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THE IMPORTANCE OF THE BUSINESS JUDGMENT RULE

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"A page of history is worth a volume of logic."[1]

Anyone who has had the opportunity to teach corporate law understands how difficult it is to provide a compelling explanation of why the business judgment rule (the "Rule") is so important. To provide a better explanation of why this is so, this Article takes the approach that the Aronson formulation of the Rule is not the proper starting place. Instead, this Article begins by starting with a close read of two cases that initiated the application of the Rule under Delaware law: the Chancery Court and Supreme Court opinions in Bodell v. General Gas & Electric. By taking this approach, the following insights into the Rule—which are not as readily apparent when the starting point is Aronson—are discovered.

First, without the Rule, the raw power of equity could conceivably require all challenged board of directors ("Board") decisions to undergo an entire fairness review. The Rule is the tool used by a court to restrain itself from persistently implementing such a review. This is the most important function of the Rule. Second, as a result of the need to restrain equity, there

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1. A quote from a Supreme Court opinion delivered by Justice Oliver Wendell Holmes. N.Y. Tr. Co. v. Eisner, 256 U.S. 345, 349 (1921).

is no room for fairness in the Rule's formulation; fairness and fiduciary duties must be mutually exclusive. Third, there are three policy drivers that underlie the use of the Rule: (1) protecting the Board's statutory authority to run the company without the fear of its members being held liable for honest mistakes in judgment; (2) respect for the private ordering of corporate governance arrangements, which almost always grant extensive authority to the Board to make decisions on behalf of the corporation; and (3) the courts' recognition that they are not business experts, making deference to Board authority a necessity. Additionally, the Rule is an abstention doctrine not just in terms of precluding duty of care claims, but also by requiring courts to abstain from an entire fairness review if there is no evidence of a breach in fiduciary duties or taint surrounding a Board decision. Moreover, stockholder wealth maximization ("SWM") is the legal obligation of the Board and the Rule serves to support that purpose. The SWM requirement enters into corporate law through a Board's fiduciary duties as applied under the Rule, not through statutory law. In essence, SWM is an equitable concept.

Introduction

The business judgment rule (the "Rule") is an equitable doctrine that is the most prominent and important standard of judicial review under corporate law. The Rule protects a decision of a corporate board of directors ("Board") from a fairness review ("entire fairness" under Delaware law) unless a well-pleaded complaint provides sufficient evidence that the Board has breached its fiduciary duties or that the decision-making process is tainted, such as with interestedness or a lack of independence.[2] However, anyone who has had the opportunity to teach corporate law understands the difficulty in providing a compelling explanation of why the Rule is so important.[3] For want of a better simile, trying to explain its importance is like throwing darts at a dart board with the goal of filling up every spot on the board. One eventually gets tired and becomes satisfied with the spots that were hit, but understands that the center of the bull's-eye has been missed.

To provide a better understanding of the Rule's importance, this Article takes the approach that the *Aronson* formulation of the Rule[4] is not the proper starting place for its explanation. The *Aronson* formulation is a common starting point because it includes an aspect of the duty of care—the need for a Board to make a decision "on an informed basis"[5]—that was not found in prior formulations used by the Delaware Supreme Court. Yet, starting with the *Aronson* formulation is like starting in the middle of a story, with much to be lost in its understanding.

Instead of starting with the *Aronson* formulation, this Article takes the novel approach of explaining the Rule by starting with a close reading of two cases which initiated the application of the Rule under Delaware General Corporation Law ("DGCL"): the Chancery Court (the "Chancery") and Delaware Supreme Court (the "Court") opinions in *Bodell v. General*

2. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

3. One corporate law scholar, Lyman Johnson, even suggests that it is time to get rid of the Rule as a judicial standard of review. *See* Lyman P.Q. Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 423–31 (2013). Johnson would prefer that the courts focus simply on whether a fiduciary duty has been breached, with the Rule being reduced to a policy statement that directs the courts "not [to] weigh in on the substantive soundness of director decisions" when reviewing a corporate Board decision for a breach in the Board's duty of care. *Id.* at 425.

4. *See infra*, Part II.

5. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citations omitted).

Gas & Electric ("*Bodell I*" and "*Bodell II*").[6] By taking this approach, the following insights into the Rule were discovered, which may not have been so readily apparent by starting with the *Aronson* formulation.

First, without the Rule, the raw power of equity, as made clear in *Bodell I*, could conceivably require all challenged Board decisions to undergo an entire fairness review. In the face of this power, the issue for courts is to determine how the interests of stockholders are to be balanced against protecting the Board's statutory authority to run the company without the fear of constantly facing potential liability for honest mistakes in judgment. Protecting against this potential liability is the original policy driver underlying the Rule. This requires equity to be restrained so as not to create an imbalance. To do this, Courts use the Rule as a tool to distinguish situations in which a Board decision should stand without further review from situations in which an entire fairness review is required and the full force of equity is to be applied. This is the most important function of the Rule.

Second, given the need to restrain equity, there is no room in the Rule formulation for fairness; fairness and fiduciary duties must be mutually exclusive. An entire fairness review is not allowed unless there is evidence that a fiduciary duty has been breached or taint surrounds the decision-making process. If a court finds no breach or taint, then review is halted and the decision stands, thus upholding the Board's statutory authority to manage the corporation. The result is that the Rule serves as a fulcrum balancing the lever between the managerial discretion of the board of directors, as provided by statutory corporate law, on one end, and equity, with its focus on fiduciary duties and the potential for an entire fairness standard of review on the other end. The Rule and its formulation ensures that equity and statutory corporate law co-exist. Removing the Rule as a standard of judicial review (if it ever were to happen) could lead the court to ignore the implications of applying its equitable powers without restraint, potentially allowing the balance to move too far in the direction of equity and resulting in far too many decisions coming under a fair-

6. Bodell v. Gen. Gas & Elec. Corp. (*Bodell I*), 132 A. 442 (Del. Ch. 1926), *aff'd*, Bodell v. Gen. Gas & Elec. Corp. (*Bodell II*), 140 A. 264 (Del. 1927).

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ness review. In essence, the Rule is a self-imposed constraint on a court's equitable powers.

Third, the role played by the Rule does not change under DGCL 141(a),[7] (*Bodell I* and *II* dealt with Section 4a of the old DGCL, currently embodied in DGCL § 152[8]) even though two additional policy drivers are identified which reinforce the use of the Rule versus an automatic entire fairness review. These policy drivers are: (1) respect for the *private ordering* of corporate governance arrangements, which almost always grant extensive authority to the Board to make decisions on behalf of the corporation, and (2) the recognition by courts that they are not business experts, making deference to Board authority a necessity.

Fourth, the Rule is an abstention doctrine not just in terms of precluding duty of care claims, as persuasively argued by Stephen Bainbridge,[9] but also in a more fundamental way, by requiring courts to abstain from an entire fairness review if there is no evidence of a breach in fiduciary duties or taint surrounding a Board decision.

Fifth, the Rule serves to support the default legal obligation of the Board known as stockholder wealth maximization ("SWM"), an approach to corporate governance that encourages a Board to implement all major decisions with only the economic interests of stockholders in mind. This is not readily apparent from the *Aronson* formulation of the Rule. The SWM requirement enters into corporate law through a Board's fiduciary duties as applied under the Rule, not through statutory law. In essence, SWM is an equitable concept. The implementation of SWM is indirect as all three of the major policy drivers that influence the Rule also guide courts to stay away from a direct focus on SWM unless the Rule has been rebutted.

The discussion that follows is specifically focused on those Board decisions which are permitted to be reviewed under the Rule. This means that the Article minimizes the discussion of those less common business decisions that come under corporate law's intermediate standards of judicial review, the *Revlon*

7. DEL. CODE ANN. tit. 8, § 141(a) (2016).
8. DEL. CODE ANN. tit. 8, § 152 (2015).
9. *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004).

duty[10] and the *Unocal* test,[11] both of which are meant to protect decisions from an automatic fairness review even if applied with a heightened level of judicial scrutiny. The Article also minimizes the discussions of those Board decisions that must initially come under the entire fairness standard of review, such as when a corporation enters into a self-dealing transaction with a controlling stockholder.[12]

Also, the discussion that follows—when it references state corporate law—has been pragmatically framed in the context of Delaware corporate law. Delaware is the state where the vast majority of the largest United States companies are incorporated,[13] and its corporate law often serves as the authority that other states look to when developing their own statutory and

10. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (establishing the *Revlon* duty to maximize stockholder wealth when the break-up, sale, or merger of a company is inevitable); *see also* Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994).

11. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (creating a two-pronged test, commonly referred to as the *Unocal* test, to review defensive measures taken by a board of directors to repel attempts by an outside investor or group of investors to gain control of the corporation).

12. Kahn v. M&F Worldwide Corp., 88 A.3d 635, 642 (Del. 2014) (according to the Delaware Supreme Court, "[w]here a transaction involving self-dealing by a controlling stockholder is challenged, the applicable standard of judicial review is 'entire fairness,' with the defendants having the burden of persuasion"). However, the Rule may still apply in a transaction where the controlling stockholder offers to buy out the minority stockholders (freeze-out) if the Board appoints a special independent committee to negotiate the transaction on behalf of the minority stockholders and the transaction is approved by an informed majority of minority stockholders. *Id.* at 645. In addition to Kahn's freeze-out merger scenario, it should also be noted that courts have recently taken other action to increase the number of Board decisions that come under the Rule, and not under an entire fairness standard of review, as long as they are satisfied that a majority of informed stockholders have approved the decision. *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015).

13. *See* LEWIS S. BLACK, JR., WHY CORPORATIONS CHOOSE DELAWARE 1, 1 (2007), http://corp.delaware.gov/whycorporations_web.pdf (stating that Delaware is the "favored state of incorporation for U.S. businesses"). According to the State of Delaware website, Delaware is the legal home to "[m]ore than 66% of all publicly-traded companies in the United States including 66% of the Fortune 500." STATE OF DELAWARE, ABOUT AGENCY, http://corp.delaware.gov/aboutagency.shtml (last visited Oct. 10, 2017).

common law.[14] Therefore, the primary examples are from Delaware, but the thinking is meant to be global.

