 10.

³²⁹ *Id.* at 14-15.

the Court of Chancery's holding that such a claim cannot be articulated on these facts" and ordered that the "plaintiffs should have been permitted to amend their complaint, if possible, to state a properly cognizable cause of action."³³⁰ Thus, the court affirmed the Court of Chancery's dismissal of the complaint, but reversed the trial court's decision that the dismissal should be with prejudice, thus allowing the plaintiffs to replead.³³¹

Malone merits mention because of its departure from the usual context of disclosure cases, in which investors have been asked to take some action. In addition, it constituted a decision that allegations of *intentional*, material misrepresentation can survive a motion to dismiss if appropriately pleaded.

This decision has engendered some criticism as expanding Delaware disclosure law and encroaching on federal securities law. The case should not be cause for alarm—it does not stand for any broader reading. It is simply a pleading case. That is, the court did not find that the facts supported a finding of fiduciary breach, but rather that such allegations might merit further investigation and factual development. In my view, it is axiomatic that directors who deliberately lie to their stockholders about material company finances have violated one or more of their fiduciary duties.

Malone is also significant from a federalism perspective. The court noted that both Delaware and federal law regulate directors' disclosure obligations.³³² Because of the potential overlap of Delaware fiduciary law and federal securities law in this area, the *Malone* court was careful to craft the directors' disclosure duties so as to minimize intrusion into traditionally federal territory. Specifically, the court reiterated that "[i]n deference to the panoply of federal protections that are available to investors in connection with the purchase or sale of securities of Delaware corporations, this Court has decided not to recognize a state common law cause of action against the directors . . . for 'fraud on the market.'"³³³ The court distinguished the *Malone* facts from that area of traditional federal regulation, however, by emphasizing that the plaintiffs had not traded their shares, and their claims therefore would not implicate federal securities laws because there

³³⁰ *Id.* at 15.

³³¹ *Id.*

³³² *Id.* at 12-13 (citing *Gaffin v. Teledyne, Inc.*, 611 A.2d 467 (Del. 1992), in which the court refused to adopt fraud on the market as a cognizable claim and held that reliance must be proven for individual stockholders).

³³³ *Id.* at 13.

was neither a purchase nor a sale of a security.³³⁴ *Malone's* holding, carefully tailored to the facts as alleged in the complaint, prudently confined the reach of the case not only to the allegations of intentional misdisclosure that misled stockholders but also to an area appropriately governed by state law. By doing so, it avoided overreaching into areas regulated by federal law.³³⁵

VIII. CORPORATE OPPORTUNITY

In *Broz v. Cellular Information Systems, Inc.*,³³⁶ the Delaware Supreme Court reversed a ruling by the Court of Chancery that a director had usurped a corporate opportunity that belonged to the corporation on the board of which he served.³³⁷ The court's general statement of the corporate opportunity doctrine was relatively unremarkable,³³⁸ but the court's discussion of the issue of presentation to the board merits mention.

The court stated that the Court of Chancery had erroneously imposed a new requirement of presentation to the board by placing too much emphasis on the defendant director's failure to do so.³³⁹ The court observed that a fair presentation to the board creates a "safe harbor" for the director, but that it is not a prerequisite to finding that the director did not usurp a corporate opportunity. The court explained:

³³⁴ *Id.*

³³⁵ *Cf. infra* text accompanying note 472 (counseling that federal authorities should avoid overreaching into areas appropriately governed by state corporate law).

³³⁶ 673 A.2d 148 (Del. 1996).

³³⁷ *Id.* at 150.

³³⁸ The court followed the classic statement of the doctrine in *Guth v. Loft*:

[A] corporate officer or director may not take a business opportunity for his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation. The Court in *Guth* also derived a corollary which states that a director or officer *may* take a corporate opportunity if: (1) the opportunity is presented to the director or officer in his individual and not his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity.

Broz, 673 A.2d at 155 (citing *Guth v. Loft*, 5 A.2d 503 (Del. 1939)).

³³⁹ *Id.* at 157.

The teaching of *Guth* and its progeny is that the director or officer must analyze the situation *ex ante* to determine whether the opportunity is one rightfully belonging to the corporation. If the director or officer believes, based on one of the factors articulated above, that the corporation is not entitled to the opportunity, then he may take it for himself. Of course, presenting the opportunity to the board creates a kind of “safe harbor” for the director, which removes the specter of a *post hoc* judicial determination that the director or officer has improperly usurped a corporate opportunity. Thus, presentation avoids the possibility that an error in the fiduciary’s assessment of the situation will create future liability for breach of fiduciary duty. It is not the law of Delaware that presentation to the board is a necessary prerequisite to a finding that a corporate opportunity has not been usurped.³⁴⁰

At least one commentator has suggested that *Broz* demonstrates the Delaware Supreme Court’s willingness to focus on the good faith of directors and to trust the directors to choose the appropriate course of action.³⁴¹ This approach reflects the broad reality that most directors do perform their duties in good faith and in keeping with legal requirements and best practices. The *Broz* approach also strikes an appropriate balance between legal and extralegal controls on corporate affairs.

IX. CONTROLLING STOCKHOLDERS

A. *The Intersection of Fiduciary Duty and Stockholder Rights*

In 1996, the Supreme Court was asked to reconcile the corporate opportunity doctrine with the principle that stockholders, even controlling stockholders, are permitted to vote their shares in their own self-interest. In *Thorpe v. CERBCO, Inc.*,³⁴² the Eriksons, two controlling stockholders of CERBCO, who were also two of the four directors of the company, were approached about the possible sale of a subsidi-

³⁴⁰ *Id.*; see also *Telxon Corp. v. Meyerson*, 802 A.2d 257, 263 (Del. 2002) (noting that presentation of an opportunity to the board creates a safe harbor for an interested director); cf. *Yiannatsis v. Stephanis*, 653 A.2d 275, 279 (Del. 1995) (holding that majority stockholders in a close corporation breached their fiduciary duties when they failed to present a corporate opportunity to the corporation).

³⁴¹ See, e.g., Deborah A. DeMott, *The Figure in the Landscape: A Comparative Sketch of Directors’ Self-Interested Transactions*, LAW & CONTEMP. PROB., Summer 1999, at 243, 260-61 (“*Broz* reflects a court willing to assume that, even in the absence of a formal presentation and a formal meeting, disinterested directors will evaluate and react appropriately to information they receive.”).

³⁴² 676 A.2d 436 (Del. 1996).

ary company, CERBCO's most valuable asset.³⁴³ Instead of presenting the offer to CERBCO, the Eriksons offered to sell their controlling interest in CERBCO to the buyer.³⁴⁴ The case raised the question whether, by effectuating such a sale, the Eriksons as directors would breach their fiduciary duties by usurping an opportunity that belonged to CERBCO.³⁴⁵ Since the Eriksons had a right to veto a sale of all or substantially all of CERBCO's assets under DGCL section 271,³⁴⁶ their failure to present the opportunity to the company might not have caused any harm to the company because as stockholders the Eriksons could have prevented the sale in any event.³⁴⁷

The Supreme Court stated:

We agree that in a particular setting these two precepts of corporate law may tend to pull in opposite directions, but the statutorily granted rights under § 271 cannot be interpreted to completely vitiate the obligation of loyalty. The shareholder vote provided by § 271 does not supersede the duty of loyalty owed by control persons, just as the statutory power to merge does not allow oppressive conduct in the effectuation of a merger. Rather, this statutorily conferred power must be exercised within the constraints of the duty of loyalty. In practice, the reconciliation of these two precepts of corporate law means that the duty of a controlling shareholder/director will vary according to the role being played by that person and the stage of the transaction at which the power is employed.³⁴⁸

Because the potential acquirer approached the Eriksons as directors, the court held the Eriksons were obligated to present the opportunity to CERBCO. By failing to do so they breached their duty of loyalty.³⁴⁹ The court indicated that the Eriksons were entitled to act as stockholders and obtain a control premium, but only after presenting the opportunity to the corporation, withdrawing from further action on behalf of the company, and allowing the outside directors to negotiate on CERBCO's behalf.³⁵⁰ Nevertheless, because the subsidiary's sale to the bidder would have constituted a sale of all or substantially

³⁴³ *Id.* at 438. The Eriksons were presumably approached in their capacity as directors. *Id.*

³⁴⁴ *Id.*

³⁴⁵ *Id.* at 437.

³⁴⁶ Section 271 of the Delaware General Corporation Law, DEL. CODE ANN. tit. 8, § 271 (2001), requires majority stockholder approval of a sale of all or substantially all of a corporation's assets.

³⁴⁷ *Thorpe*, 676 A.2d at 437.

³⁴⁸ *Id.* at 442 (citations omitted).

³⁴⁹ *Id.*

³⁵⁰ *Id.*

all of CERBCO's assets under section 271, entitling the Eriksons to veto that sale, no transactional damages were available.³⁵¹ The court required that the Eriksons disgorge the benefit they received from their dealings with the bidder and that they reimburse CERBCO for expenses it incurred in connection with the Eriksons' actions.³⁵²

The court has continued to refine the duties owed by controlling stockholders and the analytical paradigm that applies to their dealings with the companies they control. In *Weinberger v. UOP, Inc.*,³⁵³ the court commented that its determination of the fairness of a transaction might have been "entirely different" had the company used a special committee of independent outside directors in negotiating the transaction at issue.³⁵⁴ Following *Weinberger*, commentators focused on the legal effect of a properly functioning special committee of independent directors.³⁵⁵ Some Delaware cases held that approval by such a committee shifted the burden of proof concerning entire fairness

³⁵¹ The court held that transactional damages were inappropriate despite the Eriksons' breach of fiduciary duty, because:

Section 271 must . . . be given independent legal significance apart from the duty of loyalty. While the failure of CERBCO to sell East [the subsidiary] to INA [the buyer] is certainly related to the Eriksons' faithlessness, that failure did not proximately result from the breach. Instead the Eriksons' § 271 rights are ultimately responsible for the nonconsummation of the transaction. Even if the Eriksons had behaved faithfully to their duties to CERBCO, they still could have rightfully vetoed a sale of substantially all of CERBCO's assets under § 271. Thus, the § 271 rights, not the breach, were the proximate cause of the nonconsummation of the transaction.

Id. at 444 (citation omitted).

³⁵² *Id.* at 445. Although the deal was not consummated, the Eriksons were ordered to disgorge \$75,000 received from the bidder in connection with negotiations. *Id.*

³⁵³ 457 A.2d 701 (Del. 1983).

³⁵⁴ *Id.* at 709 n.7.

