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Business Strategists and Election Commissioners: How the Meaning of Loyalty Varies with the Board’s Distinct Fiduciary Roles

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Business Strategists and Election Commissioners: How the Meaning of Loyalty Varies with the Board’s Distinct Fiduciary Roles

Ethan G. Stone*

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I. INTRODUCTION

For the last 20 years, the Delaware courts have been developing special doctrines to review board decisions in the context of hostile bids for corporate control and other contested corporate elections. In the *Unocal* line of cases, courts refuse to extend to board decisions defending against hostile bids the deferential treatment they accord to normal board decisions, but also do not subject them to the intense scrutiny they give to suspect decisions. In the *Blasius* line of cases, courts are willing to invalidate decisions that shareholders prove the board took for the purpose of interfering with their voting rights, even if the court is convinced that the board acted in the careful and good faith pursuit of a valid corporate purpose.

These doctrines are troublesome. I will discuss the problems they raise in detail below, but it is worth sketching them out here. Both *Unocal* and *Blasius* seem to fit uneasily with academic theories of the board’s role in corporate governance. They leave the board too much power over shareholder choice to fit well with theories that describe the board’s role as serving the shareholders’ interests. They put too many restraints on the board’s power to fit well with theories that describe the board as an independent decision maker, valuable specifically because it is not directly accountable to the shareholders or any other corporate constituency. Likewise, the Delaware courts have never succeeded in fitting *Unocal* and *Blasius* comfortably with their treatment of board decisions in other contexts. *Unocal* purports to deal with a conflict of interest, but does not require evidence of a conflict that would bring liability in other contexts and is largely irrelevant if such a conflict is present. *Blasius* turns on proof that the board acted with improper motives, but paradoxically has its main application where the board seems to be acting in good faith pursuit of corporate interests.

Where we see a paradox, we are usually overlooking some aspect of the situation. Once the facts are rephrased to include the missing elements, the seeming contradiction often disappears. My purpose in this Article is to point out an overlooked element that explains the seeming contradictions of *Unocal* and *Blasius*. That element is the difference between two functions of the board of directors, which I term its “operating power” and its “coordinating power.” The board’s operating power is its familiar power to manage the operations of the corporate enterprise. The board’s coordinating power, which is at issue in the *Unocal* and *Blasius* cases, is its power to manage collective actions by the shareholders.

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The significance of making this distinction between two functions of the board is that the nature of the board’s duties follows the nature of the tasks it is performing. Fiduciary duty means, in essence, dedication to some purpose other than the fiduciary’s self-interest. It follows that any change in that ultimate purpose changes the specific meaning of the fiduciary’s duties. Managing a business enterprise in the interest of its nominal owner-manager (the corporate entity) is not the same as managing collective shareholder actions in the interests of the shareholders. The differences have important implications for the legal and equitable regulation of the board’s discretion.

Most importantly, the distinction between the board’s operating and coordinating powers explains the development of the *Blasius* and *Unocal* doctrines. Viewed this way, *Blasius* and *Unocal* cease to be confusing and unnecessarily duplicative standards of review. Instead, they are simply manifestations, in the context of coordinating power, of the familiar standards applicable to the board’s operating power. If proof of a subjective motive other than the interests of the corporate entity makes out a claim for bad faith in the operating context, proof of a subjective motive other than effectuation of a shareholder decision makes out a claim for bad faith in the coordinating context. If proof of a material direct or indirect personal interest establishes a rebuttable presumption of disloyalty in the operating context, proof that the board has taken action to pursue a favored outcome (rather than facilitating a shareholder decision) in the collective action context establishes a similar presumption.

While the distinct practical qualities of the board’s coordinating power have driven the development of these distinct standards for reviewing board decisions, a failure to recognize this driving factor has brought widespread confusion and controversy. Courts and commentators alike have struggled with *Blasius* and *Unocal* because they have tried to cast coordinating decisions as more familiar operating decisions. They have not seen that if the purpose of a board’s power is to effectuate a decision by collective shareholder action, it follows that the prototypical abuse of that power is to force the outcome of that shareholder action.

The distinction between the board’s different powers also helps to explain the different tolerance for fixed rules constraining board discretion in different areas of corporate law. Fixed rules of decision are anathema to efficient operating discretion. With respect to the coordination of collective shareholder action, however, they are both more feasible and often necessary. Accordingly, the differences between operating and coordinating power help to explain the relative tolerance for such rules in Delaware’s statute. These differences also explain the Delaware courts’ preference for voting over collective selling as a mechanism for accomplishing contests for corporate control. Where the board of directors has express statutory authority to manage the process and its discretion is constrained by express statutory rules, courts do not have to decide every issue on the basis of ad hoc application of fiduciary principles. Finally, recognizing these differences points the way to a clearer debate over proposals for reform.

My discussion will proceed as follows. Part II discusses the understanding of two matters that underlie the rest of my argument. These are the duties of good faith and loyalty and the role of shareholder collective action in the default corporate governance scheme. Part III lays out the problems that takeover law poses for the various sides in the dispute over shareholder primacy and the contradictions in the case law. Part IV introduces the concepts of operating and coordinating power and analyzes the principal
similarities and differences between them. Part V analyzes the problems discussed in Part III through the prism of operating and coordinating power. Part VI discusses some further manifestations of the distinction in the Delaware Code’s and courts’ treatment of the power to set the agenda for shareholder action and shareholder access to information. Part VII concludes.

II. FOUNDATIONAL UNDERSTANDINGS

To provide context for the ensuing discussion, it is worth briefly discussing two matters that are not themselves the subject of my argument in this Article. The first is the duties of good faith and loyalty and the relationship between them. The second is the role of shareholder collective action in the corporate governance scheme. Both of these are topics of considerable uncertainty in the law and controversy among scholars. That uncertainty and controversy is beyond the scope of my argument. My understanding of these topics, however, is fundamental to my argument. Accordingly, for the sake of clarity, this section lays out that understanding and its importance for the rest of the Article. Subsection A discusses good faith and loyalty. Subsection B discusses the governance role of shareholder collective action.

A. Good Faith and Loyalty

This Article largely concerns the ways in which good faith and loyalty take on different practical meanings as the nature of the fiduciary’s task changes. Accordingly, it is important first to describe what I mean by good faith and loyalty. Professor Sale has defined the fiduciary’s duty to act in good faith as a rule “requiring fiduciary compliance in its own right and encouraging fiduciary parties to comply with their obligations.”3 In other words, it is the duty to use fiduciary powers in honest and active pursuit of the purposes for which they were conferred. It is in this sense that I will use the term “good faith.” Put negatively, Professor Sale notes that fiduciaries breach their obligation of good faith if they act with “deliberate indifference to their tasks or intentional subversion of their duties.”4 It is in this sense that I will use the term “bad faith.”5

These definitions of “good faith” and “bad faith” are important to my analysis. My purpose here is to show that the practical meaning of fiduciary duty changes as the purpose for conferring fiduciary power changes. Good faith is at the center of this argument. As the nature of a fiduciary’s obligations vary, the most obvious change is in the meaning of a duty requiring an honest effort to fulfill those obligations. Asking fiduciaries to make honest decisions in managing the corporation’s business operations is different from asking them honestly to facilitate the process by which shareholders make decisions. As I will show, this difference in purpose leads to differences in the doctrines courts use to review the board’s fidelity in making decisions. What unites these doctrines,

4. Id. at 484.
5. It could be argued that only intentional subversion of duty should be described as “bad faith.” Where fiduciaries do not intend to act contrary to their duties, but are merely indifferent to their duties, it might be more accurate to say that their actions “lack good faith.” The difference is between acting for an improper motive and acting without a proper one. This distinction is not important to my argument. For the sake of convenience, I will therefore refer to both states of mind as “bad faith.”
however, is the underlying concept of good faith—that fiduciaries owe a duty to use their powers honestly to advance the purposes for which those powers are conferred.

There has been controversy of late over whether corporate boards owe a separate duty of good faith or whether good faith is merely an aspect of the duty of loyalty.6 Because the duty of loyalty and its relationship to good faith are important to my argument below, I will discuss my understanding of them here.

When courts and scholars talk about the duty of loyalty, they are generally referring to the various rules under which fiduciaries face liability for decisions made under a conflict of interest.7 Self-dealing and competition as to the subject matter of the fiduciary’s powers are the prime examples. For instance, if the board of directors causes the corporation to enter into a transaction in which a majority of directors have material personal interests, their decision is presumed a breach of duty, absent certain cleansing procedures or proof of fairness.8 Likewise, a director who takes for himself a corporate business opportunity (i.e., competes with the corporation within the scope of its business) is presumed to have breached his duty of loyalty.9

As Professor Sale has pointed out, the duty of loyalty and the duty of good faith, in the common usage of those terms, are distinct. A fiduciary can act in bad faith even if she does not face a conflict of interest of the kind that would implicate the duty of loyalty.10


The court seems, however, to have carefully avoided deciding whether good faith is a separate fiduciary duty. In reciting the bases for rebutting the business judgment rule, the court stated that its “presumptions can be rebutted if the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith.” Id. at *15. Likewise, the court expressly refused to decide “whether the fiduciary duty to act in good faith is a duty that, like the duties of care and loyalty, can serve as an independent basis for imposing liability.” Id. at *27 n.112. Presumably, the court is reserving these issues for the pending appeal of In re Emerging Commc’ns, Inc. S’holders Litig., Civ. A. No. 14641, 2004 WL 1305745 (Del. Ch. June 4, 2004).

7. See, e.g., Malpiede v. Townsend, 780 A.2d 1075, 1083-85 (Del. 2001) (describing the conflict of interest claim as “[t]he Duty of Loyalty Claim”); Sale, supra note 3, at 483 (“The duty of loyalty requires that officers and directors act in the best interests of the corporation and prioritize its interests over their own. The cases examining it usually focus on conflicts of interest.”).


9. See, e.g., Guth v. Loft, 5 A.2d 503 (Del. 1939). See also RESTATEMENT (SECOND) OF AGENCY § 393 (1958). As with self-dealing transactions, disinterested approval lifts the presumption of breach. See Broz v. Cellular Info. Sys., Inc., 673 A.2d 148, 157 (Del. 1996) (“[P]resenting the opportunity to the board creates a kind of ‘safe harbor’ for the director, which removes the specter of a post hoc judicial determination that the director or officer has improperly usurped a corporate opportunity.”).

10. As the Delaware Supreme Court recently explained:

[T]he universe of fiduciary misconduct is not limited to either disloyalty in the classic sense (i.e., preferring the adverse self-interest of the fiduciary or of a related person to the interest of the corporation) or gross negligence. Cases have arisen where corporate directors have no conflicting
It is important to my argument here, however, to understand the close relationship between the causes of action for breach of the duty of loyalty and breach of the duty of good faith.

Fiduciaries are persons who hold powers subject to a duty to conform their use of those powers to the interests of some other person, task, or goal. Accordingly, the basic duty of a fiduciary, whether it is stated as loyalty or good faith, is to use her powers to advance the interest of that person or to accomplish that task or goal. The Restatement (Second) of Agency calls this core duty the "duty of loyalty."\(^{11}\) The Restatement defines it as the duty "to act solely for the benefit of the principal in all matters connected with his agency."\(^{12}\) Although this is sometimes taken to mean only that the agent must subordinate her own interests, the duty is broader than that. A principal who can establish the agent’s subjective intent to act for some other purpose, "be it venal, familial, collegial, or nihilistic," states a cause of action for breach of fiduciary duty.\(^{13}\) A principal who can establish that the agent made no effort to pursue the principal’s interests also establishes a breach of this fundamental duty.\(^{14}\) Viewed this way, the core duty of loyalty is exactly the same as what was described above as "good faith." Professor Sale recognizes that loyalty is sometimes used in this way, but properly concentrates on the more common usage in arguing that good faith is legally distinct.\(^{15}\)

My reason for equating "good faith" with the core fiduciary duty of loyalty is to emphasize that the liability rules commonly called the duty of loyalty are evidentiary shortcuts to proving violations of this basic duty. It is very difficult to prove that a fiduciary acted for an improper purpose. Courts have, accordingly, identified objective conflicts of interest that cast enough doubt on a fiduciary’s motives to establish a “per se” case for breach without any need to convince the judge of the fiduciary’s actual state of 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. To protect the interests of the corporation and its shareholders, fiduciary conduct of this kind, which does not involve disloyalty (as traditionally defined) but is qualitatively more culpable than gross negligence, should be proscribed. A vehicle is needed to address such violations doctrinally, and that doctrinal vehicle is the duty to act in good faith.

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\(^{11}\) Restatement (Second) of Agency § 387 (1958).

\(^{12}\) Id.

\(^{13}\) Guttmann v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003). It is in this sense that I take Vice Chancellor Strine’s comment that “[b]y definition, a director cannot simultaneously act in bad faith and loyalty towards the corporation and its stockholders.” Nagy v. Bistricer, 770 A.2d 43, 48 n.2 (Del. Ch. 2000).

\(^{14}\) See Disney, 2006 WL 1562466, at *23-27 (affirming Chancery Court holding that an “intentional dereliction of duty, a conscious disregard for one’s responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith”); Sale, supra note 3, at 484 (“[D]eliberate indifference to their tasks or intentional subversion of their duties will relegate fiduciaries to the realm of bad faith.”).

\(^{15}\) See id. at 486 n.237 (“If it is a loyalty claim at all, it is so only in the sense that one who fails to do his duty or reasonably attempt to fulfill it is acting disloyally, even if not, for example, in the conflicted manner on which Delaware case law has generally focused. This type of loyalty claim is rarely explored in Delaware, perhaps because of the conflict oriented business judgment rule approach.”). Justice Jacobs apparently meant to highlight this distinction in describing bad faith as encompassing fiduciary misconduct “which does not involve disloyalty (as traditionally defined).” Disney, 2006 WL 1562466, at *26 (emphasis added).
mind. It is these easy cases for disloyalty that have come to define the duty itself.

This structure is clearly evident in the Restatement (Second) of Agency. Chapter 13, Title C, which describes “Duties of Loyalty,” begins with a statement of the “General Principle” quoted above. Title C does not end with this general principle, however. It continues with a series of rules that establish liability based on objective conflicts of interest, without evidence of the agent’s actual subjective motive. An official comment to the general principle notes that these additional rules are “applications of the rule stated in this Section.”

It is in this way that the duty of good faith can be said to be part of the general duty of loyalty. The conflict of interest rules commonly termed the duty of loyalty are a subset of the more general duty, commonly called good faith. It is presumably not this connection between loyalty and good faith to which Professor Sale objects when she argues that it is and should be possible to establish a breach of the duty of good faith in the absence of a conflict of interest. Rather, by pointing out that loyalty cases are only a subset of the larger body of good faith cases, Sale illustrates why there is a duty of good faith separate and apart from loyalty.

Likewise, this understanding of the conflict of interest rules answers the occasional complaint that “[c]ontrary to much popular usage, having a ‘conflict of interest’ is not something one is ‘guilty of’; it is simply a state of affairs.” It is true that a conflict of interest does not, in and of itself, establish that the conflicted fiduciary acted other than in the honest pursuit of the proper interests. Thus, proving a conflict of interest does not prove violation of the Restatement’s general principle of loyalty. It is not true, however, that a fiduciary cannot be “guilty,” in the liability sense, of a conflict. To the contrary, fiduciaries are most commonly held liable for fiduciary breach on exactly that basis.

There are good reasons for such evidentiary shortcuts to liability and their popularity with plaintiffs and courts. First and foremost, it is very hard to prove subjective motives. The duty of good faith would be a very weak limit on fiduciary discretion if liability were premised entirely on proof of a subjective motivation. Second, bad subjective intent is

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16. Actual state of mind may, of course, be proved by circumstantial evidence. See Sale, supra note 3, at 490-94 (discussing securities law doctrines on evidence of scienter). In either case, the evidence may consist entirely of objective facts, but in good faith cases, those facts have to prove a subjective state of mind. In loyalty cases, they do not.

17. The drafters of the Restatement (Third) of Agency have, sadly, chosen to obscure this structure. Paradoxically, they have separated the “duty to act loyally” from the portion of the Restatement titled “Duties of Loyalty.” See RESTATEMENT (THIRD) OF AGENCY § 8.01 (Tentative Draft No. 6, 2005).

18. See supra note 12 and accompanying text.


20. See id. § 387 cmt. a.


23. It is important to remember that boards of directors, like other fiduciaries, generally act for the appropriate purposes out of an internalized sense of duty, not a fear of liability. See, e.g., Margaret Blair & Lynn A. Stout, Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law, 149 U. PA. L. REV. 1735 (2001) [hereinafter Blair & Stout, Trust]; Melvin A. Eisenberg, The Conception that the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm, 24 J. CORP. L. 819, 835-36 (1999); Lynn A. Stout, On the Proper Motives of Corporate Directors (or, Why You Don’t Want to Invite Homo Economicus to Join Your Board), 28 DEL. J. CORP. L. 1 (2003). It is possible to conceive of a legal system in which fiduciary duty
not the only source of problematic decision making. In fact, it is probably not the most important. Iagos are rare, but the world is full of Babbitts. Well-meaning people’s judgment can be colored and distorted by self-interest and conflicting loyalties in many ways that approach, but nonetheless fall short of, subjective bad intent.\textsuperscript{24}

With this clarification of the connection between them, I will use the terms “good faith” and “loyalty” in their common meanings. For purposes of this Article, “good faith,” as discussed above, refers to the fiduciary’s core duty to use fiduciary powers in an honest and active pursuit of the purposes for which they were conferred. “Loyalty,” by contrast, refers to conflicts of interest that are sufficient to establish a breach of fiduciary duty without need to prove the fiduciary’s actual state of mind.

