All in Good Faith: How the RMBCA Can Revive Delaware’s Third Fiduciary Duty

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ABSTRACT

When a director of a corporation takes improper action that causes financial losses to the corporation, shareholders, on behalf of the corporation, can attempt to recover from that director through a derivative suit for breach of his fiduciary duty. Since 1985, corporations have been permitted to include a provision in their articles of incorporation that exculpates directors for certain breaches of fiduciary duty. However, these exculpation statutes generally only allow exculpation for a breach of the duty of care, but not for a breach of the duty of loyalty or the duty of good faith. While a breach of the duty of loyalty commonly applies only to self-interested conduct, a breach of the duty of good faith can encompass more situations. Thus, alleging that a director breached his duty of good faith can be the key to winning a shareholders’ derivative suit.

However, since the advent of these exculpation statutes, Delaware courts have struggled to determine the point at which director conduct is no longer exculpable. Through Delaware courts’ jurisprudence, the duty of good faith has virtually been eliminated. Despite its common law history and its positioning in statutes, the duty of good faith has been relegated to a subsidiary element of the duty of loyalty. It is no longer an independent source of liability for directors. With these developments, shareholders have lost a valuable tool for holding directors responsible for their actions.

This Comment argues that the elimination of good faith as an independent source of liability was an incorrect holding. The duty of good faith should stand alongside the duties of care and loyalty and should merit its own exception from director exculpation. To reach those goals, this Comment proposes that Delaware should adopt the Revised Model Business
Corporation Act’s (RMBCA) provision on fiduciary duties while maintaining its current exculpation provision. The RMBCA incorporates a clearer definition of the duty of good faith that would provide Delaware courts better guidance than the current case law. Additionally, the RMBCA standard of good faith uses a reasonability standard to determine whether a director’s conduct is exculpable. It would prevent directors from hiding behind the defense that their conduct was “unconscious” or “unintentional.” This standard better serves shareholders because it allows them to challenge conduct for which directors should be held accountable. At the same time, directors still have exculpation to fall back on for conduct that is not overly egregious. For all these reasons this Comment argues that a more comprehensive good faith standard is necessary to adequately protect shareholders in the modern corporate world.
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INTRODUCTION

A shareholder’s derivative suit charging directors with personal responsibility for corporate losses based on a violation of the duty of good faith “is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.”\(^1\) Since the advent of director exculpation statutes,\(^2\) Delaware courts have all but eliminated good faith from the fiduciary duties of directors.\(^3\) To succeed in a derivative suit in today’s corporate world, a shareholder must be able to prove either that a director was self-interested, or that he knowingly or intentionally engaged in wrongful conduct.\(^4\) For these reasons, this Comment takes issue with Delaware’s interpretation of good faith and proposes a more appropriate good faith standard to adequately account for shareholder interests.

Specifically, this Comment argues that the Revised Model Business Corporation Act’s (RMBCA) provision on fiduciary duties better meets the goals of corporate law.\(^5\) Combining the

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\(^1\) In re Caremark Int’l Inc. Deriv. Litig., 698 A.2d 959, 967 (Del.Ch. 1996).


\(^3\) See Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (“[T]he 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.”).

\(^4\) See, e.g., Wood v. Baum, 953 A.2d 136, 141 (Del. 2008) (“Where…directors are exculpated from liability except for claims based on ‘fraudulent,’ ‘illegal’ or ‘bad faith’ conduct, a plaintiff must also plead particularized facts that demonstrate that the directors acted with scienter, i.e., that they had ‘actual or constructive knowledge’ that their conduct was legally improper.”).

\(^5\) RMBCA § 8.30 (2007).
RMBCA’s fiduciary duty provision with Delaware’s exculpation statute\(^6\) will provide valuable guidance to courts that currently must decipher ambiguous and conflicting case law.\(^7\) This new framework would actually hold directors accountable for conduct that corporations and shareholders clearly would not approve.

This Comment’s three parts each lend support to its proposal. Part I introduces a brief background of fiduciary duties and the duty of good faith in general, discusses the important Delaware cases that have shaped the modern good faith standard, and reviews the statutory duty of good faith, specifically focusing on the RMBCA’s approach. Part II examines the various inconsistencies found in the current Delaware approach to the duty of good faith. It argues that the *In re Walt Disney Co. Deriv. Litig.*\(^8\) three category approach does not adequately capture director conduct that is not in good faith, and that the standard developed by *Stone v. Ritter*\(^9\) is overbroad and misinterprets prior case law. Finally, Part III proposes a comprehensive good faith standard based on a combination of the RMBCA’s fiduciary duty provision and Delaware’s exculpation statute.

I. BACKGROUND

This Comment proposes a new standard for the fiduciary duty of good faith of directors. This new standard combines aspects of the two most widely recognized corporate codes—the Delaware General Corporation Law and the Revised Model Business Corporation Act.

\(^6\) *DEL. CODE ANN.* tit. 8, § 102(b)(7) (West 2012).

\(^7\) *See infra* section III.C

\(^8\) 906 A.2d 27 (Del. 2006).

\(^9\) 911 A.2d 362 (Del. 2006).
Accordingly, the pertinent code sections of these two statutes are identified and discussed below, along with Delaware’s applicable case law.

This Part will lay out the foundation for an analysis of the duty of good faith. First, it will explain what corporate directors’ fiduciary duties are. Second, it will discuss one specific fiduciary duty—the duty of good faith. Third, it will contrast the Delaware General Corporation Law’s fiduciary duty provision with the newer Revised Model Business Corporation Act. Fourth, it will describe how Delaware’s good faith standard developed through its case law.

A. Fiduciary Duties of Directors and the Business Judgment Rule

Many courts and scholars have likened directors to trustees or agents of the corporation. Regardless of this distinction, directors—like trustees or agents—are considered to be fiduciaries, meaning they must act for the benefit of another party, in this case the corporation. The fiduciary duty to act for the benefit of the corporation encompasses specific duties, most commonly including the duties of care, loyalty, and good faith. Additionally, a fiduciary relationship necessitates a higher standard of trust, care and loyalty than a contractual


11 See, e.g., Franklin A. Gevurtz, Corporation Law § 4 (2d ed. 2010). A fiduciary is “[a] person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor” or “[o]ne who must exercise a high standard of care in managing another’s money or property.” BLACK’S LAW DICTIONARY (9th ed. 2009).

12 See, e.g., Gevurtz, supra note 11.
Simply put, when a director “takes on the job (1) he must give it reasonably
diligent attention; (2) he must bring to bear upon it the fair degree of such skill and judgment as
he possesses and would devote to his own affairs; and (3) he must be honest.”

While this Comment focuses on the duty of good faith, a brief explanation of the duties
of care and loyalty and the business judgment rule is necessary for context. The duty of care
requires that directors manage the corporation with the attention “which ordinarily careful and
prudent men would use in similar circumstances.” This duty also encompasses a “duty to
inform themselves, prior to making a business decision, of all material information reasonably
available to them.” The duty of loyalty, on the other hand, mandates that the best interest of the
corporation and its shareholders takes precedence over any interest possessed by a director.

Under Delaware law, there is “a presumption that in making a business decision the directors of
a corporation acted on an informed basis, in good faith and in the honest belief that the action
taken was in the best interests of the company.” Courts will respect the judgment of directors
absent an abuse of discretion, and the burden of proof is on the party challenging a director
decision to establish facts rebutting the presumption. This doctrine is called the business

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13 See, e.g., Kelli A. Alces, Debunking the Corporate Fiduciary Myth, 35 J. Corp. L. 239 (2009).
14 Percival E. Jackson, What Every Corporation Director Should Know, 134 (1949).
15 See infra section I.B.
16 Graham v. Allis Chalmers Manufacturing Company, 188 A.2d 125, 130 (Del. 1963)
18 Cede & Co. v. Technicolor, 634 A.2d 345, 361 (Del. 1993).
19 Aronson, 473 A.2d at 812.
20 Id.
judgment rule. An allegation of lack of good faith is an important method in which shareholders can rebut the presumption of the business judgment rule. Unfortunately, the concept of good faith is an ambiguous one and extremely difficult to prove in corporate law.

B. Duty of Good Faith in General

While the duty of good faith is a well-settled area of contract law, in the realm of fiduciary duties it continues to evolve. Many questions still remain unanswered. For example, is it an overarching principle, as it is in contract law? Does it stand alongside the duties of care and loyalty? Is it a subset of the duty of loyalty? Does this determination change anything or have any impact on how courts make decisions? Many scholars have tried to piece together exactly what the duty of good faith is, and most look to Delaware law to discuss the foundations.

21 The business judgment rule is a deferential standard that courts use to analyze director decisions. It mandates that courts review the process by which a decision was made, and not the results of that decision. Essentially, judges and courts feel that they are ill-equipped to second-guess a “wrong” decision made by a director. See Gevirtz, supra note 11 at §4.1.2.

22 See, e.g., Warsaw v. Calhoun, 221 A.2d 487, 493 (Del. 1966) (“The burden of showing the existence of bad faith or abuse of discretion rests upon the plaintiff.”).