³⁵⁵ See, e.g., Jesse A. Finkelstein, *Independent Committees in Interested Transactions*, 21 DEL. L. REV. 18, 18 (1994) (explaining to practitioners the implications of *Weinberger* for their clients); Geoffrey E. Hobart, Casenote, *Delaware Improves Its Treatment of Freezeout Mergers: Weinberger v. UOP, Inc.*, 25 B.C. L. REV. 685, 693 (1984) (discussing the impact that the *Weinberger* court's guidelines will have on future parent-subsidiary freezeout mergers). Over twenty years later, this issue continues to attract commentary. See, e.g., Geoffrey C. Hazard, Jr. & Edward B. Rock, *A New Player in the Boardroom: The Emergence of the Independent Directors' Counsel*, 59 BUS. LAW. 1389, 1389 (2004) (noting that committees of independent directors have become so widely used over the past thirty years that they may now need their own attorneys); E. Norman Veasey, *Separate and Continuing Counsel for Independent Directors: An Idea Whose Time Has Not Come as a General Practice*, 59 BUS. LAW. 1413 (2004) (suggesting that the general counsel will generally perform most of the legal work required by the board, including the independent directors); Steven M. Haas, Note, *Toward a Controlling Shareholder Safe Harbor*, 90 VA. L. REV. 2245, 2250 (2004) (discussing the ability of the sort of independent approval suggested in *Weinberger* to check the conduct of controlling shareholders).

from the defendants to the plaintiffs,³⁵⁶ while others held that approval by such a committee allowed for the application of the business judgment rule to the transaction in question.³⁵⁷

The Delaware Supreme Court resolved the issue in the *Kahn v. Lynch Communication Systems, Inc.* cases.³⁵⁸ In those cases, the court held that the standard of review of a transaction involving a controlling stockholder standing on both sides of the deal remains that of entire fairness.³⁵⁹ That burden may be shifted, however, where a procedure, such as use of an independent committee or majority of the minority approval, approximates arms-length negotiation.³⁶⁰

Despite the effects of the use of special committees or majority of the minority votes, the court has continued to express concern that controlling stockholders are in a unique position to exert inappropriate pressure even on independent directors or stockholders considering the propriety of a particular transaction.³⁶¹ Thus, controlling

³⁵⁶ See, e.g., *Rabkin v. Olin Corp.*, No. 7547, 1990 Del. Ch. LEXIS 50, at *16-17 (Del. Ch. Apr. 17, 1990) (indicating that majority of the minority approval or negotiation by a special committee can shift the burden of persuasion to plaintiffs, but that the standard of review remains entire fairness), *aff'd*, 586 A.2d 1202 (Del. 1990).

³⁵⁷ For example, the Court of Chancery said:

When independent directors understand the nature of their mission when negotiating a change of control transaction in which management or a controlling shareholder is involved—to agree only to a transaction that is in the best interests of the public shareholders; to say no unless they conclude that they have achieved a fair transaction that is the best transaction available—and where they pursue that goal independently, in good faith and diligently, their decision, in my opinion, deserves the respect accorded by the business judgment rule.

In re First Boston, Inc. S'holders Litig., No. 10338, 1990 Del. Ch. LEXIS 74, at *21-22 (Del. Ch. June 7, 1990).

³⁵⁸ *Kahn v. Lynch Communication Sys., Inc. (Lynch I)*, 638 A.2d 1110 (Del. 1994); *Kahn v. Lynch Communication Sys., Inc. (Lynch II)*, 669 A.2d 79 (Del. 1995).

³⁵⁹ *Lynch I*, 638 A.2d at 1117.

³⁶⁰ See *Lynch II*, 669 A.2d at 82-84, for a review of the burden-shifting paradigm established by the court in *Lynch I*, 638 A.2d at 1117.

³⁶¹ The court explained this concern in *Kahn v. Tremont Corp.*:

Entire fairness remains applicable even when an independent committee is utilized because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny. This policy reflects the reality that in a transaction such as the one considered in this appeal, the controlling shareholder will continue to dominate the company regardless of the outcome of the transaction. The risk is thus created that those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation by the controlling shareholder. Consequently, even when the transaction is negotiated by a special committee of independent directors, “no court could be certain whether the transaction fully approximate[d] what truly independent parties would have achieved in

stockholder transactions remain as only one context, of many, in which fiduciaries must be cognizant of the apparent propriety of the transaction, meaningful process, and true independence.

B. “Going Private” Transactions

The well-embedded entire fairness standard has not been applied to all transactions involving a controlling stockholder, leading to what some have described as a “possible incoherence”³⁶² in the jurisprudence. “Going private” transactions involve a controlling stockholder’s attempt to eliminate public stockholders, thereby transitioning the company to private ownership and affording certain practical benefits.³⁶³ A variety of methods may be used to take a company private,³⁶⁴ but courts and commentators have devoted substantial attention to the similarities and differences between two of these methods.

In a traditional long-form negotiated merger under Delaware law, the parties enter a merger agreement, and the board of directors of each corporation must review the agreement and recommend it to their respective stockholders.³⁶⁵ The stockholders of each party must then approve the merger by a majority of the outstanding shares.³⁶⁶ Stockholders voting against a merger that ultimately wins approval by a majority of the outstanding shares thus may be involuntarily cashed out of the company.

an arm’s length negotiation.” Cognizant of this fact, we have chosen to apply the entire fairness standard to “interested transactions” in order to ensure that all parties to the transaction have fulfilled their fiduciary duties to the corporation and all its shareholders.

694 A.2d 422, 428-29 (Del. 1997) (alteration in original) (citations omitted).

³⁶² *In re Pure Res., Inc., S’holders Litig.*, 808 A.2d 421, 435 (Del. Ch. 2002); *see also id.* (describing the “disparity in treatment . . . [between] negotiated merger versus tender offer/short-form merger”).

³⁶³ Major reasons that companies go private include the desire to avoid regulatory requirements and expenses, to pursue long-term value maximization, and to reduce agency costs. The effective closure of capital markets also gives companies less reason to be public. *See* Joshua M. Koenig, Survey, *A Brief Roadmap to Going Private*, 2004 COLUM. BUS. L. REV. 505, 509-11 (discussing reasons companies go private).

³⁶⁴ *See id.* at 532 (describing the forms going private transactions may take) (citing Dennis J. White & Patricia A. Johansen, *The Tide’s Turning for Going Private*, BUYOUTS, May 26, 2003, at 24, 24-25); Jason M. Quintana, Survey, *Going Private Transactions: Delaware’s Race to the Bottom?*, 2004 COLUM. BUS. L. REV. 547, 568 (“Generally, there are four different ways to take a company private: negotiated mergers, tender offers, asset dispositions and reverse stock splits.”).

³⁶⁵ *See* DEL. CODE ANN. tit. 8, § 251(b)-(c) (Supp. 2004) (requiring each board to adopt a resolution approving the merger and declaring its advisability).

³⁶⁶ *Id.* § 251(c).

Long-form mergers may be more favorable than other methods of going private for reasons related to taxes and financing.³⁶⁷ More often than not, however, the downside of long-form mergers outweighs any potential advantages. For instance, due to the multiple levels of approval required in a single-step, long-form merger, the process is often both costly and time consuming.³⁶⁸ In addition, as discussed more fully below, long-form mergers are subject to entire fairness review under *Lynch II*.

An alternative to the traditional long-form merger is a two-step transaction composed of an initial tender offer followed by a short-form merger. Under Delaware law, once a tender offer results in the acquisition of at least ninety percent of the company's shares, any remaining stockholders may be cashed out through a short-form merger.³⁶⁹ The short-form merger requires the approval of only the company's board of directors, not the company's stockholders.³⁷⁰ Nevertheless, appraisal rights and disclosure duties attach in the short-form model.

In a tender offer, unlike in a long-form merger, each stockholder-offeree may freely choose whether to tender her shares at the specified price.³⁷¹ The decision whether to tender therefore is individually determined and allows for personal evaluation of investment objectives and the merits of the proposed tender offer.³⁷² Consequently, the Delaware courts historically have viewed tender offer responses by stockholders as voluntary transactions.³⁷³

³⁶⁷ See Koenig, *supra* note 363, at 534 (explaining that mergers may be structured in ways that reduce or eliminate income recognition and initial financing requirements).

³⁶⁸ See *id.* at 533-34 (describing the parties and procedures involved in a long-form merger).

³⁶⁹ See DEL. CODE ANN. tit. 8, § 253 (2001 & Supp. 2004) (providing for short-form mergers).

³⁷⁰ *Id.* § 253(a) (Supp. 2004).

³⁷¹ Bradley R. Aronstam et al., *Delaware's Going-Private Dilemma: Fostering Protections for Minority Shareholders in the Wake of Siliconix and Unocal Exploration*, 58 BUS. LAW. 519, 526 (2003) (citing *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1056 (Del. Ch. 1987)).

³⁷² *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1056 (Del. Ch. 1987).

³⁷³ Aronstam et al., *supra* note 371, at 526; see also, e.g., *Solomon v. Pathe Communications Corp.*, 672 A.2d 35, 39 (Del. 1996) (noting that in the absence of coercion or materially false or misleading disclosures, a tender offer transaction is considered to be voluntary); *In re Aquila Inc. S'holders Litig.*, 805 A.2d 184, 190 (Del. Ch. 2002) (same); *In re Siliconix Inc. S'holders Litig.*, No. Civ. A. 18700, 2001 WL 716787, at *6 (Del. Ch. June 19, 2001) (same).

The advantages of submitting a tender offer and following with a short-form merger include the speed with which the merger can be concluded. The most notable advantage to the acquirer of the tender offer/short-form merger approach, however, is that Delaware courts reviewing such a transaction will apply a less stringent standard of review if the transaction is challenged.

While long-form mergers involving a controlling stockholder are subject to entire fairness review under *Lynch II*, in *Solomon v. Pathe Communications Corp.* the Supreme Court held that in the case of a voluntary tender offer used to obtain the ownership required to complete a short-form merger under section 253, the appropriate legal standard for judicial review of the transaction is not that of entire fairness.³⁷⁴ The court noted that, unlike long-form mergers, properly executed tender offer transactions are voluntary from the minority stockholders' viewpoint.³⁷⁵ The court stated that these voluntary transactions may become involuntary, however, despite their form and appearance, if one of several factors is present in the transaction.³⁷⁶ Thus, instead of entire fairness, the court held that the correct inquiry in these types of transactions is "whether coercion is present" or whether "materially false or misleading disclosures to stockholders were made in connection with the offer."³⁷⁷

The Supreme Court further "reconcil[e] a fiduciary's seemingly absolute duty to establish the entire fairness of any self-dealing transaction with the less demanding requirements of the short-form merger statute" in *Glassman v. Unocal Exploration Corp.*³⁷⁸ In *Glassman*, the court held that "absent fraud or illegality," a short-form merger effectuated under section 253 was subject to a simple business judgment standard of review, not the more stringent entire fairness standard.³⁷⁹ Thus, *Glassman* confirmed that long-form mergers are subject to a different standard of review than are short-form mergers.

Since *Pathe* and *Glassman*, courts and commentators have expressed concern that the divergent approaches to long-form mergers

³⁷⁴ 672 A.2d 35, 39 (Del. 1996) (emphasizing the voluntariness of the tender offer as opposed to its alleged unfairness).