\textit{B. The Governance Role of Collective Shareholder Action}

For the most part, shareholders have no role in the default corporate governance scheme. A corporation’s “business and affairs [are] managed by or under the direction of a board of directors.”\textsuperscript{25} It is clear that the board, and the officers and other corporate agents authorized by the board, have both the duty and power to use this power in their good faith judgment of the corporation’s interests. This duty and power extends to defying, if necessary, the shareholders’ stated preferences.\textsuperscript{26}

Although shareholders generally have no role in corporate decision making, the default corporate governance structure allocates certain decisions to collective shareholder action, whether in conjunction with or independent of the board’s judgment. The decisions allocated to collective shareholder action are, essentially, selecting directors, adopting bylaws, and, if first proposed by the board, approval of amendments to the certificate of incorporation, mergers and sales of substantially all the corporation’s assets, and corporate dissolution.\textsuperscript{27} The statutorily contemplated mechanism by which shareholders make these collective decisions is voting. Because shares of stock and their attendant voting rights are freely alienable, however, a tender offer for a majority of shares is the rough equivalent of a vote to replace the board.\textsuperscript{28} The successful tender

\begin{footnotesize}
\begin{enumerate}
\item See ABA Comm. on Corp. Laws, \textsuperscript{supra} note 22, at 1309-10 (“[T]he ultimate irresolvable problem in seeking to regulate interest conflicts is that human beings are motivated by unimaginably varied and indeterminable mixes of ambitions, likes, dislikes, and biases.”).
\item DGCL § 141(a).
\item See Paramount Comm’ns, Inc. v. Time, Inc., Civ. A. Nos. 10866, 10670 & 10935, 1989 WL 79880, at *30 (Del. Ch. July 14, 1989) (“The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm.”); Andrew R. Brownstein & Igor Kirman, \textit{Can a Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions}, 60 BUS. LAW. 23, 43 (2004).
\item See DGCL §§ 109, 211, 242, 251 & 275. Shareholders also have important individual powers to obtain corporate books and records and to sue derivatively in the corporation’s name. \textit{See id.} § 220 (books and records). \textit{Del. Ch. R.} 23.1 (derivative standing).
\item For more detailed discussions of the similarities and differences between voting and selling collectively, see STEPHEN M. BAINBRIDGE, \textit{CORPORATION LAW AND ECONOMICS} 652-54 (2002); Ronald J. Gilson, \textit{Unocal Fifteen Years Later (and What We Can Do About It)}, 26 \textit{Del. J. Corp. L.} 491, 500-06 (2001)
\end{enumerate}
\end{footnotesize}
offeror acquires a controlling block of votes and uses those votes to take control of the corporation. Accordingly, collective selling into a tender offer is best viewed as a governance mechanism, not a coincidental grouping of individual property transactions. I do not intend to decide, or even discuss, whether these allocations are sensible (let alone optimal). There are many and good reasons for allocating some role in the corporate governance scheme to the holders of equity capital. There are also many good reasons for their governance role to be highly restricted. The proper balance between these reasons to expand and to limit the scope of shareholders’ collective action rights is the subject of heated debate. All sides of this debate, however, concede that at


30. See, e.g., Bainbridge, Voting Rights, supra note 29, at 627 (“[L]ike all accountability mechanisms, shareholder voting must be constrained in order to preserve the value of authority.”); Stephen M. Bainbridge, Director Primacy in Corporate Takeovers: Preliminary Reflections, 55 STAN. L. REV. 791, 807-09 (2002) [hereinafter Bainbridge, Corporate Takeovers] (same); Thompson & Smith, supra note 29, at 273-75.
least some decisions are and should be allocated to collective shareholder action.  

If it is conceded that collective action has some role as a decision making mechanism, making that mechanism work is an issue separate from its proper scope. That is the question I deal with below. In particular, my project is to examine the special nature of the board’s fiduciary powers to effectuate shareholder collective action and the special legal rules that result.

III. A THORN IN ALL SIDES

A. Shareholder Primacy and Board Autonomy

In recent years, the formerly quiescent debate over the purpose of business corporations has taken on a new life. The dominant theory is still “shareholder primacy.” With some variations, this theory holds that the managers of corporations should function as agents of the shareholders and with a duty to maximize the value of the shares.  

Traditionally, the opposition to this view came from those who argued that corporate managers should consider the interests of other corporate “constituencies” (such as employees and communities) or other social goals (such as protecting the environment or uplifting the poor).  

The modern challenge to shareholder primacy comes from a different direction that I

31. Thompson and Smith term the areas allocated to shareholder collective action as “sacred space.” See Thompson & Smith, supra note 29, at 263. My project is different, but we are talking about the same thing. Thompson and Smith’s argument is that once we decide that shareholder collective action is the most efficient decision making mechanism for certain types of decisions, we then must preserve that decisional space as “sacred” if we are to reap the efficiency benefits. My project is to analyze why courts and commentators alike have intuitively felt that courts should use a different standard in reviewing a corporate board’s decisions when it exercises its power over the shareholder decision making mechanism. Bainbridge might seem to deny that shareholder collective action has a governance role in the corporate governance structure when he argues that “shareholder voting rights are not part of the firm’s decisionmaking system, but simply one of many accountability tools.” See Bainbridge, Corporate Takeovers, supra note 30, at 805-06; see also Bainbridge, Voting Rights, supra note 29, at 627 (“Accordingly, shareholder voting is properly understood not as an integral aspect of the corporate decision-making structure, but rather as an accountability device of last resort to be used sparingly, at best.”). Since an extra-judicial power to enforce bargains implicit in a governance structure is undoubtedly a governance power, this is probably not what Bainbridge intends. Rather, he seems to mean that the role of shareholder voting in the governance structure is limited to providing an indirect check to constrain abuse of the board’s discretion over operations, rather than to provide a mechanism for shareholders to override the board’s discretion and make management decisions directly. Stout also agrees with this general proposition. See E-mail from Lynn A. Stout, Professor of Law, UCLA School of Law, to Ethan G. Stone, Associate Professor of Law, Univ. of Iowa College of Law (Jan. 6, 2006, 16:47 PST) (on file with author) (“Team production explains why corporations go public with governance structures that give shareholders only limited rights and directors much more authority. This does not mean shareholders should or do have NO rights. They have a few, and when directors work deliberately to frustrate these few rights, the courts step in. I think this is close to your idea of directors exercising a coordination function in the few areas reserved for shareholder action.”).


33. For the classic statement of this view, see E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145 (1932).
will term “board autonomy.” Professor Bainbridge’s “director primacy” theory\textsuperscript{34} and Professors Blair and Stout’s “team production” theory\textsuperscript{35} do not challenge the shareholder primacy scholars’ emphasis on economic efficiency. These scholars argue that the board of directors’ legal insulation from shareholder control is neither a misguided perversion nor a necessary evil. Instead, they posit that an independent decision maker is a key feature of a governance structure designed to achieve something other than carrying into effect the shareholders’ collective will.

Professor Bainbridge argues that the default corporate governance structure is designed to secure the efficiency benefits of decision by fiat. The corporation is not simply a notional “nexus” at which the various corporate constituents “contract” for their respective rights in the enterprise.\textsuperscript{36} Rather, in the absence of a real owner-manager, the board of directors—serving the notional corporate owner-manager—is a central and independent decision making body capable of efficiently dealing with each of the constituents. Under this theory, the necessary evil in the structure is the shareholders’ power to oversee board decisions, through collective voting and selling and through lawsuits. Bainbridge sees shareholder power as generally undesirable, since it imposes some drag on the board’s fiat power.\textsuperscript{37} He acknowledges, however, that giving the shareholders limited power helps provide enough accountability to prevent extreme abuses of the board’s power.\textsuperscript{38}

Professors Blair and Stout contend that the default corporate governance structure responds to the problem of inducing members of a productive “team” to make team-specific capital investments. They argue that the corporation deals with this problem by placing ultimate decision making power over the allocation of corporate surplus in the

\textsuperscript{34} See Stephen M. Bainbridge, The Business Judgment Rule as Abstention Doctrine, 57 VAND. L. REV. 83 (2004); Bainbridge, Voting Rights, supra note 29; Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, 97 NW. U. L. REV. 547 (2003) [hereinafter, Bainbridge, Director Primacy]; Bainbridge, Nexus, supra note 32; Bainbridge, Corporate Takeovers, supra note 30; Stephen M. Bainbridge, Unocal at 20: Director Primacy in Corporate Takeovers (UCLA Sch. of Law, Law-Econ Research Paper No. 05-19, 2005), available at http://ssrn.com/abstract=796224 [hereinafter Bainbridge, Unocal]. It should be noted that Professor Bainbridge believes that the board’s proper end goal is shareholder wealth maximization. See Bainbridge, Director Primacy, supra note 30, at 574-605. He argues, however, that corporate governance is a distinct means to that end, not simply a complex form of agency.


\textsuperscript{36} The “nexus of contracts” theory of the corporation, as such, has its origin in Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. FIN. ECON. 305 (1976). Jensen and Meckling’s theory built on a longer tradition of scholarship. See Bainbridge, Nexus, supra note 32, at 9-10. The nexus of contracts theory was, however, distinct from theories of the firm that preceded it and originated with Jensen and Meckling.

\textsuperscript{37} See Stephen M. Bainbridge, Director Primacy and Shareholder Disempowerment, 119 HARV. L. REV. 1735, 1735 (2006) [hereinafter Bainbridge, Disempowerment] (“I do not quibble with Bebchuk’s extensive empirical demonstration of shareholder weakness; to the contrary, I celebrate it as further evidence that my director primacy model accurately describes how corporations work.”); Bainbridge, Voting Rights, supra note 29, at 626-27.

\textsuperscript{38} See Bainbridge, Voting Rights, supra note 29, at 627-28.
hands of a “mediating hierarch”—a board of directors, composed neither of shareholders, managers, or other “team” members (such as customers and vendors). This theory posits that giving the board discretion to allocate surplus to various constituents is an effective way of assuring each team member that the others will not opportunistically deny their informal expectations. Blair and Stout also characterize shareholders’ power over the board as a necessary evil.

Delaware takeover law provides both tempting evidence and frustrating contradictions for all sides of this debate and has resulted in seeming contradictions in the Delaware case law. The following three subsections will address the problems posed by this law for shareholder primacy scholars, board autonomy scholars, and Delaware case law.

Preliminarily, however, it is worth emphasizing that my purpose in this section is not to refute the normative claims of either shareholder primacy theory or board autonomy theories (although I freely confess my sympathy for the latter), or to criticize Delaware courts for doctrinal or rhetorical inconsistency. Rather, my purpose is to point out that both scholars and courts have thus far fallen short in giving us a consistent descriptive theory of current Delaware takeover law, leaving room for further explanation. My purpose here is to provide that further explanation.

B. Delaware Takeover Law from a Shareholder Primacy Perspective

Delaware takeover law seems to offer considerable solace to proponents of shareholder primacy. The doctrines established in the Unocal, Revlon, and Blasius cases all subject the decisions of an unconflicted board of directors to substantive review, merely because they seem to contradict the interests of shareholders. Unocal and its progeny have not adopted the policy of board passivity advocated early on by shareholder primacy scholars. They have, however, applied special scrutiny to a corporate board’s decisions to defend against hostile bids for corporate control. Under the current Unocal test, a shareholder who establishes that the board acted to defend against the possibility of a hostile bid for control establishes a presumption of breach of fiduciary duty. The board can rebut that presumption, however, by demonstrating that it (1) carefully and in good faith identified a valid threat to corporate policy or effectiveness (including shareholder interests) and (2) responded in a manner that (a) was within a range of reasonable responses to the threat identified, and (b) did not preclude the possibility of a successful proxy contest to unseat the board. Although the board’s burden in a Unocal case is not nearly as heavy as in a traditional loyalty case, two


40. Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985). I largely leave Revlon out of my analysis in this Article because I believe that although Revlon bears a close relationship to Unocal, the principle that animates it is very different. For a discussion of my view of Revlon, see infra notes 205-209 and accompanying text.


42. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 HARV. L. REV. 1161, 1201-03 (1981) (proposing board passivity in the face of hostile bids); Gilson, Structural Approach, supra note 29, at 878-79 (advocating a rule precluding director action in the face of a tender offer other than dissemination of information and seeking alternative transactions).

aspects of the Unocal action are starkly different from standard shareholder litigation under the business judgment rule. First, shareholders have direct standing to sue under Unocal.\textsuperscript{44} In other words, the courts see the board’s fiduciary duties in Unocal cases as running to the shareholders as such, not to the corporate entity. Second, although the board’s burden of proof in a Unocal case amounts to showing the elements of the business judgment rule, the board has the burden of proof. The plaintiff makes out a prima facie case for liability merely by showing that the board’s action was defensive in nature. This second point tends to get obscured because the plaintiff’s initial burden of proof is so light that the arguments of both parties tend to focus exclusively on the board’s evidence. Under general business judgment rule analysis, a plaintiff must meet a much heavier burden of proof to make out a prima facie case based on conflict of interest.\textsuperscript{45}

The Blasius doctrine seemingly provides further support for shareholder primacy. Blasius held board action taken for the purpose of impeding shareholder franchise rights invalid, even if the court was convinced (as it was in Blasius) that the board had acted within its statutory authority and in good faith pursuit of valid corporate interests.\textsuperscript{46} In other words, the Blasius doctrine clearly presumes that the board owes an enforceable and direct fiduciary duty to the shareholders in the context of voting. Moreover, the Blasius and Unocal doctrines are closely related. Proof of intent to interfere with voting creates an almost irrebuttable presumption of bad faith under Blasius.\textsuperscript{47} Under Unocal, proof that the board took defensive action that has the practical effect of precluding exercise of the shareholder franchise to replace the board, regardless of intent, results in a similar presumption of liability.\textsuperscript{48}

The problem with these doctrines, from a shareholder primacy perspective, is that although they recognize shareholder interests, they seem to cut those interests arbitrarily short. For instance, under Unocal, a board can validly act to prevent shareholders from

\textsuperscript{44} See In re Gaylord Container Corp. S’holders Litig., 747 A.2d 71, 75-85 (Del. Ch. 1999).

\textsuperscript{45} See infra notes 62-69 and accompanying text. As discussed there, successful suits under general business judgment rule analysis almost always involve a controlling shareholder, a director-by-director proof of a material direct or indirect (domination) conflict of interest, or both, none of which is required of Unocal plaintiffs.

\textsuperscript{46} Blasius, 564 A.2d at 652.

\textsuperscript{47} See Stroud v. Grace, 606 A.2d 75, 91 (Del. 1992) (“The stringent standards of review imposed by Stahl and Blasius arise from questions of divided loyalty. . . .”).

\textsuperscript{48} To say that the effect—a presumption of liability for breach of fiduciary duty—is similar is not to say that the evidence needed to raise that presumption is the same. To the contrary, no presumption arises under Blasius, absent proof of actual intent to interfere, but the interference itself need not be severe. In Liquid Audio, for instance, the Delaware Supreme Court held improper the board’s purpose of “diminishing the influence” of insurgent shareholder’s nominees by expanding the size of the board, even though the insurgent’s nominees would have been a minority, in any event, and the board’s action did not diminish the chances of electing them. See MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1132 (Del. 2003). By contrast, a board action is not preclusive under Unocal and Unitrin unless it not only had the effect of interfering with the shareholder franchise but also eliminated any practical chance of using the franchise to displace the board by proxy contest. See Unitrin, 651 A.2d at 1388-89 (remanding to determine whether the board’s actions made insurgent success “mathematically impossible or realistically unattainable”). This is because a Unocal case proceeds on the basis of the suspicions raised by the objective characteristics of the board’s action, not proof of the board’s actual motives. Because the presumption is so easy to raise, the suspicions that justify it are weak and relatively easy to rebut.
considering a noncoercive offer merely because it fears that it will not be able to persuade shareholders that the offered price is inadequate. Shareholder primacy scholars have no explanation for this long-standing law, other than confused or inept judges.

This divergence from shareholder primacy theory is neither trivial nor, at this late date, reasonably attributable to simple error by judges. Rather, it seems a clear indication that Unocal is something more than an inept expression of shareholder primacy theory. From a shareholder primacy perspective, a board should face, at very least, a steep burden of proof before it is allowed to prevent shareholders from accepting a bid for control. As Professor Gilson argued several years before Unocal, from a shareholder primacy perspective a board that takes action to prevent shareholders from engaging in a control transaction has engaged in self-dealing. It has used its fiduciary powers to seize control for itself from the shareholders. If a shareholder demonstrates that the board did this, under a shareholder primacy analysis, traditional principles should presume disloyalty unless the board can prove “that it was ‘fair’ [to the shareholders] for control to remain with management rather than shift to the offeror.” A board decision to prevent shareholders from accepting a bid on price alone amounts to allowing “gambles made on behalf of target shareholders by presumptively self-interested players.”

The Delaware courts do not appear to be acting in the ways this conception of shareholder primacy would predict. Although the courts sometimes describe the problem in Unocal and Blasius cases as a conflict of interest, they do not treat it as such. If Blasius were based on a conflict of interest, for instance, the plaintiff’s prima facie case would not require proof of the board’s actual subjective motives. In other words, if there is a conflict of interest, it does not provide Blasius plaintiffs with the evidentiary assistance one would expect. Unocal comes closer to a traditional conflict-of-interest action. It allows shareholders to raise a presumption of disloyalty merely by showing objective facts: a board’s action responding to an actual or potential bid for control.

49. See Paramount Commc’ns, Inc. v. Time, Inc. 571 A.2d 1140, 1153 (Del. 1990). Professor Gilson believes that the court adopted his term for this concern—substantive coercion—without requiring the level of proof he had argued should be necessary to validate it because the court was confused about his argument. See Gilson, Unocal, supra note 28, at 497 n.23. It is also possible that the court found Professor Gilson’s terminology more useful than his policy prescription.

50. See Gilson, Structural Approach, supra note 29, at 827. Because Gilson regarded this determination as impractical, he advocated a strict non-interference rule instead. For a discussion of the meaning of entire fairness, see infra note 162.


52. See Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). Although Chancellor Allen seems to have deliberately avoided describing the problem he was addressing in Blasius as a conflict of interest, the Delaware Supreme Court has done so. See Liquid Audio, 813 A.2d at 1129; Stroud v. Grace, 606 A.2d 75, 92 n.3 (Del. 1992).

53. For a discussion of the relationship between actions for breaches of the duties of good faith and loyalty, see supra Part II.A.

54. The court did not phrase its ruling this way in Unocal. It stated that, because of a conflict of interest inherent in the board defending against a hostile bid, “judicial examination at the threshold before the protections of the business judgment rule may be conferred” and that “directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person’s stock ownership” and that their response was proportional. Unocal, 493 A.2d at 954-55. When the court said that the board “must show” its grounds, it did not mean to order the board to explain itself on pain of contempt (as it would, for instance, a recalcitrant witness). Rather, it meant that the directors would be subject
Unocal, however, again diverges dramatically from the courts' treatment of traditional conflicts of interest. If a plaintiff proves a traditional conflict of interest, the board can rebut the resulting presumption of disloyalty only by bearing the stiff burden of proving the "entire fairness" of its conflicted action. By contrast, under Unocal, the board can rebut the presumption of disloyalty by proving merely that it left the shareholders with at least potentially effective voting rights. It does not require proof that the board took the shareholders' control rights fairly. Shareholder primacy theory does not explain why self-dealing in the context of control transactions is treated differently from self-dealing in other contexts.

