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.”
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

Care

Good Faith

Honesty

Candor

Oversight

Loyalty

Sloth

Theft

“Truly, you have a dizzying intellect.”
The Loyalty Continuum

Care

Candor

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Sloth

Theft

“Wait till I get going! Where was I?”

Theft

Sloth
The Loyalty Continuum

-revlon
-care
-candor
-oversight
-good faith
-honesty
-waste
-loyalty

Sloth

Theft

Honest Mistake
Incompetence

Blasius

Unocal
“The Triad”

- Loyalty
- Care
- Good Faith
Pretrial: Exculpation

Director Misconduct

Allegations

Business Judgment Rule

Rebut the presumption?

Exculpatory Provision

Case Dismissed

No

Case Dismissed

Yes

Allege more than breach of care?

Yes

Plaintiffs Win Motion to Dismiss

No

No
Pre-trial or Trial: Ratification

Business Judgment Rule
- Defendants Win

Director Misconduct
- Evidence
  - Disinterested director approval?
    - Yes: Defendants Win
    - No: Disinterested shareholder approval?
      - Yes: Care or Loyalty?
        - Care: Defendants Win
        - Loyalty: Entire Fairness Review
          - C. S.: Director or Controlling Shareholder?
            - Director: Business Judgment Rule
            - Defendants Win
          - No: Entire Fairness Review

- No: Defendants Win
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
What to do about Yahoo?

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

Bottom line: Shareholders lose lawsuit
The Alternative Path