³⁷⁵ *See id.* (noting that "in the case of totally voluntary tender offers . . . courts do not impose any right of the shareholders to receive a particular price").

³⁷⁶ *Id.*

³⁷⁷ *Id.*

³⁷⁸ 777 A.2d 242, 243 (Del. 2001).

³⁷⁹ Specifically, the court held that "appraisal is the exclusive remedy available to a minority stockholder who objects to a short-form merger." *Id.* at 248.

and tender offer/short-form mergers may be inapposite because once a tender offer and short-form merger are consummated, the end result for the minority stockholders is of “little substantive difference” as compared with a long-form merger.³⁸⁰ Vice Chancellor Strine, in his decision in *Pure Resources*, followed the existing dichotomy, but suggested a relaxation of the traditional *Lynch* rule applied in negotiated mergers.

He wrote that “the lack of harmony” between the two strands “is better addressed in the *Lynch* line, by affording greater liability-immunizing effect to protective devices such as majority of minority approval conditions and special committee negotiation and approval.”³⁸¹ The Vice Chancellor’s suggestion in dicta is that to the extent negotiated mergers make use of these protections, these mergers should be afforded business judgment protection, as distinct from being subject to the stringent entire fairness analysis.³⁸²

Under Vice Chancellor Strine’s suggested rubric, the *Pathe* standard would be modified in that an acquisition tender offer would be considered noncoercive only when “1) it is subject to a non-waivable majority of the minority tender condition; 2) the controlling stockholder promises to consummate a prompt [section] 253 merger at the same price if it obtains more than 90% of the shares; and 3) the controlling stockholder has made no retributive threats.”³⁸³ According to *Pure Resources*, such considerations would “minimize the distorting influence of the tendering process on voluntary choice” and “recognize

³⁸⁰ *In re Siliconix, Inc., S’holders Litig.*, No. 18700, 2001 WL 716787, at *7 (Del. Ch. June 19, 2001); see also *In re Pure Res., Inc., S’holders Litig.*, 808 A.2d 421, 435 (Del. Ch. 2002) (suggesting that the *Lynch* and *Pathe* lines of cases “appear to treat economically similar transactions as categorically different simply because the method by which the controlling stockholder proceeds varies,” leaving a “disparity in treatment [that] persists even though the two basic methods (negotiated merger versus tender offer/short-form merger) pose similar threats to minority stockholders”).

Professor Guhan Subramanian has conducted an empirical study of the disparate consequences for minority stockholders of a tender offer and short-form merger as compared with a more traditional merger. He concludes that controlling stockholders pay less to minority stockholders in tender offer freeze-outs than in statutory merger freeze-outs. GUHAN SUBRAMANIAN, POST-SILICONIX FREEZEOUTS: THEORY, EVIDENCE AND POLICY (Harv. Law Sch. John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 472, 2004), available at http://www.law.harvard.edu/programs/olin_center/corporate_governance/papers.htm.

³⁸¹ *In re Pure Res.*, 808 A.2d at 444.

³⁸² See *id.* at 444 n.43 (suggesting that “an easing of the *Lynch* rule” by “providing business judgment protection” to negotiated mergers would create “an incentive to use the negotiated merger route”).

³⁸³ *Id.* at 445.

the adverse conditions that confront stockholders who find themselves owning what have become very thinly traded shares.”³⁸⁴

Having two applicable standards of review available, rather than applying entire fairness review to all transactions involving controlling stockholders, leaves room for the fact-specific, contextual inquiries at which the Delaware courts are adept. Where the business judgment rule can apply, the court can abstain from interfering with a transaction that is effectively insulated from the potential taint of the controlling stockholder. A rule subjecting all transactions involving controlling stockholders to entire fairness review, on the other hand, could give rise to substantial nuisance litigation.

An answer to the question of whether the Supreme Court will modify its approach must, of course, await an appeal that presents the issue. It seems unlikely, however, that the court will alter its well-developed approach absent extraordinary circumstances.³⁸⁵ While some recent Court of Chancery cases, such as *Pure Resources*, have criticized the doctrinal dichotomy left by *Lynch* and *Pathe*, those decisions have also demonstrated that the jurisprudence is workable and have elucidated the policies underlying the dichotomy.³⁸⁶

X. APPRAISAL AND VALUATION

Appraisal actions under section 262 of the DGCL present Delaware courts with the challenge of valuing shares of stock in corporations.³⁸⁷ Delaware courts have wrestled with their role as post-transaction appraisers of the fair value of the company as a going con-

³⁸⁴ *Id.*

³⁸⁵ See *supra* text accompanying note 27 (discussing the court’s approach to the doctrine of stare decisis).

³⁸⁶ Some have argued that the full disclosure and lack of coercion required by recent cases in the context of tender offers provide sufficient safeguards for minority stockholders. See Jon E. Abramczyk et al., *Going-Private “Dilemma”—Not in Delaware*, 58 BUS. LAW. 1351, 1359 (2003) (“Perhaps the best example of the effectiveness of the protections provided in Delaware’s jurisprudence [in the tender offer context] is the fact that in [*Siliconix*] where those protections were present, the minority stockholders rejected the majority stockholder’s offer.”). The argument suggests that recent cases such as *Pure Resources* have “addressed the apparent doctrinal tension between *Solomon* and *Lynch*” by providing clear, thoughtful analysis of the rationale and procedure for applying the divergent standards. *Id.* at 1356; see also A.C. Pritchard, *Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price*, 1 BERKELEY BUS. L.J. 83, 84-85 (2004) (asserting that the current framework is “likely to be positive for shareholders” and consistent with the DGCL as established by the legislature).

³⁸⁷ See DEL. CODE ANN. tit. 8, § 262 (2001) (providing appraisal rights for stockholders dissenting from a merger or consolidation).

cern at the time of the merger because of the availability of various appraisal methods.

In the early 1930s, the Delaware courts distinguished between the “intrinsic value” of shares and the market value of those shares.³⁸⁸ In later cases, the Delaware Supreme Court further explained the concept of value by defining a stockholder’s interest in a company as her pro rata share of a going concern.³⁸⁹ Thus, an underlying principle in appraisal valuation today is that a corporation must be valued as an operating entity.³⁹⁰

Before 1983, Delaware courts primarily used the Delaware Block Method to value corporations.³⁹¹ The reliance on the Delaware Block Method as the exclusive method of appraisal equity valuation ended in 1983, when the Delaware Supreme Court held in *Weinberger v. UOP, Inc.* that “a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court Fair price obviously requires consideration of all relevant factors involving the value of a company.”³⁹² *Weinberger* opened the door for modern finance valuation techniques such as discounted cash flow (DCF) analysis and comparative transaction analysis to be used as valuation tools in appraisal proceedings.

Between 1992 and 2004, the Delaware Supreme Court decided several appraisal and equity valuation cases. Those cases served to guide the Court of Chancery with regard to certain aspects of appraisal and valuation cases, such as the acceptance and weighing of

³⁸⁸ *See* *Chi. Corp. v. Munds*, 172 A. 452, 455 (Del. Ch. 1934) (holding that the only way to restore value to defendant was to give him the “intrinsic value” of stock, rather than the market value).

³⁸⁹ *See, e.g.*, *Tri-Cont’l Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950) (“The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern.”).

³⁹⁰ *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 553 (Del. 2000) (citing *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1145 (Del. 1989)).

³⁹¹ The Delaware Block, or weighted average, method of valuation estimates fair value through a weighted average of pre-merger market price, net asset value, and capitalized earnings valuation. *Id.* at 555. Delaware judges have significant leeway in determining the weight to be placed on each valuation factor depending on the particular facts of each case. *See, e.g.*, *Bell v. Kirby Lumber Corp.*, 413 A.2d 137, 143 (Del. 1980) (“[T]he weighting of those assets with other available factors is left to the Court. As a result, appraisals involving different corporate structures have resulted in different weighting of factors for varying reasons.” (citation omitted)).

³⁹² 457 A.2d 701, 713 (Del. 1983).

evidence, with the bulk of the appraisal analysis left to the trial court.³⁹³

In *Gonsalves v. Straight Arrow Publishers, Inc.*, the Supreme Court emphasized that the Court of Chancery must independently determine the value of the shares subject to an appraisal action, bringing the judge's expertise to bear on that determination.³⁹⁴ In support of the task of independent valuation with which the Court of Chancery is charged, the Supreme Court in *Gonsalves* "continue[d] to commend" its suggestion, announced in *Shell Oil*, that the Court of Chancery may appoint a neutral expert witness to aid its objective and independent determination of value.³⁹⁵ Ultimately, the Court of Chancery has wide discretion to accept or reject the parties' experts and their respective valuation frameworks. Indeed, the judge need not adopt any methodology in toto and may reject any methodology submitted by the parties' experts.³⁹⁶ The Court of Chancery may "select one of the parties' valuation models or fashion its own."³⁹⁷ The court must, however, carefully ensure through a rational and logical deductive process that the evidence supports the ultimate valuation conclusions in its decision.³⁹⁸ These decisions reflect the Delaware Supreme Court's empha-

³⁹³ See, e.g., *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213, 1219 (Del. 1992) (referring to the "broad latitude" afforded to the "appraisal quest" at the trial court level, and acknowledging the Supreme Court's "high level of deference" to the findings of the Court of Chancery); see also *M.P.M. Enters. v. Gilbert*, 731 A.2d 790, 795 (Del. 1999) (stating that the Supreme Court reviews the Court of Chancery's findings in an appraisal case with a "high level of deference").

³⁹⁴ 701 A.2d 357, 360 (Del. 1997). The court in *Gonsalves* explained that:

[T]he deference standard . . . assumes that the court will employ its own acknowledged expertise, which is essential to the appraisal task.

. . . The modern appraisal process presumes a sophisticated judge who exercises independence in determining the value of [the] corporation in a contested proceeding. . . .

. . . .

The role of the Court of Chancery has evolved over time to the present requirement that the court independently determine the value of the shares that are the subject of the appraisal action.

Id. at 360-61.

³⁹⁵ *Id.* at 362; see also *Shell Oil*, 607 A.2d at 1222 (stating that the Court of Chancery has the "inherent authority to appoint neutral expert witnesses" to aid the court in resolving the "clash of contrary, and often antagonistic, expert opinions on value" often facing the court in appraisal cases).

³⁹⁶ See *M.G. Bancorp., Inc. v. Le Beau*, 737 A.2d 513, 521-25 (Del. 1999) (reviewing the Court of Chancery's gatekeeping role and holding that the trial court may accept or reject any witness's proposed valuation methodology).

³⁹⁷ *Id.* at 525-26.