Unocal seems to diverge from a shareholder primacy interpretation in another important respect. As shareholder primacy scholars have noted with frustration, courts applying Unocal have shown a clear preference for voting over selling. There are some potential differences between collective voting and collective selling as decision making mechanisms. Professors Gilson and Schwartz argue that voting can be equivalent to selling as a method of deciding on a hostile bid, but that voting will nearly always be less efficient because of the potential to manipulate an election process.\(^\text{55}\) Professors Bebchuk and Hart argue more convincingly that a tender offer coupled with a proxy contest is preferable to either alone as an efficient means of deciding on a proposal to change corporate management.\(^\text{56}\) As Professor Bebchuk pointed out long ago, however, it is not very difficult to make collective selling exactly equivalent to voting.\(^\text{57}\) It is therefore hard to understand why a court would allow the board to preclude indefinitely by maintaining a poison pill but invalidate any action that had the effect of precluding a vote. Shareholder primacy advocates have noted the inconsistency and concluded that it is nonsensical at best, and probably pernicious.\(^\text{58}\)

To liability for breach of fiduciary duty if the board did not make the required showing. In other words, the court was announcing that plaintiffs make out a prima facie case for liability against a board when they show that the board took action to defend against the possibility of a hostile takeover. Put differently (and usefully for my purposes in this Article), a plaintiff who can show that the board took defensive action against the possibility of a hostile takeover raises a rebuttable presumption of disloyalty. It is worth noting in this context that I have simplified slightly in saying that rebutting the business judgment rule as to the board’s decision states the plaintiff’s cause of action. Technically, rebutting the business judgment rule as to the board’s decision does not itself establish the liability of any individual director. It merely establishes that what happened was not a valid board decision (because it was tainted by conflict of interest, gross negligence or bad faith). The liability of individual directors then depends on whether and how their particular actions breached their individual fiduciary duties to the corporation. See, e.g., In re Emerging Commc’ns, Inc., Civ. A. No. 16415, 2004 WL 1305745 (Del. Ch. June 4, 2004) (analyzing culpability director-by-director). In that context, however, the bases for individual liability are still the three “presumptions” of the business judgment rule-conflict of interest, gross negligence and bad faith.

55. See Gilson & Schwartz, supra note 28.
56. See Bebchuk & Hart, supra note 28.
57. See Bebchuk, supra note 28.
58. See Lucian Arye Bebchuk et al., The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy, 54 STAN. L. REV. 887, 946-47 (2002) (arguing diplomatically that maintenance of a poison pill by a company with a staggered board should be considered automatically disproportionate under Unocal and Unitrin after the loss of one board election); Gilson, Unocal, supra note 28, at 500-06 (arguing that the distinction is nonsensical). Depending on several factors, including whether a corporation’s charter provides for a fully staggered board (only one third of which can be elected in any given year) and allows shareholders to initiate actions by written consent or special shareholder meeting, a hostile bid for control can take as long as three years to gain control of a corporate board by proxy contest. John C. Coates IV, Measuring the Domain of
C. Delaware Takeover Law from a Board Autonomy Perspective

If Delaware takeover law presents problems for shareholder primacy scholars, it is hardly an unequivocal comfort for proponents of board autonomy. Unocal’s intermediate scrutiny test does not go far enough (or, for that matter, in the right direction) for shareholder primacy advocates. Board autonomy theories, however, do not seem to explain why any special scrutiny is needed. Board autonomy theories depend, in large part, on the business judgment rule, pursuant to which the corporation’s cause of action against its board for breach of fiduciary duty in making a decision is limited to claims based on economic conflict of interest, failure to investigate minimally before deciding, or actual bad faith. In these circumstances, the board cannot be trusted to have made a neutral decision and intensive court scrutiny of its decisions is warranted. If this rule secures the value of an autonomous decision maker, it is not immediately obvious why courts should apply any extra scrutiny to the careful decisions of a disinterested and independent board as to takeover defenses or interventions in corporate elections.

Courts and most commentators have attempted to address this problem by characterizing a hostile takeover as the kind of conflict of interest that makes out a traditional case for breach of the duty of loyalty. In Unocal, for instance, the court worried that “a board may be acting primarily in its own interests.” Commentators who have elaborated on the nature of the conflict have portrayed it in terms of simple and

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59. Under the “business judgment rule” the corporation states a cause of action for a decision of its board only if it can establish that a majority of the board was interested in the decision or that the board did not act “on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). The rule is normally stated as a “presumption” that the board is disinterested and acted on reasonable investigation and in good faith. This “presumption” is sometimes portrayed as a special protection granted to boards of directors. That description is deceptive and confusing. There is nothing special about the rule’s presumptions. Before a plaintiff proves facts to the contrary, everyone (directors, doctors, drivers) is presumed to have acted without conflict of interest, after reasonable investigation, and in good faith. For that matter, we are all presumed not to have breached any contracts and not to have engaged in battery. These are evidentiary defaults. Courts do not conclude that anyone has done anything merely because someone shows up in court complaining about it. The question is not what presumptions courts start with before the evidence comes in, but rather what presumptions the evidence must rebut to make out a prima facie cause of action. The significance of the business judgment rule is that it limits the causes of action challenging a board decision to gross negligence, bad faith, or a conflict of interest. Proof that any of these affected a board decision makes out a prima facie case for liability. Proof of anything else is irrelevant. The corporation may have many other reasons to be dissatisfied with a decision of its board (in particular, substantive unreasonableness) but those give rise only to valid gripes, not valid lawsuits. This point has been obscured in the discussions of both courts and commentators by a peculiarity of suing directors: A valid board decision is the act of a collective body, whereas director liability is individual. Accordingly, the prima facie case for director liability first requires proof that the board was not acting as a board because its decision making processes were corrupted by the gross negligence, bad faith motives, or conflict of interest of a majority of its members. See Aronson, 473 A.2d at 815 (requiring particular allegations as to a majority of directors). The directors can reestablish their collective status by proving entire fairness (i.e., that their action did reflect the business judgment of the authorized decision making body, despite appearances to the contrary). If the board fails to establish entire fairness collectively, however, individual directors are only liable to the extent the plaintiff can prove that their individual actions were tainted by gross negligence bad faith, or a conflict of interest. See In re Emerging Commc’ns, Inc., Civ. A. No. 16415, 2004 WL 1305745 (Del. Ch. June 4, 2004).

powerful self-dealing: “Managers” oppose hostile bids for corporate control because such bids threaten to deprive those “managers” of the salary, benefits, power, and prestige of their positions. The problem with this view is that for Unocal to have any meaning, it must apply to corporations whose boards are—as they were in both Unocal and Blasius—indeedependent of management. In such cases, the directors whose actions are suspect under Unocal or Blasius are not the “managers” who stand to lose their jobs. The independent directors stand to lose their board seats, of course, but that would not be enough to establish a traditional conflict of interest. To do that, the plaintiff must show, on a director-by-director basis, that the value of a board position was itself material to the directors. In the absence of such a showing, directors who stand to lose their seats are still presumed disinterested and independent under traditional standards.

Commentators regularly assume that the board’s nominal independence is irrelevant because directors face overwhelming economic or social pressure to serve the top manager’s personal interests. These assumptions, however, seem inconsistent with Delaware’s interpretation of the business judgment rule. Other courts have accepted the theory that “structural bias” makes it unrealistic to expect directors to pursue the corporation’s causes of action against officers or fellow directors, no matter how independent they appear on paper. Delaware has rejected this approach. Instead, Delaware courts presume each director to be independent absent concrete evidence of a direct and material economic conflict of interest or of some strong reason to believe that a person with such a conflict could dominate that director’s discretion. Just as Delaware courts do not presume that retaining a seat on the board is materially important to any

63. See In re The Limited Inc., 2002 WL 537692, at *4 (holding that “[a]llegations as to one’s position as a director and the receipt of director’s fees, without more . . . are not enough for purposes of pleading demand futility” even though the plaintiffs were attempting to challenge a transaction with a trust for the children of the controlling shareholder); Bainbridge, Corporate Takeovers, supra note 30, at 809-10.
64. As Robert Clark put it, for instance:

Directors and officers of a corporation whose shares are subject to a hostile takeover bid face a serious conflict of interest. Indeed, we could well conclude that in no other context is the conflict of interest as serious as in the takeover situation. Often the managers’ jobs are at stake.

CLARK, supra note 61, at 588. Bebchuk et al., supra note 58, at 892 (“Under the well-known Unocal test, managers can use defensive tactics but only to an extent that is “reasonable in relation to the threat posed.””) (emphasis added); Easterbrook & Fischel, supra note 42, at 1163 (“Relying on the business judgment rule, courts typically have held that the target’s management has the right, and even the duty, to oppose a tender offer it determines to be contrary to the firm’s best interests.”) (emphasis added); Ronald J. Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers, 33 STAN. L. REV. 819, 825 (1981) (“Because corporate statutes commonly require the approval of the target’s board of directors before a proposed merger or sale of assets can even be put to the shareholders, most acquisitions cannot be undertaken without management consent. As a result management can reject offers beneficial to shareholders to retain the emoluments, both pecuniary and nonpecuniary, that flow from a position of high authority in a public corporation.”) (emphasis added); Thompson & Smith, supra note 29, at 294 (describing court review of defensive measures as search for “defensive actions that serve the interests of the managers”).
65. See Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709, 716-17 (Iowa 1983) (adopting the structural bias theory and citing sources propounding it).
director, they also refuse to presume domination. A generalized suspicion of sympathy between directors and top managers is not enough. The plaintiff must prove, director-by-director, that a majority of the directors could not be expected to act independently of some other (conflicted) person. Essentially, the only acceptable evidence of domination, other than close family ties, consists of proof that the dominant person controlled a material economic interest of the dominated person—in essence, a material indirect conflict of interest.

Unocal and cases following it depart starkly from the Delaware courts’ consistent approach to conventional conflicts of interest. In Unocal cases, courts do not consider the individual circumstances or likely motivations of individual directors. In fact, courts apply the Unocal test even in cases where the directors’ personal economic interests appear to match the shareholders’ interests. The Unocal rule thus appears to present an oddity: A rule allowing shareholders to rebut the business judgment rule without any evidence that any individual director faced a concrete and material economic conflict of interest, either directly or indirectly through domination.

This oddity is no small problem for board autonomy theories. These theories rely heavily for empirical support on the business judgment rule and the Delaware courts’ staunch insistence on respecting board decisions not obviously tainted by self-interest or misconduct. In the absence of a conflict of interest, why should the courts suddenly assume that an independent board’s judgment cannot be trusted?

Director autonomy scholars have not offered a good explanation for this discrepancy. Professors Blair and Stout simply do not mention it. They cite Unocal only to support their view that the business judgment rule protects board decisions in the interests of non-shareholder constituents of the corporation. Although they do note that Unocal describes the board’s fiduciary duties as running to the shareholders, they seem to view this as loose language, not ultimately consistent with the body of Delaware law and therefore probably not to be taken seriously.

Professor Bainbridge is aware of the issue and notes that an independent board cannot be said to face a conflict of interest in considering a hostile bid merely because top

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67. See, e.g., Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (rejecting domination arguments for failure to show that alleged dominant officer was himself conflicted).
68. See, e.g., In re The Limited, Inc. S’holders Litig., Civ. A. No. 17148-NC, 2002 WL 537692 (Del. Ch. Mar. 27, 2002) (reviewing the basis for domination of each director). Clear evidence that directors viewed themselves as dominated and acted on the behest of the dominant person against their independent judgment of corporate interest can also prove dominance. See Kahn v. Lynch Commc’n Systems, Inc., 638 A.2d 1110 (Del. 1994). Such evidence usually appears in cases, such as Lynch Communications, in which the dominant person is found to be a controlling shareholder and, therefore, treated in most respects as the board. The fact that the actual board (albeit not independent) formally retains its role in the corporation’s governance adds a complexity to these cases that is beyond the scope of the discussion here.
69. In Unitrin, the court noted that it was improper to assume that some of the directors would, as shareholders, vote their shares against their economic self-interest. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1380 (Del. 1995). Despite this skepticism, the court did not question that the plaintiffs had stated a prima facie case under Unocal by showing that the board adopted a defensive share exchange offer.
70. See, e.g., Bainbridge, Nexus, supra note 32, at 30-31; Blair & Stout, Team Production Theory, supra note 35, at 299-305.
71. See Blair & Stout, Director Accountability, supra note 29, at 428; Blair & Stout, Team Production Theory, supra note 35, at 308.
72. See Blair & Stout, Director Accountability, supra note 29, at 424 n.54.
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managers fear losing their jobs.\textsuperscript{73} He argues that the Delaware courts have applied different standards to managers and independent board members in the takeover context “[b]ecause while the conflict of interest unsolicited tender offers pose for the target company’s managers is inescapable, the independent director’s conflict of interest is merely a potential problem.”\textsuperscript{74} The trouble with this analysis is two-fold. First, it ignores the fact that even the traditional conflicts of interest raise only a rebuttable presumption of disloyalty under the business judgment rule.\textsuperscript{75} That is to say, traditional conflicts of interest also pose only a potential problem. Second, it fails to explain why independent directors face even a \textit{potential} conflict if they are, in fact, independent and disinterested by traditional standards.\textsuperscript{76}

\textit{Blasius} presents similar difficulties for board autonomy scholars. As discussed above, \textit{Blasius} holds that the act of an independent board genuinely motivated by a valid corporate purpose can be invalid as a breach of duty \textit{to the shareholders}.\textsuperscript{77} Like \textit{Unocal}, \textit{Blasius} thus departs starkly from the general pattern of business judgment rule litigation: It imposes liability on an independent board that has carefully and honestly tried to decide in the best interests of the corporation. Importantly, a doctrine premised on a direct duty owed by the board to the shareholders is also facially inconsistent with a model that places the board’s organizational novelty and value in its freedom from the control and review rights that common law principals hold over their agents.

Again, the scholars’ response is not enlightening. It is hard to know how Professors Blair and Stout would deal with the issue because they do not address it.\textsuperscript{78} It is worth noting, however, that they admit that shareholder voting in general is not easily reconciled with their theories. Instead, they argue that voting rights are generally unimportant to the governance structure of public companies and can therefore be ignored in any general account of that structure.\textsuperscript{79}

Professor Bainbridge’s response is much clearer. He thinks that \textit{Blasius} is a mistake. According to Bainbridge, when Chancellor Allen noted that “[t]he theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters,” he should have deleted “the agents of the shareholders; it

\begin{itemize}
  \item \textsuperscript{73} See Bainbridge, Corporate Takeovers, supra note 30, at 809-10.
  \item \textsuperscript{74} See id. at 810. See also Bainbridge, Unocal, supra note 34, at 54.
  \item \textsuperscript{75} “Contrary to much popular usage, having a ‘conflict of interest’ is not something one is ‘guilty of;’ it is simply a state of affairs.” ABA Comm. on Corp. Laws, supra note 22, at 1309. This passage was written about actual and traditional conflicts of interest of the kind corporate officers and other corporate employees face in a hostile takeover (i.e. the conflict that arises when they are asked to evaluate the corporation’s interest in a proposed transaction that will deprive them of the jobs that provide them with their principal occupations and sources of income). Ironically, Bainbridge cites it to explain why the independent director’s “potential” conflict does not equate to guilt. See Bainbridge, Corporate Takeovers, supra note 30, at 811 & n.115.
  \item \textsuperscript{76} As discussed supra notes 59-69 and accompanying text, the danger to the directors’ positions on the board would normally not constitute proof of self-interest, absent proof that those positions were of material economic importance to a majority of directors.
  \item \textsuperscript{77} See supra notes 46-47 and accompanying text.
  \item \textsuperscript{78} Professor Stout has indicated to me that she did not consider it relevant in composing her team production articles. She agrees, in general, that shareholders have some rights and that \textit{Blasius} stands for the proposition that the board’s power cannot be used to eliminate those rights. See E-mail from Lynn A. Stout, supra note 31.
  \item \textsuperscript{79} See Blair & Stout, Director Accountability, supra note 29, at 433-34.
\end{itemize}
does not create. That Allen erred and Delaware courts have followed his error over the years is not as damaging as it might seem, according to Bainbridge, mainly because it has no practical effect other than to declare “rhetorical allegiance . . . to the free exercise of the shareholder franchise.”

D. Court Theories

The Delaware courts have not adopted the normative programs of shareholder primacy theory or board autonomy theory in their entirety, although board autonomy seems to have the upper hand as a descriptive matter. The courts have, however, attempted to explain the conceptual basis for their decisions. As the above discussions indicate, a certain amount of inconsistency seems to appear between the courts’ descriptions of takeover and non-takeover doctrines. As I will discuss in the remainder of this Article, I believe the facial inconsistency is largely deceptive and reflects an important distinction that the courts have followed consistently, but never articulated clearly, between different kinds of board action. That said, it is worth reviewing two chief areas of apparent inconsistency.

The first inconsistency is between the *Unocal* doctrine, which purports to be based on the board’s conflict of interest in considering hostile bids, and the treatment of conflicts of interest outside of the takeover context. The inconsistency appears both in the facts that define a conflict and in the result of finding one. First, *Unocal* seems inconsistent with the courts’ general attitude toward conflicts of interest because it declares the entire board conflicted without any discussion of individual directors’ particular interests. Second, the courts have offered no explanation for why, having declared a conflict of interest, they require directors to meet only an “intermediate” standard of proof to rebut the resulting presumption of disloyalty, rather than requiring the showing of entire fairness that is normally required.

The second inconsistency pertains to the beneficiaries of the board’s fiduciary duties. Some cases seem to hold that the board owes an enforceable fiduciary duty to the shareholders. Some cases hold that the board’s duties are to the abstract corporate entity and not, where it makes a difference, to the shareholders who own its stock.

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80. Bainbridge, *Nexus*, supra note 32, at 33 (commenting with respect to the above quote from *Blasius*, “[A]s Horace cautioned, ‘even the worthy Homer sometimes nods.’ The central thesis of this Article is that directors are not mere agents of the shareholders. To the contrary, the corporation’s board of directors in fact is a Platonic Guardian.”).


82. See supra notes 59-69 and accompanying text.

83. See supra notes 52-54 and accompanying text. For a discussion of the requirements of entire fairness, see infra note 162.


85. In *Paramount*, for instance, the Delaware Supreme Court stated:

Delaware law imposes on a board of directors the duty to manage the business and affairs of the corporation . . . . This broad mandate includes a conferred authority to set a corporate course of action, including time frame, designed to enhance corporate profitability. Thus, the question of “long-term” versus “short-term” values is largely irrelevant because directors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon . . . . [A]sent a limited set of circumstances as defined under *Revlon*, a board
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Many cases are ambiguous on this point. Undoubtedly, much of this ambiguity is deliberate and intended to maintain the courts’ flexibility to deal with difficult facts in future cases. Whether the inconsistency reflects cagey equivocation or simple uncertainty, however, it seems to indicate that the courts are not applying a fully developed theory of the board’s fiduciary duties. Again, something seems to be missing. The rest of this Article will clarify the missing element.

IV. THE DISTINCTION BETWEEN OPERATING POWER AND COORDINATING POWER

My analysis in this Article turns on distinguishing between two different kinds of management power exercised by corporate boards: operating power and coordinating power. Subparts A and B of this Part define these two types of management power, respectively, and discuss briefly how and why the default Delaware corporate governance scheme grants them to the board.

Before beginning my exposition of the concepts, I should note that I do not claim to be the first one to notice this distinction. To the contrary, courts and commentators have felt comfortable with, and have often ignored, the inconsistencies described in Part III largely because they operate out of an intuitive understanding of these concepts. Usually, this understanding is implicit, but it occasionally surfaces in express analysis. Chief Justice Veasey, for instance, has distinguished between “enterprise issues” and “ownership issues,” noting that “[i]t is ownership issues which usually put corporate governance sternly to the test.”

