William & Mary Business Law Review

Volume 14 (2022-2023)
Issue 2

Article 5

2-2023

Death of a Corporation: How a Seemingly Innocuous Probate Provision Can Fundamentally Undermine the Corporate Form

Kenya JH Smith

Follow this and additional works at: https://scholarship.law.wm.edu/wmblr

Part of the Business Law, Public Responsibility, and Ethics Commons, and the Law Commons

Repository Citation
Kenya JH Smith, *Death of a Corporation: How a Seemingly Innocuous Probate Provision Can Fundamentally Undermine the Corporate Form*, 14 Wm. & Mary Bus. L. Rev. 413 (2023), https://scholarship.law.wm.edu/wmblr/vol14/iss2/5

Copyright c 2023 by the authors. This article is brought to you by the William & Mary Law School Scholarship Repository.
https://scholarship.law.wm.edu/wmblr

DEATH OF A CORPORATION: HOW A SEEMINGLY INNOCUOUS PROBATE PROVISION CAN FUNDAMENTALLY UNDERMINE THE CORPORATE FORM

KENYA JH SMITH*

ABSTRACT

Imagine that you are assisting the surviving shareholders and officers of a corporation in settling affairs with the estate of a deceased shareholder. In a corporate governance dispute that ensues, the estate representative uses a seemingly innocuous probate provision allowing him to "continue any business" of the deceased to petition the probate court for direct control of the corporation. You find that there is little statutory or jurisprudential guidance on coordinating that probate provision with longstanding corporate governance requirements that directors, not shareholders, directly manage corporate affairs. This Article explores the unintended consequences of allowing a misplaced but literal reading of probate codes to provide the above-referenced estate representative power to "continue any business" of the decedent but failing to clarify the meaning of that provision in coordination with the fundamentals of American corporate law. Core corporate governance principles require that shareholders elect directors who then manage corporate affairs, not the shareholders themselves. Allowing the estate representative to "continue any business" of the deceased, even a corporation, undermines core corporate governance principles and risks, inter alia, corporate veil-piercing exposure. This flawed default probate provision poses specific risks to small, unsophisticated businesses that lack the resources to engage in costly litigious efforts to clarify the relationship between the corporate and probate codes. These small businesses are also most susceptible to the referenced liability exposure associated with corporate veil piercing

* Judge Freddie Pitcher, Jr. Endowed Professor of Law, Southern University Law Center.

for failure to follow corporate governance requirements. This problem can be remedied statutorily by clarifying the probate provision's subordination to the respective state's corporate law. The Article highlights approaches employed by Delaware, New York, California, and other leading business jurisdictions whose probate provisions wholly or partially provide better clarity regarding the coordination of probate and corporate law, remedying the described problem.

TABLE OF CONTENTS

INTRODUCTION 416

I. CORPORATE GOVERNANCE CONSIDERATIONS: A POWER ALLOCATION PRIMER 418

A. Mandated Shareholder Deference to Corporate Director Dominion 421

B. Fiduciary Duties of Directors 433

1. Duty of Care 434

2. Duty of Loyalty 435

3. Derivative Litigation and the Business Judgment Rule 438

4. Ancillary Director Protections 446

II. THE CONSEQUENCE OF CONFUSION: CORPORATE VEIL PIERCING 447

A. Traditional Veil Piercing 449

B. Reverse Veil Piercing 451

III. COMPARATIVE PROBATE CODE APPROACHES: CORPORATE GOVERNANCE CONFUSION OR CLEAR COORDINATION 454

A. Code Confusion 455

B. Clearer Corporate Code Coordination 457

CONCLUSION 459

Introduction

Imagine that you are sitting in your office when you get a call from a small business owner who has been referred to you by a colleague. The potential client describes a situation in which their "business partner" has suddenly passed, and the remaining owners (and managers of the business) need guidance on how best to manage an impending transition in leadership and continuation of the business. After conducting your due diligence to ensure no conflicts of interest and that agreeing to engagement is a good fit, you request additional organizational documents and query the caller regarding the history and current status of the business. In the course of these conversations and your research, you discover that the caller has not quite accurately described their relationship with the deceased "partner." You learn that the business has been organized as a corporation for over 20 years; the deceased stakeholder was both a shareholder and served as President of the corporation at the time of his death. The decedent and other stakeholders have operated the business in a more informal manner than required by corporate law. However, annual reports, tax returns, and all other public filings reflect the corporate nature of the business.

The decedent left four adult children, no spouse, and no will, making the children equal heirs of his estate and succeeding to his ownership interest in the business. Decedent's oldest son, Junior, has been appointed administrator of the decedent's estate and engages the surviving corporate officers and directors concerning the management and direction of the business. After failing to reach common ground concerning the future of the business, and even the respective shareholder interests, a deeper rift develops between Junior and the surviving officers and directors. Neither side can readily provide stock certificates and other corporate evidence of the respective shareholder ownership interests as of the decedent's death. You suggest a full audit of the corporate files to locate any records that will prove ownership interests, historical governance practices, and other information that could prove helpful in advising the corporate officers and directors in resolving their differences with Junior and the decedent's other heirs. You advise the corporate officers and directors about certain default and mandatory corporate governance rules

that apply unless bylaws, resolutions, and meeting minutes are located that provide guidance that departs from corporate default law. You advise Junior's counsel of the ongoing due diligence and intended path forward. You express a desire to negotiate a resolution with Junior as representative of the decedent's estate in hopes of avoiding litigation.

During the course of negotiations, you are surprised to receive a copy of pleadings filed by Junior as a part of the probate proceeding. Junior has petitioned the court with jurisdiction over the probate proceeding for "authority to continue the business of the deceased."[1] At first blush, this seemingly nondescript process appears to have been misapplied in these probate proceedings for several reasons. All public, corporate filings (for at least the last 20 years) document the business as being run and publicly represented as a corporation. The cornerstone rationale supporting Junior's petition was that the corporate directors were excluding him from participating in the management of the corporation, that the corporate directors were making decisions and taking actions that were not in the best interest of the corporation, and that the corporate directors were usurping the ownership interests of the decedent's estate. You file an opposition to the petition, representing that the issues represented in the petition are governed by corporate law and that granting the petition would allow for the operation of a corporation not only as an unincorporated business, with attendant legal consequences.

This Article explores the danger presented by the lack of a clearly articulated subordination of the probate provision allowing the estate representative to "continue *any* business" of the deceased to well-established corporate legal principles designed to clearly distinguish the personhood of the corporation from its shareholders and to provide attendant liability protections. Part I outlines the fundamental tenets of corporate law, including a discussion of underlying history and policies.[2] Part II discusses the dangers associated with failure to adhere to the governance rules and standards embedded in corporate law, chief among them the threat of corporate veil piercing and shareholder personal

---

[1] GUY NEWHALL, SETTLEMENT OF ESTATES AND FIDUCIARY LAW IN MASSACHUSETTS, 209 (3d ed. 1937).

[2] *See infra* Part I.

liability.[3] Part III discusses the breadth of the problem presented by the various approaches employed by state probate codes in allowing the estate representative to "continue *any* business" of the deceased without stipulations that this role and corresponding powers must be carried out in accordance with established corporate law.[4] This discussion of the comparative approaches by respective states includes the resulting confusion facing estate representatives as well as corporate officers and directors as a result of the unaddressed ambiguity presented in these probate code provisions. This Article concludes that the confusion caused can be resolved by states amending their probate codes with clarifying language to remove this dangerous and potentially realized conflict between probate and corporate law.[5] This can be done through the adoption and extension of provisions comparable to the Delaware Trust Code as well as probate provisions directly addressing estate representative authority for the deceased's business under New York and California law.[6] These state codes provide a template, though imperfect, to ameliorate the corporate governance confusion between corporate and probate law by clarifying the primacy of corporate law.

I. CORPORATE GOVERNANCE CONSIDERATIONS: A POWER ALLOCATION PRIMER

Basic corporate governance arises from the state law under which the business has been incorporated, followed by its articles of incorporation, bylaws, and other governance documents.[7] The fundamental structure of corporate governance allocates corporate decision-making authority between shareholders, elected directors, and appointed officers.[8] State corporate law establishes respective stakeholder rights and duties.[9] Despite some nuanced distinctions,

---

[3] *See infra* Part II.

[4] *See infra* Part III.

[5] *See infra* Conclusion.

[6] *See infra* Conclusion.

[7] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 304 (AM. L. INST. 1971).

[8] Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 258 (2d Cir. 1984). *See also generally* HARRY C. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES, 466–67 (Student ed. 1983).

[9] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (AM. L. INST. 1971)

state corporate codes have many similarities.[10] This is generally referred to as the "internal affairs" doctrine.[11] While a particular state's corporate code will have nuanced distinctions, a consistent requirement among states is shareholder surrender of control to a board of directors at incorporation or other initial investment.[12]

("(1) Issues involving the rights and liabilities of a corporation, other than those dealt with in § 301, are determined by the local law of the state which, with respect to the particular issue, has the most significant relationship to the occurrence and the parties under the principles stated in § 6. (2) The local law of the state of incorporation will be applied to determine such issues, except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship to the occurrence and the parties, in which event the local law of the other state will be applied.").

[10] *See* William J. Carney, *The Production of Corporate Law*, 71 S. CAL. L. REV. 715, 731–34 (1998); *see also* John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 702 (1999) ("[T]he best documented finding in the empirical literature on the U.S. corporate chartering competition is that a high degree of uniformity has emerged in American corporate laws."); *see also* MODEL BUS. CORP. ACT, ix (CORP. LS. COMM. 2011) ("The Model Business Corporation Act Annotated (4th edition) contains the complete text of the Model Business Corporation Act (the 'Model Act'), together with Official Comment and Reporter's Annotations for each section. The Model Act was promulgated and approved by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association. The Model Act is designed as a free-standing general corporation statute that can be enacted substantially in its entirety by a state legislature. Thirty-one jurisdictions have adopted all or substantially all of the Model Act as their general corporation statute, and three others have statutes based on the 1969 version of the Act. Many other states have adopted selected provisions of the Model Act.").

[11] Arthur R. Pinto, *An Overview of United States Corporate Governance in Publicly Traded Corporations*, 58 AM. J. COMPAR. L. 257, 262 n.27 (2010) (citations omitted) ("The internal affairs are usually viewed as the law which governs the intra-corporate relationships involving the corporations and its officers, directors, and shareholders. Thus issues of formation, voting, fiduciary duty, structural changes, and internal corporate power and structures have traditionally been state law issues.").

[12] *E.g.*, MODEL BUS. CORP. ACT § 8.01(b) (A.B.A. 2021) ("All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under section 7.32."); *see also* Pinto, *supra* note 11, at 262 ("The corporate law of the state of incorporation will usually apply to the internal affairs of those corporations which deal with allocation of power

State laws typically require that incorporators elect a board of directors.[13] Governance expectations are usually articulated in the articles of incorporation and bylaws, with state laws allowing broad discretion in defining the board's governance role(s).[14] Accordingly, directors operate according to the corporation's articles

within the company how the company is managed and controlled."); *see* DEL. CODE ANN. tit. 8, § 107 (West 2022) ("Powers of incorporators"); Grant v. Mitchell, No. CIV.A. 18370, 2001 WL 221509, at *8 n.17 (Del. Ch. Feb. 23, 2001) ("The extent to which an incorporator can refuse to name a board of directors until the first annual meeting and manage the corporation pursuant to the powers [of incorporators under Section 107] has never been decided."); *see* Stephen M. Bainbridge & M. Todd Henderson, *Boards-R-Us: Reconceptualizing Corporate Boards*, 66 STAN. L. REV. 1051, 1101 (2014) ("State corporation statutes consist mostly of default rules that can be changed by firm owners. State law thus provides an off-the-rack set of default rules regarding basic corporation law, but generally allows firms to vary widely in their approach, so long as the divergences are set forth in the corporate charter and are effectuated in ways consistent with law (for example, done with shareholder consent).").

[13] *See, e.g.*, DEL. CODE ANN. tit. 8, § 108 (West 2022) (requiring the directors to be named either in the charter or at an organization meeting).

