

A Decision Theory Approach to the Business Judgment Rule: Reflections on Disney, Good Faith, and Judicial Uncertainty

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A DECISION THEORY APPROACH TO THE BUSINESS JUDGMENT RULE: REFLECTIONS ON *DISNEY*, GOOD FAITH, AND JUDICIAL UNCERTAINTY

ANDREW S. GOLD*

ABSTRACT

This Article presents an institutional choice perspective on the judicial role in enforcing corporate law, in light of the Delaware Supreme Court's recent formulation of a fiduciary duty of good faith. The court's Disney decision allows for the possibility that director decisions will be reviewed under a more stringent standard of review than the traditional business judgment rule (the doctrine that courts will refuse to second-guess the substantive judgments of unconflicted corporate directors). This Article argues that shifting the standard of review could dramatically alter the courts' role in policing board misconduct. Furthermore, it shows that courts do not have access to sufficient empirical data to calculate an ideal balance between board accountability and board authority. It is impossible to reliably weigh the complex variables that are relevant to this balance. Given this uncertainty, this Article then uses decision theory to suggest that the business judgment rule standard—a rational basis test—is the most reasonable means for courts to review unconflicted director conduct.

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I. INTRODUCTION

In 1995, Michael Ovitz was hired as president of the Walt Disney Company.¹ Regrettably, his presidency was not a successful one, and in December 1996, Ovitz's employment was terminated.² It is not the termination itself, but its consequences, that were controversial. Ovitz's firing resulted in a severance package valued at approximately \$130 million, yet he had worked for Disney for a mere fourteen months.³ Even by Hollywood standards, \$130 million was a lot of money for barely a year of work.

This rather large payment did not sit well with shareholders, and it led to a highly public lawsuit in the Delaware courts, seeking relief from the Disney board of directors.⁴ After a thirty-seven-day trial, the plaintiffs lost their case:⁵ they were unable to prevail on claims under

1. *In re Walt Disney Co. Derivative Litig. (Disney V)*, 906 A.2d 27, 35 (Del. 2006) (en banc).

2. *Id.*

3. *Id.*

4. *Id.* The plaintiffs brought claims based on the Disney board's hiring of Ovitz under such a lucrative contract, as well as the decision to give him a not-for-cause termination, which affected the severance Ovitz received. *Id.* at 46, 68.

5. See *In re Walt Disney Co. Derivative Litig. (Disney IV)*, 907 A.2d 693, 697 (Del. Ch. 2005).

the fiduciary duties of care, loyalty, or good faith.⁶ An important doctrinal development emerged in the process. In ruling against the shareholder plaintiffs, the Delaware courts provided guidance on the meaning of a corporate director's duty to act in good faith. Until now, the meaning of the fiduciary duty of good faith has been an open question.⁷

The *Disney* litigation thus represents a pivotal moment for fiduciary doctrine. On June 8, 2006, the Delaware Supreme Court affirmed the chancery court's finding that the Disney board did not breach its duties of care and good faith.⁸ But rather than impose an objective standard of good faith conduct, the court endorsed the view that a breach of the duty of good faith occurs when a director engages in an "intentional dereliction of duty, [or] a conscious disregard for one's responsibilities."⁹ As a result, the existence of good or bad faith acts depends on a director's subjective state of mind.¹⁰ A director with a

6. See *Disney V*, 906 A.2d at 35 (concluding that the chancery court's findings that there were no breaches of fiduciary duty or corporate waste were correct); *Brehm v. Eisner (Disney II)*, 746 A.2d 244, 267 (Del. 2000) (en banc) (affirming the chancery court's dismissal of loyalty claims with prejudice).

7. See *Disney IV*, 907 A.2d at 753–54 (describing case law outlining the fiduciary duty of good faith as a "fog of . . . hazy jurisprudence"). Within the past few years, commentators have produced a substantial body of literature attempting to explain the good faith doctrine. See Christopher M. Bruner, "Good Faith," *State of Mind, and the Outer Boundaries of Director Liability in Corporate Law* (Boston Univ. Sch. of Law, Working Paper No. 05-19, 2005), available at <http://ssrn.com/abstract=832944>; Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006); Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1 (2005); Claire Hill & Brett McDonnell, *Disney, Good Faith, and Structural Bias* (Minn. Legal Studies Research Paper No. 06-46), available at <http://ssrn.com/abstract=929488>; Elizabeth Nowicki, *The Unimportance of Being Earnest: Reflections on Director Liability and Good Faith* (Aug. 1, 2006) (unpublished manuscript), available at <http://ssrn.com/abstract=921668>; John L. Reed & Matt Neiderman, "Good Faith" and the Ability of Directors to Assert Section 102(b)(7) of the Delaware General Corporation Law as a Defense to Claims Alleging Abdication, Lack of Oversight, and Similar Breaches of Fiduciary Duty, 29 DEL. J. CORP. L. 111 (2004); David Rosenberg, *Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 491 (2004); Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004); E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1439–54 (2005).

8. See *Disney V*, 906 A.2d at 28, 35.

9. *Id.* at 66; see *id.* at 66–67 (concluding that such conduct is "properly treated" as a violation of the duty to act in good faith and "uphold[ing] the Court of Chancery's definition as a legally appropriate, although not the exclusive, definition of fiduciary bad faith").

10. But see Eisenberg, *supra* note 7, at 72 (suggesting that this definition of bad faith does not require that a "manager was subjectively conscious that he was disregarding his duties"); Sale, *supra* note 7, at 493 ("Although a breach of good faith need not be intentional or conscious, it does require some sort of obvious, deliberate, or egregious failure."). The court's decision also leaves open some possibility of additional meanings for good

pure heart and an empty head would seemingly not be liable under this formulation.¹¹

Yet defining good faith does not resolve its place in litigation. In corporate law, questions of good faith intersect with the business judgment rule.¹² Under current formulations of the business judgment rule, courts refuse to second-guess a director's decision "unless the directors are interested or lack independence[,] . . . do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process."¹³ In practice, the business judgment rule carves out a large swath of director conduct which is unreviewable by the judicial system, unless plaintiffs can demonstrate a conflict of interest or that the board's conduct is so irrational that it could not have been motivated by a legitimate business purpose.¹⁴

In recent years, commentators have looked to good faith as a means to challenge traditional understandings of the business judgment rule.¹⁵ For example, an objective test for bad faith conduct could mean that well-meaning, but egregious, business judgments trigger liability. This, in turn, would be a major inroad on the courts' typical refusal to second-guess directors' substantive business judgments.¹⁶ Limiting bad faith claims to cases where there is a conscious

faith, as it notes that the chancery court definition that it upheld is "not the exclusive" definition. See *Disney V*, 906 A.2d at 67.

11. Although controversial, this result has a long pedigree. See, e.g., *Barnes v. Andrews*, 298 F. 614, 618 (S.D.N.Y. 1924) ("Directors are not specialists . . . They are the general advisers of the business, and if they faithfully give such ability as they have to their charge, it would not be lawful to hold them liable. Must a director guarantee that his judgment is good?").

12. See Griffith, *supra* note 7, at 15 (suggesting that a distinct duty of good faith may implicate "a new standard under the business judgment rule and thereby realign[] the balance between authority and accountability in corporate law jurisprudence").

13. *Disney II*, 746 A.2d 244, 264 n.66 (Del. 2000) (en banc).

14. See William T. Allen et al., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and Its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449, 452 (2002) ("[T]he business judgment review standard ('rationality') diverges from, and becomes more lenient than, the normative standard of conduct ('reasonableness')."); Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 99-100 (2004) (suggesting that, under the standard described in *Disney II*, "[a]bsent self dealing or other conflicted interests, or truly egregious process failures, the court will abstain").

15. See, e.g., *Sale*, *supra* note 7, at 494 (suggesting that "[t]he value of a separate good faith duty . . . is in its potential for addressing those outrageous and egregious abdications of fiduciary behavior that are not simply the results of bad process or conflicts").

16. Cf. Griffith, *supra* note 7, at 32 (suggesting that reviewing board conduct for "recklessness or intentional disregard is merely to conduct the negligence inquiry under another label"); *id.* at 33 ("[I]f this standard seeks to apply a test other than gross negligence or waste, it is inconsistent with the business judgment rule.").

disregard of known duties, on the other hand, suggests a more limited judicial role.¹⁷

After the *Disney* decision, the meaning of a fiduciary's duty of good faith has been substantially clarified. Good faith is now identified with a subjective intent to further the best interests of the corporation.¹⁸ What remains to be decided is how courts will review a claimed breach of good faith.¹⁹ The content of good faith does not tell us how courts should review director decisions, or how to recognize a conscious disregard of a director's responsibilities. As will be developed below, the business judgment rule approach—a rational basis test—is the best available method for reviewing an unconflicted board's conduct for compliance with the duty of good faith.²⁰

In addressing the duty of good faith, this Article will provide a new justification for business judgment rule protections.²¹ Given the

17. *But cf. id.* at 33 (claiming that “moving good faith to a substantive standard of intent does not avoid repetition of duty-of-care analytics and, ultimately, confrontation with the business judgment rule”).

18. *See Disney V*, 906 A.2d 27, 67 (Del. 2006) (en banc) (discussing good faith requirements in terms of the chancery court's description of “a true faithfulness and devotion to the interests of the corporation and its shareholders” (quoting *Disney IV*, 907 A.2d 693, 755 (Del. Ch. 2005))).

19. Lower courts have provided some guidance using this definition of subjective bad faith conduct. *See, e.g., Disney IV*, 907 A.2d at 755 (“The presumption of the business judgment rule creates a presumption that a director acted in good faith. In order to overcome that presumption, a plaintiff must prove an act of bad faith by a preponderance of the evidence.”); Official Comm. of Unsecured Creditors of Integrated Health Servs., Inc. v. Elkins, No. Civ. A. 20228-NC, 2004 WL 1949290, at *17 n.92 (Del. Ch. Aug. 24, 2004) (indicating that “[i]n the case of an alleged breach of fiduciary duty for intentionally and consciously disregarding one's duties of faithfulness and care, the Court will focus on whether the Board's process is irrational”).

20. This form of rationality review is highly deferential to the board. As Stephen Bainbridge notes, “[e]ven the reference to a rational business purpose requires only the possibility that the decision was actuated by a legitimate business reason, not that directors must prove the existence of such a reason.” Bainbridge, *supra* note 14, at 100; *see also* Allen et al., *supra* note 14, at 452 (describing an irrational decision as “one that is so blatantly imprudent that it is inexplicable, in the sense that no well-motivated and minimally informed person could have made it”). In some cases, a different standard for determining bad faith may make sense, as in situations where there is a failure to act. *See, e.g., In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 968–70 (Del. Ch. 1996) (describing good faith requirements in context of an unconsidered board failure to act); *see also* Stone v. Ritter, No. 93, 2006 WL 3169168, at *6 (Del. Nov. 6, 2006) (adopting the *Caremark* standard for bad faith liability for cases where “directors knew that they were not discharging their fiduciary obligations”).

21. For recent explanations of the business judgment rule, *see* Allen et al., *supra* note 14, at 452–53; Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, 2000 WIS. L. REV. 573; Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 440–45 (1993); Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287 (1994); Lyman Johnson, *The Modest Business Judgment Rule*, 55 BUS. LAW. 625 (2000); Jeremy

empirical uncertainty that surrounds debates over the ideal level of board accountability, a rational basis test is appropriate to police the board's subjective failings and improper motivations. This is not because it is firmly established that courts are poor decisionmakers compared to boards.²² Rather, an optimal allocation of corporate decisionmaking authority requires an institutional choice to be made with inadequate information.

In the case of business judgments, courts must decide who decides.²³ This selection among institutions is unavoidable: to the extent courts actively review a board's decisions, they effectively supplant the board's decisionmaking authority.²⁴ The role of courts in reviewing business judgments should therefore be assessed in light of a comparative institutional analysis, taking into account the costs and benefits of boards, courts, and shareholders as decisionmakers.²⁵ But due to the complexity of this comparison, and the limited information available, this is not an analysis that can be adequately made in the near term, if ever.²⁶

Telman, *The Business Judgment Rule, Disclosure and Executive Compensation*, 81 TUL. L. REV. (forthcoming 2007), available at <http://ssrn.com/abstract=895548>.

22. There are, however, courts and commentators that suggest this view. See, e.g., *Shlensky v. Wrigley*, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (“[W]e do not mean to say that we have decided that the decision of the directors was a correct one. That is beyond our jurisdiction and ability.”); *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) (refusing to intervene in a decision to expand a business, and noting that “[t]he judges are not business experts”); cf. Bainbridge, *supra* note 14, at 119 (noting that “bounded rationality and information asymmetries counsel judicial abstention from reviewing board decisions”). On the other hand, Delaware courts have significant business expertise. *Id.* at 120–21; Telman, *supra* note 21, at 14.

23. See Wayne O. Hanewicz, *Director Primacy, Omnicare, and the Function of Corporate Law*, 71 TENN. L. REV. 511, 511 (2004) (“[C]orporate law does and should allocate decision-making authority to various institutions, such as the board, the shareholders, and the judiciary, and . . . this decision-making authority ought to be allocated so as to most efficiently advance the ultimate goal of corporate law.”); see also Bainbridge, *supra* note 14, at 121 (“Neither courts nor boards are infallible, but someone must be final. Otherwise, we end up with a never-ending process of appellate review. The question then is simply who is better suited to be vested with the mantle of infallibility that comes by virtue of being final—directors or judges?”).

24. See Bainbridge, *supra* note 14, at 108 (recognizing that the power to hold the board accountable “is ultimately the power to decide” and that “the board cannot be made more accountable without shifting some of its decision-making authority to shareholders or judges”).

25. See, e.g., Hanewicz, *supra* note 23, at 520 (indicating that decisionmaking should be assigned to a variety of institutions and that “[a]uthority should be vested in a given institution only if that institution is best suited to furthering shareholder wealth maximization”).

26. As will be developed below, certain institutional comparisons raise “trans-scientific” empirical questions—questions which cannot readily be assessed in the near term at acceptable cost, and perhaps not in the long term. See *infra* notes 331–336 and accompanying text.

Many empirical questions arise. Would shareholder wealth be maximized in the long run if courts defer to fewer board judgments under the business judgment rule? How common are judicial errors when courts review board decisions? How often do directors acting in good faith reach incorrect decisions? Are directors substantially less likely to engage in profitable risk-taking if they face increased judicial scrutiny under the duty of good faith? It is unclear what the answers to these questions are, or even how these factors should be weighed in allocating institutional authority. The necessary empirical data is simply unavailable.

A choice must nevertheless be made, despite the difficulty of assessing outcomes under different allocations of decisionmaking authority.²⁷ Fortunately, courts can do more than just guess at the right allocation of authority. Recent scholarship has suggested an approach to resolving this type of uncertainty in the context of judicial review of federal statutes.²⁸

Decision theory examines how rational actors make decisions subject to constraints.²⁹ Techniques adapted from decision theory can address hard problems of institutional choice.³⁰ For example, under the “principle of insufficient reason,” a decisionmaker assumes that unknown or speculative costs and benefits will cancel out.³¹ By focusing on those factors which are known, or at least readily knowable, it is possible to make the best of intractable uncertainty.³² This principle, among others, permits decisions to be made without resorting to random guesses or raw intuition.

27. For a helpful analysis of decisionmaking under conditions of severe uncertainty, see JON ELSTER, *SOLOMONIC JUDGEMENTS: STUDIES IN THE LIMITATIONS OF RATIONALITY* 10–13 (1989). As Elster notes, when making such choices there are a number of potential unknowns: the available options, the possible outcomes under each option, the value of each outcome, and the probability of each outcome. *Id.* at 134.

28. See ADRIAN VERMEULE, *JUDGING UNDER UNCERTAINTY: AN INSTITUTIONAL THEORY OF LEGAL INTERPRETATION* 1 (2006) [hereinafter VERMEULE, *JUDGING*] (proposing a limited role for judicial review based upon problems of severe uncertainty when comparing the relevant institutions); Adrian Vermeule, *Interpretive Choice*, 75 N.Y.U. L. REV. 74, 78 (2000) [hereinafter Vermeule, *Interpretive Choice*] (offering “methods of interpretive choice under conditions of severe empirical uncertainty”); see also Cass R. Sunstein & Adrian Vermeule, *Interpretation and Institutions*, 101 MICH. L. REV. 885, 885–86 (2003) (emphasizing the importance of an institutional choice analysis in debates over statutory interpretation).

29. VERMEULE, *JUDGING*, *supra* note 28, at 171; see also James P. Spica, *The Rationality of Normative Expectations*, 24 J. CONTEMP. L. 259, 277 (1998) (“Decision theory is the normative theory of rational choice under uncertainty.”).

30. See *infra* notes 349–368 and accompanying text.

31. See *infra* notes 349–354 and accompanying text.

32. See VERMEULE, *JUDGING*, *supra* note 28, at 174 (“[I]n such situations decisionmakers do not retreat into paralysis. Rather, they eliminate imponderables from both sides of the scales and focus instead on the variables that can be grasped.”).

Strategies for decisionmaking under severe uncertainty point toward a minimal judicial role in cases that implicate substantive business judgments. Although many of the important factors for allocating decisionmaking authority in this context are matters of conjecture, some can be assessed. High decision costs counsel against creating new exceptions to the business judgment rule.³³ These known costs, along with a reasonable desire to limit worst case scenarios, suggest that courts should leave the business judgment rule unchanged.

The initial sections of this Article provide a doctrinal analysis of the *Disney* decisions and their implications. Part II will set forth the three basic fiduciary duties in corporate law: the duties of care, loyalty, and good faith, while Part III will review the facts and decisional history leading up to the recent denial of the *Disney* plaintiffs' claims.

Part IV describes the Delaware Supreme Court's conception of the duty of good faith and analyzes its doctrinal implications. This Part will show that the Delaware Supreme Court has adopted a subjective standard for bad faith conduct, grounded in a director's conscious disregard of her responsibilities. This Part also demonstrates that the standard of review for claims of bad faith conduct is still unclear.

The remaining sections of the Article will suggest that the appropriate standard when reviewing director conduct for bad faith is a rationality test. Though it is natural to be concerned that the business judgment rule could be overly protective of directors at the expense of shareholders, it does not follow that a more expansive judicial role would actually benefit shareholders. As will be developed, a rationality test responds to severe limitations of judicial knowledge.

Part V of this Article assesses the duty of good faith with respect to business judgment rule protections, and it indicates that an analysis of board conduct under a more stringent standard of review would pose a substantial risk of judicial error. Both the subject matter and the legal standards involved are highly indeterminate.

Part VI then considers judicial review of director good faith as a matter of comparative institutional analysis. Courts should compare different decisionmaking institutions when determining the appropriate balance of board accountability and board authority. Using principles adapted from decision theory, this Part concludes that the most reasonable institutional choice, given severe empirical uncertainty, calls for a protective form of the business judgment rule.

33. See *infra* notes 406–413 and accompanying text.

II. THE DUTIES OF CARE, LOYALTY, AND GOOD FAITH

Delaware courts describe three primary fiduciary obligations: the duties of care, loyalty, and good faith.³⁴ While the duties of care and loyalty are well established, the jurisprudence of good faith is in its early stages. Good faith has been described as a bridge between the other two duties.³⁵ All three are interrelated, yet they play distinct roles in corporate governance.³⁶

A. *The Duty of Care*

The duty of care requires the manager of a business to reach decisions using the amount of care that people of ordinary prudence would use under similar circumstances, and to consider all material information that is reasonably available.³⁷ Issues of care typically implicate the process by which a business decision is reached, rather than the substantive decision itself.³⁸ Claims that the duty of care has been breached are generally reviewed for gross negligence.³⁹

34. See, e.g., *Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001) (“The directors of Delaware corporations have a triad of primary fiduciary duties: due care, loyalty, and good faith.”); *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998) (same); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (same).

35. See *Reed & Neiderman*, *supra* note 7, at 123 (“The ‘good faith’ standard, especially in the abdication context . . . acts almost as a bridge between the concepts of due care and loyalty, transforming what might otherwise be deemed certain violations of the former into violations of the latter, even in the absence of an adverse pecuniary interest.”).

36. See *Disney IV*, 907 A.2d 693, 745–46 (Del. Ch. 2005) (indicating that “issues of good faith are . . . inseparably and necessarily intertwined with the duties of care and loyalty”). Sean Griffith explains:

Whether the question is confronted from the perspective of the duty of care or of the duty of loyalty is just a difference in approach. To put it another way, the fundamental question underlying both duties really is good faith. Are the directors doing their best in acting for someone else?

Griffith, *supra* note 7, at 43.

37. See *Smith v. Van Gorkom*, 488 A.2d 858, 872–73 (Del. 1985) (en banc) (describing the duty of care as “a director’s duty to exercise an informed business judgment”); *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 968 (Del. Ch. 1996) (defining the duty of care inquiry as “whether there was good faith effort to be informed and exercise judgment”). The duty may also apply in cases where the fiduciary acts contrary to the interests of the business entity, but does not actually act out of self-interest. See D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1410–11 (2002) (“While any action that harms the beneficiary might in some sense constitute a breach of loyalty, courts typically reserve the label ‘loyalty’ for self-interested actions. Actions that advantage a third party at the expense of the beneficiary are usually treated as a breach of the duty of care.”).

38. See *Disney II*, 746 A.2d 244, 264 (Del. 2000) (en banc) (“Due care in the decision-making context is *process* due care only.”).

39. See *Disney IV*, 907 A.2d at 749 (“[D]eficiencies in the directors’ process are actionable only if the directors’ actions are grossly negligent.”).

B. *The Duty of Loyalty*

The fiduciary duty of loyalty is sometimes described as a duty of unselfishness.⁴⁰ An important component of conventional duty of loyalty claims is that they involve material conflicts of interest, typically based on financial benefits.⁴¹ Some loyalty cases do not involve director conflicts of interest, but this element is often required for a successful cause of action.⁴² In court, when a material conflict of interest is demonstrated, the burden of proof shifts to the defendants, who must show the entire fairness of their actions.⁴³

C. *The Duty of Good Faith*

Although good faith has long been required of directors, as a distinct fiduciary analysis it is a recent arrival,⁴⁴ and its meaning is notoriously vague.⁴⁵ Furthermore, the doctrine may have different meanings in different contexts.⁴⁶ Some question whether a fiduciary duty of good faith is not simply equivalent to the implied contractual covenant of good faith and fair dealing in a fiduciary setting.⁴⁷ Al-

40. See, e.g., *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939) (“The rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest.”).

41. *Disney IV*, 907 A.2d at 751.

42. The Delaware Supreme Court’s recent *Stone* decision clarifies that bad faith claims implicate a more expansive view of the duty of loyalty. See *Stone v. Ritter*, No. 93, 2006 WL 3169168, at *6 (Del. Nov. 6, 2006) (“[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest.”); cf. *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) (indicating that the underlying motive for conscious actions not in the corporation’s best interest does not make such actions faithful).

43. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983) (describing the entire
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though good faith is a longstanding feature of contract law, there is reason to think that good faith for fiduciaries means something more.

Until recently, the Delaware Supreme Court apparently viewed the duty of good faith as a freestanding fiduciary duty, independent from the duties of loyalty or care.⁴⁸ One proposed explanation for this distinction was that the duty of good faith covers instances where a fiduciary acts egregiously, abdicating her obligations in ways that implicate more than gross negligence, but without meeting the traditional loyalty test for conflicts of interest.⁴⁹ For example, where a director recklessly misleads shareholders, yet lacks a conflict of interest, he might breach his fiduciary duty of good faith.⁵⁰

The Delaware Supreme Court's announcement of a triad of independent duties met resistance from the Delaware chancery courts.⁵¹ One court expressly concluded that the duty of good faith "does not exist separate and apart from the fiduciary duty of loyalty."⁵² Under this view, a fiduciary cannot simultaneously act in bad faith and loyally

[p]roperly construed, good faith is not itself a fiduciary duty, nor is it a subset of a specific fiduciary duty. Rather, good faith is an interpretive device which can be used to determine whether directors have adhered to their traditional fiduciary duties of loyalty and care. This application of the term is analogous to its use in interpreting adherence to contractual duties.