³⁹⁸ See *id.* at 526 (explaining that the Court of Chancery may fashion its own valuation method or "adopt any one expert's model, methodology, and mathematical calcu-

sis on the benefit of active judicial attention to valuation in appraisal proceedings.³⁹⁹

During my term, the Supreme Court addressed several of the factors that may be included in valuing the corporation in an appraisal action. For instance, because the petitioner in an appraisal proceeding is entitled to her share of the value of the corporation immediately *before* the merger, the court held that the appraised value cannot include the capitalized value of possible changes that may be made by new management.⁴⁰⁰ Likewise, “where the corporation’s going forward business plan is to retain the same management, a dissenting shareholder seeking appraisal may not seek to attribute value to an alternative cost pattern which may occur post-merger.”⁴⁰¹ In addition, the court held that a discount normally applied to unmarketable, unregistered shares and untraded shares would be improper at the stockholder level.⁴⁰² The court has also held that, in the context of an appraisal to value a bank holding company, it is appropriate to include a control premium for majority ownership of the holding company’s subsidiaries to determine the holding company shares’ fair market value, irrespective of whether those subsidiaries were engaged in similar or different businesses.⁴⁰³

The Supreme Court also provided guidance to the Court of Chancery in weighing the reliability of evidence. In *M.P.M. Enterprises v. Gilbert*, the court held that “[v]alues derived in the open market through arms-length negotiations offer better indicia of reliability than the interested party transactions that are often the subject of appraisals under § 262.”⁴⁰⁴ Of course, the court also noted that “the trial court, in its discretion, need not accord any weight to such values when unsupported by evidence that they represent the going concern

lations, *in toto*, if that valuation is supported by credible evidence and withstands a critical judicial analysis on the record”).

³⁹⁹ *Cf. Gonsalves*, 701 A.2d at 360-61 (discussing the legislative history of the modern appraisal statute and the benefits resulting from amending the statute to replace valuation by an appraiser with valuation by a sophisticated, independent judge).

⁴⁰⁰ *Id.* at 363.

⁴⁰¹ *Id.*

⁴⁰² *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 557 (Del. 2000); *see also id.* (citing *M.G. Bancorp.*, 737 A.2d at 523-24, as holding that “after the entire corporation has been valued as a going concern by applying an appraisal methodology that passes judicial muster, there can be no discounting at the shareholder level”).

⁴⁰³ *M.G. Bancorp.*, 737 A.2d at 524 (citing *Rapid-Am. Corp. v. Harris*, 603 A.2d 796, 806-07 (Del. 1992)).

⁴⁰⁴ 731 A.2d 790, 796 (Del. 1999).

value of the company at the effective date of the merger or consolidation.⁴⁰⁵

Despite the Supreme Court's guidance regarding certain valuation factors, the Court of Chancery remains faced with the substantial challenge of evaluating and applying the many other methods and factors that impact a valuation determination. In many, but certainly not all, cases the court uses a DCF analysis of value.⁴⁰⁶ DCF valuation methodology is the most accepted valuation approach within the financial community and has been widely employed by Delaware courts.⁴⁰⁷ DCF has received increasing academic criticism, however.⁴⁰⁸ Almost invariably each expert witness adjusts the DCF model, which produces divergent valuation frameworks and often widely disparate per share values. The court often faces two competing valuation frameworks and must endeavor to review the valuation analysis of both sides.

In a recent decision, Chancellor Chandler articulated the difficulty of the task before the Court of Chancery:

Although [section 262] requires this Court to determine "the fair value" of a share of Technicolor on January 24, 1983, it is one of the conceits of our law that we purport to declare something as elusive as *the* fair value of an entity on a given date, especially a date more than two decades ago. Experience in the adversarial, battle of the experts' appraisal process under Delaware law teaches one lesson very clearly: valuation decisions are impossible to make with anything approaching complete confidence. Valuing an entity is a difficult intellectual exercise, especially when business and financial experts are able to organize data in support of wildly divergent valuations for the same entity. For a judge who is not an expert in corporate finance, one can do little more than try to detect gross distortions in the experts' opinions. This effort should, therefore, not be understood, as a matter of intellectual honesty, as resulting in *the* fair value of a corporation on a given date. The value

⁴⁰⁵ *Id.*

⁴⁰⁶ For a quantitative assessment of the various methodologies employed in appraisal valuations, see Rutheford B. Campbell, Jr., *The Impact of Modern Finance Theory in Acquisition Cases*, 53 SYRACUSE L. REV. 1 (2003) (demonstrating that DCF is the most common, but only slightly so, method employed by courts to determine the fair value of the enterprise). See *id.* at 5-13 for an explanation of DCF methodology.

⁴⁰⁷ See *Cede & Co. v. JRC Acquisition Corp.*, No. 18648-NC, 2004 Del. Ch. LEXIS 12 (Del. Ch. Feb. 10, 2004) (discussing the merits of DCF analysis).

⁴⁰⁸ See, e.g., William T. Allen, *Securities Markets as Social Products: The Pretty Efficient Capital Markets Hypothesis*, 28 J. CORP. L. 551 (2003) (arguing for acceptance of an efficient capital markets hypothesis by courts and a heavier presumption to market prices); Daniel R. Fischel, *Market Evidence in Corporate Law*, 69 U. CHI. L. REV. 941 (2002) (arguing that courts should give more, even conclusive, weight to market evidence when resolving valuation disputes in corporate law).

of a corporation is not a point on a line, but a range of reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value in light of all of the relevant evidence and based on considerations of fairness.⁴⁰⁹

Because of the complexity of valuation decisions, the Court of Chancery produces thorough and analytical decisions that delve deeply into the mechanics of the valuation techniques employed, as well as the nature of the company and the business context in which the company operates. Several recent Court of Chancery decisions illustrate the fact-specific nature of appraisal cases and the common sense employed by the Delaware courts in selecting appraisal methods.

In *Doft & Co., First Trust Corp. v. Travelocity.com Inc.*,⁴¹⁰ the court was asked to appraise the value of a minority interest in Travelocity.com, an online travel service. The appraisal arose in the context of a short-form merger, in which the majority stockholder of Travelocity cashed out the minority stockholders at a price of \$28 per share.⁴¹¹ Travelocity's and the stockholders' experts each employed a DCF analysis combined with a comparable company analysis, using Expedia, Inc., as the comparable company.⁴¹² The stockholders' expert concluded a fair value of between \$33.70 and \$59.95 per share for the company and Travelocity's expert concluded the company's value as a going concern was between \$11.38 and \$21.29 per share.⁴¹³

Vice Chancellor Lamb concluded that the fundamental inputs (the projections of future revenues, expenses, and cash flows) used by the experts "were not shown to be reasonably reliable."⁴¹⁴ The court found that the management's five-year projections, which generally are considered reasonably reliable, were not a "reliable basis for forecasting future cash flows."⁴¹⁵ The court's conclusion was at least partially based on the limited financial history of the company; the rapidly evolving market in which Travelocity operated; and the industry uncertainty created by the events of September 11, 2001.⁴¹⁶ Rejecting

⁴⁰⁹ *Cede & Co. v. Technicolor, Inc.*, No. 7129, 2003 Del. Ch. LEXIS 146, at *5-6 (Del. Ch. Dec. 31, 2003).

⁴¹⁰ No. 19734, 2004 Del. Ch. LEXIS 75 (Del. Ch. May 21, 2004).

⁴¹¹ *Id.* at *13.

⁴¹² *Id.* at *17-18.

⁴¹³ *Id.*

⁴¹⁴ *Id.* at *21. The court noted that the utility of DCF depends on the validity of the data relied upon, and any method of valuation, including DCF, is "only as good as the inputs to the model." *Id.*

⁴¹⁵ *Id.* at *22.

⁴¹⁶ *Id.* at *22-23.

the DCF approach, the court relied on a comparable company analysis⁴¹⁷ between Travelocity and Expedia and arrived at a value of \$32.76 per share.⁴¹⁸

In *In re Emerging Communications, Inc. Shareholders Litigation*, plaintiffs brought a joint appraisal action and a fiduciary duty action arising out of a two-step “going private” transaction between Emerging Communications, Inc., (ECM) and Innovative Communications Corp., LLC, companies both controlled by Jeffrey J. Prosser.⁴¹⁹ Minority stockholders were cashed out at \$10.25 per share.⁴²⁰ The parties’ experts both valued the company using the DCF method, with ECM’s expert valuing the company at \$10.38 per share⁴²¹ and plaintiff’s expert placing the company’s value at \$41.16 per share.⁴²² The four-fold divergence in the experts’ share price can be attributed to two variables in their calculations: (1) defendant’s expert used projections prepared in March 1998, while plaintiff’s expert prepared projections using financials from June 1998;⁴²³ and (2) plaintiff’s expert used a discount rate (range) of 8.5% to 8.85% while defendant’s expert applied a discount rate of 11.5%.⁴²⁴

⁴¹⁷ The court noted that while a comparable company analysis is often employed with a DCF analysis, it may be used on a stand-alone basis as the circumstances warrant. *Id.* at *32 n.47.

⁴¹⁸ *Id.* at *48. The court, however, subsequently reconsidered its opinion, acknowledging that it used an inappropriate earnings input and that it incorrectly adjusted the earnings per share results, leading to a revised per share value of \$30.43. *Doft & Co., First Trust Corp. v. Travelocity.com Inc.*, No. 19734, 2004 Del. Ch. LEXIS 84 (Del. Ch. June 10, 2004).

⁴¹⁹ No. 16415, 2004 Del. Ch. LEXIS 70 (Del. Ch. May 3, 2004). Defendants included ECM, ECM’s board of directors, and Innovative, ECM’s majority stockholder. *Id.* at *5. ECM provided telephone and cellular services in the U.S. Virgin Islands and had the unique position of significant tax benefits and a near monopoly in its market, factors which the court held rendered any comparable company analysis of marginal utility. *Id.* at *43 n.36.

⁴²⁰ *Id.* at *32-33.

⁴²¹ *Id.* at *40.

⁴²² *Id.* at *35.

⁴²³ *Id.* at *45-58. The June projections were prepared in the normal course of business as part of an application to ECM’s lender to secure financing and projected a substantially higher growth than the March projections. *Id.* at *47. In the context of the going-private transaction, however, ECM’s control group provided only the March projections to ECM’s board, the special committee, and its financial advisor, even though the June projections were available. *Id.* at *46-47. Thus, the committee and its advisors were mistaken in believing they had the most current projections available. The importance of the nondisclosure of the June 1998 financial projections in the determination of this case cannot be understated because this fact affected not only the court’s appraisal analysis but its analysis in the fiduciary duty claim as well.

⁴²⁴ *Id.* at *58-82.