This Article proceeds as follows: Part I discusses the origins of the Rule as a tool used by judges to restrain themselves from using their authority under equity to review Board decisions for (entire) fairness. Judges recognized that this was a necessity in order to protect directors from liability for honest mistakes in judgment that turn out badly. Part II describes how the Rule has been applied under DGCL § 141(a), the statutory law which provides the Board with almost unlimited authority to manage the corporation.[15] Part III discusses SWM as a legal obligation of Board decision-making and how the Rule is both consistent with and supportive of SWM.

I.
THE POWER OF EQUITY

As early as 1742, equity recognized that corporate boards should not be held liable for honest mistakes in judgment. According to the Lord Chancellor of England:

> [Directors] are most properly agents to those who employ them in this trust, and who empower them to direct and superintend the affairs of the corporation. In this respect they may be guilty of acts of commission or omission, of mal-feasance or nonfeasance. Now where acts are executed within their authority, . . . though attended with bad consequences, it will be very difficult to determine that these are breaches of trust. For it is by no means just in a judge, after bad consequences have arisen from such executions of their power, to say that they foresaw at the time what must necessarily happen; and therefore, were guilty of a breach of trust.[16]

This judicial policy of protecting board members from liability when their honest mistakes in judgment turn out badly has been consistently identified as a major policy objective of

14. *See* Nadelle Grossman, *Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform*, 12 FORDHAM J. CORP. & FIN. L. 393, 397 (2007).

15. DEL. CODE ANN. tit. 8, § 141(a) (2016).

16. Charitable Corp. v. Sutton [1742] 26 Eng. Rep. 642 (citations omitted).

the Rule. Fifty years ago, Henry Manne stated that the Rule "preclude[s] the courts from any consideration of honest if inept business decisions, and that seems to be the purpose of the Rule."[17] More recently, courts and commentators have become aware that protecting directors from such liability also allows for optimal risk-taking in corporate decision-making:

> Ultimately, the discretion granted directors and managers allows them to maximize shareholder value in the long term by taking risks without the debilitating fear that they will be held personally liable if the company experiences losses. This doctrine also means, however, that when the company suffers losses, shareholders may not be able to hold the directors personally liable.[18]

Protecting board members from liability when their honest mistakes in judgment turn out badly is not the Rule, as it is commonly mistaken to be.[19] Instead, it is a policy driver cited by courts in justifying the *use* of the Rule versus the alternative of an automatic (entire) fairness review. This will become clear when *Bodell II* is discussed, but first the discussion needs to focus on *Bodell I*.[20]

A. *Bodell I*

In *Bodell I*, the plaintiffs alleged that the Board violated its fiduciary duties by initiating a plan to sell no-par value stock for below its fair sales value.[21] In response, the Chancery had granted a temporary restraining order.[22] However, the Board itself was not accused of self-dealing or of personally profiting from the sales.[23] Moreover, the statute which allowed for the

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17. Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 271 (1967).
18. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009).
19. Randy J. Holland, *Delaware Directors' Fiduciary Duties: The Focus on Loyalty*, 11 U. PA. J. BUS. L. 675, 680 (citing 1 DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 9 (5th ed. 1998 & Supp. 2002).
20. Bodell v. Gen. Gas & Elec. Corp. (*Bodell I*), 15 Del. Ch. 119, 132 A. 442 (1926), *aff'd*, 15 Del. Ch. 420, 140 A. 264 (1927).
21. *See id.* at 122–23, 132 A. at 444.
22. *See id.* at 123, 132 A. at 444.
23. *See id.*

issuance of no-par value stock, Section 4a of the DGCL,[24] provided the Board with unrestrained authority to determine the adequacy of the consideration to be received in exchange for the no-par value stock as long as the Board had authority to do so under the company's certificate of incorporation.[25]

However, even in the face of this "absolute power," the Chancery had no problem with identifying the countervailing power of equity[26] as authority for reviewing the Board's actions:

> So far as the literal language of the section is concerned, the directors may from time to time issue no par stock for any consideration they may see fit, even though the price they fix is far below its actual value . . . . What I am now pointing out is simply this - that the statute does not impose any restraint upon the apparent unbridled power of the directors. Whether equity will, in accordance with the principles which prompt it to restrain an abuse of powers granted in absolute terms, lay its restraining hand upon the directors in case of an abuse of this absolute power, is another question which will be presently considered and answered in the affirmative.[27]

If this was not clear enough, the Chancery also stated, "But notwithstanding the absolute character of the language in which the power to direct the directors is expressed, it cannot be that a court of equity is powerless in *proper cases* to circumscribe it."[28]

24. A. R. Benson, General Corporation Laws of the State of Delaware 19 (1921). No-par common stock was approved in 1917 to be followed by no-par value preferred stock in 1925.

25. *Id.*

26. According to Quillen and Hanrahan, "[t]he secret of Delaware equity rests in two old concepts, both English in origin. First, equity is a moral sense of fairness based on conscience. Second, equity is the recognition that the universal rule cannot always be justly applied to the special case. Equity is the flexible application of broad moral principles (maxims) to fact specific situations for the sake of justice. Delaware has preserved the essence." William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery – 1792–1992*, 18 Del. J. Corp. L. 819, 821–22 (1993). For an excellent discussion of how equity is applied under corporate law, *see* Lyman Johnson, *Delaware's Non-Waivable Duties*, 91 B.U. L. Rev. 701, 709–13 (2011).

27. *Bodell I*, 15 Del. Ch. at 128, 132 A. at 446.

28. *Id.* at 129, 132 A. at 446 (emphasis added).

As authority for using its equitable powers in the face of statutory law that suggests otherwise, the Chancery noted, "There is no rule better settled in the law of corporations than that directors in their conduct of the corporation stand in the situation of *fiduciaries*. While they are not trustees in the strict sense of the term, yet for convenience they have often been described as such."[29]

In *Bodell I*, the Chancery begins its legal analysis by noting that when statutory law provides the Board with authority, there "accords to the acts of the directors a *presumption* in favor of their propriety and fairness."[30] This presumption is an acknowledgment of Board authority as derived through statutory law.

Nevertheless, in identifying the balance between Board authority and equity where a statute provides the maximum amount of managerial discretion, the Chancery applied a balance that was strongly oriented toward equity, requiring the Board to demonstrate fairness in their decision-making.[31] This was the result of the factual finding that the sale of equity was to occur at a price below fair market value.[32]

The application of the Chancery's fairness review focused primarily on the substantive nature of the stock sales regarding their overall benefits to stockholders, but also appears to have taken into consideration director conduct and motivations by noting that the Board was not interested in the transaction[33] and by concluding that "[a] complete absence of selfish motive and of personal profit on their part forcefully argues that

29. *Id.* (emphasis added). Directors are fiduciaries of both the corporation and stockholders. *See* ROBERT C. CLARK, AGENCY COSTS VERSUS FIDUCIARY DUTIES, IN PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 56 (John W. Pratt & Richard J. Zeckhauser eds., 1985). This gives the misleading impression that they serve two masters. In Part III, it is described how the Court reconciles this unusual situation by taking the position that the fiduciary duties owed to the corporation are for the benefit of the stockholders. *See infra*, Part III.

30. *Bodell I*, 15 Del. Ch. at 129, 132 A. at 446 (emphasis added). This is perhaps the source for the famous presumption language in the current Rule formulation.

31. *Id.* at 132, 132 A. at 448.

32. *See id.* at 122–23, 132 A. at 444.

33. *See id.* at 123, 132 A. at 444.

judgment was formed in absolute honesty and entire good faith."[34]

The Chancery found that the shares were not sold below the fair sales value, thus absolving the Board of any liability.[35] The Chancery also vacated the outstanding restraining order.[36] However, was a fairness review really required? This was the issue taken up by the Court in *Bodell II*.

B. *Bodell II*

In *Bodell I*, the Chancery made an emphatic declaration that the power of equity can never be denied, even in the face of a statutory law that provides the Board with absolute authority in a specific area of corporate decision-making and where there is no evidence of director self-interest. This declaration is not in dispute.[37] A court of equity always has the right to circumscribe Board authority when the court perceives that a wrong has been committed.[38] However, what *Bodell I* did not answer is whether a challenged Board decision would always come under a fairness review, placing the Board in the position of constantly facing significant potential liability for honest mistakes in judgment that turn out badly. Does equity require this? If not, what kind of decision-making tool or filter would the court use to make the determination that a fairness

34. *Id.* at 135, 132 A. at 449.

35. *Id.* at 134–37, 132 A. at 449–50.

36. *Id.* at 139, 132 A. at 451.

37. Sample v. Morgan, 914 A.2d 647, 675 n.54 (Del Ch. 2007) ("That the operation of Delaware corporate law depends importantly on the subjection of action in conformity with legal rules to equitable principles has long been understood.").