Rosenberg, *supra* note 7, at 515.

48. See, e.g., *Emerald Partners v. Berlin*, 787 A.2d 85, 90 (Del. 2001) (recognizing a "triad" of fiduciary duties including the duty of good faith). It is now clear that the duty of good faith is a subsidiary duty to the duty of loyalty. See *Stone v. Ritter*, No. 93, 2006 WL 3169168, at *6 (Del. Nov. 6, 2006) ("The failure to act in good faith may result in liability because the requirement to act in good faith 'is [already] a subsidiary element,' i.e., a condition, 'of the fundamental duty of loyalty.'" (quoting *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003))); see also *id.* ("[A]lthough good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty." (footnote omitted)).

49. See *Sale*, *supra* note 7, at 494 ("The value of a separate good faith duty, then, is in its potential for addressing those outrageous and egregious abdications of fiduciary behavior that are not simply the results of bad process or conflicts.").

50. See *id.* However, *Sale's* definition of good faith arguably depends upon the content of the duties of loyalty and care. Rosenberg, *supra* note 7, at 509 (indicating for support that *Sale* contends that a failure to attempt to comply with one's fiduciary duties is likely to result in a breach of good faith).

51. See, e.g., *In re Gaylord Container Corp. S'holders Litig.*, 753 A.2d 462, 475 n.41 (Del. Ch. 2000) (contending that the Supreme Court's formulation was a "fresh way of referring to the 'fundamental duties of care and loyalty'"); Rosenberg, *supra* note 7, at 500-05 (describing lower courts' reluctance to accept good faith as anything more than a subset of the duty of loyalty).

52. *Emerald Partners v. Berlin*, No. Civ. A. 9700, 2001 WL 115340, at *25 n.63 (Del. Ch. Feb. 7, 2001) (citing *In re Gaylord Container Corp.*, 753 A.2d at 475 n.41), *vacated*, 787 A.2d 85 (Del. 2001) .

toward the corporation and its stockholders.⁵³ Another chancery court opinion explained that “[i]f it is useful at all as an independent concept,” the good faith duty makes clear that a fiduciary may act disloyally even in circumstances where the fiduciary does not have a financial interest in the transaction at issue.⁵⁴

On November 6, 2006, the Delaware Supreme Court conceded the point and explained in *Stone v. Ritter*⁵⁵ that the duty of good faith is in fact a subsidiary duty, linked to the duty of loyalty.⁵⁶ The court clarified that liability based on bad faith is indirect—a failure to act in good faith does not directly result in the imposition of liability.⁵⁷ Instead, the duty of loyalty should be understood to include contexts where fiduciaries fail to act in good faith, even though the fiduciaries may not have pecuniary or other cognizable conflicts of interest.⁵⁸

Whether it is conceptualized as a subset of loyalty or its own independent duty, however, good faith is an amorphous concept.⁵⁹ Good faith is commonly understood to require that directors act with “honesty of purpose,” in pursuit of the corporation’s best interests.⁶⁰ Based on recent precedent, commentators have contended that good faith includes an objective element, including duties grounded in norms of corporate conduct.⁶¹ Commentators have also suggested severe recklessness as a touchstone for violations of the duty.⁶² Others argue that

53. *See id.*; *cf.* *Orman v. Cullman*, 794 A.2d 5, 41 (Del. Ch. 2002) (maintaining that a failure to reveal material facts can implicate all three fiduciary duties); *see also Guttman*, 823 A.2d at 506 n.34 (stating that “there is no case in which a director can act in subjective bad faith towards the corporation and act loyally”).

54. *Nagy v. Bistricher*, 770 A.2d 43, 48 n.2 (Del. Ch. 2000).

55. No. 93, 2006 WL 3169168 (Del. Nov. 6, 2006).

56. *See id.* at *6 (explaining that a breach of the duty of good faith is a violation of the duty of loyalty).

57. *See id.* (“[A] failure to act in good faith is not conduct that results, *ipso facto*, in the direct imposition of fiduciary liability.”).

58. *See id.* (“[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest.”).

59. *See supra* notes 45–46 and accompanying text.

60. *See Disney IV*, 907 A.2d 693, 753 (Del. Ch. 2005) (internal quotation marks omitted) (quoting E. Norman Veasey, *Reflections on Key Issues of the Professional Responsibilities of Corporate Lawyers in the Twenty-First Century*, 12 WASH. U. J.L. & POL’Y 1, 9 (2003)).

61. *See, e.g., Eisenberg, supra* note 7, at 24 (arguing that “the objective elements of good faith are far more important in practice than the subjective elements” and that a director may have violated the duty of good faith through the use of a manipulative process that violates “generally accepted basic corporate norms”).

62. *See Sale, supra* note 7, at 489 (discussing cases in which a breach of the duty of good faith “requires motive-based allegations of severely reckless or seemingly intentional behavior”).

bad faith conduct must be linked to the existence of improper motivations or illicit intent.⁶³

As Chancellor Chandler recently noted, the duty of good faith has been shrouded in a “fog of . . . hazy jurisprudence.”⁶⁴ This fog was the backdrop for the Delaware Supreme Court’s resolution of the *Disney* case.

III. THE HISTORY OF THE *DISNEY* LITIGATION

The following Section provides a summary of the *Disney V* opinion’s description of undisputed facts surrounding Michael Ovitz’s hiring and firing, as well as a review of the procedural history leading to the Delaware Supreme Court’s recent decision. For an in-depth analysis of the evidence presented in the case, the reader is encouraged to review the chancery court’s exhaustive post-trial opinion.⁶⁵

A. *The Facts of the Disney Case*

The Ovitz severance from Disney concluded an unhappy episode in Disney’s history. Initially, Ovitz’s hiring appeared to be an answer to Disney’s hopes for a strong second in command. The fit, however, was not a good one. Ovitz’s employment turned out to be a major mistake, ending some fourteen months later with a severance payment that was valued at approximately \$130 million.⁶⁶

Disney’s need for a new president came about when the corporation suffered several misfortunes. First came the untimely death of its President, Frank Wells, in a fatal 1994 helicopter crash.⁶⁷ Michael Eisner, the corporation’s chairman, was able to step into the role.⁶⁸ But shortly thereafter, Eisner was diagnosed with heart disease, and underwent quadruple bypass surgery.⁶⁹ The Disney board consequently discussed the need to identify a successor for Eisner.⁷⁰

Eisner supported Michael Ovitz for the position.⁷¹ Ovitz was a longtime friend of Eisner’s, and a founder of Creative Artists Agency

63. See, e.g., Matthew R. Berry, Comment, *Does Delaware’s Section 102(b)(7) Protect Reckless Directors from Personal Liability? Only if Delaware Courts Act in Good Faith*, 79 WASH. L. REV. 1125, 1146 (2004).

64. *Disney IV*, 907 A.2d at 753–54.

65. *Id.* at 699–745.

66. *Disney V*, 906 A.2d 27, 35 (Del. 2006) (en banc).

67. *Id.* at 36.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

(CAA), a leading talent agency.⁷² Ovitz was considered one of the most powerful people in Hollywood, and his role at CAA provided him with an annual income of more than \$20 million.⁷³ Accordingly, his recruitment required a substantial offer. Ovitz insisted that he would not give up his fifty-five percent interest in CAA unless he received “downside protection.”⁷⁴

The result was a draft Ovitz employment agreement (the OEA), which provided for a five-year contract with two tranches of stock options.⁷⁵ If Ovitz was terminated on any ground other than “gross negligence or malfeasance,” Disney would provide a nonfault termination payment that included Ovitz’s remaining salary, unaccrued bonuses at \$7.5 million per year, the immediate vesting of one tranche of stock options, and a \$10 million payment for the other tranche.⁷⁶

Irwin Russell, a Disney director, raised concerns about the size of Ovitz’s compensation, but also noted that “Ovitz was an exceptional corporate executive . . . who merited downside protection and upside opportunity.”⁷⁷ Russell asked Graef Crystal, an executive compensation expert, and Raymond Watson, a Disney compensation committee member, to assess the OEA’s terms.⁷⁸

Crystal and Watson prepared computations of the range of values for Ovitz’s stock options, and then met with Russell on August 10, 1995.⁷⁹ Crystal subsequently informed Russell that, under the terms of the OEA, Ovitz would earn approximately \$23.6 million per year for the first five years of his employment or, if he chose to exercise a two-year renewal option, \$23.9 million per year over seven years.⁸⁰ Crystal believed those amounts would approximate Ovitz’s compensation at CAA.⁸¹ After further discussions, Crystal revised the OEA’s value to \$24.1 million per year for seven years.⁸²

Eisner and Ovitz signed a letter of agreement that contained the central terms of Ovitz’s employment.⁸³ During the hiring process, the OEA was amended in several respects, including changes to the strike

72. *Id.*

73. *Id.*

74. *Id.* at 37.

75. *Id.*

76. *Id.*

77. *Id.* at 36–37 (internal quotation marks omitted).

78. *Id.* at 38.

79. *Id.* at 37–38.

80. *Id.* at 38.

81. *Id.*

82. *Id.*

83. *Id.* at 39. The terms of the employment agreement were subject to approval by Disney’s compensation committee and board. *Id.*

price for the options.⁸⁴ Ultimately, a revised OEA was presented to the compensation committee.⁸⁵

The compensation committee considered the amended OEA terms, as well as other items, in a one hour meeting.⁸⁶ Crystal was available by phone if questions arose, but he was not asked any questions.⁸⁷ The compensation committee voted unanimously in favor of the OEA, "subject to reasonable further negotiations within the framework of the terms and conditions" of the OEA.⁸⁸ Immediately thereafter, the Disney board unanimously elected Ovitz as president.⁸⁹

As president, Ovitz did not fulfill Disney's hopes. It is unclear precisely why Ovitz's employment worked out so poorly. The plaintiffs alleged that Ovitz ignored Eisner's directives, and generally did very little in his new role.⁹⁰ Ovitz claimed that Eisner's micromanaging prevented him from making desirable changes at Disney, and that "he was not given enough time for his efforts to bear fruit."⁹¹ Disney's directors claimed Ovitz did not adapt well to his new position.⁹² Regardless of the actual reason for Ovitz's difficulties, Ovitz received a not-for-cause termination, triggering the \$130 million severance payment.⁹³

B. The Legal History of the Disney Case

Following Ovitz's termination, shareholders filed a derivative lawsuit in the Delaware Court of Chancery. This lawsuit continued for a number of years, and several of the ensuing opinions in the *Disney* litigation are significant to defining the fiduciary duty of good faith. Accordingly, the history of the litigation is set forth below, with emphasis on the Delaware courts' discussions of fiduciary duties.

In their initial complaint, the plaintiffs made claims that fell into three categories. They claimed that Disney's board breached their fiduciary duties in approving an extravagant and wasteful employment contract; the board approved an extravagant and wasteful termination agreement; and the board's directors were neither independent nor

84. *Id.* at 40.

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.* (internal quotation marks omitted).

89. *Id.* at 41.

90. *Id.* at 42.

91. *Id.*

92. *Id.* at 42.

93. *Id.* at 35.

disinterested.⁹⁴ In the first *Disney* opinion (*Disney I*), Chancellor Chandler dismissed the plaintiffs' allegations with prejudice.⁹⁵

On appeal, the Delaware Supreme Court affirmed this dismissal (*Disney II*).⁹⁶ The *Disney II* court found that the complaint failed to allege with particularity facts sufficient to claim a breach of the duty of care, a breach of the duty of loyalty, or corporate waste.⁹⁷

The *Disney II* court rejected plaintiffs' duty of loyalty claim because the facts alleged were inadequate to support allegations of director conflicts of interest or lack of independence.⁹⁸ Moreover, the court refused to permit the plaintiffs to replead their loyalty claim.⁹⁹ Accordingly, the *Disney II* court affirmed the chancery court's dismissal of the loyalty claim with prejudice.¹⁰⁰

The *Disney II* court also rejected the plaintiffs' claims of a breach of "substantive" due care.¹⁰¹ A duty of care claim, according to the court, could only be based on allegations of an inadequate decision-making process.¹⁰² The court did, however, allow the plaintiffs to replead their claims of a violation of procedural due care.¹⁰³

In addition, the *Disney II* court made several references to good faith. For example, the court noted that the business judgment rule includes statutory protections for a board's good faith reliance on an expert's advice.¹⁰⁴ This protection provided a potential defense for Disney's directors, since Crystal had advised the board in making its compensation decision.¹⁰⁵

The court's analysis of due care also provided insight into the link between the business judgment rule and the duty of good faith. In rejecting the plaintiffs' allegations that directors breached a duty of substantive due care, Chief Justice Veasey explained that "[i]rrationality is the outer limit of the business judgment rule. Irra-

94. *Disney II*, 746 A.2d 244, 248-49 (Del. 2000) (en banc).

95. *In re Walt Disney Co. Derivative Litig.* (*Disney I*), 731 A.2d 342, 380 (Del. Ch. 1998); *Disney II*, 746 A.2d at 248 n.1.

96. *Disney II*, 746 A.2d at 248. Though the *Disney II* court agreed with the chancery court's dismissal of all of the plaintiffs' claims, the *Disney II* court reversed the chancery court's decision to dismiss all of the claims with prejudice, allowing certain claims to be repleaded. *Id.* at 267.

97. *See id.* at 248-49, 267.

98. *Id.* at 256-58.

99. *Id.* at 258 n.42.

100. *Id.* at 258.

101. *Id.* at 264.

102. *Id.*

103. *Id.* at 262, 266-67. The court also permitted the plaintiffs to replead their claims of corporate waste. *Id.* at 267.

104. *Id.* at 251.

105. *Disney V*, 906 A.2d 27, 38 (Del. 2006) (en banc).

tionality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule.”¹⁰⁶ An irrational business decision could thus be evidence of a lack of good faith.

On remand, the duty of good faith played a central role. Given the case’s procedural posture, this made sense. Under section 102(b)(7) of the Delaware General Corporation Law (DGCL), corporations may place exculpatory provisions in their charters that protect directors from monetary liability for breaching the duty of care.¹⁰⁷ The Disney Corporation had such a provision.¹⁰⁸ And, following the decision in *Disney II*, the plaintiffs’ duty of loyalty claim had been dismissed with prejudice.¹⁰⁹ Accordingly, neither a due care nor a loyalty claim was a promising avenue for the plaintiffs.

A section 102(b)(7) charter provision, however, does not protect directors where their actions are “not in good faith.”¹¹⁰ In 2003, Chancellor Chandler issued an opinion in which he denied the defendants’ motions to dismiss (*Disney III*), based on the plaintiffs’ allegations that the board lacked good faith.¹¹¹ This decision apparently represents the first time that a Delaware court had allowed a case to move forward on a theory of good faith, independent of due care and loyalty theories.¹¹²

106. *Disney II*, 746 A.2d at 264.

107. DEL. CODE ANN. tit. 8, § 102(b)(7) (repl. vol. 2001). This section precludes exculpatory provisions that would eliminate liability:

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

Id.

108. See *In re Walt Disney Co. Derivative Litig. (Disney III)*, 825 A.2d 275, 286 (Del. Ch. 2003) (indicating that the Disney charter included an exculpatory provision pursuant to section 102(b)(7)).

109. *Disney II*, 746 A.2d at 258.

110. § 102(b)(7)(ii). There are several ways to interpret this language. Elizabeth Nowicki suggests that actions “not in good faith” should constitute a separate category from actions in “bad faith.” See Nowicki, *supra* note 7, at 59 (“Bad faith acts are very different from acts undertaken in the absence of good faith and only the latter facts need to be established for duty of care and 102(b)(7) purposes.”).

111. *Disney III*, 825 A.2d at 291.

112. See Griffith, *supra* note 7, at 19–20 (“Good faith had never before been given an independent doctrinal effect, but had typically been mentioned in the context of the other two duties, most often as an aspect of the duty of loyalty.”). In fact, it was not obvious from the prior decisions in the Disney litigation that the case would focus on the duty of good faith. Cf. Veasey & Di Guglielmo, *supra* note 7, at 1441 (“On remand, the case, as repleaded, morphed into a good faith case.” (internal quotation marks omitted)).

In their amended complaint, the plaintiffs had alleged that the board effectively permitted Eisner to hire Ovitz, and to decide the terms of his employment and termination, without real board supervision.¹¹³ According to Chancellor Chandler, the allegations indicated that the directors had “consciously and intentionally disregarded their responsibilities, adopting a ‘we don’t care about the risks’ attitude concerning a material corporate decision.”¹¹⁴ Concluding that the repleaded complaint alleged facts that provided a “reason to doubt whether the board’s actions were taken honestly and in good faith,” the court permitted the suit to proceed.¹¹⁵

At trial, matters did not go so well for the plaintiffs. In a lengthy post-trial opinion (*Disney IV*), the court exhaustively analyzed the testimony and evidence,¹¹⁶ and indicated that the board did not meet the “best practices of corporate governance.”¹¹⁷ Despite these board failings, the court concluded that the board was not liable for a lack of due care or good faith.¹¹⁸

In deciding *Disney IV*, Chancellor Chandler made a concerted effort to work out what the fiduciary duty of good faith actually means. When the opinion was written, the Delaware Supreme Court and Court of Chancery had not clearly defined (or at least agreed upon) the content of good faith, and they had not consistently determined whether the duty of good faith is an independent fiduciary duty.¹¹⁹ As a result, the *Disney IV* opinion devoted considerable analysis to good faith as a concept, focusing on the meaning of “bad faith.”¹²⁰

Several themes emerged. For one, Chancellor Chandler’s reasoning suggested that there exists an overarching concept of good faith fiduciary duty that animates the duties of care and loyalty.¹²¹ This

113. *Disney III*, 825 A.2d at 277–79.

114. *Id.* at 289 (emphasis omitted).

115. *Id.* at 286.

116. *See Disney IV*, 907 A.2d 693, 699–745 (Del. Ch. 2005).

117. *See id.* at 745 (noting that compliance with fiduciary obligations does not alone establish use of best practices). The court concluded that “[f]or the future, many lessons of what not to do can be learned from defendants’ conduct here.” *Id.* at 760.

118. *See id.* at 779 (entering judgment in favor of defendants on all counts).

119. *Id.* at 753.

120. *Id.* at 753–56.

121. Chancellor Chandler explained:

Fundamentally, the duties traditionally analyzed as belonging to corporate fiduciaries, loyalty and care, are but constituent elements of the overarching concepts of allegiance, devotion and faithfulness that must guide the conduct of every fiduciary. The good faith required of a corporate fiduciary includes not simply the duties of care and loyalty . . . but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders.

Id. at 755.

view of good faith may be conceptually right, but it raises an interesting problem for judicial purposes because courts must distinguish breaches of due care from breaches of good faith when applying section 102(b)(7). While a director's failure to exercise due care may be excused, actions "not in good faith" cannot be excused.¹²²

Another significant feature of the *Disney IV* opinion was the court's conclusion that a fiduciary's motivation for acting in bad faith could stem from a variety of sources.¹²³ "[G]reed, hatred, lust, envy, revenge, [] shame or pride" would all be plausible sources of bad faith.¹²⁴ This follows naturally from the idea that good faith conduct is grounded in the fiduciary's mandate to act with honesty of purpose, in the best interests of the corporate beneficiary. To the extent that a director is not acting in the corporation's best interests, it should be irrelevant precisely why a director has chosen to act improperly.¹²⁵ It is enough that the director chose not to serve the corporation.

The key to the *Disney IV* opinion, however, was the determination that bad faith involves intentional conduct. Chancellor Chandler announced that "the concept of intentional dereliction of duty, a conscious disregard for one's responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith."¹²⁶ Although this holding leaves room for other standards to develop, it makes clear that intentional conduct is the underpinning of bad faith acts by a corporate fiduciary.¹²⁷

Chancellor Chandler further noted three primary situations in which good faith duties are implicated:

122. See DEL. CODE ANN. tit. 8, § 102(b)(7) (repl. vol. 2001) (permitting charter provisions eliminating director liability for breach of fiduciary duty but stating that such provisions may not excuse liability for "acts or omissions not in good faith"). In addition, while allegations of a material conflict of interest will shift the burden of proof to the defendant, it is less apparent how allegations of improper motives fit into judicial review of board judgments. See *Disney IV*, 907 A.2d at 754 ("It is unclear, based upon existing jurisprudence, whether motive is a necessary element for a successful claim that a director has acted in bad faith, and, if so, whether that motive must be shown explicitly or whether it can be inferred from the directors' conduct." (footnotes omitted)). The distinctions between bad faith and conventional disloyalty claims are not fully developed.

123. See *Disney IV*, 907 A.2d at 754.

124. *Id.* (internal quotation marks omitted). The court also noted that "[s]loth could certainly be an appropriate addition to that incomplete list if it constitutes a systematic or sustained shirking of duty." *Id.*

125. See *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) ("The reason for the disloyalty . . . is irrelevant, the underlying motive (be it venal, familial, collegial, or nihilistic) for conscious action not in the corporation's best interest does not make it faithful, as opposed to faithless.").

126. *Disney IV*, 907 A.2d at 755 (emphasis omitted).

127. See *id.* at 755 n.459 ("Indeed, § 102(b)(7) on its face seems to equate bad faith with intentional misconduct.").

A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.¹²⁸

Applying this understanding of the duty of good faith, the court then found for the defendants on all counts.¹²⁹

C. *The Disney V Opinion*

On June 8, 2006, the Delaware Supreme Court issued an opinion (*Disney V*) affirming the chancery court's holding in *Disney IV*.¹³⁰ In *Disney V*, the Delaware Supreme Court addressed a variety of claims against the Disney directors, including claims under the duties of care and good faith. The court first affirmed the rejection of the plaintiffs' duty of care claims.¹³¹ As a further development in the treatment of due care in Delaware, that section of the opinion is significant in its own right.¹³² This Article will focus, however, on the court's analysis of good faith duties.

In support of their claim that the directors breached their duties of good faith, the plaintiffs argued that the chancery court had improperly substituted a definition of bad faith conduct in its post-trial opinion (*Disney IV*) that was different from the definition used in its denial of defendants' motion to dismiss (*Disney III*).¹³³ The *Disney IV* opinion allegedly emphasized subjective motivation or intent as an element of bad faith.¹³⁴ But according to the plaintiffs, under the earlier *Disney III* definition, "directors violate their duty of good faith if they are making material decisions without adequate information and without adequate deliberation."¹³⁵ The plaintiffs claimed that this

128. *Id.* at 755–56 (footnotes omitted).

129. *Id.* at 779.

130. *Disney V*, 906 A.2d 27, 28, 35–36 (Del. 2006) (en banc).

131. *Id.* at 51–62.

132. For example, commentators have noted that not one reference is made to the *Van Gorkom* case throughout the *Disney V* court's due care analysis, despite the apparent relevance of that decision to the *Disney* fact pattern. See, e.g., Posting of Christine Hurt to Conglomerate, <http://www.theconglomerate.org/disney/index.html> (June 9, 2006).

133. *Disney V*, 906 A.2d at 62. The *Disney III* court indicated that directors breach their duty of good faith where they "consciously and intentionally disregarded their responsibilities, adopting a 'we don't care about the risks' attitude concerning a material corporate decision." *Disney III*, 825 A.2d 275, 289 (Del. Ch. 2003) (emphasis omitted).

134. *Disney V*, 906 A.2d at 62.