The court carefully analyzed both valuations, the nature of ECM's business, and the context of the merger transaction, and decided to rely on the June 1998 projections and a discount rate of 8.69%, yielding a value of \$38.05 per share.⁴²⁵ The court rejected the defendant's plea to give weight to the trading price of ECM's common stock prior to the merger, even though the defendant argued the stock traded in an efficient market and that market price was indicative of the stock's fair value.⁴²⁶

In *Cede & Co. v. Medpointe*, two institutional investment funds sought appraisal to determine the fair value of their shares of the stock of Carter-Wallace, Inc.⁴²⁷ The transaction had two components: an asset sale of the company's consumer products division followed by a merger of the company's healthcare division with Medpointe Capital Partners.⁴²⁸ Petitioners objected to the terms of the merger in which they would have received \$20.44 per share.⁴²⁹ Their expert concluded that the fair value of Carter-Wallace was \$37.16 per share, and defendant's expert concluded a fair value of \$19.40 per share.⁴³⁰

Both experts employed a DCF analysis, and the court stated that DCF was the preferred methodology, as "Carter-Wallace had enjoyed a long and relatively stable financial history, making the projections necessary for a cash flow analysis reasonably reliable."⁴³¹ The court analyzed and modified each expert's valuation in reaching its conclusion. To begin, the court scrutinized the nature of Carter-Wallace at the time of the merger and concluded that the fair value of the company should be determined as after the asset sale.⁴³² The court reiter-

⁴²⁵ *Id.* at *155.

⁴²⁶ *Id.* at *85. Among other reasons, the court decided not to give weight to ECM's market price because the June 1998 financial projections were never disclosed to the market.

⁴²⁷ *Cede & Co. v. Medpointe Healthcare, Inc.*, No. 19354-NC, 2004 Del. Ch. Lexis 124 (Del. Ch. Aug. 16, 2004).

⁴²⁸ *Id.* at *1.

⁴²⁹ *Id.*

⁴³⁰ *Id.* at *49-50.

⁴³¹ *Id.* at *60.

⁴³² *Id.* at *27-30. The court calculated the fair value of Carter-Wallace at the time of the merger, after the asset sale. In other words, the court considered whether the company should be valued as prior to the asset sale (with both divisions), or as the entity that in fact merged (Carter-Wallace without its Consumer Products Division), but with any proceeds and/or liabilities from the asset sale. *Cf. Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 298-300 (Del. 1996) (reversing the Court of Chancery's valuation of Technicolor stock prior to the merger, finding that value added to the going concern through a merger "accrues to the benefit of all"); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983) (stating that "elements of future value, including the nature of

ated its preference for the use of management forecasts and rejected petitioners' expert's terminal value, even though it was more conservative than the defendants' expert's, because it departed from management forecasts "without any significant reason."⁴³³ Finally, the court adjusted the value of the healthcare division to account for the net inflows from the asset sale that took place shortly before the merger, to arrive at a value of \$24.45 per share.⁴³⁴

These recent Court of Chancery cases highlight the complex and contextual nature of valuation inquiries and demonstrate that no single valuation approach will be universally accepted or receive the greatest weight in an appraisal proceeding. Rather, the facts and circumstances determine the valuation paradigm. A DCF valuation, although widely accepted and perhaps even preferred for now, will not always be the best approach to valuation. This is especially true in a context where the company has a limited financial history or lacks a reliable basis for forecasting future cash flows, where management projections are not reliable, or where financial projections are tainted. The courts have shown a strong preference for the use of management's financial assessment and will permit deviation from those predictions only upon compelling justification.⁴³⁵

Complete disclosure of all material information before the consummation of the transaction is paramount. Withholding financial projections or other material facts will be detrimental at the appraisal stage and may open the responsible parties to joint and several liability for breach of their fiduciary duties.⁴³⁶ Thus, management should ensure the disclosure of all material financial and non-financial information valuations at the transaction stage.

the enterprise . . . which are . . . not the product of speculation, may be considered" in determining a fair price).

⁴³³ See *Cede v. Medpointe*, 2004 Del. Ch. LEXIS 124, at *61 (expressing skepticism about litigation-driven adjustments to management's financial forecasts).

⁴³⁴ *Id.* at *75-77. The court listed a "number of checks" on its numbers, including the arm's-length nature of the negotiation, the comparable company analysis, and the stock's trading history. *Id.* at *77 n.107. The court found these values to be helpful checks but neither singularly nor collectively dispositive. *Id.*

⁴³⁵ *Id.* at *61.

⁴³⁶ In *Emerging Communications*, the fact that "highly material fact[s]," the June 1998 projections, were withheld from the special committee and minority stockholders prevented the defendants from claiming that the burden of proof had shifted to the petitioners because neither the special committee nor the minority stockholders were held to have made "an informed vote" on the merger. *In re Emerging Communications, Inc. S'holders Litig.*, No. 16415, 2004 Del. Ch. LEXIS 70, at *112 (Del. Ch. May 3, 2004).

Valuation is a discipline that is complex and variable. It is not an exact science. Yet, there are some traditional, textbook approaches.⁴³⁷ The laborious process of trying an appraisal case in the Court of Chancery, with its “battle of the experts” tendency, requires patience and an intellectually disciplined approach by the trial judge. As one can glean by reading the recent Court of Chancery appraisal cases, there is much for bankers, M&A lawyers, and corporate officials (including directors) to learn and apply in any major M&A transaction. It would be a wise step for the participants in such transactions to review and analyze some of the cases as part of the diligence that should be brought to bear in pricing such deals.

XI. A LOOK INTO THE FUTURE

A. *Is Delaware Law Changing?*

Are the winds of change blowing and gusting from the Delaware judges? The metaphors in vogue today to describe the corporate scene are intriguing. There is talk of storm clouds, revolution, transition, sea change, and the like. To be sure, Enron, Worldcom, and other scandals, followed by Sarbanes-Oxley and changes to the Stock Exchange rules, were a startling wake-up call.

The use of the phrase “wake-up call” here is not to suggest that corporate practitioners and judges had been asleep pre-Enron. To the contrary, the movement toward best corporate practices was a definite trend in the 1990s, and somewhat before. Corporate counselors were advising many boards to clean up their structure and intensify their diligence.⁴³⁸ This movement probably arose out of the environment of the 1980s when the takeover era produced financial changes and a refocusing of Delaware corporate jurisprudence. So, while the jurisprudence and best corporate practices were developing in the late twentieth century and the early twenty-first century, the court suddenly faced a change in the landscape. That change was not caused by judges or responsible corporate boards and counselors. It was the result of the scandals mentioned above.

⁴³⁷ See, e.g., ROBERT B. DICKIE, FINANCIAL STATEMENT ANALYSIS AND BUSINESS VALUATION FOR THE PRACTICAL LAWYER (1st ed. 1998, 2d ed. forthcoming 2006).

⁴³⁸ See, e.g., Joseph B. White & Paul Ingrassia, *Eminence Grise: Behind Revolt at GM, Lawyer Ira Millstein Helped Call the Shots*, WALL ST. J., Apr. 13, 1992, at A1 (describing reform advice given by expert to outside directors of the General Motors Corporation beginning in the mid-1980s).

Some observers have asserted that the Delaware courts are not as stable and balanced as the Delaware judges think they are. It has been suggested, for example, that the Delaware courts have a political agenda that has caused them to act as a weather vane, pointing where the winds of current events blow to the point that recent corporate cases have trended toward pleasing stockholders and federal regulators at the expense of directors, and therefore second-guessing directors more than they had previously.⁴³⁹

This is not a correct assessment of the Delaware courts. Delaware courts do not have a political agenda that vacillates from time to time to favor one type of litigant over another. Delaware courts today are not any more “pro-stockholder” and less “pro-director” or “pro-manager” than they were in the past, or vice versa. Sound bites sometimes refer to the Delaware courts as “business friendly.” I would characterize the Delaware courts as objective business experts, without the bias that the word “friendly” might imply. To be sure, the expectations of director conduct have evolved over the years, including during the post-Enron era, but that does not mean the Delaware courts have adopted a political agenda to favor stockholders over directors and managers or vice versa. Rather, the evolution in business and social expectations and norms of directorial conduct may affect outcomes in a common law system like ours by impacting the interpretation and application of such concepts as “good faith” and “best interests.”

Kurt Heyman and Christal Lint have suggested that rather than demonstrating a new prostockholder bias, the recent Delaware decisions actually reflect a clarification or refinement of “the role of equity

⁴³⁹ See, e.g., Kurt M. Heyman & Christal Lint, *Recent Supreme Court Reversals and the Role of Equity in Corporate Jurisprudence*, 6 DEL. L. REV. 451, 476 & nn.155-57 (2003) (citing several commentators who either explicitly or implicitly argue that there exists a “new ‘post-Enron era’ in which directors’ conduct will be scrutinized more closely by Delaware courts”); Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 YALE L.J. 621, 681 (2003) (arguing that the Delaware Supreme Court “has made dramatic pro-shareholder moves over the past year” possibly as a result of the threat of federal preemption created by the Sarbanes-Oxley Act). Compare Brett H. McDonnell, *Sox Appeals*, 2004 MICH. ST. L. REV. 505, 526 (“[The reasoning of the majority in *Omnicare*] attempts to balance providing room for the board to make decisions with the right of stockholders to make the final decision concerning a merger. The court’s rhetoric suggests less deference to boards and more concern for protecting shareholder choice than is usual for this court.”), with *id.* at 526 n.111 (“[T]he facts in *Omnicare* are pretty odd, particularly the presence of a lock-up agreement with two controlling shareholders, and the decision is a divided 3-2, unusual for Delaware. It could therefore be that the case has limited precedential value.”).

in corporate jurisprudence.”⁴⁴⁰ Equity continues to hold an important place in our jurisprudence, and is the means by which social and business norms and mores can affect the outcomes of cases.

The evolution in director expectations is a function of common law development. Delaware courts remain balanced and objective, and the business judgment rule is alive and well. The new regulatory, business, and adjudicative landscape does not mean that the Delaware courts have lurched in a new and menacing direction that should cause panic in the boardroom.⁴⁴¹ The substantive law has not changed. Any change in litigation outcomes has been the result of the fact that board processes have been brought under closer scrutiny, influenced by improved pleading by plaintiffs challenging board action.

Plaintiffs often achieve success when they invoke all the “tools at hand” to gain sufficient information that will allow them to state well-pleaded allegations. This is often accomplished by seeking certain specified corporate records. For example, some plaintiffs have recently—finally—heeded the Delaware Supreme Court’s and Court of Chancery’s repeated admonitions to pursue a section 220⁴⁴² action to obtain facts that will allow them to plead their claims with sufficient particularity.⁴⁴³

In the derivative litigation arising out of the Martha Stewart scandal, the Delaware Supreme Court observed that the plaintiff’s failure successfully to plead demand futility might be attributed to her failure to pursue a section 220 books and records inspection before suing.⁴⁴⁴

⁴⁴⁰ Heyman & Lint, *supra* note 439, at 479.

⁴⁴¹ *Cf. id.* at 476-78 (describing the “post-Enron theory” as not supported by the evidence).

⁴⁴² Section 220 of the DGCL permits stockholders to inspect corporate books and records for any “proper purpose” and provides for enforcement of that right by the Court of Chancery. DEL. CODE ANN. tit. 8, § 220(b)-(c) (2001).