38. *Bodell I*, 15 Del. Ch. at 129, 132 A. at 446; *see also* Lofland v. Cahall, 118 A. 1, 3 (Del. 1922) ("Directors of a corporation are trustees for the stockholders, and their acts are governed by the Rules applicable to such a relation, which exact of them the utmost good faith and fair dealing, especially where their individual interests are concerned."); Adams v. Clearance Corp., 121 A. 2d 302, 306 (Del. 1956) ("When the directors, or the majority stockholders, exercise a power that the general corporation law confers upon them, it is competent for anyone who conceives himself aggrieved thereby to invoke the processes of a court of equity for protection against its oppressive exercise. Notwithstanding therefore the absolute terms in which the power of the directors is expressed, equity will afford protection against its wrongful use." (citations and quotes omitted)); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) ("[I]nequitable action does not become permissible simply because it is legally possible.").

review was or was not required? That tool turns out to be the Rule, the standard of judicial review that the Delaware Supreme Court used in *Bodell II* to affirm the Chancery's decision.[39]

In *Bodell II*, the Court was not reticent in taking issue with both the Chancery's apparent lack of respect for the managerial discretion provided by statutory law and its fairness standard of review. According to the Court, "the broad and general language of the statute, embodied in the Certificate of Incorporation, should be liberally construed in favor of the directors."[40] Continuing with this line of thinking, the Court also said:

> The Legislature, in enacting the statute, meant to clothe the directors of a corporation with exceptionally large powers in the sale of its no par value stock. If in the particular case there is nothing to show that the directors did not exercise their discretion for what they believed to be the best interest of the corporation, certainly an honest mistake of business judgment should not be reviewable by the Court.[41]

This is a direct repudiation of the approach applied by the Chancery and perhaps the first case that explained why fairness cannot be part of the Rule formulation. It makes clear that protecting director decision-making when it only involves honest mistakes of business judgment (most critical when director liability is involved) cannot coexist with a fairness standard of review. A fairness review is only concerned with an objective analysis into whether the results were fair to the plaintiffs; it does not take into consideration whether the decision was an honest mistake of business judgment. Either fairness or the policy of protecting honest mistakes of business judgment can be a component of the Rule, but not both. They are mutually exclusive. The Delaware Supreme Court chose the latter in formulating its Rule, an approach which still stands today:

39. This was perhaps the first case where the Delaware courts applied the Rule under the DGCL, a statutory set of laws created in 1899 to allow for general incorporation. *See* 21 Del. Laws 273 (1899).

40. Bodell v. Gen. Gas & Elec. Corp. (*Bodell II*), 15 Del. Ch. 420, 426, 140 A. 264, 267 (Del. 1927).

41. *Id.*

> It may be impossible to lay down a general rule on this subject, but we think the discretion of a board of directors in the sale of its no par value stock should not be interfered with, except for fraud, actual or constructive, such as improper motive or personal gain or arbitrary action or conscious disregard of the interests of the corporation and the rights of its stockholders.[42]

By using the language, "discretion of a board of directors" this Rule formulation acknowledges the managerial authority of the Board as provided by statutory corporate law.[43] Most importantly, however, the formulation reduces the demands of equity by requiring only the absence of certain types of improper Board conduct, namely actual or constructive fraud, in order to allow the decision to stand. Moreover, in formulating its Rule without the inclusion of fairness as a substantive component, the Court established a critical precedent under Section 4a of the old DGCL (currently DGCL § 152[44]) that has been since applied to DGCL § 141(a).[45] This precedent holds that there are significant limits to the reach of equity at least where statutory law grants the board seemingly absolute authority to make corporate decisions.

In affirming the Chancery Court's decision, the Court found no evidence that the Board was not acting in the best interest of the corporation and the fact that the Board was not interested in the transaction served as significant evidence of this.[46] The Court concurred with the lower court and found that the directors had utilized their best judgment and acted in good faith.[47] Therefore, the fairness review as required by *Bodell I* was not required.

C. *Fairness (Entire Fairness) as a Standard of Review*

Before moving to a discussion of the Rule under DGCL § 141(a), it is important to understand what is meant by a fair-

42. *Id.*
43. DEL. CODE ANN. tit. 8, § 141(a) (2016).
44. DEL. CODE ANN. tit. 8, § 152 (2015).
45. DEL. CODE ANN. tit. 8, § 141(a) (2016).
46. *Bodell II*, 15 Del. Ch. 420, 426, 140 A. 264, 267 (the directors were not going to financially benefit from the transaction).
47. *Id.* at 268.

ness review. *Bodell I* required a rigorous review of the stock sales, focusing on both the substantive and procedural nature of the sales and on the conduct and motivations of the directors. Such a fairness review would have created a heavy burden on a Board if it were conjured up every time an honest mistake in judgment turned out badly. This is essentially why the Court in *Bodell II* found it inappropriate to use such a review unless its Rule had been overcome.

The fairness review found in *Bodell I* is the forerunner of the review currently used by Delaware courts when the Rule is overcome (now called "entire fairness).[48] Entire fairness is a court's most onerous standard of review[49] and the one that a Board would most like to avoid, thus encouraging a Board to conduct its decision-making process within the confines of the Rule. However, while starting afresh under entire fairness does put a heavy burden on a Board, it "is not an implication of liability."[50] Entire fairness requires a review of the result for "substantive fairness," with the burden of proof on the defendants.[51] According to Ezra (a.k.a. Lawrence) Mitchell, an "[entire] fairness [review] contemplates a range of values and fiduciary conduct that properly is analyzed within the totality of a transaction's circumstances."[52] When this standard of review applies, courts must "consider carefully how the board of directors discharged all of its fiduciary duties with regard to each aspect of the non-bifurcated components of entire fairness: fair dealing and fair price."[53] Moreover, "[n]ot even an honest

48. Cinerama, Inc. v. Technicolor, Inc., 663 A. 2d 1156, 1162 (Del. 1995) ("If the [R]ule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the 'entire fairness' of the transaction to the shareholder plaintiff."); *see also*, Solomon v. Armstrong, 747 A.2d 1098, 1112 (Del. Ch. 1999) ("[T]he board's decision is reviewed through the lens of entire fairness, pursuant to which the directors lose the presumption of good business judgment, and where the Court more closely focuses on the details of the transaction and decision-making process in an effort to assess the fairness of the transaction's substantive terms.").

49. Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 459 (Del. Ch. 2011).

50. Emerald Partners v. Berlin, 787 A.2d 85, 93 (Del. 2001).

51. *Solomon*, 747 A.2d at 1112.

52. Lawrence E. Mitchell, *Fairness and Trust in Corporate* Law, 43 DUKE L. J. 425, 427 (1993).

53. *Emerald Partners*, 787 A.2d at 97.

belief that the transaction was entirely fair will be sufficient to establish entire fairness. Rather, the transaction itself must be *objectively* fair, independent of the board's beliefs."[54]

Fair *dealing* "embraces questions of when the transaction was timed, how it was initiated, structured, *negotiated*, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained."[55] In addition, "[p]art of fair dealing is the obvious duty of candor . . . . Moreover, one possessing superior knowledge may not mislead any stockholder by use of corporate information to which the latter is not privy."[56] Fair *price* "relates to the economic and financial considerations of the proposed [transaction], including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock."[57]

While in theory the review for entire fairness is a non-bifurcated process, in practice courts have great discretion in focusing more on one component than the other.[58] For example, "at least in *non-fraudulen*t transactions, price may be the preponderant consideration. That is, although evidence of fair dealing may help demonstrate the fairness of the price obtained, what ultimately matters most is that the price was a fair one."[59] In the uncommon fact pattern where a stock price, sale price of real estate, or level of compensation, etc. is not at is-

54. Gesoff v. IIC Indus., Inc., 902 A.2d 1130, 1145 (Del. Ch. 2006) (emphasis added).

55. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (emphasis added).

56. *Id.*

57. *Id.*; *see also Encite LLC v. Soni*, No. 2476-VCG, 2011 Del. Ch. LEXIS 177 at *75 (Del. Ch. 2011). Memorandum opinion.

58. Valeant Pharm. Int'l v. Jerney, 921 A. 2d 732 (Del. Ch. 2007) (focusing on fair dealing in a Board decision to pay large cash bonuses to themselves and to certain non-Board employees). In the cash bonus context of *Valeant*, even if the "board used an unfair process to authorize the bonuses" it "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. Nevertheless, where the pricing terms of a transaction that is the product of an unfair process cannot be justified by reference to reliable markets or by comparison to substantial and dependable precedent transactions, the burden of persuading the court of the fairness of the terms will be exceptionally difficult." *Id.* at 748 (emphasis added).

59. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); *see also Encite*, 2011 Del. Ch. LEXIS 177 at *24.

sue (e.g., where the Board of a non-statutory, closely-held corporation provided themselves with advantageous ways to liquidate their illiquid company stock holdings through company repurchases without providing such means for non-employee stockholders[60]), only fair dealing may apply.[61]

The heavy burden found in both the fairness review applied in *Bodell I* and the entire fairness review, at least in terms of the volume and duration of litigation, requires some way to avoid an automatic fairness review of Board decisions that turn out badly for shareholders. This makes the Rule a necessity.

D. *Summary*

Bodell I stands for the raw power of equity and how it can potentially trump statutory law, even where statutory law provides the Board with unlimited decision-making authority. According to the court, this was true even though the court acknowledged that there "accords to the acts of the directors a *presumption* in favor of their propriety and fairness."[62] *Bodell II* stands for the need to truly respect statutory authority, requiring the courts to restrain the power of equity in the face of this authority. This required restraint provides the foundation for understanding the essence of the Rule.

Bodell II's Rule formulation guides a court in how it should apply this restraint in its review of a Board decision. It first brings to the fore the requirement that a court must respect managerial discretion. This means that fairness cannot be the first stop in a court's review. Instead, a gentler approach must be taken, an approach that involves fiduciary duties, not fairness. There is no room in the Rule formulation for fairness; fairness and fiduciary duties must be mutually exclusive. A fairness review is not allowed unless a fiduciary duty has been breached or there is some taint surrounding the decision such as director' interestedness. This is the fundamental essence of the Rule and if there is one thing that law students must understand about the Rule, this is it.

60. Nixon v. Blackwell, 626 A. 2d 1366 (Del 1993).
61. *Id.* at 1376.
62. Bodell v. Gen. Gas & Elec. Corp. (*Bodell I*), 15 Del. Ch. 119, 129, 132 A. 442, 446 (1926).