[14] "For example, many corporations contain a bylaw 'precluding director nominations by shareholders unless preceded by a notice given to the corporation by a certain time before the shareholder meeting . . . .'" Devan Grossblatt, *Boarded In: Counteracting the Consequences of Board Insularity by Legitimizing Director Elections*, 20 FORDHAM J. CORP. & FIN. L. 533, 540 n.23 (2015) (quoting Lawrence A. Hamermesh, *Director Nominations*, 39 DEL. J. CORP. L. 117, 136 (2014)). "Additionally, state business codes generally contain default rules, most of which are flexible because states want businesses to incorporate there." *Id.; see, e.g.*, Jones Apparel Group, Inc. v. Maxwell Shoe Co., 883 A.2d 837, 853 (Del. Ch. 2004) (holding for Jones Apparel Group because it correctly adopted a default rule outlined in Section 213(b) of the *Delaware General Corporation Law* ("DGCL")); Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 847 (2008) (explaining that "much of the DGCL creates statutory rules that are merely 'defaults' . . . . [that] apply only so long as the parties to the corporation choose not to deviate from them"); *see also* William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663, 664 (1974) (discussing Justice Brandeis' dissent in Liggett Co. v. Lee, 288 U.S. 517, 562–63 (1933), which acknowledged the beginning of modern liberal corporation statutes and the origin of the race). *But see* Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1369 (2013) (rejecting the explanation that states tailor their corporate statutes to entice companies to incorporate within their borders as part of a "race"); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 635–39 (2003).

of incorporation and bylaws.[15] Beyond incorporation, changes to director duties require fulfillment of certain procedural prerequisites necessitating intimate director involvement.[16] The segregation of economic and management rights is a quintessential corporate characteristic.[17]

A. Mandated Shareholder Deference to Corporate Director Dominion

Although shareholders are the ultimate owners of the enterprise, their role in corporate management is limited to decisions impacting the corporation's "ultimate destiny."[18] This category

---

[15] Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. L. 67, 72 (2003); DEL. CODE ANN. tit. 8, § 141 (West 2022); CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 234–35 (Del. 2008) ("It is well-established Delaware law that a proper function of bylaws is not to mandate how the board should decide specific substantive business decisions, but rather, to define the process and procedures by which those decisions are made.); *see* Robert Sprague & Aaron J. Lyttle, *Shareholder Primacy and the Business Judgment Rule: Arguments for Expanded Corporate Democracy*, 16 STAN. J. L. BUS. & FIN. 1, 39 (2010).

[16] *See, e.g.*, DEL. CODE ANN. tit. 8, § 103(a) (West 2022) (outlining the requirements to be satisfied for amending corporate governance documents); *id.* § 141(a) ("If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.").

[17] Separate legal personhood is a fundamental feature of corporate existence. Phillip I. Blumberg, *The Corporate Entity in an Era of Multinational Corporations*, 15 DEL. J. CORP. L. 283, 286 (1990). Accordingly, shareholders are not personally liable for corporate obligations. MODEL BUS. CORP. ACT § 6.22(b) (A.B.A. 2021) ("[Unless otherwise provided in the articles of incorporation,] a shareholder of a corporation is not personally liable for the acts or debts of the corporation except . . . that a shareholder may become personally liable by reason of the shareholder's own acts or conduct."). This is an important distinction between corporations and unincorporated business forms, particularly partnerships and sole proprietorships, in which the business owners are personally liable for business obligations. *See* REVISED UNIF. P'SHIP ACT § 306(a) (1997) ("Except as otherwise provided in subsections (b) and (c), all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.").

[18] Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 258 (2d Cir. 1984) ("[D]ecisions affecting a corporation's ultimate destiny are for the shareholders to make in accordance with democratic procedures."); *see also* Carol Seidler, *Assessing the Wisdom of the Business Judgment Rule in Corporate Control Contests: Is*

includes the right to elect and remove directors,[19] to make amendments to the articles of incorporation and/or bylaws, and to approve or disapprove extraordinary business decisions.[20] Except

---

It Time to Make Shareholders' Interests Paramount?, 23 LOY. L.A. L. REV. 919, 920 n.7 (1990) (citations omitted) ("Although corporate law grants shareholders the power to elect corporate directors, in practice, management nominates directors and shareholders ratify management's selections . . . . Besides maintaining social and professional relationships with management, directors may be part of the company's inside management.").

[19] MODEL BUS. CORP. ACT § 8.03(c) (A.B.A. 2021) ("Directors are elected at the first annual shareholders' meeting and at each annual meeting thereafter unless their terms are staggered under section 8.06."); § 8.08(a) ("The shareholders may remove one or more directors *with or without cause* unless the articles of incorporation provide that directors may be removed only for cause.") (emphasis added); DEL. CODE ANN. tit. 8, §§ 141(k), 211(b) (West 2022); DENNIS J. BLOCK & HARVEY L. PITT, PROXY CONTESTS 15 (1982); Roven v. Cotter, 547 A.2d 603, 609 (Del. Ch. 1988) ("[I]t is clear that the directors of Delaware corporations in general . . . have no vested right to hold office in defiance of a properly expressed will of the majority."); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) (citing Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) ("If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.").

It should be noted that while shareholder removal of directors doesn't necessarily require "cause," corporate codes generally do not define the term, leaving such matters to judicial resolution. *See, e.g.*, Campbell v. Loew's, Inc., 134 A.2d 852, 857–58 (Del. Ch. 1957) (citations omitted) ("While there are some cases suggesting the contrary, I believe that the stockholders have the power to remove a director for cause. This power must be implied when we consider that otherwise a director who is guilty of the worst sort of violation of his duty could nevertheless remain on the board. It is hardly to be believed that a director who is disclosing the corporation's trade secrets to a competitor would be immune from removal by the stockholders. Other examples, such as embezzlement of corporate funds, etc., come readily to mind.").

State law allows a corporation to require cause for director removal through an appropriate provision in its articles of incorporation. *See* MODEL BUS. CORP. ACT ANN. § 8.08 Official Comment (A.B.A. 4th ed. 2008) ("The power to remove a director without cause may be eliminated by a provision in the articles of incorporation. Such a provision in effect guarantees the directors the same entitlement to office that directors enjoyed at common law. It is likely to be used in closely held corporations as an element of an agreed-upon allocation of power and control which ensures directors immunity from removal except for cause. It may also be used in publicly held corporations that fear changes in ownership of the majority of the shares and desire to provide security to the directors."); DEL. CODE ANN. tit. 8, § 141(k) (West 2022).

[20] MODEL BUS. CORP. ACT § 10.03 (A.B.A. 2021) (outlining a process of shared responsibility between directors and shareholders in amending a corporate

in the case of the close corporation,[21] shareholders do not enjoy the right to dictate director decisions or actions, as discretion regarding corporate management is reserved for the board of directors.[22] Directors, not shareholders, are responsible for managing the business and affairs of a corporation.[23] Board approval is

---

charter); § 10.20 (granting both shareholders and directors independent authority to amend corporate bylaws).

[21] DEL. CODE ANN. tit. 8, § 350 (West 2022). Section 350 permits the holders of majority of a close corporation's outstanding stock to make an agreement as to how the business affairs of the corporation are to be conducted, even to the extent of interfering with the discretion of the board of directors. *Id.* By becoming parties to such an agreement, shareholders of the close corporation assume, and relieve directors of, the liability for managerial acts and omissions. *Id.* Section 351 of the Delaware Code (the Code) permits the close corporation to provide for management of the corporation by the stockholders in lieu of a board of directors; under such an election, the stockholders are treated as directors. *Id.* § 351. Section 354 of the Code also permits a close corporation to be operated as a partnership. *Id.* § 354.

[22] *See, e.g.*, Charlestown Boot & Shoe Co. v. Dunsmore, 60 N.H. 85, 86–87 (1880) (invalidating a stockholder action directly appointing a nondirector manager because the sole managerial power was given to directors by a state statute, subject to corporate bylaw restrictions); Automatic Self-Cleansing Filter Syndicate Co. v. Cuninghame [1906] 2 Ch. 34, 43 (Eng. C.A.) (invalidating a vote by a majority of the shareholders to sell the company); Carol R. Goforth, "*A Corporation Has No Soul"—Modern Corporations, Corporate Governance, and Involvement in the Political Process*, 47 HOUS. L. REV. 617, 629–30 (2010) ("Shareholders generally do not have an active role in the management of public corporations. Despite the fact that shareholders technically 'own' [the corporation], it is widely acknowledged that their primary power if they do not like how 'their' corporation is being managed is to 'vote with their feet' by selling their shares and buying into another business venture. For the most part, the shareholders have very little power in controlling, overseeing, or disciplining the managers of their corporations. They certainly have no say over day-to-day decisions about the business. This model, which very clearly distinguishes corporate management from shareholder control, has become the generally accepted way of understanding corporate governance in [the modern American corporation]."); *see, e.g.*, Abercrombie v. Davies, 123 A.2d 893, 898–900 (Del. Ch. 1956) (shareholder agreement which attempts to substantially encroach upon the directors' statutory duty to exercise independent judgment is void).

[23] *See, e.g.,* DEL. CODE ANN. tit. 8, § 141(a) (West 2022) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ."); *see also* MODEL BUSINESS CORP. ACT § 8.01(b) (A.B.A. 2021) ("All corporate powers shall be exercised by or under the authority of the board of directors, and all the business and

required to initiate charter amendments for presentation and shareholder vote.[24] There is generally no provision in corporate law allowing shareholders to present charter amendments without the board electing to hold that shareholder vote.[25]

Although state statutes and corporate organizational documents set out director duties, boards may delegate duties to committees, officers, or other agents.[26] The corporate organizational documents outline the board's obligations, but they do not give granular detail concerning the obligations imposed on individual directors.[27] Instead, boards fulfill their collective fiduciary

affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of the board of directors."). *See* N.Y. Bus. Corp. Law § 701 (McKinney 2022); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953 (Del. 1985) ("The board has a large reservoir of authority upon which to draw. Its duties and responsibilities proceed from the inherent powers conferred by . . . § 141(a), respecting management of the corporation's 'business and affairs'."); Maldonado v. Flynn, 413 A.2d 1251, 1255 (Del. Ch. 1980), *rev'd on other grounds*, 430 A.2d 779 (Del. 1981) (The *Maldonado* court noted the well-established rule that under § 141(a) of the Code, "directors, not the stockholders, are the managers of the business affairs of the corporation.").

[24] *See* DEL. CODE ANN. tit. 8, § 242(b) (West 2022); MODEL BUS. CORP. ACT § 10.03 (A.B.A. 2021); *cf.* N.Y. Bus. Corp. Law § 803(a) (McKinney 2022).

[25] *See* MODEL BUS. CORP. ACT § 10.03(a) (A.B.A. 2021).

[26] *See* DEL. CODE ANN. tit. 8, § 141(a) (West 2022); MODEL BUS. CORP. ACT § 8.01(b) (A.B.A. 2021) (*"All corporate powers* shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors.") (emphasis added). Corporate boards are generally granted broad latitude in satisfying their responsibilities. *See* Lisa M. Fairfax, *Managing Expectations: Does the Directors' Duty to Monitor Promise More Than It Can Deliver?*, 10 U. ST. THOMAS L. J. 416, 416–17 (2012) ("While it is true that directors can have both a managerial role and a monitoring role over corporate affairs, most directors of today's public corporations are not primarily responsible for managing the day-to-day affairs of the corporation. Instead, directors entrust officers and employees with managing the corporate enterprise, and thus are primarily tasked with monitoring officers and employees to ensure that they manage in the corporation's best interests. The responsibilities directors undertake when carrying out this monitoring role often implicate the oversight duty.").

[27] Renée B. Adams et al., *The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey*, 48 J. ECON. LIT. 58, 81 (2010) ("Each board of directors is likely to have its own dynamics, a function of many factors including the personalities and relationships among the directors, their backgrounds and skills, and their incentives and connections.").

duties using their judgment as a body politic.[28] The directors select the corporate officers,[29] define their duties,[30] and determine their compensation.[31] Although directors entrust primary operational responsibility to corporate officers, the board maintains responsibility for establishing the policies to be followed by those officers and supervising the activities of those officers and other corporate employees.[32] The board also operates as an intermediary between shareholders and the corporate management structure under board supervision, making the shareholders passengers in the corporate enterprise.[33] The board also has the power to issue shares of

---

[28] CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 238–39 (Del. 2008) (citations omitted) (citing Quickturn Design Systems, Inc. v. Shapiro, 721 A.2d 1281 1291–92 (Del.1998) ("This Court has previously invalidated contracts that would require a board to act or not act in such a fashion that would limit the exercise of their fiduciary duties. . . . 'One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation.'").