⁴⁴³ *See* *Beam v. Stewart*, 845 A.2d 1040, 1056 (Del. 2004) (stating that “[b]oth this Court and the Court of Chancery have continually advised plaintiffs who seek to plead facts establishing demand futility that the plaintiffs might successfully have used a Section 220 books and records inspection to uncover such facts,” and referring to the Chancellor’s extensive citation of cases in which the courts had so admonished plaintiffs).

⁴⁴⁴ *See id.* at 1057 (“Because [the plaintiff] did not even attempt to use the fact-gathering tools available to her by seeking to review MSO’s books and records in support of her demand futility claim, we cannot know if such an effort would have been fruitless.”).

The court offered the *Disney* case as an example of how the plaintiff might better have proceeded.⁴⁴⁵

In *Disney*, the Delaware Supreme Court in 2000 reversed the Court of Chancery's dismissal of plaintiffs' claim that the Disney board had committed waste by allowing Michael Ovitz to terminate his employment on a non-fault basis.⁴⁴⁶ The Supreme Court held that, while the plaintiffs' complaint did not allege sufficient particularized facts to state a cognizable claim, they should be given the opportunity to replead.⁴⁴⁷ The court suggested that facts gathered through a section 220 suit might allow the plaintiffs to better support their allegations.⁴⁴⁸ Accordingly, the plaintiffs obtained books and records as authorized by section 220 and filed an amended complaint.⁴⁴⁹

The *Disney* case to this point teaches that plaintiffs who exercise their rights under section 220 may often proceed further in litigation—at least beyond the pleading stage. Those who are able to plead particularized facts and survive a motion to dismiss, in turn, are more likely to obtain discovery and therefore ultimately succeed in proving their claims at trial. If they then achieve a judgment in their favor, that “pro-stockholder” verdict is not necessarily the result of a pro-stockholder shift in the law, but rather results from increased diligence and better pleading by plaintiffs.

In addition to improved pleading, certain cases permitting plaintiffs to survive dispositive motions create concerns that director exposure to liability has increased. These cases, however, should not be of great concern to directors when strong allegations—sometimes too strong to be proven at trial—are merely found by the Court of Chan-

⁴⁴⁵ See *id.* at 1056-57 n.51 (“Note in particular the discussion of the *Disney* case where the plaintiffs were permitted to replead, then used the Section 220 procedure, and the new complaint survived a motion to dismiss on the ground that presuit demand was excused.”).

⁴⁴⁶ *Brehm v. Eisner*, 746 A.2d 244, 267 (Del. 2000).

⁴⁴⁷ *Id.*

⁴⁴⁸ In particular, the court stated:

Plaintiffs may well have the “tools at hand” to develop the necessary facts for pleading purposes. For example, plaintiffs may seek relevant books and records of the corporation under Section 220 of the Delaware General Corporation Law, if they can ultimately bear the burden of showing a proper purpose and make specific and discrete identification, with rifled precision, of the documents sought. Further, they must establish that each category of books and records is essential to the accomplishment of their articulated purpose for the inspection.

Id. at 266-67 (footnotes omitted).

⁴⁴⁹ See *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 279 (Del. Ch. 2003) (recounting the procedural history of the case).

cery or the Supreme Court to have stated a cause of action. Cases such as the Chancellor's *Disney* decision and the Supreme Court's decisions in *Krasner v. Moffett*,⁴⁵⁰ *McMullin v. Beran*,⁴⁵¹ *Malone v. Brincat*,⁴⁵² and *In re Santa Fe Pacific Corp. Shareholder Litigation*⁴⁵³ fall into this category.

*Brehm v. Eisner*⁴⁵⁴ ushered in a new era of appellate review of decisions of the Court of Chancery granting motions to dismiss. Certain dicta in Supreme Court cases before *Brehm*, apparently beginning with *Aronson v. Lewis*⁴⁵⁵ in 1984, implied that appellate review in such cases would be deferential, not de novo. That is, the court had stated that "in determining demand futility the Court of Chancery *in the proper exercise of its discretion* must decide whether" the pleading survives Rule 23.1.⁴⁵⁶

Aronson's discretionary standard led to a narrow, deferential scope of appellate review. Ultimately, the Supreme Court decided that made no sense because the justices could read the language of a pleading as well as members of the Court of Chancery, so in *Brehm* the court explicitly clarified the standard, holding:

The view we express today, however, is designed to make clear that our review of decisions of the Court of Chancery applying Rule 23.1 is *de novo* and plenary. We apply the law to the allegations of the Complaint as does the Court of Chancery. Our review is not a deferential review

⁴⁵⁰ 826 A.2d 277 (Del. 2003).

⁴⁵¹ 765 A.2d 910 (Del. 2000). In *McMullin*, the Supreme Court held that the facts as alleged by the plaintiff stated a claim for breach of the duty of care if the directors failed adequately to inform themselves or determine whether the consideration offered in a transaction involving a tender offer followed by a short-form merger was equal to or exceeded the company's appraisal value as a going concern. *Id.* at 922. The court also held that the plaintiff had stated a claim for breach of the duty of loyalty if the directors evaluated the transaction to accommodate the majority stockholder's immediate need for cash rather than to maximize the value for all the stockholders. *Id.* at 924-25.

⁴⁵² 722 A.2d 5 (Del. 1998).

⁴⁵³ 669 A.2d 59 (Del. 1995).

⁴⁵⁴ 746 A.2d 244 (Del. 2000).

⁴⁵⁵ 473 A.2d 805 (Del. 1984), *overruled in part by Brehm*, 746 A.2d at 254.

⁴⁵⁶ *Id.* at 814 (emphasis added). In *Brehm*, the court discussed this development by stating:

Certain dicta in our jurisprudence suggest that this Court will review under a deferential abuse of discretion standard a decision of the Court of Chancery on a Rule 23.1 motion to dismiss a derivative suit. These statements, apparently beginning in 1984 in *Aronson v. Lewis*, state that the Court of Chancery's decision is discretionary in determining whether the allegations of the complaint support the contention that pre-suit demand is excused.

746 A.2d at 253.

that requires us to find an abuse of discretion. We see no reason to perpetuate the concept of discretion in this context. The nature of our analysis of a complaint in a derivative suit is the same as that applied by the Court of Chancery in making its decision in the first instance.⁴⁵⁷

That change is not particularly significant in itself. But it does highlight what has been occurring generally in appellate review of the grant of motions to dismiss, judgment on the pleadings, and summary judgment. It is often appropriate and expeditious for the Court of Chancery at the threshold to dispose on motion of a frivolous pleading or one that plainly lacks merit either as a matter of law or because it is simply a sloppy or conclusory pleading. That said, however, my instinct is that the rare reversals of the Court of Chancery usually followed dismissal of a complaint on motion rather than a trial on the merits or a discretionary ruling on an injunction.

Instead, the bulk of the reversals involved either a Supreme Court decision to follow a new jurisprudential course or what the Supreme Court understood to be a premature dismissal on motion. In these latter cases, the court believed that a reasonable reading of the pleadings, in the light most favorable to the pleader (or nonmoving party), gave the pleader the benefit of the doubt to proceed to the next step—usually obtaining some discovery, even if narrowly circumscribed.⁴⁵⁸

For example, in *Krasner v. Moffett*⁴⁵⁹ the court reversed a grant of a motion to dismiss a class action where the ultimate defense rested on the effect of action by an allegedly independent committee. The court held that it was premature to grant a Rule 12(b)(6)⁴⁶⁰ motion while a number of issues—including independence and therefore legal effect and burden of proof—could not be resolved on the face of

⁴⁵⁷ *Id.*

⁴⁵⁸ To the extent that the Delaware Supreme Court tends to encourage factual development in cases rather than dismissal on dispositive motions under state rules of civil procedure, Delaware jurisprudence may reflect an interesting difference from federal courts' treatment of motions under parallel rules of federal procedure. *See, e.g.,* Christopher M. Fairman, *The Myth of Notice Pleading*, 45 ARIZ. L. REV. 987, 988 (2003) (arguing that “notice pleading is a myth” because of federal courts' widespread use of heightened pleading standards); Jack H. Friedenthal & Joshua E. Gardner, *Judicial Discretion to Deny Summary Judgment in the Era of Managerial Judging*, 31 HOFSTRA L. REV. 91, 101 (2002) (discussing the reinvigoration in federal courts of summary judgment as a method of resolving cases based on “concerns for efficiency and fairness” and with the purpose of allowing federal trial courts “flexibility in controlling their dockets by dismissing meritless claims”).

⁴⁵⁹ 826 A.2d 277 (Del. 2003).

⁴⁶⁰ DEL. CH. CT. R. 12(b)(6).

the complaint.⁴⁶¹ The court’s language in the decision is a typical reflection of the court’s concern about premature dismissals:

A complaint must survive a motion to dismiss under Rule 12(b)(6) if the plaintiff could ultimately prevail on the merits of their claims based on any reasonable set of facts alleged in the complaint. The independence of the special committee involves a fact-intensive inquiry that varies from case to case. Thus, we cannot assume at the pleading stage that the defendants will carry the burden of establishing independence. Beyond that, it is premature to determine the legal effect—and the resulting standard of review—that would apply if a special committee that operated independently recommended a merger to the full board. Moreover, we need not decide the legal effect of the affirmative vote of the members of the independent committee, who constituted less than a quorum, when voting with the full board to approve the merger.⁴⁶²

The lesson on appellate review is twofold: (1) in the case itself, the court will give the pleader the benefit of all reasonable inferences to determine if there is any reasonable ground to go forward to discovery; and (2) in evaluating the case as a precedent where the Supreme Court has reversed a dismissal, one must bear in mind that the court has taken the pleading and all its reasonable inferences as true for purposes of the motion.⁴⁶³

Rather than pointing in whatever direction happens to be most politically expedient at the time, Delaware law takes a bilateral approach to balancing corporate interests.⁴⁶⁴ In addition, as mentioned above, the Delaware Supreme Court exhibits a strong trend toward

⁴⁶¹ *Krasner*, 826 A.2d at 287.

⁴⁶² *Id.* at 286 (citations and footnotes omitted).

⁴⁶³ As the court said in *Santa Fe*:

This case may very well illustrate the difficulty of expeditiously dispensing with claims seeking enhanced judicial scrutiny at the pleading stage where the complaint is not completely conclusory. It is appropriate and consistent with the “just, speedy and inexpensive determination of every proceeding,” Chancery Rule 1, that conclusory complaints without well-pleaded facts be dismissed early under Chancery Rule 12. But that is not this case. Here, there are well-pleaded allegations on the *Unocal* claim. As the terminology of enhanced judicial scrutiny implies, boards can expect to be required to justify their decisionmaking, within a range of reasonableness, when they adopt defensive measures with implications for corporate control. This scrutiny will usually not be satisfied by resting on a defense motion merely attacking the pleadings.

In re Santa Fe Pac. Corp. S’holder Litig., 669 A.2d 59, 72 (Del. 1995).