23 In this Comment, “the duty of good faith” refers only to corporate governance.

24 See, e.g., Restatement (Second) of Contracts § 205 (1981); U.C.C. § 1-201(b)(20) (2012) (“‘Good Faith,’ except as otherwise provided in Article 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing.”).

Additionally, the RMBCA provides some insight into what others think about the duty of good faith and where the law may head in the future.

Good faith analysis became extremely important following the creation of exculpation statutes in the wake of the now famous case of *Smith v. Van Gorkom.*\(^{26}\) In *Van Gorkom,* the Delaware Supreme Court reversed a Chancery Court decision, holding that directors of a corporation were liable for not fully informing themselves prior to approving a merger agreement.\(^{27}\) Essentially, the board of directors approved a $690 million merger agreement based on a two-hour directors’ meeting.\(^{28}\) The court rejected the presumption of the business judgment rule because the directors did not perform enough due diligence for a merger of this magnitude.\(^{29}\)

\(^{26}\) *Smith v. Van Gorkom,* 488 A.2d 858 (Del. 1985).

\(^{27}\) *Id.* at 863-64.

\(^{28}\) *Id.* at 865-68. Van Gorkom, the chairman and CEO of Trans Union, came up with a share price of $55 based on the price at which he was willing to sell his own shares. He then developed a financing structure to accomplish the sale without consulting the board or any members of Senior Management except one. Van Gorkom also personally handled all negotiations with the purchasing firm. *Id.*

\(^{29}\) *Id.* at 874 (“The directors (1) did not adequately inform themselves as to Van Gorkom's role in forcing the ‘sale’ of the Company and in establishing the per share purchase price; (2) were uninformed as to the intrinsic value of the Company; and (3) given these circumstances, at a minimum, were grossly negligent in approving the ‘sale’ of the Company upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency.”).
The court ultimately held that the directors had breached their duties by failing to prepare for the merger and not disclosing enough information to the shareholders.\(^{30}\)

*Van Gorkom* was heavily criticized, and following the decision, Delaware and every other state enacted exculpation statutes.\(^{31}\) These statutory provisions allow a corporation to limit director liability for a breach of fiduciary duty simply by including a provision in the corporation’s certificate of incorporation.\(^{32}\) However, these exculpation statutes only allow the corporation to exculpate a director for a breach of his duty of care, while explicitly forbidding exculpation for breaches of the duty of loyalty or good faith.\(^{33}\) Since directors cannot escape

\(^{30}\) *Id.* at 893-94 (“[T]he directors of Trans Union breached their fiduciary duty to their stockholders (1) by their failure to inform themselves of all information reasonably available to them and relevant to their decision to recommend the Pritzker merger; and (2) by their failure to disclose all material information such as a reasonable stockholder would consider important in deciding whether to approve the Pritzker offer.”). The court remanded and directed the lower court to determine a more accurate share price and to award damages to the extent that that share price exceeded $55. *Id.*

\(^{31}\) *See* Sharfman, *supra* note 2, at 289-90.

\(^{32}\) *See, e.g.*, CAL. CORP. CODE § 204(a)(10) (West 2012); N.Y. BUS. CORP. LAW § 402(b) (McKinney 2012).

\(^{33}\) *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2012) (emphasis added) (“A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director’s duty of
liability for a breach of the duty of good faith, a determination of what constitutes a lack of good
default (or what constitutes bad faith) becomes vitally important.\(^{34}\)

C. Statutory Duty of Good Faith

This section will discuss both Delaware and the Revised Model Business Corporation
Act’s (RMBCA) fiduciary duty provisions and definitions of the duty of good faith. First, it will
outline the fiduciary duty provisions from the Delaware General Corporation Law. Second, it
will review the background of the RMBCA, including its creation and purpose. Third, it will
analyze the RMBCA’s provision on fiduciary duties (specifically the duty of good faith) and
contrast it with Delaware’s corporate code.

1. Delaware General Corporation Law

Delaware’s fiduciary duties for directors have developed primarily through case law.\(^{35}\)
However, the Delaware General Corporation Law is also important for an analysis of the duty of
good faith. Section 141(a) provides, “[t]he business and affairs of every corporation organized
under this chapter shall be managed by or under the direction of a board of directors.”\(^{36}\)
Although this sentence does not explicitly state any duties, it lays the foundation that directors

\(^{34}\) As mentioned above, the duty of loyalty is more clearly defined as self-interested conduct
whereas the duty of good faith is a more amorphous concept. \textit{See supra} note 18 and
accompanying text.

\(^{35}\) \textit{See, e.g.}, David Rosenberg, \textit{Making Sense of Good Faith in Delaware Corporate Fiduciary

\(^{36}\) \textsc{Del. Code Ann. tit.} 8, § 141(a) (West 2012).
are responsible for managing the corporation; thus, courts impute common law duties upon them.37

2. Development of the RMBCA

Despite Delaware’s reputation as the preeminent authority on corporate matters, thirty states have adopted all or substantially all of the Revised Model Business Corporation Act (RMBCA)38 as their general corporate statute and, an additional three states have enacted statutes based on the 1969 version of the Act (MBCA or “Model Act”).39 “The Model Act is designed as a free-standing general corporation statute that can be enacted substantially in its entirety by a state legislature.”40 Additionally, its purpose is “to be a convenient guide for revision of state

37 See, e.g., Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1280 (Del. 1989) (“It is basic to our law that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation. 8 Del.C. § 141(a). In discharging this function, the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders.”).

38 From 1969 to 1984, the statute was referred to as the Model Business Corporation Act, MBCA or Model Act. After the revision in 1984, it is referred to as the Revised Model Business Corporation Act or RMBCA. This Comment will refer to the RMBCA.


40 Introduction, MOD. BUS. CORP. ACT (2007).
business corporation statutes, reflecting current views as to the appropriate accommodation of the various commercial and social interests involved in modern business corporations.” 41 The Committee on Corporate Laws of the Section of Business Law of the American Bar Association drafts and revises the Model Act, and finished a complete revision in 1984, which serves as the foundation for the Revised Model Business Corporation Act or RMBCA. 42 Additionally, in 1998 the Committee revised Section 8.30, Standards of Conduct for Directors, and added a new Section 8.31, Standards of Liability for Directors. 43

3. **RMBCA Fiduciary Duties**

Unlike the Delaware General Corporation Law, the RMBCA, in Section 8.30, specifically sets out the duties each director owes to the corporation. 44 First, “[e]ach member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation.” 45 Second, “[t]he members of the board of directors . . . shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.” 46 At first glance, these provisions seem to contain the same vague and undefined language that plagues Delaware’s case law; however, the drafters of the RMBCA included an Official Comment after the section to explain these terms.

41 *Introduction* to AMERICAN BAR FOUNDATION, *supra* note 2, at xvii.


44 RMBCA § 8.30 (2007).

45 RMBCA § 8.30(a) (2007).

46 RMBCA § 8.30(b) (2007).
Most importantly, the RMBCA clearly explains the interaction between the separate duties in its comments to Section 8.30.\textsuperscript{47} It states that "at the core of the subsection’s mandate is the requirement that, when performing directors’ duties, a director shall act in good faith coupled with conduct reasonably believed to be in the best interests of the corporation."\textsuperscript{48} The comments clarify this statement further by explaining that “[t]his mandate governs all aspects of directors’ duties.”\textsuperscript{49} Whereas Delaware courts waver between the placement of the duty of good faith in the “triad” or as a subset of the duty of loyalty, the RMBCA establishes good faith at the core of directors’ duties.\textsuperscript{50,51}

According to the \textit{Model Business Corporation Act Annotated}, “forty jurisdictions require that a director of a corporation discharge the duties of his office in good faith and with a stated standard of care.”\textsuperscript{52} The majority of states have a provision in their corporate code that requires: “A director shall discharge his duties as a director, including his duties as a member of a committee: (1) In good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner he reasonably believes to be in the best interests of the corporation.”\textsuperscript{53}

\textsuperscript{47} Official Comment to RMBCA § 8.30 (2007).

\textsuperscript{48} \textit{Id.} (emphasis added).

\textsuperscript{49} \textit{Id.} (emphasis added).

\textsuperscript{50} \textit{Id.}

\textsuperscript{51} \textit{See infra} sections I.D.2 and I.D.3.

\textsuperscript{52} \textit{Statutory Comparison, Model Business Corporation Act Annotated} § 8.30 (3d ed. 2005).

D. Delaware’s Common Law Duty of Good Faith

This section will discuss the Delaware common law interpretation of the duty of good faith. First, it will outline three cases (Graham, Caremark, and Malone) that shaped Delaware’s early good faith standard. Then, it will analyze two cases from 2006—Disney and Stone—that altered how courts have viewed the duty of good faith ever since.

1. Graham, Caremark and Malone: The Early Good Faith Standard

Delaware has a long line of cases addressing directors’ violations of their fiduciary duties, but a few cases stand out for their impact on the duty of good faith. This section will first discuss Graham v. Allis Chalmers Manufacturing Co. which is the start of the Delaware courts’ discussion of the distinction between the duty of care and the duty of good faith in the oversight context. It will then analyze In re Caremark International Inc. Derivative Litigation and its development of a good faith standard for oversight liability. Finally, this section will finish with a discussion of Malone v. Brincat and what constitutes a claim for a breach of the duty of good faith.