[29] DEL. CODE ANN. tit. 8, § 142(b) (West 2022).

[30] § 142(a). But the duties of the officers must be defined in a manner not inconsistent with any bylaw provisions, *id.*, which shareholders of course have the power to change. § 109(a).

[31] The determination of officer compensation is an exercise of the power to manage the affairs of the corporation and is incident to the power to select officers. R. FRANKLIN BALOTTI ET AL, 1 DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.1 (4th ed. 2022) ("The board has the power and the duty to decide what operations the corporation will pursue, which officers will run those operations.").

[32] DEL. CODE ANN. tit. 8, § 142(b) (West 2022); WILLIAM E. KNEPPER & DAN A. BAILEY, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 1.03, at 5–6 (4th ed. 1988); Unisuper Ltd. v. News Corp., No. 1699-N, 2005 WL 3529317, at *6 (Del. Ch. Nov. 7, 2005) ("Delaware's corporation law vests managerial power in the board of directors because it is not feasible for shareholders, the owners of the corporation, to exercise day-to-day power over the company's business and affairs.").

[33] *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 38 (Del. Ch. 2013) ("Directors must exercise their independent fiduciary judgment; they need not cater to stockholder whim."). *See* Pinto, *supra* note 11, at 259 ("Ownership usually implies control, but without a concentration of ownership in shares, managers who control corporate assets, information, and the voting mechanisms are in de facto control of the corporation with little oversight by the owners, i.e., the shareholders. Shareholders of many [public and private] corporations are passive."); Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 WM. & MARY L. REV. 2071, 2083 (2010) (citations omitted) ("[I]t is unclear why, among the many groups of corporate constituents, shareholders are deemed to be the owners. They do not, for example,

stock (or stock options),[34] to declare dividends,[35] or reduce capital.[36] As state statutes outlining traditional director duties are generally default rules, directors are granted wide latitude in determining how they carry out their responsibilities.[37]

In discharging their corporate management responsibilities, boards have a need for significant autonomy.[38] These directors must be able to make decisions without the constant threat of legal exposure.[39] The ability to manage corporate affairs without

---

possess many of the traditional rights that come with property ownership—including the right to exclude, or the right of possession. Moreover, this entire line of reasoning is circular. Shareholders purchase a set of rights from a corporation. That set of rights typically includes the right to vote for directors, but the stock ownership "bundle" could easily be constructed without that right. In the end, '[l]abeling shareholders 'owners' is no more of a justification for the vote than is labeling them 'voters.'"); Jones Apparel Group, Inc. v. Maxwell Shoe Co., 883 A.2d 837, 850 n.36 (Del. Ch. 2004) ("[C]orporate power, as a default matter, is exercised through the board."); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005) ("A central and well-settled principle of U.S. corporate law is that all major corporate decisions must be initiated by the board.").

[34] DEL. CODE ANN. tit. 8, § 157 (West 2022). The number of shares which the board may issue is limited, however, to those shares authorized in the certificate of incorporation which remain unissued. § 161.

[35] § 170. The directors may not declare a dividend, however, if losses or depreciation have diminished the corporation's capital below the total amount of capital represented by outstanding preferred stock. *Id.*

[36] § 244. There are, however, certain limitations. First, the directors must follow the procedures established by the statute. In addition, they may not endanger the corporation's ability to pay its debts. *Id.*

[37] *See* Usha Rodrigues, *A Conflict Primacy Model of the Public Board*, 2013 U. ILL. L. REV. 1051, 1054 (2013) ("State corporate law by its nature necessitates such flexibility, given the fact that the same basic corporate code serves the needs of both tiny 'mom and pop' corporations and Fortune 50 behemoths.").

[38] *See* John Wilcox, *The Autonomous Board*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Nov. 11, 2013, 9:22 AM), http://blogs.law.harvard.edu/corpgov/2013/11/11/the-autonomous-board/ [perma.cc/S5WL-KPC6] ("[D]espite the embedded connections and dependence on management, the board is expected to function autonomously."). Top corporate managers are legally and factually autonomous for many purposes. *See also* Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1471 (1989) ("[U]nder corporate law, the shareholders normally cannot make ordinary business decisions, cannot make major structural decisions unless the directors concur, and cannot remove directors without cause.").

[39] *See* Fairfax, *supra* note 26, at 437 ("[C]ourts historically have been reluctant to second-guess directors' business decisions by holding them liable

concern for interference and liability exposure is necessary because the absence of these protections could serve as a deterrent to board service.[40]

Further, requiring that directors respond to individual shareholder wishes is wholly unrealistic.[41] Directors should have the latitude to consider the interests of all shareholders and carry out their fiduciary duties accordingly.[42] Confidentiality is paramount to the director ability to discharge corporate management duties, as excessive transparency exposes the corporation to significant competitive risk.[43]

---

when those decisions result in losses. Courts are mindful that directors have been entrusted with making business decisions, some of which may, upon hindsight, appear foolish, unwise, or extremely risky. If courts hold directors liable for such decisions, they may inappropriately replace their judgment with those of directors who have greater business experience. They also may inappropriately undermine directors' willingness to make risky decisions, many of which may prove beneficial to the corporation."); David A. Katz & Laura A. McIntosh, *Boardroom Confidentiality Under Focus: Corporate Governance*, 251 N.Y.L.J., Jan. 23, 2014, at 5 ("In order for boards to function effectively, directors must feel comfortable expressing their views in the boardroom on corporate matters honestly and freely, without concern that their conversations will be made public.").

[40] *See, e.g.,* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 605 (2003) ("[T]he diffuse nature of U.S. stockownership and regulatory impediments to investor activism insulate directors from shareholder pressure. Accordingly, the board has virtually unconstrained freedom to exercise business judgment. Preservation of this largely unfettered discretion is, and should always be, the null hypothesis.").

[41] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 1 (1991) (explaining that a corporate shareholder generally only "has a small stake compared with the size of the venture.")

[42] *See, e.g.,* Paramount Commc'ns, Inc. v. Time, Inc., 571 A.2d 1140, 1154 (Del. 1989) (citations omitted) ("The fiduciary duty to manage a corporate enterprise . . . . may not be delegated to the stockholders. Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.").

[43] *See, e.g.,* Katz & McIntosh, *supra* note 39 ("Confidential, non-public corporate information falls generally into three categories: proprietary information that is of competitive, commercial value to the company; inside information about the company's finances, operations, and strategy; and sensitive information regarding board proceedings and deliberations. Unauthorized disclosures of proprietary information could imperil a company's competitive advantage or commercial success while unauthorized disclosures of inside information

The various and sundry corporate director fiduciary duties should be viewed in light of its long-understood principal objective: to conduct corporate affairs in a way that maximizes shareholder economic value.[44] The board of directors serves as a fiduciary collective entrusted with safeguarding the value of the corporation's shares.[45] That fiduciary relationship characterizes the standard by which a board must fulfill its statutory obligation to manage corporate affairs for the benefit of the shareholders.[46]

---

can lead to illegal insider trading and manipulation of the company's stock price."); Rodrigues, *supra* note 37, at 1082 ("[B]oards are not perfect . . . . Yet boards need not function perfectly. . . . Marshaling the shareholders to [become more deeply involved in corporate management] would be procedurally unwieldy: imagine having to identify a group of shareholders to pass judgment on each takeover offer or related party transaction that arose. Issues of confidentiality and the dangers of extortionate behavior would also arise, particularly if the group of shareholders was large.").

[44] *See* Miner v. Belle Isle Ice Co., 53 N.W. 218, 224 (Mich. 1892) ("The law requires of [those in control] the utmost good faith in the control and management of the corporation as to the minority. It is of the essence of this trust that it shall be so managed as to produce for each stockholder the best possible return for his [or her] investment."); Wojcik v. McNish, No. 267005, 2006 WL 2061499, at *5 (Mich. Ct. App. July 25, 2006) ("Undoubtedly, a shareholder has an interest in having his investment become as profitable as possible."); Michael K. Molitor, *The Crucial Role of the Nominating Committee: Re-Inventing Nominating Committees in the Aftermath of Shareholder Access to the Proxy*, 11 U.C. DAVIS BUS. L.J. 97, 101 (2010) ("Because the range of possible outcomes for the common shareholders is quite large, whereas the prior claims of other stakeholders are largely fixed by contract,13 a traditional view has been that the corporation should be operated primarily to maximize the wealth of its common shareholders."); A. A. Berle, Jr., *For Whom Corporate Managers* Are *Trustees: A Note*, 45 HARV. L. REV. 1365, 1365 (1932) ("Historically, and as a matter of law, corporate managements have been required to run their affairs in the interests of their security holders.").

[45] Robert A. Kutcher, *Breach of Fiduciary Duty, in* BUSINESS TORTS LITIGATION 1, 4 (David A. Soley, Robert Y. Gwin & Ann E. Georgehead eds., 2d ed. 2005); *see also* MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 206 (8th ed. 2000) ("A single director . . . has no power[,] [and] [i]nstead, directors can act only as a body"); Jill E. Fisch & Caroline M. Gentile, *The Qualified Legal Compliance Committee: Using the Attorney Conduct Rules to Restructure the Board of Directors*, 53 DUKE L.J. 517, 544 (2003) ("Directors act collectively, and they have generally been held to lack the authority to act for the issuer in their individual capacities.").

[46] DEL. CODE ANN. tit. 8, § 141(a) (West 2022); *see, e.g.*, *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 36 (2013) (quoting eBay Domestic Holdings v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010)) ("Delaware corporate law starts from the bedrock principle that '[t]he business and affairs of every corporation . . . shall

As long as the directors act in good faith, within their statutory authority, and in accordance with applicable provisions of the articles of incorporation and bylaws, director decisions stand as the decisions of the corporation, despite shareholder displeasure.[47] Shareholders and the board do hold the concurrent authority to amend corporate bylaws.[48] However, bylaws are subordinated to and cannot alter corporate charter provisions.[49] Thus, the scope of management restrictions permitted through corporate bylaws is much more limited than restrictions articulated in the corporate charter.[50] The authority to declare distributions also rests fully with the board; such decisions are viewed as part of the ordinary conduct of business delegated to the sole prerogative of management.[51] This is a prime example of authority reserved for corporate boards.[52]

---

be managed by or under the direction of a board of directors.' 8 *Del. C.* § 141(a). When exercising their statutory responsibility, the standard of conduct requires that directors seek 'to promote the value of the corporation for the benefit of its stockholders.'"); *In re* Stillwater Capital Partners Inc. Litig., 851 F. Supp. 2d 556, 573 (S.D.N.Y. 2012) ("A corporation does not owe a fiduciary duty to its shareholders.").

[47] Andrew R. Brownstein & Igor Kirman, *Can a Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions*, 60 THE BUS. LAWYER 23, 24 (2004). *But cf.* DEL. CODE ANN. tit. 8, § 350 (West 2022).

[48] *See* DEL. CODE ANN. tit. 8, § 109 (West 2022); MODEL BUS. CORP. ACT § 10.20 (A.B.A. 2021); *cf.* N.Y. Bus. Corp. Law § 601 (McKinney 2022).

[49] "[B]ylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." DEL. CODE ANN. tit. 8, §109(b) (West 2022); *see also* MODEL BUS. CORP. ACT § 2.06(b) (A.B.A. 2021) ("The bylaws of a corporation may contain any provision that is not inconsistent with law or the articles of incorporation.").

[50] "One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation. Section 141(a) requires that any limitation on the board's authority be set out in the certificate of incorporation." Quickturn Design Sys. v. Shapiro, 721 A.2d 1281, 1291 (Del. 1998).

[51] *See* DEL. CODE ANN. tit. 8, § 170(a) (West 2022); MODEL BUS. CORP. ACT § 6.40 (A.B.A. 2021); *see also* Romanik v. Lurie Home Supply Ctr., Inc., 435 N.E.2d 712, 723 (Ill. App. Ct. 1982) ("Courts are reluctant to interfere with the exercise of the directors' business judgment unless the withholding is fraudulent, oppressive or totally without merit."); Kamin v. Am. Express Co., 383 N.Y.S.2d 807, 812 (Sup. Ct. 1976); Victor Brudney, *Dividends, Discretion, and Disclosure*, 66 VA. L. REV. 85, 104 (1980).