⁴⁶⁴ See Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 903-08 (2002) (arguing that bilateral devices—those that enjoy support from both stockholders and managers—“hold a privileged position in Delaware corporate law”).

consensus. These two features help to ensure Delaware maintains its competitive edge in the incorporation race—an edge which would be lost were Delaware law to favor one corporate constituency over another.⁴⁶⁵

Directors are not required to be perfectionists in their processes in any context. Nor are they guarantors of good results. Delaware jurisprudence is clear that even when directors are expected to maximize stockholder value, all that the law requires is that they act reasonably under the circumstances.⁴⁶⁶

Commissioner Campos of the SEC, in the context of new federal rules, said virtually the same thing in a recent interview:

In looking at the business judgment rule, courts have long held that in making business decisions, directors must consider all material information reasonably available and act in good faith. Some directors are questioning whether a new set of expectations on directors will play a role in a court's assessment of what information was "reasonably available" and whether the directors have "acted in good faith." But I firmly believe that Sarbanes-Oxley and the self-regulatory organization rules

⁴⁶⁵ Kahan and Rock explain:

The challenge for Delaware was to come up with a set of rules that, in conjunction with adaptive devices, would leave both shareholders and managers sufficiently satisfied to avoid significant governance pressure on existing public companies to reincorporate elsewhere, to avoid significant market pressure to induce companies to incorporate elsewhere at the IPO stage, and to avoid significant political pressure to pass a federal corporate law. . . . Delaware's cautious approach—the contextual, two-steps-forward-one-step-back tendency of its case law, the fact that its takeover statute came late and was mild, and its encouragement of bilateral responses—can all be understood as responses to this challenge.

Id. at 907. Compare the following analysis by Cunningham and Yablon:

Delaware's need to avoid massive reincorporation by disgruntled corporate managers, on the one hand, and to recognize its important role in the functioning of the capital markets and American economy, on the other, do place serious constraints on Delaware law and prevent it from tilting too far in either a pro-management or pro-shareholder direction. Delaware corporate law shows a persistent tendency to look for the middle way between rules that empower shareholders at the expense of management and rules that are overtly management protective. Given that predilection, however, the Delaware courts are still free to choose from a variety of doctrinal possibilities that fall within the middle range of the manager-shareholder spectrum.

Cunningham & Yablon, *supra* note 98, at 1617-18 (footnote omitted).

⁴⁶⁶ See *In re MONY Group Inc. S'holder Litig.*, 852 A.2d 9, 20 (Del. Ch. 2004) (“[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a *reasonable* decision, not a *perfect* decision.”).

have not eroded the business judgment rule. If directors act reasonably and in good faith, they will be protected from liability.⁴⁶⁷

Finally, Vice Chancellor Strine made a similar statement in a speech in 2002:

I won't pretend that directors don't have a reason to be concerned [But t]he legal reality today is identical to the legal reality a year ago: Independent directors who apply themselves to their duties in good faith have a trivial risk of legal liability. Let me repeat that: If you do your job as a director with integrity and attentiveness, your risk of damages liability is minuscule.⁴⁶⁸

I agree with both of these statements.

B. *Federalism v. Federalization*

While noting in historical context the interesting events that have occurred since the turn of the twenty-first century, I have resolved not to take anything for granted, and I have expressed a need for vigilance.⁴⁶⁹ Vigilance is needed because Delaware's corporate preeminence is more vulnerable to a pervasive federal encroachment now than it was before the turn of the century and certainly before the collapses of Enron and WorldCom. Keeping the fragile Delaware franchise healthy is in the best interests of business lawyers and investors everywhere.

The Delaware franchise is fragile largely because of encroaching federalization. Professor Mark Roe has written that federalization of corporate law threatens Delaware's franchise perhaps even more than competition from other states' laws:

[W]e live in a federal system where Washington can, and often does, take over economic issues of national importance. . . . That happened for securities trading during the Depression, takeovers in the early 1980s, and corporate governance after the Enron and WorldCom scandals. And if fundamental issues of corporate governance often move into the federal arena, then Delaware is not deciding all key corporate law matters. . . . [F]ederal power may make Delaware law.

⁴⁶⁷ National Association of Corporate Directors, *Questions for Commissioner Campos*, DIRECTORS MONTHLY, May 2004, at 3.

⁴⁶⁸ Leo E. Strine, Should I Serve? Useful Considerations for Prospective Directors Deciding Whether to Join a Board and Incumbents Pondering Whether to Continue, Speech at the Director's Education Institute at Duke University (Oct. 2003), in CORP. GOVERNANCE ADVISOR, Jan.-Feb. 2003, at 1-2.

⁴⁶⁹ Veasey, *supra* note 249, at 163.

. . . [T]he federal government does not threaten to take away Delaware's chartering business in its entirety . . . [but] Delaware players know that the federal government can take away their corporate lawmaking power in whole or in part, because it has acted often enough

Delaware's competition in making corporate law thus comes not just—and at times not even primarily—from other states, but also from the federal government: It comes from Congress and the SEC, not just California, Nevada, Ohio, or New York. It comes from the Second Circuit Court of Appeals when that court interprets the scope of the securities laws And it comes from the New York Stock Exchange, which itself is often prodded to act by the SEC or Congress.

. . . Federal authorities reverse state corporate law that they dislike and leave standing laws that they tolerate.⁴⁷⁰

One of the interesting and challenging facets of this phenomenon going forward is how—if at all—the Sarbanes-Oxley Act, the requirements of the Self-Regulatory Organizations (the New York Stock Exchange and NASDAQ), and the quest for optimum corporate practices will play out in Delaware courts. Sarbanes-Oxley has many dimensions, one of which is an intrusion by the federal legislative branch into the internal affairs of corporations. Internal affairs have long been thought to be the province of state law, while regulation of markets (through disclosure) has been thought to be largely (though not entirely) controlled by federal law.⁴⁷¹

Despite the limited but significant intrusion into internal corporate affairs by Sarbanes-Oxley and the listing requirements of the exchanges—the principal remedy of the exchanges is delisting—the only direct enforcement mechanism in the legislation is relegated to the SEC. Neither the Sarbanes-Oxley statute nor the SEC rules provides for a private right of action. In a culture where many corporate disputes play out in direct, class, and derivative suits, one wonders how the creativity of the plaintiffs' bar will manifest itself under the federal regulations. Many of us in Delaware believe these issues may play out to some extent in Delaware courts—and with no certain outcome.⁴⁷² Meanwhile, Sarbanes-Oxley and SEC rules, on a “one size fits all” basis, continue to add significantly to the costs of compliance.

⁴⁷⁰ Roe, *supra* note 9, at 591-92.

⁴⁷¹ See Chandler & Strine, *supra* note 64, at 958 (characterizing Sarbanes-Oxley requirements as “imping[ing] on the managerial freedom permitted to directors by state corporation law”).

⁴⁷² See, e.g., *id.* at 957 (“Delaware judges also anticipate being among the first governmental decision makers to confront real-world disputes influenced by the 2002 Reforms.”).

Nevertheless, there is still a very large area where the state law of internal corporate affairs predominates. The Delaware courts remain very busy with important and challenging litigation in many areas: mergers and acquisitions, derivative and class actions, alternative entities, bankruptcy, and intellectual property. Delaware lawyers and lawyers elsewhere are busy not only with the litigation itself but also with giving advice on Delaware law.

If there is ever a significantly more extensive federal intrusion into internal corporate affairs, the degree of reasonable stability we have come to expect from Delaware judge-made law and legislation could be lost. Most of the law that business lawyers understand comes not only from the quintessential Delaware common law principle of *stare decisis*—respecting time-honored principles of fiduciary duty—but also the fact that the ten Delaware judges of the Court of Chancery and the Supreme Court have the expertise and experience to deal promptly and reasonably predictably with complex business law cases in an international arena on a daily basis.⁴⁷³

In my view, increased federalization will lead to more uncertainty by introducing new corporate concepts and compounding the problem that the introduction of such new concepts creates by calling on hundreds of busy federal district court judges from ninety-four separate federal districts to interpret these new federal concepts. Planning by business lawyers and prudent entrepreneurial risk-taking by directors and officers could become chaotic.

Perhaps cooler heads will prevail, absent another crisis like Enron or WorldCom. The movement toward best practices now sweeping American boardrooms, the continuous digestion process of the Sarbanes-Oxley and SRO requirements, and the responsible state corporation law decisions may help those cooler heads to prevail. The best way to demonstrate that federal intervention into the internal affairs of corporations is unnecessary and undesirable is for boards of direc-

⁴⁷³ The same is true with respect to state legislation. Last year, the SEC floated a stockholder access proposal that now appears to be dead. *See* Stephen Labaton, *S.E.C. Rebuffs Investors on Board Votes*, N.Y. TIMES, Feb. 8, 2005, at C2 (reporting that the Commission's recent actions have been "seen as an unambiguous sign that an earlier proposal to open the proxies, or votes, to greater shareholder participation was dead"). What is happening at the state level is significant. The ABA Committee on Corporate Laws, through a task force headed by Peggy Foran and A. Gilchrist Sparks, III, is studying whether the MBCA's current provisions allowing directors to be elected by a plurality of votes cast, MODEL BUS. CORP. ACT § 7.28 (1999) should be amended. *See also* DEL. CODE ANN. tit. 8, § 216(3); Phyllis Plitch, *ABA Task Force Opens Door to Possible Board Vote Changes*, DOW JONES NEWSWIREs, Feb. 4, 2005.

tors—guided by business lawyers—to continue what the Delaware judges have consistently encouraged: the quest for best practices of due care, loyalty, good faith, and independence, mixed with a good dose of constructive skepticism and a demand for total understanding before taking action.

C. *Best Practices*

Among the prime areas of best corporate practices are the trends toward director independence, executive sessions, and empowerment of directors to exercise their primacy in corporate governance. The proper use of independent committees may hold the key to the future of best corporate practices. Beyond the proper use of these committees under the comprehensive charters for each that many companies have developed, counseling directors to “do the right thing” is a proper function of the courts as well as counsel.

The best advice as a general matter is that the most effective prophylactic against liability is for directors to implement a pattern of best corporate governance practices. That is not to say that directors who do not follow these good practices are necessarily vulnerable to liability. But if they do have good corporate governance processes, those processes and the optics might help them in the eyes of a court or a regulatory authority.⁴⁷⁴ Some specifics I might offer include the following:

- Be careful and thoroughly investigate the integrity and financial position of a company before agreeing to serve as a director.
- Embrace best practices in governance processes.
- Appoint a strong independent board leader, whether a nonexecutive chair or a lead director.

⁴⁷⁴ I recommend that directors and their counselors consult the excellent summary of best corporate practices found in the *Corporate Director's Guidebook*, Fourth Edition. The Guidebook is the product of the ABA Committee on Corporate Laws. Aspirational standards of director conduct are not necessarily coextensive with the standards of judicial review. ABA COMM. ON CORPORATE LAWS, CORPORATE DIRECTOR'S GUIDEBOOK (4th ed. 2004). See also *Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000) (“[T]he law of corporate fiduciary duties and remedies for violations of those duties are distinct from the aspirational goals of ideal corporate governance practices.”); Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 438 (1993) (“[T]he standards of review in corporate law pervasively diverge from the standards of conduct.”); see also MODEL BUS. CORP. ACT §§ 8.30, 8.31 (1999) (defining the standards of director conduct in Section 8.30, but elucidating the standards of judicial review in section 8.31).

- Be certain that all directors are financially literate.
- Be certain that the board has regular executive sessions.
- Pay special attention to the board agenda—is the board focused on the right issues and is the board involved in making that determination?
- Make sure you have a reasonably complete understanding of the company’s business, competitive environment, financial controls, and financial disclosures. The same is true of the need to have a thorough understanding of a particular transaction being considered for board action.
- Pay special attention to the board’s information needs—does the board have access to the information it needs, and is the board in control of determining what information it needs?
- Actively engage in board discussions and deliberations with healthy skepticism always and constructive criticism when called for. There is no such thing as a “stupid” question.
- Review board and committee minutes—and ask that they be circulated to all directors within a week for comments (not approval; that can wait)—to ensure they accurately reflect the matters considered, and capture the general extent and nature of the board’s discussions, deliberations, considerations, decisions, and directions (not a transcript of who said what).
- Insist that management keep track of and report progress on items that came before the board and resulted in board decisions or directions.
- Take special care in reviewing registration statements.⁴⁷⁵
- Make sure disclosures are clear and that you understand them; ask management for assurances and representations.
- Ask independent auditors for assurances of the integrity of the reporting and their due diligence.
- Understand what you sign.

⁴⁷⁵ The news reports in January 2005 engendered much concern. See E. Norman Veasey, A Perspective on Liability Risks to Directors in Light of Current Events, Address at the Annual Audit Committee Issues Conference (Jan. 19, 2005) (advising that directors should “take heed” of current events, such as the proposed Worldcom and Enron settlements, but should not panic).

- Beware of a CEO who manages to the market, or who tries unduly to manage the board.
- Resist a culture of complacency when things look to be running well.
- Rely in good faith on well-chosen experts.

Best practices must be realistic. Do not undertake to jump over an impossibly high bar of best practices. Failure to follow your own guidelines is not a good optic in court.

CONCLUSION

As I suggested at the outset, this retrospective has bumped along the twelve-year landscape selectively and without being totally comprehensive. If I ever get the time, I might consider expanding this piece into a book. Of course, “time” is the operative word. If it takes too much time to write the book, it will become—like some interstate highways—obsolete before it is finished. That is because the law is dynamic. The expectations of directors continue to evolve and business issues move on.

I am very sanguine about the role of the Delaware courts as this dynamism of corporate law and corporate governance plays out. The Delaware courts are in good hands and they fit the mold of the seven obligations that stockholders and directors expect of courts: (i) be clear; (ii) be prompt; (iii) be balanced; (iv) have a coherent rationale; (v) render decisions that are stable in the overall continuum; (vi) be intellectually honest; and (vii) properly limit the function of the court. But I worry about the need to preserve principles of federalism relating to the internal affairs of corporations. In my opinion, there has already been too much federal encroachment into state law that is supposed to govern internal affairs. In my view, this encroachment is an intrusion on internal affairs that has exponentially increased the cost of reasonable corporate governance measures.

My hope is that federal authorities either cut back on the encroachment that has already happened or at least refrain from extending the encroachment. Despite some of the doctrinal anomalies I have discussed, Delaware law, in its dynamic, contextual, expert, and objective manner, strikes the right balance, and that should be respected.

APPENDIX

DELAWARE SUPREME COURT CORPORATE CASES
1992 – 2004*

1. *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004).¹
2. *Beam v. Stewart*, 845 A.2d 1040 (Del. 2004).¹
3. *Emerald Partners v. Berlin*, 840 A.2d 641 (Del. 2003).³
4. *Krasner v. Moffett*, 826 A.2d 277 (Del. 2003).¹
5. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003).⁵
6. *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003).³
7. *Applebaum v. Avaya, Inc.*, 812 A.2d 880 (Del. 2002).¹
8. *Parfi Holding AB v. Mirror Image Internet, Inc.*, 817 A.2d 149 (Del. 2002).¹
9. *Gotham Partners v. Hallwood Realty Partners*, 817 A.2d 160 (Del. 2002).¹
10. *Levco Alternative Fund Ltd. v. Reader's Digest Association*, Nos. 466-67, 2002 Del. LEXIS 488 (Del. Aug. 13, 2002).³
11. *Grimes v. Alton Inc.*, 804 A.2d 256 (Del. 2002).¹
12. *Stifel Financial Corp. v. Cochran*, 809 A.2d 555 (Del. 2002).³
13. *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113 (Del. 2002).²
14. *Telxon Corp. v. Meyerson*, 802 A.2d 257 (Del. 2002).³
15. *Gentile v. SinglePoint Financial, Inc.*, 788 A.2d 111 (Del. 2001).⁴
16. *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001).³
17. *White v. Panic*, 783 A.2d 543 (Del. 2001).¹
18. *Account v. Hilton Hotels Corp.*, 780 A.2d 245 (Del. 2001).³
19. *Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001).¹
20. *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242 (Del. 2001).²
21. *Duncan v. TheraTx, Inc.*, 775 A.2d 1019 (Del. 2001).¹
22. *McMullin v. Beran*, 765 A.2d 910 (Del. 2000).²

* My participation in each of these cases is noted by the following numbering system: 1: I authored the opinion for the Court; 2: I was on the panel and concurred in the opinion but did not author the opinion for the Court; 3: I did not participate in the case due to recusal or panel assignment to other Justices; 4: I was on the panel, but the Court issued a per curiam opinion; 5: I dissented.

23. *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170 (Del. 2000).²
24. *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549 (Del. 2000).²
25. *International Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437 (Del. 2000).⁴
26. *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).¹
27. *Elf Atochem North America, Inc. v. Jaffari*, 727 A.2d 286 (Del. 1999).¹
28. *Emerald Partners v. Berlin*, 726 A.2d 1215 (Del. 1999).³
29. *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243 (Del. 1999).²
30. *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513 (Del. 1999).²
31. *Frank v. Arnelle*, No. 424, 1998, 1999 Del. LEXIS 25 (Del. Jan. 22, 1999).²
32. *Gonsalves v. Straight Arrow Publishers, Inc.*, No. 232, 1998, 1999 Del. LEXIS 7 (Del. Jan. 5, 1999).³
33. *M.P.M. Enterprises v. Gilbert*, 731 A.2d 790 (Del. 1999).¹
34. *Quickturn Design Systems, Inc. v. Shapiro*, 721 A.2d 1281 (Del. 1998).³
35. *Malone v. Brincat*, 722 A.2d 5 (Del. 1998).²
36. *Elliott Associates, L.P. v. Avatex Corp.*, 715 A.2d 843 (Del. 1998).¹
37. *VonFeldt v. Stifel Financial Corp.*, 714 A.2d 79 (Del. 1998).¹
38. *Klang v. Smith's Food & Drug Centers, Inc.*, 702 A.2d 150 (Del. 1997).¹
39. *Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357 (Del. 1997).³
40. *Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135 (Del. 1997).¹
41. *Scattered Corp. v. Chicago Stock Exchange, Inc.*, 701 A.2d 70 (Del. 1997).¹
42. *Brody v. Zaucha*, 697 A.2d 749 (Del. 1997).²
43. *Box v. Box*, 697 A.2d 395 (Del. 1997).⁴
44. *Kahn v. Tremont Corp.*, 694 A.2d 422 (Del. 1997).³
45. *Brazen v. Bell Atlantic Corp.*, 695 A.2d 43 (Del. 1997).¹
46. *United Vanguard Fund, Inc. v. TakeCare, Inc.*, 693 A.2d 1076 (Del. 1997).²
47. *Taylor v. LSI Logic Corp.*, 689 A.2d 1196 (Del. 1997).¹
48. *Security First Corp. v. U.S. Die Casting & Development Co.*, 687 A.2d 563 (Del. 1997).¹

49. *Levy v. Stern*, No. 211, 1996, 1996 Del. LEXIS 468 (Del. Dec. 20, 1996).³
50. *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289 (Del. 1996).³
51. *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392 (Del. 1996).¹
52. *Zirn v. VLI Corp.*, 681 A.2d 1050 (Del. 1996).¹
53. *Thomas & Betts Corp. v. Leviton Manufacturing Co.*, 681 A.2d 1026 (Del. 1996).¹
54. *Kahn v. Roberts*, 679 A.2d 460 (Del. 1996).²
55. *Arnold v. Society for Savings Bancorp, Inc.*, 678 A.2d 533 (Del. 1996).¹
56. *Grimes v. Donald*, 673 A.2d 1207 (Del. 1996).¹
57. *Thorpe v. CERBCO, Inc.*, 676 A.2d 436 (Del. 1996).³
58. *Broz v. Cellular Information Systems, Inc.*, 673 A.2d 148 (Del. 1996).¹
59. *Williams v. Geier*, 671 A.2d 1368 (Del. 1996).¹
60. *Solomon v. Pathe Communications Corp.*, 672 A.2d 35 (Del. 1996).³
61. *Riblet Products Corp. v. Nagy*, 683 A.2d 37 (Del. 1996).¹
62. *Klotz v. Warner Communications, Inc.*, 674 A.2d 878 (Del. 1995).³
63. *Kahn v. Lynch Communication Systems, Inc.*, 669 A.2d 79 (Del. 1995).³
64. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156 (Del. 1995).³
65. *In re Santa Fe Pacific Corp. Shareholder Litigation*, 669 A.2d 59 (Del. 1995).¹
66. *Yiannatsis v. Stephanis*, 653 A.2d 275 (Del. 1995).¹
67. *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361 (Del. 1995).²
68. *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464 (Del. 1995).³
69. *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994).¹
70. *Preston v. Allison*, 650 A.2d 646 (Del. 1994).²
71. *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110 (Del. 1994).³
72. *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34 (Del. 1993).¹
73. *Farahpour v. DCX, Inc.*, 635 A.2d 894 (Del. 1994).²
74. *In re Tri-Star Pictures, Inc., Litigation*, 634 A.2d 319 (Del. 1993).³
75. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993).³

76. *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993).¹
77. *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199 (Del. 1993).³
78. *Zirn v. VLI Corp.*, 621 A.2d 773 (Del. 1993).³
79. *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).¹
80. *Gaffin v. Teledyne, Inc.*, 611 A.2d 467 (Del. 1992).¹
81. *Heineman v. Datapoint Corp.*, 611 A.2d 950 (Del. 1992).³
82. *In re Shell Oil Co.*, 607 A.2d 1213 (Del. 1992).³
83. *Shell Petroleum, Inc. v. Smith*, 606 A.2d 112 (Del. 1992).³
84. *Stroud v. Grace*, 606 A.2d 75 (Del. 1992).³