

Hard Cases Make Bad Law:
The Past, Present, and Future of
Delaware Fiduciary Law

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- Delayed negotiations
- Threatened deals with Google or AOL
- Adopted severance plans
- Valued Yahoo too highly
- Adopted a poison pill

Claims Against Yahoo's Managers

“Due to their personal interests in maintaining Yahoo's independence and their strong antipathy towards Microsoft, Yang and Filo failed to consider and respond in **good faith** to the acquisition offers by Microsoft to the detriment of Yahoo and its shareholders.”

Claims Against Yahoo's Managers

“Yang and Filo used the **threat** of pursuing measures that make Yahoo an unattractive acquisition target ... as an **improper means** to thwart Microsoft's advances.”

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What do we really want to know?

- Did Yahoo's managers lie to the shareholders?
- Are Yahoo's managers engaged in self-dealing?
- Are Yahoo's managers competent to conduct this negotiation?

How do we
get there
from here?

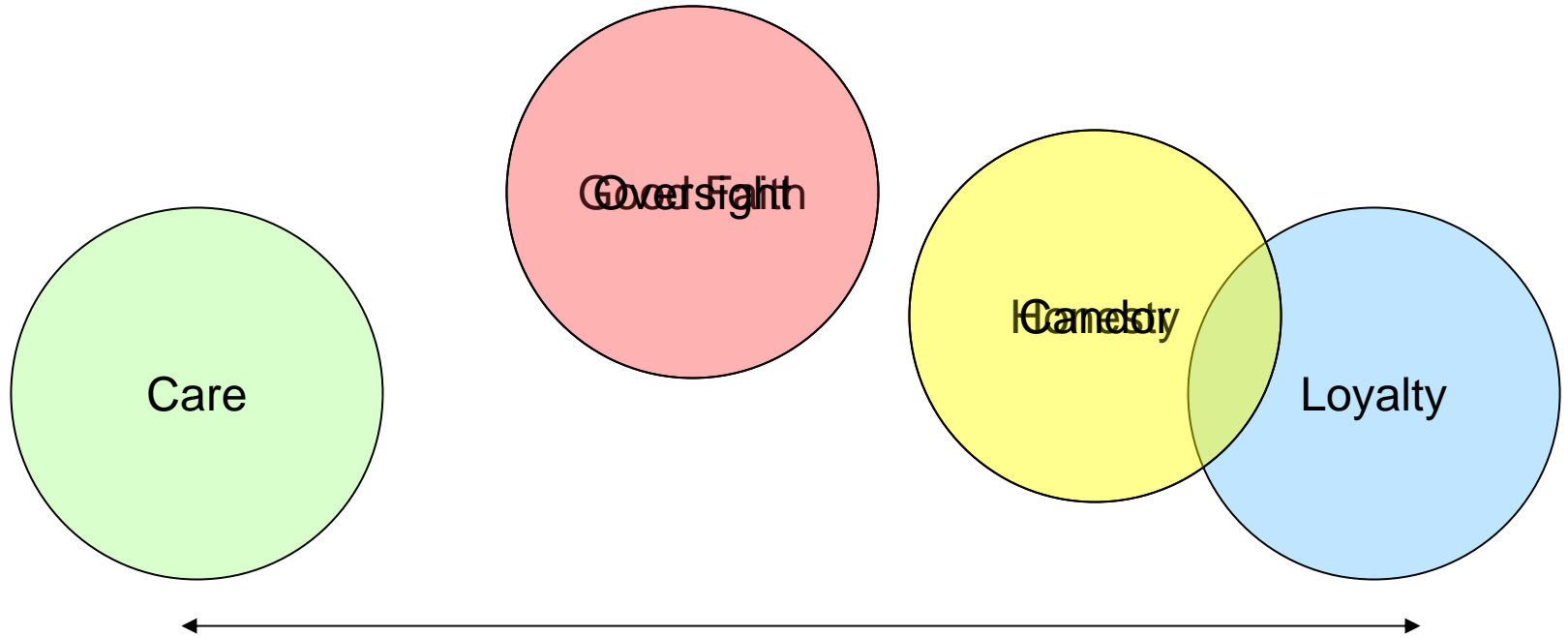
The Past: Guth v. Loft (1939)

“A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.”