[52] *See Romanik*, 435 N.E.2d at 723.

While mergers, consolidations, sales of all assets, and dissolutions require approval by a majority of the outstanding shares under the Delaware Code and the MBCA,[53] shareholders hold only veto power over such decisions.[54] The power to initiate these proposals still rests with the board.[55] Further, Delaware law expressly authorizes the board to abandon a proposed merger or sale of assets even after shareholder approval has been given.[56]

Shareholders generally enjoy the exclusive right to amend the certificate (or articles) of incorporation.[57] Thus, shareholders could theoretically limit the board's ability to take an action permitted by the articles of incorporation.[58] Similarly, since directors are limited in the shares of stock they can issue to those authorized in the certificate of incorporation,[59] shareholders are granted

---

[53] *See* DEL. CODE ANN. tit. 8, § 251(c) (West 2022) (merger and consolidation); § 271(a) (asset sale); § 275(b) (dissolution); MODEL BUS. CORP. ACT § 11.04(e) (A.B.A. 2021) (merger); § 12.02(e) (asset sale); § 14.02(e) (dissolution).

[54] *See* DEL. CODE ANN. tit. 8, § 251(c) (West 2022) (merger and consolidation); § 271(a) (asset sale); § 275(b) (dissolution); MODEL BUS. CORP. ACT § 11.04(e) (A.B.A. 2021) (merger); § 12.02(e) (asset sale); § 14.02(e) (dissolution).

[55] *See, e.g.*, DEL. CODE ANN. tit. 8, § 11.04(a) (West 2022) ("The plan of merger or share exchange must be adopted by the board of directors."). *But see* § 275(c) ("Dissolution of a corporation may also be authorized without action of the directors if all the stockholders entitled to vote thereon shall consent in writing and a certificate of dissolution shall be filed with the Secretary of State pursuant to subsection (d) of this section.").

[56] § 271(b) ("Notwithstanding authorization or consent to a proposed sale, lease or exchange of a corporation's property and assets by the stockholders or members, the board of directors or governing body may abandon such proposed sale, lease or exchange without further action by the stockholders or members, subject to the rights, if any, of third parties under any contract relating thereto."); § 251(d) ("Any agreement of merger or consolidation may contain a provision that at any time prior to the time that the agreement (or a certificate in lieu thereof) filed with the Secretary of State becomes effective in accordance with § 103 of this title, the agreement may be terminated by the board of directors of any constituent corporation notwithstanding approval of the agreement by the stockholders of all or any of the constituent corporations. . . .").

[57] § 242. The term "charter" is synonymous with "certificate of incorporation." *Certificate of Incorporation*, BLACK'S LAW DICTIONARY (10th ed. 2014). This exclusive power belongs to the shareholders only after the corporation has received payment for stock. DEL. CODE ANN. tit. 8, § 242 (West 2022). Prior to the corporation receiving any payment for shares, the power to amend the certificate belongs to the incorporators or provisional board of directors, § 241, but seldom if ever would this be the case at the time of a takeover bid. *Id.*

[58] § 242.

[59] § 161.

essential control over the number of shares to which directors have access.[60] Available 'supermajority' voting requirements to effect bylaw and charter amendments provide an additional shareholder veto opportunity.[61] Thus, shareholder power to adopt, amend and repeal bylaws is another tool to at least influence corporate management decisions.[62]

Shareholders also have the right to inspect corporate record books,[63] vote at annual and special shareholder meetings,[64] and take action by consent in lieu of shareholder meetings.[65] Access to information concerning the corporation's financial health is important to these shareholder interests.[66] Shareholders have

---

[60] § 242.

[61] Section 216 of the Delaware Code provides that the affirmative vote of the majority of outstanding voting shares represented at a shareholders' meeting is required to transact business but permits the bylaws or certificate of incorporation to specify a different required vote. § 216. *See also* Young v. Valhi, Inc., 382 A.2d 1372 (Del. Ch. 1978) (upholding a supermajority voting provision). The existence of a bylaw or charter provision requiring a higher voting proportion might discourage a corporate raider from making a tender offer by increasing the number of shares needed to acquire voting control. *See generally* Hochman & Folger, *Deflecting Takeovers: Charter and By-Law Techniques*, 34 BUS. L. 537 (1979).

[62] *See supra* notes 57–61 and accompanying text.

[63] DEL. CODE ANN. tit. 8, § 220 (West 2022).

[64] §§ 151(a), 212.

[65] § 228. The consent procedure permits shareholders to take the same action permissible at shareholder meetings without the necessity of holding a meeting. *Id.* A written resolution is circulated among shareholders for approval by signature. *Id.* When the resolution has the written approval of the holders of a majority of outstanding stock, it is deemed to represent the action of the shareholders, having the same effect as if it had been adopted at a shareholders' meeting. *Id.* While shareholder action at a meeting requires only a majority (or other specified proportion) of shares present and voting, § 216, consent action under section 228 requires a majority of all outstanding shares entitled to vote. § 228. The right to vote at meetings (or to take action by consent in lieu of a meeting) gives shareholders the ultimate voice in expressing approval or disapproval of board actions. § 211(b) (allowing shareholders to elect board members whom they feel best represent the shareholders' interests). But shareholders have no preemptive power to *direct* specific actions by the board in any way which interfered with the board's powers. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953–54 (Del. 1985) (noting that board members' powers derive from the fact they are supposed to protect the corporation from harms both internal and external).

[66] DEL. CODE ANN. tit. 8, § 220 (West 2022).

electoral rights.[67] State laws generally provide for shareholder election of directors each year at the required annual shareholder meetings.[68] However, shareholders are still not permitted to directly participate in corporate management as shareholders.[69] It should be noted that many shareholders do not actively use the powers provided by law.[70]

---

[67] *See, e.g.*, § 211(b) (setting out meeting, notice and voting requirements for shareholder election of directors); MODEL BUS. CORP. ACT § 7.01(a) (A.B.A. 2021) ("Unless directors are elected by written consent in lieu of an annual meeting as permitted by section 7.04, a corporation shall hold a meeting of shareholders annually at a time stated in or fixed in accordance with the bylaws. . . ."); *see also* Harrah's Ent., Inc. v. JCC Holding Co., 802 A.2d 294, 311 n.39 (Del. Ch. 2002) ("[T]he election of directors may be the most . . . important action[ ] that shareholders can take.") (citing Durkin v. Nat'l Bank of Olyphant, 772 F.2d 55, 59 (3d Cir.1985)); *see also* Brett H. McDonnell, *Setting Optimal Rules for Shareholder Proxy Access*, 43 ARIZ. ST. L.J. 67, 114 (2011) ("Shareholder election of directors is a core legitimate and legitimating shareholder power. This is an area where directors are tempted to set suboptimal rules that entrench themselves.").

[68] *See* DEL. CODE ANN. tit. 8, § 211(b) (West 2022). *But see* N.D. CENT. CODE ANN. § 10-19.1-71 (West 2022) ("1. Regular meetings of shareholders may be held on an annual or other less frequent periodic basis but need not be held unless required by the articles or bylaws or by subsection 2."); MINN. STAT. ANN. § 302A.431 (West 2022) ("Subdivision 1. Frequency. Regular meetings of shareholders may be held on an annual or other less frequent periodic basis, but need not be held unless required by the articles or bylaws or by subdivision 2."); *see also* Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1777 (2006) ("The right to elect directors is an important tool for stockholders, allowing them to hold centralized management accountable and thereby contributing to the creation of stockholder wealth by checking agency costs.").

[69] *See* DEL. CODE ANN. tit. 8, § 141(a) (West 2022); Dalia Tsuk Mitchell, *Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1547–48 (2006) ("[S]tate corporation statutes and charters govern shareholder voting. They determine which issues . . . require shareholder voting as well as the particular procedures that voting processes should follow. Historically, shareholders had . . . to vote [at the annual meeting]. But . . . with the rise of the large public corporation, proxy voting became the norm . . . .").

[70] *See* Lee Harris, *Corporate Elections and Tactical Settlements*, 39 J. CORP. L. 221, 246 (2014) (footnotes omitted) ("Most shareholders have limited ability or desire to affect the firm's strategic direction. They may hold their investment for years without ever even closely reading the firm's annual reports and proxy statements they receive in the mail. They never ask to review or inspect the

B. Fiduciary Duties of Directors

Incident to their management powers, directors also owe fiduciary obligations to the corporation and its shareholders.[71] It is a longstanding legal maxim that directors hold a fundamental fiduciary place vis-à-vis the corporation and its shareholders.[72] Courts have correspondingly held directors responsible to act in the best interests of the corporation and by extension its shareholders.[73] This standard reflects an acknowledgment of trust that the directors enjoy in managing the affairs of the corporation, ultimately for the benefit of the shareholders.[74] The shareholders are correspondingly incapable of intervening in management decisions.[75] There are two primary duties that the directors owe in this respect; the duty of care and the duty of loyalty.[76]

---

books of the corporation and are unlikely to have the resources or desire to engage in litigation against the firm. They never launch a contest for control of the board."). Accordingly, "many shareholders pay little or limited attention to the question of how to vote." Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 692 (2007).

[71] *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); John L. Warden, *The Boardroom as a War Room: The Real World Applications of the Duty of Care and the Duty of Loyalty,* 40 BUS. LAW 1431, 1431 (1985); *see generally* DENNIS J. BLOCK ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS AND OFFICERS (Prentice Hall L. and Bus. ed., 2nd ed. 1988).

[72] *See, e.g.*, Lofland v. Cahall, 118 A. 1, 4 (Del. 1922). The *Lofland* court stated that "[d]irectors of a corporation are trustees for the stockholders and their acts are governed by the rules applicable to such a relation, which exact of them the utmost good faith and fair dealing, especially where their individual interests are concerned." *Id.* at 3; Bowen v. Imperial Theaters, Inc., 115 A. 918, 922 (Del. Ch. 1922) (directors stand in position as trustees of shareholders).

[73] *Guth,* 5 A.2d at 510.

[74] *Id.* at 509.

[75] Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984) (directors' statutory power to manage affairs of corporation carries with it fiduciary duties owed to corporation and shareholders); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (statutes mandate that directors, not the shareholders, manage the corporation, and the position "carries with it certain fundamental fiduciary obligations to the corporation and its shareholders.").

[76] *See* McMullin v. Beran, 765 A.2d 910, 921 (Del. 2000) ("A director's duty to exercise an informed business judgment implicates the duty of care."); *id.* at 925 ("In properly discharging their fiduciary responsibilities, directors of Delaware corporations must exercise due care, good faith and loyalty whenever they communicate with shareholders about the corporation's affairs.").

1. Duty of Care

In fulfilling the mandates embedded in the duty of care a director "exercise[s], in the performance of his [or her] tasks, the care that a reasonably prudent person in a similar position would use under similar circumstances."[77] In discharging this duty, directors must exercise the level of care ordinarily expected of corporate directors.[78] When in compliance with this duty, a director is protected from personal liability, with directorial decisions granted strong judicial deference.[79] However, a director's failure to act within mandates of the duty does not automatically trigger personal liability.[80] Whether director liability should be measured against a standard of gross negligence versus ordinary negligence is the source of debate, at least partially showing the scope of the business judgment rule.[81]

---

[77] Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984). *See also* Briggs v. Spaulding, 141 U.S. 132, 147 (1981) ("The degree of care required . . . has to be determined in view of all the circumstances.").

[78] Polk v. Good, 507 A.2d 531, 536 (Del. 1986) (directors owe duty of care to the corporation and shareholders) (citing Aronson v. Lewis, 473 A.2d 805, 811 (1984) and *Guth,* 5 A.2d at 510); *Aronson*, A.2d at 812 (directors must act with care in exercising their duties).

[79] BLOCK ET AL., *supra* note 71, at 28.