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57 In re Walt Disney Co. Derivative Litigation, 906 A.2d 27 (Del. 2006).


59 See, e.g., Graham, 188 A.2d at 125; Caremark, 698 A.2d at 959; Malone, 722 A.2d at 5.

60 Graham, 188 A.2d at 125.

61 Caremark, 698 A.2d at 959.

Graham v. Allis Chalmers Manufacturing Co. was a 1963 case in which the Delaware Supreme Court questioned whether certain director conduct violated the duty of care or the duty of good faith. In Graham, shareholders of Allis Chalmers brought a derivative action against its directors alleging either actual or constructive knowledge of anti-trust conduct that resulted in severe liability to the corporation. The shareholders alleged the liability was caused by a lack of director oversight. The court, however, rejected the plaintiffs’ allegations and explained that directors may rely on their subordinates until something occurs that would cause someone to be suspicious; the court opined that “absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists.”

While the court did not explicitly discuss the duty of good faith, it did provide examples of when a director could face liability for a broader “neglect of duty.” The court stated, “[i]f he has recklessly reposed confidence in an obviously untrustworthy employee, has refused or neglected cavalierly to perform his duty as a director, or has ignored either willfully or through inattention obvious danger signs of employee wrongdoing, the law will cast the burden of liability upon him.” The Graham court used ambiguous language making it unclear whether

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63 Graham, 188 A.2d at 130.
64 Id. at 128.
65 Id. at 129-30.
66 Id. at 130.
67 Id.
68 Id.
these examples of “neglect of duty” were breaches of the duty of care or the duty of good faith.\textsuperscript{69} To some, the argument may just be semantic, but in light of Delaware’s exculpation statute, the distinction could eliminate director liability.\textsuperscript{70}

Thirty-three years later, the Delaware Court of Chancery revisited the \textit{Graham} decision in \textit{In re Caremark International Inc. Derivative Litigation}.\textsuperscript{71} The court in \textit{Caremark} developed the good faith standard for director oversight liability that is still widely used today.\textsuperscript{72} In \textit{Caremark}, shareholders brought a derivative action alleging that members of the board of directors had breached their fiduciary duty.\textsuperscript{73} The shareholders contended that the board of directors failed to monitor the enterprise, which resulted in violations of federal and state laws by Caremark employees and ultimately monetary sanctions against the corporation.\textsuperscript{74}

\begin{itemize}
\item \textsuperscript{69} \textit{Id.}
\item \textsuperscript{70} \textit{See, e.g.}, \textsc{Del. Code Ann.} tit. 8, § 102(b)(7) (West 2012) (“A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director’s duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law”).
\item \textsuperscript{71} \textit{In re Caremark Int’l Inc. Deriv. Litig.}, 698 A.2d 959 (Del.Ch. 1996).
\item \textsuperscript{72} \textit{Id.} at 971. \textit{See infra} note 80.
\item \textsuperscript{73} \textit{Id.} at 960.
\item \textsuperscript{74} \textit{Id.} at 960. Caremark was charged with an indictment of multiple felonies and ultimately pleaded guilty to a single felony of mail fraud and agreed to pay fines and reimbursements of approximately $250 million. \textit{Id.} at 960-61.
\end{itemize}
The court in *Caremark* began by explaining the business judgment rule in the context of the duty of care.\(^75\) The court wrote, “whether a judge or jury considering the matter after the fact, 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 court determines that the process employed was either rational or employed in *a good faith* effort to advance corporate interests.”\(^76\) This standard allows directors substantial leeway in decision-making because courts will not second-guess directors’ decisions if they are reasonable and made in good faith.\(^77\)

However, the court also addressed the holding in *Graham* regarding director’s oversight responsibilities and what constitutes a breach of their fiduciary duties of care and good faith.\(^78\) The court explained that a director must make sure that an adequate information and reporting system exists, and if he fails to do so, he may be held liable.\(^79\) Despite this potentially stricter standard, the court in *Caremark* did not find a breach of fiduciary duty by the directors,\(^80\) and

\(^75\) *Id.* at 967.

\(^76\) *Id.*

\(^77\) *Id.*

\(^78\) *Id.* at 969.

\(^79\) *Id.* at 970 (“[A] director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards.”).

\(^80\) *Id.* at 971.
ultimately dismissed the derivative claims for failure to state a claim. 81 The court held that to establish a lack of good faith requires “a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists.” 82 The court recognized that this standard of liability would be difficult to prove. 83 However, it reasoned that a high standard was necessary to encourage qualified candidates to serve on boards as directors. 84 Since the court set such a high burden for pleading a breach of the duty of good faith, it seemed unlikely that a plaintiff could ever adequately plead let alone prove a breach of the duty of good faith except in the most obvious and egregious circumstances. 85

Throughout the 1990s Delaware courts continued to rely on the standard that “[t]he director’s fiduciary duty to both the corporation and its shareholders has been characterized by this Court as a triad: due care, good faith, and loyalty.” 86 Under this framework, the Delaware courts

81 Id.
82 Id.
83 Id.
84 Id. (“But, a demanding test of liability in the oversight context is probably beneficial to corporate shareholders as a class, as it is in the board decision context, since it makes board service by qualified persons more likely, while continuing to act as a stimulus to good faith performance of duty by such directors.”).
85 Id. The court in Caremark held that there was not a breach of fiduciary duty by the directors. See infra note 137.
86 Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998). The opinion also contains an oft quoted passage about Delaware’s corporate jurisprudence: “This Court has endeavored to provide the directors with clear signal beacons and brightly lined-channel markers as they navigate with due
Supreme Court in *Malone v. Brincat* was asked to determine which of these fiduciary duties directors had breached. Shareholders alleged that the directors of a corporation breached their fiduciary duty by intentionally overstating the financial condition of the corporation on repeated occasions in disclosures to shareholders. The court analyzed whether the directors had breached their duty of loyalty or good faith by circulating false financial information about the corporation to its shareholders. However, the Delaware Supreme Court upheld the Court of Chancery’s dismissal because the complaint did not properly plead whether the claim was direct, derivative, or a class action. Although the court did not come to a conclusion regarding director liability for misleading disclosures to shareholders, it did leave the door open for additional litigation when it stated “we disagree with the Court of Chancery's holding that such a claim cannot be articulated on these facts.”

This Court has also endeavored to mark the safe harbors clearly.” *Id.* See also *Cede & Co. v. Technicolor*, Inc., 634 A.2d 345 (Del. 1993) (analyzing the “triad” of fiduciary duties in regards to the business judgment rule).

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88 *Id.*

89 *Id.* at 10 (“[The issue] is whether they breached their more general fiduciary duty of loyalty and good faith by knowingly disseminating to the stockholders false information about the financial condition of the company. The directors' fiduciary duties include the duty to deal with their stockholders honestly.”).

90 *Id.* at 14.

91 *Id.* at 15.
2. Disney and Stone: A Changing of the Guard

The year 2006 saw perhaps the most influential Delaware cases on director fiduciary duties: *In re Walt Disney Co. Derivative Litigation* and *Stone v. Ritter*. The *Disney* court recognized the three traditional fiduciary duties—care, loyalty, and good faith—but sought to define “bad faith” by delineating three different categories of conduct that could constitute bad faith. *Stone*, on the other hand, decided that the duty of good faith was a subset of the duty of loyalty and could not serve as an independent basis for director liability.

In *Disney*, shareholders brought a derivative action alleging breach of fiduciary duty and waste claims against directors and officers because they had awarded a $130 million severance package to Disney’s president upon his termination without cause. The Delaware Court of Chancery entered judgment in favor of the defendants, holding that Disney’s CEO and board of

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92 *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27 (Del. 2006).


94 *Disney*, 906 A.2d at 64.

95 *Stone*, 911 A.2d at 362.

96 *Disney*, 906 A.2d at 35. In August 1995, Michael Ovitz and The Walt Disney Company entered into an employment agreement under which Ovitz would serve as President of Disney for five years. Fourteen months later, Ovitz was terminated because he was “a poor fit with his fellow executives” and “the disconnect between Ovitz and the Company was likely irreparable.” *Id.* at 41-42.
directors had not breached their fiduciary duties. On appeal, the Delaware Supreme Court rejected plaintiffs’ contention that the Court of Chancery had applied an incorrect definition of bad faith. 

It held that there was no substantive difference between the Court of Chancery’s 2003 definition of bad faith and its 2005 post-trial definition. Regardless, the court found that the directors had not breached their duty under either standard.

The Delaware Supreme Court in Disney also offered “some conceptual guidance to the corporate community” about the duty of good faith. The court developed three categories of fiduciary behavior that could constitute “bad faith.” The first category of “subjective bad faith” or “fiduciary conduct motivated by an actual intent to do harm” clearly subjects directors

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97 In re Walt Disney Co. Deriv. Litig., 825 A.2d 275 (Del. Ch. 2003). Plaintiffs were required to plead a breach of the duty of loyalty or good faith because Disney had an exculpation clause in its articles of incorporation.