135. *Id.* (internal quotation marks omitted).

change was prejudicial because they had relied on the earlier formulation in presenting evidence at trial.¹³⁶

Thus, the plaintiffs in effect argued that a breach of the duty of care is a breach of the duty of good faith, and that their claims succeeded under this standard.¹³⁷ The Delaware Supreme Court disagreed. The *Disney V* court found that the chancery court's word choice in its post-trial opinion had changed from its earlier formulation, but that the substantive standard for bad faith conduct had remained the same.¹³⁸ More importantly, the *Disney V* court found that it made no difference whether the chancery court's formulation of the legal standard had changed because plaintiffs would lose in either case.¹³⁹

In the Delaware Supreme Court's view, the plaintiffs "essentially concede[d] that their proof of bad faith is insufficient to satisfy the standard articulated by the Court of Chancery"—i.e., the plaintiffs could not make a showing of an "intentional dereliction of duty, a conscious disregard for one's responsibilities."¹⁴⁰ The plaintiffs' good faith argument instead depended on a legal conclusion that a breach of care amounts to a breach of good faith.¹⁴¹ As a result, the plaintiffs' argument had to fail because the plaintiffs were unable to prove that the Disney directors breached their duties of care.¹⁴² Even under the plaintiffs' preferred definition of good faith, their claim could not survive the decision that there was no breach of due care.

Given this conclusion, nothing further needed to be said on the duty of good faith.¹⁴³ The Delaware Supreme Court nevertheless decided it was appropriate to address the nature of the duty of good faith, given the importance of the subject.¹⁴⁴ In the court's words, "some conceptual guidance to the corporate community may be helpful."¹⁴⁵ The ensuing discussion of good faith was arguably dicta.¹⁴⁶

136. *Id.*

137. *Id.* at 63 (describing plaintiffs' theory as a "verbal effort to collapse the duty to act in good faith into the duty to act with due care").

138. *See id.* ("Both formulations express the same concept, although in slightly different language.")

139. *Id.*

140. *Id.* (internal quotation marks omitted).

141. *See id.*

142. *Id.*

143. *See id.* ("For that reason, our analysis of the appellants' bad faith claim could end at this point.")

144. The court emphasized that the duty of good faith played a prominent role in the *Disney* litigation, yet "the duty to act in good faith is, up to this point[,] relatively uncharted." *Id.* at 63–64.

145. *Id.* at 64.

Even so, the *Disney V* opinion offers significant guidance on what good faith means for a corporate director.

The meaning of good faith, as the Delaware Supreme Court noted, is open to several interpretations. In particular, the court reasoned that three categories of behavior were candidates for “bad faith” conduct.¹⁴⁷ The first and most obvious category was “subjective bad faith.”¹⁴⁸ This occurs where there is “fiduciary conduct motivated by an actual intent to do harm.”¹⁴⁹ There is little debate that this first category qualifies as a breach of the good faith duty.

The court’s second category consisted of cases where a fiduciary acts “solely by reason of gross negligence and without any malevolent intent.”¹⁵⁰ Here, the court delved into the blurred line between bad faith conduct and other fiduciary breaches. The court acknowledged that, from a philosophical perspective, the duty of good faith is necessarily intertwined with the duties of care and loyalty.¹⁵¹

Despite this overlap among fiduciary duties, the court concluded that the exercise of due care and good faith should be sharply distinguished.¹⁵² Grossly negligent conduct, without more, the court concluded, cannot constitute a breach of the duty of good faith.¹⁵³ The court’s reasoning was primarily based on statutory guidance. In particular, the court emphasized sections 102(b)(7) and 145 of the DGCL, both of which refer to “good faith.”¹⁵⁴

146. A case could be made, however, that the good faith discussion was an alternate ground for the court’s substantive holding. Toward the end of the court’s analysis of good faith, the court stated that “we uphold the Court of Chancery’s definition as a legally appropriate, although not the exclusive, definition of fiduciary bad faith.” *Id.* at 67. The court further stated that it “sustained the Chancellor’s finding that the Disney directors acted in good faith when approving the OEA and electing Ovitz as President.” *Id.* at 67–68. This language is consistent with a holding that the plaintiffs lost because they did not meet the *Disney IV* court’s definition of good faith.

147. *Id.* at 64.

148. *Id.* (internal quotation marks omitted).

149. *Id.*

150. *Id.* The court also described this category as a “lack of due care.” *Id.*

151. *Id.* at 65; see also Griffith, *supra* note 7, at 43 (“Whether the question is confronted from the perspective of the duty of care or of the duty of loyalty is just a difference in approach. To put it another way, the fundamental question underlying both duties really is good faith.”).

152. See *Disney V*, 906 A.2d at 65 (stating that “from a legal standpoint those duties are and must remain quite distinct”).

153. *Id.* at 66.

154. *Id.* at 65–66. The court noted that “[b]oth our legislative history and our common law jurisprudence distinguish sharply between the duties to exercise due care and to act in good faith.” *Id.* at 65. The emphasis was on the legislative side. Because the need for separation between good faith and other duties is of recent origin, a lack of precedent supporting such a sharp distinction is not surprising. Although the court cited common

Under section 102(b)(7),¹⁵⁵ Delaware corporations may adopt a charter provision to exculpate directors from monetary liability for a breach of the duty of care.¹⁵⁶ However, a statutory exception excludes coverage of exculpatory provisions “for acts or omissions not in good faith.”¹⁵⁷ In the Delaware Supreme Court’s view, “[t]o adopt a definition of bad faith that would cause a violation of the duty of care automatically to become an act or omission ‘not in good faith,’ would eviscerate the protections accorded to directors by the General Assembly’s adoption of Section 102(b)(7).”¹⁵⁸ Accordingly, the court concluded that section 102(b)(7) weighed against treating due care and good faith violations as one and the same.

Section 145 provides for the indemnification of directors and officers for litigation expenses under specified circumstances.¹⁵⁹ Yet this statute specifically limits certain indemnification provisions to persons who “acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation.”¹⁶⁰ Under this statute, the court explained, directors and officers “can be indemnified for liability (and litigation expenses) incurred by reason of a violation of the duty of care, but not for a violation of the duty to act in good faith.”¹⁶¹ The court concluded that if a violation of the duty of care were automatically a violation of the duty of good faith, these legislative protections would be nullified.¹⁶²

In light of the need to draw a line between breaches of care and breaches of bad faith, the court found the second category—actions caused solely by gross negligence—inadequate as a formulation of bad faith.¹⁶³ The court therefore turned to a third category of conduct that falls between the first two. This intermediate category, the court determined, “is what the Chancellor’s definition of bad faith—intentional dereliction of duty, a conscious disregard for one’s responsibilities—is intended to capture.”¹⁶⁴

The *Disney V* opinion endorsed the chancery court’s definition, offering two justifications. The *Disney V* court’s initial reason for

law cases involving good faith, it did not explain how those cases supported the proposed distinction. *Id.* at 67 n.111.

155. DEL. CODE ANN. tit. 8, § 102(b)(7) (repl. vol. 2001).

156. *See id.*

157. *Id.* § 102(b)(7)(ii).

158. *Disney V*, 906 A.2d at 65.

159. DEL. CODE ANN. tit. 8, § 145.

160. *Id.* § 145(a)–(b).

161. *Disney V*, 906 A.2d at 66.

162. *Id.*

163. *Id.*

164. *Id.*

adopting this intent-based definition was that it covers improper conduct that is not addressed by duty of loyalty claims in their classic form—i.e., this definition covers misconduct by directors even if they do not have a material conflict of interest and are independent of outside influences.¹⁶⁵ At the same time, it also covers conduct which is “more culpable than simple inattention or failure to be informed of all facts material to the decision.”¹⁶⁶ Intentional dereliction of duty is a form of fiduciary misconduct, but it is separate from the traditional scope of care and loyalty claims.

The court’s second reason for adopting this intermediate definition was that section 102(b)(7) contains several exceptions: it does not permit exculpatory provisions for “intentional misconduct,” “knowing violation of law,” or for conduct “not in good faith.”¹⁶⁷ The *Disney V* court found that the first two exceptions are examples of “subjective bad faith,” and inferred that action “not in good faith” describes less severe conduct.¹⁶⁸ The court thus read the DGCL to distinguish between acts which involve an intent to do harm or break the law, and acts which are “not in good faith” because they involve a conscious disregard of the director’s responsibilities. Viewing intentional dereliction of duty as an intermediate category enabled the court to give distinct meaning to the phrase “not in good faith” contained in section 102(b)(7).

After defining the duty of good faith, the court upheld the chancery court’s rejection of the plaintiffs’ claims under the fiduciary duties of care and good faith.

IV. IMPLICATIONS OF *DISNEY V* FOR THE DUTY OF GOOD FAITH

A. *The Significance of Good Faith as a Standard of Conduct*

Disney V announces a definition of bad faith conduct that requires an intentional disregard of a director’s duties. To understand the significance of this formulation, it is helpful to compare the alternatives. The outcome in this case was not a foregone conclusion, and the indeterminacy of earlier good faith precedents allowed for a variety of formulations.¹⁶⁹

165. *See id.* (“To protect the interests of the corporation and its shareholders, fiduciary conduct of this kind, which does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence, should be proscribed.”).

166. *Id.*

167. *Id.* at 67 (quoting DEL. CODE ANN. tit. 8, § 102(b)(7)(ii) (repl. vol. 2001)).

168. *Id.*

169. For a helpful discussion of the various ways that Delaware courts conceived of good faith in recent years, see Bruner, *supra* note 7, at 23–46.

One plausible way to read the prior case law was to limit bad faith claims to cases involving dishonesty or improper motivations.¹⁷⁰ However, *Disney V* offers no indication that bad faith conduct needs to be linked to a director's possession of "furtive design or ill will."¹⁷¹ The Delaware Supreme Court rejected the idea that a director must intend to do harm to the corporation,¹⁷² and it made clear that director self-interest is not a prerequisite to a finding of bad faith.¹⁷³ Instead, the court found bad faith is present where there is an awareness that the fiduciary is not acting in the corporation's best interests.¹⁷⁴ All that this requires is that a fiduciary be conscious that her actions are inconsistent with her responsibilities.¹⁷⁵

In other respects, *Disney V* restricted the potential scope of behavior that qualifies as bad faith. In theory, bad faith might cover conduct that is more egregious than gross negligence, but less severe than conscious disregard of one's duties. Hillary Sale, for example, suggests that egregious violations of the duty of care should qualify as bad faith.¹⁷⁶ In her formulation, "[a]lthough a breach of good faith need

170. See, e.g., Berry, *supra* note 63, at 1146 ("The Delaware State Supreme Court requires that defendants have a bad faith motive or illicit intent to breach the duty of good faith."); see also Zirn v. VLI Corp., 681 A.2d 1050, 1061-62 (Del. 1996) (concluding that board members' misstatements were made in good faith because plaintiffs failed to offer any evidence that the directors spoke with an intent to deceive); Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P., 624 A.2d 1199, 1208 (Del. 1993) ("[A] claim of bad faith hinges on a party's tortious state of mind.")

171. Cf. McGowan v. Ferro, 859 A.2d 1012, 1036 (Del. Ch. 2004) ("Bad faith is not simply bad judgment or negligence, but rather implies the conscious doing of a wrong because of dishonest purpose or moral obliquity . . . it contemplates a state of mind affirmatively operating with furtive design or ill will." (internal quotation marks omitted)).

172. See *Disney V*, 906 A.2d at 66 (recognizing that bad faith is not limited to "conduct motivated by subjective bad intent").

173. See *id.* (indicating that a director's behavior may violate the duty of good faith regardless of whether the director has a conflict of interest); see also Stone v. Ritter, No. 93, 2006 WL 3169168, at *6 (Del. Nov. 6, 2006) ("[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest.")

174. *Disney V*, 906 A.2d at 67.

175. See *id.* at 66 (noting that a director's "conscious disregard" for his duties constitutes a breach of the duty of good faith).

176. See Sale, *supra* note 7, at 488 ("Good faith based liability, then, moves the bar from negligent behavior to deliberately indifferent, egregious, subversive, or knowing behavior, and thereby raises issues related to the motives of the actors."). Although this standard may sound intent-based, it apparently has an objective element. Sale compares good faith cases to federal securities fraud cases, where "[f]or particularly egregious behavior, it is presumed that knowledge of an omission or misstatement existed, or *should have existed*." *Id.* at 489-90 (emphasis added). Sale further suggests that "as the Disney cases make clear, allegations of unintentional but flagrantly reckless actions or inactions are also problematic and, if proved, are breaches of good faith responsibilities." *Id.* at 493-94. But see Veasey & Di Guglielmo, *supra* note 7, at 1448 ("How does one define gross negligence and good faith, and how does one articulate where gross negligence ends and failure to act in good

not be intentional or conscious, it does require some sort of obvious, deliberate, or egregious failure.”¹⁷⁷ Yet following *Disney V*, a breach of good faith apparently *does* need to be an intentional or conscious breach of duty.¹⁷⁸

The Delaware Supreme Court’s reasoning makes clear that bad faith involves the defendant’s actual state of mind. Although a director might violate the duty of care and the duty of good faith at the same time, this would be a matter of the director’s psychological state.¹⁷⁹ In the court’s example, a director could have a subjective hostility toward his corporation, and for that reason fail to sufficiently inform himself while making decisions, thereby also displaying gross negligence.¹⁸⁰ Both the duty of care and the duty of good faith would be implicated by these facts, but the two concepts remain distinct.¹⁸¹

Alternatively, the *Disney V* court could have interpreted good faith to include both objective and subjective standards, even under the *Disney IV* definition. For example, Melvin Eisenberg understood Chancellor Chandler’s definition of bad faith—“intentional dereliction of duty, a conscious disregard for one’s responsibilities”¹⁸²—as incorporating an objective element.¹⁸³ In his view:

The terms “intentional” and “conscious,” as used in that and some other tests, need interpretation. The formulations that employ these terms would make little or no sense unless they mean either that the manager was conscious that he was disregarding his duties or that a reasonable person in the manager’s position would have known that he was disregarding his duties—not that the actual manager was subjectively conscious that he was disregarding his duties.¹⁸⁴

faith begins? . . . Is there such a concept as ‘severe recklessness?’); see also Griffith, *supra* note 7, at 32 (“Any attempt to distinguish the recklessness inquiry by limiting it to extreme deviations from the norm must encounter the objection that corporate law already has doctrines, such as gross negligence and waste, for dealing with extremes.” (footnote omitted)).

177. Sale, *supra* note 7, at 493.

178. See *Disney V*, 906 A.2d at 66 (describing bad faith in terms of an “intentional dereliction” and a “conscious disregard”).

179. See *id.* at 65 & n.104 (describing how a director might have two coexisting mental states—“subjective bad intent and gross negligence”).

180. *Id.* at 65 n.104.

181. *Id.*

182. *Disney IV*, 907 A.2d 693, 755 (Del. Ch. 2005) (emphasis omitted).

183. Eisenberg, *supra* note 7, at 72.

184. *Id.*

On its face, the *Disney IV* formulation—“intentional dereliction of duty, a conscious disregard of one’s responsibilities”¹⁸⁵—indicates a subjective standard. One does not do something intentionally without being aware of it. But, even if “conscious” and “intentional” should mean what Eisenberg contends, the *Disney V* rationale closes off that possibility.¹⁸⁶ A manager who did not know he had disregarded his duties, despite the fact that a reasonable person in his position would have known, is hard to distinguish from a manager who acted with gross negligence.¹⁸⁷ Eisenberg’s example is precisely what the Delaware Supreme Court sought to avoid in rejecting gross negligence as a category of “bad faith” conduct.

Throughout its discussion of good faith duties, the *Disney V* opinion referred to conduct that is intentional.¹⁸⁸ In rejecting the second “bad faith” category—which would have equated bad faith with gross negligence—the court referred to the fundamental torts distinction between “conduct that is negligent (or grossly negligent) and conduct that is intentional.”¹⁸⁹ The opinion also indicated that the duty of good faith is a vehicle to address conduct that is “qualitatively more culpable than gross negligence.”¹⁹⁰ In short, bad faith seems to require a subjective state of mind.

The court’s formulation also appears to avoid an indeterminacy that plagues intent-based standards. Sean Griffith suggests that there is an inherent difficulty in attempting to distinguish questions of negligence and intent for business judgment purposes. Defining conduct

185. *Disney IV*, 907 A.2d at 755 (emphasis omitted).

186. This conclusion is further supported by language in the recent *Stone* opinion. See *Stone v. Ritter*, No. 93, 2006 WL 3169168, at *6 (Del. Nov. 6, 2006) (explaining, in the director oversight context, that “imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations”).

187. In fact, this type of conduct may not even rise to the level of gross negligence. Arguably, Eisenberg’s example describes ordinary negligence because conduct that a reasonable director would avoid is likely to overlap closely with conduct that a reasonable director would believe violates his fiduciary duties. See Eisenberg, *supra* note 7, at 72 (arguing that the *Disney IV* formulation of the duty of good faith must include conduct that a reasonable person would have known violated his fiduciary duties).

188. See *Disney V*, 906 A.2d 27, 66 (Del. 2006) (en banc) (referring to “intentional dereliction of duty, a conscious disregard for one’s responsibilities”); *id.* at 67 (suggesting it is bad faith when “the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act”).

189. *Disney V*, 906 A.2d at 66 n.109.

190. *Id.* at 66.

as negligent or as intentional requires courts to consider how individuals choose to “direct their attention.”¹⁹¹ As Griffith explains:

Whatever the board is deciding, its intent, consistent with fiduciary principles, is always the same—to maximize corporate welfare. To frame the question of whether they are doing it as they ought to as a matter of recklessness or intentional disregard is merely to conduct the negligence inquiry under another label.¹⁹²

If Griffith is right, a judicial reference to “conscious disregard” could mean little in practice because negligence can easily be rephrased in terms of conscious disregard. A court might recast a business judgment in terms of subjective intent by determining that a director was inadequately informed, and then conclude that the choice not to gather the necessary information was intentional. Griffith argues that “[n]egligence merely sets the standard of reasonable attention in doing something, but the decision to direct one’s attention can still be understood as a question of intent—that is, the choice to allocate attention to one place rather than another.”¹⁹³

Yet the reasoning of the *Disney V* opinion provides a potential way out of this predicament. The court expressly approved the definition given by the chancery court, which covers instances

where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a *known* duty to act, demonstrating a conscious disregard for his duties.¹⁹⁴

This definition of misconduct is less malleable because the intent question relates to the defendant’s state of mind with respect to *known* duties. It is more difficult to simply recharacterize negligence as an intentional abdication of duty when the meaning of good faith is framed in this way. Following *Disney V*, a defendant who is unaware that his acts violated his responsibilities does not breach the duty of good faith, even if he should have known better.

191. Griffith, *supra* note 7, at 31. In Griffith’s view, a director’s decision as to where he focuses his attention “can be characterized equally as intentional or negligent.” *Id.*

192. *Id.* at 32.

193. *Id.* at 31–32 (footnote omitted).

194. *Disney V*, 906 A.2d at 67 (quoting *Disney IV*, 907 A.2d 693, 755 (Del. Ch. 2005) (emphasis added)); see also *Stone v. Ritter*, No. 93, 2006 WL 3169168, at *6 (Del. Nov. 6, 2006) (explaining, in the director oversight context, that plaintiffs must show that directors knew they were not fulfilling their fiduciary duties for liability to be imposed).

In light of the confusion that has surrounded the duty of good faith,¹⁹⁵ *Disney V* creates a degree of clarity. The court's test for bad faith—"intentional dereliction of duty, a conscious disregard for one's responsibilities"¹⁹⁶—is a straightforward, subjective standard of conduct. Although this standard will be case-specific and does not exclude other formulations in the future, it provides a meaningful baseline for director obligations. Good faith is all about the director's state of mind, namely, her belief that her actions are in the corporation's best interests.

B. The Significance of Good Faith for Standards of Review

Unfortunately, the recent judicial guidance on the duty of good faith fails to discuss the appropriate standard of review. Standards of conduct determine how a director should perform his duties, while standards of review determine how courts should review that performance when deciding whether to impose liability.¹⁹⁷ Corporate law often provides one standard for appropriate director behavior and another standard for purposes of liability.¹⁹⁸

This distinction is particularly clear in duty of care cases. Directors are expected to avoid negligent conduct when performing their duties, but for purposes of judicial review, a successful claim under the duty of care must show gross negligence—a higher standard.¹⁹⁹ The standard of review can thus be crucial when it comes to enforcing fiduciary duties.

The opinion in *Disney V* expressly stated that it did not address "the issue of whether the fiduciary duty to act in good faith is a duty that, like the duties of care and loyalty, can serve as an independent basis for imposing liability upon corporate officers and directors."²⁰⁰ The *Disney IV* court had indicated that the business judgment rule could be overcome if a plaintiff showed "an act of bad faith by a pre-

195. See *supra* note 7.

196. *Disney V*, 906 A.2d at 66–67.

197. See Eisenberg, *supra* note 21, at 437 ("A *standard of conduct* states how an actor should conduct a given activity or play a given role. A *standard of review* states the test a court should apply when it reviews an actor's conduct to determine whether to impose liability or grant injunctive relief."). Standards of review are relevant to courts when addressing claims of bad faith. See Eisenberg, *supra* note 7, at 26 ("[W]hile the baseline conception of the duty of good faith is a standard of conduct, noncompliance with that conception does not in and of itself give rise to liability.").

198. Eisenberg, *supra* note 21, at 438.

199. Allen et al., *supra* note 14, at 449.

200. *Disney V*, 906 A.2d at 67 n.112.

ponderance of the evidence,"²⁰¹ but the *Disney V* opinion never detailed what a plaintiff must do to prevail.

Post-*Disney V*, the Delaware Supreme Court has indicated that demonstrating a breach of the duty of good faith is not an independent basis for imposing liability, but rather an indirect way of imposing liability under the duty of loyalty.²⁰² Because a loyalty claim that sounds in bad faith need not be grounded in a fiduciary's conflict of interest, however, there is potential room for claims of bad faith that are different in kind from traditional fiduciary duty claims. Courts will still have to determine what kinds of allegations suffice to plead bad faith.

Given that the duty of good faith provides a different basis for imposing liability under the duty of loyalty, what should this mean in practice? Courts might make good faith-based claims very difficult to allege, in an effort to avoid enforcing the duty against directors who lack the subjective awareness that their actions run contrary to their obligations. Or, courts might ease the plaintiff's burden, in an effort to redress improper board behavior.²⁰³

A likely judicial approach would consider board conduct as an indicator of director motivations. Direct evidence of improper motivations or intent is rare. What usually is visible is the board's decision and its decisionmaking process. Consequently, Delaware precedents recognize the use of objective standards of conduct as a means of inferring subjective states of mind.

For example, some modern business judgment rule cases permit limited consideration of whether a business judgment is irrational.²⁰⁴

201. *Disney IV*, 907 A.2d 693, 755 (Del. Ch. 2005). The *Disney IV* court did note that the burden would be on the plaintiffs to rebut the business judgment rule. *See id.* As Claire Hill and Brett McDonnell note respecting the *Disney* decisions, "neither court provided much guidance as to what plaintiffs could do to demonstrate that decisions have been made in bad faith (or lack of good faith) so defined." Hill & McDonnell, *supra* note 7, at 13.

202. *Stone v. Ritter*, No. 93, 2006 WL 3169168, at *6 (Del. Nov. 6, 2006).

203. *Cf. Griffith*, *supra* note 7, at 8, 16–28 (contending that good faith rhetoric serves to "loosen the doctrinal constraints on the Delaware judiciary and to enable its judges to shift the authority/accountability balance in response to a change in the set of pressures and constraints then operating upon them" and describing cases that accomplish this result).