[80] *Id.* This is because "the degree of culpability required for the imposition of liability may be higher than the standard of care." *Id.*

[81] Delaware state law provides directors with a higher degree of protection by establishing a gross negligence standard. *Aronson*, 473 A.2d at 812 n.6 ("director liability is predicated on a standard which is less exacting than simple negligence"); *see, e.g.,* Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) ("gross negligence is . . . the proper standard for determining whether [directors exercised proper] business judgment"). Similarly, Indiana's law reserves director liability for instances when "breach or failure to perform constitutes willful misconduct or recklessness." IND. CODE ANN. § 23-1-35-11e(2) (West 2022). Conversely, California employs a more rigorous standard for imposing director liability under an ordinary negligence standard. CAL. CORP. CODE § 309(a) (West 2022) ("A director shall perform the duties of a director . . . in good faith . . . as an ordinarily prudent person in a like position would use under similar circumstances."). New York law also employs an ordinary negligence standard. N.Y. BUS. CORP. LAW § 717(a) (McKinney 1989) ("A director shall perform his duties as a director . . . in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances."); *see also* Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 273–74 (2d Cir. 1986) (citations omitted) ("[T]he exercise of fiduciary duties by a corporate board member includes more than avoiding fraud, bad faith and self-dealing. Directors must exercise their 'honest judgment in the lawful and

2. Duty of Loyalty

In particular, the trust expressed through director corporate control carries with it a nondelegable duty of loyalty owed by the board to manage the corporation for the economic benefit safeguard of the shareholders.[82] Although particular duties owed often vary by corporation, boards are typically required to pursue corporate profits for shareholder benefit.[83] The duty of loyalty requires that directors discharge a duty to protect the economic interests of the corporation, and not interests of others that might be in conflict.[84] The directors must take particular care to maintain the interests of the corporation above their personal interests.[85] In assessing director compliance with the duty of loyalty, courts consider the motives and purposes of directors.[86] Directors are not allowed to pursue personal interests in matters for which the director is entrusted to represent the interests of the corporation and its shareholders.[87] It is a breach of the director's duty to

---

legitimate furtherance of corporate purposes.' . . . It is not enough that directors merely be disinterested and thus not disposed to self-dealing or other indicia of a breach of the duty of loyalty. Directors are also held to a standard of due care. They must meet this standard with "conscientious fairness. . . .").

[82] Benihana of Tokyo, Inc., v. Benihana, Inc., 891 A.2d 150, 191 (Del. Ch. 2005) ("The duty of loyalty, in essence, 'mandates that the best interest of the corporation and its shareholders take precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.'") (quoting Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993). *But see* Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 WM. & MARY L. REV. 2071, 2114 (2010) ("The history of corporate constituency status should be instructive here. Thirty-one states have provisions that permit directors to take the needs of all corporate constituencies into account when making certain decisions.").

[83] *See* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end . . . .").

[84] *Van Gorkom*, 488 A.2d at 872; *see* Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984).

[85] Guth v. Loft, 5 A.2d 503, 510 (Del. 1939).

[86] Nw. Indus., Inc. v. B.F. Goodrich Co., 301 F. Supp. 706, 711 (N.D. Ill. 1969) (directors are held to a standard of care which businessmen of ordinary prudence would exercise in managing their own affairs); Polk v. Good, 507 A.2d 531, 536 (Del. 1986) (citing *Aronson*, 473 A.2d at 811 and *Guth,* 5 A.2d at 510) (directors owe fiduciary duty of loyalty to the corporation and shareholders).

[87] *Norlin,* 744 F.2d at 264.

use his or her corporate position of trust to advance self-serving economic ends.[88]

The foundational policy of the duty of loyalty is safeguarding the financial interests of the corporation and its shareholders.[89] When a conflicted transaction is deemed unfair, directors can incur personal liability.[90] Correspondingly, when a violation of a director's duty of loyalty results in a decision determined to be nevertheless "fair" to the corporation and its shareholders, the involved

---

[88] Solash v. Telex Corp., No. CIV.A. 9518, 1988 WL 3587, at *7 (Del. Ch. Jan. 19, 1988) ("[I]t is possible to say broadly that the duty of loyalty is transgressed when a corporate fiduciary, whether director, officer or controlling shareholder, uses his or her corporate office or, in the case of a controlling shareholder, control over corporate machinery, to promote, advance or effectuate a transaction between the corporation and such person (or an entity in which the fiduciary has a substantial economic interest, directly or indirectly) and that transaction is not substantively fair to the corporation. That is, breach of loyalty cases inevitably involve conflicting economic or other interests, even if only in the somewhat diluted form present in every 'entrenchment' case").

[89] In *Guth*, the Supreme Court of Delaware court articulated the philosophical support of the duty of loyalty as follows:

> A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty . . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.

Guth, 5 A.2d at 510. In Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (citations omitted), this court further explained the good faith and fairness elements embedded in the duty:

> There is no "safe harbor" for such divided loyalties in Delaware. When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness. The requirement of fairness is unflinching in its demand that where one stands on both sides of the transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.

Id.; *see also Norlin,* 744 F.2d at 265 (citations omitted) ("Once self-dealing or bad faith is demonstrated . . . the burden shifts to the directors to 'prove that the transaction was fair' . . . .").

[90] *Cf.* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719 (Del. 1971)(finding the holding company liable to its subsidiary for breach of the fiduciary duty of loyalty in a derivative action brough by the subsidiary's minority shareholders).

director will escape personal exposure, and the transaction will be permitted.[91]

An example of this policy in practice is *Lyondell Chemical Co. v. Ryan,* in which the Delaware Supreme Court found for the directors and against the shareholders alleging that the board of directors breached their fiduciary duties of care and loyalty in considering various competing merger options.[92] Lyondell's certificate of incorporation contained an exculpatory provision excusing the directors from personal liability for a breach of the duty of care.[93] Although this exculpatory option is unavailable to directors for violations of the duty of loyalty, the Lyondell shareholders, were found not to have proven that the duty of loyalty was implicated by the directors' alleged omissions.[94] Specifically, the shareholders failed to show that the directors acted in bad faith by "intentionally fail[ing] to act in the face of a known duty to act, demonstrating a conscious disregard for [their] duties."[95]

---

[91] *Norlin*, 744 F.2d at 265 (citation omitted) ("Once self-dealing or bad faith is demonstrated . . . the burden shifts to the directors to 'prove that the transaction was fair' . . . .").

[92] Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 239 (Del. 2009) ("The class action complaint challenging this $13 billion cash merger alleges that the Lyondell directors breached their 'fiduciary duties of care, loyalty and candor . . . and . . . put their personal interests ahead of the interests of the Lyondell shareholders.' Specifically, the complaint alleges that: 1) the merger price was grossly insufficient; 2) the directors were motivated to approve the merger for their own self-interest; 3) the process by which the merger was negotiated was flawed; 4) the directors agreed to unreasonable deal protection provisions; and 5) the preliminary proxy statement omitted numerous material facts. The trial court rejected all claims except those directed at the process by which the directors sold the company and the deal protection provisions in the merger agreement. The remaining claims are but two aspects of a single claim, under *Revlon v. MacAndrews & Forbes Holdings, Inc.*, that the directors failed to obtain the best available price in selling the company.").

[93] *Id.* at 239–40 ("Lyondell's charter includes an exculpatory provision, pursuant to 8 *Del. C.* § 102(b)(7), protecting the directors from personal liability for breaches of the duty of care. Thus, this case turns on whether any arguable shortcomings on the part of the Lyondell directors also implicate their duty of loyalty, a breach of which is not exculpated.").

[94] *Id*. at 244.

[95] *Id*. at 243 (quoting *In re W*alt Disney Co. Derivative Litg., 906 A.2d 27, 67 (Del. 2006).

3. Derivative Litigation and the Business Judgment Rule

Although state corporate codes generally protect director decisions made in the ordinary course from external review, shareholder derivative litigation is a means by which shareholders are allowed to hold directors accountable for alleged maladministration of corporate affairs or breach of their fiduciary duties.[96] However, even this option remains limited as state laws generally require shareholder derivative suits to involve the oversight and direction of a special litigation committee ("SLC").[97] Courts generally give a deferential review[98] of an SLC's refusal to file the lawsuit

---

[96] *See* Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263, 1286 (1992) (footnotes omitted) ("Directors are punished for self-dealing by electoral removal, hostile takeovers, or derivative litigation. Although none of these is [sic] likely to happen to a particular board of directors, their aggregate pressure, at least theoretically, disciplines directors to act in the stockholders' interests.").

[97] *See* McKee v. Rogers, 156 A. 191, 193 (Del. Ch. 1931) ("[A] stockholder cannot be permitted as a general rule to invade the discretionary field committed to the judgment of the directors and sue in the corporation's behalf when the managing body refuses. This rule is a well settled one."); *see also* Zapata Corp. v. Maldonado, 430 A.2d 779, 783 (Del. 1981).

[98] Courts will, however, inquire into director independence and a reasonable basis for the decision to dismiss the litigation. *See Zapata,* 430 A.2d at 782, 788–89 ("First, the Court should inquire into the independence and good faith of the committee and the bases supporting its conclusions. Limited discovery may be ordered to facilitate such inquiries. The corporation should have the burden of proving independence, good faith and a reasonable investigation, rather than presuming independence, good faith and reasonableness. If the Court determines either that the committee is not independent or has not shown reasonable bases for its conclusions, or, if the Court is not satisfied for other reasons relating to the process, including but not limited to the good faith of the committee, the Court shall deny the corporation's motion. If, however, the Court is satisfied under Rule 56 standards that the committee was independent and showed reasonable bases for good faith findings and recommendations, the Court may proceed, in its discretion, to the next step.

The second step provides, we believe, the essential key in striking the balance between legitimate corporate claims as expressed in a derivative stockholder suit and a corporation's best interests as expressed by an independent investigating committee. The Court should determine, applying its own independent business judgment, whether the motion should be granted. This means, of course, that instances could arise where a committee can establish its independence and sound bases for its good faith decisions and still have the corporation's motion denied. The second step is intended to thwart instances where corporate actions

or request dismissal of a derivative suit unless "the [decision] does not appear to satisfy the spirit of the requirements."[99] Ultimately, disinterested director ratification will shield conflicted directors from legal liability, even with respect to self-dealing transactions.[100]

Even in the shadow of shareholder litigation, the business judgment rule,[101] exculpation for duty of care claims,[102] indemnification,[103] and insurance[104] are other devices available to protect directors from derivative litigation-induced liability.[105] The

meet the criteria of step one, but the result does not appear to satisfy its spirit, or where corporate actions would simply prematurely terminate a stockholder grievance deserving of further consideration in the corporation's interest. The Court of Chancery of course must carefully consider and weigh how compelling the corporate interest in dismissal is when faced with a non-frivolous lawsuit. The Court of Chancery should, when appropriate, give special consideration to matters of law and public policy in addition to the corporation's best interests."); *see also* London v. Tyrrell, No. 3321-CC, 2010 WL 877528, at *11 (Del. Ch. Mar. 11, 2010) ("The second step of the analysis is discretionary. The court applies its own business judgment to the facts to determine whether the corporation's best interests would be served by dismissing the suit."); Beam v. Stewart, 845 A.2d 1040, 1049 (Del. 2004) ("Independence is a fact-specific determination made in the context of a particular case."); Kaplan v. Wyatt, 499 A.2d 1184, 1192 (Del. 1985) ("Proceeding to the second step of the Zapata analysis is wholly within the discretion of the court."). *But see* Joseph M. McLaughlin & Simpson Thacher, *Special Litigation Committees in Shareholder Derivative Litigation*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Apr. 25, 2010), https://corpgov.law.harvard.edu/2010/04/25/special-litigation-committees-in-shareholder-derivative-litigation/ [https://perma.cc/TQT8-PPQD] ("SLC members are not given the benefit of the doubt as to their objectivity.").

[99] *London*, No. 3321-CC, 2010 WL 877528 at *11.

[100] Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C. L. REV. 855, 882 (2014).

[101] *See Zapata*, 430 A.2d 779, 782 (Del. 1981); Sprague & Lyttle, *supra* note 15, at 3 (footnotes omitted) ("But under the business judgment rule, shareholders are often left with no legal recourse when their directors fail to maximize shareholder wealth.").

[102] DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2022).

[103] § 145.

[104] § 145(g).