98 Disney, 906 A.2d at 62.

99 “[A] conscious[,] and intentional[,] disregard[,] of responsibilities, adopting a ‘we don’t care about the risks’ attitude concerning a material corporate decision.” Disney, 825 A.2d at 289.

100 “[An] intentional dereliction of duty, a conscious disregard for one’s responsibilities.” In re Walt Disney Co. Deriv. Litig., 907 A.2d 693, 755 (Del. Ch. 2005).

101 Disney, 906 A.2d at 63.

102 Id. at 64.

103 Id. The categories fall on a spectrum ranging from the most nonindemnifiable conduct to the least with the exact point where nonindemnifiable becomes indemnifiable falling somewhere between Category 3 and 2.

↩ 1) Subjective Bad Faith 3) Conscious Disregard 2) Gross Negligence
to liability.\textsuperscript{104} On the other hand, the second category of conduct falls on the opposite end of the spectrum and does not subject directors to liability; it is characterized as gross negligence.\textsuperscript{105} The court explained that “grossly negligent conduct, without more, does not and cannot constitute a breach of the fiduciary duty to act in good faith.”\textsuperscript{106} The court reasoned that ruling otherwise would eliminate the distinction between the duty of care and the duty of good faith.\textsuperscript{107} The court cited both Section 102(b)(7)\textsuperscript{108} and Section 145\textsuperscript{109} of the Delaware General Corporation Law as evidence of its interpretation that a violation of the duty of care cannot automatically be a violation of the duty of good faith as well.\textsuperscript{110} The third category of fiduciary conduct falls between the first two and would include “the Chancellor's definition of bad faith-intentional

\textsuperscript{104} \textit{Id.} This category is the common sense idea of bad faith.

\textsuperscript{105} \textit{Id.} (“The second category of conduct…involves lack of due care—that is, fiduciary action taken solely by reason of gross negligence and without any malevolent intent.”).

\textsuperscript{106} \textit{Id.} at 65.

\textsuperscript{107} \textit{Id.}

\textsuperscript{108} \textsc{Del. Code Ann.} tit. 8, § 102(b)(7) (West 2012). This section permits corporations to exculpate their directors from monetary damage liability for a breach of the duty of care, but specifically excludes acts or omissions not in good faith.

\textsuperscript{109} \textsc{Del. Code Ann.} tit. 8, § 145 (West 2012). This section permits a corporation to indemnify a director 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.

\textsuperscript{110} \textit{Disney}, 906 A.2d at 65–66. The court explained that automatically making a breach of the duty of care also a breach of the duty of good faith would “nullify those legislative protections and defeat the General Assembly's intent.”
dereliction of duty, a conscious disregard for one's responsibilities.”¹¹¹ The court found that this type of conduct should be treated as “a non-exculpable, nonindemnifiable violation of the fiduciary duty to act in good faith.”¹¹² It reasoned that the duty of good faith should prohibit situations where “directors have no conflicting self-interest in a decision, yet engage in misconduct that is more culpable than simple inattention or failure to be informed of all facts material to the decision.”¹¹³ The court did not provide guidance to distinguish this category from category two (gross negligence), but merely stated that it falls somewhere between subjective bad faith and gross negligence.¹¹⁴ Ultimately, the Delaware Supreme Court upheld the lower court’s “definition as a legally appropriate, although not the exclusive, definition of fiduciary bad faith.”¹¹⁵ However, the court refused to craft a definition of good faith¹¹⁶ or to address “whether

¹¹¹ Id. at 66.

¹¹² Id.

¹¹³ Id.

¹¹⁴ Id. at 67. The court also cited examples mentioned by the Court of Chancery in support of its position: “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. There may be other examples of bad faith yet to be proven or alleged, but these three are the most salient.” Id. (citing In re Walt Disney Co. Deriv. Litig., 907 A.2d 693, 755–56 (Del. Ch. 2005)).

¹¹⁵ Id.
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.”\textsuperscript{117} Instead, it reserved those issues for a later case.\textsuperscript{118}

In the same year as the Disney decision, the Delaware Supreme Court in Stone v. Ritter attempted to answer the questions left unaddressed by Disney regarding the duty of good faith.\textsuperscript{119} In Stone, plaintiff shareholders brought a derivative suit against fifteen directors of AmSouth Bancorporation for failing in their oversight duties.\textsuperscript{120} The lower court dismissed the plaintiffs’ derivative complaint for failure to make a pre-suit demand on AmSouth’s board of directors.\textsuperscript{121} The Delaware Supreme Court affirmed the Court of Chancery’s decision that the directors had

\textsuperscript{116} Note that “bad faith” and “lack of good faith” are not the same thing. See generally infra section II.A.

\textsuperscript{117} Disney, 906 A.2d at 67 n. 112.

\textsuperscript{118} To reiterate: Category 1, Subjective Bad Faith, Nonexculpable; Category 2, Gross Negligence, Exculpable; Category 3, Intentional Dereliction of Duty/Conscious Disregard, Non Exculpable.

\textsuperscript{119} Stone v. Ritter, 911 A.2d 362 (Del. 2006).

\textsuperscript{120} Id. at 364. Plaintiffs alleged that the directors of a bank had failed to ensure that a reasonable federal Bank Secrecy Act compliance and reporting system existed. The bank “paid $40 million in fines and $10 million in civil penalties to resolve government and regulatory investigations pertaining principally to the failure by bank employees to file ‘Suspicious Activity Reports’ (‘SARs’), as required by the federal Bank Secrecy Act (‘BSA’) and various anti-money-laundering (‘AML’) regulations.” Id. at 365.

\textsuperscript{121} Id. at 364.
not breached their duty of oversight, but more importantly, the Court discussed the duty of good faith in the wake of Caremark and Disney.\footnote{Id. at 369.}

The court determined that the lack of good faith necessary for oversight liability from Caremark\footnote{Id. (quoting In re Caremark Int’l Inc. Deriv. Litig., 698 A.2d 959, 971 (Del.Ch. 1996)) (“[A] sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists....”).} was consistent with the standard in Disney.\footnote{Id. (quoting In re Walt Disney Co. Deriv. Litig., 907 A.2d 693, 755–56 (Del. Ch. 2005)) (“Where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.”).} The court then attempted to clarify exactly how the duty of good faith operates.\footnote{Id.} It explained that a lack of good faith does not automatically result in liability.\footnote{Id.} Instead, the court found that the duty to act in good faith is a “subsidiary element” or a “condition” of the duty of loyalty.\footnote{Id. at 369-70.} So in the context of oversight liability, the bad faith conduct described in Disney and Caremark actually establishes a violation of the duty of loyalty.\footnote{Id. at 370.}

The court was responding to the question left open in Disney about whether the duty of good faith could serve as an independent basis of liability, and its conclusion resulted in two

\begin{itemize}
  \item\footnote{Id. at 369.} Id. at 369.
  \item\footnote{Id. (quoting In re Caremark Int’l Inc. Deriv. Litig., 698 A.2d 959, 971 (Del.Ch. 1996)) (“[A] sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists....”).} Id. (quoting In re Caremark Int’l Inc. Deriv. Litig., 698 A.2d 959, 971 (Del.Ch. 1996)) (“[A] sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists....”).
  \item\footnote{Id. (quoting In re Walt Disney Co. Deriv. Litig., 907 A.2d 693, 755–56 (Del. Ch. 2005)) (“Where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.”).} Id. (quoting In re Walt Disney Co. Deriv. Litig., 907 A.2d 693, 755–56 (Del. Ch. 2005)) (“Where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.”).
  \item\footnote{Id. at 369-70.} Id. at 369-70.
  \item\footnote{Id. at 370.} Id. at 370.
\end{itemize}
consequences. First, the court held that the “triad” of fiduciary duties is inaccurate because “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. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly.”

Second, “the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.”

Although the court attempted to clarify fiduciary duties once and for all, it is unclear whether the decision is consistent with earlier case law. While the Disney court was careful not to conflate duties, the Stone court may have done exactly that. It concluded that “[w]here directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.”

129 Id.


131 Stone, 911 A.2d at 370.

132 Id.

133 See In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 65 (Del. 2006) (“The conduct that is the subject of due care may overlap with the conduct that comes within the rubric of good faith in a psychological sense, but from a legal standpoint those duties are and must remain quite distinct.”).