The Past: Guth v. Loft (1939)

“The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. *The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.*”

The Loyalty Continuum



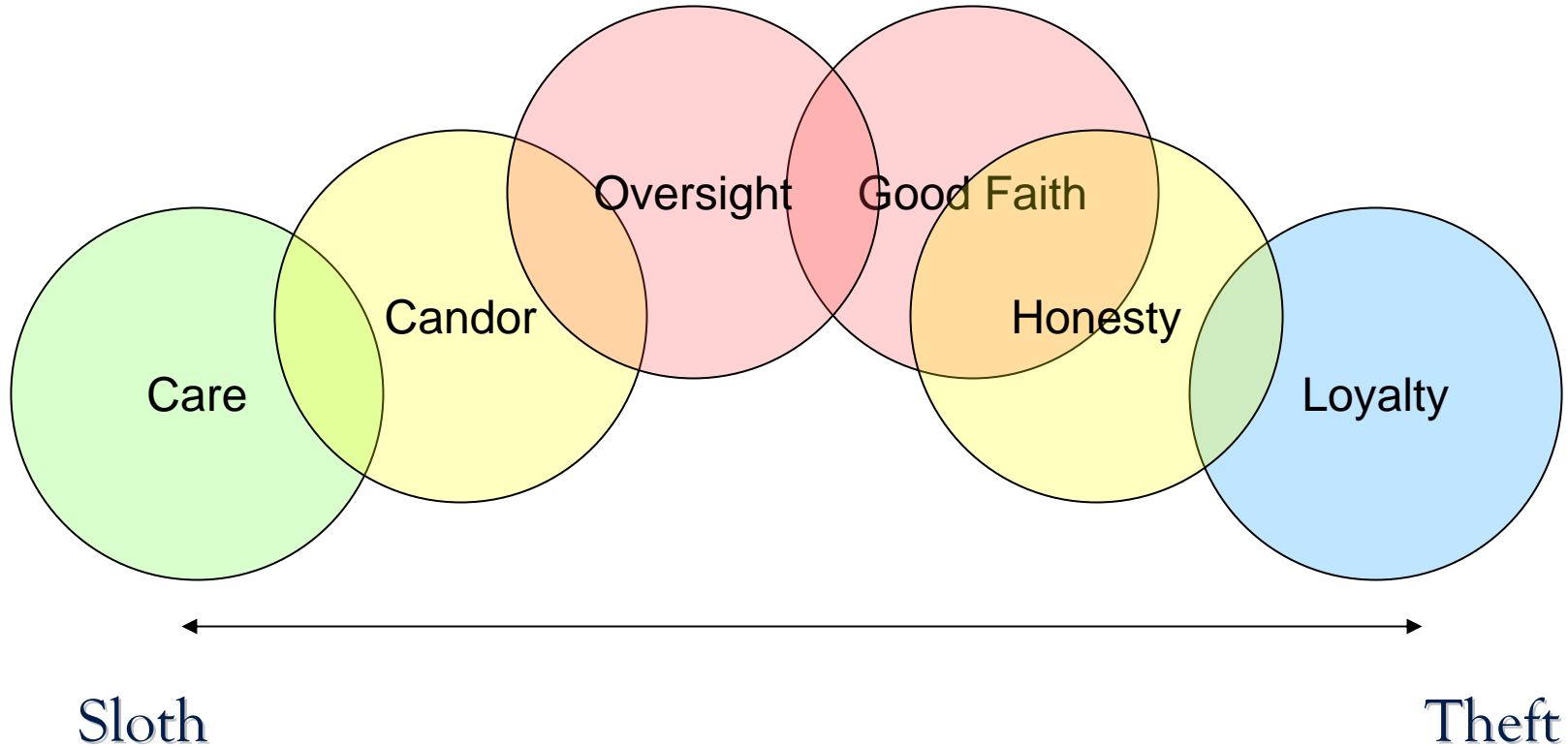
Sloth



Theft

“Truly, you have a dizzying intellect.”