[105] *See* Daniele Marchesani, *The Concept of Autonomy and the Independent Director of Public Corporations*, 2 BERKLEY BUS. L.J. 315, 329 (2005) ("[F]iduciary duties and personal liability rules fail to create a sufficient incentive to act in the best interest of the corporation. In particular, the standard of care that governs the directors' duty to monitor, the business judgment rule, the possibility of limited monetary damages for breach of the standard of care, and the availability

business judgment rule is the standard under which courts adjudicate claims brought against directors.[106] The rule manifests a recognition of the difficulties involved in applying fiduciary standards to business decisions made by directors.[107] Therefore, courts apply a "presumption that in making a vebusiness decision, the directors have acted on an informed basis, in good faith and in honest belief that the action taken was in the best interests of the company."[108]

The U.S. Supreme Court initially acknowledged the business judgment rule over a century ago in *Briggs v. Spaulding.*[109] This rule soon became entrenched as the standard for measuring director actions.[110] It reflects the philosophy that business decisions,

---

of insurance coverage all make it unlikely that a director's exposure to liability will provide a serious incentive to act."); Mary Siegel, *The Illusion of Enhanced Review of Board Actions*, 15 U. PA. J. BUS. L. 599, 600 (2013) ("[T]he conventional wisdom is that the other five tests—the enhanced business judgment rule, Revlon, entire fairness, Blasius, and Schnell (hereinafter the "five tests")—require substantial judicial involvement and scrutiny. Such involvement makes sense since the applicability of each test necessarily first required a court to conclude that the business judgment rule was inapplicable.

This Article contends that the conventional wisdom about the five tests is an overstatement: While courts state openly that they defer to the directors' judgment under the business judgment rule, similar deference, repackaged, occurs with three of the other five tests as well. In addition, Delaware courts often utilize three external monitors that offer a high probability of fairness—independent directors, disinterested shareholder approval, and the market—to avoid judicial review.").

[106] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citations omitted) ("The business judgment rule is an acknowledgment of the managerial prerogatives of Delaware directors under Section 141(a). . . . It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption.").

[107] *See* Johnson v. Trueblood, 629 F.2d 287, 292. (3d Cir. 1980).

[108] Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 954 (Del. 1985); *Aronson*, 473 A.2d at 812; *accord* Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964).

[109] *See* Briggs v. Spaulding, 141 U.S. 132, 163 (1891) (finding the corporate directors "should not be subjected to liability upon the ground of want of ordinary care."), *abrogated by* Erie R. Co. v. Tompkins, 304 U.S. 64 (1938).

[110] *See, e.g.*, Robinson v. Pittsburgh Oil Refin. Corp., 126 A. 46, 50 (Del. Ch. 1924). The *Robinson* court applied the presumption of sound business judgment

typically filled with uncertainty regarding the outcome of decisions, should not be assessed by the courts through the lens of hindsight.[111] The rule is also firmly rooted in the view that it would be unfair to hold directors liable for making difficult, complex business choices in the discharge of their management duties.[112] It seems more equitable to grant directors the benefit of the doubt.[113] The rule forbids "hindsight evaluations of decisions at the heart of the business judgment of directors."[114] The business judgment rule acknowledges that typical business environments require quick decisions made with limited and imperfect information. [115] As such, the business judgment rule specifically inhibits "Monday-morning quarterbacking."[116] Courts generally recognize their limited capacity to judge the prudence of complex corporate board choices derived from the dynamic economic circumstances for which corporate directors are particularly suited.[117] They are, therefore, reluctant to second guess decisions made by business professionals who are closer to the challenged decision and the processes from which it emanates.[118]

The presumption incumbent in the business judgment rule applies when the board of directors' actions in question can be connected to a valid business purpose.[119] Once the presumption

---

to a board's decision to accept a lower cash price for all of the corporation's assets and an assumption of all liabilities by one purchaser, instead of a larger cash price from a purchaser that would have required the corporation to collect its own receivables. *Id.* at 48.

[111] *See, e.g.*, Panter v. Marshall Field & Co., 646 F.2d 271, 293 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981). The court declared that as to the prudence of particular business decisions, "[i]t is precisely this sort of Monday-morning-quarterbacking that the business judgment rule was intended to prevent." *Id.* at 297.

[112] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citing Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (1981) (business judgment rule is a recognition of the managerial powers of the directors under § 141(a) of the Code).

[113] *See In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 126 (Del. Ch. 2009).

[114] *Id.* at 131.

[115] KNEPPER & BAILEY, *supra* note 32, § 6.03, at 183.

[116] *Id.* (quoting *Panter*, 646 F.2d at 297, *cert. denied,* 454 U.S. 1092 (1981)).

[117] *See* Solash v. Telex Corp., No. CIV.A. 9518, 1988 WL 3587, at *1 (Del. Ch. Jan. 19, 1988).

[118] *Id.*

[119] Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A board of

is triggered, the burden of proof shifts to the complaining shareholders.[120] The shareholders can rebut the presumption by proving that the directors were grossly negligent, uninformed, or acted fraudulently, in bad faith, or otherwise in their self-interest.[121]

---

directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose. A court under such circumstances will not substitute its own notions of what is or is not sound business judgment.")); Kaplan v. Goldsamt, 380 A.2d 556, 568 (Del. Ch. 1977) ("the presumption of sound business judgment" of directors "will not be disturbed if any rational business purpose can be attributed to its decision"); *see also* Martin v. American Potash & Chem. Corp., 92 A.2d 295, 302 (Del. Ch. 1952). The court held that the desire to eliminate a block of shares held by a shareholder who is at odds with corporate policy is not an improper purpose. *Id.*

[120] *See, e.g.*, Panter v. Marshall Field & Co., 486 F. Supp. 1168, 1194 (N.D. Ill. 1980) (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971) and Warshaw v. Calhoun, 221 A.2d 487, 492–93 (Del. 1966)), *aff'd*, 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981). The *Panter* court noted that "[i]n the absence of fraud, bad faith, gross overreaching or abuse of discretion, courts will not interfere with the exercise of business judgment by corporate directors." *Panter*, 486 F. Supp. at 1194;; Kaplan v. Goldsamt, 380 A.2d 556, 568 (Del. Ch. 1977) (presumption of sound business judgment "will not be disturbed if any rational business purpose can be attributed to [board's] decision"); Puma v. Marriott, 283 A.2d 693, 696 (Del. Ch. 1971) (court is precluded from substituting its own judgment for that of directors who independently exercise their good faith business judgment).

[121] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (under business judgment rule, directors liable only for gross negligence); Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 438–39 (Del. 1971) (The court held that after management refuses to release a shareholder list for a proxy contest, its action in advancing the date of the meeting to make proxy solicitation difficult amounts to an impermissible use of corporate power to perpetuate management's control.); Kaplan v. Goldsamt, 380 A.2d 556, 569 (Del. Ch. 1977). The *Kaplan* court held the use of corporate funds to acquire shares of a dissident shareholder to be a proper exercise of business judgment where it is done to eliminate what appears to be a clear threat to the company's business policy and is not accomplished primarily to perpetuate management's control. *Id.* at 569; Petty v. Penntech Papers, Inc., 347 A.2d 140, 143 (Del. Ch. 1975) (use of corporate funds to purchase shares to maintain management in power is improper); *Marriott*, 283 A.2d at 695. The court held that absent fraud; the business judgment rule applies to a decision to exchange corporate shares for shares of another corporation from which the one leases property, even though inside directors of the first corporation own the second corporation. *Id.* at 695; Kors v. Carey, 158 A.2d 136, 141–42 (1960). In *Kors*, the court held that the plaintiff failed to prove fraud, misconduct, or abuse of discretion on the part of the defendant directors, or that the directors' primary motive was to entrench themselves in office. *Id.*; *see*

Assuming the shareholders can make such a showing, the protection of the business judgment rule would be removed, and the directors would then be required to justify their decision.[122]

The rule incentivizes calculated risk-taking by the directors on behalf of the shareholders as such is generally deemed necessary to produce expected return on shareholder investments.[123] Without the protection of the business judgment rule, experienced and capable persons might decline board service,[124] and those who do serve might be inclined to become excessively circumspect.[125] Since excessively deliberative decision-making has the potential to impede the creation of profits ultimately distributed to shareholders, risk-taking by company directors must be accepted and expected as a fundamental part of the corporate business model.[126] The business judgment rule seems especially appropriate where the directors, acting in good faith, make choices that might favor one category of stakeholder to the detriment of another.[127] In

---

also Bowen v. Imperial Theatres, Inc., 115 A. 918, 920–21 (Del. Ch. 1922) (issuance of shares by directors to themselves without consideration is a fraud upon the corporation and other shareholders); Lofland v. Cahall, 118 A. 1, 7–8 (Del. 1922) (holding those directors who fraudulently pay themselves salaries and issue themselves shares without paying for them must account for all money and dividends received).

[122] *Petty*, 347 A.2d at 143; Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964).

[123] Joy v. North, 692 F.2d 880, 885–86 (2d Cir. 1982) ("[I]t is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions."), *cert. denied,* 660 U.S. 1051 (1983).

[124] S. Samuel Arsht, *The Business Judgment Rule Revisited,* 8 HOFSTRA L. REV. 93, 97 (1979) ("The business judgment rule grew principally from the judicial concern that persons of reason, intellect, and integrity would not [otherwise] serve as directors . . . .").

[125] *Joy*, 692 F.2d 886.

[126] *Id.* ("A rule which penalizes the choice of seemingly riskier alternatives thus may not be in the interest of shareholders generally.").

[127] The court in Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980) noted:

> [I]f directors were held to the same standard as ordinary fiduciaries the corporation could not conduct business . . . . [B]y the very nature of corporate life a director has a certain amount of self-interest in everything he does. The very fact that the director wants to enhance corporate profits is in part attributable to his desire to keep shareholders satisfied so that they will not oust him. The business judgment rule seeks to alleviate this problem by validating certain situations that otherwise would involve a conflict of interest for the ordinary fiduciary.

addition to the business judgment rule's protective stance towards corporate board decisions, it also presents a high bar to complaining shareholders who must plead facts sufficient to rebut the presumption enjoyed by the board.[128]

Several conditions must be fulfilled to trigger business judgment rule coverage for directors and the decisions made in the discharge of their management powers.[129] These conditions represent particular requirements embedded in the directors' fiduciary obligations.[130] Directors must positively act or make a deliberate decision not to act.[131] Director inaction resulting from ignorance[132] or dereliction of duties are not protected.[133] In acting, directors must not have a conflict of interest.[134] This condition reflects the

---

Id. at 292. It stands to reason that if it is appropriate to apply the business judgment rule even where directors are partially motivated by some degree of self-interest which conflicts with the interests of the complaining shareholders, then it is even more appropriate to apply the rule where the interests of the corporation and other shareholders motivate the directors. *See id.*

[128] *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009) (citations omitted) ("The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors. The rule itself 'is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'"); Fairfax, *supra* note 26, at 434 ("Courts have repeatedly emphasized the high hurdle shareholders must cross in order to prove an oversight breach. Consistent with this emphasis, courts have been clear that only a "very extreme set of facts" would lead to a finding of oversight liability."); Sprague & Lyttle, *supra* note 15, at 15–16 ("From the earliest days of the corporation, courts have demonstrated a reluctance to hold directors accountable for anything less than gross negligence or self-dealing.").

[129] BLOCK ET AL., *supra* note 71, at 12.

[130] *See id.*; Panter v. Marshall Field & Co., 646 F.2d 271, 293 (7th Cir. 1981).

[131] *See* Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984) ("[I]t should be noted that the business judgment rule operates only in the context of director action. Technically speaking, it has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act." "But it also follows that under applicable principles, a conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment and enjoy the protections of the rule.").

[132] *See* Rabkin v. Philip A. Hunt Chem. Corp., 547 A.2d 963, 972 (Del. 1986).

[133] *See Aronson*, 473 A.2d at 813, 813 n.7.

[134] BLOCK ET AL., *supra* note 71, at 13–16; *see also* Drobbin v. Nicolet Instrument Corp., 631 F. Supp. 860, 881 (S.D.N.Y. 1986) ("[A]n individual may

directors' duty of loyalty.[135] In deferring to directorial decisional discretion, courts presume that the decision reached was the result of a logical weighing of reasonable options.[136] When the result of a decision impacts the personal interests of the decision maker, the presumption is compromised because the decision maker's objectivity is now called into question.[137]

Directors must further satisfy their duty of care mandate that the board consider all reasonably available information in their deliberations.[138] Directors' efforts to acquire and evaluate relevant information becomes subject to closer judicial scrutiny when disputes arise over corporate control.[139] Lastly, directors must act in good faith[140] under which directors must honestly

---

forfeit the saving status of 'independent director' for [even] subtle, less direct entanglements and alliances.").