134 Stone, 911 A.2d at 370.

135 Id.
Since *Stone*, a shareholder’s derivative claim for breach of the duty of good faith rarely survives a motion to dismiss.\(^{136}\) Some courts allude to the ambiguity in the *Stone* decision but still manage to assign their set of facts to one of the bad faith categories.\(^{137}\) Other courts have addressed the line of cases from *Caremark* to *Stone* but then added their own wrinkles to the already amorphous concept of a breach of the duty of good faith.\(^{138}\) Perhaps the clearest result of


\(^{137}\) See, e.g., *Desimone*, 924 A.2d at 935 (“Some respected scholars seem to fear that *Stone* opens directors to new kinds of claims foreclosed by *Caremark*, while others read it as taking away a non-scienter based claim *Caremark* supposedly seemed to suggest. Neither position seems entirely consistent with the decision itself.”); Ryan v. Lyondell Chemical Co., C.A. No. 3176-VCN, 2008 WL 4174038, at *4 (Del. Ch. Aug. 29, 2008) (“As a result of that apparent and unexplained inaction in the face of a well-settled and well-known duty to act, the Court finds itself somewhere in the intermediate grey area of conduct identified by the Delaware Supreme Court as deserving of the ‘bad faith pejorative label.’ Whether the directors have crossed the line into a cognizable violation of the good faith component of the duty of loyalty is not clear, but, in any event, the possibility of ‘bad faith’ on this record raises questions of material fact regarding the directors' entitlement to exculpation.”).

\(^{138}\) See, e.g., *Citigroup*, 964 A.2d at 125 (Del. Ch. 2009) (quoting Wood v. Baum, 953 A.2d 136, 141 (Del. 2008)) (“More recently, the Delaware Supreme Court held that when a plaintiff seeks
this case law is the uphill battle that shareholders face in alleging a breach of the duty of good faith. A shareholder must prove there was “a sustained or systematic failure of the board to exercise oversight.”\footnote{In re Caremark Int’l Inc. Deriv. Litig., 698 A.2d 959, 971 (Del.Ch. 1996).} Additionally, he must demonstrate that the conduct was not in good faith through either an “actual intent to do harm”\footnote{In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 64 (Del. 2006).} or an “intentional dereliction of duty, a conscious disregard for one’s responsibilities.”\footnote{Id. at 66.} On top of all that, the shareholder must establish that the breach of the duty of good faith constitutes a breach of the duty of loyalty, as well.\footnote{Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).}

II. EXAMINATION OF DEFICIENCIES IN CURRENT GOOD FAITH STANDARDS

to show that demand is excused because directors face a substantial likelihood of liability where “directors are exculpated from liability except for claims based on ‘fraudulent,’ ‘illegal’ or ‘bad faith’ conduct, a plaintiff must also plead particularized facts that demonstrate that the directors acted with scienter, \textit{i.e.,} that they had ‘actual or constructive knowledge’ that their conduct was legally improper.”); McPadden v. Sidhu, 964 A.2d 1262, 1274 (Del. Ch. 2008) (“Thus, from the sphere of actions that was once classified as grossly negligent conduct that gives rise to a violation of the duty of care, the Court has carved out one specific type of conduct—the intentional dereliction of duty or the conscious disregard for one's responsibilities—and redefined it as bad faith conduct, which results in a breach of the duty of loyalty. Therefore, Delaware's current understanding of gross negligence is conduct that constitutes reckless indifference or actions that are without the bounds of reason.”).
This Part will identify the various inadequacies in Delaware’s current good faith standard. It will analyze the problems that stem from the Disney decision focusing on the contradictions in the three category approach to “bad faith.” It will also explain why the holding in Stone—that good faith is a subset of loyalty—is unpersuasive and incorrect. Finally, it will review Delaware General Corporation Law Section 102(b)(7) in the wake of Stone. Addressing the problems with Delaware’s good faith doctrine will explain why a new good faith standard is necessary to better serve the purposes of director fiduciary duties.

A. Disney’s Ambiguous and Imprecise Standard

This section will discuss three main problems in the Disney court’s analysis. First, the terminology the court used (“bad faith”) is not precise and does not mirror the statutory language (“not in good faith”). Second, the description of what constitutes exculpable conduct is too ambiguous to provide any guidance. Third, the court created two categories of conduct that are essentially the same, so its analysis is based solely on whether the bad faith conduct was intentional.

The clearest problem with Disney comes from its imprecise language when it attempted to define “bad faith” using a three category approach. The court should have attempted to define “not in good faith” instead of “bad faith.” While Delaware does not have an affirmative fiduciary duty provision in its corporate code, Section 102(b)(7) uses the language “not in good

143 Disney, 906 A.2d at 64.
145 See, e.g., Disney, 906 A.2d at 64. See supra note 103.
146 Disney, 906 A.2d at 64.
The distinction may seem trivial, but failing to act in good faith as opposed to intentionally acting in bad faith are two separate concepts.

Regardless of the distinction, the court’s three category analysis is too ambiguous to provide any guidance and does not adequately account for director conduct as it should, because only “intentional” conduct results in liability. Category two is the only category that does not result in a violation of the duty of good faith. It accounts for a simple breach of the duty of care or “grossly negligent conduct, without more.” The problem with this definition is it does not explain what would qualify as a breach of the duty of good faith instead of gross negligence. Since Delaware General Corporation Law Section 102(b)(7) exculpates directors for one but not the other, the court should provide something clearer than “without more.” This distinction determines whether a director will be held personally liable for losses suffered by a corporation as a result of his conduct, and whether shareholders will recoup some of the

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147 See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2012). This point becomes even more important for RMBCA states whose statutes mandate that directors act in good faith as opposed to refraining from acting in bad faith.

148 See, e.g., Elizabeth A. Nowicki, Not in Good Faith, 60 SMU L. REV. 441 (2007).

149 Disney, 906 A.2d at 65.

150 Id.

151 Id.

152 Id. The spectrum contains an ambiguous zone where grossly negligent conduct is bad enough to no longer be indemnifiable.

153 See, e.g., DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2012).
diminution in value of their holdings. A standard as vague as “without more” does not adequately inform directors of what conduct they should avoid; at the same time, it does not provide shareholders with a clear cause of action under which to file suit.

Additionally, the Disney three category approach really only encompasses two types of conduct because two categories overlap. Category one is the most straightforward of the three because it aligns with how bad faith is commonly understood already. The court called it “subjective bad faith” and explained that “such conduct constitutes classic, quintessential bad faith.” Although the court found this type of conduct was self-evident, it included a footnote with some additional definitions. Bad faith means “an action taken with the intent to harm” or the “conscious doing of a wrong.” Intent seems to be the underlying requirement of this category.

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154 For example, shareholders sought $250 million in Caremark and $130 million in Disney.
155 Disney, 906 A.2d at 65.
156 Id. at 64.
157 Id.
158 Id. at 64 n. 142 (“[A]n action taken with the intent to harm the corporation is a disloyal act in bad faith.”). See 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.’”) (quoting Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P., 624 A.2d 1199, 1208, n. 16 (Del.1993)).
159 McGowan, 859 A.2d at 1036.
160 Desert Equities, 624 A.2d at 1208, n. 16.
Oddly, category three—the unclear middle ground—was defined as “intentional dereliction of duty, a conscious disregard for one's responsibilities.”\(^{161}\) The court was trying to capture situations where “directors have no conflicting self-interest in a decision, yet engage in misconduct that is more culpable than simple inattention or failure to be informed of all facts.”\(^{162}\) Or put in more simple terms, category three includes conduct that is worse than a breach of the duty of care—“simple inattention”—but not as bad as a breach of the duty of loyalty—“conflicting self-interest.”\(^{163}\)

This definition fails, though, because intentional conduct is already captured as “subjective bad faith” in category one.\(^{164}\) A deliberate breach of the duty of care is no different from a “conscious doing of wrong.”\(^{165}\) The court recognized that this type of conduct should be a violation of the duty of good faith but failed to realize the overlap with category one.\(^{166}\) It even cited Section 102(b)(7) for “distinguish[ing] between ‘intentional misconduct’ and a ‘knowing violation of law’ (both examples of subjective bad faith) on the one hand, and ‘acts ... not in good faith,’ on the other.”\(^{167}\)

\(^{161}\) *Disney*, 906 A.2d at 66.

\(^{162}\) *Id.*

\(^{163}\) *Id.* This interpretation alludes to a somewhat different spectrum:

\[\leftarrow 1) \text{Breach of Loyalty} \text{---------} 3) \text{Culpable Misconduct} \text{---------} 2) \text{Breach of Care} \rightarrow\]

\(^{164}\) *Id.*

\(^{165}\) *Desert Equities*, 624 A.2d at 1208, n. 16.

\(^{166}\) *Disney*, 906 A.2d at 67. The *Disney* spectrum should look more like this:

\[\leftarrow 1) \text{Intentional Conduct} \text{-----------------------------} 2) \text{Gross Negligence} \rightarrow\]

\(^{167}\) *Disney*, 906 A.2d at 67 (citing *Del. Code Ann.* tit. 8, § 102(b)(7) (West 2012)).
What the Delaware Supreme Court should have recognized is that category one is “bad faith,” while category three is “acts or omissions not in good faith.” 168 Consider the following hypothetical:

A, B, and C are directors of different Delaware corporations. Each of their corporations is in the process of being taken over. Director A takes bribes from other companies in return for giving them confidential information that will help them in their takeover bids. Director B has another job so he entirely neglects to assist the board of directors during the takeover. Ultimately, the board does not select the highest bid, in part because Director B did not keep himself informed. Director C actively participates in his board’s takeover defenses, but makes a number of errors (despite doing his best) that cost the corporation significant amounts of money.

Which category does each director’s conduct fall into? Clearly Director A’s conduct falls into category one because he had the malevolent intent necessary to constitute “subjective bad faith.” Director C had the best intentions but his ineptitude resulted in a loss. His conduct would fall into category two as simple gross negligence. Director B’s conduct, however, could constitute bad faith or just gross negligence, depending on how a court looks at it. If Director B intended to neglect his duties or consciously disregarded them, then his conduct would be category three.

But, if Director B had the best intentions for his corporation and simply forgot to perform his duties, isn’t that the same as “gross negligence, without more?”

This Comment argues that conduct not in good faith should include exactly what Director B did. However, the Disney court really defined only two categories of conduct—gross negligence and intentional misconduct—so Director B’s conduct does not fall in a well-defined

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168 Under this interpretation, the spectrum would look like this:

←1) Intentional Bad Faith Conduct ----3) Conduct Not in Good Faith ----2) Gross Negligence →
category.\textsuperscript{169} Category three under Disney begs the question: how does a “fiduciary intentionally fail[] to act in the face of a known duty to act?”\textsuperscript{170} After Disney, the Stone court had the opportunity to clarify this and other ambiguities but instead developed its own interpretation.

B. Stone: Where Everything Goes Wrong

Stone is most notable due to its holding that the duty of good faith is not an independent source of liability but rather a subsidiary element of the duty of loyalty.\textsuperscript{171} This Comment argues that Stone’s new twist on the duty of good faith is an incorrect holding. First, this proposition was developed from a series of footnotes in lower court decisions with no Delaware Supreme Court lineage. Second, the change is overbroad and misinterprets Caremark. Third, the Stone decision—and Disney as well—failed to consider the more important distinction between the duty of care and the duty of good faith.

1. The Lack of Foundation for Good Faith as a Subset of Loyalty

The proposition that good faith is a subsidiary element had a circuitous route prior to being asserted by the court in Stone.\textsuperscript{172} However, the basis for the holding does not bear much weight when examined closely. Essentially, the foundation for the proposition comes from a confusing series of footnotes and cross-references from Chancery Court opinions.\textsuperscript{173}


\textsuperscript{170} Disney, 907 A.2d at 755–56.

\textsuperscript{171} Stone v. Ritter, 911 A.2d 362 (Del. 2006).

\textsuperscript{172} Id. at 370.

\textsuperscript{173} The following diagram attempts to clarify the development of this proposition:
The *Stone* court cited *Guttman v. Huang*, a Delaware Chancery Court decision, as evidence that the duty of good faith is a subset of the duty of loyalty.\(^{174}\) *Guttman* had cited another Chancery Court decision, *In re Gaylord Container Corp. Shareholders Litigation*, as support for that proposition.\(^{175}\) However, that so-called support came from a footnote in which the court in *Gaylord* contested that although the Delaware Supreme Court in *Cede & Co. v. Technicolor, Inc.* called a board’s fiduciary duties a “triad,” the opinion only really addresses loyalty and care.\(^{176}\) The *Gaylord* court’s basis for this assertion comes from a footnote in *Cede* where the court inserted bracketed language to a sentence from another Delaware Supreme Court opinion: “[A] board's actions must be evaluated in light of relevant circumstances to determine if they were undertaken with due diligence [care ] and good faith [loyalty ].”\(^{177}\) Somehow, the *Gaylord* court determined that because the *Cede* opinion had two lengthy sections on the duties of loyalty and care, but no comparable section on the duty of good faith, the duty of good faith

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\(^{174}\) *Stone*, 911 A.2d at 370 (quoting *Guttman v. Huang*, 823 A.2d 492, 506 n. 34 (Del. Ch. 2003)) (“[a] director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest”).

\(^{175}\) *Guttman*, 823 A.2d at 506 n. 34 (citing *In re Gaylord Container Corp. Shareholder Litigation*, 753 A.2d 462, 475 n. 41 (Del. Ch. 2000)).

\(^{176}\) *Gaylord*, 753 A.2d at 475 n. 41 (citing *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 368 n. 36 (Del. 1993)).

\(^{177}\) *Id.*
should not be a part of the triad. The Guttman court then furthered this proposition explaining that “[t]here might be situations when a director acts in subjective good faith and is yet not loyal (e.g., if the director is interested in a transaction subject to the entire fairness standard and cannot prove financial fairness), but there is no case in which a director can act in subjective bad faith towards the corporation and act loyally.”

It then suggested that the Delaware General Assembly rewrite Section 102(b)(7) “to make clear that its subparts all illustrate conduct that is disloyal.”

If the General Assembly rewrote Section 102(b)(7) as suggested, it would substantially clarify this issue. Until that time, however, Stone’s reliance on these cases is problematic. First and foremost, this analysis comes from dicta from Chancery Court opinions interpreting more dicta from a Delaware Supreme Court decision. While the court may look to whatever sources it chooses, the Stone court should have applied Disney which was a more recent Supreme Court case that took an entirely different approach. Specifically, Disney’s third category of conduct falls exactly in between the two examples cited by Guttman. It is neither subjective good faith

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178 Id.

179 Guttman, 823 A.2d at 506 n. 34 (citing Gaylord, 753 A.2d at 475 n. 41).

180 Id.


182 In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 67 (Del. 2006).

183 Disney, 906 A.2d at 67. See supra note 176.
nor bad faith but simply a lack of good faith. Disney was the most recent and most persuasive case on the issue of good faith, but the Stone court failed by not building on Disney’s foundation.

2. An Overexpansion of Caremark

The Stone court’s explanation of good faith as a subsidiary element of the duty of loyalty is also overbroad and misinterprets Caremark.184 The Caremark court held that “only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.”185 The Stone court then interpreted that explanation to mean that a breach of the duty of good faith cannot independently establish liability, but failing to act in good faith could establish a breach of the duty of loyalty.186

This is wrong for two reasons. First, Caremark, Disney, and Stone dealt specifically with oversight liability. Stone, however, extended its holding to include all breaches of the duty of good faith, in any context in addition to oversight.187 It arbitrarily concluded that the duty of loyalty includes both financial self-interest and failure to act in good faith.188 However, a failure to act in good faith does not automatically breach the duty of loyalty and establish liability. The court merely stated it “may do so.”189 This Comment argues that the duty of good faith is meant to be a catchall for director behavior that is wrong but does not fit into the duty of loyalty or the

186 Stone, 911 A.2d at 370.
187 Id.
188 Id.
189 Id. (emphasis added).
duty of care. For example, if a director breaks the law or bribes an official to further the interests of his corporation, is he being disloyal? This conduct is a breach of the duty of good faith completely separate from the duty of loyalty and outside the scope of oversight liability.\(^{190}\)

Second, the language used by Caremark may not have been the most precise,\(^{191}\) but it did not stand for the proposition that Stone developed.\(^{192}\) Lack of good faith is a “necessary condition” for liability not because of the need to establish a breach of the duty of loyalty, but rather because liability requires causation and harm.\(^{193}\) What Caremark really meant was, even if lack of good faith is present, the corporation would still have to have suffered a harm directly attributable to the lack of good faith.\(^{194}\) A board of directors can utterly fail to implement a

\(^{190}\) Section 102(b)(7) even includes this type of conduct in the good faith section: “(ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law.” Del. Code Ann. tit. 8, § 102(b)(7) (West 2012).

\(^{191}\) In re Caremark Int’l Inc. Deriv. Litig., 698 A.2d 959, 971 (Del.Ch. 1996) (“only a sustained or systematic failure of the board to exercise oversight-such as an utter failure to attempt to assure a reasonable information and reporting system exists-will establish the lack of good faith that is a necessary condition to liability”).

\(^{192}\) Stone, 911 A.2d at 370.

\(^{193}\) Caremark, 698 A.2d at 970 n.27 (“Any action seeking recovery for losses would logically entail a judicial determination of proximate cause, since, for reasons that I take to be obvious, it could never be assumed that an adequate information system would be a system that would prevent all losses.”) (emphasis added).

\(^{194}\) Id. at 971.
reporting system but if the corporation does not lose any money or violate a law, then liability has not been established.

Furthermore, Stone seems to have ignored completely the next sentence in the Caremark opinion: “Such a test of liability-lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight-is quite high.”\textsuperscript{195} That statement suggests lack of good faith can establish liability on its own. So if lack of good faith can serve as a “test of liability”\textsuperscript{196} as the Caremark court explained, then the holding in Stone that good faith is not an independent source of liability would have overturned Caremark. However, the Stone court repeatedly stated that its holding was consistent with Caremark.\textsuperscript{197} It seems the Stone court simply chose particular phrases from the Caremark opinion to craft an entirely new doctrine.

3. Asking the Wrong Question

Both Disney and Stone failed to adequately address a more vital question in the good faith analysis: when does a breach of the duty of care become a breach of the duty of good faith? Delaware General Corporation Law Section 102(b)(7) allows exculpation for a breach of the duty of care, but specifically forbids it for a breach of the duties of loyalty or good faith.\textsuperscript{198} Thus, it seems intuitive that the important analysis would be in the difference between what conduct is exculpable (duty of care) and what conduct is nonexculpable (duties of good faith and loyalty).