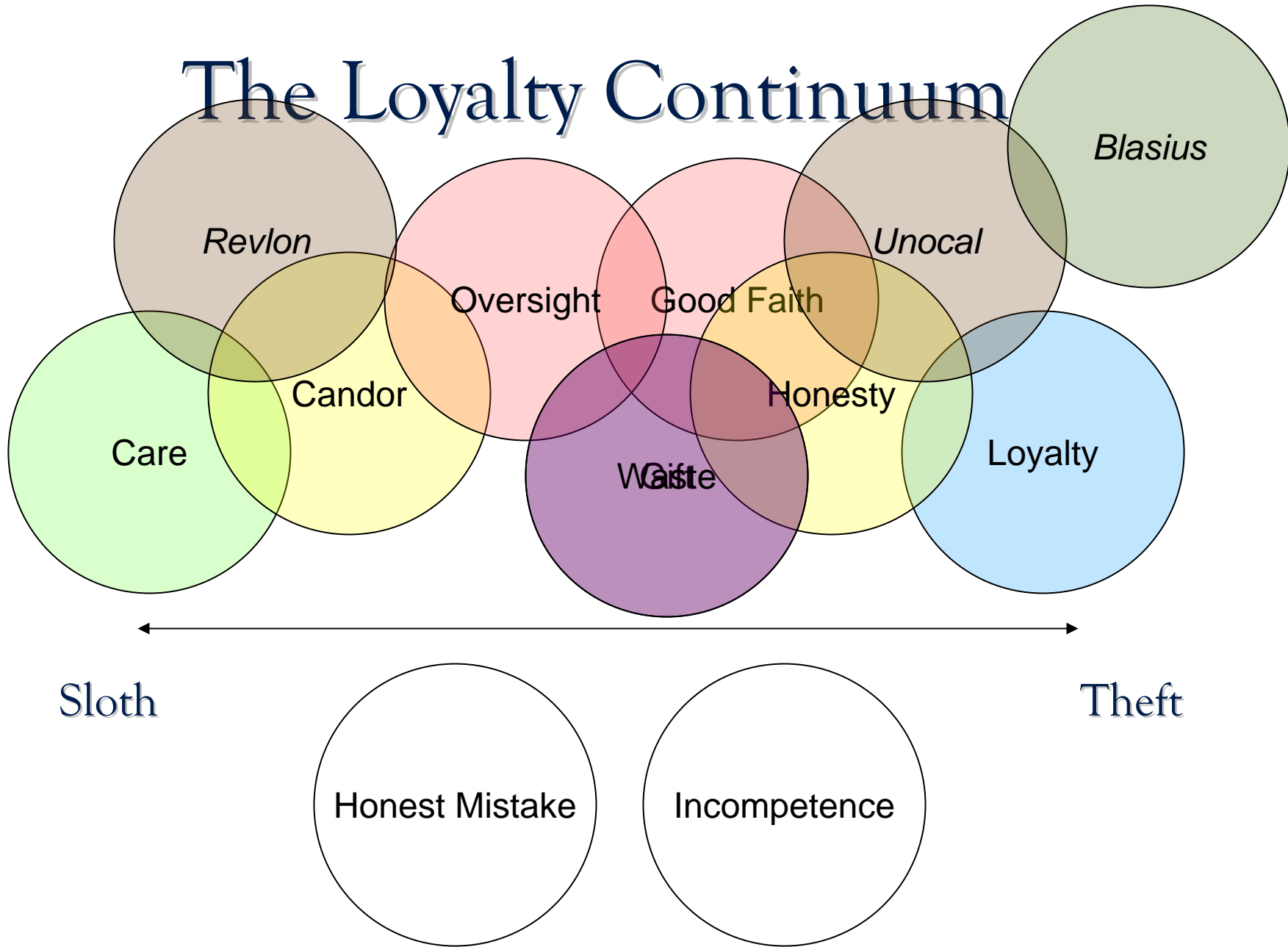
The Loyalty Continuum



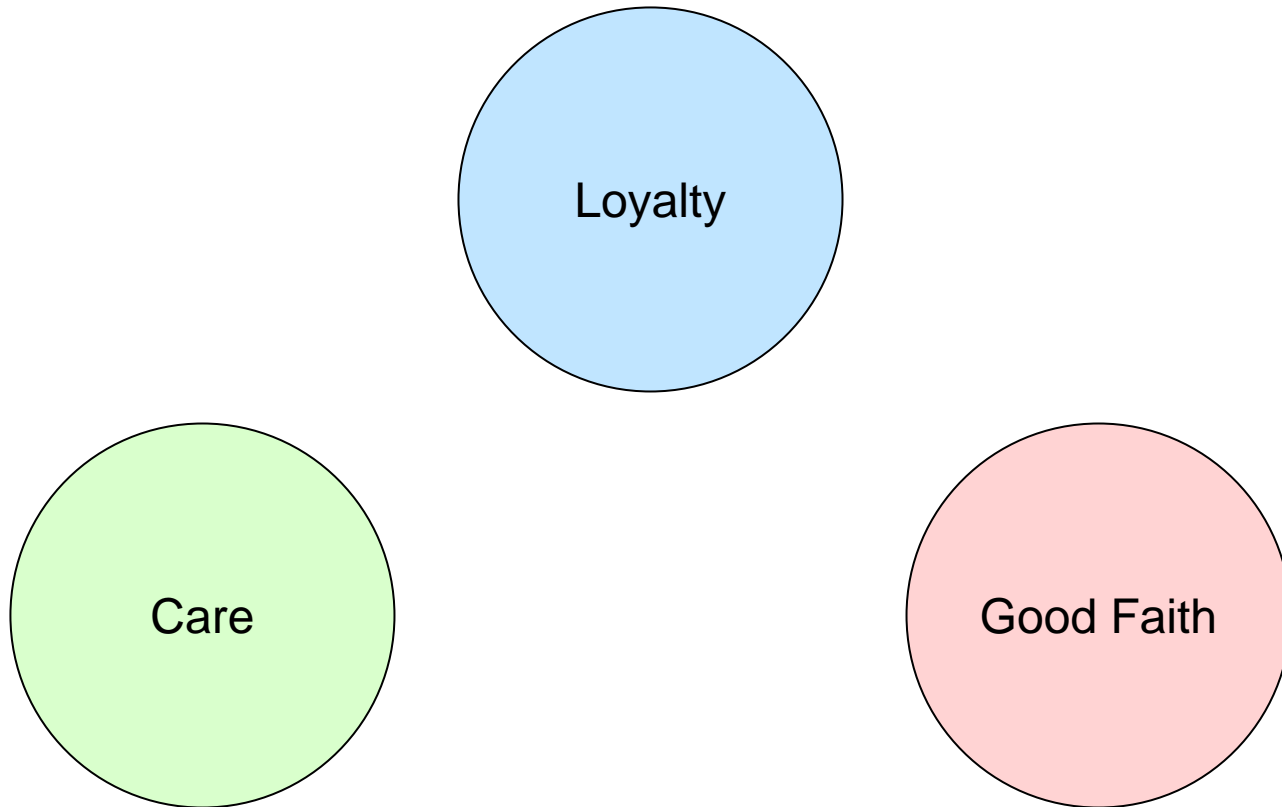
“Wait till I get going!
Where was I?”



The Loyalty Continuum



“The Triad”



Pretrial:
Derivative
Litigation

Director Misconduct

Allegations

Derivative or Direct?

Class Certification ...

Demand Requirement

Demand Futility

Demand?

Futile?

Case Dismissed

Honored?

Plaintiffs Win
Motion to Dismiss

Business Judgment Rule

Defendants Win

Direct

Derivative

No

Yes

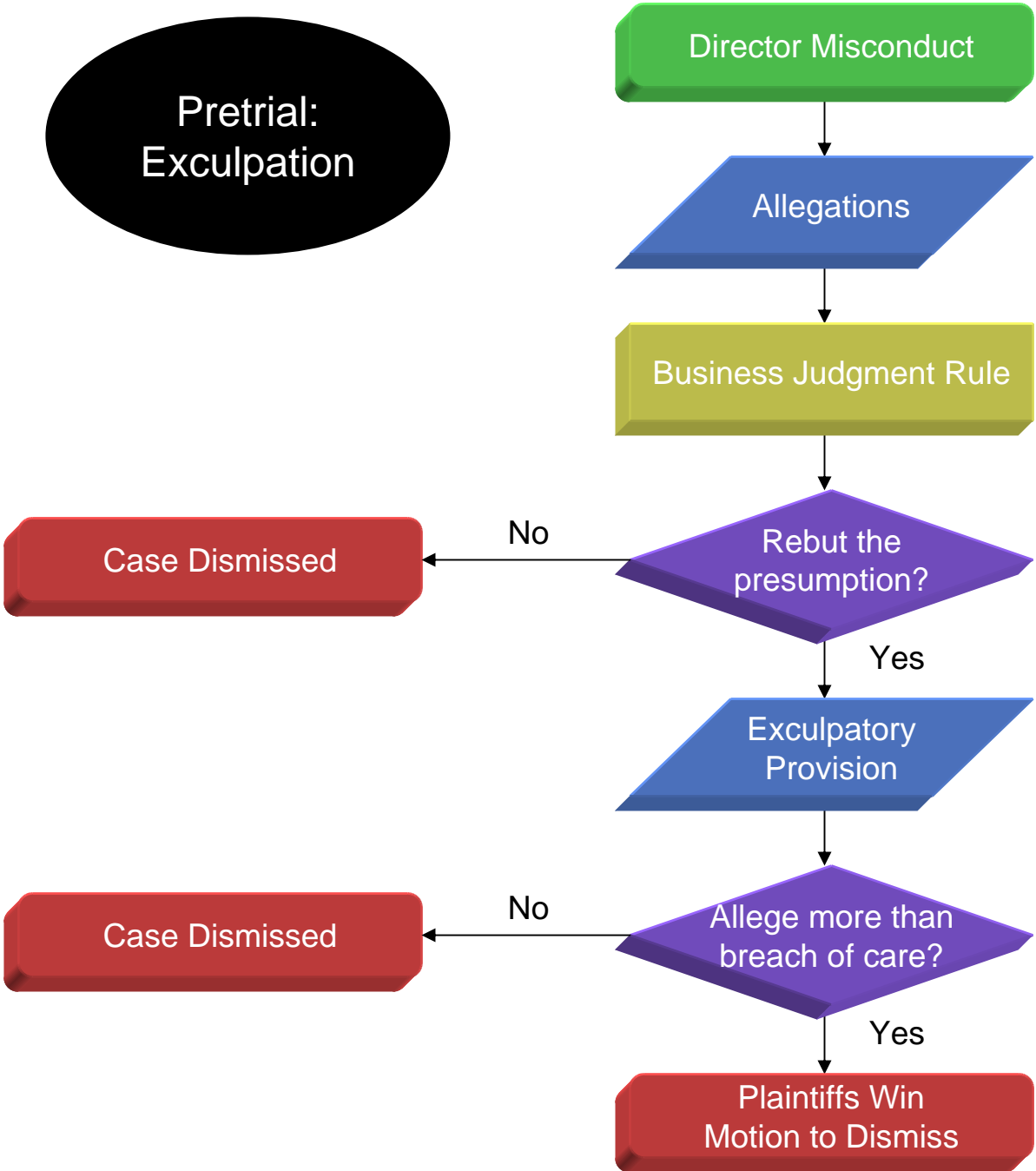
No

Yes

Yes

No

Pretrial:
Exculpation



Pre-trial or Trial:
Ratification

Business Judgment Rule
Defendants Win

Director Misconduct

Evidence

Disinterested director approval?

Disinterested shareholder approval?

Entire Fairness Review

Defendants Win

Care or Loyalty?

Director or Controlling Shareholder?