[135] *See* Norlin Corp. v. Rooney, Pace Inc., 744 F.2d 255, 264 (2d Cir. 1984) ("A board member's obligation to a corporation and its shareholders has two prongs, generally characterized as the duty of care and the duty of loyalty. . . . The second restriction traditionally imposed, the duty of loyalty, derives from the prohibition against self-dealing that inheres in the fiduciary relationship.").

[136] *See Aronson*, 473 A.2d at 812.

[137] S. Samuel Arsht, *The Business Judgment Rule Revisited,* 8 HOFSTRA L. REV. 93, 115 (1979) (citations omitted) ("The 'profound knowledge of human characteristics and motives,' from which was derived the public policy and duty of loyalty announced in Guth, also requires a recognition that where a director or controlling stockholder stands to benefit personally from the decision as a director or controlling stockholder, his or her business judgment is likely to be affected by personal interest. Indeed, the law presumes that in cases of personal interest or self-dealing, the individual benefit, not the corporate best interest, will have governed the decision. Thus, where a director or controlling stockholder has a material personal interest in the outcome of a transaction or is engaged in self-dealing, it will fall to that individual to prove that the transaction he or she authorized is intrinsically fair to the corporation and its stockholders.")

[138] Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985) ("[A] director's duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty.").

[139] *See, In re* Fort Howard Corp. Shareholders Litig., No. CIV. A. 9991, 1988 WL 83147 at *1 (Del. Ch. Aug. 8, 1988) ("It is essential for valid director action that it be taken on an informed basis. . . . The more significant the subject matter of the decision, obviously, the greater will be the need to probe and consider alternatives. When the decision is to sell the company or to engage in a recapitalization that will *change control of the firm*, the gravity of the transaction places a special burden upon the directors to make sure that they have a basis for an informed view.") (emphasis added).

[140] *See* BLOCK ET AL., *supra* note 71, at 19.

believe that their actions are in the corporate best interests.[141] As is the case in the requirement that there be no conflict of interest, the good faith requirement is a part of the directors' duty of loyalty.[142]

4. Ancillary Director Protections

Directors' fiduciary duties are also allowed to be managed through the corporate charter by including "[a] provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director."[143] Exculpatory provisions addressing potential duty of care claims effectively insulate directors from liability for their actions, a double-edged sword.[144]

Most states also allow corporate adoption of indemnification provisions in favor of directors.[145] As corporations universally desire informed and experienced directors, most use indemnification to incentivize corporate board service.[146] Directors remain

---

[141] *See id.*

[142] *See* KNEPPER & BAILEY, *supra* note 32, § 6.04, at 184.

[143] DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2022); *see also* MODEL BUS. CORP. ACT § 2.02(b)(4)(A)–(B), (D) (A.B.A. 2021).

[144] *See In re* Baxter Intern., Inc., 654 A.2d 1268, 1270 (Del. Ch. 1995) ("When the certificate of incorporation exempts directors from liability, the risk of liability does not disable them from considering a demand fairly unless particularized pleading permits the court to conclude that there is a substantial likelihood that their conduct falls outside the exemption."); *see also* Christine Hurt, *The Duty to Manage Risk*, 39 J. CORP. L. 253, 275 (2014) (reiterating the applicable criteria in claims arising from the 2008 financial crisis. "For breaches of the duty of care, the shareholders [must] point to specific decisions made by the boards of directors. Shareholder plaintiffs [are] required to show that these decisions were not only grossly negligent (to overcome the business judgment rule), but also in bad faith (to overcome any applicable exculpation clause.").

[145] *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2022) (allowing a corporate charter to contain "[a] provision eliminating or limiting the personal liability of a director or officer to the corporation or its stockholders for monetary damages for breach of [the] fiduciary duty [of care]as a director or officer." However, this inoculation is not permitted for, inter alia, a breach of the duty of loyalty.").

[146] *See* Kimberly C. Harris, *Recent Development: The Impact of Bankruptcy on Liability of Corporate Directors*, 5 BANK. DEV. J. 289, 289–90 (1987) ("[A] general principle of corporate law has been to provide indemnification as an incentive to attract competent directors because, arguably, the better executives are the more careful ones."); *see also* DEL. CODE ANN. tit. 8, § 145(g) (West 2022)

under the potential, if unlikely, threat of personal liability. If they incur legal costs, an assurance of indemnification adds another protective layer.[147]

Lastly, most state business codes permit corporate procurement of director insurance coverage.[148] While a corporation can indemnify its directors from liability in direct lawsuits, corporations are able to purchase insurance to protect directors from personal exposure stemming from derivative allegations of director wrongdoing for which indemnification is not an available option.[149]

II. The Consequence of Confusion: Corporate Veil Piercing

Failure to adhere to the formalities embedded in corporate law carries certain risks, chief among them being the potential piercing of the corporate veil.[150] Corporate veil piercing is a doctrine under which courts ignore the deeply ingrained and fundamental

(outlining the indemnification powers granted to corporations to protect directors and certain other agents).

[147] Stuart R. Cohn, *Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule*, 62 TEX. L. REV. 591, 600–01 (1983) (footnotes omitted) ("Although there is no adequate guide to either the economic or practical impact of such settlements in due care litigation, any impact is reduced by the ready availability to directors of indemnification and insurance. Moreover, corporate practice reflects a trend toward the use of such protective devices."); *see also* DEL. CODE ANN. tit. 8, § 145(a) (West 2022) (specifically allowing corporate indemnification of directors for claims at any stage, whether a "threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative . . . .").

[148] *See, e.g.*, DEL. CODE ANN. tit. 8, § 145(g) (West 2022) ("A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the corporation would have the power to indemnify such person against such liability under this section.").

[149] *See* E. Norman Veasey et al., *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399, 404 (1987) ("Indemnification is not, of course, a substitute for insurance: Insurance can protect the directors where indemnification cannot, but indemnification can also protect the directors when insurance cannot.").

[150] *See* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1041 (1991).

limited liability tenet of corporate law.[151] Limited liability is a fundamental feature of corporate existence.[152] Shareholders are shielded from liability for the corporation's debts (also known as inside liability), while the corporation is protected from liability for shareholders' personal debts (referred to as outside liability).[153] Shareholder protection is an important incentive for corporate investors as it assures shareholders that they are not committing financial resources to an endless pit of liability.[154] Without shareholder protection from inside liability, the corporate form as we know it would likely be unstainable as it would be indistinguishable from the unincorporated businesses from a liability standpoint.[155] The doctrine began jurisprudentially but has since been incorporated into most state statutes.[156]

---

[151] *See id.* at 1036.

[152] *See id.* at 1039–40 (discussing the purpose of limited liability within the corporate form).

[153] *See* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89–90 (1985) (outlining the fundamentals of limited liability as a concept. "It may be helpful to recall what limited liability is. The liability of 'the corporation' is limited by the fact that the corporation is not real. It is no more than a name for a complex set of contracts among managers, workers, and contributors of capital. It has no existence independent of these relations. The rule of limited liability means that the investors in the corporation are not liable for more than the amount they invest. . . . Limited liability is not unique to corporations. Indeed it is the rule. . . . The instances of 'unlimited' liability are few. The general partners of a partnership may be required to contribute additional capital to satisfy the association's debts. Even here, though, a discharge in bankruptcy enables the partner to limit his liability to the assets he possesses at the time the partnership requires more capital. Limitations on liability turn out to be pervasive.").

[154] *See* Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1967) (explaining the underlying policy rationale for shareholder liability protections).

[155] *See id.*; John H. Matheson, *The Doctrine of Piercing the Veil in an Era of Multiple Limited Liability Entities: An Opportunity to Codify the Test for Waiving Owners' Limited-Liability Protection*, 75 WASH. L. REV. 147, 154 (2000) ("By limiting responsibility for corporate actions to the assets of the corporation while immunizing the owners' personal assets, corporations can attract other owners whose risk of loss is limited by the amount of capital contributed to the corporation.").

[156] *See* Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 591–94 (1986) (outlining the historical trajectory and theory underlying corporate limited liability).

Notwithstanding the generally accepted view that corporate limited liability is fairly absolute,[157] courts have shown a willingness to disregard the separate personhood of the corporation and attendant limited liability. This, in turn allows the corporate veil to be pierced and permits creditors access to shareholder personal assets.[158] This application carries with it the dangerous potential of an "unprincipled hodgepodge of seemingly ad hoc and unpredictable results."[159] Scholars have noted the lack of a uniform standard among jurisdictions carrying with it the danger of confusion as to particular jurisdictional applicability comparative.[160] Some courts emphasize the concept of the corporation as the "alter ego" of the shareholders, while other courts reference shareholder "complete domination" of the corporation.[161] It should be noted, however that a common strand of these courts will permit veil piercing only when necessary to avoid fraud or injustice, while other courts ignore matters of equity.[162]

A. Traditional Veil Piercing

There is no one comprehensive standard employed in supporting the judicial determination that it is proper to disregard the separate identity of a corporate person and pierce the corporate

---

[157] Easterbrook & Fischel, *supra* note 153, at 109.

[158] *Id.*

[159] *See* David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305, 1311 (2007).

[160] *See id.* at 1327 ("When one attempts to rationalize the piercing cases according to some other set of values, one encounters a dismal morass of repetitive rhetoric masking conclusory evaluation. The cases typically list a series of more or less standard factors. Little if anything is said about how they are to be weighted or which ones are necessary or sufficient by themselves to support a piercing result.").

[161] *See, e.g.*, Baillie Lumber Co. v. Thompson, 612 S.E.2d 296, 299 (Ga. 2005) ("Under the alter ego doctrine in Georgia, the corporate entity may be disregarded for liability purposes when it is shown that the corporate form has been abused."); State v. Easton, 647 N.Y.S.2d 904, 908 (N.Y. Sup. Ct. 1995) (quoting Morris v. New York State Dept. Tax. and Fin., 82 N.Y.2d 135 141–42 (N.Y. 1993) ("It must be emphasized that 'while complete domination of the corporation is the key to piercing the corporate veil . . . such domination, standing alone, is not enough; some showing of a wrongful or unjust act toward plaintiff is required'").

[162] *See, e.g.*, Kline v. Kline, 305 N.W.2d 297, 299 (Mich. Ct. App. 1981); Amoco Chems. Corp. v. Bach, 567 P.2d 1337, 1342 (Kan. 1977); Polaris Indus. Corp. v. Kaplan, 747 P.2d 884, 886 (Nev. 1987).

veil.[163] Each court crafts its own test in deciding whether and how to apply the doctrine.[164] The doctrine is largely a function of common law and generally omitted from state corporate codes.[165] While the theories most often employed by courts are alter ego or instrumentality,[166] courts usually require the party petitioning the piercing of the corporate veil to satisfy a two prong test: "(1) that there be such unity of interest and ownership that the separate personalities of the corporation and the individual [shareholders] no longer exist; and (2) that, if the acts are treated as those of the corporation alone, an inequitable result will follow."[167]

Undercapitalization of the corporation is another factor courts consider.[168] "It is coming to be recognized as the policy of the law that shareholders should in good faith put at the risk of the business unencumbered capital reasonably adequate for its

---

[163] *See* Millon, *supra* 159, at 1327.

[164] *See* Richard v. Bell Atl. Corp., 946 F. Supp. 54, 60–61 (D.D.C. 1996) (outlining alternative corporate liability shield piercing tests: "(1) the 'agency' test under which the plaintiffs must establish that the parent exercised a significant degree of control over the subsidiary's decision-making; (2) the 'alter ego' test which is founded in equity and permits the court to pierce the corporate veil when the court must prevent fraud, illegality or injustice, or when recognition of the corporate entity would defeat public policy or shield someone from liability from a crime; (3) the 'instrumentality' test under which the plaintiff must establish that the parent exercises extensive control over the acts of the subsidiary giving rise to the claim of wrongdoing; and (4) the 'integrated enterprise' test under which the court considers (a) interrelations of operations, (b) centralized control of labor relations, (c) common management, and (d) common ownership or financial control.").

[165] Thompson, *supra* note 150, at 1041; *see* David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?*, 51 OKLA L. REV. 427, 429 (1998) ("The inability of any one understanding of limited liability entities to obtain complete dominance is perhaps a reason that the law of piercing the veil . . . remains a predominantly common law doctrine, uncodified by statute in most states.").

[166] Michael J Gaertner, *Reverse Piercing the Corporate Veil: Should Corporation Owners Have It Both Ways?*, 30 WM & MARY L. REV. 667, 678 (1989).