\textsuperscript{195} Id. (emphasis added).

\textsuperscript{196} Id.

\textsuperscript{197} Stone, 911 A.2d at 365, 369.

\textsuperscript{198} DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2012).
The *Disney* court tried to clarify this dividing line between exculpable and nonexculpable conduct by creating a categorical approach.\(^{199}\) That standard is ambiguous, though, with intent serving as the deciding factor between a breach of the duty of care or good faith.\(^{200}\) This intent-based interpretation is wrong and the court in *Stone* did little to clarify it. Instead, the *Stone* court muddled the issue further by focusing on the interaction between good faith and loyalty.\(^{201}\)

C. *Section 102(b)(7): What did Delaware Intend?*

*Stone*’s holding that good faith is a subset of loyalty also created a gray area regarding what conduct the Delaware Supreme Court intends to be exculpable.\(^{202}\) Section 102(b)(7) of Delaware’s corporate code expressly limits the exculpation of directors for two distinct reasons: “(i) For any breach of the director’s duty of loyalty” and “(ii) for acts or omissions not in good faith.”\(^{203}\) In light of *Stone*, there are two outcomes to a Section 102(b)(7) analysis that are equally problematic.\(^{204}\)

First, did the Delaware legislature intend that there is conduct which is not in good faith but does not constitute a breach of the duty of loyalty? A simple reading of the statute suggests that this is exactly what the legislature meant. Before 2006, Delaware courts held that conduct

\(^{199}\) In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 65 (Del. 2006). *See supra* note 152.

\(^{200}\) *Disney*, 906 A.2d at 65.

\(^{201}\) *Stone*, 911 A.2d at 370. *See supra* section I.D.2.

\(^{202}\) *Stone*, 911 A.2d at 369-70.

\(^{203}\) DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2012).

\(^{204}\) Note that the *Disney* court specifically analyzed the statutory language of Section 102(b)(7) to ensure its holding did not contradict the legislative intent, whereas the *Stone* court seems to have ignored it. *See supra* note 110 and accompanying text.
not in good faith was separate from the duty of loyalty, and a breach of the duty of loyalty required director self-interest.\(^\text{205}\) It would seem that a director could act not in good faith without acting for his own self-interest.\(^\text{206}\) However, Stone holds that acts or omissions not in good faith are not an independent basis for liability.\(^\text{207}\) So under that interpretation, Section 102(b)(7) forbids exculpation of director liability for conduct that the Delaware Supreme Court says does not even result in liability.\(^\text{208}\) The Delaware legislature most likely did not intend for a portion of the statute to be ineffective.\(^\text{209}\)

Second, if the first interpretation is incorrect, did the Delaware legislature intend that all conduct not in good faith establishes a breach of the duty of loyalty? Stone stands for the proposition that “the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.”\(^\text{210}\) This interpretation of the statute causes redundancy because a breach of the duty of loyalty would already include any conduct not in good faith. Under this analysis, a breach of the duty of good faith would still be non-exculpable though, which is the ultimate purpose of the statute. Stone, however, limited its holding by stating that “failure to act in good

\(^{205}\) See, e.g., Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361-36 (Del. 1993).

\(^{206}\) For example, a director could push for a merger at a lower price because it benefits a friend of his. This would not be in his own best interests (because it does not benefit him, and he could be fired), but it still would not be in good faith.

\(^{207}\) Stone, 911 A.2d at 369-70.

\(^{208}\) Id.


\(^{210}\) Stone, 911 A.2d at 370.
faith may result in liability.” 211 This qualifying language once again raises the question: what happens to conduct not in good faith that doesn’t rise to the level of liability as a breach of the duty of loyalty?

III. PROPOSAL FOR A NEW GOOD FAITH STANDARD

This Part will propose a combination of Delaware and the RMBCA’s approach to the duty of good faith. First, it will suggest that Delaware should adopt as binding the RMBCA’s provision on standards of conduct for directors including its definition of good faith. 212 Second, it will argue that Delaware’s exculpation statute fits better with the ultimate goals of fiduciary duties. 213 Third, it will analyze how these combined provisions will form a more comprehensive good faith standard.

A. The RMBCA’s Good Faith Definition

A simple solution to Delaware’s ambiguous good faith standard would be for the legislature to pass or adopt a definitional provision. Currently, the Delaware General Corporation Law sets forth only that “[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors.” 214 The RMBCA contains virtually the same provision as the Delaware General Corporation Law, but the RMBCA supplements the provision with its “Standards of Conduct for Directors.” 215

211 Id. at 369-70 (emphasis added).

212 RMBCA § 8.30 (2007).

213 DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2012).

214 DEL. CODE ANN. tit. 8, § 141(a) (West 2012)

215 RMBCA § 8.30 (2007). The comments to Section 8.30 explain that “Section 8.30 should be read in light of the basic role of directors set forth in Section 8.01(b), which provides that the
Section 8.30—the “Standards of Conduct for Directors”—outlines three distinct duties—loyalty, good faith, and care—as opposed to the two explained in the Stone decision.\(^{216}\) By adopting this fiduciary duty provision, Delaware would clarify the inconsistencies in its case law.

The RMBCA mandates that directors shall act “in good faith,” “in a manner the director reasonably believes to be in the best interests of the corporation,” and “with the care that a person in a like position would reasonably believe appropriate under similar circumstances.”\(^{217}\) If Delaware adopted RMBCA Section 8.30, it would overrule Stone since the duty of good faith could not be a subset of the duty of loyalty based on the text of Section 8.30.\(^{218}\)

Adopting Section 8.30 would also provide more direction for Delaware courts, as it contains comments that further describe the definition of good faith.\(^{219}\) The comments to Section 8.30 state that good faith and loyalty are “peremptory” and “govern[] all aspects of directors’ duties.”\(^{220}\) Also, the duties “do not necessarily compartmentalize and, in fact, tend to overlap.”\(^{221}\) These guidelines suggest that the duty of good faith serves as an independent basis of liability, and also that director conduct does not need to be classified neatly into one category or another.

Disney theorized a schism between an exculpable breach of the duty of care and a nonexculpable

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\(^{216}\) RMBCA § 8.30 (2007).

\(^{217}\) Id.


\(^{219}\) Official Comment to RMBCA § 8.30 (2007).

\(^{220}\) Id.

\(^{221}\) Id.
breach of the duty of good faith.\textsuperscript{222} The RMBCA, however, finds that conduct breaching one duty may also breach the duty of good faith or at least “give rise to an inference of bad faith.”\textsuperscript{223} RMBCA Section 8.30 would not overrule \textit{Disney} because a breach of the duty of care would not automatically constitute a breach of the duty of good faith as the \textit{Disney} court feared.\textsuperscript{224} The RMBCA merely recognizes that a breach of one duty may constitute a breach of another.\textsuperscript{225}

Additionally, if Delaware adopted the RMBCA provision on fiduciary duties, it would aid courts in determining whether a director breached the duty of good faith because the RMBCA provides guidance regarding what constitutes a “reasonable belief.”\textsuperscript{226} Although this phrase is applied to the duty of loyalty, the RMBCA’s interpretation could be useful to courts in good faith analysis as well.\textsuperscript{227} The inquiry requires both a subjective look at what a particular director actually believes and an objective look at whether that belief is reasonable.\textsuperscript{228} This two-prong approach is helpful for deciphering \textit{Disney}’s “gross negligence, without more” standard.\textsuperscript{229} Instead of attempting to read directors’ minds to establish intent or conscious disregard, courts

\begin{thebibliography}{99}
\bibitem{222} \textit{In re Walt Disney Co. Deriv. Litig.}, 906 A.2d 27, 66 (Del. 2006).
\bibitem{223} Official Comment to RMBCA § 8.31 (2007).
\bibitem{224} \textit{Disney}, 906 A.2d at 65.
\bibitem{225} Official Comment to RMBCA § 8.30 (2007).
\bibitem{226} \textit{Id.}
\bibitem{227} \textit{Id.}
\bibitem{228} \textit{Id.}
\bibitem{229} \textit{Disney}, 906 A.2d at 65.
\end{thebibliography}
can assess whether “a reasonable person in a like position and acting in similar circumstances [could] have arrived at that belief.”\(^\text{230}\)

This determination does not override the business judgment rule because it asks “could” rather than “would.”\(^\text{231}\) A judge need not decide whether a decision was correct after the fact. Instead, the judge must decide whether it was reasonable that the director believed his decision to be correct. Essentially this is what should separate a breach of the duty of care from a breach of the duty of good faith. Consider the following example:

Director A thoroughly prepares himself for the potential takeover of his corporation. He pores over everything he thinks is relevant before settling on a share price of $10. After the takeover, the shareholders discover that the actual share price should have been $15. The difference arose either from a miscalculation by Director A or from him undervaluing certain assets.

Director B’s corporation is also being taken over. Director B does not look over anything except for a balance sheet. He is a CPA and has an MBA so he is confident that he knows enough to set the share price at $10 per share. After the takeover, the shareholders discover that the share price should have been $15 because Director B did not adequately prepare himself.