204. *See, e.g., Disney II*, 746 A.2d 244, 264 (Del. 2000) (en banc) ("Irrationality is the outer limit of the business judgment rule." (footnote omitted)). Rationality is often described as a precondition for the business judgment rule presumption. *See Bainbridge, supra* note 14, at 99 ("[S]ome courts and commentators contend that the business judgment rule does not protect an irrational decision."). For a suggestion that the role for courts in assessing rationality of board conduct should be curtailed, see Michael P. Dooley, *Two Models of Corporate Governance*, 47 *BUS. LAW.* 461 (1992). Dooley argues against adoption of the ALI Governance Project's version of the business judgment rule, stating that

Chancellor Allen, in an effort to explain why this type of review is permitted, has explained that “such limited substantive review as the rule contemplates (*i.e.*, is the judgment under review ‘egregious’ or ‘irrational’ or ‘so beyond reason,’ etc.) really is a way of inferring bad faith.”²⁰⁵ This same reasoning is evident in *Disney II*, where the court suggested that “[i]rrationality . . . may tend to show that the decision is not made in good faith.”²⁰⁶

In *White v. Panic*,²⁰⁷ decided in 2001, the Delaware Supreme Court offered the following guidelines:

The standards for corporate waste and bad faith by the board are similar. To prevail on a waste claim or a bad faith claim, the plaintiff must overcome the general presumption of good faith by showing that the board’s decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation’s best interests.²⁰⁸

Although the *White* court’s language refers to “egregious” as well as “irrational” decisions, this standard of review is directed at conduct that goes so far that it could not have been based on “a valid assessment of the corporation’s best interests”—in other words, the *White* court’s standard resembles a rational basis test. The fact that the *White* court drew a parallel to corporate waste, a claim that requires a showing of irrational squandering of assets, provides added support for this reading.²⁰⁹

“[a]nyone who believes that the plaintiffs’ bar will not try to expand the definition of behavior that is ‘not quite rational’ has not been paying attention.” *Id.* at 477–78, 481.

205. *In re* RJR Nabisco, Inc. S’holders Litig., Civ. A. No. 10389, 1989 WL 7036, at *13 n.13 (Del. Ch. Jan. 31, 1989); see Davis, *supra* note 21, at 576 (suggesting that the rational basis test “serves as an objective confirmation of the critical, but entirely subjective, requirement that the directors have a good faith belief that their decision is in the corporation’s best interest”). But see *In re* Caremark Int’l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) (“[W]hether a judge or jury . . . believes a decision substantively wrong, or degrees of wrong extending through ‘stupid’ to ‘egregious’ or ‘irrational,’ provides no ground for director liability, so long as the . . . process employed was either rational or employed in a *good faith* effort to advance corporate interests.”).

206. *Disney II*, 746 A.2d at 264.

207. 783 A.2d 543 (Del. 2001) (en banc).

208. *Id.* at 554 n.36.

209. See *Disney V*, 906 A.2d 27, 74 (Del. 2006) (en banc) (“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 business purpose.” (internal quotation marks omitted)). Furthermore, the *White* court specifically referenced a case that announced that bad faith may be identified by “assessing whether th[e] decision is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith.” *White*, 783 A.2d at 554 n.36 (citing *In re* J.P. Stevens & Co. S’holders Litig., 542 A.2d 770, 780–81 (Del. Ch. 1988)).

More recently, in *Official Committee of Unsecured Creditors of Integrated Health Services, Inc. v. Elkins*,²¹⁰ Vice Chancellor Noble determined that the irrationality of a board's conduct is an appropriate test for analyzing whether a corporate board acted "with intentional and conscious disregard of a board's duties."²¹¹ In such cases, he explained, the court "will generally be required to look to the Board's actions as circumstantial evidence of state of mind."²¹²

Furthermore, the *Elkins* court would apply this standard when assessing claims of bad faith that otherwise implicate duty of care violations. The court reasoned that "[i]n the case of an alleged breach of fiduciary duty for intentionally and consciously disregarding one's duties of faithfulness and care, the Court will focus on whether the Board's process is irrational."²¹³ This application of an irrationality test for process would be a counterpart to waste claims, where the court evaluates the exchange itself for irrationality.²¹⁴

As the *Elkins* case shows, the *Disney V* opinion can readily be interpreted to permit courts to consider director actions as evidence of bad faith. And based on its fit with prior decisions, the *Elkins* approach is a promising candidate for the standard of review in future cases. Delaware already has an established line of precedent that limits claims against unconflicted directors to allegations that the directors' actions are irrational, whether in terms of waste or an irrational process. Adopting a rational basis test would largely reaffirm the pre-*Disney* case law, and it would be consistent with conventional understandings of the business judgment rule.²¹⁵

Admittedly, a rational basis test could also create doctrinal tension. Duty of care claims are reviewed under a gross negligence standard.²¹⁶ *Disney V* implies that the standard of review for claims of bad faith should be different from the standard used to evaluate claims

210. No. Civ. A. 20228-NC, 2004 WL 1949290 (Del. Ch. Aug. 24, 2004).

211. *Id.* at *17 n.92.

212. *Id.*

213. *Id.*

214. *Id.* at *17.

215. This result would require that a rational basis test is paid more than lip service. Actual practices may diverge from announced legal standards. Sean Griffith suggests:

[W]hat courts have *done* in analyzing good faith is to raise issues under each of the traditional fiduciary duties, mix them together, then conclude that the board's conduct has thrown good faith into doubt. It is difficult to reduce this pattern of analysis to scienter or perhaps to any substantive standard, and attempts to do so are subject to the criticism that they credit what courts *say* without paying adequate attention to what courts *do*.

Griffith, *supra* note 7, at 33.

216. *Disney IV*, 907 A.2d 693, 749 (Del. Ch. 2005).

under the duty of care.²¹⁷ The court was quite explicit that bad faith conduct is something more than gross negligence, and it sought to avoid nullifying the effect of section 102(b)(7).²¹⁸ This poses a problem if the test for inferring bad faith is equivalent to the test for gross negligence.

If Delaware courts permit claims of bad faith as evidenced by a board's actions, a stringent pleading requirement could require a showing of irrationality—conduct so egregious that it is inexplicable except as a result of bad faith motives.²¹⁹ A less demanding standard could easily be confused with gross negligence. Assuming the bar is set this high, however, the required showing for a duty of care claim and for a bad faith claim may still be indistinguishable.

The difficulty is that gross negligence is a nebulous standard.²²⁰ Depending on what gross negligence means, evidence of gross negligence need not imply subjective bad faith.²²¹ But recent statements of the legal test for “gross negligence” in Delaware have been quite strict. Delaware courts indicate that a successful allegation under the duty of care calls for “facts that suggest a *wide* disparity between the process the directors used . . . and that which would have been rational.”²²² It is hard to see how this level of irrationality would differ from conduct meeting the test for bad faith articulated in cases like *Elkins*.²²³

217. See *supra* notes 152–154 and accompanying text.

218. See *supra* notes 152–154 and accompanying text.

219. In theory, courts might limit bad faith claims to an even narrower sphere, requiring irrationality plus something more, such as sustained conduct. See Veasey & Di Guglielmo, *supra* note 7, at 1457 (“[T]he question remains whether the good faith standard of review should result in liability for a single transaction or only for a sustained and egregious failure to direct the management of the corporation in good faith.”).

220. See Bruner, *supra* note 7, at 8–9 (“Setting aside whether gross negligence adequately summarizes the range of formulations identified by the court, the range of conduct intended to be captured by the gross negligence concept is, at the margin, notoriously difficult to identify even in abstract terms.”); Gevurtz, *supra* note 21, at 299 (“[I]t is difficult to pin a precise meaning upon the term gross negligence. This has led some to suggest that the term has no significance or, put another way, gross negligence is the same thing as negligence, ‘with the addition of a vituperative epithet.’” (quoting *Wilson v. Brett*, 11 M. & W. 113, 115–16, 152 Eng. Rep. 737, 739 (Ex. 1843)) (footnotes omitted)).

221. A prominent torts treatise indicates that the prevalent definition of gross negligence “differs from ordinary negligence only in degree, and not in kind.” W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 34, at 212 (5th ed. 1984). If this is so, then evidence tending to show gross negligence would not thereby demonstrate a conscious disregard of a director's duties.

222. *Guttman v. Huang*, 823 A.2d 492, 507 n.39 (Del. Ch. 2003); see also Allen et al., *supra* note 14, at 453 (“The selection of a gross negligence standard to govern due care cases may be viewed as synonymous with, and as a practical way to articulate a judicially useful metric to apply, the rationality test embodied in the business judgment rule.”).

223. A similarity here is arguably appropriate. As former Chancellor Allen and his co-authors indicate, pre-1985 Delaware “decisions that addressed director liability for non-self-

To avoid circumventing section 102(b)(7), the standard of review for bad faith must presumably be distinguishable from the standard of review for a violation of due care. This may be possible if one views section 102(b)(7) as addressing prior iterations of “gross negligence.” The gross negligence standard has fluctuated over time. Historically, some Delaware precedents have found grossly negligent conduct where a board’s actions were arguably just negligent,²²⁴ and it was such a case, *Smith v. Van Gorkom*,²²⁵ that triggered the enactment of section 102(b)(7).²²⁶ Applying a rational basis test as the standard of review for bad faith would at least prevent *Van Gorkom*-style liability.²²⁷

Perhaps the best that can be done to reconcile the case law and the statutory language is to recognize that gross negligence is a moving target. If in recent years the standard for gross negligence more clearly requires a showing of irrational conduct, then successful allegations of gross negligence may now imply a conscious disregard of director responsibilities. Barring a decision to effectively forego enforcement of the duty of good faith, there may be little alternative but to accept this overlap.²²⁸ At any rate, if gross negligence ever falls back to mean a less egregious form of misconduct—not an unthink-

dealing transactions suggested that the imposition of liability would require a showing akin to subjective bad faith.” Allen et al., *supra* note 14, at 450.

224. See William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 872–73 (2001) (suggesting that in two important decisions, *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (en banc), and *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), the “Delaware supreme court, although purporting to apply the gross negligence standard of review, in reality applied an ordinary negligence standard”).

225. 488 A.2d 858 (Del. 1985) (en banc).

226. Allen et al., *supra* note 224, at 873 n.49.

227. In *Van Gorkom*, a board of directors was held liable for a business judgment in connection with a merger. 488 A.2d at 864. The court applied a test that assessed whether the directors informed themselves of “all material information reasonably available to them.” *Id.* at 872 (internal quotation marks omitted). Based on the facts, the directors’ liability was widely felt to be inconsistent with business judgment rule protections. See, e.g., Allen et al., *supra* note 14, at 458 (arguing that the *Van Gorkom* court abandoned “the gross negligence review standard in deed albeit not in word”).

228. It is also hard to generate workable alternatives. For example, if courts included a requirement that plaintiffs must allege particularized facts supporting an improper motive, this standard might overlap with the conventional duty of loyalty inquiry, which looks for allegations of a material conflict of interest. If improper motives could be shown in broader circumstances than traditional loyalty cases, the duty of good faith could be in substantial tension with the Delaware Supreme Court’s recent jurisprudence limiting what qualifies as a conflict of interest. See *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004) (en banc) (noting, in the demand futility context, that “[a]llegations of mere personal friendship or a mere outside business relationship, standing alone, are insufficient to raise a reasonable doubt about a director’s independence”). A requirement of irrational conduct plus an improper motive, on the other hand, might limit enforcement of the duty of good faith to the point of irrelevancy.

able event—a rational basis test for alleged bad faith conduct would give teeth to section 102(b)(7).

A less exacting hurdle for bad faith claims would produce an even greater tension with section 102(b)(7). However, there are indications that Delaware courts may ease the requirements for a successful claim of bad faith. In particular, courts may infer bad faith where allegations raise concerns under both the duty of care and loyalty, without quite meeting the standard of review for either duty.²²⁹

An irrational decision has been described as “one that is so blatantly imprudent that it is inexplicable, in the sense that no well-motivated and minimally informed person could have made it.”²³⁰ Should the Delaware courts adopt this standard for claims under the duty of good faith, it would be a reasonable method of inferring a subjective state of mind when little direct evidence of intent is available. Nevertheless, it is not the only path available. Choosing among standards of review therefore requires an analysis of the business judgment rule.

V. THE BUSINESS JUDGMENT RULE AND THE DUTY OF GOOD FAITH: A COST-BENEFIT ANALYSIS

A. *The Business Judgment Rule Defined*

The business judgment rule is often described as “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.”²³¹ Although the precise contours of the business judgment rule are debated, in practice, this doctrine prevents courts from reviewing a board’s sub-

229. As Griffith notes:

The duties of care and loyalty have traditionally been viewed as distinct, with separate doctrinal requirements. Now, however, the good faith thaumatrope suggests that there are situations in which the categories may be blended, allowing claims to survive when some but not all of the traditional doctrinal requirements have been met.

Griffith, *supra* note 7, at 44. Hill and McDonnell advocate a sliding scale which would draw from loyalty and care concepts. They suggest consideration of two elements:

First, structural factors were present that would be likely to cause the directors making the relevant decision to be biased against the interests of the corporation, where the decision itself concerns a matter where a director, officer or controlling shareholder has an interest adverse to the corporation’s interests. Second, influenced by those structural factors, the directors were grossly negligent in making the decision.

Hill & McDonnell, *supra* note 7, at 25 (emphasis and footnote omitted).

230. Allen et al., *supra* note 14, at 452.

231. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

stantive business judgments.²³² Traditionally, the way for plaintiffs to get around this presumption was to allege fraud, illegality, or a conflict of interest.²³³ Otherwise, a plaintiff would have to demonstrate that the board's decisions did not have a rational basis—i.e., that there is no possibility of a legitimate business purpose.²³⁴

More recently (and controversially), there have been indications that a showing of gross negligence will suffice to rebut the business judgment rule.²³⁵ Claims of gross negligence that survive the business judgment rule are quite rare.²³⁶ In addition, as a result of section 102(b)(7), the significance of permitting gross negligence claims to move forward under the business judgment rule is somewhat limited.²³⁷ Exculpatory provisions may preclude liability even if there is a breach of the duty of care.

Because an exculpatory provision does not cover breaches of the duty of good faith, the ability to describe a fiduciary breach in good faith terms grows in importance to plaintiffs. An allegation of bad faith may be the sole route to director liability in many instances of corporate litigation, assuming directors do not have a conflict of interest. This is where the business judgment rule becomes relevant to good faith duties.

In *Disney II*, the Delaware Supreme Court offered the following formulation of the business judgment rule:

232. *E.g.*, *Disney II*, 746 A.2d 244, 264 (Del. 2000) (en banc) (“As for the plaintiffs’ contention that the directors failed to exercise ‘substantive due care,’ we should note that such a concept is foreign to the business judgment rule. Courts do not measure, weigh or quantify directors’ judgments.”).

233. *See* Bainbridge, *supra* note 14, at 95–99 (describing cases that recognized this version of the business judgment rule); *see also* Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (supporting this formulation of the business judgment rule).

234. *See* Bainbridge, *supra* note 14, at 100 (“Even the reference to a rational business purpose requires only the possibility that the decision was actuated by a legitimate business reason, not that directors must prove the existence of such a reason.”).

235. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993) (holding that plaintiffs rebutted the business judgment rule’s presumption by demonstrating that the defendant directors failed to fully inform themselves of all material information reasonably available before approving a merger agreement). For a spirited critique of this decision, *see* Bainbridge, *supra* note 14, at 90–95, 100–02. In Bainbridge’s view, the result under *Technicolor* is that “the business judgment rule is nothing more than a restatement of the basic principle that the defendant is entitled to summary judgment whenever the plaintiff fails to state a *prima facie* case.” *Id.* at 101.

236. There are, however, significant examples of such decisions. *See, e.g.*, *Smith v. Van Gorkom*, 488 A.2d 858, 873–74 (Del. 1985) (en banc) (finding gross negligence when board members failed to properly inform themselves when making a significant business decision).

237. For a discussion of the practical effect of section 102(b)(7) on due care claims, *see* Allen et al., *supra* note 14, at 462–64.

[D]irectors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.²³⁸

As this wording indicates, the duty of good faith remains an integral part of the business judgment rule. When the rule is applicable, good faith is presumed.²³⁹

Once good faith is seen as a distinct aspect of the duty of loyalty, courts are faced with the possibility that good faith provides a new, less demanding way to rebut the business judgment rule presumption.²⁴⁰ This could result in a more stringent standard for reviewing board conduct than the rationality review currently recognized under the business judgment rule. In turn, this potential for a revision to business judgment rule protections raises a host of policy concerns, not to mention fairness considerations. A new method of rebutting the business judgment rule under the rubric of good faith could produce substantial changes in corporate law.²⁴¹

B. *The Indeterminate Ends of Fiduciary Conduct*

When testing for a conscious disregard of a director's responsibilities, courts must contend with an incredible degree of uncertainty. If this problem is viewed solely in terms of accuracy, it is clear that an inquiry into a director's intentions will usually require some degree of guesswork. Boards rarely declare that they seek anything other than

238. *Disney II*, 746 A.2d 244, 264 n.66 (Del. 2000) (en banc).

239. See Veasey & Di Guglielmo, *supra* note 7, at 1442 ("To carry out this entrepreneurial theme that lies at the heart of Delaware jurisprudence, the concept of good faith is an immutable ingredient of the business judgment rule."); see also *In re J.P. Stevens & Co. S'holders Litig.*, 542 A.2d 770, 780 (Del. Ch. 1988) ("[O]rdinarily the policy of the [business judgment] rule prevents substantive review of the merits of a business decision made in good faith and with due care.").

240. See Griffith, *supra* note 7, at 15 (suggesting that the good faith duty "may demand a new standard for rebutting the presumptions of the business judgment rule—a standard different from a showing of either gross negligence or an uncorrected conflict of interest").

241. Liability risk under the good faith rubric could be different in kind from liability risk under due care claims, even if business judgment rule protections are otherwise viewed as indeterminate. Cf. Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1084–85 (2000) ("Indeed, good faith is typically the key to insuring [directors'] protection under statutory and charter limitations on personal liability and corporate indemnification provisions. As a result, decisionmakers may not face a substantial risk of personal monetary liability under indeterminate legal rules." (footnotes omitted)).

the best interests of the corporation, and figuring out what thoughts lurked inside the head of each director will typically be a daunting task.²⁴² Inevitably, there is a risk of judicial error.

At a more fundamental level, the measurement of a director's subjective good faith may require courts to rethink the ends of corporate law and fiduciary duties. Without a clear idea of what ends good faith directors are supposed to seek, it is difficult to determine when directors have failed to make a valid attempt to achieve those ends. If courts look for bad faith in terms of conscious disregard, courts (and directors) must be able to determine what corporate goals are acceptable.

The business judgment rule is an example of an "incompletely theorized agreement."²⁴³ That is, its presumption produces a doctrinal result on which courts and commentators can roughly agree, even though the higher level theories that support this convergence are in conflict.²⁴⁴ As Cass Sunstein observes, the law is replete with agreements of this type, and they can serve useful purposes.²⁴⁵ But incompletely theorized agreements can also mask a serious dispute over why a legal outcome is justified, and this dispute may come to the surface in later cases. Because the target of good faith duties is so foundational, disputes over the ends of corporate legal doctrine—largely obscured by the business judgment rule—are now relevant.

242. See *In re Emerging Commc'ns, Inc. S'holders Litig.*, No. Civ. A. 16415, 2004 WL 1305745, at *38–40 (Del. Ch. May 3, 2004) (noting, in the context of the duties of loyalty and good faith, that "divining the operations of a person's mind is an inherently elusive endeavor"); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 658 (Del. Ch. 1988) (suggesting that a board's "subjective good faith . . . will typically, if not always, be a contestable or debatable judicial conclusion"); see also Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 778 (2005) (recognizing the problems associated with inquiries into directors' actual motives).

243. See Cass R. Sunstein, *Incompletely Theorized Agreements*, 108 HARV. L. REV. 1733, 1735–36 (1995) ("Participants in legal controversies try to produce incompletely theorized agreements on particular outcomes. They agree on the result and on relatively narrow or low-level explanations for it. They need not agree on fundamental principle." (emphasis and footnote omitted)).

244. While courts and commentators agree that the business judgment rule stands for the general proposition that courts should be wary of second-guessing director decisions, this is not to say that the precise contours of the rule are agreed upon. See Gevurtz, *supra* note 21, at 287–88 ("[A] problem occurs when courts and writers attempt to inject specific content into this general proposition—immediately, a lack of consensus emerges as to what the rule really is."). Among other things, there is substantial disagreement as to whether the business judgment rule should be seen as an abstention doctrine or a standard of review. See Bainbridge, *supra* note 14, at 89–100 (illustrating competing conceptions of the business judgment rule embodied in case law).

245. See Sunstein, *supra* note 243, at 1735 (suggesting that time pressures and the need for mutual respect support a judicial willingness to adopt incompletely theorized agreements).

Commentators debate lower level justifications for the business judgment rule, such as creating optimal incentives for director risk-taking or encouraging able directors to serve.²⁴⁶ But assuming there is broad judicial agreement that the business judgment rule is proper under some combination of instrumental justifications,²⁴⁷ it will rarely be necessary to decide which of these justifications animates the legal doctrine.

The business judgment rule also represents a convergence of distinct higher level value commitments. Proponents of very different ideas of fiduciary conduct may agree on the need for courts to refrain from second-guessing a board's substantive decisions.

Several of these higher level commitments are now implicated. As defined in *Disney V*, the duty of good faith applies in cases of intentional dereliction of duty and conscious disregard of responsibilities. Under Chancellor Chandler's formulation, quoted approvingly by the Delaware Supreme Court, the duty of good faith covers circumstances "where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation."²⁴⁸ This emphasis on a director's intent to advance "the best interests of the corporation" brings a major conceptual dispute to the surface.

Thanks in large part to the business judgment rule, directors are free to exercise broad discretion when they interpret what the "best interests of the corporation" are.²⁴⁹ This is not just a matter of discretion regarding the best means to reach corporate ends (although the choice of means is protected by the business judgment rule). Rather, the ends themselves are open to different interpretations. If the business judgment rule is modified to permit a searching judicial inquiry into director motivations, the proper ends of director conduct will likely need to be filled in.

246. See, e.g., Allen et al., *supra* note 14, at 455 ("A standard of review that imposes liability on a board of directors for making an 'unreasonable' (as opposed to an 'irrational') decision could result in discouraging riskier yet socially desirable economic decisions, because an ordinary negligence standard of care will tend to make directors unduly risk averse."); Gevurtz, *supra* note 21, at 305–06 (concluding that "a negligence standard should neither deter the taking of desirable risks nor punish simply bad results").

247. *But see* Gevurtz, *supra* note 21, at 289 (arguing that "the rule should be abolished and directors [should] be required to live with the same rules of negligence as everyone else").

248. See *Disney V*, 906 A.2d 27, 67 (Del. 2006) (en banc).

249. Cf. Elhauge, *supra* note 242, at 769 ("[D]uty of care laws never define the 'best interests of the corporation' as meaning solely the interests of shareholders, nor do they ever define the interests of the corporation or shareholders to mean solely their *financial* interests.").

A brief review of proposed ends demonstrates the diversity of theoretical opinion. Suppose, for example, that we view director decisions from the perspective of shareholder wealth maximization and think of directors as shareholders' agents—a shareholder primacy view.²⁵⁰ Benefiting shareholders is a commonly accepted end for director action, and it is supported under several conceptions of fiduciary duty.²⁵¹ Putting aside the practical question of how best to attain shareholder wealth maximization, a theory of shareholder primacy leaves substantial room for different understandings as to acceptable ends.

The Delaware Supreme Court has stated that time horizons are open to director judgment: “directors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon.”²⁵² Directors effectively get to pick which shareholder time horizons to favor in their corporate strategy. In addition, the idea of shareholder primacy is subject to investor risk preferences. If directors are viewed as agents of shareholders, directors must decide which shareholders they are acting to benefit. Should the board look out for the interests of diversified or non-

250. Shareholder wealth maximization, along with shareholder primacy, is a commonly held norm of corporate law. See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 248 (1999) (“Who owns a corporation? Most economists and legal scholars today seem inclined to answer: Its shareholders do.”). However, these norms are not beyond question. See, e.g., *id.* at 249 (“[W]e take issue with both the prevailing principal-agent model of the public corporation and the shareholder wealth maximization goal that underlies it.”); D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 279 (1998) (contending that “the shareholder primacy norm is nearly irrelevant to the ordinary business decisions of modern corporations”); Thomas A. Smith, *The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214, 220 (1999) (“It will, under standard and plausible assumptions of modern finance theory, never be efficient for firm managers to ‘maximize shareholder value,’ as long as there are fixed claims such as bonds in the firm’s capital structure.”); Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1190 (2002) (concluding that some of the most frequently made arguments in favor of the shareholder primacy norm are incorrect).

251. See, e.g., *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998) (en banc) (“The board of directors has the legal responsibility to manage the business of a corporation for the benefit of its shareholder owners.”). For an economic argument, see FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 36 (1991) (“For most firms the expectation is that the residual risk bearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock.”). But see Stout, *supra* note 250, at 1192–95 (contending that several nonshareholder constituencies can be seen as residual risk bearers).

252. *Paramount Commc’ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989); see also Henry T.C. Hu, *Risk, Time, and Fiduciary Principles in Corporate Investment*, 38 UCLA L. REV. 277, 308–13 (1990) (discussing the *Paramount* decision in the context of judicial efforts to provide directors with discretion to decide on appropriate time horizons).

diversified shareholders, risk-averse shareholders or risk-neutral shareholders?²⁵³

The shareholder primacy norm is not universally accepted. It is also possible to conclude that corporate fiduciaries owe their duties to the corporation as such, and that shareholders do not actually own the corporation.²⁵⁴ If directors are not really agents of shareholders, but independent actors assigned to make assessments of the corporation's best interests, this opens up a greater range for director choices. Perhaps the board of directors is more like a "Platonic guardian," granted substantial discretion to decide what is in the corporation's interests.²⁵⁵

Under a director primacy conception, where directors are not considered agents but independent actors, directors may still owe a duty of shareholder wealth maximization.²⁵⁶ Yet some theories suggest that a duty to the corporation should include consideration of the various constituencies that comprise the corporate entity.²⁵⁷ Under a team-production theory of the corporation, for example, directors owe a duty to all members of the corporate "team."²⁵⁸ Follow-

253. See Richard A. Booth, *Stockholders, Stakeholders, and Bagholders (or How Investor Diversification Affects Fiduciary Duty)*, 53 BUS. LAW. 429, 442 (1998) (noting that directors would reach different results depending on whether they seek to benefit diversified or nondiversified shareholder interests).

254. See, e.g., Blair & Stout, *supra* note 250, at 253 ("[B]oards exist not to protect shareholders *per se*, but to protect the enterprise-specific investments of *all* the members of the corporate 'team,' including shareholders, managers, rank and file employees, and possibly other groups, such as creditors.").

255. See Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 550–51 (2003) (asserting that "the board of directors is not a mere agent of the shareholders, but rather is a *sui generis* body—a sort of Platonic guardian—serving as the nexus for the various contracts comprising the corporation" (footnote omitted)). *But see* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1998) ("The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters.").

256. See Bainbridge, *supra* note 255, at 572 ("Director primacy does not deny that the proper 'end' of corporate governance is shareholder wealth maximization. Director primacy does deny the logic of shareholder primacy—that the powers of the board of directors are delegated to the board by shareholders." (footnote omitted)).

257. A variety of scholars support some form of duty to nonshareholder constituencies. See Blair & Stout, *supra* note 250, at 253 n.16 (listing scholarly articles so arguing). It is also possible to view this doctrinal result in terms of shareholder wealth maximization, but with respect to all shareholders, rather than to shareholders of a specific firm. See Stout, *supra* note 250, at 1203 (noting "the possibility that allowing directors discretion to consider the interests of stakeholder groups can encourage firm-specific investment, and so be in the *ex ante* interests of shareholders as a class, even if not always in the *ex post* interests of the shareholders of a particular firm").

258. Blair & Stout, *supra* note 250, at 253.

ing this model, it is acceptable for the board to take into account the interests of corporate employees and other corporate stakeholders.²⁵⁹

The idea of a director duty to nonshareholder stakeholders is supported by case law. In *Unocal Corp. v. Mesa Petroleum Co.*,²⁶⁰ the Delaware Supreme Court determined that, when the board considers a response to a perceived threat to corporate interests from a takeover bid, it can take into account the interests of various constituencies, and that the interests of shareholders need not be a controlling factor.²⁶¹ Also, in cases where the corporation is on the brink of insolvency, directors are thought to owe duties to the corporate enterprise, not just to the shareholders.²⁶²

As Stephen Bainbridge notes, the possibility of a duty toward different corporate constituencies raises a “two masters problem.”²⁶³ Boards face indeterminacy regarding their duties. Perhaps more troubling, a director who acted out of selfish motives could more easily mask his aim by couching his decision in terms of benefits to one of many permissible constituencies.²⁶⁴ But these concerns aside, the case law can be reasonably interpreted to support a team-production understanding, where directors are permitted to look out for the various members of the “team” that makes the corporation run. The board may simply owe duties to adverse parties, as shareholders, employees, and creditors will not always have the same interests.

At the margins, moreover, the range of acceptable ends may be broader still. Einer Elhauge has recently suggested that directors have the discretion to act in the public interest, even in instances where it appears that the board’s decision is not profit-maximizing.²⁶⁵ Once again, Delaware precedents bolster this theory. In *Mills Acquisition Co.*

259. *Id.*

260. 493 A.2d 946 (Del. 1985).

261. *Id.* at 955–56.

262. See, e.g., *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc’ns Corp.*, Civ. A. No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991) (“At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise.”). For a helpful analysis of this case, see *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 787–89 (Del. Ch. 2004).

263. See Bainbridge, *supra* note 255, at 581 (“Because stakeholder decisionmaking models necessarily create a two masters problem, such models inevitably lead to indeterminate results. . . . The alternative to following the shareholder wealth maximization norm would . . . force directors to struggle with indeterminate balancing standards.” (footnote omitted)); see also EASTERBROOK & FISCHER, *supra* note 251, at 38 (“[A] manager told to serve two masters . . . has been freed of both and is answerable to neither.”).

264. Bainbridge, *supra* note 255, at 581.

265. Elhauge, *supra* note 242, at 743.

v. Macmillan, Inc.,²⁶⁶ for example, the Delaware Supreme Court indicated that directors may reject a tender offer based upon a variety of factors, including “any special factors bearing on stockholder and public interests.”²⁶⁷ Although shareholder interests occupy a primary role, the public interest is occasionally viewed as an acceptable consideration.

Elhauge also suggests that profitability may be assessed *ex ante* and *ex post*.²⁶⁸ A profit-sacrificing transaction could be the result of an *ex ante* implicit understanding between a corporation and other parties. A city might provide regulatory benefits to a corporation, with an implicit expectation that the corporation will act to benefit the local community in future years.²⁶⁹ The city might show forbearance in its zoning regulations in hopes of corporate conduct that will meet moral and social norms.²⁷⁰ The corporation might respond to favorable regulation by restraining its profit-maximizing behavior in situations in which it would impinge on the city’s interests.²⁷¹ This trade-off might appear profitable when assessed *ex ante*, but the corporation’s subsequent charitable acts could appear profit-sacrificing when viewed in isolation after the fact.²⁷²

This Article will not take a position on the merits of these competing theories. Each conception of appropriate corporate ends has some basis in case law, and Delaware courts have yet to clearly pin down a theory of director duties to resolve this indeterminacy.²⁷³ As a result of business judgment rule protections, a true resolution of fiduciary ends is often unnecessary. Yet in order to fairly assess whether a

266. 559 A.2d 1261 (Del. 1989).

267. *Id.* at 1285 n.35 (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954–56 (Del. 1985)).

268. Elhauge, *supra* note 242, at 779.

269. *Id.* at 780.

270. *Id.*

271. *Id.*

272. Elhauge explains that

[a] regime that denied corporate managers the discretion to engage in *ex post* profit-sacrifices would *decrease* shareholder profits in such cases, for it is the prospect of such managerial behavior that encourages others to treat the corporation in beneficial ways that increase profits before the profit-sacrificing decision has to be made.

Id. at 780–81.

273. See William T. Allen et al., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1067 (2002) (asserting that Delaware corporate law is ambivalent on the issue of “whether corporation law exists solely in order to facilitate shareholder economic welfare or whether the ‘republican’ form of corporate governance represents a partial commitment by the law to values in addition to implementing shareholder will”).

director has consciously disregarded the best interests of the corporation, it may become necessary to figure out what or whose “best interests” are at issue.

Perhaps the question of corporate ends can be evaded in specific cases, even with major inroads on the business judgment rule. For example, a transaction could be viewed as objectively “reckless” under a shareholder wealth maximization theory and under a team-production theory. The creation of a standard of review that looks for evidence of such “recklessness” could be plausible under several theories of corporate “best interests.” This possibility, however, seems overly optimistic when generalized to all good faith litigation.

Under a rational basis test, differing high level views of corporate ends are rarely implicated. As an example, corporate waste or self-dealing are both unacceptable under any of the views described above. If courts instead begin looking for objective recklessness, “egregious” cases, or for conduct that implicates a mix of factors from the duties of due care and loyalty, there will inevitably be instances where a decision is more reasonable under one corporate governance theory than another. Assuming the duty of good faith results in a less exacting business judgment rule, the current indeterminacy of ends invites judicial error.

C. Risks of Error and the Indeterminacy of Acceptable Means

Whatever the appropriate ends, judicial review of director intentions will also focus on the director’s chosen means. If anything, this focus on means raises an even greater judicial challenge. For any particular corporate end, there are an indefinite number of reasonable ways to achieve that end.²⁷⁴ Boundedly rational directors—directors limited in their access to information and in their decisionmaking abilities—must choose among those ends, with an omnipresent risk of error.²⁷⁵ There is no standardized method to attain corporate ends. To the extent customary corporate norms govern board behavior, the

274. As commentators have noted, business decisions generally do not involve one “right” way to do things. Cf. Melvin A. Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. PITT. L. REV. 945, 964 (1990) (“[B]ecause every business decision is unique, directors and officers can seldom shield the quality of their decisions by pointing to protocols or accepted practices, and factfinders will seldom have an objective benchmark to guide them.”).

275. Even wise decisions will sometimes turn out to be serious mistakes in retrospect. See Allen et al., *supra* note 14, at 454 (“[I]f the board chooses one alternative based on its assessment that a negative result is improbable, but the negative result nonetheless occurs, the decision may (in hindsight) be ‘wrong’ but it is not ‘bad,’ because in any normal probability distribution some outcomes will inevitably fall on the ‘unlucky’ side.”).

Delaware courts have made clear that they are not legally mandatory.²⁷⁶

Each case is also fact-intensive. There will be some instances where director conduct creates a very strong inference of improper intent. In contrast, a number of cases will offer plausible examples of bad decisionmaking, yet good faith conduct.²⁷⁷ For example, assume that a plaintiff contends a director acted to benefit a good friend, as in the *Disney* litigation. This same director might also think the chosen transaction was highly desirable because it would benefit shareholders. A director may have multiple motivations for reaching a particular decision. These motivations, known only to the director, are hard to disaggregate, let alone prove in a court of law as the basis of the director's business judgments.²⁷⁸

As Elhauge explains, the task of determining actual director motivations is a very difficult one for courts to undertake:

[B]ecause subjective motives are unobservable, courts will—absent the rare and unlikely-to-recur case of an explicit admission by management—have to ascertain motivation based on which purposes seemed objectively probable given the observable circumstances. Such an inquiry into objective motives will inevitably turn on the court's business judgment about which method of operation would actually maximize

276. See *Disney II*, 746 A.2d 244, 256 (Del. 2000) (en banc) (“All good corporate governance practices include compliance with statutory law and case law establishing fiduciary duties. But the law of corporate fiduciary duties and remedies for violation of those duties are distinct from the aspirational goals of ideal corporate governance practices.”). These pronouncements make it unlikely that standardized governance norms will permit courts to readily assess the quality of most board decisions. *But see Davis*, *supra* note 21, at 584 (“Over time, a consensus might emerge as to how directors should act in a particular situation.”).

277. Delaware courts have indicated that such good faith errors, no matter how severe, do not violate fiduciary duties. In *Gagliardi v. Trifoods International, Inc.*, Chancellor Allen explained:

To allege that a corporation has suffered a loss as a result of a lawful transaction, within the corporation's powers, authorized by a corporate fiduciary acting in a good faith pursuit of corporate purposes, does not state a claim for relief against that fiduciary no matter how foolish the investment may appear in retrospect.

683 A.2d 1049, 1052 (Del. Ch. 1996); see also *Barnes v. Andrews*, 298 F. 614, 618 (S.D.N.Y. 1924) (“[Directors] are the general advisers of the business, and if they faithfully give such ability as they have to their charge, it would not be lawful to hold them liable.”).

278. See ROBERT C. CLARK, *CORPORATE LAW* 137–38 (1986) (suggesting that proving directors' genuine motives is a difficult task, that such an endeavor may encourage directors to perjure themselves, and that directors may try to defend against such an inquiry by crafting documentation that justifies corporate decisions with vague rhetoric about long-term strategy); see also Elhauge, *supra* note 242, at 778 (noting “the imponderable difficulties of sorting out mixed motives”).

profits, which again gets us into the problem that courts are worse at making such decisions than corporate managers.²⁷⁹

Hindsight bias is a significant concern when courts review these judgments.²⁸⁰ Reasonable business risks will often appear foolish after the fact, particularly when a transaction has failed spectacularly.²⁸¹ To the extent that courts are influenced by cognitive biases, an objective recklessness standard may not be much different from an ordinary negligence standard.²⁸² Courts have the benefit of knowing the actual outcome of a transaction and are aware of factors that were unknowable when the board's decision was made.²⁸³ Courts are also boundedly rational, and they may have less experience than the directors in the relevant area of expertise.²⁸⁴ These factors can readily bias an ex post assessment of what is reasonable.

279. Elhauge, *supra* note 242, at 778.

280. Hindsight bias is the tendency to exaggerate the predictability of past events. Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 571 (1998). For a thorough discussion of how this bias is relevant to legal decisions, see Rachlinski, *supra*. Rachlinski suggests that the business judgment rule arises from the apprehension that hindsight bias can influence judicial decisionmaking. *Id.* at 621; *see also* Allen et al., *supra* note 14, at 455 (indicating that hindsight bias "is one reason why the business judgment rule employs a standard of review that is more lenient than the standard of conduct"); *cf.* Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 Nw. U. L. REV. 749, 758 (2000) (suggesting that the business judgment rule reflects skepticism about the quality of judicial decisionmaking).

281. *See* Allen et al., *supra* note 14, at 454–55 (describing the risk that courts will unfairly impose liability by erroneously "treat[ing] reasonable decisions that turned out badly as bad decisions").

282. Even a high standard of proof may not protect against hindsight bias if the bias is particularly strong. *See* Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1097 (2000) ("If the hindsight bias is strong, raising the standard of proof might not eliminate overdeterrence. On the other hand, raising the standard of proof could swamp the bias, leading to underdeterrence."); *see also* Bainbridge, *supra* note 14, at 128 ("No matter how gingerly courts apply the standard of liability, trying to measure the 'quantity' of negligence is a task best left untried. . . . [C]ourts will be tempted constantly to apply the standard in ways that sanction honest decisions that, with the benefit of hindsight, have proved unfortunate or appear inept." (footnote omitted)); *cf.* Dooley, *supra* note 204, at 481 (suggesting that even a test for "rational" conduct may come to mean "reasonable" conduct).

283. *See* EASTERBROOK & FISCHEL, *supra* note 251, at 100 ("Judges also are accustomed to deciding cases on full records and may be too quick to blame managers who act—as often they should—in haste or on incomplete information.").

284. *See id.* ("Judges are neither chosen for business acumen nor fired or subject to reductions in salary if they err in assessing business situations."). However, this argument is debatable as applied to Delaware judges. *See* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. REV. 542, 589–90 (1990) ("[B]ecause corporate lawyers are prominent in the Delaware bar, many judges come to the bench with corporate law experience."); *see also* Bainbridge, *supra* note 14, at 120–21 ("In contrast to judges in other states, however, Delaware chancellors frequently have considerable prior corporate

Faced with a great risk of error in assessing a director's subjective intent, courts could plausibly choose to leave the business judgment rule untouched. If so, only cases of true extremes would expose unconflicted directors to liability.²⁸⁵ The test for a lack of good faith based on objective standards of conduct would then be irrationality, conduct which is considered so far beyond the pale that it is inexplicable but for a director's bad faith.²⁸⁶

D. Instrumental Justifications for the Business Judgment Rule

However, there is more at issue than the accuracy of judicial assessments of directors' intentions. Courts often justify the business judgment rule as an instrument to effect broader goals. For example, courts fear that a more stringent standard of review might discourage directors from making risky but wealth-maximizing choices, thus indirectly harming shareholders.²⁸⁷

Although these instrumental concerns buttress the traditional business judgment rule, there are also countervailing arguments. Proponents of enhanced judicial scrutiny in good faith cases point to the incentive effects of a more stringent standard of review.²⁸⁸ Even if the duty of good faith is difficult to enforce accurately, perhaps a more plaintiff-friendly burden of proof would encourage improvements in director behavior.²⁸⁹

experience as practitioners. Once on the bench, there is a substantial pay-off for Delaware chancellors who continue to master corporate law." (footnote omitted)).

285. *But cf.* Griffith, *supra* note 7, at 32–33 (noting that "corporate law already has doctrines, such as gross negligence and waste, for dealing with extremes" (footnote omitted)). Technically, less extreme conduct might also trigger liability for bad faith, in the very rare case of admitted bad faith motives that coincide with otherwise defensible transactions. *Cf. Disney IV*, 907 A.2d 693, 749 (Del. Ch. 2005) ("The Delaware Supreme Court has implicitly held that committing waste is an act of bad faith. It is not necessarily true, however, that every act of bad faith by a director constitutes waste." (footnote omitted)).

286. *See supra* notes 205–206 and accompanying text.

287. *See* Allen et al., *supra* note 14, at 449–50 (noting that the business judgment rule is "designed to encourage directors to act without undue inhibition"); *id.* at 450 ("By intruding on the protected space that the business judgment rule accords such decisions, courts create disincentives for businesses to engage in the risk-taking that is fundamental to a capitalist economy."); *cf.* Andrew S. Gold, *On the Elimination of Fiduciary Duties: A Theory of Good Faith for Unincorporated Firms*, 41 WAKE FOREST L. REV. 123, 123 (2006) ("Judicial error, with the moral hazard that it encourages, has real costs when it comes to an optimal exercise of business judgment.").

288. *See, e.g.,* Sale, *supra* note 7, at 494 (suggesting that the value of a separate duty of good faith "is not simply in the compensation it can provide to, for example, Disney shareholders, but in the *ex ante* role it can play in changing the behavior and incentives of corporate fiduciaries and, thereby changing corporate governance").

289. *See id.* at 495 ("Strong enforcement of the duty of good faith creates an incentive to prompt fiduciaries to better behavior, even if we cannot change their character.").

In the end, the fear of judicial error in specific cases is only one of several reasons for having the business judgment rule. As commentators have noted, courts' use of the business judgment rule is supported by a number of factors, including the fact that directors must reach decisions with only limited information; the potential that competent directors will choose not to serve if liability risk is too severe; the potential that directors will choose less risky transactions, even if they are also less profitable; the difficulties courts face in determining *ex post* whether a board's decision was reasonable at the time it was made; and the ability of shareholders to remedy poor management by electing new directors.²⁹⁰

Delaware courts have also justified the business judgment rule by reference to the broad scope of directors' statutory grant of authority.²⁹¹ Limiting the availability of derivative suits protects the board's ability to manage the corporation. Recently, Stephen Bainbridge has emphasized the potential negative effects of judicial review on intracorporate relations.²⁹² Additional considerations include judicial economy and the avoidance of exorbitant corporate litigation costs.²⁹³ If courts play a larger role, well-intentioned judges may push corporate policy away from the ideal, rather than toward it.

These factors supporting the business judgment rule may be decisive in the aggregate, but if courts are to seriously consider a distinct role for good faith duties in corporate litigation, they must weigh these factors against the potential benefits of alternative legal doctrines. A variety of commentators argue that the business judgment rule is overly protective of directors.²⁹⁴ The policy basis for this claim should not be dismissed out of hand.

290. See Allen et al., *supra* note 14, at 451–52 (discussing rationales for the business judgment rule); see also Davis, *supra* note 21, at 573 (identifying various rationales for the business judgment rule).

291. See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (en banc) (“Under Delaware law, the business judgment rule is the offspring of the fundamental principle . . . that the business and affairs of a Delaware corporation are managed by or under its board of directors.”).

292. See Bainbridge, *supra* note 14, at 125–26 (“[J]udicial review could interfere with—or even destroy—the internal team governance structures that regulate board behavior.”).

293. See Douglas M. Branson, *The Rule That Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 637–38 (2002) (“[A] policy behind the rule is conservation of the judicial resource. The business judgment rule is a filter that enables courts to easily screen out non-meritorious challenges to the actions of directors and executives.”); Telman, *supra* note 21, at 37 (proposing that the business judgment rule should be understood to act as “a prophylactic tool designed to protect corporations against exposure to litigation”).

294. See, e.g., Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1183 (1999) (suggesting that a “lack of accountability exists because of the business judgment rule and the rhetori-

It may be that a higher risk of liability under the duty of good faith will cause directors to take their duties more seriously. Corporate governance standards may develop that will be easier to enforce in future cases.²⁹⁵ Chastened directors could develop an improved corporate culture, or a market for professional directors could develop.²⁹⁶ For that matter, experienced judges may be more accurate in their assessments of good faith than people realize.²⁹⁷

These possibilities raise a series of questions. How often do judicial errors occur when courts review substantive board judgments? How often do judicial errors occur when courts inquire into subjective good faith? Would it be worth over-enforcing the duty of good faith, as defined in *Disney V*, if this would produce substantial improvements in corporate governance? Would it be worth under-enforcing the duty of good faith to avoid deterrence of desirable risk-taking by the board? Is it even possible to determine how to weigh the costs and benefits that could result from the available standards of review?

As the next Section will elaborate, these questions can only be addressed under conditions of severe empirical uncertainty. A necessary part of the analysis requires a comparison of courts and boards as decisionmaking authorities. In order to take the various policy and fairness concerns into account, and thereby determine the proper scope of the business judgment rule, courts face a challenging institutional choice.

cal nature of fiduciary duty law"); Gevurtz, *supra* note 21, at 336 ("[T]here is simply no call for treating business judgments by corporate directors any differently than any other judgment."); Telman, *supra* note 21, at 59–60 (suggesting that, outside of cases where the discovery process would harm the corporation, "the Rule impedes the adjudication of shareholder rights and interests, prevents shareholder actions from constraining boards, promotes board passivity and thus permits negligent boards to cause economic harm to corporations and their shareholders").

295. See Davis, *supra* note 21, at 584 (suggesting the possible emergence of a consensus among courts and experts as to proper director behavior). But see *Disney II*, 746 A.2d 244, 256 (Del. 2000) (en banc) (indicating that directors are not required to conform their behavior to "aspirational ideals of good corporate governance" in order to avoid liability).

296. See Nowicki, *supra* note 7, at 67 (proposing that "a more exacting definition of 'good faith' [will] either discourage potentially half-hearted directors from serving or will give rise to a market in professional directors"); Sale, *supra* note 7, at 462 (suggesting that the duty of good faith "holds considerable promise for creating incentives to instill effective corporate governance").

297. See *supra* note 284.

VI. THE BUSINESS JUDGMENT RULE AND THE PROBLEM OF INSTITUTIONAL CHOICE: A DECISION THEORY RESPONSE

From an institutional choice perspective, decisionmaking authority should be allocated to the institution that will best further the legal goal at issue.²⁹⁸ Rather than focus on the strengths and weaknesses of a single decisionmaking institution, the comparative merits of each institution are assessed. This approach has been urged as a guiding principle for corporate law.²⁹⁹ Such institutional concerns are commonplace in Delaware precedent; case law indicates that the proper division of authority among shareholders, directors, and courts animates many corporate law disputes.³⁰⁰

As will be developed below, setting the proper standard of review for good faith calls for an institutional choice.³⁰¹ Judicial oversight of a corporate board effectively removes some of the board's authority to decide what is in the corporation's best interest. Courts, whether or not they intend to do so, acquire decisionmaking authority when they decide cases in a way that limits director choices. Courts are determining how much authority the board possesses.

Assessing standards of review as an institutional choice, however, raises a problem of intractable empirical uncertainty. It is very difficult to test for the ideal balance of board accountability and board authority. The best that can be done to resolve this uncertainty is to use principles adapted from decision theory—principles designed to assist in choices that must be made under severe information constraints. Following these principles suggests that courts should apply a

298. For a useful discussion of legal doctrine in terms of allocating institutional authority over decisionmaking processes, see generally NEIL K. KOMESAR, *IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMICS, AND PUBLIC POLICY* (1994) [hereinafter KOMESAR, *IMPERFECT ALTERNATIVES*]; NEIL K. KOMESAR, *LAW'S LIMITS: THE RULE OF LAW AND THE SUPPLY AND DEMAND OF RIGHTS* (2001).

299. Wayne Hanewicz contends that "corporate law does and should allocate decisionmaking authority to various institutions, such as the board, the shareholders, and the judiciary, and . . . this decision-making authority ought to be allocated so as to most efficiently advance the ultimate goal of corporate law." Hanewicz, *supra* note 23, at 511. Hanewicz assumes that the ultimate goal of corporate law is shareholder wealth maximization. *Id.* at 511–12. This Article will leave that question open.

300. See *id.* at 529–31 (suggesting that the business judgment rule and the entire fairness standard reflect institutional choice concerns); see also *MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1126 (Del. 2003) ("The most fundamental principles of corporate governance are a function of the allocation of power within a corporation between its stockholders and its board of directors.").

301. See Griffith, *supra* note 7, at 15 (suggesting that the question of good faith is "the question of creating a new standard under the business judgment rule and thereby realigning the balance between authority and accountability in corporate law jurisprudence").

rational basis test when confronting allegations of bad faith conduct.³⁰²

A. *The Role for an Institutional Choice Analysis*

When a court reviews a board's business judgments for breach of good faith, its analysis will likely consider whether the board's actions or processes were designed to further the best interests of the corporation or its shareholders.³⁰³ At the least, the court would consider whether a board's decision could conceivably advance those interests. Courts, however, may not be the best institution to determine a corporation's true interests, and courts' decisions may supplant the board's decisions.³⁰⁴

The analysis below will examine the business judgment rule with an eye toward the ideal allocation of authority among courts, directors, and shareholders.³⁰⁵ From this perspective, the review of board judgments for bad faith raises problems of severe empirical uncertainty.

Business judgment rule protections can be assessed in terms of which institution, or set of institutions, is best suited to making the decisions at issue.³⁰⁶ In those cases where the business judgment rule has teeth, it precludes judicial review of the board's exercise of discre-

302. For these purposes, this Article will use "bad faith" conduct as a synonym for "actions not in good faith." The two concepts appear to be equivalent for purposes of the *Disney V* opinion. *But see* Nowicki, *supra* note 7, at 59 & n.202 (suggesting that "[b]ad faith acts are very different from acts undertaken in the absence of good faith"). In any event, the policy considerations described in this Article would be the same for either concept.

303. This would be so even if the ultimate judicial inquiry is into the board's subjective good or bad faith. A decision which is clearly not in the best interests of the corporation would have bearing on the directors' state of mind with respect to the decision under review. It is true, however, that some cases do not implicate an analysis of corporate interests. For example, business judgments may also be reviewed for compliance with specific statutory provisions.

304. The director primacy model of corporate authority reflects this concern. *See* Bainbridge, *supra* note 14, at 108 ("That we do not expose director decisions to judicial scrutiny absent self-dealing suggests that the law finds a value in the board's authority that might be lost if director decisions were routinely subject to review.").

305. In addition, judicial review of business judgments is, de facto, an institutional choice. *See id.* (describing the value of business judgment rule protections in terms of "[the] observation that the power to hold to account is ultimately the power to decide"); *cf.* VERMEULE, *JUDGING*, *supra* note 28, at 157 ("The idea that judges should take each case as it comes, interpreting sensibly in light of the materials at hand, itself constitutes an implicit choice of interpretive method and an implicit allocation of interpretive authority.").

306. *Cf.* Bainbridge, *supra* note 255, at 602 ("[T]he [business judgment] rule ensures that the null hypothesis is deference to the board's authority as the corporation's central and final decisionmaker."); Hanewicz, *supra* note 23, at 529 (suggesting that the business judgment rule is connected to the question of "who decides?").

tion.³⁰⁷ Absent court intervention, business judgments are left to the board,³⁰⁸ and potentially the corporation's shareholders.³⁰⁹ Whether such an outcome is desirable is a function of the costs and benefits of selecting directors, courts, or shareholders as a decisionmaking authority.³¹⁰

This is not to say that all problems in corporate law should be viewed through an institutional lens.³¹¹ Normative concerns, issues of morality, and other considerations may supersede institutional considerations.³¹² Statutory texts may mandate a particular doctrinal answer, irrespective of whether this mandate produces an ideal institutional outcome.³¹³ For example, if the Delaware corporate

307. As described in *Disney II*, “[c]ourts do not measure, weigh or quantify directors’ judgments. We do not even decide if they are reasonable in this context.” 746 A.2d 244, 264 (Del. 2000) (en banc).

308. Hanewicz, *supra* note 23, at 530 (“The business judgment rule results in the board being the decision-maker.”).

309. As Bainbridge suggests, however, in the public corporation context “the obvious mechanical difficulties of achieving consensus amongst thousands of decision makers impede shareholders from taking an active role.” Bainbridge, *supra* note 14, at 106. In addition, there are also substantial information asymmetries. *Id.* But see Hanewicz, *supra* note 23, at 567 (arguing that shareholders may be better decisionmakers than directors in the context of a board conflict of interest).

310. See Hanewicz, *supra* note 23, at 569 (suggesting a multi-institutional approach “under which the shareholders would be treated as a separate decision-making institution in whom authority might be vested simply because they are a better decision-maker under the circumstances than alternate institutions.”). In addition to shareholders, courts must also be considered. See *id.* at 568.

311. For one thing, institutional analysis is arguably outside the scope of judicial inquiry. Thomas Merrill notes that “[c]ourts, as they presently operate, are not in the business of ‘choosing institutions’; they decide cases.” Thomas W. Merrill, *Institutional Choice and Political Faith*, 22 LAW & SOC. INQUIRY 959, 993 (1997). To the extent that an institutional analysis might be desirable, it may not be up to courts to make that decision. In some cases, the question of allocation of decisionmaking authority could be resolved by an authoritative text. *Id.* at 991. The arguments in this Article do not depend on the assumption that the correct allocation of decisionmaking authority between courts and other actors will always be a problem of institutional choice.

312. A commitment to faithfully following legislative commands, for example, could also affect how a court decides on its institutional role. Cf. William N. Eskridge, Jr., *No Frills Textualism*, 119 HARV. L. REV. 2041, 2051 (2006) (book review) (“To reduce statutory interpretation to an institutional cost-benefit analysis threatens . . . to anesthetize an arena of public inquiry that is relentlessly moral, normative, and socially constitutive. If constitutional principle or meaning supports a certain methodology, that methodology ought to be the presumptive baseline for federal judges.”).

313. It should be noted that, in the context of Delaware corporate law, such statutory boundaries are somewhat permeable. See Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft*, 60 BUS. LAW. 877, 879–80 (2005) (noting Delaware’s “use of a court of equity—the Delaware Court of Chancery—to ensure that corporate directors do not use the wide authority granted to them by statute for ends that are inimical to the best interests of the corporations they serve”). Even if boards could be

code expressly required that courts review business judgments using a negligence standard, there would be little room for an institutional analysis to address optimal standards of review.

But the backdrop for the present analysis is a general grant of board discretion, subject to a recently announced conception of the duty of good faith.³¹⁴ Delaware law is sufficiently indeterminate to invite analysis of which entity *should* decide on the corporation's (or shareholder's) best interests.³¹⁵ In other words, this is not a context where institutional considerations are superseded by textual or precedential commitments.

Instead, the duty of good faith has provided an opportunity to reconsider the scope of the business judgment rule.³¹⁶ If there is a new, distinct means to allege fiduciary breaches—by claiming bad faith—the standard of review might provide an alternative to the rational basis test that usually covers the actions of unconflicted directors. To determine what standard of review is appropriate for allegations of bad faith, courts must think about what allocation of decisionmaking authority is best suited to attaining desired outcomes.

Institutional choice analysis functions at an operational level as a means of putting normative commitments into effect. As Cass Sunstein and Adrian Vermeule observe:

In many domains, the question is posed whether one institution should review the acts of another, and if so, the intensity with which that review should occur. . . . In all of these areas, it is important to pay close attention to institutional variables. The costs of error and the costs of decision are crucial. It is necessary to examine dynamic effects. There is no sensible acontextual position on the question whether re-

viewed as the chosen institution to determine a corporation's best interests through a strict reading of the enabling legislation, the Delaware precedents have long made clear that courts may limit that authority for reasons of equity.

314. The judicial role in enforcing equitable limitations on statutory grants of corporate authority is long established. *See id.* at 881 ("Nearly thirty-five years ago, the Delaware Supreme Court emphatically rejected the proposition that compliance with the DGCL was all that was required of directors to satisfy their obligations to the corporation and its stockholders.").

315. This is partly due to the longstanding indeterminacy of Delaware case law in general. However, it also stems from the novelty of treating good faith as an independent and enforceable fiduciary duty in cases which do not properly raise due care and loyalty breaches. *See* Griffith, *supra* note 7, at 19 (noting that, prior to *Disney III*, "[g]ood faith had never before been given an independent doctrinal effect").

316. *See id.* at 15 (suggesting that the question of good faith "is the question of creating a new standard under the business judgment rule and thereby realigning the balance between authority and accountability in corporate law jurisprudence").

view, of one institution or another, should be intense or deferential, or indeed available at all.³¹⁷

Despite the need for a comparison of institutional strengths and weaknesses, normative commitments may still be outcome determinative.³¹⁸ A court that seeks the best decisionmaking process for shareholder wealth maximization could make an institutional choice differently from one that seeks benefits for other constituencies. If judicial error is a consideration in assessing comparative institutional merits (which it ought to be), it is necessary to define what qualifies as an error.³¹⁹ An observer with one value commitment might condemn a court's decision as badly mistaken, while another with a different set of values might view the decision as enlightened jurisprudence.³²⁰

Debates over legal goals may be put to one side, however, if institutional considerations lead to the same results under disparate normative commitments.³²¹ A devoted advocate of shareholder primacy

317. Sunstein & Vermeule, *supra* note 28, at 936; *see also* KOMESAR, IMPERFECT ALTERNATIVES, *supra* note 298, at 5 ("A link is missing . . . in analyses that suppose that a given law or public policy result follows from a given social goal. . . . Embedded in [an] analysis that ostensibly depends solely on goal choice is the judgment, often unarticulated, that the goal in question is best carried out by a particular institution.").

318. As Neil Komesar notes:

Goal choice and institutional choice are both essential for law and public policy. They are inextricably related. On the one hand, institutional performance and, therefore, institutional choice can not be assessed except against the bench mark of some social goal or set of goals. On the other, . . . the decision as to who decides determines how a goal shapes public policy.

KOMESAR, IMPERFECT ALTERNATIVES, *supra* note 298, at 5; *see also* VERMEULE, JUDGING, *supra* note 28, at 80 (noting the importance of a value theory to institutional choice in the context of interpretive approaches).

319. *Cf.* VERMEULE, JUDGING, *supra* note 28, at 80 ("Without such a [value] theory, we will be unable to know what counts as interpretive 'error.'").

320. For example, *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), and its expansion of potential board liability for breaches of the duty of care, could be analyzed as a judicial error. A significant number of commentators see the case this way. *See, e.g.*, Allen et al., *supra* note 21 at 458 (arguing that the Delaware Supreme Court incorrectly applied an ordinary negligence standard while purporting to apply the gross negligence standard of review). But the case also has its proponents. *See, e.g.*, Eric A. Chiappinelli, *Trans Union Unreconsidered*, 15 J. CORP. L. 27, 32 (1989) (indicating that the *Van Gorkom* case was consistent with prior case law). Absent an agreement on cases like this, it is hard to assess whether courts are committing more, or worse, errors than boards.

321. Vermeule notes that "institutional considerations may themselves be sufficient to select operating-level rules of interpretation in many domains, because different high-level value theories converge upon similar operating-level prescriptions." VERMEULE, JUDGING, *supra* note 28, at 80. Institutional choice might also permit courts to avoid deciding on a value theory. Vermeule suggests that

value theories may be bracketed and thus ignored where incompletely theorized agreements at the operational level are possible. Institutional analysis might even enable interpreters to choose particular doctrines before, or in place of, choosing

may agree with an advocate of director primacy that a director who engages in self-dealing should be required to prove the fairness of his actions.³²² Both advocates might also prefer a strong business judgment rule, albeit for different reasons. In cases of incompletely theorized agreement, courts pursuing inconsistent theoretical ends could still converge on a common result in specific cases.

This possibility—that different schools of thought might converge on the same institutional approach—is in turn dependent on empirical realities.³²³ If we take shareholder wealth maximization as a goal, some allocations of decisionmaking authority depend on empirical considerations.³²⁴ For example, it is a factual question whether shareholders or boards are better suited to making ordinary business decisions, regardless of the goal against which these business decisions are evaluated.³²⁵ It may or may not be more costly to a corporation to have courts second-guess business decisions after the fact.³²⁶ Although a multitude of factors would determine the answers to these questions, each can, in theory, be resolved through empirical study.

B. Decision Theory and the Problem of Uncertainty

An important challenge then arises. What if empirical analysis is not an option? In the social sciences, an empirical dispute can be answered in the ensuing decades as more and more data is collected; i.e., while scholars wait out the “stalemate of empirical intuitions.”³²⁷

a value theory that specifies what counts as a good or bad consequence of interpretive practices.

Id. at 82–83. *But see* Eskridge, *supra* note 312, at 2054 (“How does one determine whether a decision is mistaken without the kind of ‘high level conceptual commitments’ that Professor Vermeule avoids?” (citation omitted)).

322. For example, Stephen Bainbridge supports a strong form of the business judgment rule, but would make an exception in cases of self-dealing. Bainbridge, *supra* note 14, at 126–27.

323. *See* VERMEULE, *JUDGING*, *supra* note 28, at 83 (“The scope of convergence cannot be established in the abstract; it can only be established by inspection, through detailed consideration of various interpretive areas and problems.”).

324. The choice of one’s goal has a potentially significant effect on what counts as a judicial error, and may also affect how other costs and benefits are balanced. Although shareholder wealth maximization (and shareholder primacy) is embraced by many commentators, the arguments set forth in this Article should apply to a variety of conceptual frameworks, including the director primacy and team-production theories of corporate law.

325. A strong case can be made that shareholders are inferior to boards for purposes of making ordinary business decisions. *See* Bainbridge, *supra* note 255, at 557–58 (critiquing the idea that shareholders could efficiently govern by consensus).

326. For a helpful analysis of the potential costs arising from judicial review of board judgments, *see* Bainbridge, *supra* note 14, at 109–27.

327. VERMEULE, *JUDGING*, *supra* note 28, at 153 (emphasis omitted).

Courts do not have that luxury.³²⁸ They must decide cases as they arise, within a reasonable time frame. They cannot wait twenty years. Accordingly, when the relevant data is unavailable, courts must reach interim decisions about how to interpret laws and about which institutions should have decisionmaking authority in particular contexts.³²⁹

In a recent book, Adrian Vermeule grapples with severe empirical uncertainty in the contexts of statutory interpretation and judicial review.³³⁰ As he notes, some of the empirical questions that an institutional analysis raises in this context are “trans-scientific”: there is no cost-effective way to resolve them within a reasonable time frame.³³¹ In some cases, experimentation is impossible to carry out in a reliable manner.³³² Comparative and historical empirical work is also doubtful as a means to resolve this type of question, given the difficulty of making comparisons when so many factors are involved.³³³

In addition, the judges who must make these determinations have substantial information constraints and suffer from bounded rationality.³³⁴ As a result, for difficult institutional choices, “judges are unable to put values to the variables that institutional analysis identi-

328. *Id.* at 154.

329. *Id.* at 149. For example, Vermeule suggests an interim interpretive theory for “an awkward transitional period in which academics and judges have begun to appreciate that the dispositive questions about the interpretive system are empirical and institutional rather than conceptual, but in which the relevant empirical information is largely absent.” *Id.* at 289.

330. See generally VERMEULE, *JUDGING*, *supra* note 28.

331. *Id.* at 158.

332. *Id.* at 159.

333. *Id.* This empirical problem readily extends to corporate law debates. The difficulty of comparing the corporate law doctrine of several jurisdictions to that of Delaware, given Delaware’s unique status in corporate law, makes clear how hard it would be to conduct experiments to test the effects of different methods for reviewing director good faith. In the case of good faith, the inquiry would be further hindered by the novelty of good faith analysis and the uniqueness of each corporate concern. Cf. Griffith, *supra* note 7, at 8 n.16 (contending that the debate over the proper balance of board authority and accountability “depends on empirical evidence that currently does not exist”); Stout, *supra* note 250, at 1201 (“Whether the social losses from shareholder primacy outweigh the social losses from allowing greater director discretion is an extraordinarily complex question. Moreover, the answer is likely to vary from firm to firm and from one historical period to another.”). To the extent that shareholder wealth maximization may not be the ultimate goal, the empirical question may be complicated further. See Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 638 (2006) (challenging the incorporation of the shareholder primacy norm into empirical analysis).

334. VERMEULE, *JUDGING*, *supra* note 28, at 154–55. For example, a judge will be largely reliant on the parties’ briefs as a source of information about the facts of the case, and will not usually be aware of each development in the relevant social science literature. Time constraints and discovery rules preclude the exhaustive analysis that could contribute to, for example, an economist’s study of the problems at issue.

fies as relevant.”³³⁵ Cognitive biases contribute further inaccuracies to the adjudicative process. Accordingly, too much weight for some variables and not enough weight for others can lead to judicial error.³³⁶ And courts may be in a poor position to discover after the fact if they erred in their institutional choices.³³⁷

Uncertainty and bounded rationality are thus fundamental challenges for courts assessing the allocation of authority between different institutions. The weighing of institutional capacities, decision costs, error costs, and other systemic effects can be extraordinarily complex.³³⁸ Where the probabilities of particular outcomes are known, a rational decisionmaker can maximize expected utility by comparing the outcomes in terms of their probabilities.³³⁹ Yet when those probabilities are unknown, additional decisionmaking techniques become important.

Vermeule’s response is to look to decision theory. Decision theory studies choices by rational actors subject to constraints.³⁴⁰ It analyzes how individuals may seek to maximize their expected utility when they are lacking certain information.³⁴¹

For purposes of this analysis, decisions may be made under conditions of risk, uncertainty, or ignorance.³⁴² In this context, decisions under risk are made when the decisionmaker knows the payoffs associated with various choices as well as the probabilities associated with those payoffs.³⁴³ Uncertainty arises where the decisionmaker knows the potential payoffs of each choice but does not know the relevant probabilities that the payoffs will occur.³⁴⁴ Ignorance exists when the decisionmaker knows neither the payoffs nor their probabilities.³⁴⁵

335. *Id.* at 155.

336. *See id.* (noting that “salience causes decisionmakers to focus on vivid foreground particulars, such as the hardships suffered by parties in particular cases, while ignoring larger background abstractions, such as the systemic effects of interpretive rules”). For an analysis of the business judgment rule as a response to the problem of hindsight bias, see Rachlinski, *supra* note 280, at 619–23.

337. For this reason, a provisional institutional choice is problematic. VERMEULE, JUDGING, *supra* note 28, at 164–65. Courts may not readily assess alternative doctrines which they did not choose, and “[s]witching to the originally rejected doctrine in order to generate information about that alternative is possible, but highly destabilizing.” *Id.* at 164.

338. *Id.* at 154–55.

339. *Id.* at 171.

340. *Id.*

341. *Id.*

342. *Id.*

343. *Id.*

344. *Id.*

345. *Id.*

These concepts occupy a spectrum. Where there is uncertainty, a decisionmaker might have some knowledge about the probability of a particular outcome. For example, the decisionmaker might know that the probability of a desired outcome exists within a band of likely percentages, perhaps 10% to 40%.³⁴⁶ In a more extreme case, even the range of probabilities might be unknown. Problems of institutional choice tend toward the latter, more severe type of uncertainty.³⁴⁷

When courts review other decisionmaking institutions, multiple variables are at issue, and they can be difficult to measure accurately. Not only probabilities, but the values assigned to outcomes, may be unavailable. Furthermore, the relevant institutional actors are not static—a change in one institution's authority can readily alter the behavior of another institution.³⁴⁸ This is where decision theory can help.

346. See Cass R. Sunstein, *Irreversible and Catastrophic*, 91 CORNELL L. REV. 841, 885 (2006) (giving an example of such a case).

347. For example, Wayne Hanewicz suggests the following factors for consideration when making an institutional choice in the corporate law context: "the risk preferences of the different possible decision-makers, the possibility that a decision-maker may be beholden to a group with interests that are not aligned with shareholder wealth maximization, and the transaction costs that each decision-maker faces in reaching a decision." Hanewicz, *supra* note 23, at 511–12. Additional factors are relevant, including the potential effects of legal change on each institution's actions, and the potential for the chosen institution to err in its judgments. The possibility that values could be assigned to each factor in the context of most business decisions, that probabilities could reliably be assigned for each factor, and that the conclusions would be anything other than contested is remote. Cf. ELSTER, *supra* note 27, at 14 ("Uncertainty and strategic interaction, taken separately, create problems for rational belief formation. When both are present, they wreak havoc.").