Chancellor Allen likewise pointed out in Blasius that the exercise of the board’s power over shareholder elections is different from “the exercise of the corporation’s power over its property, or with respect to its rights or obligations.”

While courts and commentators have intuitively understood the distinction between operating and coordinating power, and occasionally mentioned it, they have not analyzed its implications. They have not asked why board decisions on “enterprise issues” and

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86. See, e.g., Malone v. Brinecat, 722 A.2d 5, 10 (Del. 1998) (“The directors of Delaware corporations stand in a fiduciary relationship not only to the stockholders but also to the corporations upon whose boards they serve.”); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (holding that the board’s “duty of care extends to protecting the corporation and its owners from perceived harm whether a threat originates from third parties or other shareholders”); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (“The existence and exercise of [the board’s power under DGCL § 141(a)] carries with it certain fundamental fiduciary obligations to the corporation and its shareholders.”); Guth v. Loft, 5 A.2d 503, 510 (Del. 1939) (“Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders.”).

87. See E. Norman Veasey, The Defining Tension in Corporate Governance in America, 52 Bus. Law. 393, 397 (1997) (“Directors are fiduciaries to the corporation and the stockholders, and owe duties of loyalty and care to both.”); see also In re Gaylord Container Corp. S’holders Litig., 753 A.2d 462, 475 n.2 (Del. Ch. 2000) (wisely quoting Veasey).

88. Veasey, supra note 87, at 394.

“ownership issues” are different, why those differences demand different rules, and how those demands manifest themselves in current law. It is that analytical task that I undertake here.

A. Operating Power

The concept of the board’s “operating power” is familiar. It is the board’s power to make, or decide who will make, decisions about what business activities the corporation pursues and how it goes about them. The board has the ultimate power, for instance, to decide how, where, and when the corporation raises and invests capital, or whom it hires for what positions and on what terms.

Operating power is crucial to the corporation’s effectiveness as a form of business organization. It allows financial, physical, and human capital to be managed as a unified whole in the absence of a single owner-manager, who could enforce hierarchical organization through property and contract rights alone. The board itself generally makes few direct operating decisions in a large corporation. It is nonetheless structurally important that the authority of the corporate officers and other employees and agents to make those decisions, for the corporation flows ultimately and exclusively from a single autonomous decision making body. It is this hierarchical decision making apparatus,

90. Economists would generally use the term “authority” to refer to a governing decision maker or rule within the structure of a hierarchical organization. See, e.g., Arrow, supra note 29, at 63; Chester I. Barnard, The Functions of the Executive 163 (1938); Herbert A. Simon, Administrative Behavior 125 (1947). Since “authority” has a specific and somewhat different meaning in the legal context, I use the Hohfeldian term “power” in this Article. See Wesley Newcomb Hohfeld, Fundamental Legal Conceptions as Applied in Judicial Reasoning 50-51 (1919) (“A change in a given legal relation may result . . . from some superadded fact or group of facts which are under the volitional control of one or more human beings . . . . [T]he person (or persons) whose volitional control is paramount may be said to have the (legal) power to effect the particular change of legal relations . . . .”). One difference between Hohfeld’s “power” and the economists’ “authority” is that the latter includes systems of decision making both by designated persons (personal authority) and fixed rules of decision (impersonal authority). See Arrow, supra note 28, at 63. For convenience of discourse, I will refer to “impersonal authority” simply as “fixed rules of decision” and contrast it, as a decision making mechanism, with discretionary “power” vested in boards or courts.

91. For the sake of simplicity, I include financing decisions within operations. The power to finance the corporation is also the key to the “poison pill,” by which modern boards exercise coordinating power over collective selling by shareholders.

92. As transaction-cost economists point out, it is a hierarchy of decision making by fiat, rather than by spot contracting that ultimately distinguishes a “firm” from a market. See Oliver E. Williamson, The Mechanics of Governance 95 (1996) (distinguishing governance by market, hierarchy, and hybrid combinations); Ronald H. Coase, The Nature of the Firm, 4 Economica 386 (1937). Board autonomy theories are based on this form of analysis. See, e.g., Bainbridge, Nexus, supra note 32, at 17-24; Blair & Stout, Team Production Theory, supra note 35, at 265-76; Thompson & Smith, supra note 29, at 275. There are very important differences between these scholars, some of which derive from the economic models they prefer. Bainbridge is principally concerned with information efficiency. Following Kenneth Arrow, he sees the firm as a structure that allows the various constituents of a firm to enter into an interlocking set of contracts without the need for each constituent to contract with (or even know about) the others. He argues that the corporation handles this problem by designating the board as the central decision maker, vested with a nearly autonomous power of “fiat” to contract with various parties inside and outside the firm boundaries. Blair and Stout place a heavier emphasis on the problem of finding a governance structure that allows various constituents to make “team-specific” investments in a common productive team, without reaching a fully contingent contract about how any surplus will be divided among them.
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guided and bounded by fiduciary duty but largely detached from any control through “ownership” (property rights), that distinguishes the modern corporation as an organizational form.

Corporate law leaves the operating power of the corporation entirely to the board’s discretion: “The business and affairs of every corporation... shall be managed by or under the direction of a board of directors.”

The board’s discretion in exercising its operating power is constrained by fiduciary duties. To preserve the board’s autonomy, however, its accountability for breach of fiduciary duty is highly constrained. Under the business judgment rule, the corporation states a cause of action for a decision of its board only if it can establish that a majority of the board was interested in the decision or that the board did not act “on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”

B. Coordinating Power

I. General Concept

The second form of power, which I will term “coordinating power,” is the board’s power to manage collective action by the shareholders. Shareholders in the default Delaware corporate governance scheme have powers, albeit limited powers, to act collectively by voting or selling their shares. Where the shares are not concentrated in a single controlling shareholder or group, however, shareholders who want to use these powers effectively face a form of coordination problem.

I am using the term “coordination problem” to mean simply that the task at hand involves organizing the shareholders to make a decision, as opposed to exercising business judgment to make a decision directly. This is not the pure sense of the term defined by David Lewis. Lewis, building on the work of Thomas Schelling, defined a coordination problem as a situation in which two or more persons need to make an “interdependent decision” (each person’s preference depends on what the other person or persons do), and they can choose between at least two “coordination equilibria” (combinations of actions in which no person would have been better off if that person or any other person had acted differently). See DAVID K. LEWIS, CONVENTION: A PHILOSOPHICAL STUDY 24 (1969). The challenge, in a coordination problem, is for all the persons trying to solve it to develop a common understanding of how the others will act. If each person develops the same understanding of how each person will act and will expect everyone else to act (a state Lewis terms “common knowledge”), the problem solves itself. Id. at 56. Each person’s direct self-interest is then to act according to that common understanding. No one has any incentive to defect. Recurring coordination problems tend to generate spontaneous and self-reinforcing coordination norms—solutions to the problem that, through successful repetition, generate stronger and stronger common expectations of conformity. See EDNA ULLMANN-MARGALIT, THE EMERGENCE OF NORMS 85 (1977). This kind of problem is to be distinguished from a collective action problem of the “prisoners’ dilemma” type. The difficulty in this kind of problem is that the set of choices that maximizes everyone’s collective welfare is not an individual equilibrium for each participant. To the contrary, each participant has a personal incentive to defect, so long as no one else does. Id. at 115-16. The
accomplish anything through unilateral action. For any shareholder action to be effective, it must generally coincide with the coordinated actions of shareholders holding at least a majority of the shares. This means that shareholders must overcome two major obstacles before they can turn their potential power into effectively coordinated actual power: the inherent instabilities of majority rule and the costs of coordination.

First, shareholder collective action by majority rule must deal with the inherent instability of majority rule as a way to make decisions. If majority rule is not constrained fairly severely, the losers in any given contested vote can often quickly schedule a new vote on a proposal that reverses the previous vote, while offering just enough benefits to selected members of the previous majority to induce them to switch their votes. In practice, organizations that rely on majority rule to make decisions use several methods (usually in combination) to mitigate this weakness. One of these methods is to vest coordinating power in a central decision maker. Another is to promulgate fixed rules of procedure to constrain the process of scheduling votes and setting the voting agenda.

The default Delaware corporate governance scheme uses both of these methods to constrain majority rule in shareholder voting. For instance, by default, a shareholder can force a vote only once every 13 months, and shareholder actions cannot interfere with solution to such problems must involve some method of reordering each person’s preferences, whether through external sanctions or internalized norms of discipline or trust. See id. at 29-30. As previous commentators have pointed out, the board’s operating power serves to solve a prisoners’ dilemma between the various prospective participants in a complicated enterprise. See, e.g., Lynn A. Stout, The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance, 152 U. PA. L. REV. 667 (2003) (discussing the corporate governance regime as a means for shareholders and other participants to tie themselves to the mast in order to convince the other participants that they will not give in to opportunism once everyone is committed). Although organizing shareholder collective action involves, among other things, a fairly pure coordination problem (getting everyone to show up at the right time and place to vote on the same matters or consider selling into the same tender offer), it is not a pure coordination problem. This is because collective shareholder actions function as a governance mechanism. Accordingly, in any interesting case, participants will have strong and differing interests in the outcome of the action. For this reason, they may not all be interested in holding an effective collective action. Some parties may be interested in a coordination failure because failure will tend to produce the outcome they favor. In the Schnell case, for instance, the board advanced the annual meeting and moved it to a remote location in the hope that potential supporters of the insurgent shareholders would be unable to vote. See Schnell v. Chris-Craft Indus., 285 A.2d 430, 432 (Del. Ch. 1971). Managing shareholder collective action also differs from pure coordination in that it involves gathering, processing, and disseminating the information shareholders need to make rational decisions. That task presents problems of informational organization and agency, not coordination. See infra note 108 and accompanying text.

98. An individual shareholder can sell its shares unilaterally. Sales that are not part of a coordinated effort, however, have no effect on governance of the firm.


100. See Shepsle & Weingast, supra note 99, at 507-11.

101. See DGCL § 211(o)(1) (granting the board default power to call meetings). Other jurisdictions provide shareholders a default right, and sometimes a mandatory right, to call meetings. See, e.g., CAL. CORP. CODE § 600(d) (West 2005) (allowing shareholders with ten percent or more of outstanding shares to call special meetings).
the board’s power to manage the corporation’s business and affairs.102

Another problem facing shareholder collective action is the cost of initiating and coordinating collective action, including the cost of gathering and disseminating the information needed to make decisions. Collective action is never free and is unlikely to arise spontaneously in large groups.103 Someone has to organize it and doing that takes time, effort, and (usually) money. But collective shareholder action that might benefit the shareholders is also, as between the shareholders, a public good: It is impossible to prevent all the shareholders from benefiting if anyone goes to the trouble of bringing it about.104 Thus, non-controlling shareholders often lack individual incentives to do the coordinating work that would benefit them collectively. Shareholders who bear the expense of instigating, coordinating, and participating in a collective action cannot prevent passive shareholders from participating in any resulting benefit. The expenses can be significant, including investigating and communicating with the other shareholders to propose an action, to convince them of the proposal’s merits, and to coordinate the collective action necessary to implement it.105 If no shareholder holds a significant portion of the shares and coordination is expensive, few if any proposals will promise any single shareholder a high enough payoff to justify the expenses of coordinating collective action to accomplish it. Traditionally, these incentive issues have largely precluded corporate election contests that were not part of an attempt to buy out the company.106

102. See DGCL § 109(a) (permitting bylaw proposals on any matter “not inconsistent with law”); id. § 141(a) (granting the board exclusive power to manage corporate “business and affairs” unless varied by certificate). While the existence of a limitation on shareholder intervention by bylaw into corporate operations is universally acknowledged, the exact limit of permissible action is unclear and disputed. See John C. Coffee, Jr., The Bylaw Battlefield: Can Institutions Change the Outcome of Corporate Control Contests?, 51 U. MIAMI L. REV. 605 (1997), Gordon, Shareholder Initiative, supra note 29, at 375-84; Lawrence A. Hamermesh, Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?, 73 TUL. L. REV. 409 (1998).

103. The following discussion derives largely from MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION 22-36 (1965). In the purer sense of a “coordination problem,” discussed supra note 97, there are often very cheap solutions. As discussed above, managing shareholder collective action means managing a governance mechanism and imposing the constraints necessary to stabilize majority rule. Initiating and coordinating a collective action under those circumstances is more difficult and costly than simply designating a time and place for shareholders to appear and cast their votes, or sell their shares. See supra note 97 for a discussion of the ways in which managing shareholder collective action is not a simple coordination problem.

104. See Bainbridge, Disempowerment, supra note 37, at 1753-54.

105. An activist shareholder often must bear additional expenses to “bond” against other shareholders’ suspicions that the activist is acting opportunistically:

Because control provides private benefits, the fact that a rival is interested in replacing the incumbent does not imply that the rival would manage the company better. Consequently, if shareholders do not observe the quality of rivals, but know that the average quality of potential rivals is worse than the incumbent’s, the rational strategy of shareholders will be to vote for the incumbent.

Bebchuk & Hart, supra note 29, at 2; see also Gordon, Shareholder Initiative, supra note 29, at 375-84 (discussing the threat of opportunism that haunts collective action at the initiative of individual shareholders).

There are two basic methods for dealing with this kind of coordination problem. The first is to grant a central decision maker discretionary coordinating power and the concentrated resources to use it. These may include the power to inform the electorate about matters of substance and procedure, the power to make logistical preparations for collecting and tallying votes, and even the power to call or schedule votes, to place items on the agenda and to persuade the electorate to vote for a particular outcome. The second method to lower the cost of collective action is to set fixed rules, such as regular polling times and places.

Both techniques help reduce the cost of coordination by providing a coordinating “convention” around which each participant can coordinate its actions, secure in the knowledge that all participants will probably do likewise. Where the solution is to designate a decision maker, the convention is to follow the decisions of that person or body. Where the solution is to fix a rule, the convention is to follow such rules. It should be noted, however, that a grant of coordinating power does more to reduce the cost of collective action than merely providing an organizing principle for shareholder action. It also reduces information costs by centralizing the gathering and processing of some of the information necessary both to determine what issues should be placed on the agenda for shareholder collective action and to make an informed decision on the issues presented. To this extent, the board’s coordinating power begins to look more like its operating power. Managing the voting agenda and the production of useful information looks more like managing business operations than the classic coordinator’s role (holding up a sign to let scattered participants see where they should gather). In these areas, the difference between operating and coordinating power is not in its fundamental character, but rather in its goal. Operating power has the goal of choosing and pursuing the business goals of the enterprise. Coordinating power has the goal of facilitating and effectuating collective choices by shareholders.

The default Delaware corporate governance regime deals with the costs of collective action almost exclusively by granting the board discretionary coordinating power. By
default, the board has discretionary power to call annual and special elections, set meeting and record dates, put forward candidates and issues for shareholder vote, and use corporate resources to promote the outcomes it favors.109 The board also has discretionary power to run the meeting, open and close the polls, adjourn and reconvene meetings, and, except in certain public companies, judge voter credentials and challenged proxies, although corporate bylaws often assign some of these powers to the chairman of the board or another specific corporate agent.110

The Delaware Code does, however, subject the board’s coordinating power to fixed rules of decision, aimed at preventing extreme abuse. The board, for instance, may call the annual shareholders meeting at the time and place of its choosing, but a fixed statutory rule allows any shareholder to force its hand if it does not call an annual meeting within 13 months of the last meeting.111 Similarly, fixed rules limit the board’s discretion as to the timing and content of the notice to shareholders.112

2. Collective Selling

The foregoing paragraphs deal with shareholder voting, as to which the board’s coordinating power is largely statutory and unquestioned.113 Under modern Delaware law, however, it is also clear that the board has coordinating power over collective sales into a tender offer.114 In the Unocal and Moran decisions, the Delaware Supreme Court held that protecting the interests of shareholders by taking control of collective sales was

109. See DGCL §§ 211(a)(1) & 211(d) (time and place of meetings); 213(a) (record date). The board’s power to propose candidates and to campaign for a particular result is based on its general power to manage the corporation’s business and affairs. Id. § 141(a). At this point, the power is unquestioned. See Hall v. Trans-Lux Daylight Picture Screen Corp., 171 A. 226, 228 (Del. Ch. 1934) (holding that the board has authority to expend corporate resources on a proxy fight when the issues concern policy, not merely personality).

110. See, e.g., Amended and Restated By-Laws of Mercury Interactive Corporation § 3.4 (Exhibit 3.7 to Form 8-K) (Dec. 21, 2005), available at http://www.sec.gov/Archives/edgar/data/867058/000119312505246556/dex37.htm (“The chairman of the board shall, if present, preside at all . . . meetings of the stockholders.”); id. § 2.8 (“The chairman of any meeting of stockholders shall determine the order of business and the procedure at the meeting, including such regulation of the manner of voting and the conduct of business.”). The statute does not assign specific authority for any of these tasks, although it clearly contemplates that they will be done by someone authorized to act for the corporation. See DGCL §§ 222(b) (providing rules for notice of adjourned meetings); 231 (referring to “the person presiding at the meeting” of stockholders and providing that “[t]he date and time of the opening and the closing of the polls . . . shall be announced at the meeting”). Section 231 provides, with respect to certain public corporations, only that “the corporation” must name specific agents—inspectors of elections—to judge the validity of proxies and tally the votes. See id. §§ 231(a) (requiring appointment); 231(e) (limiting application of this section to certain public corporations). The necessary implication is that the board has free discretion to decide how to handle these situations if section 231 does not apply. See id. § 141(a).

111. See DGCL § 211(c).

112. See DGCL §§ 222 (general notice timing and content); 242(b)(1) (content of notice of meeting to approve certificate amendment); 251(c) (content of notice of meeting to approve merger); 271(a) (content of notice of meeting to approve asset sale and minimum vote); 273(a), (b) (content of notice of meeting to approve dissolution).

113. The board’s power to expend corporate funds promoting particular proposals is not explicit in the statute. There is little doubt that DGCL § 141(a) grants this power. See supra note 109.

114. For a discussion of the rough equivalence between voting and collective selling of voting shares, see supra note 28 and accompanying text.
a proper purpose for board action. Accordingly, it allowed boards to use any tools they could devise for that purpose. The tool of choice, after Moran, was Martin Lipton’s “rights plan” (the “poison pill”), a purported issuance of securities that has no obvious business purpose other than giving the board effective control over hostile tender offers. The poison pill and these opinions continue to be controversial among some commentators, but their place in Delaware law seems safe. Indeed, the inference seems almost inescapable that the board must have a “fundamental duty and obligation to protect . . . stockholders,” using any powers at hand.

V. UNDERSTANDING BLASIUS AND UNOCAL: DIFFERING PURPOSES OF OPERATING AND COORDINATING POWER

A. Introduction and Basic Applications

It is initially worth noting that when the board wields coordinating power, it is not merely managing a business in which the shareholders hold an indirect interest. Instead, it is managing the shareholders’ personal governance rights. It is easy to miss this point because those personal rights are largely useless if their exercise is not coordinated and because collective shareholder action functions within the corporation as a governance mechanism. But it is nonetheless true and ultimately important that when non-controlling shareholders vote or sell their shares collectively, each of them is exercising a personal right.