[167] David H. Barber, *Piercing the Corporate Veil*, 17 WILLAMETTE L. REV. 371, 376 (1981) (quoting Automotriz del Golfo de Cal. v. Resnick, 306 P.2d 1, 3 (Cal. 1957)).

[168] *See* William O. Douglas & Carol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193, 218 (1929) (stating that the inadequacy of capitalization of the corporation by the shareholders weighs heavily in determining whether or not to respect limited liability).

prospective liabilities."[169] It is predictable that undercapitalization is a factor considered in veil-piercing cases since the doctrine was developed, at least in part, to remediate the moral hazard associated with limited liability.[170] "[T]he lower the amount of the firm's capital, the greater the incentive to engage in excessively risky activities."[171] Making shareholders accountable for corporate undercapitalization minimizes the incentive to engage in unjustifiably risky business behavior.[172]

B. Reverse Veil Piercing

The concept of reverse veil piercing can prove even more complex in application.[173] While veil piercing is generally recognized among states, there is more variation in approaches to reverse veil piercing.[174] While certain states expressly spurn the doctrinal concept, others have embraced it in varying degrees and under differing conditions.[175] Some courts apply the same lens to reverse veil piercing and traditional veil piercing alike.[176] Other courts

---

169 HENRY WINTHROP BALLANTINE, BALLENTINE ON CORPORATIONS 303 (Callaghan and Company rev. ed. 1946).

170 Easterbrook & Fischel, *supra* note 153, at 112.

171 *Id.* at 113.

172 *Id.*

173 Nicholas B. Allen, *Reverse Piercing of the Corporate Veil: A Straightforward Path to Justice*, 85 ST. JOHN'S L. REV. 1147, 1153 (2011) ("Whereas traditional piercing holds an individual liable for the acts of a corporation, or a parent liable for the acts of a subsidiary, reverse piercing imposes liability on a corporation for the obligations of an individual shareholder, or on a subsidiary corporation for the acts of a parent corporation.").

174 *Id.* at 1157–66 (discussing states that have adopted reverse piercing in varying degrees as well as those that have rejected the concept).

175 *Id.* at 1158 n. 74 ("While not exhaustive, states that have adopted the inverse method of piercing include Connecticut, Idaho, Illinois, Iowa, Kentucky, Nevada, New York, Oregon, Texas, Virginia and Wisconsin."). *But see* Postal Instant Press, Inc. v. Kaswa Corp., 77 Cal. Rptr. 3d 96, 98 (Cal. Ct. App. 2008) ("The reasoning of the cases adopting outside reverse piercing of the corporate veil is flawed, and we join other courts declining to accept it.); Acree v. McMahan, 585 S.E.2d 873, 874 (Ga. 2003) ("We reject reverse piercing, at least to the extent that it would allow an 'outsider,' such as a third-party creditor, to pierce the veil in order to reach a corporation's assets to satisfy claims against an individual corporate insider.").

176 Allen, *supra* note 173, at 1154 ("Despite the differences, reverse piercing initially requires the same two-pronged analysis of domination and promotion of fraud or injustice.").

introduce criteria in their reverse piercing analysis that is absent from traditional veil piercing analyses.[177]

While traditional veil piercing creates shareholder liability for corporate debts, reverse veil piercing makes the corporation liable for what are otherwise strictly personal shareholder obligations.[178] Put another way, traditional veil piercing disregards the corporate shareholder liability shield, while reverse veil piercing creates entity liability for unrelated shareholder personal debts.[179] In a reverse veil piercing claim, a claimant seeks the piercing of the corporate veil to render the corporation liable for the shareholder's personal debts.[180] The theory behind reverse piercing is that the claimant should be allowed to access corporate assets after obtaining a judgment against liable shareholders to prevent shareholders from sheltering personal assets in the corporation that would otherwise be available to satisfy claims against the shareholder.[181]

The aforementioned protections afforded to corporations from outside liability, also referred to as affirmative asset partitioning, is another vital facet of corporate law.[182] This principle

---

[177] *See, e.g.,* United States v. Boscaljon, No. CIV.07-4111, 2010 U.S. Dist. LEXIS 26980, at *12 (D.S.D. Mar. 22, 2010) (introducing injury to third party criteria. "This reverse piercing of corporate veil is appropriate when there is evidence that the trust was merely a sham entity operated in a fraudulent manner, when there is a strong degree of identity between the taxpayers and the trust, and when no innocent individual would be harmed thereby.")).

[178] Allen, *supra* note 173, at 1153 (citing Connolly v. Englewood Post No. 322 Veterans of Foreign Wars of the U.S., Inc. (*In re* Phillips), 139 P.3d 639, 644 (Colo. 2006) (en banc)).

[179] *See id.*

[180] Michael Richardson, *The Helter Skelter Application of the Reverse Piercing Doctrine*, 79 U. CIN. L. REV. 1605 (2011) ("'Outsider' reverse piercing occurs when a party with a claim against an individual or corporation attempts to be repaid with assets of a corporation owned or substantially controlled by the defendant."); *id.* at 1605 n.2 ("In 'insider' reverse piercing, by contrast, the controlling members will attempt to ignore the corporate fiction in order to take advantage of a benefit available to the corporation, such as an interest in a lawsuit or protection of personal assets.").

[181] Allen, *supra* note 173, at 1154.

[182] Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L. J. 387, 390 (2000) ("In every developed market economy, the law provides for a set of standard-form legal entities. In the United States, these entities include, among others, the business corporation. . . . It is therefore natural to ask what more, if anything, these entities offer. . . . In short, what, if any, essential role does organizational law play in modern society? We offer an answer to that question here. . . . [T]he essential role of all forms

"protects the entity and its creditors against the claims of the creditors of the owners, a risk that otherwise might dissipate the assets of the business, or discourage investors from making initial investments."[183] If shareholders cannot satisfy their financial obligations, their personal creditors could attempt to seize corporate assets, often with the objective of liquidation, to satisfy their claims after exhausting the shareholders' personal assets.[184] This could harm the corporation's ability to meet its financial responsibilities and diminish the equity stakes of other shareholders.[185] This very danger posed by shareholders' personal creditors is why adherence to corporate governance requirements is important.[186]

The protections provided by the corporate shield also reduce the costs to shareholders associated with securing other equity investors.[187] If corporate exposure could easily result from shareholder personal activity, incumbent shareholders would be much more likely to limit the universe of new investors to persons they already know and trust.[188] Maintenance of the corporate liability shield removes this risk by facilitating the admission of new, unknown investors without associated risk mitigation costs.[189] The integrity of the corporate liability shield also benefits the corporation's creditors, granting the assurance that their rights regarding the corporation will not be impaired by obligations incurred privately by individual shareholders.[190] A lack of separateness and associated risk mitigation could cause increases in the cost of credit to mitigate increased uncertainty or simply cause a dearth of available credit facilities.[191] It should be noted that outside

---

of organizational law is to provide for the creation of a pattern of creditors' rights—a form of 'asset partitioning'—that could not practicably be established otherwise.")).

[183] Robert B. Thompson, *Agency Law and Asset Partitioning*, 71 U. CIN. L. REV. 1321, 1323 (2003).

[184] *See* Allen, *supra* note 173, at 1154–55.

[185] *See id.*

[186] *See id.*

[187] Henry Hansmann et al., *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1344–45 (2006).

[188] *See id.*

[189] *Id.*

[190] Thompson, *supra* note 183, at 1323 ("[A]ffirmative asset partitioning, protects the entity and its creditors against the claims of the creditors of the owners. . . .").

[191] Hansmann & Kraakman, *supra* note 182, at 403.

liability considerations are not unique to the corporate form.[192] Partnerships tend to provide better outside liability protection even though partners are not shielded from inside liability.[193]

III. COMPARATIVE PROBATE CODE APPROACHES: CORPORATE GOVERNANCE CONFUSION OR CLEAR COORDINATION

This Part compares two broad categories of state probate code provisions and how they treat the continuation of a business at the death of a stakeholder. The first is labeled "Incidental Entity Enmity." This group of states generally and collectively reflects a lack of depth in contemplation concerning the potentially detrimental impact the permissive legislation poses to the corporation continued thereunder.[194] These states seem to maintain apparent, if not open, hostility to protecting the integrity of the corporate form, as expressed statutorily.[195] The second category, labeled "Corporate Code Coordinated Clarity," is represented by a group of prominent states (most notably California, New York, and the majority of states adopting the Uniform Probate Act) who seem to take a more measured and deliberate approach to providing for the continuation of a business upon the death of an owner.[196] These states incorporate various stipulations into the permissive provisions, which clarify the applicability of the powers allowed to estate representatives seeking control of a business in which the decedent held an ownership interest.[197] These descriptive categories

---

[192] *Id.* at 394 ("This type of [protection] is found not only in business corporations but also, for example, in cooperative corporations and limited liability companies, and for the limited partners in a limited partnership.").

[193] *Id.* at 395 ("At the other extreme lies the contemporary U.S. general partnership, in which . . . in which partnership creditors share equally with the creditors of individual partners in distributing the separate assets of partners when both the partnership and its partners are insolvent.").

[194] *See, e.g.*, WIS. STAT. ANN. § 857.25 (West 2022).

[195] *See, e.g.*, *id.*

[196] *See infra* Section III.B.

[197] *See* UNIF. PROBATE CODE § 3-715(24) (amended 2010) ("Except as restricted or otherwise provided by the will or by an order in a formal proceeding and subject to the priorities stated in Section 3-902, a personal representative, acting reasonably for the benefit of the interested persons, may properly . . . continue any unincorporated business or venture in which the decedent was engaged at the time of death (i) in the same business form for a period of not more than 4 months from the date of appointment of a general personal representative if continuation is a reasonable means of preserving the value of the

show the collective range of state law coordination (or lack thereof) between the state probate and corporate codes.[198] Unfortunately, they also demonstrate the corporate governance confusion risked and longstanding precedent potentially undermined.[199]

A. Code Confusion

As mentioned above, the corporate governance requirements are universally accepted among states as embodied in state corporate codes.[200] However, a seemingly innocuous provision in the probate codes of various states throughout the Nation threaten to undermine the very premise on which the corporate form and corresponding protections are based.[201] In many of these states, the estate representative is allowed to "continue *any* business" of the deceased or his (or her) estate.[202] This allowance is articulated in various nuanced forms, but they share a common thrust, the

---

business including good will, (ii) in the same business form for any additional period of time that may be approved by order of the court in a formal proceeding to which the persons interested in the estate are parties; or (iii) throughout the period of administration if the business is incorporated by the personal representative and if none of the probable distributees of the business who are competent adults object to its incorporation and retention in the estate . . . ."); CAL. PROB. CODE § 9760(b) (West 2022) ("If it is to the advantage of the estate and in the best interest of the interested persons, the personal representative, with or without court authorization, may continue the operation of the decedent's business; but the personal representative may not continue the operation of the decedent's business for a period of more than six months from the date letters are first issued to a personal representative unless a court order has been obtained under this section authorizing the personal representative to continue the operation of the business."); Philco Radio & Tel. Corp. v. Damsky, 294 N.Y.S. 776, 779 (N.Y. App. Div. 1937) (Only if a will authorizes the executor to continue a business may she do so, except for the limited purpose of converting the business assets to cash for the benefit of the estate. However, if the estate beneficiaries consent to or acquiesce in an executor's continuing a business without authorization, some courts consider it the equivalent of authorization in the will); *see also In re* Hammond, 997 N.Y.S.2d 761, 762–63 (N.Y. App. Div. 2014) (in which the Surrogate granted a summary judgment motion to hold the executors responsible for losses sustained by the business they had continued without authorization, the Appellate Division sent it back to the Surrogate for a hearing on that point.).

[198] *See infra* Sections III.A–B.

[199] *See infra* Section III.A.

[200] *See infra* notes 204, 206–07 and accompanying text.

[201] *See infra* notes 204–07 and accompanying text.

[202] *See infra* notes 204, 206–07 and accompanying text (emphasis added).

allowance of an estate representative to "continue" a business in which the deceased had ownership stake prior to his or her death.[203]

The Wisconsin probate code provides "the court may by order authorize the personal representative to continue any business of the decedent . . . ."[204] The code further shows its anticipated coverage breadth in referencing the estate representative's use of or involvement in partnerships and corporations in use of the powers permitted in this section.[205] Similarly, