TERRA INCOGNITA: APPLYING THE ENTIRE FAIRNESS STANDARD OF REVIEW TO BENEFIT CORPORATIONS

Brent J. Horton*

ABSTRACT

In the traditional corporation context, faced with a claim that a board of directors breached its fiduciary duty when it made a decision (or took an action), a court will focus on the financial impact on shareholders only; that is to say, the court will find that the directors met their fiduciary duty as long as their decision maximized shareholder wealth. (And the court may not even make it that far; if the business judgment rule applies, the court will defer to the directors' decision entirely.)

The job of the court is somewhat more complicated when it must review the directors' decision using the entire fairness standard (the standard applied when the board is not properly functioning, perhaps due to a conflict); in that case, the court must confirm that the board of directors followed a fair process, and that in turn led to a fair price. One simplifying factor is that the court need only think about fair process and fair price with reference to the shareholders, who are primarily benefited by, or harmed by, the directors' decision.

The rise of benefit corporations (a hybrid business model where directors are required to balance the interests of shareholders and stakeholders) presents a serious challenge for the application of the entire fairness standard of review; it is terra incognita, or uncharted territory for courts (there is, as of yet, no case law directing courts how to proceed). When faced with a claim that the board of directors at a benefit corporation breached its fiduciary duty, the court will need to confirm that it (the board) followed a fair process and obtained a fair price, but now with regard to *both*

* Associate Professor of Law & Ethics, Corporate Social Responsibility Fellow, Fordham University Gabelli School of Business. LL.M. in Corporate Law, New York University School of Law; J.D., Syracuse University College of Law. Thanks are in order to Victor Borun, Elizabeth Cosenza and Iftekhar Hasan for their comments on prior drafts. Thank you to Alison Rae for research assistance. All views expressed, and errors made, are wholly my own. Fordham University provided grant assistance, for which I am grateful.

shareholders and stakeholders, including customers, employees, suppliers, local communities, and the environment.

This Article explains how the traditional entire fairness standard of review—i.e., examining decisions through the dual-lens of fair process and fair price—can be modified by courts to work in the benefit corporation context as well. In short, this Article suggests that courts confirm that the decision-making process employed by directors was designed to gather information regarding impacts on shareholders and stakeholders. As to fair price, this Article suggests that courts confirm that directors made adjustments to price that reflect the fact that the entity is a benefit corporation, and relatedly, be open to new valuation methods that account for impacts on stakeholders.

INTRODUCTION

In August 2019, the Business Roundtable, in conjunction with 181 CEOs, released its *Statement on the Purpose of a Corporation*.[1] This new document affirmed that a significant portion of large corporations are discarding the traditional shareholder-centric model, and adopting in its place a stakeholder-centric model, where the corporation commits to generate long-term value for shareholders, while also supporting customers, employees, suppliers, local communities, and the environment.[2]

Statutory law is also beginning to reflect the rise of the stakeholder-centric model. Starting in 2010, state legislatures began to pass new legislation allowing for the formation of benefit corporations.[3] Delaware passed its benefit corporation legislation in 2013 (the Delaware Benefit Corporation Law or DBCL).[4] Delaware's legislation requires directors to "balance[] the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific

1. *Statement on the Purpose of a Corporation*, BUSINESS ROUNDTABLE (Aug. 2019), https://opportunity.businessroundtable.org/wp-content/uploads/2019/08/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf [https://perma.cc/V94N-HZSK] [hereinafter *Statement on the Purpose*].

2. *Id.*

3. The first benefit corporation legislation was passed in Maryland. Act of Apr. 13, 2010, ch. 97, 2010 Md. Laws 980 (codified as amended at MD. CODE ANN., CORPS. & ASS'NS § 5–6C–01(2017)).

4. An Act To Amend Title 8 Of The Delaware Code Relating To The General Corporation Law, 79 DEL. LAWS, c. 122, § 8 (codified as amended at DEL. CODE ANN. tit. 8, §§ 361–368 (2018)).

public benefit . . . identified in its certificate of incorporation."[5] Today, benefit corporation legislation is adopted in thirty-six states and the District of Columbia;[6] and the Accountable Capitalism Act (ACA) proposed by Senator Elizabeth Warren would supercharge that effort, requiring directors at large corporations (greater than $1 billion in gross receipts) to consider the impact of decisions on stakeholders, without regard to whether they had voluntarily elected to be a benefit corporation.[7] (The ACA is modeled on state benefit corporation legislation).[8]

Directors at benefit corporations—which are undeniably bound by the strictures of benefit corporation legislation—face a difficult task; they must make decisions with an eye toward pecuniary return to shareholders (as the traditional shareholder-centric model has always mandated), *but also* with an eye toward the impact on customers, employees, suppliers, local communities, and the environment (as the new stakeholder-centric model now mandates).[9]

Where the directors' balancing analysis is challenged in court, and the entire fairness standard of review applies (entire fairness is the most searching of the standards of review applied in Delaware[10]), judges will be required to carefully scrutinize the directors' balancing analysis; judges must embark upon their own balancing analysis, a journey into terra incognita, uncharted territory.[11]

---

5. DEL. CODE ANN. tit. 8, § 365(a) (2020).

6. *State by State Status of Legislation*, BENEFIT CORPORATION, http://benefitcorp.net/policymakers/state-by-state-status [https://perma.cc/3H47-3HJK] (last visited Apr. 21, 2020).

7. Accountable Capitalism Act, S. 3348, 115th Cong. § 5(c)(1) (2018).

8. Technically, both the ACA and the DBCL are outgrowths of the Model Business Corporation Law (MBCL). Sen. Elizabeth Warren, *Accountable Capitalism Act One-Pager*, https://www.warren.senate.gov/imo/media/doc/Accountable%20Capitalism%20Act%20One-Pager.pdf [https://perma.cc/VE2G-GRZW] [hereinafter *ACA One-Pager*].

9. DEL. CODE ANN. tit. 8, § 365(a) (2020).

10. *See* In re Trados Inc. S'holder Litig., 73 A.3d 17, 43 (Del. Ch. 2013) ("Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness." (citing Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 457 (Del. Ch. 2011))). Entire fairness applies when the there is a controlling shareholder, the board itself is interested in the transaction, or the board is otherwise not operating properly. *See infra* Part II.C.

11. The inspiration for the title of this Article, "Terra Incognita", is drawn from the following quote from Admiral John Lort Stokes, who once shared a room aboard the H.M.S. Beagle with Charles Darwin:

> We were now once more stepping out over a terra incognita; . . . all was clothed with the charm of novelty. The feelings of delight which are naturally aroused in those whose feet for the first time press a new and rich country, and which I have so often before endeavoured in vain to express, burst forth on this occasion with renewed intensity.

It is terra incognita because courts are accustomed to applying the entire fairness standard of review in a uniquely shareholder-centric way (*i.e.*, traditionally, courts give no consideration to the impact of a decision on stakeholders).[12] Let me explain:

Traditional Fair Process Analysis. The court focuses on the information gathered by the directors (did the directors gather information regarding how shareholders will be impacted?), and the negotiation process (did the directors zealously negotiate on behalf of the shareholders?).[13]

Traditional Fair Price Analysis. The court focuses on the price paid to shareholders.[14] In the context of decisions to merge, acquire or be acquired, the price must be the "highest transaction price the market will permit"[15] for the shareholders' stock.[16]

And thus, this Article arrives at this normative question: *How should Delaware courts*[17] *apply the entire fairness standard of review in the benefit*

JOHN LORT STOKES, 2 DISCOVERIES IN AUSTRALIA 163 (1846). As will become clear, applying the entire fairness standard of review to benefit corporations is terra incognita, but as the quote also suggests, it is territory that we can approach with delight.

12. It is true that some Delaware cases suggest in dicta that directors can take into account impact on stakeholders. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (suggesting that the business judgment rule allows directors to consider, among other factors, effect of takeover on "creditors, customers, employees, and perhaps even the community generally" when enacting defensive measures). However, considering other constituencies may only be done when there is also a related benefit accruing to the stockholders. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986); *see* Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH & LEE L. REV. 1409, 1411 (1993) (saying courts can consider the interests of other stakeholders only when they do not conflict with the interests of shareholders).

13. Weinberger v. UOP, 457 A.2d 701, 711 (Del. 1983).

14. *Id.* at 712.

15. William T. Allen, Jack B. Jacobs, & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 874-875 (2001).

16. Here, the use of the term "highest price" to define "fair price" may be somewhat controversial. However, it is consistent with Delaware case law. *See* Cinerama, Inc. v. Technicolor, 663 A.2d 1134, 1142 (Del. Ch. Oct. 6, 1994) (stating that the fair price was the "highest value reasonably available"); In re First Boston, Inc. S'holder Litig., No. 10338, 1990 Del. Ch. LEXIS 74, at *21 (Del. Ch. June 7, 1990) ("Nor is [it] sufficient to get a price that falls within a range of 'fair values' somehow defined, if the fiduciary (or another) would pay more."); *but see* Cede & Co. v. Technicolor, Inc., No. 7129, 2003 Del. Ch. LEXIS 146, at *6 (Del. Ch. Dec. 31, 2003) ("The value 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.").

17. While this Article focuses on Delaware courts, the lessons are readily transferable to any of the other thirty-five states that have adopted benefit corporations.

corporation context? Phrased differently: how should Delaware courts apply a shareholder-centric test in a stakeholder-centric world?

This Article takes a three-step approach to answering that question: Part I explains the difference between a traditional corporation and a benefit corporation (here, it is important to recognize that the overriding difference—*i.e.*, that benefit corporations are stakeholder-centric—necessarily requires that the entire fairness standard of review be applied differently). Part II explains how the entire fairness standard of review is applied to decisions to merge, acquire or be acquired at traditional corporations—distilling the essential elements of entire fairness analysis. Thereafter, Part III suggests how those elements can be applied to decisions to merge, acquire or be acquired at benefit corporations. Part IV discusses entire fairness in the context of operational decisions. This Article then concludes.

In short, the answer to the normative question posed is as follows:

Modified Fair Process Analysis. When conducting the fair process portion of the entire fairness test, the court should, in addition to confirming that the board of directors gathered information about the impact of the decision on shareholders, also confirm that the directors gathered information about the impact of the decision on stakeholders.[18] For example, in addition to commissioning a fairness opinion from an investment bank (focused on price paid to shareholders), did the directors also commission a report quantifying (in dollar terms if possible) the impact on stakeholders?

Modified Fair Price Analysis. When conducting the fair price portion of the entire fairness test, courts have traditionally focused on whether the directors achieved the highest price the market will permit for the shareholders' stock.[19] I suggest that, when benefit corporations are involved, the court should:

(1) confirm that the directors made adjustments to the price that reflect the fact that the entity is a benefit corporation;

(2) be open to new valuation methods that take into account social impact (as is necessary to achieve (1));[20] and

(3) where the process was robust, the court should take comfort in that fact, and be more deferential to the price arrived at by the parties.[21]

18. *See infra* Part III.C.
19. *See infra* Part III.D.1.
20. *See infra* Part III.D.2.
21. *See infra* Part III.D.3.

I. POSITIVE LAW MEETS STAKEHOLDER THEORY

For at least a century, legal scholars have debated whether positive law[22] should require corporate directors to maximize the return to shareholders (a shareholder-centric model), or instead focus on stakeholders more generally (a stakeholder-centric model).[23]

However, while scholars were busy debating, positive corporate law increasingly grew to embrace the shareholder-centric model.[24] Today, a short passage from the Supreme Court of Michigan's 1919 decision in *Dodge v. Ford* dominates any discussion about the role of corporate directors: "The powers of the directors are to be employed . . . primarily for the profit of the stockholders."[25] While the foregoing statement may be controversial in academic circles,[26] it is clearly reflected in the positive law of Delaware (with

---

22. Positive law is statute and case law. This Article focuses on Delaware positive law, because Delaware is where a majority of corporations are formed. Press Release, Jeffrey W. Bullock, Del. Sec'y of State, A Message from the Secretary of State, https://corp.delaware.gov/stats/ [https://perma.cc/LM2T-FTSL] (last visited Feb. 4, 2020) (stating that 67% of Fortune 500 companies are incorporated in Delaware).

23. In 2001, Hansmann and Kraakman wrote, "[o]ver the past decade, the literature on corporate governance and corporate law has sometimes advocated "stakeholder" models as a normatively attractive alternative to a strongly shareholder-oriented view of the corporation." Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 447 (2001). However, the roots of the debate go back much further than that, to the debate between Adolf Berle and Merick Dodd in the 1930s. *See* A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) ("[A]ll powers granted to a corporation or to the management of a corporation . . . are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears."); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees*? 45 HARV. L. REV. 1145, 1161 (1932) ("[T]he association, once it becomes a going concern, takes its place in a business world with certain ethical standards which appear to be developing in the direction of increased social responsibility.").

24. Kevin V. Tu, *Socially Conscious Corporations and Shareholder Profit*, 84 GEO. WASH. L. REV. 121, 172–73 (2016) ("[T]he dominant view of corporations may currently favor shareholder primacy and profit maximization."); Einer Elhauge, *Sacrificing Corporate Profits In The Public Interest*, 80 N.Y.U. L. REV. 733, 736–38 (2005) (describing the traditional view that directors must maximize corporate profits); Judd F. Sneirson, *The Sustainable Corporation and Shareholder Profits*, 46 WAKE FOREST L. REV. 541, 551–552 (2011) ("Corporate law . . . projects a shareholder-centric bent in describing the nature of corporate fiduciaries' legal obligations . . . the recurring message is that shareholders and their profits trump all other considerations.").

25. Dodge v. Ford Motor Co., 204 Mich. 459, 507 (1919).

26. Some prominent scholars object to any assertion that the purpose of the corporation is to maximize shareholder wealth. *See* LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC *passim* (2012); Elhauge, *supra* note 24, at 738 ("Corporate managers have never had an enforceable legal duty to maximize corporate profits."); *but see* Miriam F. Weismann, *The Missing*

the recent exception of Delaware's Benefit Corporation Legislation). William B. Chandler III, Chancellor of the Delaware Court of Chancery from 1997 to 2011, wrote in *Ebay Domestic Holdings, Inc. v. Newmark*, "[d]irectors of a for-profit Delaware corporation cannot . . . eschew[] stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law."[27] Leo E. Strine, Chief Justice of the Delaware Supreme Court from 2014 to 2019, wrote in his aptly titled article, *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, "the corporate law requires directors, as a matter of their [fiduciary duties], to pursue a good faith strategy to maximize profits for the stockholders."[28]

However, just because something "is" (positive law), does not mean it "should be" (normative law). At times, the development of positive law lags behind the broader views of society. In 2018, Larry Fink, CEO of Blackrock, wrote, "[s]ociety is demanding that companies . . . not only deliver financial performance, but also show how [they] make[] a positive contribution to society."[29]

And as mentioned in the introduction, in August 2019, the Business Roundtable in conjunction with 181 CEOs released *Statement on the Purpose of a Corporation*, affirming that a significant portion of large corporations are discarding the traditional shareholder-centric model and

---

Metrics of Sustainability: Just How Beneficial Are Benefit Corporations?, 42 DEL. J. CORP. L. 1, 5–6 ("For those scholars dedicated to a stakeholder agenda, the case law and other legal precedent pose no obstacle to arguing both in favor of a corporate duty to the "other constituencies" and for an outright rejection of shareholder primacy.").

27. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del. Ch. Sept. 9, 2010). The duty to maximize shareholder wealth is perhaps most obvious when a company is being sold. *See* Paramount Communications v. QVC Network, 637 A.2d 34, 44 (Del. 1994) ("In the sale of control context, the directors must focus on one primary objective—to secure the transaction offering the best value reasonably available for the stockholders—and they must exercise their fiduciary duties to further that end. The decisions of this Court have consistently emphasized this goal."); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("The duty of the board . . . [is] the maximization of the company's value at a sale for the stockholders' benefit.").

28. Leo E. Strine, Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155 (2012).

29. Larry Fink, *Larry Fink's 2018 Letter to CEOs: Purpose & Profit*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter [https://perma.cc/HU8H-C2FG] (last visited Feb. 14, 2020). Even the large law firm of Wachtell, Lipton, Rosen & Katz, which represents many super-sized corporations such as Ebay and TD Ameritrade agrees. *See* Martin Lipton, *It's Time to Adopt the New Paradigm*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 11, 2019), https://corpgov.law.harvard.edu/2019/02/11/its-time-to-adopt-the-new-paradigm/ [https://perma.cc/53WT-6MBE].

adopting in its place a stakeholder-centric model.[30]

In those situations where the development of the common law lags behind societal change (or where it has moved such a "considerable distance in one direction [that it] cannot retrace its steps"[31]), correction by legislation may be required.[32] And indeed, that is what has occurred. Concerned that the case law would not catch up with the growing societal acceptance of stakeholder theory, state legislatures began passing legislation authorizing benefit corporations (which mandates directors both produce profits for shareholders *and* benefit other stakeholders).[33] Further, presidential candidate Elizabeth Warren has proposed the ACA, which would require all large corporations to obtain a federal charter that would mandate both producing profits for shareholders, as well as benefiting other stakeholders.[34]

A. State Benefit Corporations

State benefit corporation legislation is a reaction to the requirement that directors of traditional corporations pursue profit maximization. Benefit corporations are designed for social entrepreneurs who have an idea for improving society that "is too much of a 'business' for the nonprofit form and too 'socially conscious' for the for-profit corporate model."[35] This is sometimes characterized by commentators as doing well (financially), while doing good (socially).[36]

---

30. *Statement on the Purpose*, *supra* note 1.

31. To stick with our one-way street metaphor, even if we could back up, the distance back to the crossroads, the point at which we took a wrong turn, if it was indeed a wrong turn, is a long one, and slow (a car can only go so far in reverse). The process of case law development is necessarily gradual. 1 FRIEDRICH A. HAYEK, LAW, LEGISLATION AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE 88 (1979); *see* William B. Chandler III and Leo E. Strine, Jr., *Views From The Bench: The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953, 988–989 (2003) (discussing that the common law is slow to evolve and sensitive to context).

32. *See* HAYEK, *supra* note 31, at 88 (discussing legislative correction of common law); *see also* M. Stuart Madden, *The Vital Common Law: Its Role in a Statutory Age*, 18 U. ARK. LITTLE ROCK L.J. 555, 569 (1996) ("[C]ommon law approaches may also be subject to statutory correction where there is neither public nor legislative consensus that the common law rule satisfies an instrumentalist objective—an objective either to encourage worthy conduct, or to deter harmful or wasteful conduct.").

33. MD. CODE ANN., CORPS. & ASS'NS § 5–6C–01(2017); DEL. CODE ANN. Tit. 8, §§ 361-368 (2018).

34. Accountable Capitalism Act, S. 3348, 115th Cong. § 5(c)(1) (2018).

35. Tu, *supra* note 24, at 158.

36. Adi Ignatious, *Profit and Purpose*, HARV. BUS. REV., Mar.–Apr. 2019, at 10; FREDERICK H. ALEXANDER, BENEFIT CORPORATION LAW AND GOVERNANCE:

The DBCL is no different.[37] It empowers businesses to do "well" and "good" by statutorily altering the purpose of the corporation, as well as statutorily altering the fiduciary duties owed by directors.[38]

1. Statutorily Altering the Corporate Purpose

The DBCL expressly alters the purpose of the corporation.[39] The statute provides that a "'public benefit corporation' is a for-profit corporation . . . that is intended to produce a public benefit[s] . . . and to operate in a responsible and sustainable manner."[40]

Thus, as expressed in the DBCL, the purpose of the benefit corporation is to promote a public benefit while also making a profit. The DBCL takes this one step further, requiring that each benefit corporation's certificate of incorporation expressly identify "one or more specific public benefits to be promoted by the corporation."[41] One of the most well-known benefit corporations, Patagonia, promises in its certificate of incorporation that it will provide these public benefits:

> (1) Each year, this corporation shall contribute one-percent (1%) of its annual net revenue to non-profit charitable organizations that promote environmental conservation and sustainability . . . .
>
> (2) . . . (b) designing and fabricating products . . . that are made from materials that can be reused or recycled, (c) . . . with minimum impacts throughout the supply-chain—including resource extraction, manufacturing and transportation—on water use, water quality, energy use, greenhouse gas emissions, chemical use, toxicity and waste.[42]

Patagonia pursues the first benefit purposes by donating millions of dollars to grassroots nonprofits that fight climate change, promote a future

PURSUING PROFIT WITH PURPOSE *passim* (2018); Brett H. McDonnell, *Committing to Doing Good and Doing Well: Fiduciary Duty in Benefit Corporations*, 20 FORDHAM J. CORP. & FIN. L. 19, *passim* (2014).

37. DEL. CODE ANN. tit. 8, §§ 361–368 (2020).

38. *Id.* § 362, 365.

39. *Id.* § 362.

40. *Id.* § 362(a).

41. *Id.* § 362(a)(1).

42. Restated Articles of Incorporation of Patagonia, Inc., filed with State of Del., Sec'y of State (Oct. 30, 2013), https://businesssearch.sos.ca.gov/Document/RetrievePDF?Id=00928053-17025484 [https://perma.cc/C9R3-N7GK].

in sustainable energy, and protect public lands.[43] It pursues the second by, among other things, using 51% recycled or renewable materials, and repairing over 100,000 garments every year to combat the throw away culture.[44]

2. Statutorily Altering Director Fiduciary Duties

If benefit corporations are tasked with pursuing profit and purpose, then it follows that director fiduciary duties must change—directors must do more than focus on maximizing return to shareholders. The DBCL makes that clear:

> (a) The board of directors shall manage or direct the business and affairs of the public benefit corporation in a manner that *balances* the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation.
>
> (b) A director of a public benefit corporation . . . with respect to a decision implicating the balance requirement in subsection (a) of this section, will be deemed to satisfy such director's fiduciary duties to stockholders and the corporation if such director's decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve.[45]

Subsection (a) mandates that directors balance the impact of their decision on stakeholders and shareholders.[46] For a director, it is not enough to be informed as to how her decision will financially impact shareholders (the requirement of the traditional fiduciary duty of care), she must also inform herself how the decision will impact those materially affected (*i.e.*, stakeholders) .[47]

---

43. PATAGONIA, INC., ANNUAL BENEFIT CORPORATION REPORT 4-5 (2018) [hereinafter PATAGONIA 2018 REPORT].

44. *Id.* at 6–9.

45. DEL. CODE ANN. tit. 8, § 365 (2020).

46. *Id.* § 365(a).

47. Some scholars characterize this as an expansion of fiduciary duties. *See* Rugger Burke and Samuel P. Bragg, *Sustainability in The Boardroom: Reconsidering Fiduciary Duty Under Revlon in the Wake of Public Benefit Corporation Legislation*, 8 VA. L. & BUS. REV. 59, 75–76 (2014) ("This expansion of fiduciary duties is at the heart of what it means to be a

However, confusion arises from the use of the word "balance". It is necessarily vague. The Oxford English Dictionary defines "balance" as "to estimate the two aspects or sides of anything; to ponder."[48] This is a procedure-based definition, and consistent with Subsection (b), which requires that the director "inform" herself.[49] (Interestingly, it is also consistent with the traditional Delaware view of the fiduciary duty of care, which is process—as opposed to outcome—oriented.)[50]

But does the statute require that the director do more than inform herself? The Oxford English Dictionary also defines "balance" as "[t]o bring to or keep in equilibrium."[51] This would seem to indicate that even the most informed decision could run afoul of the statutory mandate if it alters the equilibrium between shareholders and stakeholders.

Finally, the DBCL provides:

> A director of a public benefit corporation shall not, by virtue of the public benefit provisions or § 362(a) of this title, have any duty to any person on account of any interest of such person in the public benefit or public benefits identified in the certificate of incorporation or on account of any interest materially affected by the corporation's conduct.[52]

As a practical matter, this means that any failure to comply with section 362(a), the balancing requirement, violates a fiduciary duty of care owed not to the stakeholders, but instead, to the shareholders.[53] It is the shareholders that have standing to sue.[54] To illustrate: if a board of directors of Patagonia made a decision without considering the impact on its non-profit partners, only a shareholder could bring the lawsuit claiming that the directors violated their fiduciary duty of care.

---

benefit corporation.").

48. "balance, v." *OED Online*. Oxford University Press, December 2019. Web. (last visited Feb. 7, 2020).

49. DEL. CODE ANN. tit. 8, § 365(b)(2020).

50. *See infra* Part II (discussing that the duty of care is fulfilled by process, not outcome).

51. "balance, v." *OED Online*. Oxford University Press, December 2019. Web. (last visited Feb. 7, 2020).

52. DEL. CODE ANN. tit. 8, § 365(b)(2020).

53. The drafters of the legislation rejected the idea that fiduciary duties should run directly to stakeholders. For arguments in favor of such a dramatic shift, *see* Margaret M. Blair and Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 288-289 (1999) (advocating a system where fiduciary duties run to the "team" as a whole); John Gregory Scott Crespi, *Redefining the Fiduciary Duties of Corporate Directors in Accordance with the Team Production Model of Corporate Governance*, 36 CREIGHTON L. REV. 623, 627 (2003) ("[F]iduciary duties in favor of shareholders should be . . . respecified to run in favor of a larger class of stakeholders.").

54. DEL. CODE ANN. tit. 8, §§ 365(b), 367 (2020).

The structure of the law is a good compromise. On the one hand, shareholders—who presumably invested in the benefit corporation because they believed in its mission—are granted standing to enforce that mission.[55] On the other hand, stakeholders are not.[56] A rule otherwise would be too unwieldy. The Delaware courts would be inundated with derivative suits by employees, suppliers, the local community, or even the environment.

3. Limited Reach

Benefit corporations offer an option to those that want to pursue profit and purpose,[57] without imposing a new paradigm upon traditional corporations that are happily operating under the old rules. Benefit corporations are a new entrant into the marketplace—which consists of partnerships, LPs, LLPs, LLCs, corporations, and S-corporations—and benefit corporations will rise or fall based on their ability to compete.

The thirty-six states that encourage the creation of benefit corporations do so without risking the traditional corporate paradigm on which so much of the American economy rests. As Louis Brandeis famously expounded, "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[58]

Professor Kevin Tu, who has written extensively on benefit corporations, points out that there is very little change to traditional corporations as a result of the creation of benefit corporations.[59] To my mind, that is a good thing (along the lines of Brandeis' laboratory of democracy quote above).

However, Professor Tu raises two important, closely related points. First, by enacting benefit corporation legislation, he argues, states are reinforcing the idea that the traditional corporation exists to provide pecuniary gain to shareholders. He points out "the rhetoric surrounding Benefit Corporations may be overly simplified such that Benefit

55. *Id.* § 367.

56. *Id.*

57. Kyle Westaway & Dirk Sampselle, *The Benefit Corporation: An Economic Analysis With Recommendations to Courts, Boards, and Legislatures*, 62 EMORY L.J. 999, 1006 (2013) ("[T]he rise of the benefit corporation simply presents a much needed option for those who wish to incorporate values-based decision making into their business practices and procedures.").

58. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

59. Tu, *supra* note 24, at 127 ("In the absence of additional action, traditional for-profit corporations see little, if any, improvement from the addition of Benefit Corporations.").

Corporations are viewed as necessary because traditional for-profits prohibit the consideration of broader stakeholder interests and the pursuit of a public benefit. Accordingly, traditional for-profit corporations may be mistakenly relegated to the pursuit of shareholder profit alone."[60] The problem with that argument is, as Professor Tu hints, that the battle is already resolved in favor of the shareholder wealth-maximization norm.[61] (That is to say, to the extent that the benefit corporation adds fuel to the wealth-maximization fire, that fire was already blazing hot.)

Professor Tu's follow-on argument flows from the previous and is slightly more complicated. It consists of three assumptions followed by a conclusion:

- *if* before benefit corporations, directors at traditional corporations believed that their duty to maximize return for shareholders was an open question (i.e., the law was unsettled as to whether they could eschew shareholder wealth maximization); and
- *if* before benefit corporations, directors relied on said uncertainty as an opening to pursue philanthropy; and
- *if* benefit corporation legislation is an affirmative signal that at traditional corporations the fiduciary duty of directors is to maximize shareholder profit;
- *then*, following benefit corporation legislation, directors at traditional corporations may forego philanthropy to mitigate risk.[62]

I believe that there are simply too many "if" clauses to worry that the rise of benefit corporations will discourage traditional corporations from engaging in philanthropy. Second, as Professor Tu himself points out, benefit corporation statutes include language to eliminate or diminish the foregoing argument. The Model Benefit Corporation Law (MBCL) provides:

> The existence of a provision of this [*chapter*] shall not of itself create an implication that a contrary or different rule of law is applicable to a business corporation that is not a benefit corporation. This [*chapter*] shall not affect a statute or rule of law

60. Tu, *supra* note 24, at 173; *see* J. William Callison, *Benefit Corporations, Innovation, and Statutory Design*, 26 REGENT U.L. REV. 143, 153 (2013-2014) ("[Benefit corporation legislation] divid[es] corporations into two categories: benefit corporations that must act for 'general public benefit' and all other corporations that do not elect benefit corporation status and impliedly must act only in ways that relate to shareholder profit maximization.").

61. Tu, *supra* note 24, at 172–73.

62. Tu, *supra* note 24, at 174–75.

> that is applicable to a business corporation that is not a benefit corporation.[63]

As I have written elsewhere, traditional corporations are allowed to engage in philanthropy. Courts are not "concerned that some of [a corporation's] cash surplus [is] going to charity."[64] However, a court will intervene when a controlling shareholder, or the board of directors, "attempt[s] to *change the very purpose of the corporation* from benefiting investors to benefiting the public."[65]

B. Federal Benefit Corporations

Unlike the DBCL (or the MBCL), Elizabeth Warren's Accountable Capitalism Act (ACA) is mandatory.[66] That is, accountable corporation status is imposed on all large entities.[67] Large corporations must obtain a charter from the newly created Office of United States Corporations.[68] (For ease of discussion, this Article will distinguish between state and federal benefit corporations by referring to the latter as "accountable corporations".)

The rest of the ACA's structure[69] is modeled on state benefit corporation legislation (of which the DBCL is one example).[70] Like the DBCL, the ACA mandates that an accountable corporation "have the purpose of creating a general public benefit," defined as "a material positive impact on society resulting from [its] business and operations . . . when taken as a whole."[71]

---

63. MODEL BENEFIT CORP. LEGISLATION § 101(b) (2014). The DBCL provides a similar provision, "[t]his subchapter shall not affect a statute or rule of law that is applicable to a corporation that is not a public benefit corporation." DEL. CODE ANN. tit. 8, § 368 (2020).

64. Brent J. Horton, *Rising to Their Full Potential: How a Uniform Disclosure Regime Will Empower Benefit Corporations*, 9 HARV. BUS. L. REV. 101, 116 (2019).

65. *Id.*

66. Accountable Capitalism Act, S. 3348, 115th Cong. § 4 (2018).

67. The ACA defines a large entity as any corporation or LLC that engages in interstate commerce with greater than $1 billion gross receipts per year. Accountable Capitalism Act, S. 3348, 115th Cong. § 2(2)(A) (2018).

68. Accountable Capitalism Act, S. 3348, 115th Cong. § 3 (2018).

69. I am not including in this discussion provisions of the ACA that are not included in state benefit corporation legislation. If those provisions are included, one could argue that the ACA goes much farther than state benefit corporation legislation. For example, the ACA requires employees to be represented on the board of directors, limits executive compensation, and limits political spending by corporations. *ACA One-Pager*, *supra* note 8. These matters are beyond the scope of this Article.

70. *ACA One-Pager, supra* note 8 (explaining that the ACA is modeled on state benefit corporation legislation).

71. Accountable Capitalism Act, S. 3348, 115th Cong. § 5(b)(2), § 5(a)(1) (2018).

Like the DBCL, the ACA requires directors to balance the interests of shareholders and stakeholders.[72] Directors will be required to "balance[] the pecuniary interests of the shareholders . . . with the best interests of persons that are materially affected by the conduct of the United States corporation."[73]

Indeed, Senator Warren explains that the ACA's "approach is derived from the thriving benefit corporation model that 33 [now 36] states and the District of Columbia have adopted and that companies like Patagonia, Danone North America, and Kickstarter have embraced with strong results."[74] In short, the approach to entire fairness review advocated in this Article applies equally well to Benefit Corporations and Accountable Corporations.

II. ENTIRE FAIRNESS APPLIED TO TRADITIONAL CORPORATIONS

This Part starts with the basics of fiduciary duties and the business judgment rule. It then moves on to discussing the entire fairness standard of review—distilling the essential elements. Part III will then explain how those elements can be applied in the benefit corporation context.

A. Fiduciary Duty Basics

In Delaware, director fiduciary duties are divided into the duty of loyalty and the duty of care.[75] The duty of loyalty requires, by way of example, that directors not misappropriate corporate opportunities[76] or compete with the corporation.[77] It requires no further elucidation here.

The duty of care requires directors to make decisions "us[ing] that amount of care which ordinarily careful and prudent men would use in

---

72. *Id.* § 5(c)(1).

73. *Id.*

74. *ACA One-Pager, supra* note 8.

75. In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 745 (Del. Ch. 2005), *aff'd*, Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.), 906 A.2d 27, 40 (Del. 2006).

76. Guth v. Loft, Inc., 5 A.2d 503, 511 (Del. 1939) ("[I]f there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself.").

77. Thorpe by Castleman v. CERBCO, 676 A.2d 436, 442 (Del. 1996) ("[It is a] fundamental proposition of the [fiduciary duty of loyalty] that directors may not compete with the corporation.").

similar circumstances."[78] While the use of the word "care" sounds like a standard against which the *substance* of the directors' decision can be measured (i.e., is it in line with what a reasonable director would decide?); it is not.[79] The use of the word "care" is with regard to the *process* the directors employed to make the decision.[80] Generally speaking, a careful process is one that is informed[81] and not rushed.[82]

B. The Business Judgment Rule

Adding a layer of complexity to the foregoing—at least the portion regarding the fiduciary duty of care[83]—is the business judgment rule.

---

78. *Walt Disney*, 907 A.2d at 749.

79. Some states' courts examine whether the substance of the decision itself is "grossly negligent." Delaware courts do not. The court explained in *Brehm v. Eisner* that Delaware courts do not care about the substance of the decision itself, but instead about the process by which the decision is reached. 746 A.2d 244, 264 (Del. 2000). The most important part of that process is the board informing itself. *Id.* The court stated:

> As for the plaintiffs' contention that the directors failed to exercise "substantive due care," we should note that such a concept is foreign to the business judgment rule. [Delaware] courts do not measure, weigh or quantify directors' judgments. We do not even decide if they are reasonable in this context. Due care in the decision-making context is process due care only.

Id.

80. Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 425 (2013) (discussing that the standard of care requires that the board follow a procedure).

81. Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985) (stating that there is a breach of duty of care where directors are not informed). It should be noted that the process of becoming informed is more than a "check-the-box" exercise. "[T]he duty of care . . . requires more than passive acceptance of information presented to the board; instead, directors must proceed with a "critical eye" in assessing information in order to protect the interests of the corporation and its stockholders." William M. Lafferty, Lisa A. Schmidt & Donald J. Wolfe, Jr., *A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law*, 116 PENN. ST. L. REV. 837, 842 (2012); *but see* Stephen J. Lubben & Alana J. Darnell, *Delaware's Duty of Care,* 31 DEL. J. CORP. L. 589, 591 (2006) ("[It] requires little more of a director than a ritualistic consideration of relevant data. [And that] after the director engages in this ritual, her decision will not violate the duty. In short, the classic duty of care no longer exists in Delaware.").

82. *Van Gorkom*, 488 A.2d at 869 (finding a breach of duty of care where board made decision to merge in under two hours).

83.

> In Delaware, the two standards have been joined by innovations that are—or, at least, originally were—fairly unorthodox. All claims of breach of fiduciary duty initially are protected by the presumption of the business judgment rule. If a plaintiff can establish a breach of fiduciary duty, whether the duty of loyalty or the duty of care, then the entire fairness test is invoked.

The business judgment rule "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."[84] (Thus, as will be discussed below, the first way to overcome the business judgment presumption is to show that the board of directors was not informed.[85])

Where a plaintiff claims that a board of directors violated their fiduciary duty of care, the business judgment rule makes it very difficult to prevail.[86] (That is why it is essential for a plaintiff to allege facts that overcome the business judgment rule, and trigger entire fairness review, as discussed below.) Illustrating the foregoing point is *Brehm v. Eisner*.[87] In *Brehm*, the plaintiff challenged the Disney board of director's decision to pay luxurious compensation in cash and stock options to a new president, Michael Ovitz.[88] The board did so despite Ovitz questionable qualifications and value to Disney.[89] What was worse, the employment agreement provided for a golden parachute that actually incentivized Ovitz to leave, because he could make more money leaving—assuming he did so on a no fault basis—than if he fulfilled his contract.[90]

The court in *Brehm* stated that the board of directors decision was "very troubling case on the merits" and that "the compensation and termination payout for Ovitz were exceedingly lucrative, if not luxurious, compared to Ovitz' value to the Company."[91] Yet, the court refused to hold the directors liable for violating the fiduciary duty of care. It held that the business judgment rule prohibited it from "measure[ing], weigh[ing] or quantify[ing] directors' judgments."[92] This echoed the statement by the court of Chancery in the proceedings below:

[The fact that a judge] believes a decision substantively wrong, or

---

Julian Velasco, *Structural Bias and the Need for Substantive Review*, 82 WASH. U. L. Q. 821, 823 (citing Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994)).

84. *Van Gorkom*, 488 A.2d at 872.

85. *See infra* Part II.C.

86. The practical effect of the business judgment rule is that courts will abstain from second guessing management decisions. In *Business Judgment Rule as Abstention Doctrine*, Professor Bainbridge explains that the business judgment rule is "a doctrine of abstention pursuant to which courts . . . refrain from reviewing board decisions." Stephen M. Bainbridge, *Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87 (2004).

87. Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

88. *Brehm*, 746 A.2d at 249.

89. *Id.*

90. *Id.* at 251.

91. *Id.* at 249.

92. *Id.* at 264.

> degrees of wrong extending through "stupid" to "egregious" or "irrational", provides no ground for director liability. . . . To employ a different rule — one that permitted an "objective" evaluation of the decision — would expose directors to substantive second guessing by ill-equipped judges or juries, which would, in the long-run, be injurious to investor interests.[93]

Certainly, *Brehm* illustrates how the business judgment rule can in certain circumstances lead to a bad result.[94] However, the court should be applauded for resisting the temptation to let bad facts lead to bad law.

Indeed, there are sound policy reasons for not second-guessing business decisions made by a board of directors. The first two are (1) encouraging persons to serve as directors,[95] and (2) encouraging risk taking by directors.[96] These recognize that it is good policy to protect directors from personal liability for good faith business decisions (even though, with the benefit of hindsight, they are now viewed as bad decisions). Holding directors liable for good faith business decisions discourages them from agreeing to serve as directors, or if they do agree to serve, renders them much too cautious in their decision making.[97]

Further policy considerations weighing in favor of the business judgment rule include: (3) judges are not business experts and thus not in a position to challenge the substantive decision of directors (but judges, as

93. In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 697 (Del. Ch. 2005) (citing *Caremark,* 698 A.2d at 967).

94. Nor is business judgment deference limited to operational decisions. It applies to decisions to merge, acquire or be acquired as well. The court in *Paramount Communications, Inc. v. Time, Inc.*, reviewed Time board's original decision to enter into a merger agreement with Warner Brothers using the business judgment standard. 571 A.2d 1140, 1151-52 (Del. 1989); *see* Mary Siegel, *The Illusion of Enhanced Review of Board Actions*, 15 U. PA. J. BUS. L. 599, 606 (2013) (discussing the application of business judgment standard in *Paramount v. Time*). Fourteen years later, the case of *Omnicare, Inc. v. NCS Healthcare, Inc*., involved a challenge to the merger of NCS and Genesis Health Ventures, Inc. 818 A.2d 914, 931 (Del. 2003). Again, the court refused to second guess the decision of the NCS board, citing with approval its earlier decision, stating, "in *Paramount v. Time*, we held that the business judgment rule applied to the Time board's original decision to merge with Warner." *Omnicare*, 818 A.2d. at 931; *see* Lawrence A. Hamermesh, *Doctrines and Markets: Premiums in Stock-For-Stock Mergers and Some Consequences in the Law of Director Fiduciary Duties*, 152 U. PA. L. REV. 881, 903 (2003) ("In *Omnicare*, the court determined that deal protection measures triggered enhanced scrutiny, despite its assumption that the business judgment rule applied to the directors' decision to approve the merger itself.").

95. Todd M. Aman, *Cost-Benefit Analysis of the Business Judgment Rule: A Critique in Light of the Financial Meltdown*, 74 ALB. L. REV. 1, 12 (2010/2011).

96. Bainbridge, *supra* note 86, at 110.

97. Aman, *supra* note 95, at 12; Bainbridge, *supra* note 86, at 110.

lawyers, are in a good position to review process),[98] and (4) judicial economy, that is, "the business judgment rule . . . foster[s] both business and judicial economy by not allowing every corporate transaction to be subject to judicial review at the request of a disagreeing stockholder."[99] The third and fourth recognize the limitations of judges, both in terms of expertise and time.

C. Overcoming the Business Judgment Rule

The business judgment rule is a presumption. As has been hinted at above, that presumption can be overcome in two ways:

- *One element of the presumption is proved false.* A shareholder plaintiff can show that one of the elements of the business judgment presumption is false, *i.e.*, that the board was informed (it really wasn't),[100] or that the board acted in good faith (it really didn't).[101]
- *It is really a duty of loyalty issue.*[102] A shareholder plaintiff can show that the facts implicate the fiduciary duty of loyalty, either because (a) there was a controlling shareholder with an interest in the transaction,[103] or (b) a majority of the board has a personal interest in the transaction.[104]

The above exceptions to the business judgment rule share one thing in common—each is an example of a situation where the board cannot be said

---

98. After all, it is those directors that are tasked by the shareholders with running the corporation. *See* DEL. CODE ANN. tit. 8, § 141 (2020) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors.").

99. S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 95 (1979).

100. *See* Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985) (finding the board uninformed).

101. *See* Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 174 (Del. Ch. Dec. 8, 2005) (stating that business judgment does not protect a decision made in bad faith).

102. "The category of transactions that require judicial review pursuant to the entire fairness standard *ab initio* do so because, by definition, the inherently interested nature of those transactions are inextricably intertwined with issues of loyalty." Emerald Partners v. Berlin, 787 A.2d 85, 93 (Del. 2001) (citing Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994).

103. As was the case in Weinberger v. UOP, 457 A.2d 701, 704 (Del. 1983).

104. In re Trados Inc. S'holder Litig., 73 A.3d 17, 20 (Del. Ch. 2013) (finding no controlling shareholder, but board interested in the transaction); In re PNB Holding Co. S'holders Litig., C.A. No. 28-N, 2006 Del. Ch. LEXIS 158, at *40 (Del. Ch. Aug. 18, 2006) (applying entire fairness where board conflicted by self-interest).

to be properly functioning, and as such, its decision is likely flawed. In such case, the decision is not entitled to deference from the court.

In the first case—where the board was not informed—then it is arguable that a business decision was never made in the first place. Consider that a business decision has three steps: (1) the intelligence step—finding conditions calling for a decision; (2) the design step—inventing, developing, and analyzing possible courses of action; and (3) the choice step—selecting a course of action.[105] Each of those three steps are information dependent; without information, the steps cannot be followed.

As to the second case—where there is a controlling shareholder—the board members may fear retaliation if they do not approve the transaction (especially where some of them may be employed by the controller). Shareholders too may feel pressure.[106] "[S]hareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder. For example, the controlling stockholder might decide to stop dividend payments or to effect a subsequent cash out merger at a less favorable price."[107]

In either case, deference to the board of directors is not justified. The court can never be confident that the price agreed to by the board was truly the highest price that the market would bear.[108]

If the plaintiff shareholder is successful in overcoming the business judgment presumption, the court will be required to review the challenged decision using the entire fairness standard.[109]

D. Entire Fairness Basics

When the entire fairness standard applies, the court will not defer to the decision of the board of directors.[110] The posture of the court shifts from deferential to searching.[111] It scrutinizes (1) the process the board used to

105. Earnest R. Archer, *How to Make a Business Decision: An Analysis of Theory and Practice*, 69 MGMT. REV. 54, 55 (1980) (explaining the work of Nobel Laureate Herbert A. Simon).

106. Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110, 1116-17 (Del. 1994) (quoting Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (1990)).

107. *Id.*

108. *Id.*

109. For an excellent analysis of when entire fairness is triggered, Robert B. Little & Joseph A. Orien, *Determining the Likely Standard of Review in Delaware M&A Transactions*, HARV. L. SCH. FORUM ON CORP. GOV. & FIN. REG., Apr. 28, 2017, https://corpgov.law.harvard.edu/2017/04/28/determining-the-likely-standard-of-review-in-delaware-ma-transactions-2/ [https://perma.cc/ST7B-BFCG].

110. Weinberger v. UOP, 457 A.2d 701, 710–11 (Del. 1983).

111. *Id.*

reach its decision (was it aimed at achieving a fair price for shareholders?), and (2) the substance of the decision itself (was a fair price achieved?).[112]

More specifically, as to process, the court will examine the timing of the decision (was the decision was rushed?), the information available to the directors, and the negotiation process.[113] As to substance, the court will focus on the price obtained.[114] In the merger and acquisitions context, the court will ask whether the board of directors obtained the highest price the market will permit for the shareholders' stock.[115]

Finally, while the test has two parts, it is not bifurcated.[116] Both aspects must be examined as a whole (consider: a fair process leads to, and makes more likely, a fair price).[117] Be that as it may, courts "recognize that price may be the preponderant consideration outweighing other features of the merger."[118]

E. Applying Entire Fairness to Decisions to Merge, Acquire or Be Acquired at Traditional Corporations

Below, this Article will examine several important Delaware decisions applying entire fairness to board decisions to merge, acquire or be acquired. These include: *Weinberger v. UOP,* which explains why entire fairness (as opposed to business judgment) must be used to review transactions involving a controlling shareholder;[119] *Kahn v. Lynch*, which expands on *Weinberger* by discussing burden of proof issues when entire fairness is applied to transactions involving a controlling shareholder;[120] *Kahn v M&F Worldwide*, which provides a process to avoid *Weinberger* entire fairness review (called the *MFW* framework);[121] and *In Re Trados*, which illustrates the important

112. *Id.* at 710–15.
113. *Id.* at 711.
114. *Id.* at 712.
115. Allen, Jacobs & Strine, *supra* note 15, at 874–75.
116. *Weinberger*, 457 A.2d at 711.
117. *Id.*; Monroe County Emp. Retire. Sys. v. Carlson, No. 4587-CC, 2010 Del. Ch. LEXIS 132, at *6 (Del. Ch. June 7, 2010) ("Quite frankly, Delaware law focuses on fair dealing in controlling shareholder transactions primarily because a fair price is more likely to follow fair dealing. Fair price, however, is often the paramount consideration."); Valeant Pharms. Int'l v. Jerney, 921 A.2d 732, 748 (Del. Ch. 2007) ("The court's finding that [defendants] used an unfair process to authorize the bonuses does not end the court's inquiry because it is possible that the pricing terms were so fair as to render the transaction entirely fair.").
118. *Weinberger*, 457 A.2d at 711.
119. *Id.*
120. Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994).
121. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. Mar. 14, 2014).

point that entire fairness is not limited to transactions involving a controlling shareholder.[122]

1. The Starting Point—*Weinberger v. UOP*

Weinberger v. UOP, Inc. involved a cash out merger of UOP, Inc. into Signal Companies, Inc.[123] The story began in 1975 when Signal become the majority owner of UOP, acquiring 50.5% of its shares at $21 per share (this represented a substantial premium over UOP's trading price of $14 per share).[124]

Signal became interested in buying the remainder of UOP's shares in 1978.[125] Signal tasked two of its directors, Arledge and Chitea, with preparing a feasibility study regarding purchasing all remaining shares of UOP.[126] Arledge and Chitea were perfect for the task because they were also directors of UOP—having been placed there by Signal—and thus had access to UOP's financial information.[127] They concluded that a purchase price of up to $24 per share would be a "good investment."[128]

Signal kept the existence of the feasibility study secret from UOP.[129] On February 28, 1978, Signal approached UOP's President, James Crawford, about the possibility of the merger at $20 to $21 per share.[130] Crawford responded that he was supportive of the idea (while $21 per share was below the "good" purchase price of up to $24 per share, all that Crawford knew was that it represented a substantial premium over the market price).[131] Crawford did not suggest that Signal should pay more for UOP.[132]

At that point, at the insistence of Signal, Crawford began to move very quickly.[133] Over the next four business days, Crawford was able to (1) ascertain that UOP's board was interested in the merger,[134] and (2) obtain a rushed fairness opinion from Lehman Brothers (the fairness opinion concluded that $21 was a fair price).[135]

122. In re Trados Inc. S'holder Litig., 73 A.3d 17, 21 (Del. Ch. 2013).
123. *Weinberger*, 457 A.2d at 703.
124. *Id.* at 704.
125. *Id.* at 705.
126. *Id.*
127. *Id.*
128. *Id.* at 705, 707.
129. *Id.* at 707.
130. *Id.* at 705.
131. *Id.*
132. *Id.*
133. *Id.* at 706.
134. *Id.*
135. *Id.* at 707.

On March 6, Signal's board met, having heard from Crawford that UOP's board was interested.[136] At that point, Signal's board voted to authorize an offer of $21 per share.[137]

That same day, UOP's board met.[138] UOP's board considered the offer of $21 per share.[139] They measured the offer against the company's financial data for the past three years, market price information, budget projections, as well as the hastily prepared Lehman Brothers fairness opinion.[140] They did not have—indeed, did not know it existed—the feasibility study prepared by Arledge and Chitea opining that $24 per share was a "good" price.[141]

Further, Arledge and Chitea (who were also Signal directors) participated in the deliberations without disclosing the existence of the report.[142] The UOP board adopted the proposal with Arledge, Chitea and two other signal-affiliated board members abstaining.[143] While the Delaware Supreme Court decision is ambiguous on the matter, the decision of the Chancery Court makes clear that all the non-Signal directors voted in favor of the merger (and that all conflicted directors would have voted in favor, had they not abstained).[144]

Interestingly, the shareholders would not vote until May 26, 1978.[145] (This calls into question why the Signal board decision and the Lehman Brothers fairness opinion needed to be rushed.) When the shareholders did vote, 51.9% of the minority voted for the merger, 4.5% voted against, and the remainder did not vote.[146]

---

136. *Id.*

137. *Id.* The offer also required that it be approved by a majority of the minority of UOP's shareholders.

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.* There is actually some disagreement here, but the court ultimately found they did not have access to the feasibility study:

> Signal also suggests that the Arledge-Chitiea feasibility study, indicating that a price of up to $24 per share would be a "good investment" for Signal, was discussed at the UOP directors' meeting. The Chancellor made no such finding, and our independent review of the record . . . satisfies us by a preponderance of the evidence that there was no discussion of this document at UOP's board meeting.

Id.

142. *Id.*

143. *Id.*

144. Weinberger v. UOP, Inc., 426 A.2d 1333, 1340 (Del. Ch. 1981).

145. *Weinberger*, 457 A.2d at 708.

146. *Id.*

Thus, the merger was approved.[147] Each minority share was converted to a right to receive $21 cash.[148] This was immediately challenged by several minority shareholders who believed $21 was less than a fair price for their shares.[149]

a. The Decision to Apply Entire Fairness

A court will use entire fairness review if (a) there is an interested shareholder controlling the board,[150] or (b) the board is itself interested in the transaction.[151]

Here, the argument that entire fairness should apply was fairly strong, as both grounds were met: UOP was a controlling shareholder of Signal, with 50.5% of the shares; further, five UOP employees served on the Signal Board of Directors.[152] While the first point was certainly not lost on the court (and by itself would be sufficient to require entire fairness review), the court focused on the second point:

> Signal cannot escape the effects of the conflicts it faced, particularly when its designees on UOP's board did not totally abstain from participation in the matter. There is no "safe harbor" for such divided loyalties in Delaware. When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness. . . .[153]

The court went on to state that "[entire] fairness has two basic aspects: fair dealing and fair price," and discussed each in turn.[154]

b. Fair Dealing

Turning to fair dealing, the court emphasized candor.[155] The court was especially bothered by the fact that Signal hid from UOP the feasibility study

147. *Id.*
148. *Id.*
149. *Id.* at 714–15.
150. *Id.*
151. In re Trados Inc. S'holder Litig., 73 A.3d 17, 20 (Del. Ch. 2013).
152. *Weinberger*, 457 A.2d at 710–11.
153. *Id.* at 710 (citation omitted).
154. *Id.* at 711.
155. *Id.*

prepared by Arledge and Chitea.[156] This prevented the UOP board from being able to deliberate with all information.[157] It also tainted the approval of the UOP shareholders.[158]

Second, Crawford made no effort to negotiate the price higher.[159] He simply accepted that $21 was fair.[160]

Third, the court was bothered by the fact that Signal rushed UOP to approve the merger in just four business days, including preparation of the fairness opinion by Lehman Brothers (and for that reason, the fairness opinion was largely disregarded by the court).[161] This is exacerbated by the fact that there was no business purpose for the rush.[162] In fact, the UOP board approved the merger on March 6, but the shareholders did not vote until May 26, over two months later.[163]

c. Fair Price

Here, much of the court's decision was focused on whether fair price must be shown by the "Delaware block" or weighted average method.[164] The Chancellor below had used the fact that plaintiff did not use the Delaware block method to reject their argument that the fair price was $26 per share.[165] Instead, the Plaintiff's expert had used a comparative analysis (to the price achieved in ten other tender offer-merger combinations) as well as a discounted cash flow analysis.[166]

The court found that it was improper for the Chancery Court to reject Plaintiff's valuation, holding: "We believe that a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community . . . ."[167] Certainly, the discounted cash flow analysis used by the Plaintiff's expert fits within the

156. *Id.* at 712.
157. *Id.*
158. *Id.*
159. *Id.* at 711.
160. *Id.*
161. *Id.* at 712.
162. *Id.*
163. *Id.* at 708.
164. *Id.* at 712. The Delaware Block Method "involves separate calculations of market value, earnings value and asset value, then multiplication of each valuation by weights chosen by the appraiser to reach a final fair value." Joel Seligman, *Reappraising the Appraisal Remedy*, 52 GEO. WASH. L. REV. 829, 842 (1984).
165. *Weinberger*, 457 A.2d at 712.
166. *Id.*
167. *Id.* at 713.

definition of generally accepted techniques and methods.[168]

The court did not suggest a monetary result, but directed that on remand, the court of Chancery should consider the Plaintiff's valuation.[169] As such, the case was remanded to the Chancery Court below for a determination of fair price.[170]

d. On Remand

Interestingly, while the Chancery Court recognized that the Supreme Court of Delaware directed it to consider the valuation that had been provided by the Plaintiff's expert, it stated that it had already done so ("actually, I thought that I had made it clear that I had considered it before and rejected it as being unpersuasive on its merits").[171] It further stated that:

> Having reconsidered the plaintiff's evidence, I find that my reaction to it now is no different than it was earlier. If anything, I feel that my earlier decision to reject the plaintiff's discounted cash flow analysis as a method for placing a value on a share of UOP stock has been solidified. . . .[172]

Nevertheless, the Chancery Court did state that it was proper to compensate the minority shareholders in some way for the wrong perpetrated against them.[173] It decided that "$1 per share represents a fair measure of compensation for the wrong done to the members of the minority."[174] It used the testimony of the Defendant's expert to do so:

> [Defendant's expert] indicated that based upon information available as of the time of the merger he could have issued an opinion . . . that a price within the range of $20 - $22 would have been fair to the UOP minority. He further acknowledged that if a date 30 days prior to the announcement of the transaction was used as the date to measure the premium in his list of comparable transactions, the median and average premium reflected by such comparables would be in the vicinity of 50% or more. A 50%-plus premium applied against the market price of the UOP shares on the day prior to the announcement of the proposed merger would indicate that a price of $22 per share would not have been

168. *Id.* at 714.
169. *Id.*
170. *Id.* at 715.
171. Weinberger v. UOP, Inc., No. 5642, 1985 Del. Ch. LEXIS 378, at *19–20 (Del. Ch. Jan. 30, 1985).
172. *Id.* at *20–21.
173. *Id.* at *30.
174. *Id.* at *29–30.

> out of line for the acquisition of the 49.5% minority interest of UOP.[175]

The plaintiffs again appealed the decision of the Chancery Court. This time the Supreme Court of Delaware affirmed.[176]

2. Shifting the Burden—*Kahn v. Lynch*

Another controlling shareholder case is *Kahn v. Lynch Communication Systems.*[177] Lynch manufactured telecommunications equipment.[178] In 1986, Lynch was acquired in a tender offer and cash out merger by its largest shareholder, Alcatel U.S.A. Corporation.[179] A cashed out shareholder brought an action claiming that the price paid—$15.50—was too low.

Despite the fact that Alcatel only held 43.3% of Lynch, the court found that Alcatel was a controlling shareholder, and reviewed the transaction using the entire fairness standard.[180]

Importantly, the court stated that rather than placing the burden on Alcatel to prove entire fairness, if there was a properly functioning special committee, the burden would shift to the plaintiff to show that the transaction was not entirely fair.[181] More precisely, the court held that:

> [I]n "entire fairness" cases, the defendants may shift the burden of persuasion to the plaintiff if either (1) they show that the transaction was approved by a well-functioning committee of independent directors; *or* (2) they show that the transaction was approved by an informed vote of a majority of the minority stockholders.[182]

---

175. *Id.* at *29–30.

176. Weinberger v. UOP, Inc., 497 A.2d 792 (Del. 1985).

177. Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110–11 (Del. Apr. 5, 1994).

178. *Id.* at 1112.

179. *Id.* at 1112–13. Alcatel had purchased 30.6% of Lynch in 1981 and increased its holding to 43.3% in 1986. *Id.* at 1112.

180. The court rejected Alcatel's argument that the decision of the board should be reviewed under the more deferential business judgment rule, because it was only a 43.3% shareholder. *Id.* at 1112–15. The court focused on agreements that gave Alcatel veto power over whether Lynch could be sold. *Id.* at 1114. These agreements, the court reasoned, meant that Alcatel exercised de facto control over Lynch's business affairs, specifically in the area at issue, mergers and acquisitions. *Id.* at 1115. In fact, Alcatel had a history of using its position of dominance to prevent Lynch from making acquisitions that would be good for Lynch, but bad for Alcatel. *Id.* at 1118. Prior to the transaction in question, Alcatel had blocked Lynch from purchasing Telco Systems, Inc. (because Telco was a competitor of Celwave Systems, Inc., an affiliate of Alcatel). *Id.* at 1112–13.

181. *Id.* at 1117.

182. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 642 (Del. Mar. 14, 2014) (citing

Alcatel argued that the burden should shift to the plaintiff, because of the use of a special committee.[183] However, the court held that for the burden to properly shift, the special committee must be independent with the power to say no.[184] Here, the special committee lacked the power to say no.[185] Alcatel coerced the special committee into accepting an offer of $15.50 using threats.[186] Alcatel told the special committee that if it did not approve the deal it would commence a hostile takeover at a lower price.[187] The court likened the situation to a prior case, *American General,* where the special committee was issued an ultimatum—accept or we (the majority shareholder) will proceed without your input.[188]

As such, the Supreme Court of Delaware remanded to the Court of Chancery—which had improperly placed the burden on the Plaintiff, Kahn—to take a fresh look at the issue of entire fairness, this time with the burden on Defendant, Alcatel.[189]

Upon remand, the Court of Chancery stated, "I am satisfied that the Supreme Court did not intend to foreclose a finding of entire fairness after remand," despite the fact that it had found "the independent committee had been coerced into accepting Alcatel's final offer by the 'explicit threat that Alcatel was "ready to proceed with a hostile bid."'"[190] Indeed, upon remand, despite coercion (and the burden being on Defendant, Alcatel), the Court of Chancery held that the transaction was entirely fair based upon (1) other aspects of the procedure employed mitigated the fact the special committee was coerced, and (2) the ultimate price paid was fair.[191]

One factor considered in determining fair dealing is how the approval of the directors was obtained.[192] This factor weighed in favor of plaintiffs, given the coercion already discussed. However, the court found—unpersuasively in my opinion—that the other factors weighed in favor of

Lynch, 638 A.2d at 1117).

183. *Lynch*, 638 A.2d at 1115.

184. *Id.* at 1119–20.

185. *Id.* at 1120.

186. *Id.* The court also noted that in prior dealings between the independent committee and Alcatel, "the non-Alcatel [independent] directors deferred to Alcatel because of its position as a significant stockholder and not because they decided in the exercise of their own business judgment that Alcatel's position was correct." *Id.* at 1115.

187. *Id.* at 1119–20.

188. *Id.* at 1120 (quoting American Gen. Corp. v. Texas Air Corp., No. 8390, 1987 Del. Ch. LEXIS 382, at *12 (Del. Ch. Feb. 5, 1987)).

189. *Id.* at 1121–22.

190. Kahn v. Lynch Comm. Sys., No. 8748, 1995 Del. Ch. LEXIS 44, at *2 (Del. Ch. Apr. 17, 1995) (quoting Kahn v. Lynch Commc'n Sys., 638 A.2d 1110, 1121 (Del. Supr. 1994)).

191. *Id.* at *4–6.

192. *Id.* at *4.

defendant.[193] These other factors, set out in *Weinberger*, include how the deal was initiated, structured, negotiated, and disclosed.[194] For example, as to how the deal was initiated, the court found that the merger was in response to Lynch's need for a partner with fiber optic technology (but ignores the fact that it was Alcatel that prevented Lynch from obtaining that technology in the past).[195]

Turning to price, the Court of Chancery likewise found that it was fair.[196] It credited defendant's expert more than the plaintiff's.[197] The defendant's expert had used a comparable sale premium to determine that a price of $15.50-16.00 was fair.[198] It stated of the former, "defendants' expert, explained the valuation analysis . . . and the basis for his conclusion that $15.50 was more than a fair price. I find [his] testimony persuasive."[199] As to the plaintiffs' expert, the court summarily dismissed it as flawed.[200]

On the second appeal, the Supreme Court of Delaware affirmed dismissal of the Plaintiffs' action.[201]

3. Avoiding Entire Fairness Altogether—*Kahn v. M&F Worldwide*

In cases involving controlling shareholders, there are times when the process is so fair—*i.e.*, the transaction is preconditioned on the approval of a properly functioning special committee *and* a majority of the minority shareholder vote—that the court will return to applying the business judgment rule.[202] This is referred to as the *MFW* framework, in reference to the target company, MFW, in *Kahn v. M&F Worldwide Corp*.[203] That case

193. *Id.* at *4–5.
194. *Id.* at *3–4 (quoting Weinberger v. UOP, Inc., 457 A.2d 701, 711 (1983)).
195. *Id.* at *4.
196. *Id.* at *5.
197. *Id.* at *5–6.
198. Kahn v. Lynch Commc'n Sys., No. 8748, 1993 Del. Ch. LEXIS 151, at *19 (Del. Ch. July 9, 1993) ("[U]sing the closing market price of $ 11.00 per share on October 17, 1986, and adding a merger premium of 41-46%.").
199. *Lynch*, 1995 Del. Ch. LEXIS 44, at *6.
200. *Id.* at *5. The original decision stated that plaintiff's expert testified that the fair price for Lynch was $18.25, arrived at by "averaging market price, book value, earning power and capitalization." *Lynch*, 1993 Del. Ch. LEXIS 151, at *13-14. The court was concerned that the average of the first three led to a valuation of $14.80, which was—unfortunately for plaintiffs—below the eventually agreed upon price of $15.50 per share. *Id.* It was only after the plaintiff's expert included capitalization—using a capitalization ratio that the court found unpersuasive—that the valuation miraculously jumped to $18.25. *Id.*
201. Kahn v. Lynch Commc'n Sys., 669 A.2d 79, 86 (Del. 1995).
202. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. Mar. 14, 2014).
203. *Id.* at 638.

involved a going private merger instigated by a controlling shareholder.[204] MacAndrews & Forbes Holdings, Inc. ("M&F") was the controlling stockholder in M&F Worldwide Corp. (MFW).[205] M&F sought to purchase the remaining shares of MFW and take the company private.[206]

M&F sent a proposal to MFW to purchase the remaining shares at $24 (a 50% premium over the then trading share price), with the proviso that M&F would not move forward with the transaction unless MFW formed an independent special committee to recommend the sale, and that the sale was approved by a non-waivable majority of the minority vote (minority shares being defined as "shares of the Company not owned by M&F or its affiliates").[207]

The board of MFW was interested in moving forward with the transaction and formed a special committee.[208] Each member of the special committee was truly independent.[209] (The court rejected arguments that prior business dealings, removed from the present matter, negated said independence.)[210] After eight meetings, spanning several months, the special committee, "although empowered to say 'no,' instead unanimously approved and agreed to recommend the merger at a price of $25 per share."[211]

The merger was thereafter approved by 65% of MFW's minority shareholders.[212] Here, there was little for the court to discuss, because "the plaintiffs themselves do not dispute that the majority-of-the-minority vote was fully informed and uncoerced, because they fail to allege any failure of

204. *Id.* Despite the fact that M&F was only a 43% shareholder, the matter was treated as a controlling shareholder transaction. While the decision does not state the reason, it is clear from the complaint in the matter. It alleges, among other facts evidencing control, that:

> M&F . . . is the controlling shareholder of MFW. . . . M&F and MFW share the same address as their corporate headquarters; [s]ince 2005, [M&F] has provided the services of [MFW's] CEO and Chief Financial Officer. . . . M&F employs each of the executive officers of MFW and supplies them to MFW through the management services agreement . . . ; Perelman [owner of M&F] has been a director of [MFW] since 1995 and has been Chairman of the Board of the Company from 1995 to 1997 and since September 2007.

Complaint, *In re* MFW S'holders Litig., C.A. No. 6566-CS (Del. Ch., Sept. 15, 2011), *available at* https://www.law.upenn.edu/live/files/8829-a [https://perma.cc/8VTJ-SZ7S].

205. *M&F Worldwide*, 88 A.3d at 638–40.

206. *Id.* at 640–41.

207. *Id.* at 640.

208. *Id.* at 641.

209. *Id.* at 650.

210. *Id.*

211. *Id.* at 652–653.

212. *Id.* at 654.

disclosure or any act of coercion."[213]

The Delaware Supreme Court provided what has become known as the *MFW* framework:

> [B]usiness judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders.[214]

In so finding, *Kahn v. M&F Worldwide* answered a question that had been left open in *Kahn v. Lynch*: if one protection is used (special committee *or* majority of the minority vote) then the burden shifts to the plaintiff; what happens if both protections are used (special committee *and* majority of the minority vote)?[215] In short, the possibility of coercion is greatly reduced when such structures are in place.[216] The independent board need not worry about repercussions should they not recommend the transaction, because they have no attachment to the controller.[217] An independent committee with the power to say no—to reject the deal if they are not offered the best price the market will bear—is a powerful agent in favor of the shareholders.[218]

Minority shareholders do not need to worry that they will be left behind by the majority, so they too have the power to say no.[219] When uncoerced, the shareholders are free to insist on the highest price the market will bear.[220]

4. Non-Controlling Shareholder Transactions—*In re Trados*

Before moving on, it is important to point out that there does not need to be a controlling shareholder for entire fairness to apply to decisions to merge, acquire or be acquired. Entire fairness applies when the board itself in interested (personal financial benefit) in the outcome of the transaction.[221]

In *In re Trados Inc.*, the Plaintiff shareholder claimed that the board violated its fiduciary duties when it approved a sale of Trados to SDL, PLC

---

213. *Id.*

214. *Id.* at 644. The court points out that the special committee must be (1) independent, (2) empowered to freely select its own advisors and to say no definitively, and (3) meet its duty of care in negotiating a fair price. *Id.* at 645.

215. *Id.* at 642 (Del. Mar. 14, 2014) (citing *Lynch,* 638 A.2d at 1117).

216. *Id.* at 654.

217. *Id.* at 650.

218. *Id.* at 644.

219. *Id.* at 654.

220. *Id.*

221. In re Trados Inc. S'holder Litig., 73 A.3d 17, 44–45 (Del. Ch. 2013).

in 2005.[222] This case is unlike *Weinberger*, *Lynch* and *M&F Worldwide* because it did not involve a controlling shareholder.[223] Instead, the board was conflicted because of a management incentive plan (MIP) that rewarded the directors for selling Trados to another company, even if the sale resulted in no return for the common shareholders.[224]

The MIP was implemented at the insistence of venture capitalists (Hg Capital, Sequoia, Wachovia, and others) that had purchased preferred shares in Trados as far back as 2000 and now, five years later, were looking for an opportunity to exit, preferably through the sale of Trados.[225]

The transaction in question was the sale of Trados to SDL for $60 million.[226] To understand why the MIP caused a conflict of interest on the part of the directors, one must understand how it impacted the proceeds of the sale. Compare:

- Absent the MIP, the proceeds of the sale would go first to Trados' preferred shareholders (who held a liquidation preference) and then to the common shareholders: $57.9 million to the preferred, with the remaining $2.1 million to the common.[227]
- With the MIP, the proceeds of the sale would go first to Trados' management,[228] then to preferred shareholders and then to the common shareholders: $7.8 million to management, followed by $52.2 million to the preferred, with nothing remaining for the common.[229]

Because the directors were interested in the transaction (not because there was a controlling shareholder, there was not), the court reviewed the transaction using the entire fairness standard of review.[230] As to fair dealing, the court looked to how the transaction was initiated to benefit the preferred

---

222. *Id.* at 20.

223. *Id.*

224. *Id.* (applying entire fairness because the board was conflicted). Here, I am focusing on the MIP for ease of explanation. However, there were actually many conflicts: two directors were also members of management and received compensation under the MIP. Three more were conflicted because they worked for corporations (Hg Capital, Sequoia, Wachovia, et al) that held preferred shares in Trados, and thus would benefit from the liquidation preference. One more director owned preferred shares individually and was conflicted for that reason. *Id.* at 45–48.

225. *Id.* at 20.

226. *Id.*

227. *Id.* at 20, 59–60.

228. However, the MIP allowed management to take a percentage off the top, scaled, depending on the sale proceeds (it worked out to 13%). *Id.* at 59.

229. *Id.* at 60.

230. *Id.* at 44–45.

shareholders, and the negotiations were for the sole benefit of the preferred shareholders.[231] The transaction was initiated to benefit the preferred shareholders—specifically the venture capital investors that wanted to exit—and not to benefit the common shareholders.[232] Indeed, the CEO was hired one year before and given the express mission of finding a way to sell the company so that the preferred shareholders could exit without suffering a substantial loss (or realize a gain, if possible).[233]

Further, in negotiating the price, the directors' sole emphasis was not selling below sixty million dollars.[234] The price at which the VC firms would break even.[235] They gave no thought to whether that would produce a return for the common shareholders (it would not).[236]

In short, the court found that the process was not fair to the common shareholders.[237]

Nevertheless, the court found that the price paid to common shareholder—$0—was fair because the common shares had no value.[238] The court reasoned that the Trados management found themselves in a catch-22: the only way to return value to the shareholders was to get new funding; *but* SDL (the only potential source) would only provide new funding if it could purchase Trados outright, wiping out the common shareholders.[239]

F. Conclusions (or Principles to be Applied)

Weinberger, *Lynch*, *M&F Worldwide* and *Trados* allow us to sketch a rough outline of what courts in Delaware examine when determining whether entire fairness is met. That outline is below:

231. *Id.* at 56.
232. *Id.*
233. *Id.* at 26.
234. *Id.* at 61.
235. *Id.*
236. *Id.* at 61–62.
237. *Id.* at 56.
238. *Id.* at 76.
239. *Id.* at 76–77.

Elements of Traditional Entire Fairness Analysis Process

- Was the board fully informed?[240] This can include asking for, receiving, and reviewing a fairness opinion.[241]
- Was information hidden from the board by the acquirer?[242]
- Did the board take a reasonable amount of time to make the decision?[243] A rushed decision—especially when there is no reason for the rush—will weigh against procedural fairness.[244]
- Was the board diligent[245] in protecting the interests of the common shareholders?[246] The board should not agree to the first price offered.[247]
- Was the board coerced? This can be subtle (connections[248]) or blatant (threats).[249]

240. Weinberger v. UOP, 457 A.2d 701, 711 (Del. 1983).

241. *See* Cinerama, Inc. v. Technicolor, 663 A.2d 1134, 1143 (Del. Ch. Oct. 6, 1994) (seeking a fairness opinion strongly weighed in favor of finding procedural fairness); *see also* Steven E. Bochner & Amy L. Simmerman, *The Venture Capital Board Member's Survival Guide: Handling Conflicts Effectively While Wearing Two Hats*, 41 DEL. J. CORP. L. 1, 22 (2016) ("Directors should seek advice from both legal and financial advisors as appropriate.").

242. *See Weinberger*, 457 A.2d at 712 (stating that a fair process was not present where target board was not afforded the opportunity to review the feasibility study prepared by the acquirer); *In re* Emerging Comm. Inc. S'holders Litig., 2004 Del. Ch. LEXIS 70, at *149 (finding that the fact that directors were provided with incomplete projections undermined argument for procedural fairness); *but see In re* PNB Holding Co. S'holders Litig., C.A. No. 28-N, 2006 Del. Ch. LEXIS 158, at *60–63 (Del. Ch. Aug. 18, 2006) (holding that not turning over stale projections did not impact procedural fairness).

243. *Weinberger*, 457 A.2d at 711.

244. *Id.* at 712.

245. Bochner & Simmerman, *supra* note 241, at 22 (nothing that a fair process argument is stronger where directors acted with diligence); Cathy L. Reese & Kelly A. Herring, *Recent Developments in Delaware Corporate Law*, 7 DEL. L. REV. 177, 193 (2004) (demonstrating that a fair process argument is bolstered by "an active and aggressive search for a third-party buyer").

246. The diligence must be exercised in favor of the common shareholders. *See* In re Trados Inc. S'holder Litig., 73 A.3d 17, 40–41 (Del. Ch. 2013) (faulting directors for looking after interests of VC investors, not common shareholders); *see also* Bochner & Simmerman, *supra* note 241, at 22 ("In all cases, directors should understand their fiduciary duties—including that their duties run to common stockholders—and this understanding should motivate the board's actions.").

247. *See Weinberger*, 457 A.2d at 711 (holding that there is no procedural fairness where the board of directors agreed to the first price offered); Smith v. Van Gorkom, 488 A.2d 858, 868–70 (Del. 1985).

248. Oliver v. Boston Univ., No. 16570-NC, 2006 Del. Ch. LEXIS 75, at *66 (Del. Ch. Apr. 14, 2006) (finding fair process not present where board members faced pressure to side with majority shareholder); *In re* Dairy Mart Convenience Stores, Inc., No. 14713, 1999 Del. Ch. LEXIS 94, at *13–14 (Del. Ch. May 24, 1999) (finding no procedural fairness where acquirer used a stalking horse to place pressure on the board).

249. *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1120 (Del. Apr. 5, 1994)

Process "Plus"

- Was an independent committee of the board used?
- Was a majority of the minority vote used?

If used together, the standard of review will return to business judgment under the *MFW* framework.[250] If only one is used, it switches the burden of proof under *Lynch.*[251]

Price

- Was an accepted methodology used to determine the price? This could be "discounted cash flow, comparable companies, comparable sale premiums, or a weighted average of results from more than one approach."[252]
- Were the assumptions fed into the formula (e.g., discount rate or assumptions as to future company growth) reasonable?[253]
- Was it the "highest transaction price the market will permit"?[254]

III. ENTIRE FAIRNESS APPLIED TO BENEFIT CORPORATIONS

The preceding Part examined the traditional approach to entire fairness review. That approach is focused on confirming that shareholders received the highest price the market will permit.[255] It looks at only one impact (pecuniary return) on only one constituency (shareholders).[256] For that reason, it is not well suited for review of director decisions at benefit corporations.

In this Part, I suggest how courts can modify the traditional entire

---

(indicating that using the threat of a hostile takeover at a lower price weakens procedural fairness argument); *see also In re Cysive, Inc.,* 836 A.2d 531 (Del. Ch. 2003) (explaining that a lack of coercion weighed in favor of procedural fairness).

250. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. Mar. 14, 2014).

251. *Lynch*, 638 A.2d at 1117.

252. William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 TEX. L. REV. 1, 14-15 (2014). In *Weinberger*, the court rejected the Delaware block method as the sole method of determining fair price. *Weinberger*, 457 A.2d at 713.

253. Delaware courts are not shy about questioning inputs and assumptions used in discounted cash flow analysis. *See, e.g.*, Cede & Co. v. Technicolor, No. 7129, 1990 Del. Ch. LEXIS 259, at *39 (Del. Ch. Oct. 19, 1990) ("It is the next step, in which he selects inputs for the equation described above, that I cannot conclude is a reasonable way to do what the model requires.").

254. Allen, Jacobs & Strine, *supra* note 15, at 874–75.

255. *See supra* Parts II.D, II.E, II.F.

256. *See supra* Parts II.D, II.E, II.F.

fairness standard of review so that it will apply in the benefit corporation context. I make suggestions as to procedure and price (in the case of the price, there are several sub-suggestions). These suggestions can be adopted piecemeal, or in their totality, as the courts deem appropriate.

A. The Merger Hypothetical

As stated in the introduction, the normative question this Article seeks to answer is *How should Delaware courts apply the entire fairness standard of review in the benefit corporation context?* Consider the following hypothetical:

> Clean, PBC is a Delaware public benefit corporation that uses captured CO_2 to manufacture polypropylene carbonate (a plastic); that is to say, Clean's benefit purpose is "to convert a waste product that causes global warming into something useful."[257] This is a two-step process. First, a manufacturer captures its CO_2 emissions and transports them to Clean. Second, Clean uses the CO_2 to manufacture plastics, "trapping" it, and preventing it from entering the environment.
>
> Clean was formed in 2013 by Controlling, Inc., a manufacturing giant that produces large amounts of CO_2. Controlling's forward-thinking CEO wanted to create a "free-standing partner" that it could work with to cut its own CO_2 emissions.
>
> Clean has 100,000 shares outstanding. Controlling owns 55,000 shares of Clean. The remaining 45,000 shares are owned by nine individual shareholders (5,000 shares each).
>
> Since 2013, one-half of the captured CO_2 that Clean has used to manufacture its plastics was provided by Controlling, the other one-half came from other manufacturers. In all, Clean has successfully prevented 300,000 metric tons of CO_2 from entering the environment per year,[258] and in the process, produced a positive cash flow of $2,000,000 per year selling its "green" plastics. (Ironically, these plastics compete with the plastics produced by

257. Bernie Bulkin, *Turning Carbon Dioxide Emissions into Chemicals, Fibres and Jet Fuel*, THE GUARDIAN (Aug. 4, 2014), https://www.theguardian.com/sustainable-business/carbon-dioxide-chemicals-fibres-jet-fuel-photosynthesis [https://perma.cc/EY3H-R2Y4].

258. This is a modest amount. Microsoft estimates that it will produce 16 million metric tons of carbon in 2020. Brad Smith, *Microsoft Will Be Carbon Negative By 2030*, OFFICIAL MICROSOFT BLOG (Jan. 16, 2020), https://blogs.microsoft.com/blog/2020/01/16/microsoft-will-be-carbon-negative-by-2030/ [https://perma.cc/U6JN-HASX].

> Controlling.)
>
> However, in 2020, Controlling appoints a new CEO that wants to "focus on profit maximization." The CEO decides that Controlling will only comply with the minimum requirements of the Clean Air Act, and stop capturing CO_2.[259]
>
> Controlling offers to buy the interests of all nine minority shareholders at $133.21 per share (a total valuation of $13,321,029.30) in a cash out merger. Clean will disappear, and its assets will be absorbed by Controlling.
>
> The five-person board of directors of Clean—each director beholden to Controlling for their seat—approves the merger by unanimous vote. Thereafter, the shareholders approve the merger when Controlling and three other shareholders vote their shares in favor (70,000 shares or 70%). The remaining six shareholders voted against. The six opposing shareholders sue to enjoin the merger, or alternatively, for damages, arguing that the board of directors violated its fiduciary duties of loyalty and care when it approved the merger.

B. The Decision to Apply Entire Fairness

Because Controlling's purchase of Clean is a controlling shareholder transaction (Controlling owns 55% of Clean), the court should apply the entire fairness standard of review.[260] The similarity to *Weinberger* is clear; our hypothetical involves a cash-out merger into a controlling shareholder.[261] The dissimilarity to Weinberger is equally clear; our hypothetical involves a benefit corporation.

259. For purposes of this hypothetical, I am making a simplifying assumption that Controlling would not otherwise be required to capture its CO_2 emissions. In *Util. Air Regulatory Group v. EPA*, the supreme court held that the EPA may not treat CO_2 from stationary sources as an air pollutant *unless* the source is already regulated as a polluter. 573 U.S. 302, 320, 329 (2014). If, to the contrary, Controlling was required by law to implement Best Available Control Technology (BACT) the loss of public benefit from the transaction would need to be adjusted accordingly. *See infra* Part III.D.1 (discussing price adjustment for public benefit reducing transactions).

260. Weinberger v. UOP, 457 A.2d 701, 710–11 (Del. 1983).

261. *Id.*

C. Fair Process

The first step is for the court to recognize that when applied in the benefit corporation context, the process employed by the directors (if employed correctly) is different—and thus how the court conducts its examination must also be different.

The difference arises because the process now has a dual purpose: (1) ensuring that shareholders receive the highest transaction price, and (2) ensuring that the decision is fair to stakeholders and furthers the benefit purpose (or in DBCL terms, "balances . . . the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation."[262]). In our hypothetical, the parties with interests to be balanced are the shareholders and stakeholders (primarily the environment) that would be harmed by the resulting increase in CO_2 emissions.

It follows that the court should begin, as it would in the traditional corporation context, by examining whether the directors asked an investment bank to prepare a fairness opinion regarding the price to be paid to shareholders.[263] If informed, and not rushed, a fairness opinion can go a long way toward convincing a court that the process was fair to shareholders (because it evidences that the board was likewise informed, and not rushed).[264]

But the court should also examine whether the board of directors sought a report regarding the impact of its decision on other stakeholders, in the case of Clean, the environment. There are two types of report that may serve well here: the first describes the environmental impact, but does not place a dollar value on it;[265] the second, more difficult to prepare, but arguably more useful to decision makers (especially because fair price is an issue, as will be discussed below) is one that measures the environmental impact in dollars.[266]

262. DEL. CODE ANN. tit. 8, § 365(a) (2020).

263. *See supra* Part II.E.1 (discussing the fairness opinion prepared in *Weinberger v. UOP*, 457 A.2d 701 (Del.1983)).

264. Cinerama, Inc. v. Technicolor, 663 A.2d 1134, 1143 (Del. Ch. Oct. 6, 1994); *see* Bochner & Simmerman, *supra* note 241, at 22 (discussing the importance of a fairness opinion).

265. There is ample precedent for the preparation of environmental impact statements, although in a different context, usually how a project (e.g., building a power plant) will impact the surrounding environment. *See* Amy L Stein, *Climate Change Under Nepa: Avoiding Cursory Consideration Of Greenhouse Gases*, 81 U. COLO. L. REV. 473, 474 (2010) ("Environmental Impact Statement[s] ("EIS") . . . assesses the impacts, alternatives, and potential mitigation of . . . proposed action[s].").

266. For possible valuation methodologies *see infra* Part III.D.1.

Further, the other factors that a court considers in determining fair process in the traditional corporation context are equally applicable. For example, the court should confirm that the board acted with diligence both in negotiating the best possible price for shareholders, but also in obtaining the best possible outcome for stakeholders.[267] Based on the facts presented in our hypothetical, there is no indication that the Clean board of directors acted diligently with respect to stakeholders, weighing against a finding of procedural fairness.

D. Fair Price

The price portion of the entire fairness test is more difficult to modify to fit the benefit corporation context. Here, I suggest three changes that the court should make when applying entire fairness review to benefit corporations. The court should:

(1) confirm that the directors made adjustments to the price that reflect the fact that the entity is a benefit corporation;

(2) be open to new valuation methods that take into account social impact (as is necessary to achieve (1)); and

(3) where the process was robust, the court should take comfort in that fact, and be more deferential to the price arrived at by the process.

1. Confirm Adjustments That Reflect the Fact That the Entity Is a Benefit Corporation

When entire fairness review is being applied to a decision made by the board of directors of a benefit corporation, the court should confirm that the directors (or more precisely, their expert) used a method for calculating fair price that reflects that fact. Let me explain:

When determining fair price, the starting point should still be a discounted cash flow (DCF) analysis, as was the case in *Weinberger*,[268] *Lynch*[269] and *Trados*.[270] As explained by Hood, Mylan and O'Sullivan, "[t]he DCF method determines the values of the assets of a business to be equivalent to the future expected cash flows of the entity discounted at a rate

---

267. *See* In re Trados Inc. S'holder Litig., 73 A.3d 17, 40–41 (Del. Ch. 2013) (holding fair process not present where directors did not diligently look after the interests of common shareholders).

268. Weinberger v. UOP, 457 A.2d 701, 712–13 (Del. 1983) (discussing discounted cash flow analysis).

269. Kahn v. Lynch Commc'n Sys., No. 8748, 1993 Del. Ch. LEXIS 151, at *15 (Del. Ch. July 9, 1993)

270. *Trados*, 73 A.3d at 72–73.

reflective of the risks involved in achieving these cash flows."[271] The inputs include future cash flows (calculated from net income), a discount rate (representing risk), and a terminal value (which assumes that all assets are sold off after the final year).[272]

I will use a simplified DCF analysis to make my point regarding Clean (it is simplified because I will not adjust the cash flows to reflect future company growth; I will not include a terminal value).[273] I begin by identifying the future cash flows (here $2,000,000 per year) and choosing a discount rate (here 15%).[274] Using those inputs, the value of the company is:

DCF Analysis for Clean

	Future Annual Cash Flow	Discount Rate	Net Present Value[275]
Year 1	2,000,000	15%	$ 1,739,130.43

271. Edwin T. Hood, John J. Mylan & Timothy P. O'Sullivan, *Valuation Of Closely Held Business Interests*, 65 UMKC L. REV. 399, 417–18 (1997); *see* Steven M. Davidoff, *Fairness Opinions*, 55 AM. U.L. REV. 1557, 1576 (2006) (discussing the use of discounted cash flow analysis in fairness opinions).

272. Hood, Mylan & O'Sullivan, *supra* note 271, at 417–18; Davidoff, *supra* note 271, at 1576.

273. *See* Hood, Mylan & O'Sullivan, *supra* note 271, at 423, 427 (discussing adjustments for growth factor and terminal value).

274. The discount rate (or cost of capital) represents the time value of money. A promise to give you $100 today, is worth more than a promise to give you $100 in one year. How discount rates are calculated are well beyond the scope of this Article. I chose 15% because it is a round number, simplifying the illustration, and it is within the range of discount rates used by courts in Delaware. *See, e.g.*, Cede & Co. v. Technicolor, Inc., 884 A.2d 26, 30 (Del. 2005) (using a discount rate of 15.28%); Zutrau v. Jansing, 7457-VCP, 2014 Del. Ch. LEXIS 156, at *123 (Del. Ch. July 31, 2014) (holding that a 12.9% discount rate accords with common valuation practices).

275. The net present value of each future cash flow is calculated using the following formula: $PV=FV/(1+r)^n$, where: PV is present value, FV is future value, r is the discount rate, and n is the number of years before the cash flow is realized. By way of example, for year three $\$1,315,032.46=2,000,000/(1+.15)^3$.

Year 2	2,000,000	15%	$ 1,512,287.33
Year 3	2,000,000	15%	$ 1,315,032.46
Year 4	2,000,000	15%	$ 1,143,506.49
Year 5	2,000,000	15%	$ 994,353.47
Year 6	2,000,000	15%	$ 864,655.19
Year 7	2,000,000	15%	$ 751,874.08
Year 8	2,000,000	15%	$ 653,803.55
Year 9	2,000,000	15%	$ 568,524.82
Year 10	2,000,000	15%	$ 494,369.41
Year 11	2,000,000	15%	$ 429,886.45
Year 12	2,000,000	15%	$ 373,814.30
Year 13	2,000,000	15%	$ 325,055.91
Year 14	2,000,000	15%	$ 282,657.32
Year 15	2,000,000	15%	$ 245,788.97
Year 16-50[276]	2,000,000	15%	$ 1,626,289.12
		Value of Clean	$13,321,029.30

The DCF calculates the value of Clean is $13,321,029.30, as Controlling claims. It follows that $133.21 per share is a fair price if Clean is a traditional corporation. That is to say, if Clean is a traditional corporation, the court should find that the transaction is entirely fair (assuming that the process was also adequate).

276. The dollar value of any year beyond fifty would be de minimus.

However, Clean is a benefit corporation. As such, there must be a second step in order for the court to properly find that the board of directors met its obligation to balance "the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation."[277] The court must confirm that the directors adjusted the calculation of fair price to reflect the impact of the transaction on the stakeholders and public benefit. There are three possibilities here:

- *A public benefit increasing transaction.* The resulting company will do more to pursue the stated benefit purpose. Here, the fair price must be adjusted downward.[278]
- *A public benefit decreasing transaction.* The resulting company will do less to pursue the stated benefit purpose. Here, the fair price must be adjusted upward.[279]
- *A neutral transaction.* The resulting company will do the same to pursue the stated benefit purpose. Here, the fair price is not adjusted.

The merger of Clean into Controlling is a public benefit decreasing transaction, so the directors should have adjusted the price they were negotiating on behalf of the shareholders and other stakeholders—the fair price—upward to compensate for the loss of the public benefit (i.e., the benefit to the environment). But then the question becomes, how much should such adjustment be? Can the dollar value of Clean preventing 300,000 metric tons of CO_2 from being released be quantified? It turns out it can. The value of preventing 300,000 metric tons of CO_2 from being released in 2020 is $2,040,000.[280]

---

277. DEL. CODE ANN. tit. 8, § 365 (2020).

278. Adjusting fair price downward in a public benefit increasing transaction may be counterintuitive (shouldn't we value transactions that increase public benefit more?). Think of it like this: the buyer is paying the purchase price to the seller for the business, and then a portion is paid back (in return for agreeing to increase the public benefit the business creates).

279. Adjusting fair price upward in a public benefit decreasing transaction may be counterintuitive (shouldn't we value transactions that decrease public benefit less?). Think of it like this: the buyer is paying the purchase price to the seller for the business, plus compensating the seller for the loss of the public benefit.

Further, it may not be intuitive why the shareholders should receive the compensation for the loss of the public benefit. Here, the idea is that the shareholder (who cares about the public benefit in question, or they would not have invested in the benefit corporation in the first place) can put the money to work furthering another public benefit.

280. This is based on $6.80 per metric ton; $6.80 x 300,000 = $2,040,000. For a discussion of how $26.30 is calculated, see *infra* Part III.D.1. That number represents the social benefit for just one year. For a complete analysis:

> [T]he benefits from reduced . . . emissions in [all] future year[s] can be estimated

What becomes clear is that $13,321,029.30 is not a "fair price". It does not take into account the elimination of the loss of the public benefit (i.e., the benefit to the environment). The court should find that the transaction is not entirely fair.

What could the directors have done to increase the likelihood that the court would find the transaction entirely fair? The most obvious solution: the directors could have negotiated a total price equal to the value of Clean calculated by DCF analysis plus the adjustment for this being a public benefit decreasing transaction. If Controlling did not agree, the directors would have a fiduciary duty not to approve the transaction. Alternatively, during the negotiation process, the directors could have required that Controlling make concessions unrelated to the price paid to shareholders that would mitigate the impact on the environment. Again, if Controlling did not agree, the directors would have a fiduciary duty not to approve the transaction.

In short, the court must confirm that a fair price was reached, both in terms of price paid to the shareholders, and also in terms of outcome for stakeholders.

2. Be Open to New Valuation Methods

In order to achieve recommendation 1 above, the court will need to be open to new valuation methods.[281] There are ways to measure the loss of environmental benefit in monetary terms. They include: damage cost avoided and substitute cost methods; market price method; productivity method; hedonic pricing method; travel cost method; contingent valuation method; contingent choice method; and benefit transfer method (hereinafter "valuation methods").[282]

> by multiplying the change in emissions in that year by the SCC value appropriate for that year. The net present value of the benefits can then be calculated by multiplying each of these future benefits by an appropriate discount factor and summing across all affected years.

INTERAGENCY WORKING GRP. ON SOC. COST OF CARBON, U.S. GOV'T, TECHNICAL SUPPORT DOCUMENT: SOCIAL COST OF CARBON FOR REGULATORY IMPACT ANALYSIS UNDER EXECUTIVE ORDER 12866 (2010), https://obamawhitehouse.archives.gov/ sites/default/files/omb/inforeg/for-agencies/Social-Cost-of-Carbon-for-RIA.pdf [https://perma.cc/685G-TA9H] [hereinafter INTERAGENCY WORKING GRP.].

281. The Delaware courts are often at the forefront of using new valuation techniques. As the court in *Weinberger* stated when it abandoned blind reliance on the Delaware Block Method, "We believe that a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community. . . ." *Weinberger*, 457 A.2d at 713.

282. ROBERT A. YOUNG & JOHN B. LOOMIS, DETERMINING THE ECONOMIC VALUE OF WATER: CONCEPTS AND METHODS 107–123 (2005) (discussing various valuation

Damage Cost Avoided. The United States Government (USG), under the Obama Administration, used the damage cost avoided method to calculate the social cost of carbon (SCC).[283] The USG states that:

> The SCC is an estimate of the monetized damages associated with an incremental increase in carbon emissions in a given year. It is intended to include (but is not limited to) changes in net agricultural productivity, human health, property damages from increased flood risk, and the value of ecosystem services due to climate change.[284]

The USG used a discounted cash flow analysis to turn those future damages into a current value, using discount rates of 5, 3 and 2.5%.[285] The results are in the following chart:

Social Cost of CO2, 2010 – 2050 (in 2007 dollars per metric ton)[286]

Year	Discount Rate		
	5% Avg. ($)	3% Avg. ($)	2.5% Avg. ($)
2010	4.7	21.4	35.1

methodologies); Frank Pasquale, *Toward an Ecology of Intellectual Property: Lessons from Environmental Economics for Valuing Copyright's Commons*, 9 YALE J.L. & TECH. 1, 48 (2006) (discussing various valuation techniques including direct use value and indirect use value); Dennis M. King & Marisa Mazzotta, *Dollar-based Ecosystem Valuation Methods*, ECOSYSTEM VALUATION, *available at* http://www.ecosystemvaluation.org/dollar_based.htm [https://perma.cc/HF5Q-W2PZ] (last visited Feb. 1, 2020).

283. INTERAGENCY WORKING GRP, *supra* note 280. Quantifying environmental impact in dollar terms is a long-standing effort spanning several administrations. Since the 1990s the EPA has been at the forefront of advocating for environmental accounting. *See* Searching for the Profit in Pollution Prevention: Case Studies in the Corporate Evaluation of Environmental Opportunities, EPA No. 742-R-98-005 (1998), at 45 ("[E]nvironmental accounting . . . reveals a benefit to investment from a process change, a benefit that may not otherwise have been captured in a capital budgeting decision."); Mitchell F. Crusto, *Endangered Green Reports: "Cumulative Materiality" In Corporate Environmental Disclosure After Sarbanes-Oxley*, 42 HARV. J. ON LEGIS. 483, 496 (2005) ("[I]n 1992, the EPA created an Environmental Accounting Project to "encourage and motivate business to understand the full spectrum of their environmental costs, and integrate these into decision-making.").

284. INTERAGENCY WORKING GRP, *supra* note 280, at 1 (using factors developed by R. Newell & W. Pizer, *Discounting the Distant Future: How Much Do Uncertain Rates Increase Valuations*? 46 J. ENV. ECON. & MANAGEMENT 52 (2003)).

285. INTERAGENCY WORKING GRP, *supra* note 280, at 1.

286. INTERAGENCY WORKING GRP, *supra* note 280, at 1.

2015	5.7	23.8	38.4
2020	6.8	26.3	41.7
2025	8.2	29.6	45.9
2030	9.7	32.8	50.0
2035	11.2	36.0	54.2
2040	12.7	39.2	58.4
2045	14.2	42.1	61.7
2050	15.7	44.9	65.0

For purposes of our hypothetical, I used the SCC for 2020 calculated using a 5% discount rate. Assuming $6.8 per metric ton, the value of preventing 300,000 metric tons of CO_2 from being released in 2020 is $2,040,000.

Substitute Cost. Stepping away from our hypothetical for a moment (after all, not all public benefits are environmental), consider the public benefit provided by Greyston Bakery, Inc.[287] Greyston is a benefit corporation that hires any applicant, regardless of background—indeed, they studiously avoid questions regarding background when hiring.[288] At Greyston, "most of the workers have a 'history'."[289] That may include drug dealing, theft, or just being homeless.[290]

The public benefit that Greyston provides to society can be calculated using the substitution cost method.[291] "The substitute cost method is applied by estimating the costs of providing a substitute for the affected services."[292] In the case of Greyston, the substitute is government supporting the individuals. For example, if we assume that individuals hired by Greyston could not otherwise find employment, what is the cost to government

287. GREYSTON BAKERY, INC., ANNUAL REPORT (2019), https://bcorporation.net/directory/greyston-bakery-inc [https://perma.cc/AA9M-H9SX].

288. Juli Steadman Charkes, *Bakery's 'Open Hiring' Offers Anyone a Chance*, N.Y. TIMES (Nov. 26, 2006), https://www.nytimes.com/2006/11/26/nyregion/employment-bakerys-open-hiring-offers-anyone-a-chance.html [https://perma.cc/3H4X-BNY2]; Tina Rosenberg, *No Background Check, Drug Test or Credit Check. You're Hired!,* N.Y. TIMES (May 29, 2019), https://www.nytimes.com/2019/05/29/opinion/greyston-bakery-open-hiring.html [https://perma.cc/8CGT-LSHF].

289. Charkes, *supra* note 288; Rosenberg, *supra* note 288.

290. Charkes, *supra* note 288; Rosenberg, *supra* note 288.

291. Dennis M. King & Marisa Mazzotta, *Damage Cost Avoided, Replacement Cost, and Substitute Cost Methods*, ECOSYSTEM VALUATION, *available at* http://www.ecosystemvaluation.org/cost_avoided.htm [https://perma.cc/GTJ5-VD8Q] (last visited Apr. 1, 2020); *see* Antonia Sajardo & Inmaculada Serra, *The Economic Value of Volunteer Work: Methodological Analysis and Application to Spain*, 40 NONPROFIT & VOLUNTARY SECT. Q. 873 (2011) (using the substitution cost method to value the work of volunteers).

292. King & Mazzotta, *supra* note 291.

supporting those individuals per year? The costs of Temporary Assistance for Needy Families (TANF), Supplemental Nutrition Assistance Programs (SNAP), and housing assistance per individual can be calculated on a yearly basis.[293]

Of course, such methods are open to criticism that they are plagued by uncertainty.[294] However, "[m]ere uncertainty in valuation . . . does not preclude [these valuation methods] from offering valuable information to courts."[295] The courts are often called upon to price the unpriceable, such as in the case of pain and suffering—it does not mean that courts should limit plaintiffs recovery to medical expenses only.[296]

Further, the entire fairness process, reliant as it is on DCF analysis, is already uncertain.[297] "[T]he large number of subjective judgments that need to be made when performing a valuation analysis (choice of comparables, estimating future cash flows, choice of a discount rate, etc.) creates fertile opportunities for widely divergent conclusions."[298] Yet the Delaware courts have managed, in the past, to apply entire fairness despite these uncertainties. The environmental or social cost of a decision, while a further uncertainty,

---

293. *See Government Benefits*, USA.GOV, https://www.usa.gov/benefits [https://perma.cc/DQ5Z-Z438] (last visited Feb. 14, 2020) (listing social welfare programs). Another option is a more generic impact statement. In fact, some municipalities have passed ordinances requiring them when a factory closes. The city of Pittsburgh, Pennsylvania, passed an ordinance mandating that firms about to close a factory issue an economic impact statement. Michael H. Shuman, *GATTzilla v. Communities*, 27 CORNELL INT'L L.J. 527, 532 (1994). The ordinance was later invalidated on the grounds that the city had exceeded its power. *Id.* (citing Smaller Mfrs. Council v. Council of Pittsburgh, 485 A.2d 73, 77 (Pa. Commw. Ct. 1984)).

294. In fact, the work of the USG, summarized above, contains the following disclaimer:

> When attempting to assess the incremental economic impacts of carbon dioxide emissions, the analyst faces a number of serious challenges. A recent report from the National Academies of Science (NRC 2009) points out that any assessment will suffer from uncertainty, speculation, and lack of information about (1) future emissions of greenhouse gases, (2) the effects of past and future emissions on the climate system, (3) the impact of changes in climate on the physical and biological environment, and (4) the translation of these environmental impacts into economic damages. As a result, any effort to quantify and monetize the harms associated with climate change will raise serious questions of science, economics, and ethics and should be viewed as provisional.

INTERAGENCY WORKING GRP, *supra* note 280, at 2.

295. Jeffrey C. Dobbins, *The Pain and Suffering of Environmental Loss: Using Contingent Valuation to Estimate Nonuse Damages*, 43 DUKE L.J. 879, 884 (1994).

296. *Id.*

297. Brief Amici Curiae of Law Professors at 10, DFC Global Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017) (No. 518, 2016, at 10) [hereinafter DFC Amici Curiae Brief].

298. Daniel R. Fischel, *Market Evidence in Corporate Law*, 69 U. CHI. L. REV. 941, 943 (2002).

is one that the courts are equipped to handle in the context of entire fairness analysis.

Finally, despite the uncertainty some companies are already incorporating such valuations into their internal decision-making processes. For example, Microsoft imposes an internal $15 per metric ton SCC fee (while it is unclear whether Microsoft used the USG figures to arrive at that amount,[299] it is interesting that $15 fits squarely within the range of estimates—$6.8 to $41.7—for 2020).

At Microsoft, managers calculate the cost that their decision will have on the environment and treat it as an actual expense. According to Microsoft: "[e]ach quarter, the organizational divisions obligated under the program are charged a fee reflecting projected emissions."[300] The division then pays the fee into a Carbon Neutral Fee Fund.[301] Microsoft invests the money from that fund into green initiatives.[302]

Another criticism is that adjusting the price upward may result in double counting. That is to say, the cash flow of $2,000,000 per year may already capture the positive externality. However, that assumes (1) that customers are paying more for products that are manufactured from captured CO_2,[303] and (2) that the increased price is equal to the environmental benefit created.

This is a good segue to the point made in the next section: where a robust process was employed by the board of directors, the court should be willing to let that fact provide some comfort that a fair price was achieved. It is the board of directors that is in the best position to determine if the corporation's cash flows incorporate all, some, or none of the positive externalities resulting from the manner in which the plastic is produced. As long as that question was diligently considered by the board—i.e., the process was fair—the court should trust the price arrived at.

299. Professor Light writes that "Microsoft sets the fee by examining the price for carbon offsets." Sarah E. Light, *The New Insider Trading: Environmental Markets within the Firm*, 34 STAN. ENVTL. L.J. 3, 44 (2015) (quoting Telephone Interview with Robert Bernard, Chief Environmental Strategist, Microsoft Corp. (June 4, 2014)).

300. *Id.*

301. *Id.*

302. *Id.*

303. This is far from a forgone conclusion. *See* Shuqin Wei, Tyson Ang, Vivien E. Jancenelle, *Willingness to Pay More for Green Products: The Interplay of Consumer Characteristics and Customer Participation*, 45 J. RETAILING & CONSUMER SERV. 230, 230 (2018) (discussing that evidence evaluating consumers' willingness to pay more for green products has been mixed); Céline Michaud and Daniel Llerena, *Green Consumer Behaviour: An Experimental Analysis of Willingness to Pay for Remanufactured Products*, 20 BUS. STRATEGY & ENV'T 408, 417 (2011) (finding consumers are not willing to pay a premium for green products).

3. Revitalize the Fair Process Portion of the Entire Fairness Test

In Delaware, the courts are very comfortable calculating fair price. As one commentator pointed out, "Delaware courts have become quite sophisticated in reviewing valuation analyses and are thoroughly conversant in the related, highly technical financial arcana."[304]

A great illustration of this is *In re PNB*.[305] In that case the court picked apart the experts' discounted cash flow analysis, and conducted its own.[306] The court focused on the cash flow and the discount rate.[307] As to the cash flow, the court found flaws with the calculations of both experts, and so chose a point in between.[308] Likewise, as to the discount rate, the court was not satisfied with the recommendation of either expert and used 12% (between 11.5% recommended by the plaintiff, and 14% recommended by the defendant).[309] As such, using its own inputs, the court arrived at a fair price of $52.34 per share, which was $11.34 per share higher than that paid by the company to cash out the plaintiffs, and awarded the plaintiffs that amount in damages.[310]

Because the courts are so confident in their ability to conduct a DCF analysis, they often gloss over the fair process portion of the entire fairness test.[311] But the fair price in a transaction involving a benefit corporation is

304. William A. Groll & David Leinwand, *Judge and Banker—Valuation Analyses in the Delaware Courts*, 116 PENN. ST. L. REV. 957, 959 (2012). A recent Brief Amici Curiae by finance professors was critical of this point, arguing "[a]ppraisal proceedings have hardly been the Delaware courts' finest moments." DFC Amici Curiae Brief, *supra* note 297 (quoting William J. Carney & Mark Heimendinger, *Appraising the Nonexistent: The Delaware Courts' Struggle with Control Premiums*, 152 U. PA. L. REV. 845, 845 (2003)). It further criticized that Delaware courts "cobble together a discounted cash flow model from the disparate proposals of the parties' experts. Respectfully, however, judges are ill-equipped to undertake that task." *Id.*

305. *In re* PNB Holding Co. S'holders Litig., C.A. No. 28-N, 2006 Del. Ch. LEXIS 158, at *98–117 (Del. Ch. Aug. 18, 2006).

306. *Id.*

307. *Id.*

308. *Id.* at *104–08.

309. *Id.* at *108–14.

310. *Id.* at *116–17.

311. Weinberger v. UOP, 457 A.2d 701, 711 (1983) ("[W]e recognize that price may be the preponderant consideration outweighing other features of the merger."); Monroe County Emp. Retire. Sys. v. Carlson, No. 4587-CC, 2010 Del. Ch. LEXIS 132, at *6 (Del. Ch. June 7, 2010) ("Fair price . . . is often the paramount consideration."); Valeant Pharms. Int'l v. Jerney, 921 A.2d 732, 748 (Del. Ch. 2007) ("The court's finding that [defendants] used an unfair process to authorize the bonuses does not end the court's inquiry because it is possible that the pricing terms were so fair as to render the transaction entirely fair."); *PNB Holding*, 2006 Del. Ch. LEXIS 158, at *86 (2006) ("As in most fairness cases, the ultimate issue of fairness turns on my perception of the economics. That is, did the defendants cause the

more nuanced (as should be clear from above). In some ways, it is more elusive. I am not saying that the court should not try to calculate a fair price (indeed, no court is better equipped to do so than the Delaware Court of Chancery). The court should certainly be willing to calculate a number within a range, as suggested in the sections above.

My point is simply this: in cases where a robust process was employed by the board of directors, the court should also be willing to let that fact provide some comfort that a fair price was achieved.[312] After all, the reason that fair process is included in the analysis is because a robust process is more likely to produce a fair price.[313]

E. Application of The MFW Framework

Many of the difficulties inherent in applying the entire fairness standard of review in the benefit corporation context can be avoided if the controlling shareholder conditions the merger on approval by a special committee and a majority of the minority vote, that is to say, follow the *MFW* framework.[314]

However, there are some slight differences between how the *MFW* framework is applied to the traditional corporation context, and how it would need to be applied in the benefit corporation context. The framework itself remains the same: the court will apply the more deferential business judgment standard where a transaction is conditioned on approval by a special committee of the target and a majority of the minority vote.[315]

The difference is how the special committee must operate, and how the consent of a majority of the minority must be obtained.

As to the special committee, it must be informed, and that means informed of both impacts to shareholders and stakeholders.[316] Further, it

---

corporation to pay a fair price?").

312. *See* Bochner & Simmerman, *supra* note 241, at 24 (where a robust process was used, courts are more likely to defer on the question of price); Daniel E. Meyer, *Maybe Publius Was Right: Relying On Merger Price To Determine Fair Value In Delaware Appraisal Cases,* 165 U. PA. L. REV. 153, 176 (2016) ("[T]here may be certain instances where the court does not have particular expertise and cannot fall back on default presumptions to determine the appropriate inputs. Under such circumstances, the court cannot credibly conduct a DCF analysis, and as a result, has at times resorted to the merger price achieved in a robust sales process.").

313. *Carlson*, 2010 Del. Ch. LEXIS 132, at *6 ("Quite frankly, Delaware law focuses on fair dealing in controlling shareholder transactions primarily because a fair price is more likely to follow fair dealing.").

314. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644–45 (Del. 2014).

315. *Cf. id.*

316. *Cf. id.*

must be fully empowered.[317] It must have the power to say no.[318] Traditionally, that means that the special committee can veto any transaction not in the best interests of the shareholders.[319] In the benefit corporation context, the special committee must have the power to veto any transaction not in the best interest of the shareholders, *or* stakeholders *or* the company's benefit mission (although the last two are inextricably intertwined). That is the only approach that is consistent with the directors' duty to balance the interest of shareholders and stakeholders.[320]

Finally, the *MFW* framework also requires that the majority of the minority vote be informed and uncoerced.[321] Traditionally, that means that the shareholders must receive all information necessary to calculate a fair price for their shares.[322] In the benefit corporation context, in addition, the investors must be provided with information regarding how stakeholders and the corporation's benefit purpose will be impacted. After all, investors in benefit corporations, who were likely motivated to invest in a benefit corporation by its benefit purpose, have an interest in ensuring that benefit purpose is furthered.

IV. WHAT ABOUT OPERATIONAL DECISIONS?

Up until now, this Article, with its focus on *Weinberger*, *Lynch*, *MFW* and *Trados*, may have left the reader with the impression that entire fairness only applies when there is a decision to merge, acquire, or be acquired. That is not the case. It also applies to operational decisions where there is a controlling shareholder or interested board. The range of operational decisions that may be implicated include: "(1) security issuances, purchases, and repurchases; (2) asset leases and acquisitions; (3) compensation arrangements, consulting agreements, and service agreements; (4) settlements of derivative actions; and (5) recapitalizations."[323]

317. *Cf. id.* at 644. The court points out that the special committee must be (1) independent, (2) empowered to freely select its own advisors and to say no definitively, and (3) meet its duty of care in negotiating a fair price. *Id.* at 645.

318. *Cf. id.* at 644–45.

319. *Id.*

320. DEL. CODE ANN. tit. 8, § 365 (2020).

321. *M&F Worldwide*, 88 A.3d at 644–45.

322. *Id.*

323. IRA Tr. FBO Bobbie Ahmed v. Crane, No. 12742-CB, 2017 Del. Ch. LEXIS 869, at *18 (Del. Ch. Dec. 11, 2017) (citations omitted).

A. Traditional Corporation—Summa v. TWA

Summa v. Trans World Airline, Inc. involved the well-known American air carrier, Trans World Airline (TWA)[324] and its equally well-known majority owner, Howard Hughes.[325] Hughes owned 100% of Toolco, and in turn, Toolco owned 78% of TWA.[326] Toolco, which had operational control of TWA, prohibited TWA from purchasing its own aircraft.[327] Instead, Toolco purchased the aircraft and sold them to TWA at a profit.[328] (That, in turn, enriched Hughes.)

Although the case did not involve a decision to merge, acquire, or be acquired, the court begins by citing the recently decided case of *Weinberger* for the "well established" proposition "that one who stands on both sides of a transaction has the burden of proving its entire fairness."[329] The court found that the transaction at issue was with a controlling entity, Toolco, which was a 78% shareholder in TWA.[330]

The court then turned to applying the entire fairness standard of review articulated in *Weinberger*.[331] The court found that the TWA board's process for making the decision to purchase the aircraft from Toolco was not fair, because it was entirely dominated by Toolco and Hughes.[332] (The court suggested that a vote of independent directors would have helped an argument that the process was fair.)[333] The board was prohibited from seeking out competing bids with which it could negotiate down the price it paid to Toolco.[334]

Given the issues with the process, it should come as no surprise that the resulting price was unfair to TWA.[335] Toolco purchased the aircraft at fair market value and then sold them to TWA at a profit.[336] Over the years, this inefficient approach (but beneficial to Toolco and Hughes) resulted in significant amounts being diverted from TWA to Toolco and Hughes.[337] In

324. TWA operated from 1930 to 2001.
325. Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 404 (Del. 1988).
326. *Id.* at 404–05.
327. *Id.* at 405.
328. *Id.*
329. *Id.* at 406–07 (quoting Weinberger v. UOP, 457 A.2d 701, 710 (Del. 1983)).
330. *Id.* at 407.
331. *Id.* (citing *Weinberger*, 457 A.2d at 710).
332. *Id.*
333. *Id.*
334. *Id.*
335. *Id.* at 407–08.
336. *Id.* at 405.
337. *Id.* at 406.

short, the court found that the transaction was not entirely fair.[338]

B. Benefit Corporation—Pirron v. Impact Makers

As stated in the introduction, as of the date of writing, there is no case law regarding the application of the entire fairness standard of review in the benefit corporation context. However, there is one (and only one, that I am aware of) lawsuit that settled before any decisional law could be written: *Pirron v. Impact Makers, Inc*.[339] As alleged,[340] the facts of the case are complicated (the broader allegation is that management tried to freeze-out the founder Michael Pirron because he blocked proposals to compensate Impact Makers' traditionally volunteer board and blocked implementation of a bonus plan for executives),[341] and I simplify them for purposes of this Article, focusing on the director pay aspect of the case.

Impact Makers (IM) was incorporated as a benefit corporation in Virginia in 2015.[342] IM offered information technology and management consulting services with an "all profits to charity" model (similar to Newman's Own).[343] Its articles of incorporation were clear that its management would consider the impact of its actions on its stockholders and stakeholders.[344] The articles of incorporation further provide that IM would follow a profits to charity business model (the "PtoC Business Model").[345] In practice, it donated 100% of its profits to charity.[346]

IM's eleven-member board of directors had always served for free.[347] However, in 2017 the board became worried that it was becoming more difficult to retain directors.[348] As such, the board of directors began to explore

338. *Id.* at 407.

339. Complaint, Pirron v. Impact Makers, Inc., No. CL 19-2358-3 (Va. Cir. Ct., filed May 8, 2019), https://michaelpirron.com/wp-content/uploads/2019/05/Pirron-v-Impact-Makers_Stamped-w-Exhibits.pdf [https://perma.cc/MCS6-PTQK] [hereinafter Pirron Complaint].

340. The facts of *Pirron v. Impact Makers*, as presented in this Article, are borrowed from the allegations in the Pirron Complaint. It must be remembered that allegations in a complaint are just that, allegations.

341. John Reid Blackwell, *Impact Makers' Founder, Former CEO Files Suit Against the Consulting Firm*, RICHMOND TIMES DISPATCH, May 16, 2019, at A1.

342. Pirron Complaint, *supra* note 339, ¶ 2.

343. Pirron Complaint, *supra* note 339, ¶ 10.

344. Impact Makers, Inc., Fourth Amended and Restated Articles of Incorporation 1 (Dec. 30, 2015), *reprinted in* Pirron Complaint, *supra* note 339, at Exhibit 2.

345. *Id.*

346. Pirron Complaint, *supra* note 339, ¶ 15.

347. Pirron Complaint, *supra* note 339, ¶ 29.

348. In Michael Pirron's report opposing the compensation plan, he discussed interviews with several past directors. *See* Report from Michael Pirron to Board of Directors of Impact Makers, Inc. and IM Holdings, Inc., (July 23, 2017) [hereinafter Pirron Report], *reprinted in*

the possibility of paying themselves.[349]

After some research, they proposed to pay themselves $1000 per quarter.[350] It is not clear that the plan was implemented, but the complaint in the matter stated that the board of directors violated its fiduciary duty by "failing to consider all of the Stakeholders in weighing whether they should approve a proposal to compensate themselves for their service on IM's Board of Directors."[351]

The benefit enforcement proceeding (a type of derivative action)[352] was brought by Michael Pirron, the founder of the company and the sole dissenting member of the board of directors.[353] While the case settled before any decisional law could be written, Pirron's allegations, together with contemporaneous documents attached to the complaint, paint a picture of how entire fairness review of an operational decision in the benefit corporation context may work.

First, because the matter involved board members approving their own compensation, it is likely that a court would have reviewed the matter using the entire fairness standard of review.[354] Here, the main focus is process (there are no allegations regarding whether the pay constituted a "fair price" for purpose of entire fairness analysis).

Where an operational decision is involved, fair process is often shown by the board informing itself using comparables.[355] In the case of IM, the

---

Pirron Complaint, *supra* note 339, at Exhibit 4. Such interviews were mixed with regards to the need for compensation to retain directors. *Id.* One past director did state that she "would have renewed for another term if the Board role was compensated." *Id.*

349. Pirron Complaint, *supra* note 339, ¶¶ 29–37.

350. Proposal for Impact Makers Board Compensation 4 (June 21, 2017) [hereinafter Compensation Proposal], *reprinted in* Pirron Complaint, *supra* note 339, at Exhibit 3.

351. Pirron Complaint, *supra* note 339, ¶ 118(c).

352. Va. Code Ann. § 13.1–790 (2011) (providing that benefit enforcement proceedings may be brought by a shareholder or director).

353. Pirron Complaint, *supra* note 339, ¶ 1. "[Other] shareholders subsequently backed Pirron's litigation, including Jerry Greenfield, the co-founder of Ben & Jerry's Ice Cream. . . ." John Reid Blackwell, *Richmond-Based Impact Makers and Its Founder Settle Lawsuit,* RICHMOND TIMES DISPATCH, June 18, 2019, at 1A.

354. In *Williams v. Ji*, directors of Sorrento Therapeutics, Inc. granted to themselves stock options in several wholly owned subsidiaries. No. 12729-VCMR, 2017 Del. Ch. LEXIS 115, at *13 (Del. Ch. June 28, 2017). The court found that entire fairness applied because "[t]he Sorrento board approved the Grants, and every member of the board at the time of the Grants was interested in them, as [all directors] received options." *Id.*; *see* Steiner v. Meyerson, No. 13139, 1995 Del. Ch. LEXIS 95 (Del. Ch. July 19, 1995) (applying entire fairness to executive compensation decision).

355. Carlson v. Hallinan, 925 A.2d 506, 536 (Del. Ch. 2006) (rejecting comparison to service contract it where involved different work); Summa Corp. v. Trans World Airlines, Inc., 540 A.2d 403, 407 (finding that failure to seek out competing bids weighs against

board gathered some information regarding what other for-profit corporations pay their board members, but they failed to consider what companies that follow the PtoC Business Model pay.[356]

Pirron prepared a report opposed to the proposal, which importantly, included information regarding a more appropriate comparable, Newman's Own, another corporation that followed the PtoC Business Model.[357] In fact, he attached to the report a letter from Newman's Own's CEO stating that its directors were not compensated:

> In my travels lecturing and promoting [philanthropic enterprises, including Newman's Own[358]] it is not unusual for there to be an initial level of skepticism about the commitment to contribute 100% of profits to charity, and one of the most persuasive aspects of the case to be made, is my ability to point to my own Board of Directors, noting that our directors are . . . not compensated.[359]

According to the Pirron Complaint, IM's board of directors refused to consider the report (which attached the above referenced letter).[360] Even worse, despite the fact that IM is a Virginia benefit corporation—and therefore the board of directors is required to balance the interests of shareholders and stakeholders[361]—the board of directors did not do so.[362] The board of directors should have reviewed information regarding how the following stakeholders would be impacted: *Clients* (they chose IM over competitors based on the fact that IM is a benefit corporation following the PtoC Business Model); *Employees* (they may value working at a benefit corporation following the PtoC Business Model; *Charity Partners* (they receive the benefit of the PtoC Business Model); and *Shareholders* (they

---

procedural fairness).

356. Compensation Proposal, *supra* note 350, at 4.

357. *See* Pirron Report, *supra* note 348.

358. Technically, Newman's Own is not a benefit corporation. It is a corporation owned 100% by a 501(c)(3) not-for-profit. But the purpose of the structure is the same as forming a benefit corporation; it allows the company to pursue profit and purpose—in the case of Newman's own, giving away 100% of profits to charity. *100% Profits to Charity*, NEWMAN'S OWN https://www.newmansown.com/100-percent-profits-to-charity/ [https://perma.cc/84C9-GDAS] *(last visited Apr. 11, 2020)*; *see* Haskel Murray, *For Profit and Foundation Owned*, BUS. L. PROF. BLOG. (May 1, 2015), https://lawprofessors.typepad.com/business_law/2015/05/for-profit-and-foundation-owned.html [https://perma.cc/J8RS-BKTV] ("[A]s a practical matter, the benefit corporation and c-corporation forms may operate similarly when wholly-owned by one or more foundations.").

359. Letter from Robert Forester, CEO of Newman's Own, to Michael Pirron, CEO of Impact Makers, (July 15, 2017), *attached to* Pirron Report, *supra* note 348.

360. Pirron Complaint, *supra* note 339, ¶¶ 32–33.

361. Va. Code Ann. § 13.1–788 (2011).

362. Pirron Complaint, *supra* note 339, ¶ 31.

invested in a benefit corporation following the PtoC Business Model).[363]

Further, according to the Pirron Complaint, Pirron did prepare a stakeholder analysis, but as was the case with the letter from the CEO of Newman's Own, the board of directors refused to consider it.[364]

The case settled in June 2019 with Pirron Reinstated as a permanent director.[365] It was widely seen as a win for benefit corporations. The attorney for Michael Pirron stated:

> [This Social Enterprise, IM] was jeopardized in April 2019 by a Board of Directors whose vision for the company did not align with its governing documents that were drafted to protect the company's public benefit mission.
>
> Fortunately, Michael [Pirron] received a settlement that . . . ensure[d] that IM's pledged gift to the community is fulfilled. We achieved that along with other key protections. This lawsuit was the first benefit enforcement proceeding in the United States and we are satisfied with the outcome . . . .[366]

CONCLUSION

Benefit corporations are a relatively new form of business organization, but already, social entrepreneurs have formed over seven thousand in the United States.[367] Of that number, over twelve hundred are formed in Delaware.[368] It is inevitable that at some point the Delaware courts will be called upon to review a board decision at one of those benefit corporations using entire fairness analysis. (And many times thereafter.)

Applying the entire fairness standard of review to a benefit corporation is more difficult than applying it to a traditional corporation, where the court confirms that the directors considered only one impact (pecuniary return) on only one constituency (shareholders).[369] The court will need to confirm that the directors "balance[d] the pecuniary interests of the stockholders, the best

363. Pirron Report, *supra* note 348.

364. Pirron Complaint, *supra* note 339, ¶¶ 32–33.

365. Blackwell, *supra* note 353, at 1A.

366. Tricia Dunlap, *Why the Impact Makers B Corp Lawsuit Matters to All of Us*, DUNLAP LAW (June 17, 2019), https://dunlaplawplc.com/why-the-impact-makers-b-corp-lawsuit-matters-to-all-of-us/ [https://perma.cc/H68N-3B95].

367. Ellen Berrey, *Social Enterprise Law in Action: Organizational Characteristics of U.S. Benefit Corporations*, 20 TRANSACTIONS: TENN. J. BUS. L. 21, 44 (2018) (building an inventory of 7704 benefit corporations).

368. *Id.* at 52 (finding that 16% of benefit corporations are formed in Delaware).

369. *See supra* Parts II.D, II.E.

interests of those materially affected by the corporation's conduct, and the specific public benefit . . . identified in its certificate of incorporation."[370]

The court will be called upon to embark upon its own balancing analysis, a journey into terra incognita, uncharted territory. This Article set out to answer this normative question: how should Delaware courts conduct entire fairness review of a board decision at a benefit corporation?

As set out in detail above, the answer to the normative question posed is as follows: when conducting the fair process portion of the entire fairness test, in addition to confirming that the board of directors gathered information about the impact of the decision on shareholders, the court should also confirm that the board of directors gathered information about the impact of the decision on stakeholders.[371] When conducting the fair price portion of the entire fairness test, the court should:

(1) confirm that the directors made adjustments to the price that reflect the fact that the entity is a benefit corporation;[372]

(2) be open to new valuation methods that take into account social impact (as is necessary to achieve (1));[373] and

(3) where the process was robust, the court should take comfort in that fact, and be more deferential to the price arrived at by the parties.[374]

370. DEL. CODE ANN. tit. 8, § 365(a) (2020).
371. *See supra* Part III.C.
372. *See supra* Part III.D.1.
373. *See supra* Part III.D.2.
374. *See supra* Part III.D.3.