This observation itself helps to clarify the contradictory evidence from existing corporate law that seems, at times, to support shareholder primacy theories and, at times, to support board autonomy theories. The reason why the law sometimes seems to impose on the board direct duties to the shareholders is that the board is sometimes managing the shareholders’ personal, if collective, governance rights. This is true because, as discussed above, the default corporate governance regime constitutes the shareholders as the designated decision maker for a limited but significant set of corporate decisions.

Proponents of board autonomy have often bristled at any suggestion that the board has a duty to the shareholders. They should not. But neither should proponents of shareholder primacy take much heart that the board sometimes owes direct duties to the shareholders. Noticing that the board is sometimes managing shareholder collective action, rather than the corporate enterprise, tends to strengthen board autonomy theory.

First, it eliminates the need to dismiss all suggestions of shareholder rights in case law and statutes as nonsense or error. As noted above, this need has tended to suggest that

117. Unocal, 493 A.2d at 954.
118. See supra notes 27-31 and accompanying text.
120. See supra notes 27-31 and accompanying text.
board autonomy theories were falling short of describing the entire corporate governance structure. If shareholder rights are seen to pertain to the specific areas in which the shareholders and not the board make decisions, it becomes clearer that shareholder interests have no direct role in the vast majority of corporate decisions allocated to an autonomous board. Second, it helps to clarify why the board owes special duties when it is administering the shareholders’ governance rights and why special doctrines apply to regulate those duties.

This section lays out two basic ways in which the differences between operating and coordinating power affect the board’s relationship with shareholders. Subsection 1 of this Section discusses one of the most obvious reflections of the distinction: the difference in standing rules between shareholders’ derivative and direct actions. Subsection 2 develops the distinction by discussing the different meanings of good faith and loyalty in the context of the board’s coordinating power.

1. Standing: Derivative and Direct Causes of Action

The different objects of the directors’ duties in exercising operating and coordinating power is most starkly visible in the different standing rules that apply to shareholders’ derivative and direct suits. Derivative claims attempt to vindicate the corporation’s rights, generally against the board or other corporate agents.\(^{121}\) The Delaware courts emphasize that managing such claims is squarely within the board’s operating power.\(^{122}\) Not surprisingly, shareholders generally have no standing to pursue the corporation’s legal claims; shareholders generally have no operating power at all in the default corporate governance scheme.

To establish standing to represent the corporation in court, a shareholder must allege with particularity some reason why the corporation’s authorized decision makers—the board and the officers, employees, and agents it designates—cannot be trusted to manage the corporate claims alleged.\(^{123}\) In other words, a shareholder can obtain standing to pursue a corporate claim only by establishing that the normal governance mechanism is so corrupted, as to that claim, that it cannot be relied upon to make decisions regarding that claim.\(^{124}\) Even then, the shareholder obtains standing only as a representative of the

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\(^{121}\) Because derivative standing requires a showing that the current board is too conflicted to be trusted with the action, shareholders rarely try to get derivative standing to vindicate the corporation’s claims against non-fiduciary third parties. In theory, such actions are possible. One of the few practical appearances of this theory is Miller v. American Telephone & Telegraph Co., 507 F.2d 759 (3d Cir. 1974), where the Third Circuit reversed the district court’s dismissal of an attempted derivative suit to enforce the Democratic National Committee’s debt to AT&T for services rendered at the 1968 Democratic national convention. The plaintiff did not allege that the AT&T board’s decision to leave the debt uncollected was self-interested. He recognized that the board’s purpose was to benefit the corporation, but argued that its decision was a breach of fiduciary duty because it caused the corporation to break the law.

\(^{122}\) See, e.g., White v. Panic, 783 A.2d 543, 550 (Del. 2001) (“In most situations, the board of directors has sole authority to initiate or to refrain from initiating legal actions asserting rights held by the corporation.”).

\(^{123}\) See Del. Ch. R. 23.1; Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984) (“[I]n determining demand futility the Court of Chancery in the proper exercise of its discretion must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.”).

\(^{124}\) See CLARK, supra note 61, at 138 (“The charge is not simply that the managers’ business judgment
corporation, not to pursue its individual interests. Moreover, the board retains its power to manage the claim if it can reestablish the credibility of its decisions.

By contrast, a shareholder complaining about the misuse of coordinating power has uncomplicated standing to sue in its own name. This is true even if the shareholder’s claim and the relief it seeks pertain to a collective interest of all shareholders rather than the plaintiff’s individual interest. A prime example of this is the shareholder’s direct standing to force candid disclosure prior to a shareholder vote. The fact that the plaintiff shareholder, by definition, is aware of the inaccuracies in prior disclosures does not moot the case.

When courts grant standing to shareholders in such cases, they are not, as they sometimes imply, merely allowing shareholders to vindicate their personal rights in the same way they would grant them standing to collect damages for personal injury or a breach of contract. Rather, they are treating shareholders as the direct beneficiaries of the board’s fiduciary powers. It is no coincidence that shareholders’ standing in these cases resembles that of common law trust beneficiaries. Trust beneficiaries have direct standing to seek remedies for breaches of fiduciary duty, even if they have no power under the trust to direct the trustee’s decisions or even to remove and replace the trustee. In each case, the beneficiary has a personal interest in the cause of action only because the fiduciary’s unambiguous duty is to exercise its discretion in the beneficiary’s interest.

Delaware courts are aware of this distinction between coordinating and operating power, although they have not specifically identified it. As the Delaware Supreme Court pointed out in Tooley, Delaware law has long distinguished between the board’s duties directly to shareholders and its duties to the corporation in which they have only a derivative interest. Faced with a single statutory grant of power to manage “[t]he business and affairs of [the] corporation,” however, courts have been very unclear in explaining why some exercises of that power involve direct rights and others do not. The differing treatment becomes clearer if we recognize that the board manages both

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125. See, e.g., Tooley, 845 A.2d at 1036 (stating that when a derivative plaintiff brings “suit on behalf of the corporation for harm done to the corporation . . . . [T]he recovery, if any, must go to the corporation”). Likewise, the Chancery Court rules require a court to review any proposed settlement or voluntary dismissal of a shareholder derivative suit for fairness. See Del. Ch. R. 23.1.


127. See, e.g., Zirn v. VLI Corp., 681 A.2d 1050 (Del. 1996). Where a shareholder vote has taken place, the Delaware statute expressly grants any shareholder standing to challenge its validity. See DGCL § 225(a). Not all direct actions concern the board’s coordinating power. A suit to enforce the payment of a declared but unpaid dividend or to require the corporation to register a share transfer would, for example, concern direct duties owed by the board to shareholders, but not the power to manage collective action by shareholders.

128. Prior to Tooley, there was considerable confusion as to whether a shareholder adequately alleged a direct claim if all shareholders had the same claim. In Tooley the court held that the question is whether the duty is owed to shareholders directly, not whether it is owed differently to one or another shareholder. See Tooley, 845 A.2d at 1038-39.


131. See Tooley, 845 A.2d at 1036 & n.9.

132. DGCL § 141(a).
corporate operations and collective action and that the shareholder’s interests in these two tasks are different. It is important to note, however, that having direct standing to complain is not the same thing as having a valid cause of action. In Tooley, for instance, the court held that the shareholder’s complaint against the board for agreeing to delay closing a third-party tender offer was direct in nature, but also held that the shareholder failed to state a claim upon which relief could be granted. Likewise the allegations of corruption in the board’s decision making process that establishes a shareholder’s derivative standing to bring a corporate claim, says little about the ultimate strength of that claim. The next subsection will examine how the distinction between operating and coordinating power affects the shareholder’s case for breach of fiduciary duty.

2. Fiduciary Duty in the Exercise of Coordinating Power: Outcome Manipulation as Bad Faith

The object of the board’s discretion is different in kind when it is exercising its operating and coordinating powers. In exercising operating power, the board’s job is to tend to the interests of the incorporated enterprise. The potential to benefit shareholders is a likely and intended result of serving the interests of the enterprise, but it is not the direct or even a necessary objective. By contrast, the board’s job in exercising coordinating power is to facilitate effective and efficient exercises of shareholder collective action. The benefit to shareholders is direct. The potential benefit to the enterprise is, again, a likely and intended result of turning over certain decisions to the shareholders, but it is not the direct or necessary objective. The board is now acting to maximize the value of the shareholders’ personal rights to participate in collective action. Neither the fictional corporate entity nor any other corporate constituent has any valid claim to control the exercise of this power, although individual constituents may have strong interests in the

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133. The Delaware courts also seem to recognize direct fiduciary duties after the board decides to sell the business. Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985). However, as discussed infra notes 205-209 and accompanying text, the distinction in these cases is premised not on the board’s role in organizing collective action, but rather on the consequences of the board’s prior decision, which effectively narrows the business plan to a short-term liquidation for the benefit of the shareholders. In a true Revlon case, the shareholder’s claim to direct standing is identical to the common law trust beneficiary’s.

134. See Tooley, 845 A.2d at 1039.

135. See, e.g., In re Walt Disney Co. Derivative Litig., Civ. A. No. 15452, 2005 WL 2056651 (Del. Ch. Aug. 9, 2005) (rejecting derivative claims after trial). See also In re Walt Disney Co. Derivative Litig., No. 411, 2005, 2006 WL 1562466, at *24 n.95 (Del. June 8, 2006) (“[O]ur decisions clearly hold that for purposes of rebutting the business judgment presumptions, the plaintiffs have the burden of proving bad faith” at trial.).

136. For a discussion of the role of shareholder collective action in the default corporate governance scheme, see supra notes 25-31 and accompanying text.

137. For a discussion of reasons for granting voting rights to shareholders, see supra note 29. The better view seems to be that shareholder voting is desirable mainly because the shareholders’ interests in the corporate enterprise are so indefinite that they are difficult, if not impossible, to spell out with enough precision to support judicial enforcement. Shareholders are therefore well served by a governance mechanism that allows them to hold the board accountable. See, e.g., Bainbridge, supra note 37, at 21-27; Macey, supra note 29, at 36-40. The assumption behind these theories, however, is that the corporate enterprise benefits when some corporate constituents participate on the basis of holding common stock. That assumption implies that the corporate enterprise, and with it, all constituents, benefits indirectly from granting the governance rights that help induce people to participate on that basis.
outcome.

Within the set of decisions allocated to collective shareholder action, the validity of individual actions cannot depend on a judgment—which by the board, a court, or anyone else—that it serves the best interests of the enterprise. To the contrary, the logic that protects board decisions against second-guessing with the business judgment rule applies here with equal force. If shareholder collective action functions as a true governance mechanism, its validity must depend on procedural regularity alone. The shareholders truly decide only if they can freely make poor decisions.

This is important because the board’s normal duty is to use all available legal means available in pursuit of its honest assessment of the corporation’s best interests. The board could easily and honestly conclude that the shareholders’ preference on a particular question would harm the enterprise (and maybe even the value of the shares). Nonetheless, if the statute or the certificate allocates a decision to shareholder collective action and the shareholders are well informed and of one mind, the board has no coordinating power to do anything other than help them make that decision effectively. The board’s judgment as to the shareholders’ wisdom must ultimately be irrelevant.

The result of the foregoing is that the board’s fiduciary duty is very different when it exercises coordinating power. Fiduciary duty means, in essence, dedication to some purpose other than the fiduciary’s self-interest. It logically follows that any change in that ultimate purpose will change the exact duty. More importantly, the kind of evidence that might call into question a fiduciary’s dedication to one purpose could be irrelevant to another. In particular, the facts that constitute bad faith in the exercise of a board’s operating power—the pursuit of interests other than those of the corporate entity—are not directly relevant to the board’s ultimate purpose in exercising coordinating authority.

What facts call good faith directly into question in the context of coordinating power? The major danger inherent in granting discretionary coordinating power to facilitate collective decision making is that it can be used to manipulate the outcome. Granting centralized coordinating power over the agenda, in particular, is a double-edged sword. While some such power is necessary to stabilize pure majority rule, the very

138. See Thompson & Smith, supra note 29, at 263 (drawing an analogy between the benefits of insulating board decisions against interference through the business judgment rule and insulating shareholder decisions against interference through proposed “sacred space” principles).

139. The board’s duties, of course, include helping the shareholders make an informed choice and we expect the board to speak out loudly if it feels the shareholders are likely to make a mistake. See, e.g., McMullin v. Beran, 765 A.2d 910, 919 (Del. 2000) (holding that the board of a majority-owned subsidiary had a duty to inform itself before speaking to shareholders regarding the advisability of accepting the parent’s offer in a short-form merger or seeking judicial appraisal). Likewise, it is fairly clear that the appropriate realm for shareholder collective action within the default corporate governance scheme is highly limited and that the board has significant discretion to limit it, among other things, in order to stabilize majority rule. See supra notes 99-102 and accompanying text. It is my thesis, however, that the tension between the board’s discretion in exercising coordinating power and the special goals of that power has been at the heart of the Unocal and Blasius lines of cases. See infra Part V.B.

140. See, e.g., Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) (“Although the fiduciary duty of a Delaware director is unremitting, the exact course of conduct that must be charted to properly discharge that responsibility will change in the specific context of the action the director is taking with regard to either the corporation or its shareholders.”).

141. See supra notes 99-102 and accompanying text.
The Meaning of Loyalty

instability that makes it necessary also makes it dangerous. In theory, a person with complete control over the voting agenda can produce any desired result through careful manipulation of vote matchings and the order of votes.\footnote{See Shepsle & Weingast, supra note 99, at 510. Agenda control is especially powerful where the status quo is especially undesirable. See Thomas Romer & Howard Rosenthal, Political Resource Allocations, Controlled Agendas, and the Status Quo, 33 PUB. CHOICE 27, 35-36 (1978). This presumably heightens the importance of agenda control in a hostile takeover situation, where the status quo—the trading price of a stock without the immediate prospect of a control premium—is painful to the shareholders.}

This theory is not very far from practical reality. Every politician, board chairman, proxy solicitor, dean, committee chair, and Delaware judge understands the power of agenda control. Examples of its use abound. In the \textit{Unocal} case, for instance, the target board initially attempted to counter a hostile tender offer for the target’s shares by causing the target to run a simultaneous offer to exchange stock for debt worth more than the bid price if the hostile bid succeeded.\footnote{Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 951 (Del. 1985).} If the hostile bid failed, however, the offer was void and the tendering shareholders would return to the status quo. Under heavy criticism, the board quickly dropped the condition that the hostile bid succeed. But the original idea was clear: By forcing the shareholders to choose between two options of the board’s choosing, the board hoped to induce them, in effect, to turn down an offer they probably would have accepted if it were otherwise presented.

The point is not that the board necessarily harms shareholders’ interests by using its coordinating power to manipulate the outcome of their collective action. To the contrary, in the hands of a faithful, well-informed, and rational board, such manipulation could reduce the danger that careless or ill-informed shareholders might act against their own rational interests. In \textit{Unocal}, for instance, the board does not seem to have been badly motivated. In fact, the Unocal board seems to have felt justified in its tactics in large part because it was trying to thwart a raider who was himself using a kind of agenda manipulation in an attempt to fleece the target shareholders.\footnote{In hostile takeovers, the bidder attempts to coordinate shareholder collective action but, unlike the board, it has no coordinating power in the governance structure to use for that purpose. The only tool for coordination is the offer itself. Because the bidder is not exercising any fiduciary power, its efforts to coordinate shareholder action are not subject to fiduciary duties. Unlike the board, the bidder also has an economic interest directly adverse to the shareholders’ economic interests. In \textit{Unocal}, Mesa attempted to minimize the consideration to Unocal’s shareholders by deliberately shaping its offer to bundle two separate decisions: whether the shareholder wanted to allow Mesa to take control on the terms offered and, if so, whether the shareholder wanted to participate in the first tier consideration that everyone understood was more valuable than the consideration that would be offered in the second tier. Effectively, shareholders could opt to participate in the first tier only if they simultaneously approved the takeover. The assumption behind Mesa’s offer was that shareholders might well decide differently if they were allowed to approve or disapprove the offer collectively and only asked whether they wanted to participate if the offer was first collectively approved. The problem was not exactly agenda manipulation, in that the second decision was personal, not collective. As in agenda manipulation, however, the source of the problem was Mesa’s control over the ordering of the shareholders’ decisions.} Professor Bainbridge believes that this potential for benefit is important enough to constitute the board as a Platonic guardian over the corporation, free to prevent or distort shareholder action, so long as it is honestly pursuing the interests of the corporate enterprise.\footnote{See Bainbridge, Corporate Takeovers, supra note 30, at 813-14.}

Rather, the point is that allowing the use of discretionary coordinating power to
predetermine the result of collective action fundamentally transforms its function as a
decision making mechanism. If we allow the board to influence the result of collective
shareholder actions, other than by candid information, collective shareholder action
ceases to be a decision making mechanism. Instead, it becomes an advisory process.
Shareholders’ preferences will still matter in some cases, but only if the board is either
too indifferent or uncertain to make its own decision.146

For this reason, the board subverts the purpose of its coordinating power if it uses
that power to determine the outcome of decisions allocated to collective shareholder
action. The board holds that power to facilitate decisions that express the shareholders’
preferences, not to manipulate the voting to achieve predetermined results. Actions taken
for the purpose of manipulating the outcome of a collective shareholder action are, in this
context, taken in bad faith. This is true even if the outcome the board seeks reflects its
honest assessment of the corporate interest.

This subsection has analyzed in the abstract the difference between the board’s
fiduciary duty in exercising its operating and coordinating power. To state the board’s
duty, however, is not the same as stating the rules by which courts oversee its exercise of
that duty.147 The following section will use the analysis developed above to explain how
the courts have dealt with the board’s exercise of its coordinating authority in the Blasius
and Unocal lines of cases.

B. Understanding Blasius and Unocal

1. Blasius

The Blasius line of cases directly reflects the distinct purpose of the board’s
coordinating power. The Blasius rule is that the business judgment rule does not protect a
board decision if a shareholder can show that the “board of directors act[ed] for the
primary purpose of impeding or interfering with the effectiveness of a shareholder
vote.”148 After the shareholder has made this showing, the board must show a
“compelling purpose” for its decision to survive scrutiny. To date, no one has ever proved
a compelling purpose and the courts have given no hint as to what might qualify or
why.149 Faced with an apparently outcome-determinative test based entirely on findings

146. The situation is more nuanced. As the intensity and uniformity of the voters’ preference increase and the
intensity and certainty of the agenda-setter’s preference decrease, the agenda-setter’s power to manipulate
becomes less important to the result. The point is, however, that if the board’s preferences are irrelevant, their
intensity should also be irrelevant.

147. See William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., Function Over Form: A Reassessment of
Standards of Review in Delaware Corporation Law, 56 BUS. LAW. 1287 (2001) (noting difference between
standard of board conduct and standard for court review); Melvin Aron Eisenberg, The Divergence of Standards

148. MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1128 (Del. 2003); see also Blasius Indus., Inc. v.

*42-55 (Del. Ch. Dec. 4, 2000), the Chancery Court reviewed a “plethora” of justifications for adjourning a
meeting until management could drum up enough votes in its favor to win approval for a certificate amendment.
While the court held that none of the justifications by itself was compelling, it was not comfortable deciding as
a matter of summary judgment that, collectively, they could not meet the standard. This judgment seems to
of subjective intent, courts have rarely applied *Blasius* to invalidate a board decision and have publicly proclaimed their reluctance to do so. Why then do the courts insist on a separate standard of review that almost never applies and, when it does apply, serves more as a basis for condemning the board than reviewing it?

Chancellor Allen stated the basic justification in a much-cited passage in *Blasius*:

[T]he ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context. A board’s decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of the corporation’s power over its property, or with respect to its rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation.

What this explanation assumes but leaves unstated is the board’s *legitimate* role in the voting process. If it is important to preserve untrammeled shareholder power over certain areas, why should we allow any interference by the board of directors? Courts, understandably, have avoided answering this question directly. Rather than forcing boards to abstain from certain kinds of intervention in the voting process, courts have generally preferred to abstain from the process themselves. Unable to articulate exactly what the board should be doing to manage elections, courts interfere only in board actions that seem entirely illegitimate, such as shutting down elections altogether, disseminating false or misleading information, or openly threatening shareholders to coerce them into agreeing to a chosen result.

Several commentators, especially advocates of shareholder primacy, have commented on the more subtle abuses that seem to escape review because courts are uncertain what board interference in collective action is legitimate. These commentators have proposed one or another form of mandatory board abstention to solve the problem. These proposals, however, can never be as bold as they sound. It has been intuitively obvious to courts (and most commentators) that it is useful, and perhaps necessary, to grant the board at least some discretionary power to coordinate shareholder collective actions. The need for fiduciary coordinating power is particularly

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151. *Blasius*, 564 A.2d at 659-60.
152. See Easterbrook & Fischel, *supra* note 42 (proposing board passivity in the face of hostile bids); Gilson, *Structural Approach, supra* note 29, at 1201-03 (proposing modified abstention); Thompson & Smith, *supra* note 29 (proposing “sacred space” in which untrammeled shareholder power assures shareholders can make decisions as to their own interests, rather than relying on fiduciary duties).
153. See, e.g., Thompson & Smith, *supra* note 29, at 309 (“Our proposal is not one that says that shareholders and markets should always determine the results of takeovers. We expressly recognize director ability to temper or delay shareholder action for the benefit of shareholders or other constituencies.”). Easterbrook and Fischel took a more extreme position, proposing a ban on all acts by “managers” in reaction to a tender offer, all of which they viewed as “resistance.” Easterbrook & Fischel, *supra* note 42, at 1201-03 (arguing for a presumption that “plans or programs set in motion before target managers had reason to believe that there would be a takeover attempt” are not resistance measures and a contrary presumption for all business decisions taken thereafter).
compelling in a contested proxy fight or a tender offer, since a third-party bidder is attempting to coordinate the shareholders to take collective action in the bidder’s personal interest. Although the bidder has no coordinating power, it can gain considerable leverage from shaping its offer, and is under no fiduciary constraints in doing so. 154 What is missing from these abstention proposals, like Blasius itself, is a positive theory of how much or what kind of discretionary board power is beneficial.

What the courts and commentators alike have been intuited is the distinction between the purposes of operating power and coordinating power. As the objects and purposes to be served by a fiduciary change, the definition of what behavior is in good faith and the considerations attendant to allowing shareholder enforcement also necessarily change. By applying the distinction between the two types of power, then, it becomes easier to analyze the differing application of fiduciary duties to them.

As discussed above, the board holds its coordinating power for the purpose of facilitating effective collective expression of the shareholders’ preferences. 155 This seems to be what Chancellor Allen meant when he noted that he was confronting something different from “the exercise of the corporation’s power over its property, or with respect to its rights or obligations.” 156 Shareholders have a direct cause of action for breach of duty with respect to coordinating power because the purpose and corresponding duty is different.

The most obvious result of a different duty, which animates the logic of Blasius if not its wording, is a different meaning of good faith: the range of legitimate subjective motives for a board decision. A board exercising operating power acts in good faith if it honestly believes it is serving the best interests of the corporate enterprise. 157 By contrast, a board exercising coordinating power acts in good faith if it honestly believes it is serving the interest of shareholders, as such, 158 in effective collective action.

Blasius expressed this distinction by holding that the board could be liable on the basis of an improper subjective purpose, even if it was acting “in good faith.” 159 As discussed above, juxtaposition seems contradictory, on its face. 160 Either the board was acting for a proper purpose or it was not. If the board was not acting for a proper purpose, it seems wrong to say that it acted in good faith. What Chancellor Allen seems to have meant by “good faith,” however, was good faith in the context of operating power. In other words, motivations that constitute good faith in the exercise of operating power can

154. See supra note 144 for a discussion of the problem of bid manipulation.
155. See supra notes 136-147 and accompanying text.
156. Blasius, 564 A.2d at 660.
158. By “the interests of shareholders, as such,” I mean to distinguish the inherent interests of someone holding stock from the idiosyncratic interests of the persons who happen to do so. An individual holding stock might be interested in obstructing shareholder action, for instance, because he anticipates that an effective meeting will cause him to lose a lucrative job with the company. A shareholder in the abstract would not have that extraneous interest. Directors serve the interests of the shareholders in the manner of a trustee, not an agent. See supra note 130 and accompanying text. They have no duty of obedience to the expressed desires of persons holding shares (even a majority of them). They only have a duty of loyalty to act in what they reasonably and honestly conceive to be the interests of the shareholders as such. See supra note 26.
159. Blasius, 564 A.2d at 653.
160. See supra note 77 and accompanying text.
coexist with motivations that constitute bad faith in the exercise of coordinating power.

Considering the different purposes of the two powers, this point should not be surprising. Blocking a shareholder vote that seems likely to result in a foolish decision might be entirely in keeping with the purpose of the board’s operating power—to judge and further the corporate enterprise’s best interests. The reason the board cannot use its coordinating power in good faith to thwart a successful shareholder vote is that it holds that power for an entirely different purpose. The board properly exercises its coordinating power to facilitate successful shareholder votes, even if these votes lead to foolish outcomes. Blasius points out that only the latter purpose is relevant in judging an exercise of coordinating power. Honestly pursuing the corporate enterprise’s best interest can easily be a bad faith motivation for exercising coordinating power.

Once we analyze Blasius this way, it suddenly fits comfortably into the general structure of Delaware fiduciary law. A shareholder who can prove that a majority of the board acted in bad faith rebuts the business judgment rule and states a case that is all but determinative of liability, at least for those directors shown to have acted in bad faith. As in Blasius, it is nearly inconceivable that a board could bear its burden of showing that its decision was entirely fair, in the sense of both fair price and fair dealing, if the plaintiff established that a majority of the directors were not acting in what they subjectively believed to be the corporation’s best interests.

Like the Blasius plaintiff, however, plaintiffs seeking to make a case that the board breached its duty of good faith face a very difficult evidentiary hurdle. Operating power cases premised purely on a theory of bad faith rarely, if ever, succeed. That plaintiffs rarely succeed in proving the subjective bad faith required to make out a claim under Blasius is not surprising in this light.

161. See supra note 59.

162. Courts have made clear that a board can rebut a prima facie case that its decision did not reflect business judgment only by establishing “entire fairness,” not simply whether the outcome of the transaction was concluded on “below market” terms. Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993) (considering fair dealing in the absence of challenge to fair price); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983). Properly understood, the board’s burden is to prove to a court’s satisfaction the same sound business judgment that the court would presume if the board’s decision making process was not corrupted. For this reason, the board’s burden is the same, whether the plaintiff placed its judgment into question by demonstrating a lack of good faith, a conflict of interest, or gross negligence. See Cinerama v. Technicolor, Inc., 663 A.2d 1156, 1163 (Del. 1995). This is a recurring pattern in litigation against corporate boards. Because the board retains its institutional position as the designated corporate decision maker, the court will defer to the board’s decisions, even if it reached them under suspicious conditions, if the board can prove that it actually exercised sound business judgment. See, e.g., Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995) (holding that the decision of an independent board to resist a hostile takeover attempt will be respected if the board can prove elements of business judgment and the court has no reason to think the method chosen was out of the range of reasonable responses to the stated objective or was preclusive of future shareholder action); Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981) (holding that the decision of the independent litigation committee to terminate the derivative suit will be respected if the committee can prove the elements of business judgment and the court does not doubt the result reached by the committee as a matter of substantive business judgment); Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657 (Mass. 1976) (allowing the board of a closely held corporation to defend its decisions inflicting disproportionate harm on minority shareholders by proving elements of business judgment unless the plaintiff can prove that the board could have achieved its stated objective in a less harmful manner).

This understanding of *Blasius* also helps to explain why the case appears to support and undermine both shareholder primacy and director autonomy theories. Chancellor Allen was not, as Professor Bainbridge fears, nodding off when he wrote that “[t]he theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters.”\(^{164}\) Allen did not mean, as Bainbridge assumes, that the board can generally be described as an agent of the shareholders. Rather, he meant that the board misplaces its duties when it tries to exercise coordinating power to force an outcome it feels best serves the corporate interest. In this context, but, importantly, only in this context, the board’s power to pursue corporate interests is only indirect: the power to assure that the designated decision making mechanism functions properly.

This analysis places *Blasius* largely in harmony with board autonomy scholars. Unfortunately for shareholder primacy scholars, it seems unlikely that Chancellor Allen would extend his characterization of the board’s duties to questions of operating power. Nor need Bainbridge fight against *Blasius* out of concern that admitting any direct duties to the shareholders means stepping on a slippery slope away from board autonomy. The slide stops at the division between operating and coordinating power.\(^{165}\)

2. *Unocal*

Analyzing *Blasius* cases as actions challenging bad faith board decisions also explains the relationship between *Blasius* and *Unocal*. *Unocal* represents an evidentiary shortcut to *Blasius*: an action premised on proving a set of objective facts that raise a presumption of disloyalty, rather than on proving actual bad faith motives.\(^{166}\) I will elaborate on this relationship below, but it is first worth noting that it is analogous to the

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\(^{164}\) *Blasius*, 564 A.2d at 659-60; see *supra* notes 80-81 and accompanying text (describing Bainbridge’s criticism of *Blasius*). Incidentally, Allen seems wrong to characterize the board as the shareholders’ “agents.” The proper analogy is to trustees, who owe the trust’s beneficiaries directly enforceable fiduciary duties, but generally owe a duty of obedience only to the trust document. See *supra* note 130 and accompanying text. Allen has himself commented on this analogy and was presumably using “agent” loosely in *Blasius*. See *Cinerama*, 663 A.2d at 1148 (noting an analogy between a trustee’s duty to follow the trust instrument and a director’s duty to follow the corporate charter).

\(^{165}\) I do not mean to suggest that the division between operating and coordinating power is always clear. Because the Delaware Code grants the board no direct powers to manage tender offers, many of the powers boards use to assert control are primarily operating powers. The poison pill, relying on the power to issue securities under DGCL section 151, is the most important example. Signing lock-up contracts and selling blocking positions to white knights also blur the line between operating and coordinating power. See, e.g., Carrick Mollenkamp, *Sovereign Shareholder Wants NYSE Inquiry*, WALL ST. J., Nov. 8, 2005, at C1. This ambiguity weakens the board’s operating power in the context of control contests. It does not, however, threaten the larger principle of the board’s autonomy in the exercise of its operating powers.

\(^{166}\) For a discussion of the relationship between actions for breaches of the duties of good faith and loyalty, see *supra* notes 3-24 and accompanying text. Calling *Unocal* a shortcut may be somewhat deceptive in this context. It is not clear from the reported cases that either *Blasius* or *Unocal* claims often succeed or that one is more likely to succeed than the other. See Thompson & Smith, *supra* note 29, at 284-86 (declaring the “death of Unocal”). See also *infra* notes 183-189 and accompanying text (discussing some reasons why *Unocal* may be of more limited use than an analogy to traditional conflict of interest cases would predict). That said, it is clearly easier for plaintiffs to make out a prima facie case under *Unocal* than *Blasius* (or, for that matter, under Rule 23.1). If the reported cases hide unreported settlements, it could well be that *Unocal* is much more successful than *Blasius* for this reason.
relationship between actions for breach of the duties of good faith and loyalty in the exercise of operating power. As discussed above, the duty of loyalty in the context of operating power is also an evidentiary shortcut, allowing a challenge to the board’s good faith that does not require proof of subjective motivation.\(^{167}\)

Although *Unocal* actions are similar to traditional actions for breach of the duty of loyalty in their general function, they are different in important particulars. This is not surprising. One would not expect the objective situations that cast doubt on the board’s motives in exercising operating power to be the same as those that cast doubt on its motives in exercising coordinating power. As noted above, *Unocal* cases, unlike traditional loyalty cases, do not turn on a suspicion that the directors are seeking their own self-interest.\(^{168}\) Rather, a plaintiff can make out a prima facie case under *Unocal* by proving that the board took action to defend against a takeover attempt without any evidence that individual directors are interested in the decision or dominated by someone who is interested, judged by traditional standards.\(^{169}\)

The *Unocal* rule begins to look less odd, however, when the differences between coordinating and operating power are taken into account. In *Unocal* cases, the conflict that is always submerged within the board’s coordinating power comes unmistakably to the surface and raises a presumption of disloyalty. The underlying logic of *Unocal* and *Blasius* is the same: the board acts improperly when it exercises its coordinating power for the purpose of influencing the outcome of a contested shareholder collective action, *no matter what its reason for preferring that outcome.*\(^{170}\) The suspicion is not that directors are seeking personal benefit, but rather that they have lost track of their proper role in shareholder collective actions. Pursuing a particular outcome automatically conflicts with the proper purpose of the board’s coordinating power-to effectuate shareholders’ power of decision. Just as facts that establish an economic conflict of interest raise a strong presumption of an improper bias or worse,\(^{171}\) facts that establish that the board has taken actions that have the effect of influencing the outcome of a contested shareholder collective action raise a strong presumption that the board acted for the improper purpose of influencing the outcome.

The divergence between the standard of proof a board must meet to rebut a presumption of traditional conflict of interest and the board’s standard of proof under *Unocal* also becomes less mysterious when viewed in light of the differences between coordinating and operating power. Although actions for traditional conflict of interest and *Unocal* actions are structurally similar, the suspicion raised by the plaintiff’s evidence is different in each case. Consequently, the rebuttal demanded by the board also differs.

When a plaintiff shows a traditional conflict of interest, we suspect that the directors have favored their own direct or indirect economic interests at the corporation’s expense. Proof of entire fairness is designed to allay that particular suspicion. Directors must address both “fair dealing”—proof that they conducted the transaction in a manner

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167. *See supra* notes 16-21 and accompanying text.
168. *See supra* notes 60-69 and accompanying text.
169. *See supra* note 43 and accompanying text.
170. *See supra* notes 157-162 and accompanying text.
171. For a discussion of the relationship between actions for breaches of the duties of good faith and loyalty, see *supra* notes 3-24 and accompanying text.
conducive to a fair result and not suggesting slinking or deception— and “fair price”—proof that the process produced terms comparable to what might have been obtained from arm’s-length dealing. Given the myriad ways in which self-interest can bias both a transaction and the evidence adduced to show its fairness, neither element is sufficient alone. Strong evidence of an apparently fair procedure does little to allay suspicion if it produces terms grossly unfair to the corporation. Likewise, a professional valuation loses much of its sheen if the transaction is concluded in the dark of night or if interested directors deliberately conceal material facts from independent board members or shareholders. The end result of an entire fairness analysis is not a valuation or appraisal. It is an assessment of whether the directors have proved that they did not favor themselves in the transaction.

The reason the standard of proof required of directors in traditional conflict-of-interest cases is not applied to the board in *Unocal* actions does not seem to be, as some have suggested, that it is hard to value what the board has seized. The problem is that the entire fairness test is trying to allay an entirely different suspicion. To rebut a case under *Unocal*, the directors must allay the suspicion that they were trying to influence the outcome of a decision that should be made by the shareholders. As Professor Gilson has noted, evidence that the board negotiated a fair price for the corporation in paying greenmail is entirely beside the point. Although he did not put his finger on the exact conflict of interest that concerned him, Gilson’s analysis demonstrates exactly why entire fairness cannot be the board’s burden of proof in *Unocal* cases: It is irrelevant to the question at hand.

The resulting standard of proof is now easy to understand. Like the entire fairness standard and any number of similar tests requiring fiduciaries to prove their fidelity, the *Unocal* standard requires proof of both procedural regularity and substantive reasonableness. In a *Unocal* case, both elements are geared to proving that the board did not act to influence the outcome of a shareholder decision. The first prong of *Unocal* demands a showing of procedural regularity; the board must specify the purpose for its decision and demonstrate that it decided on that purpose only after reasonable investigation.

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172. See, e.g., Nixon v. Blackwell, 626 A.2d 1366, 1379 (Del. 1993) (holding that directors showed sufficient fair dealing where policies favoring employee shareholders over outside shareholders had their inception in policies originally adopted by the former controlling shareholder). For a discussion of the meaning of entire fairness, see supra note 162.


174. See id. at 711 (“[T]he test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.”).

175. See id. at 711 (“[T]he test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.”).

176. See id. at 711 (“[T]he test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.”).

177. See supra note 29.

178. This is not the phrasing used by *Unocal* and its progeny. They require the board to demonstrate that they “had reasonable grounds for believing that a danger to corporate policy and effectiveness existed . . . . by showing good faith and reasonable investigation” and that their action was “reasonable in relation to the threat posed.” *Unocal* Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). Asking a board to prove that it determined a threat in good faith, as opposed to making up something that sounded plausible, and to prove that its action was related to that threat, is the same as asking it to offer proof of good faith—an actual and proper
decisions to give an appearance of procedural regularity. The requirement, however, presumably discourages at least some independent boards from reflexively defending against any and all hostile proposals.\textsuperscript{179} It also catches boards so oblivious to the problematic nature of the proposed action that they clearly justify the suspicions raised by a \textit{Unocal} case.\textsuperscript{180}

The second prong of \textit{Unocal} demands substantive reasonableness. Regardless of how the board decided on a defensive action, it must show that the effect neither precluded the shareholders from entertaining hostile bids altogether nor coerced the shareholders into accepting a board proposal. It must also must show that its action fell within a range of reasonable responses to its stated purpose. These two substantive tests are designed to detect decisions the substantive result of which casts doubt on the procedural bona fides of their adoption. The coercive/preclusive test looks for results that, regardless of the good reasons for adopting them, have the effect of forcing the outcome of collective shareholder action.\textsuperscript{181} The “range of reasonableness” test looks for decisions that simply do not follow from the valid purposes the board claims prompted them.

In other words, \textit{Unocal} does not impose an “intermediate” standard of review somewhere between entire fairness and business judgment. Rather, it imposes a test that parallels traditional entire fairness review. The difference is in the object, not the degree, of court scrutiny.

If this analysis makes the nature of \textit{Unocal} review clearer, it also highlights one of its most problematic aspects.\textsuperscript{182} Critics have noted that it seems too easy for a well-motivation for the action it took. The standard of proof required is not very demanding, but that is the nature of what the board must prove.

179. See Gilson & Kraakman, \textit{supra} note 51, at 271-72 (arguing that a tough proportionality review could generate “systemic institutional effects” by forcing boards to think carefully about why they were rejecting an offer). Gilson and Kraakman do not feel that the Delaware courts have required sufficient proof of “substantive coercion” to generate this effect. See Gilson, \textit{Unocal, supra} note 28, at 497 n.23.

180. Arguably, boards that have failed this element have also been susceptible to attack under the business judgment rule for traditional self-dealing. See Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000) (noting that the board obviously was dominated by a self-dealing officer, the board was unable to demonstrate minimal care, and that the court did not believe the pretense of neutral purpose); \textit{In re Dairy Mart Convenience Stores, Inc. Derivative Litig., Civ. A. No. 14713, 1999 WL 350473} (Del. Ch. May 24, 1999) (noting the presence of a double self-dealing transaction, that the board was unable to demonstrate minimal care, and that the court did not believe the pretense of neutral purpose).

181. As discussed above, this test is distinct from \textit{Blasius} in that it turns on the practical effect of the decision, rather than the subjective motivations of the directors in adopting it. In \textit{Unitrin}, for instance, the Delaware Supreme Court instructed the Chancery Court to determine on remand whether the Unitrin board’s action would make a hostile bid “mathematically impossible or realistically unattainable.” Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1389 (Del. 1995). Even if the board met this burden of proof, however, the court noted that the plaintiff could still succeed under the business judgment rule by proving that the directors’ actions “were primarily based on . . . perpetuating themselves in office.” \textit{Id.} at 1390.

182. Another interesting question raised by this analysis is whether \textit{Unocal} should be expanded. Arguably, \textit{Unocal’s} concerns apply equally in any contested corporate election. Should the courts presume disloyalty on a showing that the board expressed a preference for a particular outcome and took an action that tended to promote that outcome? It is beyond the scope of this Article to answer this normative question, but it is worth emphasizing why it is a normative policy question and not a simple matter of logic and consistency. \textit{Unocal} is not a logical corollary of the board’s duty of good faith, any more than are traditional loyalty actions. Rather, \textit{Unocal’s} presumption of liability without a showing that the directors acted out of improper subjective motives reflects a policy judgment. At least two distinct policies are involved. The first is the policy toward enforcing fiduciary duty. An easier prima facie case makes it easier to hold the board accountable, but also diminishes the
advised board to meet the Unocal test by acting out a scripted play of procedural regularity.\textsuperscript{183} Once we lay out the Unocal test in a way that makes it easily comparable to the entire fairness test, it becomes apparent that the tests diverge in two ways that may explain why the board’s burden in Unocal cases is lighter than in traditional loyalty cases.

The first is that Delaware courts have not insisted on administering the procedural and substantive elements of the board’s burden of proof under Unocal as a unified proof of loyalty in the way they do in an entire fairness analysis. A self-dealing board would find it easier to surmount the entire fairness test by careful choreography if the courts had not made it clear that proving entire fairness is not a matter of checking separate boxes, but rather presenting proof of a single fact—fairness—from two different perspectives. Put that way, however, it is not clear whether it would be preferable to modify the Unocal test to match entire fairness or vice versa. Arguably, substantive court review of board decisions achieves most of its benefit if it forces independent, but biased, boards to think about what they are doing and how it will look to an outsider.\textsuperscript{184} It could also be argued, however, that adding highly indeterminate and fact-intensive burdens of proof (that render claims impossible to dismiss and difficult to dispose of on summary judgment) would do more to increase the settlement value of bogus cases in the hands of enterprising plaintiffs’ lawyers than it would to improve the quality of board decisions.\textsuperscript{185}

Unocal diverges from entire fairness in a second respect that lightens the board’s burden. Entire fairness requires the board to prove that its decision was, in substance, one we would expect a competent and disinterested board to reach (fair price). By contrast, Unocal requires the board to prove only that its decision was, in substance, not obviously improper (preclusive or coercive of shareholder action or outside of the range of

\textsuperscript{183} See, e.g., Gilson, Unocal, supra note 28, at 500; Thompson & Smith, supra note 29, at 284-86.


\textsuperscript{185} See In re Cox Commcn’s, Inc., 879 A.2d 604, 605 (Del. Ch. 2005) (implicitly criticizing the Delaware Supreme Court’s decision in Lynch Communications for spawning a set of meritless class actions that are brought and quickly settled because they cannot be dismissed); Gilson, Structural Approach, supra note 29, at 825 (praising entire fairness, conceived before Weinberger as essentially an appraisal test, as a workable standard for planners).
reasonable responses to the stated threat). This difference may simply reflect the conceptual confusion that has attended the *Unocal* standard’s development. Several other factors may, however, account for the difference. First, it may reflect the breadth of facts that make out a prima facie case under *Unocal*. Virtually any board decision that might have a noticeable impact on a pending or even potential hostile bid makes out a case under *Unocal*, forcing the board to its proof. Given the wide variety of ways boards can try to resist a hostile bid for control, this easy prima facie case makes sense. Such a low burden of proof, however, raises only a weak presumption of wrongdoing which may explain why it is relatively easy to rebut. Another potential factor is the mixture of operating and coordinating power that is often present in *Unocal* cases. Because boards have no express statutory powers to manage tender offers, they generally use methods whose primary applications involve the board’s power to issue securities, is the most important example. While the poison pill is fairly easy to distinguish from operating exercises of that power, it is often hard to distinguish between genuine exercises of operating power and purported operating decisions actually designed to exert control over a hostile bid. At least in the minds of the justices of the Delaware Supreme Court, the *Time* case seems to have raised concern that the courts could significantly intrude on the operating power of corporate boards if they forced the boards to make too strong a showing in the face of such ambiguity.

A further criticism of the *Unocal* test—that it unreasonably forces hostile bids into proxy contests where they can be delayed for up to three years—is also illuminated by the distinction between coordinating and operating authority. It implicates a different aspect of the distinction, however, and will be discussed in Part VI.

VI. UNDERSTANDING *UNITRIN*: THE ROLE OF FIXED RULES OF DECISION IN REGULATING COORDINATING POWER

As discussed above, shareholder primacy scholars criticize *Unitrin*’s version of the *Unocal* rule. They argue that *Unitrin* gives boards wide discretion to block tender offers, so long as they leave open the possibility of a successful proxy contest. Working from the assumption that tender offers and proxy contests, in the context of a contest for control, offer the same choice to the same shareholders, these scholars assume that the law should treat them at least equivalently. In particular, they argue that the law should give shareholders the chance to make a fairly prompt decision on any hostile control bid, without hindrance or distortion by management manipulation.
There are two parts to these arguments. The first is the normative argument that shareholders should decide the fate of hostile bids for control. This leads to various proposals for fixed rules of decision that override the board’s discretion, ranging from a requirement of absolute passivity in the face of a hostile bid to less stringent rules that allow boards to delay putting the decision to the shareholders so as to develop alternatives for the shareholders’ consideration and to assure shareholders a non-coerced and fully informed vote.

These proposals are, for the moment, just that. They are arguments against Unitrin and in favor of rules that have not been adopted. The explanation for their failure is facially simple. As Professor Bainbridge puts it, proponents “fail to acknowledge that their proposal marks a departure from the Delaware courts’ long-standing practice of preferring standards to rules.”\(^{192}\) In considering the passivity rule proposed by Professors Easterbrook and Fischel, the Delaware Supreme Court noted that the board’s discretion in managing the corporation is limited only by its fiduciary duties. It concluded that fixed rules were simply “not the law of Delaware.”\(^{193}\) The implication, certainly for Bainbridge and probably for the Delaware courts, is that such rules not only are not the law of Delaware but also should not be adopted as such because they would impair the fiduciary flexibility that is at the heart of the corporate governance regime.

The second element of the argument against Unitrin is that, regardless of what rule the courts apply to board actions managing or interfering with shareholder consideration of hostile bids, they should apply the same rule to collective actions by selling and voting.\(^{194}\) The Delaware courts clearly have not followed this suggestion but, as the critics have pointed out, their reasons here are less clear.

This section considers the above arguments in light of the distinction between the board’s coordinating and operating powers. Subsection A considers use of fixed rules of decision in Delaware’s default corporate governance scheme. I note that this scheme uses fixed rules of decision to limit the board’s coordinating power, but not its operating power. I then discuss why coordinating power might be more susceptible to this kind of control. Subsection B considers why Unitrin preferred voting to selling, concluding that the Delaware courts strongly prefer to channel the board’s coordinating authority into voting, where equitable judgments are backstopped by fixed legislative rules. Subsection C considers proposals to limit the board’s coordinating power over tender offers with new fixed rules of decision.

\(^{192}\) Bainbridge, \textit{Corporate Takeovers}, supra note 30, at 814.

\(^{193}\) \textit{Unocal Corp. v. Mesa Petroleum Co.}, 493 A.2d 946, 955 n.10 (Del. 1985) (rejecting the Easterbrook & Fischel proposal).

A. Introduction and Basic Applications

At first glance, the board wields operations and coordinating power for similar reasons that have been discussed above. Someone has to decide whether, when, and how to invest corporate capital. Similarly, someone has to decide the date, time, and agenda of the next shareholders’ meeting.

These decisions require a discretionary choice between large numbers of plausible alternatives, not the logical articulation of a fixed rule or principle. It is easy to see why the various participants in a business enterprise might benefit from a governance structure that vests nearly unquestionable authority to make such decisions in a single body, the board of directors. Potential participants in a joint endeavor are often unwilling to commit themselves without a guarantee as to how such decisions will be made later, but it is usually impossible to make all such decisions in advance or even to reduce them to comprehensive contractual rules. These twin problems of opportunism and bounded rationality plague planning for the management of both business enterprises and electoral systems. Likewise, considerations of information efficiency may give huge advantages to a hierarchical decision making system that does not require large numbers of people to get and process all the information needed to make good decisions.

In both cases, designating a decision maker often looks cheaper and more effective than articulating a comprehensive set of fixed rules of decision.

Given these important similarities, it is not surprising that corporate law generally treats the board’s exercises of operating and coordinating powers similarly. Both are considered aspects of managing the corporation’s business and affairs. As such, both involve the exercise of “business judgment” that, absent evidence of a corruption of the decision making process, is the corporation’s final decision, unchallengeable by anyone inside or outside its management hierarchy. My purpose in this Subsection, however, is to point out that where these functional similarities end, the legal ones do, too.

Granting discretionary decision making power is not the only way participants in a joint enterprise can commit in advance to a method for making future decisions. Although it is impossible to contract fully for all future contingencies, it is possible to contract for some future contingencies. Likewise, fixed rules of decision can limit or

195. Transaction-cost economists refer to these practical problems, respectively, as “opportunism” and “bounded rationality.” See, e.g., Oliver E. Williamson, The Economic Institutions of Capitalism 44-50 (1985). A parallel school of economic thought describes the problem as one of “agency costs”—the costs of monitoring, bonding, and disloyalty inherent in any arrangement in which one person is retained to act for another. See, e.g., Jensen & Meckling, supra note 36, at 308-10. As Williamson has pointed out, these two schools of thought differ primarily in their focus on planning problems before the fact and coping problems after the fact. Williamson, supra note 92, at 171. This differing focus, however, tempts some agency cost scholars to view the effectuation of shareholder control over the corporate enterprise as the central goal of the corporate governance structure. These scholars often ignore the potential for opportunistic threats to the legitimate interests of the other participants inherent in shareholder control. For criticisms of this failing see Bainbridge, Director Primacy, supra note 34, at 565-74 and Stout, supra note 35, at 673-77.

196. See supra note 108.

197. See, e.g., Bainbridge, Director Primacy, supra note 34, at 555-56; Blair & Stout, Team Production Theory, supra note 35, at 284-87; Thompson & Smith, supra note 29, at 273-75.

198. See DGCL § 141(a) (granting boards the exclusive power to manage corporate “business and affairs” unless varied by certificate); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953 n.6 (Del. 1985) (emphasizing “and affairs” to extrapolate power to manage collective shareholder interests).
supplement any grant of discretionary decision making power.

Where the possible contingencies are limited or the danger of an abuse of discretion is high, fixed rules of decision can be a more useful alternative to granting discretionary power. The prototypical example of a pre-commitment strategy is Odysseus’ decision to bind himself to the mast of his ship and plug his crew’s ears with wax while he passed the sirens’ island. Odysseus was sufficiently certain of how he wanted to exercise his discretionary power as captain of his ship: He wanted to steer a course past the island of the sirens with no stops or deviations. In fact, he was so certain of his choice that he did not need to delegate any of his discretionary power of command, even though he knew that he would not be competent to command the ship as it passed the island. Instead, he codified his discretionary choice as a fixed rule of decision. He gave the crew their orders and told them to maintain the planned course, no matter what he or anyone later said or did.

Although fixed rules of decision are a possible alternative to discretionary power, the default corporate governance regime makes almost no resort to them with respect to operating power. It is not hard to understand why. A generic governance structure that relied heavily on fixed rules of decision (e.g., “always dividend out 50% of corporate profits” or “never go in against a Sicilian when death is on the line”) would be unhelpful for the same reasons that a generic structure that relies heavily on designating authorized decision makers is efficient and profitable. Managing operations usually means deciding both the ends and means of action from a large number of possibilities. These decisions often must be made decisively in the face of severe uncertainty about both current facts and future conditions and significant differences of opinion and interest between corporate participants. Fixed rules of decision that constrain operating power are safe only if they are tailored to the particular operations planned and if someone with discretionary power to grant exceptions, and the information and incentives to use it
promptly and well, is immediately available. The generic process of managing operations is so inherently indeterminate that imposing fixed decision making rules by statute would almost always be counterproductive. Such rules would preclude many desirable, but hard to foresee, choices. At the same time, they would tempt corporate participants into opportunism, producing unforeseen benefits to some and detriments to others.

The board’s coordinating power is a different matter. As discussed above, some decisions about shareholder collective action (such as the exact date, time, and place of a shareholders’ meeting) are similar to operating decisions; there is much to be gained from central and decisive decision making and little to be gained from open-ended reconsideration. The board’s coordinating power, however, has some features that tend to make it more susceptible to fixed rules of decision.

First, the possible ends and means of the board’s coordinating power are much simpler and more easily constrained. The board holds this power only to facilitate effective and decisive shareholder decision making within the narrow range of decisions allocated to the shareholders and through the limited means available for deciding. Under these conditions, fixed rules of decision are more feasible because the contingencies are fewer. There is still a danger that a fixed rule will misfire in unforeseen circumstances, but it is much lower.

In this sense, the board’s coordinating power more closely resembles its power under the Revlon doctrine. Under Revlon, if a corporate board decides to sell the company, it must justify any decisions that favor one bidder over another upon shareholder challenge. The only permissible justification is that the board’s decisions were reasonably calculated to increase the value shareholders would ultimately receive out of the sale. For several years after Revlon, it was not clear what would trigger the court’s willingness to question board discretion. A stray comment in the Revlon opinion left the impression that a sufficiently high hostile bid might render the break-up of the company inevitable, leaving the board’s actions open to special scrutiny. Later decisions, however, clarified that the courts would not second guess a board that deliberately chose a long-horizon business strategy over an immediate buy-out offer, even one that was priced high enough to make a sale seem “inevitable” to outsiders. Rather, the board’s actions would not be subjected to special scrutiny until the board itself decided on the “abandonment of the corporation’s continued existence.”

Properly understood, Revlon and its progeny turn on the board’s initial choice of a single, near-term, simple goal from among the nearly endless business goals that are initially open to it. Once the board has chosen a short-term and “straightforward” goal that

202. It is for this reason, among others, that private loans tend to have different and more restrictive covenants than public bonds. See Yakov Amihud et al., A New Governance Structure for Corporate Bonds, 51 STAN. L. REV. 447, 462-65 (1999).
203. See supra notes 195-197 and accompanying text.
204. As noted above, fixed rules of decision become more feasible as the number of potential contingencies decreases and the risk of abuse of discretion rises. See supra note 199 and accompanying text.
206. See id.
207. See id. at 182 (“However, when Pantry Pride increased its offer to $50 per share, and then to $53, it became apparent to all that the break-up of the company was inevitable.”).
directly affects the near-term interests of shareholders—selling the company to the highest bidder—both the value of unfettered discretion and the danger of judicial review at shareholder demand decrease.\textsuperscript{209} Easy shareholder standing and more searching judicial scrutiny of the board’s operating power naturally follow.

Returning to the board’s coordinating power, fixed rules of decision are not only less dangerous in the context of coordinating collective action than they are in the context of managing operations, they are also often more effective than unconstrained discretionary power. Indeed, one of the major goals of coordinating power is, as discussed above, to constrain and systematize the majority rule process to make it a more effective decision making mechanism. Fixed rules for agenda control and voting procedure are almost necessary to this end. To the extent the mechanisms of collective shareholder action are reduced and systematized, the process generally benefits.

Not only are the contingencies involved in coordinating power fewer and more predictable, the danger of discretion is also high. As discussed above, the grant of discretionary coordinating power always involves a significant danger of outcome manipulation.\textsuperscript{210} In this way, fixed constraints on the board’s coordinating power promise to make it more effective. The more we grant one central authority discretionary coordinating power, the more the process begins to look like a mechanism for that authority to manufacture consent. For this reason, the exercise of discretionary coordinating power, including the power to interpret and apply rules, often raises deep suspicions of outcome manipulation. In the context of contested corporate elections, for instance, Professor Gilson has noted that “[i]t is difficult to imagine an electoral process that can both confer legitimacy on the victor and still leave the incumbent very substantial discretion to manipulate the process.”\textsuperscript{211} The Supreme Court has voiced similar concerns in the context of political voting.\textsuperscript{212} Fixed rules can work to mitigate both the danger of outcome manipulation and the suspicion of such manipulation that can undermine the perceived legitimacy of the process.