Clearly both Director A and B breached their duty of care. Under current Delaware law (Disney), if there was an exculpation clause, neither would face personal financial liability because there was not a “conscious disregard.”\(^\text{232}\) This is unacceptable because although Director B did not intentionally shirk his responsibility, his conduct clearly seems more culpable than Director A’s.

Delaware’s adoption of RMBCA Section 8.30 would result in a different outcome in the above hypothetical for two reasons. First, fiduciary duties may overlap so a breach of the duty of care could also be a breach of the duty of good faith. Second, Director B’s conduct does not pass

\(^{230}\) Official Comment to RMBCA § 8.30 (2007).

\(^{231}\) Id.

\(^{232}\) Disney, 907 A.2d at 755.
the objective reasonability test. Both Director A and Director B made subjectively reasonable decisions because they each felt they were adequately prepared. Director A’s decision was also objectively reasonable because another director could have arrived at his belief, albeit by making the same mistakes. Thus, Director A would only be guilty of a breach of the duty of care. However, a reasonable person would not have arrived at Director B’s belief. Even someone as qualified as Director B would not reasonably reach the conclusion that he was adequately prepared. This is why the RMBCA would correctly determine that Director B is guilty of both a breach of the duty of care and the duty of good faith. As long as the duty of good faith has been breached—even in conjunction with the breach of another duty—then exculpation would specifically be forbidden under Section 102(b)(7) of the Delaware General Corporation Law.²³³

B. Delaware’s Exculpation Provision

While Section 8.30 of the RMBCA is a solid starting point for a good faith standard, modern corporate codes still need a provision permitting exculpation of directors for certain types of conduct.²³⁴ These statutes must strike a balance between the interests of shareholders and the interests of directors. On one hand, shareholders want assurance that the directors they have appointed will actually do their jobs. On the other hand, directors want the freedom to make decisions and perform their duties without fear of personal, financial repercussions. This

²³³ Del. Code Ann. tit. 8, § 102(b)(7) (West 2012) (“such provision shall not eliminate or limit the liability of a director… for acts or omissions not in good faith”).

²³⁴ See Sharfman, supra note 2.
Comment proposes that Delaware should keep its current exculpation statute because it strikes a better balance than the RMBCA’s exculpation provision.\(^{235}\)

Delaware should maintain its exculpation statute and not adopt the RMBCA’s exculpation provision because the RMBCA provision is too inclusive. Delaware limits exculpation of directors to breaches of the duty of care,\(^{236}\) whereas the RMBCA has only a few exceptions that do not qualify for exculpation in its provision.\(^{237}\) RMBCA directors are free from liability so long as they do not receive a financial benefit to which they are not entitled, intentionally inflict harm on the corporation or shareholders, make unlawful distributions, or intentionally violate criminal law.\(^{238}\) Shareholders of RMBCA corporations must first establish that director conduct falls into one of those exceptions (and does not fit into any other safe harbor provision) before a court will consider a personal liability claim for a breach of the duty of good faith or loyalty.\(^{239}\) So after developing one of the most comprehensive fiduciary duty

\(^{235}\) See Del. Code Ann. tit. 8, § 102(b)(7) (West 2012); RMBCA § 2.02(b)(4) (2007); RMBCA § 8.31 (2007).


\(^{237}\) RMBCA § 2.02(b)(4) (2007).

\(^{238}\) Id.

\(^{239}\) RMBCA § 8.31 (2007). “If a provision in the corporation’s articles of incorporation (adopted pursuant to Section 2.02(b)(4)) shelters the director from liability for money damages…and such defense applies to all claims in plaintiff’s complaint, there is no need to consider further the application Section 8.31’s standards of liability.” Official Comment to RMBCA § 8.31 (2007).
provisions in corporate law, the RMBCA negated its impact through an overbroad exculpation statute.\textsuperscript{240}

Section 102(b)(7) of the Delaware General Corporation Law does not allow directors to escape personal liability for many types of conduct that are not covered by the RMBCA. For example, self-dealing in which an associate or an acquaintance of a director receives a financial benefit would not meet the requirements of the first exception to RMBCA Section 2.02(b)(4),\textsuperscript{241} but is a perfect example of a nonexculpable breach of the duty of loyalty in Delaware.\textsuperscript{242} Similarly, a grossly negligent, though unintentional, infliction of harm on the corporation or an inadvertent violation of criminal law would not fall into a nonexculpable exception under the RMBCA.\textsuperscript{243} While the intentions of Section 2.02(b)(4) are admirable, Section 102(b)(7) of the Delaware General Corporation Law better achieves them without overprotecting directors and underserving shareholders.\textsuperscript{244}


\textsuperscript{241} RMBCA § 2.02(b)(4)(A) (2007).


\textsuperscript{243} RMBCA § 2.02(b)(4)(B) and (D) (2007).

\textsuperscript{244} See Official Comment to RMBCA § 2.02 (2007) (explaining that exculpation statutes are necessary so that “directors would not be discouraged from fully and freely carrying out their duties” and also to curb the “reluctance of qualified individuals to serve as directors.”)
Delaware’s exculpation statute aligns with the RMBCA in forbidding exculpation for unlawful distributions and in cases in which a director receives an improper personal benefit. However, Delaware also recognizes that under no circumstances should a director be disloyal to his corporation or its stockholders, regardless of whether he benefits financially. Additionally, the mandate against “acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law” serves as somewhat of a catchall that is much more expansive than the RMBCA Section 2.02(b)(4). Certain director conduct is unacceptable whether it is intentional or unintentional, and shareholders deserve some assurance that directors will be careful not to commit these acts. If they do, shareholders should have some opportunity to recoup the corporation’s losses caused by the action.

C. Comprehensive Good Faith Standard

Section 102(b)(7) of the Delaware General Corporation Law remains the majority standard for exculpation statutes, as only twelve states have adopted RMBCA Section 2.02(b)(4). However, most states also have enacted the RMBCA’s provision—or a substantially similar one—on fiduciary duties. Many state legislatures have apparently

245 See Del. Code Ann. tit. 8, § 102(b)(7)(iii) and (iv) (West 2012).

246 See Del. Code Ann. tit. 8, § 102(b)(7)(i) (West 2012); see also Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (“There is no ‘safe harbor’ for such divided loyalties in Delaware. When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.”).


248 See Honabach, supra note 240.

249 See supra section II.C.3.
determined that a combination of the two provisions better meets the goals of corporate law. Coupling RMBCA Section 8.30 with Delaware’s exculpation statute solves the problems presented in Disney, Stone, and prior Delaware case law.

No matter what standard is implemented, courts will always have to analyze the facts and circumstances in a specific situation and make a decision on a case-by-case basis. This process becomes much easier with the guidelines presented in RMBCA Section 8.30. Courts can begin their analysis of the duty of good faith with certain factors in mind.

First, the duty of good faith is an independent source of liability and stands alongside the duties of care and loyalty. Second, the duty of good faith is an affirmative charge so both bad faith and lack of good faith constitute a breach. Third, the line between the duty of care and the duty of good faith has some clear guidelines. Instead of using a test of intent or “gross negligence, without more,” courts can apply reasonableness standards developed by the RMBCA.

CONCLUSION

This Comment argues that Delaware’s current good faith standard for directors of corporations does not adequately protect shareholders from director impropriety. The Delaware Supreme Court has essentially eliminated good faith as an exception to director exculpation, and

250 See, e.g., CAL. CORP. CODE § 204(a)(10) and 309 (West 2012); CONN. GEN. STAT. § 33-636(b)(4) and 33-756(a) (2012); N.Y. BUS. CORP. LAW § 402(b) and 717(a) (McKinney 2012).

251 RMBCA § 8.30 (2007).

252 “Each member of the board of directors…shall act: (1) in good faith.” RMBCA § 8.30 (2007).

253 In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 65 (Del. 2006).

254 See Official Comment to RMBCA § 8.30 (2007).
in the process, has made it virtually impossible for a shareholder to succeed on a claim against a director for a violation of the duty of good faith. Without this good faith exception, directors can only be held liable for self-interested conduct that constitutes a breach of the duty of loyalty. As this Comment pointed out, there are several examples of director conduct that are not self-interested but nonetheless do not deserve exculpation.

Delaware’s current two duty standard under Stone is the product of misinterpretation of past case law. It overprotects directors for conduct that should be eliminated. It ignores the plain meaning of Delaware’s exculpation statute that conduct not in good faith is separate from the duty of loyalty, and it employs ambiguous language that courts continue to interpret differently.

In light of the problems with Delaware’s good faith standard, this Comment proposes a solution: Delaware should supplement its corporate code by adopting as binding the RMBCA’s provision on fiduciary duties. The RMBCA’s guidance on the duty of good faith would help Delaware courts better determine what director conduct is exculpable. When analyzing Section 102(b)(7), courts can employ a reasonability assessment instead of relying solely on director intent as the defining characteristic between a breach of the duty of care and a breach of the duty of good faith.

Most importantly, shareholders need some means of recouping losses due to improper director conduct that does not qualify as a breach of the duty of loyalty. A more robust provision on fiduciary duties coupled with Delaware’s exculpation statute achieves that goal.