Business Judgment Rule

Defendants Win

Yes

No

Yes

No

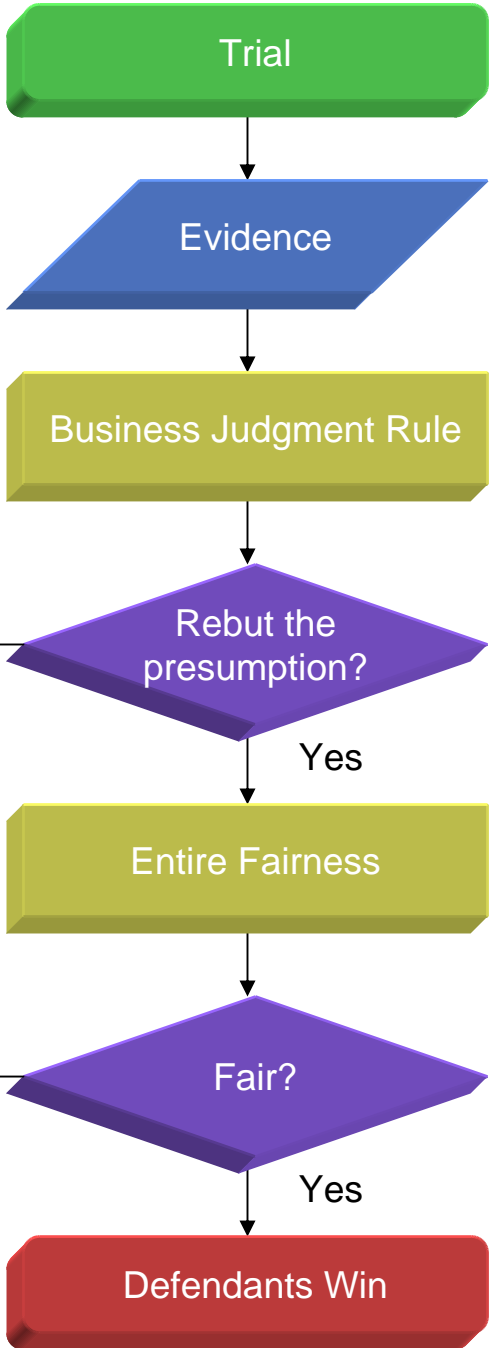
C. S.

Care

Loyalty

Director

Trial:
Entire
Fairness



No Damages

Exculpatory
Provision

Ratio decidendi?

Damages

Care

Loyalty

No

Yes

No

Yes

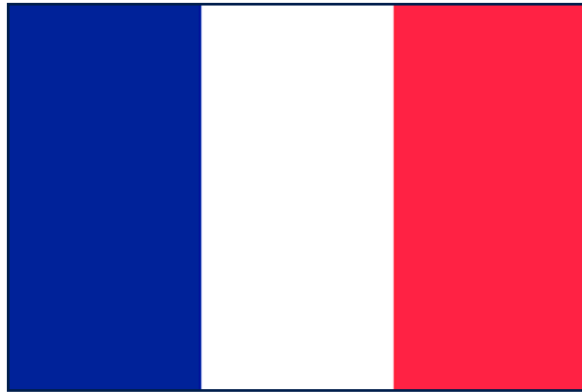
Why do hard cases make bad law?

- The trivial answer:
 - ~ Law does not clearly resolve the “hard case,” so a court must craft a solution that inevitably comes into tension with established rules
- A more interesting answer:
 - ~ “Bad law” is the distortion or even the disregard of clear rules for the sake of a “just” result
- A different twist in the Delaware context:
 - ~ The tool (fiduciary law) is ill-equipped for the task (regulating director behavior that is not explicitly self-interested)

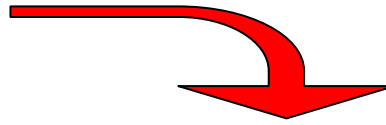
My Critique of Delaware

- The Delaware courts use fiduciary law to determine director motivation, rather than shareholder welfare.
- The problem: in the hard cases, director motivation is inherently ambiguous.
- In the face of mixed motives, the Delaware courts defer to directors, and the result is that directors almost always win, even when their actions fall well short of “best practices.”

The Future?



Self-Dealing Transactions



Prohibitions (e.g., loans to managers, “concealed distributions” to shareholders)



The law of corporate groups



Procedures: *Ex ante* approval and *ex post* ratification



Ex post disclosure



Shareholder initiatives to enforce duty of loyalty

- Liability actions (rare)
- Appointment of auditor
- Nullification of board or shareholder actions

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What to do about Yahoo?

- No conflict of interest
- Defensive action?
- Business judgment rule?

Bottom line:
Shareholders
lose lawsuit

The Alternative Path