The above discussion gives reasons why the board’s coordinating power might be more amenable to constraint by fixed legislative rules. The proof of a theoretical pudding, however, is in the practical eating. The board’s coordinating power is much more constrained by mandatory statutory provisions than is its operating power. Delaware law places very few restrictions on the board’s exercise of operating power. Most of the constraints it does impose only require the board to seek a shareholder vote to approve certain decisions.\textsuperscript{213} These constraints are better viewed as defining a scope for collective
stockholder action, rather than constraining the board’s discretion with fixed rules of decision.\textsuperscript{214} Aside from requiring shareholder approval, the Delaware statute places mandatory constraints on only three specific categories of board decision: indemnification, declaring dividends/redeeming stock, and dissolution.\textsuperscript{215}

By contrast, the Delaware statute places fairly detailed mandatory constraints on all exercises of the board’s coordinating power over shareholder voting. Most importantly, the board must call a shareholder meeting at least once every 13 months, the shareholders can force its hand, at least one third of the directors must stand for election at each such meeting, and the board must allow shareholders to place items on the meeting agenda.\textsuperscript{216} Other mandatory rules govern voter qualification, minimum quorums, winning vote percentages, and the timing and content of meeting notices.\textsuperscript{217}

By reciting these limitations on the board’s coordinating power, I do not intend to suggest that they provide shareholders with a powerful or even effective means of controlling a recalcitrant board. Shareholders who feel that board hostility has left them without an effective coordinating fiduciary have reason to resent the high costs of coordinating themselves, including the additional costs that a hostile board can impose by exercise of its coordinating powers. Plausible arguments can be made that additional fixed rules would produce a more efficient and efficacious system of shareholder collective action.\textsuperscript{218} Rather, my point is that the greater amenability of coordinating power to fixed rules has a noticeable effect on its treatment under the Delaware statute.

\textsuperscript{214} The requirement of shareholder approval does not tell the board how to make decisions about the matters to which it applies, nor does it ever require the board to make a particular choice or reject a particular choice. Prudence and an awareness of shareholder sentiment might color the board’s judgment, but the board ultimately has unfettered discretion. If a board decides to propose a merger to the shareholders despite apparent shareholder sentiment against it, the shareholders’ recourse is to vote it down. They cannot sue the board for having decided incorrectly.

\textsuperscript{215} See DGCL §§ 145(d) (indemnification); 160(a) (redemption of stock); 170(a) (dividends); 275(a) (dissolution). Additional rules, in general, require a minimum quorum and winning the vote at board meetings. See id. § 141(b). The requirement of legality might also be seen as an implicit limitation on the board’s discretion.

\textsuperscript{216} See DGCL §§ 141(d), 211(c). The code gives shareholders standing to force a meeting and courts summarily order meetings on petition. See, e.g., MFC Bancorp Ltd. v. Equidyne Corp., 844 A.2d 1015 (Del. Ch. 2003). Since shareholders cannot bring an action under section 211(c) until 13 months have passed, the board effectively delays the meeting for several more months. See id. at 1021 (ordering a meeting 15 months after the last meeting). The shareholders’ right to propose directors and bylaws is more tenuous as a matter of statutory construction. Section 109 of the Delaware General Corporation Law gives shareholders the “power to adopt, amend or repeal bylaws.” When compared to section 242(b), which unambiguously grants the board the exclusive power to propose certificate amendments, section 109 seems to grant shareholders the power of initiative. The power to nominate directors is even less clear in the statute. Nonetheless, courts and commentators consider these powers self-evident. See Gordon, supra note 29, at 350; Hamermesh, supra note 102, at 413-14.

\textsuperscript{217} See DGCL §§ 213(a) (providing a limited period for the board to set a record date and a default record date); 216 (quorum and minimum winning vote); 222 (general notice timing and content); 231 (inspectors of elections for public companies); 242(b)(1) (content of notice of meeting to approve certificate amendment and minimum vote); 251(c) (content of notice of meeting to approve merger and minimum vote); 271(a) (content of notice of meeting to approve asset sale and minimum vote); 275(a), (b) (content of notice of meeting to approve dissolution and minimum vote).

\textsuperscript{218} The severe practical limits of these and other constraints on the board’s coordinating power have been extensively documented and discussed. See, e.g., Bebchuk et al., supra note 58 (discussing the strong anti-takeover power of the poison pill when combined with a staggered board).
Nor is this a purely analytical point. Those interested in arguing for more constraints on the board’s coordinating power would do well to notice that the current structure of corporate law supports such arguments. Likewise, those honestly interested in preserving the benefits of unconstrained operating power may take comfort that imposing fixed rules to constrain the board’s coordinating power demonstrably does not mean embarking on a slippery slope to imposing similar rules on the board’s operating power.

B. Understanding Unitrin

Once we understand both the importance of fixed rules of decision in regulating coordinating authority and the set of fixed rules imposed by the Delaware Code, it becomes easier to understand Unitrin’s preference for proxy contests over tender offers. The key to this preference is the difference between the Delaware Code’s treatment of the board’s coordinating power over elections and collective sales.

Unlike shareholder voting, the statute does not address selling as a mechanism of collective action. It does not specifically grant the board powers to govern it. More importantly, it does not constrain the board’s power with the kind of fixed legislative rules that limit the board’s discretion in exercising its coordinating power over voting. Given this difference in the statutory coverage, it should not surprise us that courts prefer voting to selling. While economists and raiders may see voting and selling as functional equivalents, the two look very different to a Delaware court.

Consider the courts’ perspective: The Delaware courts recognized, as they had to, that the board would not be required to permit adverse outsiders to coordinate collective shareholder selling, unfettered by fiduciary duty, merely because the statute did not contemplate that the shareholders would make collective decisions in that manner. Having disappointed shareholder primacy scholars by recognizing the board’s power where they had hoped statutory silence would deny it, the courts were then faced with

220. See Gilson, Unocal, supra note 28, at 503 (noting that the board’s statutory power to manage proxy fights “invites manipulation on the part of the target company to influence the outcome of the election”). Gilson assumes that the statutory disparity reflects a legislative policy judgment (subverted, in his opinion, by the Delaware Supreme Court in Unitrin) that collective selling should be free of all but minimal board management. That view is hard to sustain more than ten years after Unitrin brought the subversion to the attention of the Delaware legislature.
221. The origins of this disparity in statutory treatment and the explanation for its continuation are an issue worthy of thought, but beyond the scope of this Article. Admittedly, my argument would be strengthened if we observed parallel statutory provisions governing the board’s power to manage voting and collective selling. The statutory evidence supporting my argument, however, is the disparity between the statutory treatment of coordinating and operating power. I am not making a normative argument that the current statute’s fixed rules of decision constraining the board’s coordinating power over voting should be extended to collective selling or tightened to further constrain board discretion. Accordingly, it is largely beside the point for my purposes that the differing treatment of coordinating power is not consistent, as between voting and selling, or that the further constraints on the board’s authority would arguably produce desirable results.
222. Even though a frustrated shareholder might regard a corporate raider as less adverse than a recalcitrant and incompetent board, the raider is still an adverse party. Tender offerors, left unchecked, take on the task of coordinating the shareholders’ collective action. Logic, human nature and the history of hostile takeover tactics all indicate that bidders would take advantage of the shareholders’ inability to coordinate themselves (and the absence of a fiduciary with coordinating power) to structure an offer that would leave as little of the control premium as possible in the shareholders’ hands.
boards who hoped that statutory silence would leave their power unconstrained. This left
the question of what kinds of constraint the courts would impose in the absence of any
statutory rules.

Courts are well-suited to decide and police the legitimate purposes of board action.
Such decisions require the kind of reasoned extrapolation of the board’s function and
purpose that courts do well. The Delaware courts developed the *Blasius* and *Unocal*
doctrines along these lines. Neither doctrine imposes a fixed rule of decision. Rather,
both are equitable doctrines by which courts review whether fiduciary’s who have
complied with all fixed rules have used their power for the right purposes (equitably). By
contrast, courts are institutionally unsuited to come up with specific (and ultimately
arbitrary) fixed rules of decision to constrain the board’s discretion.223 As discussed
above, there are good principled arguments for imposing some fixed rules of decision to
constrain discretionary coordinating power. None of these arguments, however, logically
require any particular constraining rule or rules. In fact, shareholder primacy scholars
have placed numerous and divergent proposals on the table.224 The courts are not the
right institution to decide whether the board’s coordinating power over collective selling
should be constrained by some or all of the rules that constrain voting, some other set of
equally plausible alternative rules, some combination of those, or no fixed rules of
decision at all. Not surprisingly, they have refused to do so.

That said, courts understand the danger that coordinating power may be abused, and
they are not immune to the temptation to transform difficult factual questions of fiduciary
good faith and loyalty into simple questions of compliance with technical rules. It is also
worth remembering that courts reviewing board decisions are themselves exercising
coordinating power. As discussed, such power always entails the potential of outcome
manipulation.225 Accordingly, it often raises suspicions that it is being used to that end.
Courts are not immune from such suspicions.226 This presumably adds another reason for

223. Lon Fuller provided a more conceptual discussion of the limits of adjudication noting that adjudication
as a distinctive form of social ordering is characterized by a commitment to decide on the basis of reasoned
arguments. Lon L. Fuller, The Forms and Limits of Adjudication, 92 H ARV. L. REV. 353, 366 (1978). As such,
adjudication is suitable for making decisions that require either a logical deduction of the implications of
accepted rules or a reasoned articulation of the implications of shared purposes. Id. at 370-71, 377-81. It is
particularly unsuited to deciding what Fuller termed (following Michael Polanyi) “polycentric tasks”—
decisions that are not well made on the basis of the logical implications of pre-existing rules or purposes
because they involve some combination of multiple interdependent issues, many parties in interest, and a fluid
set of relevant facts. Id. at 394-99. When courts take it upon themselves to make such decisions, they invite
charges that they have exceeded their institutional role. See, e.g., Roe v. Wade, 410 U.S. 113 (1973); Miranda v.

224. See sources cited supra note 191. It is notable, for instance, that although Professor Gilson felt that his
proposed abstention rule was suitable for court adoption, he based it on the “City Code”—a set of fixed rules of
decision adopted by an industry self-regulatory body—and felt the need to draft the exact text of his proposal.
See Gilson, Structural Approach, supra note 29, at 876-79.

225. See supra notes 141-146 and accompanying text.

226. See, e.g., Gilson, Unocal, supra note 28, at 508 (arguing that Delaware courts’ treatment of poison
pills “reflects the sense of the times, incorrect to be sure but an understandable accommodation in a moment of
perceived crisis, that shareholders could not be trusted to vote for sensible defensive measures”); cf. Harold
Supreme Court (more precisely, of its five right-wingers) to W. is roughly analogous to the one that existed
between the Yugoslav Supreme Court and Slobodan Milosevic. The justices go through the motions of deciding
matters of law, but their only real goal is to keep—or in this case, put—their guy in power.”).
avoiding discretionary choices, where possible.

Faced with the difficult and ultimately thankless task of sorting out proper fiduciary actions from illegitimate abuses, it is not surprising that courts prefer to direct the action to an area where they can sometimes rely on fixed rules to impose limitations on a no-fault basis. It is in this context that we must understand *Unitrin’s* preference to shunt conflicts over collective action into shareholder voting. The statute clearly contemplates collective action by voting and imposes some fixed rules that have the effect of restraining opportunistic exercises of coordinating power without the need to judge motivations. If Delaware courts are somewhat indulgent of boards exercising their coordinating power in situations that might suggest bad motivations, they show no such hesitation in administering the fixed rules of voting.227

C. Proposals for Legislative Reform

Aside from greater sympathy for the Delaware courts, what should we take from the above discussion? Recognizing that coordinating authority certainly permits, and probably demands, some constraint by fixed rules of decision is ultimately important to considering proposals for reform.

We should first understand that reform in this area will come from the federal or Delaware legislatures, not from the Delaware courts. There may be ways the courts could clarify the *Blasius* and *Unocal* doctrines, but they will never transform those doctrines from equitable examinations of motivation into fixed rules of decision, no matter how much easier such rules would be to administer and no matter what benefits of efficiency they seem to promise. Even if we couch a fixed rule of decision in terms of proving one or another factor in a fiduciary analysis,228 the answer is likely to be “that clearly is not the law of Delaware.”229

It is also important to recognize that if we accept proposals to impose fixed rules of decision to constrain the board’s discretion in exercising coordinating power, whether over shareholder voting or tender offers, we are not breaching the dikes surrounding board autonomy. It is neither necessary nor sufficient for proponents of board autonomy to argue against such proposals on the basis that “Delaware’s preference for standards

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227. See, e.g., MFC Bancorp Ltd. v. Equidyne Corp., 844 A.2d 1015 (Del. Ch. 2003) (summarily ordering shareholder meeting after thirteen months, even though board had already noticed a meeting).

228. See, e.g., Bebchuk et al., supra note 58, at 944-47 (arguing for the integration of a “one election and you’re out” rule into *Unocal*).

229. *Unocal* Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); see Strine, supra note 191, at 881 (“The authors’ proposal puts pressure on the Delaware courts to determine a fundamental, normative issue that is legislative in character.”). As discussed above, *Unocal*, like the traditional duty of loyalty, represents a kind of fixed rule in that it represents a policy decision to presume disloyalty on evidence of certain objective facts, without evidence of subjective motivation. See supra note 182. As Vice Chancellor Strine admits, Bebchuk, Coates, and Subramanian’s proposal is more difficult to reject than earlier proposed passivity rules in that it is couched in the terms of judicial presumptions. As discussed, supra note 182, however, such presumptions represent a complicated mix of policy considerations, not the logical implications of underlying principles. Bebchuk, Coates, and Subramanian present plausible policy arguments for their presumption. It is worth noting, however, that their proposal seems to contradict the substantive policy implicit in the statute’s tolerance for three-class staggered boards. See DGCL § 141(d). From a judicial administration perspective, the proposal seems unlikely to add anything. As discussed supra note 182, *Unocal* already limits litigation in this area.
over rules is consistent . . . with the basic thrust of director primacy.” 230 A careful reading of the Delaware Code reveals that this preference is far stronger with respect to operating power than coordinating power. Delaware courts have such a preference, but, as to coordinating power, it reflects institutional competence more than normative preference. Given their choice between administering the board’s coordinating power on the basis of fiduciary standards alone or with the assistance of a minimal, but important, set of rules, the Delaware courts have chosen the rules.

It is also worth noting that other bodies of law use fixed rules of decision to constrain collective selling, apparently without disastrous consequences. Federal securities law, for instance, imposes a set of fixed rules on both bidders’ and boards’ conduct in making and responding to tender offers. 231 In the United Kingdom, the “City Code” has long imposed rules on hostile bids. 232 I do not mean to suggest that the current federal rules are sufficient or that Delaware should adopt the City Code. But it is important not to get confused about what is and is not at stake in considering normative arguments along these lines. It is possible to argue that additional fixed rules of decision should constrain the board’s coordinating power without ignoring or sacrificing the value of board autonomy in the exercise of operating power.

Noticing that the Delaware Code currently imposes fixed rules of decision on the board’s coordinating power over voting may also place less radical parameters on the debate. As discussed above, the Delaware courts’ preference for voting annoys most shareholder-primacy scholars not because of an aesthetic concern for symmetry, but because they continue to believe that the board should have little or no power to manage tender offers. It seems reasonable to infer, however, that the current policy of the Delaware legislature favors coordinating powers and constraining rules that govern shareholder voting. There is little reason to believe that the Delaware legislature would constrain the board’s power over collective sales more tightly than its power over voting. Accordingly, legislative reform, if it comes, might well give the board express powers over collective selling that mirror its current powers over voting. The result might produce a more rational system of control, but might not satisfy those who really want stricter constraints on board discretion.

For example, the Delaware Code limits the board’s discretion to put off elections, among other things, by requiring that shareholders have an opportunity to replace a majority of the board by voting, at most, two successive annual meetings. 233 Scholars have pointed out that this rule seems to decrease the value of corporations that take it to the limit of a three-class staggered board. 234 On this basis, Professors Thompson and Smith have advised the Delaware courts to grant shareholders the right to force an election of the entire board as a “self-help” remedy for suspected fiduciary breaches. 235 Professors Bebchuk, Coates, and Subramanian have advised the courts to

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230. See Bainbridge, Corporate Takeovers, supra note 30, at 815.
233. See DGCL § 141(d).
234. See Bebchuk et al., supra note 58.
235. See Thompson & Smith, supra note 29, at 299-312 (proposing mandatory annual elections of boards and mandatory shareholder initiatives to remove all barriers to hostile bids between annual elections).
deem all defenses disproportionate if the board loses at least one board election to a bidder’s candidates. But the data are compelling and deserve careful consideration by faithful boards and the Delaware legislature. But it is important to remember that there is no reason to think that an annual shareholder choice over corporate control is the natural default position for either voting or selling. Rather, the current statute presumptively reflects the current preferences of the Delaware legislature. Even if the legislature agreed that the rules governing tender offers should parallel those governing voting, it might easily conform any new rules governing tender offers to provide the same two-meeting limit imposed by the voting rules.

I do not contend that the current statutory scheme is optimal in some way or that arguments for reform are misguided. Rather, I mean to point out that arguments from parallelism cannot alone justify a change in the substantive policy regarding the proper constraints on the board’s coordinating power. An argument for substantive reform must be based on substantive policy, not symmetry.

VII. CONCLUSION

It is important to understand that fiduciary duties are entirely contextual. To say that a person or body acts in a fiduciary capacity tells us only that it must conform its decisions, in that capacity, to the interests of some other person, task, or goal. It tells us nothing about the person, task, or goal whose interests are to govern. Without knowing that person, task or goal, it is impossible to determine, except in the broadest of generalities, how that fiduciary should make any decision and how the law will regulate adherence to its fiduciary role. While commentators, legislatures, and, especially, courts in equity, are aware of this generality, they easily lose sight of its specific applications, even as they grope out a path along their rough contours.

In this Article, I have demonstrated that the distinction between the board’s operating and coordinating power is such a case. The courts have developed special doctrines to review the board’s exercise of operating and coordinating powers because the different purposes of those powers require different applications of the same underlying fiduciary principles. Both the nature of an improper motive and the facts that suggest the danger of an improper motive are different. Differences in dangers inherent in granting and in constraining fiduciary discretion over operating and coordinating powers also contribute to doctrinal differences.

My project in this Article is analytical—bringing to the fore explanatory regularities that have been overlooked. Merely analyzing and illuminating what courts and legislatures have been doing is, itself, significant. Rules of law function better when citizens, legislatures, and courts understand the conceptual framework into which they fit. Directors and their counsel will be better warned off demonstrably improper conduct and

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236. See Bebchuk et al., supra note 58, at 944-50 (proposing that staggered boards be required to rescind pills and take neutral stances toward hostile bids if insurgent board candidates win one election with a hostile bid pending).

better able to plan demonstrably compliant conduct when they understand what they are trying to accomplish. When legislatures see the pattern and purpose of the rules they have enacted, they can better understand whether those rules are functioning as intended and whether new rules or modifications of existing rules might improve on them. Finally, when courts and litigants understand the purpose of the applicable rules, they are more likely to make decisions that advance them and less likely to view the outcome of litigation as a function of random chance or personal judicial preference.

In all of these senses, distinguishing between the board’s operating and coordinating power has important implications for the development of corporate law. I have sketched out some of these implications above. In particular, a proper understanding of the Blasius and Unocal doctrines has importance beyond determining their proper application in particular cases. It is also important to considering the competing arguments that Blasius and Unocal represent, on the one hand, an unprincipled and unwarranted digression from “real” fiduciary law, and, on the other hand, an unprincipled and ineffectual response to the real need to develop a free market for corporate control. In each case, understanding the principles at work in Blasius and Unocal lays bare for dispassionate consideration the real policy proposals embedded in those arguments.