II.
THE BUSINESS JUDGMENT RULE AND § 141(a)

The significance of the Rule peaks when the Rule is applied under the critically important statutory corporate law that provides the Board with authority to manage the corporation. In Delaware, this law is DGCL § 141(a), which states, "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."[63]

On its face, this statutory law can be interpreted as providing the Board with unlimited managerial authority, similar to the authority provided by DGCL Section 4a (as discussed in *Bodell I and II*). Unlike Section 4a and its successor DGCL § 152,[64] DGCL 141(a) is an opt-out or "default" rule, not an opt-in rule. As a default rule, the delegation of unlimited authority to the Board is not expected to be substantively altered through a charter amendment. In practice, this has certainly been the case, especially in the context of public companies.

Most importantly, both are examples of the private ordering or enabling approach found in statutory corporate law. According to the Court in *Williams v Geier*, "At its core, the Delaware General Corporation Law is a broad enabling act which leaves latitude for substantial *private ordering*, provided the statutory parameters and judicially imposed principles of fiduciary duty are honored."[65] Private ordering of authority is considered efficient because it allows for the implementation of market-driven corporate governance arrangements.[66] That is, "ob-

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63. DEL. CODE ANN. tit. 8, § 141(a) (2016).
64. DEL. CODE ANN. tit. 8, § 152 (2015).
65. Williams v. Geier, 671 A.2d 1368, 1381 (1996).
66. According to Professor Jonathan Macey:

> [B]ecause informal norms generate outcomes that are generally welfare-enhancing, while law *at best* generates outcomes that are mixed (and tend strongly towards the welfare-reducing), informal norms should come with a strong presumption of legitimacy. Formal legal rules are likely to be inefficient at best and amorally redistributive at worst. Thus, under a wide range of circumstances, such as when society is interested in maximizing utilitarian considerations, and when society is interested in resolving standard legal disputes within groups, lawmakers are unlikely to improve upon the customary rules the group develops through voluntary, private interaction.

served governance choices are the result of value-maximizing contracts between stockholders and management."[67] Courts understand that this private ordering has been agreed to under the sanction of statutory corporate law and will feel compelled to respect the wishes of those parties to have the Board manage the company with minimal interference, including interference from the courts.[68] Such respect is not speculative. For example, when a corporation amends its charter to provide for an exculpation clause to protect directors from duty of care liability as allowed under the authority granted by DGCL § 102(b)(7),[69] courts have shown great deference for the authority provided by this type of amendment.[70] In essence, the Board and stockholders have agreed to contract away the Board's fiduciary duty of care. Thus, private ordering provides another policy rationale for why the courts should restrain themselves when applying equitable principles to Board decision-making, adding weight to the lever on the side where statutory law rests and away from equity under the Rule.

Why stockholders permit the Board unrestrained authority under both DGCL § 152 and DGCL § 141(a) is based on the recognition that the Board, with superior information, including confidential information, is in the best position to make the most important corporate decisions. The parties to the corporate contract recognize that a centralized, hierarchi-

Jonathan R. Macey, *Public and Private Ordering and the Production of Legitimate and Illegitimate Legal Rules*, 82 CORNELL L. REV. 1123, 1140–41 (1997).

67. David F. Larcker et al., *The Market Reaction to Corporate Governance Regulation*, 101 J. FIN. ECON. 431, 431 (2011).

68. Bernard S. Sharfman, *The Tension Between Hedge Fund Activism and Corporate Law*, 12 J. L. ECON. & POLICY 251, 253 (2016).

69. DEL. CODE ANN. tit. 8, § 102(b)(7) (2015). Section 102(b)(7) bars any claim for money damages against the director defendants based solely on the board's alleged breach of its duty of care.

70. Malpiede v. Townson, 780 A.2d 1075 (Del. 2001). Delaware courts have also demonstrated respect for the statutory right of corporations, by either a charter amendment or simply a Board resolution, to contract out of the fiduciary duty of loyalty when applying the corporate opportunities doctrine. *See* DEL. CODE ANN. tit. 8, § 122(17) (2000); Gabriel V. Rauterberg & Eric L. Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, COLUM. L. REV. (forthcoming 2017). However, as Lyman Johnson has pointed out, an exculpation clause does not eliminate the duty of care, only the consequences of its breach when the financial liability of the Board is the focus. *See* Johnson, *supra* note 26, at 705.

cal authority is necessary for the successful management of a corporation, especially as it grows to any significant size.[71]

Such deference to Board authority is shared by the courts in its application of the Rule. The Delaware Supreme Court has described the Rule as "an acknowledgment of the managerial prerogatives of Delaware directors under Section 141(a),"[72] a point which, if seriously taken, will help make sure the balance does not tip too far towards equity:

> The "business judgment" rule is a judicial creation that presumes propriety, under certain circumstances, in a board's decision. Viewed defensively, it does not create authority. In this sense the "business judgment" rule is not relevant in corporate decision-making until after a decision is made. It is generally used as a defense to an attack on the decision's soundness. The board's managerial decision-making power, however, comes from § 141(a). The judicial creation and legislative grant are related because the "business judgment" rule evolved to give recognition and deference to directors' business expertise when exercising their managerial power under § 141(a).[73]

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71. Robert Charles Clark, Corporate Law 801–16 (1986) (arguing that "facilitation of cooperation" allows for efficiently completing large tasks). According to Kenneth Arrow, information scattered over a large organization must be both filtered and transmitted to a centralized authority in order for a large organization to make informed decisions and minimize error in decision-making. Kenneth J. Arrow, The Limits of Organization 68–70 (1974). Arman Alchian and Harold Demsetz argued that a centralized authority was necessary to eliminate the problems associated with having a large number of stockholders:

> If every stock owner participated in each decision in a corporation, not only would large bureaucratic costs be incurred, but many would shirk the task of becoming well informed on the issue to be decided, since the losses associated with unexpectedly bad decisions will be borne in large part by the many other corporate stockholders. More effective control of corporate activity is achieved for most purposes by transferring decision authority to a smaller group, whose main function is to negotiate with and manage (renegotiate with) the other inputs of the team.

Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. 777, 788 (1972).

72. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citing Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981)).

73. Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981).

Unlike the defensive nature of the policy rationale utilized in *Bodell II* (i.e., directors should not be blamed for honest mistakes of business judgment), this policy rationale focuses on how corporate decision-making is enhanced because of a Board's business expertise.[74] Embellishing this important point, the Court has also stated that "the core rationale of the Rule is that judges are poorly positioned to evaluate the wisdom of business decisions and there is little utility to having them second-guess the determination of impartial decision-makers with more information (in the case of directors) . . . ."[75]

Judges need to respect Board decision-making for the simple reason that they are inferior to the Board in terms of determining what is the best corporate decision and therefore should not take on the role of reviewing the substantive decisions of the Board, including determining the "appropriate degrees of business risk."[76] Judges recognize that they lack information, decision-making skills, expertise, and vested interest (i.e., stake in the company) relative to corporate management.[77] As stated by the Michigan Supreme Court in the famous case of *Dodge v. Ford Motor Co.*,[78] "[J]udges are not business experts."[79] Therefore, as long as the courts do not find a breach in a Board's fiduciary duties, they typically do not want to get involved in any type of substantive review of a Board decision.[80]

In part, the humility expressed by courts with respect to their own decision-making abilities is reflective of their understanding that making a business decision can be the result of a long and complicated thought process requiring expertise that courts do not have. The following statement, in the context of a Board trying to make a wealth maximizing decision on behalf of stockholders, makes that point:

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74. *Id.*

75. Corwin v. KKR Financial Holdings LLC, 125 A.3d 304, 313–14 (Del. 2015).

76. Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000) (quoting Lewis v. Vogelstein, 699 A. 2d 327, 336 (Del Ch. 1997)).

77. Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389, 406–09 (2014).

78. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

79. *Id.*

80. Sharfman, *supra* note 77, at 409–11.

> [D]etermining whether a business decision is stockholder wealth-maximizing is not just about plugging in a formula and calculating the result, which any computer or calculator can do. Rather, it refers to the specific formula that will be utilized by management to determine if a particular decision maximizes stockholder wealth. One can think of this in terms of a mathematical formula where the decision maker is given the responsibility of choosing the variables and estimating the coefficients of those variables. This requires many sources of knowledge and expertise that chancellors and judges lack, including experience in the particular business that the company may be in, product and company knowledge, management skills, financial skills, creative and analytical thinking pertinent to a company's business, confidential information, and so on. For example, who has the knowledge and expertise to decide whether a distinctive corporate culture enhances or detracts from stockholder value? The clear answer is that the board and its executive management are the proper locus of authority for making this decision.[81]

In sum, what courts desire in terms of corporate authority can be summarized in the following statement by Professor Stephen Bainbridge: the "[p]reservation of managerial discretion should always be the null hypothesis."[82] This approach is supported not only by the desire to refrain from punishing the Board for honest mistakes in judgment but also by two additional policy drivers: (1) respect for the *private ordering* of corporate governance arrangements, which almost always place the bulk of authority for decision-making with the Board, and; (2) courts' recognized lack of business expertise. All three policy drivers encourage a court to use the Rule and discourage it from going directly to an entire fairness review.

A. *The Business Judgment Rule Formulation*

In contrast to the Rule formulation found in *Bodell II*, the current formulation of the Rule under § 141(a) (the *Aronson*

81. *Id.* at 408.
82. Bainbridge, *supra* note 9, at 109.

formulation) includes an aspect of the duty of care, the need for a Board to make a decision on an informed basis:

> It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption.[83]

For many, this additional requirement was a mistake, leading to the heavily criticized decision in the famous corporate law case of *Smith v Van Gorkom*,[84] where the Court made absolutely clear that an uninformed Board decision could overcome a court's deference to Board authority and could create director liability.[85] In *Van Gorkom*, this liability occurred despite the fact that the Board had agreed to sell the company for a forty-eight percent premium above the previous day's closing price.[86]

Under *Van Gorkom*, to establish that a Board has made an informed decision, a court must determine "whether the directors have informed themselves 'prior to making a business decision, of all material information reasonably available to them.' "[87] Gross negligence is the standard used to determine

83. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citations omitted). In *Aronson*, the Court addressed the issue of "when is a stockholder's demand upon a board of directors, to redress an alleged wrong to the corporation, excused as futile prior to the filing of a derivative suit?" *Id.* at 807.

84. Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985).

85. Frank Easterbrook and Daniel Fischel found the criticism of *Van Gorkom* to be entirely justified:

> It is not hard to see why the case produced such a swift and sweeping reaction. Judicial inquiry into the amount of information managers should acquire before deciding creates the precise difficulties that the business judgment rule is designed to avoid. Information is necessary for corporate managers to maximize the value of the firm. But there is a limit to how much managers should know before making a decision.

FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 107–08 (1991).

86. *See* Bernard S. Sharfman, *The Enduring Legacy of Smith v. Van Gorkom*, 33 Del. J. Corp. L. 287, 291 (2008).

87. *Van Gorkom*, 488 A.2d at 872 (quoting *Aronson*, 473 A.2d at 812).

if there has been a breach of the directors' duty of care in becoming informed.[88]

Soon after *Van Gorkom*, the Delaware General Assembly, responding to concerns that directors faced too much in the way of personal liability, enacted DGCL 102(b)(7),[89] a statutory provision that protects directors from monetary liability for any actions arising from a breach of their duty of care if corporations opt-in through a charter amendment.[90] In essence, Delaware lawmakers have given Delaware corporations the opportunity to veto the *Van Gorkom* decision if they found it was not in their best interests.

However, consistent with the underlying policies of not punishing the Board's honest mistakes in judgment and deferring to Board decision-making authority as provided by private ordering and the court's recognition of its lack of business expertise, the "informed" element of the Rule refers only to "procedural due care," not "substantive due care."[91] According to the Delaware Supreme Court in *Brehm v Eisner*, "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."[92] In sum, meeting the requirements of procedural due

88. *Id.* at 873.

89. DEL. CODE ANN. tit. 8, § 102(b)(7) (2015). Under § 102(b)(7), stockholders are allowed to incorporate into their certificate of incorporation:

> A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; . . . ; or (iv) for any transaction from which the director derived an improper personal benefit.

Id.

90. *Id.*

91. Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000).

92. *Id.* Interestingly, a valid waste claim may still exist even if the plaintiff cannot overcome the presumption of the Rule. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 73–74 (Del. 2006). In essence, waste is a standard of review that stands outside the Rule and is applicable when irrationality is not found to be associated with a lack of good faith:

> To recover on a claim of corporate waste, the plaintiffs must shoulder the burden of proving that the exchange was so one sided that

care under the Rule means that a Board has not reached their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available."[93]

B. *Rebutting the Presumption*

Since *Bodell II*, courts have created a fuller picture of what kinds of conduct (fiduciary duties) and lack of taint surrounding the decisions (e.g., disinterestedness, independence and rational business purpose), are required in order for a Board decision to receive the protections of the Rule:

> The business judgment rule, as a general matter, protects directors from liability for their decisions so long as there exist "a business decision, disinterestedness[94] and independence,[95] due care, good

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> no business person of ordinary, sound judgment would conclude that the corporation has received adequate consideration. A claim of waste will arise only in the rare, unconscionable case where directors irrationally squander or give away corporate assets. This onerous standard for waste is a corollary of the proposition that where business judgment presumptions are applicable, the board's decision will be upheld unless it cannot be attributed to any rational purpose.

Freedman v. Adams, 58 A.3d 414, 417 (Del. 2013) (quotations and citations omitted) (citing *Disney*, 906 A.2d at 74).

93. *Brehm*, 746 A.2d at 264 n.66.

94. Under Delaware law, "[a] director is interested in a given transaction if she stands to gain monetarily from it in a way that other stockholders do not." Usha Rodrigues, *The Fetishization of Independence*, 33 J. Corp. L. 447, 466 (2008) (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm*, 746 A.2d at 254).

95. Under Delaware law:

> Directors must not only be independent, but must act independently. Kahn v. Tremont Corp., 694 A.2d 422, 429 (Del. 1997). As this Court has previously stated in defining director independence: "[i]t is the care, attention and sense of individual responsibility to the performance of one's duties . . . that generally touches on independence." *Id.* at 430, quoting Aronson v. Lewis, 473 A.2d 805, 816 (Del. 1984). Where only one director has an interest in a transaction, however, a plaintiff seeking to rebut the presumption of the business judgment rule under the duty of loyalty must show that "the interested director controls or dominates the board as a whole." Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1168 (Del. 1995).
>
> A party alleging domination and control of a company's board of directors bears the burden of proving such control by showing a

> faith[96] and no abuse of discretion[97] and a challenged decision does not constitute fraud, illegality, ultra vires conduct or waste." There is a presumption that directors have acted in accordance with each of these elements, and this presumption cannot be overcome unless the complaint pleads specific facts demonstrating otherwise. Put another way, under the business

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> lack of independence on the part of a majority of the directors. Odyssey Partners, L.P v. Fleming Cos., Inc., 735 A.2d 386, 407 (Del. Ch. 1999). Theoretically, a director can be "controlled" by another, for purposes of determining whether the director lacked the independence necessary to consider the challenged transaction objectively. A controlled director is one who is dominated by another party, whether through close personal or familial relationship or through force of will. Orman v. Cullman, 794 A.2d 5, 25 n. 50 (Del. Ch. 2002). A director may also be deemed "controlled" if he or she is beholden to the allegedly controlling entity, as when the entity has the direct or indirect unilateral power to decide whether the director continues to receive a benefit upon which the director is so dependent or is of such subjective material importance that its threatened loss might create a reason to question whether the director is able to consider the corporate merits of the challenged transaction objectively. *Id.*

Telxon Corp. v. Meyerson, 802 A.2d 257, 264 (Del. 2002).

96. In *Lyondell v. Ryan*, the Delaware Supreme Court stated that failing to act in good faith means that a Board has intentionally failed "to act in the face of a known duty to act, demonstrating a conscious disregard for his duties." Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 243 (Del. 2009) (quoting *Disney*, 906 A.2d at 67).

97. For example, it may be an abuse of discretion when the Board refuses to pay out a dividend even though the company has accumulated a large amount of earnings. As stated by the Chancery Court in *Eshleman v. Keenan*:

> That courts have the power in proper cases to compel the directors to declare a dividend, is sustained by respectable authorities. But that they should do so on a mere showing that an asset exists from which a dividend may be declared, has never, I dare say, been asserted anywhere. In such a case a court acts only after a demonstration that the corporation's affairs are in a condition justifying the declaration of the dividend as a matter of prudent business management and that the withholding of it is explicable only on the theory of an oppressive or fraudulent abuse of discretion.

22 Del. Ch. 82, 87–88, 194 A. 40, 43 (1937). *See also* Moskowitz v. Bantrell, 190 A.2d 749, 750 (Del. 1963) (citing *Eshleman* (in discussing when a court may direct a Board to declare a dividend, the court said: "[t]he principle of law applicable to the relief sought is well settled. Before a court will interfere with the judgment of the Board of Directors, fraud or gross abuse of discretion must be shown.").

> judgment rule, the Court will not invalidate a Board's decision or question its reasonableness, so long as its decision can be attributed to a rational business purpose.[98]

If the presumption has been overcome, "the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its stockholders."[99] As a result, even though the decision may have lost the protections of the Rule, the court cannot go directly to a determination of damages.[100] Instead, it must first make a determination that the transaction was not entirely fair.[101] Such a finding "will be the basis for a finding of substantive liability."[102]

Under this Rule formulation, relative to the Rule found in *Bodell II*, the balance provided by the Rule has shifted toward equity through the explicit requirements of independence, a rational business purpose and most importantly, the relatively new requirement that the Board be informed. These are additional ways for a court to move a Board decision out of the category of Board decisions that the courts are barred from scrutinizing and into the realm of a fairness review, notwithstanding the prevalence of exculpation clauses that mute the effect of a finding that the Board was not informed when it made the challenged decision.

Therefore, while director conduct and lack of taint requirements under this Rule formulation may seem more extensive and demanding than those found in *Bodell II*, this formulation's purpose is exactly the same: to serve as a tool that courts can use to determine whether a Board decision should stand or be subject to a fairness review, i.e., an entire fairness review. These additional requirements can be understood as simply technical corrections when put in the context of maintaining the Rule as the first and most important line of defense against an entire fairness review. In that vein, the presumption

98. Robotti & Co. *ex rel.* Gulfport Energy Corp. v. Liddell, No. 3128-VCN, 2010 WL 157474, at *11 (Del. Ch. Jan. 14, 2010) (footnotes omitted) (quoting 1 STEPHEN A. RADIN ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES FOR CORPORATE DIRECTORS 110 (6th ed. 2009)).
99. *Id.* at 91.
100. *Id.* at 93.
101. *Id.*
102. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1165 (Del. 1995).

language can be understood to mean that the court must presume that a board decision does not come under a fairness review so long as a Board's fiduciary duties have been met.

C. *The Rule as Abstention Doctrine?*

Stephen Bainbridge, one of the most important corporate law scholars of the past twenty years, has argued that the Rule is an abstention doctrine.[103] As such, "the business judgment rule's function is to preclude courts from deciding whether the directors violated their duty of care."[104] Even though required to focus on procedural due care, courts are still precluded, under the Rule, from reviewing for substantive due care, i.e., the *quality* of a Board's decisions, or for breaches in the duty of care that arise from ordinary negligence in becoming informed. According to Bainbridge, courts are willing to abstain from the review of most duty of care claims because they find this the best way to protect Board authority from unwarranted court interference:

> Establishing the proper mix of deference and accountability thus emerges as the central problem in applying the business judgment Rule to particular situations. Given the significant virtues of discretion, however, one must not lightly interfere with management or the board's decision-making authority in the name of accountability. Preservation of managerial discretion should always be the null hypothesis.[105]

Duty of care claims that go beyond the judicially defined carve-out will quickly be dismissed without discovery even under the lenient standard of "reasonable conceivability," the standard of review that the Delaware courts use in determining whether a complaint will survive a defendant's motion to dismiss.[106] That courts define the duty of care in such narrow

103. Bainbridge, *supra* note 9.
104. *Id.* at 101.
105. *Id.* at 109.
106. According to the Chancery Court:

> As recently reaffirmed by the Delaware Supreme Court, the governing pleading standard in Delaware to survive a motion to dismiss is reasonable conceivability. That is, when considering such a motion, a court must: accept all well-pleaded factual allegations in the Complaint as true, accept even vague allegations in the Complaint as "well-pleaded" if they provide the defendant notice of the

terms means that the claims simply do not describe a violation of the law.[107] Given this carve-out for most duty of care claims, the Rule can indeed be understood as an abstention doctrine.

But the Rule as a means of precluding duty of care claims could not have been the Rule's original intent, at least under Delaware corporation law. At the time of *Bodell I* and *II*, in 1926 and 1927 respectively, a Board's fiduciary duties did not include a duty of care.[108] It was not until 1963 that the Delaware courts recognized the duty of care as a Board duty and it was not even in the context of the Rule, but rather in regard to the Board's oversight of the company.[109] Finally, in 1971, the Delaware Chancery Court established that being informed was part of a Board's fiduciary duties under the Rule.[110]

> claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof. This reasonable "conceivability" standard asks whether there is a "possibility" of recovery. If the well-pled factual allegations of the complaint would entitle the plaintiff to relief under a reasonably conceivable set of circumstances, the court must deny the motion to dismiss.

Dent v. Ramtron Int'l Corp., C.A. No. 7950-VCP (Del Ch. 2014) (citing Central Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC, 27 A.3d 531, 536 (Del. 2011)).

107. As pointed out by Robert Rhee, the concept of the Rule as abstention doctrine does not imply judicial abnegation:

> The business judgment rule cannot be an abnegation of power because its very existence arises from the exercise of judicial lawmaking. The court's power to give deference must also mean the court's power to take it. . . . Rather, the systematic outcomes of no liability are achieved because the business judgment rule reflects a reasoned judgment of courts on the nature of a wrong; they evince the exercise of judicial power, and not the relinquishment of it.

Robert J. Rhee, *The Tort Foundation of Duty of Care and Business Judgment*, 88 NOTRE DAME L. REV. 1139, 1193 (2013).

108. Bernard S. Sharfman, *Being Informed Does Matter: Fine Tuning Gross Negligence Twenty Plus Years After Van Gorkom*, 62 BUS. LAW. 135, 147 (2006).

109. *Id.* (citing Graham v. Allis-Chalmers Manufacturing Co., 188 A.2d 125, 130 (Del. 1963) ("It appears that directors of a corporation in managing the corporate affairs are bound to use that amount of care which ordinarily careful and prudent men would use in similar circumstances.").

110. *Id.* at 148 (citing Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971)) ("Application of the Rule of necessity depends upon a showing that *informed* directors did, in fact, make a business judgment authorizing the transaction under review.") (emphasis added).

The observation that the duty of care was a late arrival as part of a Board's fiduciary duties is not meant to imply that the Rule was not originally meant to be an abstention doctrine. That is, it is not necessary to focus only on the preclusion of duty of care claims to come to the conclusion that the Rule is and has always been an abstention doctrine, at least since *Bodell II*. As already discussed, as a result of the application of the Rule formulation, courts must abstain from a fairness review when the plaintiff fails to show that the Board decision has been tainted with fraud, interest, lack of good faith, abuse of discretion, lack of independence, gross negligence in becoming informed, etc.[111] Therefore, in a very global and fundamental way, the Rule can be understood as an abstention doctrine, requiring the court to abstain from a fairness review unless some sort of director misconduct or taint surrounding the decision is found.

D. *Summary*

The role played by the Rule does not change under DGCL 141(a).[112] However, two additional policy drivers are identified which reinforce the use of the Rule as a means to restrain the courts from reviewing a Board decision for fairness. First, respect for the *private ordering* of corporate governance arrangements, which grant extensive authority to the Board to make decisions on behalf of the corporation. Second, the recognition by the courts that they are not business experts, meaning that they must typically defer to the judgment of the Board in the determination of whether a Board decision is wealth maximizing. Additionally, taints surrounding a business decision now include lack of independence or a rational business purpose. Moreover, the Rule is an abstention doctrine not just in terms of precluding duty of care claims, as persuasively argued by Stephen Bainbridge, but also in a more fundamental way, by requiring courts to abstain from a fairness review if there is no breach in fiduciary duties or taint surrounding a Board decision.

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111. Robotti & Co. *ex rel.* Gulfport Energy Corp. v. Liddell, No. 3128-VCN, 2010 WL 157474, at *11 (Del. Ch. 2010) (footnotes omitted) (quoting 1 STEPHEN A. RADIN ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES FOR CORPORATE DIRECTORS 110 (6th ed. 2009)).

112. DEL. CODE ANN. tit. 8, § 141(a) (2016).

III.
THE RULE AND THE OBJECTIVE OF SHAREHOLDER WEALTH MAXIMIZATION

The *Aronson* formulation does not expand on what it means for directors to act "in the best interests of the corporation."[113] This opens the door for some to argue that the objective of Board decision-making is not SWM, but rather the balancing of the interests of the multiple stakeholders that interact with the corporation. This point is very timely as a number of academics recently signed a statement arguing in part that the Rule serves as evidence that the Board is under no legal obligation to maximize the wealth of stockholders:

> Contrary to widespread belief, corporate directors generally are not under a legal obligation to maximize profits for their stockholders. This is reflected in the acceptance in nearly all jurisdictions of some version of the business judgment rule, under which disinterested and informed directors have the discretion to act in what they believe to be in the best long term interests of the company as a separate entity, even if this does not entail seeking to maximise short-term stockholder value. Where directors pursue the latter goal, it is usually a product not of legal obligation, but of the pressures imposed on them by financial markets, activist stockholders, the threat of a hostile takeover and/or stock-based compensation schemes.[114]

Does the Rule really serve as evidence that corporate law does not require the Board to maximize shareholder value? This Part makes the argument that the answer is a decisive "no."

113. Aronson v. Lewis, 473 A.2d 805, 812.

114. Lynn Stout et al., *The Modern Corporation Statement on Company Law*, JACK G. CLARKE BUSINESS LAW INSTITUTE (Oct. 29, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2848833 (this document was signed by 55 signatories, mainly corporate law scholars, but also including some prominent practitioners such as Martin Lipton, the purported inventor of the poison pill).

A. *Shareholder Wealth Maximization as the Objective of Corporate Governance*

There are several different reasons and explanations for why it is optimal to have SWM as the objective of corporate governance and why corporate law should support that objective by imposing legal obligations on the Board. First, unlike a stakeholder approach (to be discussed below) where the board of directors is given the unenviable task of balancing the interests of multiple stakeholders without maximizing the interests of any, SWM allows for the maximization of an objective function.[115] Second, by serving only one master—shareholders—a Board can be held more accountable for its decisions. According to Frank Easterbrook and Daniel Fischel, "a manager told to serve two masters . . . has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other."[116] According to Jensen, if a stakeholder approach is taken, then "[t]he result will be confusion and lack of purpose that will [fundamentally] handicap the firm in its competition for survival."[117] Third, according to Easterbrook and Fischel, one can think of SWM as the default rule under corporate law because it is "the operational assumption of successful firms."[118] Fourth, according to John Boatwright, "corporate decision-making is more efficient and effective when management has a single, clearly defined objective and shareholder wealth maximization provides not only a workable decision guide but one that, if pursued, increases the total wealth creation of the firm."[119]

Why SWM is preferable as the corporate objective can also be explained through two models of the corporation, the principal-agent model and the nexus of contracts model.

115. Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPL. CORP. FIN. 8 (2001).

116. EASTERBROOK & FISCHEL, *supra* note 85, at 38.

117. Jensen, *supra* note 115, at 11.

118. EASTERBROOK & FISCHEL, *supra* note 85, at 36.

119. See George A. Mocsary, Freedom of Corporate Purpose, 2016 BYU L. REV. 1319, 1390 (2016) (citing John R. Boatright, *What's Wrong—and What's Right—with Stakeholder Management*, 22 J. PRIVATE ENTERPRISE 106, 119 (2006)).

1. *Principal–Agent Model*

In a principal-agent model of the corporation, shareholders are viewed as owners of the corporation and Boards as their agents.[120] However, the typical separation within the corporation of ownership from control creates great potential for managerial self-dealing and shirking. If realized, the results are increased agency costs, including Board decisions that are not focused on SWM. Agency costs are a detriment to shareholder profit. Therefore, directors should be legally bound to minimize agency costs with the objective of maximizing shareholder profits.

2. *Nexus of Contracts Model*

Michael Jensen and William Meckling would describe an organization that takes the corporate form as a legal fiction that serves "as a nexus for a set of contracting relationships among individuals."[121] Under a nexus of contracts or "contractarian" model of the corporation, shareholders are not perceived to own the corporation but are considered to be only one of many parties that contract with the corporation.[122] Nevertheless, the board of directors still has fiduciary duties to maximize shareholders' wealth.[123] This is a result of the hypothetical bargain struck between shareholders and the other parties in the corporation.[124]

In this hypothetical bargain, shareholders, the sole claimants to the residual cash flows generated by the firm, would argue that since they are the least contractually protected relative to other parties, they deserve SWM as the gap filler in their corporate contract.[125] That is, they are the parties to the corporate contract that have the greatest risk of ending up with nothing as a result of their dealings with the corporation. In the context of public companies, shareholders enforce their

120. Alan J. Meese, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629, 1631 (2002).

121. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310 (1976).

122. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 547–48 (2003).

123. *Id.* at 548.

124. *See id.* at 547–48.

125. *See id.* at 547–48, 579.

preference for SWM through the market for corporate control[126] and hedge fund activism.[127]

One reason why other stakeholders would support a Board and executive management targeting SWM is because all other parties that have contracted with the corporation must be paid off prior to the shareholders receiving any residual.[128] As stated by Henry Manne, SWM as the corporate objective is an example of "pure positive economics"[129] and should be accepted as such.

Like the principal-agent model of the corporation, a nexus of contracts model tells us to expect the corporate ob-

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126. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). Manne provides the following description of how the market for corporate control operates:

> Briefly, the market for corporate control in our system operates in the following manner: if an existing corporation with publicly traded shares is poorly managed, holders of those shares will respond by selling. This will drive the price down to the point indicated by the quality of management which the corporation is receiving. As the price of securities of any corporation is thought to be low relative to the price that would be generated by more efficient managers, the stage is set for the critical functioning of the market for corporate control. Outsiders . . . will respond to the opportunity to make substantial capital gains (not necessarily in the tax sense) by buying control, managing the company efficiently, and then perhaps disposing of the shares. It is not necessary that they remain permanently to manage the business.

Henry G. Manne, *Cash Tender Offers for Shares – A Reply to Chairman Cohen*, 1967 DUKE L.J. 231, 236 (1967) (citations omitted).

127. An activist hedge fund works in a similar manner to the potential acquirer. The difference is that the activist hedge fund attempts to correct inefficiencies through its influence, not its control of the company. It acquires a significant but not controlling share in a company at a relatively low price with the expectation that existing inefficiencies will eventually be corrected through its efforts and the price will rise to reflect these enhanced efficiencies. In essence, hedge fund activism provides a corrective function similar to, but with less investment and more advocacy than, what is found in the market for corporate control. *See* Bernard S. Sharfman, *A Theory of Shareholder Activism and Its Place in Corporate Law*, 82 TENN. L. REV. 791, 804–07 (2015); *see also* Bernard S. Sharfman, *Activist Hedge Funds in a World of Board Independence: Creators or Destroyers of Long-Term Value?*, 2015 COLUM. BUS. L. REV. 813 (2016).

128. EASTERBROOK & FISCHEL, supra note 85, at 38 ("[M]aximizing profits for equity investors assists the other 'constituencies' automatically.").

129. E-mail from Henry G. Manne, Professor Emeritus of Law, Geo. Mason Univ., to Bernard S. Sharfman (Dec. 29, 2012) (on file with author).

jective to be SWM. However, unlike the principal-agent model, it does not suggest that an exclusive focus on minimizing agency costs is the only way to achieve that objective. From a nexus of contracts approach, that determination should be up to the organizers of the corporation with input from all stakeholders. For example, the critical question of what should be the balance of power between the Board and shareholders needs to be resolved prior to commencing operations as a corporation. This, of course, is referred to as the private ordering of corporate governance arrangements and is assumed to be value-maximizing for all stakeholders, including shareholders. Again, the balance of authority is almost always tilted heavily toward the Board.

If one is to think of the corporation as a nexus of contracts, then one must also include the role played by the courts in making sure those contracts are enforced. The courts create fiduciary duties which serve "as gap-filling devices for incomplete contracts between shareholders and firm managers." Moreover, if fiduciary duties are crafted carefully to maximize shareholder value,[130] this would mean that all stakeholders would benefit from their application. However, the three policy drivers already discussed—(1) protecting the Board from liability for honest mistakes in judgment, which also serves the purpose of allowing the Board "to maximize shareholder value in the long term by taking risks without the debilitating fear that they will be held personally liable if the company experiences losses"[131]; (2) deference to private ordering as authorized by statutory law, and; (3) courts' recognition that the Board, and not the courts, is in the best position to make corporate decisions—severely restrain judicial desire to take an active role in arbitrating disputes. These drivers strongly encourage courts, as a means of maximizing shareholder value, to defer to the judgment of the Board.

B. *A Stakeholder Model of Corporate Governance*

Those who signed off on the statement rejecting SWM as the legal objective of Board decision-making most likely be-

130. Frederick Tung, *Gap Filling in the Zone of Insolvency*, 1 J. BUS. & TECH. L. 607 (2007).

131. *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009).

lieve in a stakeholder model of the corporation. In such a model, there is no one stakeholder holding the position of residual claimant. According to Henry Hansmann and Reinier Kraakman, there are two types of stakeholder models.[132] The first model is called a "'fiduciary' model of the corporation."[133] In this model, "the board of directors functions as a neutral coordinator of the contributions and returns of all stakeholders in the firm."[134] This is in contrast to another type of stakeholder model which they describe as a "'representative' model of the corporation."[135] In this model, "two or more stakeholder constituencies appoint representatives to the board of directors, which then elaborates policies that maximize the joint welfare of all stakeholders, subject to the bargaining leverage that each group brings to the boardroom table."[136]

From a normative perspective, a stakeholder model would allow, without legal ramifications, a Board to consider multiple stakeholders, not just stockholders, in its decision-making. This would require the Rule to protect the interests of multiple stakeholders, not just stockholders. As a result, director conduct, as embodied in fiduciary duties, would not have SWM as the objective of this conduct.

Perhaps the best-known stakeholder model in corporate law literature is the team production model of Margaret Blair and Lynn Stout.[137] They use their model, a fiduciary model, to argue that SWM is not the correct objective[138] of a public company[139] and that this conclusion is already recognized by courts.[140]

132. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 447–48 (2001).
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.*
137. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).
138. *Id.* at 249 ("In this Article we take issue with . . . the stockholder wealth maximization goal . . . .").
139. Blair & Stout focus exclusively on the corporation as a public company. *Id.*
140. *Id.* at 287–319. At the time of their article's publication, this was a relatively new argument. *Id.* at 252–53.

Blair and Stout model the public company as a team of members who make firm-specific investments in the corporation with the goal of producing goods and services as a team ("team production"), with the board of directors serving as a "mediating hierarchy."[141] In this role, board members are "mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together."[142]

Any person or entity that makes a specialized investment that has little or no value outside the joint enterprise (a "firm-specific" investment) is a member of the team.[143] The result is "that no one team member is a 'principal' who enjoys a right of control over the team."[144] Team members are primarily made up of executives, rank-and-file employees, and equity investors, but can also include researchers, creditors, the local community, marketers, and vendors who provide specialized products and services to the firm.[145] Like equity investors, these stakeholders have made firm-specific investments and therefore must be considered residual interest holders, protected only by long-term, implicit agreements (non-contractual and therefore not legally enforceable) that they enter into because they trust the board of directors to do its best to ensure the stakeholders recoup their investments.[146]

In their model, Blair and Stout suggest that "the business judgment rule may help prevent coalition members (and especially stockholders) from using lawsuits as strategic devices to extract rents from the coalition. This is because the Rule works to ensure that directors can only be found liable for breach of the duty of care in circumstances where a finding of liability serves the collective interests of all the firm's members."[147] Moreover, Blair and Stout find support for their understanding in the *Aronson* formulation[148] of the Rule, since it omits express language stating that directors who act in "the best in-

141. *Id.* at 271–76.
142. *Id.* at 281.
143. *Id.* at 272.
144. *Id.* at 277.
145. *Id.* at 288.
146. *Id.* at 274–76.
147. *Id.* at 300.
148. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citations omitted).

terests of the company"[149] do so solely for the benefit of shareholders. While it is not known why the Court did not clarify what "best interests" means in the context of the Rule, it should be noted that the *Aronson* formulation was applied in a derivative suit where shareholders were suing on behalf of the corporation. In that case, the Court may simply have felt there was no need to clarify what "best interests" means. Nevertheless, Blair and Stout argue that the Rule works to support all team members, not just stockholders, when it is used to defend a legal challenge to a Board decision.

C. *For the Benefit of Stockholders*

While the stakeholder approach of Blair and Stout has much appeal, a much stronger argument can be made that the Board *does* have a legal obligation to maximize stockholder value and that the Rule, as applied, facilitates fulfillment of this legal requirement.

Surprisingly, this argument begins by noting that statutory corporate law is silent regarding this objective. Instead, DGCL simply states that corporations can be formed "to conduct or promote any lawful business or purposes."[150] This silence regarding the objective of the corporation has always been the approach of statutory corporate law. As a result, statutory corporate law must be understood as being concerned only with the "basic organizational design" of the corporation: its attributes as a legal entity (such as limited liability for stockholders), and how its default rules distribute decision-making authority.[151]

So, where does the idea of SWM as a legal requirement come from? In yet another twist, the idea is derived from courts applying principals of equity when determining if a Board has breached its fiduciary duties as applied under the Rule. In essence, SWM is a creation of equity, and not of statutory law.

149. Blair & Stout, *supra* note 137, at 300.

150. DEL. CODE ANN. tit. 8, § 101(b) (1998).

151. Jonathan R Macey, *Fiduciary Duties as Residual Claims: Obligations to Non-shareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266, 1269 (1999) ("Indeed, the very justification for having different types of business organizations is to permit investors, entrepreneurs, and other participants in the corporate enterprise to select the basic organizational design they prefer from a menu of standard form contracts.").

Under the Rule, fiduciary duties are a means to an end. They embody the type of conduct that the courts require of directors in order to avoid having their decisions fall under an entire fairness review. The courts have significant latitude in defining what that conduct should be. For example, as noted above, the duty of care is only *procedural* due care in the *Aronson* formulation. But most importantly, this conduct requires the Board to act in the best interests of stockholders. This was clearly spelled out in a series of statements by the Delaware Supreme Court in *NACEPF* v. *Gheewalla*,[152] a case which answered the critical question of whether the Board still owed fiduciary duties solely to its stockholders when the corporation entered the "zone of insolvency," i.e., when it is financially distressed and may become insolvent.

Gheewalla begins by explaining why only stockholders are given the right to bring derivative suits:

> It is well settled that directors owe fiduciary duties to the corporation. When a corporation is solvent, those duties may be enforced by its stockholders, who have standing to bring derivative actions on behalf of the corporation because they are the ultimate beneficiaries of the corporation's growth and increased value.[153]

In opposition to a stakeholder model of the corporation such as the team production model, this statement reflects the understanding that *only* stockholders hold residual claims to the cash flows of the corporation.

The Court then goes on to explain that the separation of ownership and control as provided by the default rules of statutory corporate law is the reason fiduciary duties must be applied by the courts for the benefit of stockholders:

> Delaware corporate law provides for a separation of control and ownership. The directors of Delaware corporations have 'the legal responsibility to manage the business of a corporation for the benefit of its stockholder owners.' Accordingly, fiduciary duties

152. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007).
153. *Id.* at 101.

> are imposed upon the directors to regulate their conduct when they perform that function.[154]

Moreover, the Court stated that even when a corporation is in the zone of insolvency, a Board still owes fiduciary duties to stockholders and not to creditors:

> When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its stockholders by exercising their business judgment in the *best interests of the corporation for the benefit of its stockholder owners.*[155]

Here, we have the Court telling us exactly what the phrase "best interests of the corporation" should mean in the context of a Rule review: the protections of the Rule will apply if Board decisions are made for "the benefit of its stockholder owners."

Vice Chancellor Laster, in *In re Trados Inc. Shareholder Litigation*,[156] encapsulates this thinking in the following quote:

> It is, of course, accepted that a corporation may take steps, such as giving charitable contributions or paying higher wages, that do not maximize profits currently. They may do so, however, because such activities are rationalized as producing greater profits over the long-term. Decisions of this nature benefit the corporation as a whole, and by increasing the value of the corporation, the directors increase the share of value available for the residual claimants. Judicial opinions therefore often refer to directors owing fiduciary duties to the corporation and its shareholders. This formulation captures the foundational relationship in which directors owe duties to the corporation for the ultimate benefit of the entity's residual claimants. Nevertheless, stockholders' best interest must always, within legal limits, be the end. Other constituencies may be considered only instrumentally to advance that end.[157]

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154. *Id.*
155. *Id.*
156. *In re* Trados Inc. S'holder Litig., 73 A.3d 17 (Del. Ch. 2013).
157. *Id.* at 36–37.

If that was not clear enough, Vice Chancellor Laster stated in *The Frederick Hsu Living Trust v. ODN Holding Corp.*, "Delaware case law is clear that the board of directors of a for-profit corporation . . . must, within the limits of its legal discretion, treat stockholder welfare as the only end, considering other interests only to the extent that doing so is rationally related to stockholder welfare."[158]

These statements are explicit endorsements of SWM and a direct repudiation of the idea that corporate law espouses a stakeholder model of the corporation. Almost 100 years ago this same understanding was espoused by the Michigan Supreme Court in the famous corporate law case of *Dodge v. Ford Motor, Co.*, noted above.[159] In *Dodge*, the Court found that the Board abused its discretion in withholding a special dividend payment because its decision to do so was a result of intentionally disregarding the interests of stockholders.[160] Speaking in terms of the duties that the Board and Henry Ford owed to minority shareholders under corporate law,[161] the Court stated that the Board had a legal obligation to maximize the profits of the corporation for the benefit of stockholders:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or the nondistribution of profits among stockholders in order to devote them to other purposes.[162]

This legal obligation was a result of the court applying its power of equity, as opposed to implementing statutory corporate law. In sum, equity requires the objective of the Rule to be

158. Frederick Hsu Living Tr. v. ODN Holding Corp., No. 12108-VCL, 2017 Del. Ch. LEXIS 67, at *45 (Ch. Apr. 14, 2017) (citations omitted).

159. Dodge v. Ford Motor Co., 170 N.W. 668, 682 (1919).

160. *Id.* at 684–85.

161. *Id.* at 684. ("There should be no confusion . . . of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority stockholders.")

162. *Id.* George Mocsary notes that this was not something that the *Dodge* court came up with out of the blue, but an affirmation of Michigan case law. *See* Mocsary, *supra* note 119, at 1344.

SWM and only SWM. Unfortunately, starting with the *Aronson* formulation of the Rule may cause this to be overlooked.

D. *The Continued Denial of SWM*

Even in the face of clear statements by the courts that SWM is a legal obligation of all Board decision-making under corporate law, continued resistance to SWM should still be expected. I expect this for the following three reasons. First, as already mentioned, statutory corporate law is silent on SWM. This opens the door for those who believe in a stakeholder model of the corporation to argue that corporate law does indeed support such an approach in practice. Second, those who believe in a stakeholder model are not willing to accept SWM as being the objective of equitable principles, no matter how many times courts state this to be their understanding. Perhaps this is just inconsistent with their long-held views on what equity means and therefore cannot be accepted as true. Yet, what could be fairer to shareholders and other stakeholders who contract with the corporation than to require that Board decision-making be targeted to SWM if all parties benefit from such an objective? Third, the courts utilize the Rule in an indirect way to maximize shareholder value. This last point requires further explanation.

When a court reviews a Board decision under the Rule, a decision will rarely lose the protections of the Rule just because the decision was sub-optimal in terms of SWM. In this context, the protections will be lost only if it is clear that the decision was made without stockholder interests in mind, e.g. in *Dodge*, where the Court found that the Board had abused its discretion when it withheld the annual payment of its special dividend.[163]

However, this does not mean that the courts are not focused on SWM as the objective of a Board's fiduciary duties per se; it simply means that courts must restrain themselves in making such a determination. Underlying this approach are

163. This is consistent with what then Chancellor William Chandler said in the context of a rights plan (poison pill) as reviewed under the *Unocal* test: "Directors of a for-profit Delaware corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law." eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del. Ch. 2010).

the three policy drivers that have already been discussed; drivers which direct a court to forego a direct focus on SWM under the Rule. Instead, courts focus on the conduct of the directors and evidence of taint surrounding the decision-making process: fraud, self-dealing, lack of independence, etc. In essence, protecting the ability of Boards to make decisions without interference by shareholders and courts is the best way to ensure that SWM occurs.[164] However, this lack of direct focus on SWM provides the opportunity for those so willing to interpret this approach as a court's lack of interest in SWM, thereby helping make their case that the court is endorsing a stakeholder approach to corporate law over SWM.[165]

E. *Summary*

While one can argue that corporate law encompasses a stakeholder model and that the Rule serves as evidence of this, a better argument is that the legal obligation of the Board is SWM and that the Rule serves to support that purpose and only that purpose.[166] Case law clearly states that the Board is under a legal obligation to maximize shareholder wealth. The requirement of SWM enters corporate law through a Board's fiduciary duties, not through statutory law. In essence, SWM is an equitable concept. The implementation of SWM is indirect, as all three of the major policy drivers that influence the Rule guide courts away from a focus on SWM unless the Rule has been rebutted, either by a breach in a Board's fiduciary duties or because the court has identified a taint surrounding the decision-making process.

164. Sharfman, *supra* note 77, at 399–412.

165. *Id.* at 400. ("Preserving managerial discretion necessarily means that fiduciary duties will be weak and that courts will primarily refrain from determining whether a decision maximizes shareholder wealth. The problem is that this approach is counterintuitive and therefore subject to being misunderstood, especially by those who have been trained in the law and believe that accountability should always be the default rule.").

166. While beyond the scope of this Article, a stakeholder model, such as team production, may be appropriate in the special case of a public benefit corporation (PBC). Newly enacted DGCL 365(a) allows the Board to manage the PBC in a manner that balances the interests of stockholders and those stakeholders who have made a significant non-stock investment in the corporation. DEL. CODE ANN. tit. 8, § 365(a) (2013).

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Conclusion

In the court's decision in *Bodell I*, one is immediately struck by the power of equity and how the court felt so easily justified in challenging statutory law, Section 4a of the DGCL (currently DGCL § 152[167]), with a fairness review of a Board decision even when the Board had statutory authority to act without restraint.[168] The Court in *Bodell II* took a more sophisticated approach, understanding that corporate law is all about the separation of ownership from control and how the interests of stockholders must be in balance with the Board's statutory authority. The policy driver behind this approach is that the Board should be allowed to run the company without the fear of constantly facing potential liability for honest mistakes in judgment. For this to occur, equity must be restrained. In order to implement such restraint, the Court employed the Rule: the tool used to determine when a Board decision should stand without further review and when a fairness review is required and the full force of equity is to be applied. Here, the Court made clear that under the Rule, the review of a board decision could not include fairness unless a court had made a finding that a fiduciary duty had been breached or some sort of taint had surrounded the decision (i.e., interestedness). To serve as this tool of restraint is precisely why the Rule must be retained in its present form. If courts were to lose this ability to restrain themselves from imposing a fairness review, then Board decision-making and shareholder wealth would doubtless suffer as a result.

It should now be easy to see that the defining moment in the history of the Rule was not the famous case of *Smith v. Van Gorkom*,[169] where the Court made absolutely clear that director liability could result from an uninformed Board decision, but the much older case of *Bodell II*.[170] In *Bodell II*, the Court, by precluding a fairness review of a Board decision unless a fiduciary duty had been breached or some sort of taint had surrounded the decision, established the Rule as an abstention doctrine in the most fundamental way.

167. Del. Code Ann. tit. 8, § 152 (2015).
168. Bodell v. Gen. Gas & Elec. Corp., 132 A. 442, 444 (1926).
169. Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985).
170. Bodell v. Gen. Gas & Elec. Corp., 140 A. 264, 267 (1927).