348. One answer that avoids the problem of uncertainty is to assign probabilities to the relevant outcomes. VERMEULE, *JUDGING*, *supra* note 28, at 171. This may be done by assigning probabilities based on frequencies from comparable situations in the past (frequentism), or it may be accomplished by selecting subjective probabilities based on "judgment and intuitive hunch" (Bayesian subjectivism). *Id.* at 171–72. There is little basis for assigning probabilities based on frequencies, given the case-specific nature of Delaware law and the absence of decisions under an independent duty of good faith. There is also little reason to think that a court's intuitive hunch would be a valuable method of assigning probabilities in the present context. Cf. Sunstein, *supra* note 346, at 884–85 ("Even if subjective expected utilities can be assigned on the basis of behavior, regulators (like everyone else) may well be operating in circumstances of genuine uncertainty."); see also Vermeule, *Interpretive Choice*, *supra* note 28, at 115 ("[D]ecisionmakers will sometimes simply lack the background information or sources of judgment necessary to form a probability estimate that is more accurate than a random assignment."). As Jon Elster notes, a subjective probability assignment may offer little reason to act on its basis. See Jon Elster, *Risk, Uncertainty and Nuclear Power*, 18 SOC. SCI. INFO. 371 (1979), reprinted in JON ELSTER, *EXPLAINING TECHNICAL CHANGE* 199 (1983) ("One could certainly elicit from a political scientist the subjective probability that he attaches to the prediction that Norway in the year 3000 will be a democracy rather than a dictatorship, but would anyone even contemplate acting on the basis of this numerical magnitude?"). As will be developed below, the analysis of this

The Principle of Insufficient Reason. Decision theory provides several techniques to overcome uncertainty. One means of addressing uncertainty is through the principle of insufficient reason (also called the principle of indifference).³⁴⁹ Under this principle, where the probabilities of outcomes relating to two alternatives are speculative, the unknown probabilities are assumed to be equal.³⁵⁰ An informal version of this technique permits a decision to be made on the basis of what is known, by assuming that unknown costs and unknown benefits are equally likely, and therefore cancel each other out.³⁵¹

Although it may be argued that costs and benefits rarely turn out to be equal in reality, under conditions of severe uncertainty, the probabilities and values of potential outcomes are unknown to the decisionmaker.³⁵² The allure of the principle of insufficient reason is the idea that sometimes the best that one can do is to focus on what is known.

This principle can greatly assist in resolving severe empirical uncertainty. As Jon Elster explains:

In many, indeed most, decision problems there are associated with each of the options a number of unknown and essentially unknowable possibilities whose materialization depends on the future development of the universe. When trying to make up one's mind, one has to assume that those and other unknowable factors on each side cancel out, so that one can concentrate on the knowable ones. Even among the latter, one has to focus mainly on the known ones, because of the direct costs and opportunity costs of collecting and processing information. The ensuing decision, although not ideally rational from the point of view of an

Article is grounded on the premise that courts decide under genuine uncertainty, without the ability to provide subjective probabilities in a useful manner. See *infra* Part VI.C.

349. VERMEULE, JUDGING, *supra* note 28, at 173.

350. DAVID M. KREPS, NOTES ON THE THEORY OF CHOICE 146 (1988) (describing the principle of insufficient reason, "which says that if I have no reason to suspect that one outcome is more likely than another, then by reasons of symmetry the outcomes are equally likely, and equally likely probabilities may be ascribed to them").

351. VERMEULE, JUDGING, *supra* note 28, at 173.

352. See *id.* at 174 (noting that the principle "might be akin to trying to pick the larger of two numbers by choosing the one with the larger digit in the second decimal place, even if one knows nothing about the digit in the first decimal place") However, there may be little in the way of alternatives. See *id.* ("If the decisionmaker knows that one component of cost is higher in one regime than in the other, but has little other information, on what other basis could the decision be made?").

omniscient observer, will at least be as rational as can be expected.³⁵³

Other than random guessing, this may be all that one can do—when probabilities and values are unobtainable, the principle of insufficient reason provides a basis for making a reasonable choice.³⁵⁴

The Maximin Criterion. In some cases of uncertainty, the principle of insufficient reason will not suffice. It may be that the known costs and benefits produce a tie, giving an indeterminate result. But there are other strategies for deciding under uncertainty. Another common technique is known as the “maximin criterion.”³⁵⁵ This is basically a strategy for limiting the downside risk of a decision. Here, the method is to choose the option “whose worst possible outcome is better than the worst possible outcomes of the alternatives.”³⁵⁶

The maximin criterion assumes some degree of risk aversion. But not every decisionmaker would avoid a downside risk if the potential upside of the choice is sufficiently worthwhile. The case for using the maximin criterion is therefore strengthened where the worst possible outcome under one option is significantly more undesirable than the worst possible outcome under another option, and where, if maximin were followed, any resulting losses in potential benefits would be limited in scope.³⁵⁷

353. ELSTER, *supra* note 27, at 135. Arguably, this type of thinking is necessary in order to engage in consequentialist reasoning, given that unforeseen events are always possible. See generally Elinor Mason, *Consequentialism and the Principle of Indifference*, 16 UTILITAS 316 (2004).

354. It should be noted that technically, the principle of insufficient reason applies under more ascertainable conditions than those implicated by institutional choice. As Vermeule recognizes, the principle of insufficient reason “assumes that the full range of possible outcomes is known.” See Vermeule, *Interpretive Choice*, *supra* note 28, at 123 n.196. These conditions do not apply here. Accordingly, the technique described in this Article is really an informal analogue of the principle of insufficient reason, akin to the principle described above by Jon Elster. ELSTER, *supra* note 27, at 135.

355. R. DUNCAN LUCE & HOWARD RAIFFA, *GAMES AND DECISIONS* 278 (1957). Once again, decisionmakers must use an informal analogue of the maximin criterion under conditions of uncertainty. As Vermeule explains:

Decision theory describes strategies or approaches that decisionmakers can draw upon even if the formal conditions that describe those strategies are not satisfied, for decision-theoretic criteria will often have informal, pragmatic analogues. The maximin strategy, for example, is well defined only if the payoffs of various outcomes are specified.

VERMEULE, *JUDGING*, *supra* note 28, at 176; see also Sunstein, *supra* note 346, at 890 (suggesting that “a useful form of cost-benefit balancing is possible even without reliable information about probability”).

356. VERMEULE, *JUDGING*, *supra* note 28, at 176.

357. Sunstein, *supra* note 346, at 892. In cases where the worst-case scenario is just slightly worse under one choice than it is under alternatives, the criterion seems weak; and in such cases, if the potential benefits lost by using maximin are substantial, it can seem

The maximin criterion may be helpful in situations where the principle of insufficient reason is inadequate to reach a decision.³⁵⁸ Additional options are also available.³⁵⁹ For example, “satisficing”—searching until one finds an option that is “good enough”—is sometimes used in cases where the search for a correct answer could be excessively costly.³⁶⁰ To the extent that courts are not in a position to spend years searching for the correct institutional choice, satisficing could assist in reaching an answer. In extreme cases, a decisionmaker

irrational. Although maximin appears to require infinite risk aversion in cases where probabilities can be assigned, Sunstein suggests that it can make more sense in the context of genuine uncertainty. *See id.* at 879–80, 882.

358. For example, the principle of insufficient reason would not be helpful if all of the costs and benefits involved are speculative. And, in some cases, the known costs may cut in opposite directions. *See* Vermeule, *Interpretive Choice*, *supra* note 28, at 126 (“An interesting and troublesome feature of all-else-equal arguments is that they can appear on both sides of a question of interpretive choice.”). Along these lines, a change in statutory interpretation doctrine might lower decision costs, yet raise transition costs. *See* Eskridge, *supra* note 312, at 2054 (contending, in part on this basis, that Vermeule’s suggestions for statutory interpretation would produce “a tie” under the principle of insufficient reason). *But see* VERMEULE, JUDGING, *supra* note 28, at 270 (suggesting the inapplicability of the transition cost argument in a case where transition costs would be small).

359. One option, generally not urged as a desirable method to resolve genuine uncertainty, is “maximax”—choosing among alternatives based upon the best possible outcome for each alternative. *See* VERMEULE, JUDGING, *supra* note 28, at 176 n.35 (discussing the possibility of applying maximax, while noting that it has “few supporters”); *see also* Evan Tsen Lee, *On the Received Wisdom in Federal Courts*, 147 U. PA. L. REV. 1111, 1154 (1999) (suggesting that “it is difficult to take the maximax rule seriously in any environment other than a game environment”). It is unclear whether the traditional business judgment rule or another standard of review would produce the best possible outcome, nor whether the best possible outcome would be significantly better for one option than another.

Another technique is known as the “minimax regret” criterion. LUCE & RAIFFA, *supra* note 355, at 280–81. This criterion compares the differences in payoffs between alternative choices. Lee, *supra*, at 1150. The difficulty with minimax regret as a technique for present purposes is that potential payoffs have unknown values.

Yet another option is the “pessimism-optimism rule,” which compares average minimum and maximum payoffs under each decision. *See* David H. Kaye, *Playing Games with Justice: Rawls and the Maximin Rule*, 6 SOC. THEORY & PRAC. 33, 35 (1980) (describing the pessimism-optimism rule). This rule leads to indeterminate results when assessing the business judgment rule. Although each of these decision rules has its strengths and weaknesses, some options are more helpful than others in the present context.

360. *See* David Schmidt, *Satisficing as a Humanly Rational Strategy*, in SATISFICING AND MAXIMIZING 30, 31, 33–40 (Michael Byron ed., 2004) (analyzing the merits of this technique). Inasmuch as it is a matter of dispute whether the present case law is satisfactory, it would not be helpful to assert that this method answers the uncertainty problem regarding the business judgment rule. Different standards of adequacy clearly matter here, and the spate of articles debating the merits of Delaware law suggest the topic is one of controversy. For an example of an article which concludes Delaware law is not close to good enough, *see* Lawrence E. Mitchell, *The Sarbanes-Oxley Act and the Reinvention of Corporate Governance?*, 48 VILL. L. REV. 1189, 1189 & n.2 (2003) (stating that the “laxity of Delaware law . . . [w]ith [its] shameful and disingenuous opinions . . . can no longer be in dispute”).

might just “pick” among the alternatives,³⁶¹ or use heuristics as a means to reach a decision under time constraints.³⁶²

Several of these methods are useful when boundedly rational actors seek to resolve problems of uncertainty and institutional choice.³⁶³ Depending upon the uncertainties involved, these techniques also have their limitations, and there is debate as to whether they are rational.³⁶⁴ In some cases, the methodology may be open to manipulation.³⁶⁵ Nevertheless, it is hard to see an alternative to using these methods, other than relying on raw intuition. Regrettably, there

361. Given the probable negative reactions if courts announced they have just “picked” an answer, this seems like a dubious methodology in the judicial context. See VERMEULE, JUDGING, *supra* note 28, at 179 (“Overt picking is rare in law generally and in the formulation of interpretive doctrine in particular.”).

362. See, e.g., VERMEULE, JUDGING, *supra* note 28, at 180 (suggesting that a “take the best” rule, where decisionmakers employ “the single most valid cue or predictor,” may be useful where “complex decision rules demand too much of decisionmakers whose ability to process information is limited”). This technique would seem to be indeterminate in the present context, although it is arguable that a formalistic version of the business judgment rule would be consistent with using this heuristic technique.

363. See *id.* at 168–69 (noting that the applicability of decision theory techniques is context-dependent).

364. For example, the maximin criterion makes little sense when the worst case scenario under consideration is extremely improbable and an alternative is “both much better and much more likely.” See Sunstein, *supra* note 346, at 879. It is also unclear what justifies the assumption under the principle of insufficient reason that unknown probabilities should be deemed equal so that they cancel out. See Lawrence B. Solum, *You Prove It! Why Should I?*, 17 HARV. J.L. & PUB. POL’Y 691, 697 (1994) (asking “[w]hy is it any more rational to assume the states are equally probable than to make some other guess[?]”). In addition, different partitionings of potential outcomes may change the results under this method. See ELSTER, *supra* note 27, at 43 (explaining that the principle of insufficient reason “rests on a naïve assumption that the individuation of states is unproblematic”). But see VERMEULE, JUDGING, *supra* note 28, at 173 (suggesting that “[s]ometimes outcomes do come prepartitioned by the nature of the problem or by established conventions”). With respect to analysis of the business judgment rule, the principle of insufficient reason tends to partition into an analysis of two broad factors, the costs and benefits to the corporation or to its shareholders. Cf. Mason, *supra* note 353, at 319 (contending that some version of the principle of insufficient reason is a necessary part of practical rationality). It appears that there are at least as many plausible costs as plausible benefits from creating new limits on the business judgment rule. Nevertheless, it should be noted that the manner in which people decide under uncertainty may be a product of confusion. See Sunstein, *supra* note 346, at 889 (noting that individuals’ intuitions under circumstances of uncertainty may be the product of confusion). The possibility that our intuitions are wrong does not, however, offer a better technique. This Article is premised on the idea that we lack a more reasonable alternative to the decision theory approach described below.

365. See Eskridge, *supra* note 312, at 2056–57 (suggesting that a decision-theory approach to statutory interpretation is subject to manipulation). Eskridge’s argument appears much stronger in a context where decision theory is used to support a change from the doctrinal status quo. Eskridge is readily able to suggest different outcomes, and worst case scenarios, based upon such factors as transition costs, which are inapplicable to the present discussion. Here, the doctrinal status quo already calls for a highly restricted judicial role under the business judgment rule.

is little reason to believe that personal intuitions are reliable when assessing difficult institutional choices.³⁶⁶

Vermeule correctly notes that courts have few options where they must make institutional comparisons under conditions of uncertainty: “[T]he indeterminacy point is fatally noncomparative, because there just is no other type or mode of reasoning on offer in such situations. Concretely, the choices are that judges use some repertoire of weakly reasonable techniques, on the one hand, or nothing at all, on the other.”³⁶⁷ Given the import of making a correct institutional choice, courts must assess the institutional alternatives in some fashion.

As the above examples suggest, there are a range of available ways to decide under conditions of uncertainty, and their suitability can depend on the decision’s context. But, for purposes of addressing problems like judicial review, some methods of resolving uncertainty are more promising than others.³⁶⁸ This Article advocates use of the principle of insufficient reason and the maximin criterion as reasonable methods for assessing good faith and the business judgment rule.

C. *Assessing Uncertainty in the Corporate Context*

At the outset, one might ask whether Delaware courts face a problem of genuine uncertainty. Decision theory has been suggested as a method to address the uncertainty of institutional choices with respect to judicial review of federal laws.³⁶⁹ It remains to be seen whether a similar strategy fits the business judgment context.

At first glance, judicial review of a board’s business judgments may not seem much like judicial review of federal statutes. Boards are not legislatures, and business judgments are not generally law-like.³⁷⁰

366. See *supra* notes 327–329 and accompanying text. These intuitions might, however, be useful in assessing easier institutional questions. See *infra* note 416 and accompanying text.

367. See VERMEULE, JUDGING, *supra* note 28, at 182.

368. For example, the use of frequentist or Bayesian methods of reducing uncertainty are relatively unhelpful when courts are confronted with difficult matters of institutional choice. See *supra* note 329. As Vermeule notes, “the large-scale character of the institutional variables bars decisionmakers from proceeding on the sort of confident intuitive hunches that often prove useful for quotidian decisions on a smaller scale.” VERMEULE, JUDGING, *supra* note 28, at 163. Burden-allocation techniques are also ill-suited to this type of context. See *id.* at 170–71 (indicating that the use of burden allocation in the interpretive choice context “will often have the rhetorical function of saddling one view or another with the weight of irresolvable uncertainty”).

369. See VERMEULE, JUDGING, *supra* note 28, at 230–88.

370. Cf. Richard A. Booth, *A Minimalist Approach to Corporation Law*, 34 GA. L. REV. 431, 440 (2000) (“One might say that the business judgment rule is the corporate equivalent of rational basis review in constitutional law, but it is not clear whether that helps explain anything.”). Interestingly, there are some historical links between corporate law and judi-

Despite these differences, the parallel to judicial review of legislative judgments is substantial. In fact, the case for using decision theory to resolve uncertainty in the corporate litigation context may be stronger than it is in the constitutional law context.³⁷¹

In both cases, the issue is how a court should review decisions that have been allocated to a different institutional actor. Courts must decide who decides. Section 141(a) of the DGCL gives boards the discretion to manage the corporation,³⁷² while Article I of the United States Constitution gives legislatures discretion to enact legislation.³⁷³ In each case, the problem is how best to conduct judicial review of discretionary conduct that has been delegated to another institution when that other institution is permitted a very broad scope of acceptable means and ends in exercising its discretion.

For example, in constitutional law, the Supreme Court has interpreted the scope of “general welfare” under the Spending Clause³⁷⁴ and the content of “public use” under the Takings Clause³⁷⁵ to allow for a variety of public goals.³⁷⁶ This permissibility of different goals implicates the standard of judicial review. As Henry Monaghan has explained:

[O]nce the Court has determined, as it now has, that Congress can spend and take to achieve a virtually unlimited range of goals, the constitutional standard recedes into a deep background with the result that the political branches are empowered to supply much of the operational content of the constitutional clauses. The Court, in short, simply determines whether Congress has exceeded the outer boundaries of a very wide domain for choice. . . . The standard is virtu-

cial review. See generally Mary Sarah Bilder, *The Corporate Origins of Judicial Review*, 106 YALE L.J. 502 (2006).

371. In part, this is because there is less concern that an authoritative text precludes an institutional analysis. Another notable difference is that the prescriptions of the principle of insufficient reason and maximin support the status quo in Delaware corporate law, rather than calling for a significant change in legal doctrine. See *infra* Part VI.E.

372. DEL. CODE ANN. tit. 8, § 141(a) (repl. vol. 2001).

373. U.S. CONST. art. I, § 7.

374. U.S. CONST. art. I, § 8, cl. 1.

375. U.S. CONST. amend. V.

376. See, e.g., *South Dakota v. Dole*, 483 U.S. 203 (1987) (holding that Congress could properly use its power under the Spending Clause to encourage national uniformity in legal drinking age); *Kelo v. City of New London*, 545 U.S. 469 (2005) (holding that the transfer of property from one private party to another in furtherance of a state's economic revitalization plan satisfied the “public use” requirement in the Takings Clause).

ally empty because its premises postulate a virtually indefinite number of permissible legislative goals.³⁷⁷

A similar range of permissible objectives affects the ability of courts to police board conduct.

As described in Part V of this Article, boards may pursue a number of goals, each identified with the corporation's interests, with largely abstract constraints.³⁷⁸ And, boards may use a large and indefinite number of means to pursue their chosen goals.³⁷⁹ The boundaries of board discretion are vague, and to some degree the limits on a director's actions are aspirational.³⁸⁰ An abstract enabling act provides little guidance as to the limits of board authority, while judicial precedent has largely left that authority untouched.

The breadth of board discretion in deciding what is in the best interests of the corporation makes it difficult for courts to assess when a particular board decision was the product of bad faith, even if bad faith were defined to mean "severely reckless" or "egregious" conduct.³⁸¹ Yet if we posit that a court can make these assessments in

377. Henry P. Monaghan, *Marbury and the Administrative State*, 83 COLUM. L. REV. 1, 33-34 (1983) (footnote omitted); see also Cass R. Sunstein, *Naked Preferences and the Constitution*, 84 COLUM. L. REV. 1689, 1697-98 (1984) ("Modern rationality review is also characterized by extremely deferential means-ends scrutiny. The Supreme Court demands only the weakest link between a public value and the measure in question, and it is sometimes willing to hypothesize legitimate ends not realistically attributable to the enacting legislature."). In addition, as with corporate boards, a judicial effort to determine subjective legislative motivations is subject to serious difficulties. Cf. John F. Manning, *Competing Presumptions About Statutory Coherence*, 74 FORDHAM L. REV. 2009, 2044 (2006) (suggesting, in the context of rational basis review, that the Court's "focus on outcome, rather than intent, follows from the Court's acceptance of the imperfections of the legislative process").

378. See *supra* notes 232-251 and accompanying text. This is so regardless of whether the court believes in shareholder primacy, director primacy, or some combination of shareholder primacy with public interest concerns. Under all of these models, corporate ends are vague and permissive.

379. See *supra* notes 252-263 and accompanying text.

380. See *Disney II*, 746 A.2d 244, 256 (Del. 2000) (en banc) (noting that "[a]spirational ideals of good corporate governance" are not required by Delaware corporation law). Many of the limits on board discretion may be seen as non-legally enforceable norms. See Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1685 (2001) ("[T]he duty of care is not a negligence rule, but, rather, is intended to be 'self-enforcing,' with the self-enforcement protected by the business judgment rule.").

381. Cf. Bainbridge, *supra* note 14, at 128 ("No matter how gingerly courts apply the standard of liability, trying to measure the 'quantity' of negligence is a task best left untried. As we have seen, courts will be tempted constantly to apply the standard in ways that sanction honest decisions that, with the benefit of hindsight, have proved unfortunate or appear inept."). Courts may also simply be incapable of subdividing modes of deference beyond a certain point. See VERMEULE, *JUDGING*, *supra* note 28, at 220 ("Judges can operate in a mode of deference and in a mode of independent decisionmaking, but more refined, intermediate modes are either psychologically unattainable or nonexistent."). The con-

individual cases, that would not resolve the institutional choice problem.³⁸²

The true question is whether, in light of numerous variables, it is better to have the board alone or a combination of the board plus other institutions (most notably the judiciary) decide the merits of these business judgments.³⁸³ How do these options compare?

Historically, the substantive review of unconflicted board judgments has not been a judicial task.³⁸⁴ As with many of the contexts where courts review federal statutes, Delaware courts apply a rational basis test to a wide range of business judgment cases. A rational basis test rarely challenges the decisions under review, effectively leaving them to another institution.³⁸⁵ So long as a court can hypothesize a

cern with judicial accuracy in reviewing board judgments is also relevant in cases that implicate an “abdication” of board duties. See Griffith, *supra* note 7, at 26 (questioning “whether the decision not to deliberate at all, like the decision to deliberate for ten minutes or twenty, is not also a business decision, insulated from judicial second guessing by the business judgment rule”).

382. Resolving institutional choice on this basis would be an example of a “single institutional” analysis, that is, an analysis of one institution’s merits without the necessary comparison to alternative institutions. See KOMESAR, IMPERFECT ALTERNATIVES, *supra* note 298, at 11 (suggesting failures of institutional analysis under a “single institutional” approach).

383. To some degree, cumulative review is inevitable in this context—the real issue is the scope of that review. Cf. VERMEULE, JUDGING, *supra* note 28, at 276 (“The costly layering of cumulative review is not peculiar to any particular regime of judicial review. It is inevitable, no matter how restricted the domain of judicial review and no matter how exclusive the judges’ authority within that domain.”). The option of judicial review to the exclusion of board review is extremely unlikely. See Elhauge, *supra* note 242, at 777–78 (“Presumably shareholders . . . delegate managerial authority to professional managers because they are better at managing businesses than judges are.”). For that matter, boards still formally retain their authority under a regime where courts review substantive business judgments. The institutional question involves the effects of an increased allocation of judicial authority to review board decisions. A more frequent judicial review of business judgments could prove too costly in practice.

384. As former Chancellor Allen and his co-authors note:

The pre-1985 Delaware (and the American and English) tradition was highly deferential to decisions made by well-motivated corporate directors who acted without any conflicting self-interest. Judicial decisions that addressed director liability for non-self-dealing transactions suggested that the imposition of liability would require a showing akin to subjective bad faith.

Allen et al., *supra* note 14, at 450 (footnote omitted). And, as they suggest, the *Disney II* decision appeared to reaffirm this perspective on the business judgment rule. See *id.* at 465.

385. See *id.* at 452 n.12 (“Once invoked, the business judgment rule standard almost always results in nonliability.”); see also Dooley, *supra* note 204, at 479 (“By definition, aberrant behavior occurs so infrequently as to qualify as a ‘sport.’”); *id.* at 478–79 n.58 (suggesting that the rationality test in Delaware “clearly does not mean, and cannot legitimately be cited for the proposition, that individual directors must have, and be prepared to put forth, proof of rational reasons for their decisions”); cf. VERMEULE, JUDGING, *supra* note 28, at 268 (describing the rational basis test in constitutional law as a “de facto” retreat from judicial review).

rational basis for the action being reviewed, the court will leave the decision undisturbed.³⁸⁶

Yet the weight of precedent does not decide this issue. The recent emergence of the duty of good faith does not require changes to the business judgment rule, but it opens up that possibility. Courts may follow the implicit suggestion of *Disney II*, reviewing substantive board judgments only when they are so irrational that bad faith is considered the only plausible explanation.³⁸⁷ On the other hand, Delaware courts might use the duty of good faith as a tool to increase scrutiny of board conduct. Given the recent arrival of good faith liability as a distinct claim, courts must now decide if corporate law would be better served by adding another layer of review to the board's decisionmaking process.

In inquiring into good faith business judgments, there are a multitude of factors relevant to a comparative institutional analysis.³⁸⁸ A more aggressive judicial review in good faith cases could have a variety of benefits, including encouragement of responsible business decisions, development of desirable corporate governance norms, accountability for director misconduct, and mitigation of director errors.³⁸⁹ Such expanded review could also include various costs: harms arising from judicial errors, deterrence of desirable risk-taking by nervous directors, an increased risk of frivolous lawsuits, added un-

386. See Bainbridge, *supra* note 14, at 100 ("Even the reference to a rational business purpose requires only the possibility that the decision was actuated by a legitimate business reason, not that directors must prove the existence of such a reason.").

387. If the Delaware courts chose this option, the standard of review for good faith claims could effectively be subsumed by preexisting doctrines. See Griffith, *supra* note 7, at 32 ("Any attempt to distinguish the recklessness inquiry by limiting it to extreme deviations from the norm must encounter the objection that corporate law already has doctrines, such as gross negligence and waste, for dealing with extremes." (footnote omitted)).

388. See Hanewicz, *supra* note 23, at 512 (suggesting that selection of a decisionmaking institution should involve evaluation of "the risk preferences of the different possible decision-makers, the possibility that a decision-maker may be beholden to a group with interests that are not aligned with shareholder wealth maximization, and the transaction costs that each decision-maker faces in reaching a decision").

389. See Sale, *supra* note 7, at 462 (suggesting that the duty of good faith "holds considerable promise for creating incentives to instill effective corporate governance and preventing the kind of fiduciary abdication that has occurred"). Melvin Eisenberg also suggests that the duty of good faith may play a positive role where legal change is desired. Eisenberg, *supra* note 7, at 75 ("Looking forward, the general duty of good faith may give rise to the articulation of new specific fiduciary obligations that come to be seen as appropriate in response to social changes, but cannot be accommodated within the duties of care or loyalty."). But see *Disney IV*, 907 A.2d 693, 698 (Del. Ch. 2005) ("Times may change, but fiduciary duties do not. . . . [T]he development of aspirational ideals, however worthy as goals for human behavior, should not work to distort the legal requirements by which human behavior is actually measured.").

certainty for various parties, transition costs as the new legal regime is implemented, and decision costs from the litigation process.³⁹⁰

Most of the effects described above, such as potential deterrence of director risk-taking, are matters of empirical conjecture.³⁹¹ The probabilities and extent of the costs associated with these factors are unknown. Reasonable arguments can be made that desirable risk-taking will substantially decrease if courts take a more active role, but such arguments might be countered by noting the expertise of Delaware courts in business matters and the potential for developing standardized norms of corporate conduct.³⁹² Since each corporation is unique, and each jurisdiction distinct, it is quite hard to assess how much desirable risk-taking would be deterred by a particular legal doctrine.

In this context, it is not just one factor, but several uncertain factors that must be weighed against each other. It is impossible to estimate how long it would take to obtain adequate empirical data on all of these factors combined.³⁹³ An institutional choice, moreover, may alter how the relevant institutions behave—for example, boards might act to hide improper conduct if courts allowed more litigation to proceed—without substantially improving their behavior.³⁹⁴ Even if there were reliable empirical results on some of these factors under

390. For a discussion of the effects of judicial review on director risk-taking, see Allen et al., *supra* note 14, at 455. See also Bainbridge, *supra* note 14, at 110–17.

391. See Telman, *supra* note 21, at 16–18 (indicating that there is a lack of empirical support for the conclusion that greater judicial scrutiny would result in undesirable avoidance of risk-taking).

392. Cf. Gevurtz, *supra* note 21, at 307 (suggesting that an alleged lack of judicial expertise does not distinguish business judgment cases from other contexts, such as medical practice claims, which apply negligence standards); see also Bainbridge, *supra* note 14, at 120–21 (noting that Delaware judges have expertise in corporate law); Davis, *supra* note 21, at 586 (“[U]ntil some alternative institutional arrangements emerge to assume responsibility for developing standards for directors, we must look to the present system of a legally enforceable, liability-based duty of care to play that role.”). Some might argue that directors would be undeterred from desirable risk-taking as a result of section 102(b)(7) and statutory indemnification provisions. Because the context under discussion is a claim of bad faith, however, those provisions would be of little use to a director defendant. See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (repl. vol. 2001) (exempting good faith violations from protection of exculpatory charter provisions). *But cf.* Telman, *supra* note 21, at 19–22 (noting the significance of these statutory protections in the business judgment rule context).

393. It may not even be true that some data is better than no data in this context. See VERMEULE, JUDGING, *supra* note 28, at 162 (suggesting that the gains from acquiring data may not be continuous, such that the data obtained may be as helpful as “knowing only the first digit of a phone number”).

394. For example, a director might reach a bad faith decision under a more expansive regime of judicial review, but spend more time and effort hiding the true motivations for his decision. If so, an enhanced review could add costs without producing any benefit for shareholders.

the current legal doctrine, this data would not reveal much about board behavior under an alternative set of doctrines.

Here, the indeterminacy of good faith is particularly troubling.³⁹⁵ Because of the uncertain content of “good faith” and its context-dependent nature, it is not only difficult to assess when boards breach this duty, it is also difficult to assess when courts have erred in enforcing this duty.³⁹⁶ Assuming a rise in judicial errors, it would be very hard to ascertain whether and to what extent directors were changing their behavior as a result. It is also unclear how costly such hypothetical errors would prove to be.³⁹⁷

Even assuming a court can reasonably accurately assess good faith in a particular case, it is difficult to determine whether courts make sufficient errors across the board to counterbalance any benefits,³⁹⁸ how readily judicial intervention deters risk taking,³⁹⁹ or whether an expansive form of review would really prevent future corporate scandals.⁴⁰⁰ Weighing such uncertain costs and benefits is guesswork.⁴⁰¹

395. See, e.g., Gold, *supra* note 287, at 133 (“The fiduciary duty of good faith is a source of potential confusion. This area of the law is still developing, and the doctrine may have different meanings in different contexts.”); Veasey & Di Guglielmo, *supra* note 7, at 1452 (noting that good faith is an “amorphous concept”).

396. For discussion of the indeterminacy of what it means to act in the corporation’s best interests, see *supra* notes 242–273 and accompanying text.

397. There is good reason to think that even a small risk of error could be quite costly. As Stephen Bainbridge suggests:

As long as there is some non-zero probability of erroneous second-guessing by judges . . . the threat of liability will skew director decision making away from optimal risk taking. That this result will occur even if the risk of judicial error is quite small is suggested by the work of behavioral economists on loss aversion and regret avoidance.

Bainbridge, *supra* note 14, at 123. Such costs would include not only harm to the particular corporation and shareholders involved, but also any systemic effects as others react to judicial error by changing future behavior.

398. Note that the existence of judicial error may be invisible to outside observers unfamiliar with the inner workings of the corporation. The board may know better than judges, or third parties, which decisions are in the best interests of the corporation, based upon their firm-specific knowledge. See *id.* at 119 (noting that courts have “less information about the specifics of the particular firm in question” than directors).

399. See Telman, *supra* note 21, at 16–18 (noting the dearth of empirical evidence underlying the concern that stricter judicial review would have a deleterious effect on director risk-taking).

400. For example, directors might simply devote more time to camouflaging bad faith conduct. See CLARK, *supra* note 278, at 137–38 (suggesting that, if courts did not usually prohibit shareholders from attempting to prove subjective motivations, knowledgeable managers would “easily forestall all such challenges by couching all documentation about corporate decisions in vague rhetoric about the corporation’s long-run interest”).

401. Vermeule notes with respect to judicial review under the Constitution that “[a] persistent illusion among academics as well as judges is the faith that ‘I can have all the invalidations I like and none of the ones I don’t’—a perfectionist faith that overlooks the

Many of the costs and benefits, in other words, are matters of severe uncertainty and perhaps ignorance.⁴⁰²

D. Applying Decision Theory to Determine the Standard of Review

Among the various uncertain variables, decision costs are a notable exception.⁴⁰³ It is possible for a court to assess the significance of decision costs associated with corporate litigation.⁴⁰⁴ These costs include the costs of legal representation, prolonged discovery, and time spent by the court that could be devoted to other cases.⁴⁰⁵ Courts have an informational advantage here—they are in a position to witness these effects of legal doctrine.

In the context of shareholder derivative suits, the costs of litigation can be especially severe. Even where claims are dubious, discovery may disrupt normal corporate functions, create disastrous public relations consequences, and force corporations to reveal their prospective business plans.⁴⁰⁶ This is one justification for imposition of

fallibility of judicial institutions.” VERMEULE, JUDGING, *supra* note 28, at 281. A parallel illusion may exist with respect to judicial review of business judgments.

402. As Lynn Stout explains:

Whether the social losses from shareholder primacy outweigh the social losses from allowing greater director discretion is an extraordinarily complex question. Moreover, the answer is likely to vary from firm to firm and from one historical period to another. Case studies, and even large longitudinal studies, may be of limited value.

Stout, *supra* note 250, at 1201; *see also* Griffith, *supra* note 7, at 8 n.16 (noting, with respect to the dispute over the optimal balance of board discretion and judicial oversight, that “the ultimate resolution of this debate depends on empirical evidence that currently does not exist”).

403. *See* Telman, *supra* note 21, at 37 (“[T]he dynamics of shareholder derivative suits leads to settlements that benefit plaintiffs’ attorneys but not really the corporation or its shareholders, who end up paying for the suit through higher insurance costs that the corporation is forced to pay.” (footnote omitted)).

404. *Cf.* VERMEULE, JUDGING, *supra* note 28, at 166 (“The elements of interpretive choice for which the judges’ informational advantage seems most pronounced are the costs of adjudication and the effects of various interpretive rules on the judges’ caseloads—two critical components of decision costs.”).

405. As Vermeule notes:

“Decision costs” is a broad rubric that might encompass the direct (out-of-pocket) costs of litigation to litigants and the judicial bureaucracy, including the costs of supplying judges with information needed to decide the case at hand and formulate doctrines to govern future cases; the opportunity costs of litigation to litigants and judges (that is, the time spent on a case that could more profitably be spent on other cases); and the costs to lower courts of implementing and applying doctrines developed at higher levels.

Id. at 166–67.

406. *Cf.* Telman, *supra* note 21, at 37 (suggesting that “the real purpose of the [Business Judgment] Rule today should not be to protect board members from liability but to protect them and the corporation from the dissipation of assets and reputational harm that

tough pleading requirements: the expenses associated with corporate litigation are not small by any measure.⁴⁰⁷

Courts can readily determine that there are sizable decision costs associated with heightened judicial review of the board's substantive business decisions (or even review of the board's decisionmaking processes). These added costs are an inevitable consequence of expanded judicial review of business judgments. Furthermore, legal transition costs would be a near certainty under a regime of enhanced judicial review, as the various actors would have to adjust their behavior to respond to the new legal doctrine.⁴⁰⁸

Under the principle of insufficient reason, it is appropriate to treat speculative costs and benefits as canceling out, while focusing on those costs and benefits that the decisionmaker can know. Once the focus is on the known costs and benefits of a chosen standard of review, the comparison between legal doctrines becomes manageable.

Rationality review bars recovery for almost all business judgment litigation—only the most unthinkable board conduct gets past this test. In contrast, high decision costs are to be expected if courts start permitting lawsuits alleging bad faith to proceed based on evidence that the board's conduct was in some sense unreasonable under the circumstances. The amorphous nature of good faith, not to mention the subjective quality of the applicable evidence, are ideal for protracted litigation.

Similar difficulties arise if courts adopt a test that draws from features of loyalty and care claims. For example, in a recent draft article, Claire Hill and Brett McDonnell suggest a sliding scale, where courts would assess breaches of the duty of good faith by looking to two factors: evidence of structural bias and gross negligence in the decision-making process.⁴⁰⁹ Risks of judicial error are certainly substantial in

results from litigation"); see also Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 948–52 (1993) (describing the costs associated with shareholder derivative lawsuits).

407. See Winter, *supra* note 406, at 952 & n.29 (advocating strict pleading requirements for shareholder derivative suits and noting that Delaware's demand requirement may perform this function).

408. For a useful analysis of legal transition costs, see Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. REV. 789 (2002). If the business judgment rule is retained in its standard form, the absence of transition costs is significant, as transition costs may counterbalance decision costs in some cases where the principle of insufficient reason is applied. See VERMEULE, JUDGING, *supra* note 28, at 266 (discussing the relevance of transition costs to changes in judicial review, particularly with respect to the principle of insufficient reason); Eskridge, *supra* note 312, at 2054 (noting the significance of transition costs when assessing proposed changes to statutory interpretation).

409. See Hill & McDonnell, *supra* note 7, at 25.

this context, as are the potential effects on director risk-taking. The legal standard would not only be hard to predict *ex ante*, but potentially quite variable from judge to judge. Quite possibly, the effects of their suggestion would be salutary, but the proposed change would be significant and its systemic effects unknown. The increase in decision costs in comparison to rationality review, however, would be substantial.

Vermeule identifies two conditions for applying the principle of insufficient reason to institutional choices: “the decisionmaker ought to have a pronounced informational advantage with respect to the consideration that is given dispositive weight,” and “the decisionmaker should be able to discern that the consideration given dispositive weight is, in some rough sense, of the same order of importance as the discarded imponderables.”⁴¹⁰

The decision costs of corporate litigation should be relatively well known to the judiciary. As far as orders of importance, these costs are hardly trivial, and could plausibly outweigh the benefits offered by a more involved judicial review of business judgments. Consequently, it is reasonable to select the traditional business judgment rule allocation of decisionmaking authority as a source of lower decision costs.

The maximin criterion also supports this conclusion.⁴¹¹ Assume that increased judicial scrutiny does not function as planned; rather than eliminate bad faith, directors simply devote more energy to hiding their schemes. A plausible worst-case scenario with heightened judicial review of director decisions might resemble the following: Enron-style scandals occur with the same frequency as in prior years; judicial errors increase; desirable risk-taking is deterred; sizable transition costs are incurred as parties adapt to the new regime; and decision costs substantially increase.⁴¹²

410. VERMEULE, JUDGING, *supra* note 28, at 175.

411. *But cf.* Eskridge, *supra* note 312, at 2054–57 (demonstrating different ways of describing worst-case scenarios in an interpretive choice context). Eskridge argues that the use of maximin for this type of problem is vulnerable to manipulation. *See id.* at 2057. However, Eskridge’s argument has greater strength in the contexts he discusses, where a substantial legal change, such as the decision to stop reviewing legislative history, is proposed. With a small number of exceptions among the Delaware precedents, the approach described in this Article is supportive of the status quo.

412. In fact, if changes to the status quo were significant enough, some predict a truly dire worst-case scenario. Consider Chancellor Chandler’s assessment:

Should the Court apportion liability based on the ultimate outcome of decisions taken in good faith by faithful directors or officers, those decision-makers would necessarily take decisions that minimize risk, not maximize value. The entire advantage of the risk-taking, innovative, wealth-creating engine that is the Delaware

The worst-case scenario under the traditional business judgment rule formulation would also be very undesirable and might involve substantial board misconduct. If we imagine the worst-case scenario under Delaware's business judgment rule standard, however, there would naturally be no legal transition costs, and decision costs would be lower than under the alternative. A rational basis test has significantly lower decision costs than heightened scrutiny.

All of the harms feared under a regime that strictly follows the business judgment rule could realistically occur under a regime in which courts review business judgments more closely.⁴¹³ On this basis, the high decision costs associated with corporate litigation should tip the balance. Of course, these worst-case scenarios may not occur. But there is as much reason to expect that a new doctrine will cause damage as there is to think legal change would produce an improvement.

Courts are not in a position to weigh the highly uncertain effects of a new allocation of board authority against the uncertain effects of the business judgment rule. Legitimate concerns exist for both choices. Until more empirical information is available, the foregoing analysis is at least responsive to those factors that courts can assess.

E. The Broader Implications of a Decision Theory Approach

Importantly, decision cost considerations do not require the Delaware courts to resolve the shareholder primacy/director primacy debate, nor do they require courts to definitively weigh optimal director risk-taking against ideals of corporate governance. Resolving those debates is unnecessary. The selection of a standard of review for good faith claims invites an incompletely theorized agreement.

For each of the plausible normative commitments in corporate law (for example, the various potential understandings of shareholder wealth maximization, the team production model, and theories that take the public interest into account), an increase in decision costs would justify an allocation of primary decisionmaking authority to the

corporation would cease to exist, with disastrous results for shareholders and society alike.

Disney IV, 907 A.2d 693, 698 (Del. Ch. 2005). Whether or not one imagines a worst case of quite the severity Chancellor Chandler describes, the potential for serious negative systemic effects in this context should not be downplayed.

413. It is always possible that this Article has not successfully hypothesized the worst-case scenarios. Nonetheless, it is difficult to imagine a major harm which could plausibly occur under the present legal regime that could not also occur under a case of expanded judicial review in fiduciary duty litigation. A significant increase in decision costs, on the other hand, is associated with an expanded review of board conduct, but not with retaining the status quo.

board. The business judgment rule permits a convergence on legal doctrine, even though courts and commentators may disagree as to the ends that doctrine should serve.

A possible rejoinder to this use of the principle of insufficient reason and the maximin criterion is that the argument proves too much. Courts presently review board decisions under an exacting standard in cases where directors engage in self-dealing. One might argue that courts could lower decision costs further if they abstained from reviewing self-dealing cases.⁴¹⁴ Indeed, if the sole criterion to resolve this uncertainty of institutional choices is decision costs, a coin flip might be an ideal decision method.⁴¹⁵ The answer to these concerns is to recognize that there are different degrees of uncertainty at issue.

There are some empirical hunches that observers can comfortably follow, despite the difficulties in directly testing their systemic effects. To use Vermeule's example: jurors should not be authorized to hear cases involving close relatives.⁴¹⁶ A similar assumption, shared by commentators of various stripes, is that directors with a material conflict of interest are sufficiently dubious decisionmakers to merit closer judicial review of their choices.⁴¹⁷ Thus, the principle of insufficient reason and the maximin approach need not require a radical restructuring of corporate law.

Institutional analysis has a significant descriptive aspect. From the descriptive perspective, the above principles of judging under uncertainty fit well with the typical judicial implementation of the business judgment rule. With the exception of outlier cases, courts tend to review business judgments solely in cases where the uncertainties that surround an optimal allocation of decisionmaking authority are limited.

414. Cf. Gold, *supra* note 287, at 159–61 (describing how the elimination of fiduciary duties in limited liability corporation and limited partnership charters may serve to address litigation risk and other business needs for certain parties).

415. *But cf.* VERMEULE, JUDGING, *supra* note 28, at 196 (“The point of all this is not that decision costs should be minimized *tout court*. If it were, judges might flip coins to decide cases or simply close the courthouse doors.”); Eskridge, *supra* note 312, at 2053 (suggesting that, if inexpensive decisionmaking were an end in itself, “there would be no role for judicial review of agency interpretations at all, or the role might be carried out by summary opinions or even by flipping coins”).

416. VERMEULE, JUDGING, *supra* note 28, at 162–63.

417. *See, e.g.*, Bainbridge, *supra* note 255, at 603–04 (“The business judgment rule . . . has no application where the board of directors is disabled by conflicted interests. In such cases, concern for director accountability trumps protection of their discretionary authority.”).

But as the foregoing discussion makes clear, there is also a prescriptive aspect. Prior to the *Disney III* chancery court opinion, there was little Delaware precedent for holding directors liable absent a showing of gross negligence in the decisionmaking process or a material conflict of interest.⁴¹⁸ In fact, the few cases in which allegations of gross negligence alone enabled a plaintiff to rebut the business judgment rule are outliers.⁴¹⁹ Should courts lower the bar for claims of bad faith, it would work a radical transformation of business judgment rule doctrine. Absent empirical support, this gamble is unwarranted.

VII. CONCLUSION

The duty of good faith will always be somewhat indeterminate. Its case-specific nature requires reinterpretation for each new fact pattern, and its legal content is largely dependent on the meaning of other fiduciary duties. However, the Delaware Supreme Court's *Disney V* opinion goes a long way toward defining good faith conduct. A director breaches this obligation by intentionally or consciously disregarding her responsibility to act in the best interests of the corporation and its shareholders.⁴²⁰

The *Disney V* opinion is less helpful with respect to clarifying standards of review for courts that confront claims of director bad faith. As a newly defined standard of conduct for fiduciaries—alongside the conventional care and loyalty standards—good faith presents an opportunity to revise the scope of the business judgment rule. Courts might, if they so choose, use the duty of good faith to lower the requirements for successful allegations of director misconduct. To the extent this occurs, it could dramatically alter a director's risk of monetary liability.

This possibility of limiting business judgment rule protections implicates the proper balance between board accountability and board authority. It calls for a comparative institutional analysis. Each institu-

418. Arguable exceptions where courts more closely scrutinize boards of directors include the unique contexts of corporate merger and takeover jurisprudence, as well as special litigation committees. In certain contexts, Delaware courts apply an intermediate standard of review to board decisions. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981). For helpful analysis of these cases as a response to an increased risk of bias, see Hill & McDonnell, *supra* note 7, at 5–7. In light of the apparent bias problems that these cases address, however, they may be analogized to the more standard conflict of interest cases.

419. See Gevurtz, *supra* note 21, at 299 (noting the difficulty in finding cases in which the use of the gross negligence standard determined the outcome).

420. *Disney V*, 906 A.2d 27, 62, 67 (Del. 2006) (en banc).

tion—courts, directors, and shareholders—has strengths and weaknesses. Even if boards do a poor job of looking out for corporate and shareholder interests, it does not follow that courts would do a better job.

Judicial errors may be common, and directors may become unduly risk-averse if they face sufficient liability. But a greater role for judicial oversight could encourage directors to take their responsibilities more seriously and might protect shareholders from director misconduct. Courts must consider whether an increased judicial role will serve the best interests of the corporation and its shareholders, or whether most business judgments should be made by directors alone.

Regrettably, there is insufficient empirical data to make a well-informed judgment about the ideal balance between board accountability and authority. Factors such as rates of judicial error are nearly impossible to measure, and the effects of liability risk on directors' business judgments are hard to test. Any improvements in director behavior are also case-specific. This lack of useful empirical support is unlikely to be resolved in the near future, and could be with us for years to come. It is a trans-scientific problem.

Many of the effects of greater judicial involvement are matters of conjecture, and there is little reason to think that one subjective judgment on these questions is better than another. Yet courts still have to decide. Since courts do not have the option of waiting for sufficient empirical information, they must instead analyze the merits of the business judgment rule under conditions of severe empirical uncertainty. Decision theory offers strategies for resolving this type of uncertainty.

When choosing among legal alternatives, it is reasonable to assume that uncertain costs and uncertain benefits will cancel out. It is also reasonable to minimize worst-case scenarios. Applying these criteria points toward preservation of conventional business judgment rule protections. The one sure effect of increased judicial involvement in business judgment litigation is a substantial rise in litigation costs. The other effects of judicial oversight have long been subject to debate—they may or may not occur under a new legal standard. Without the necessary data, large costs and benefits from legal change are equally plausible.

Ultimately, the business judgment rule is the most reasonable choice under these conditions. If board conduct is to be reviewed for a lack of good faith, rationality review minimizes the high costs of corporate litigation. At the same time, it does not let directors off the hook entirely. Sufficiently outrageous board conduct will still result in

liability, and directors with conflicts of interest must prove the entire fairness of their actions. This is admittedly a modest judicial role. Perhaps the future will offer empirical findings that support a different result. Until that time, however, rationality review under the business judgment rule is the best option available.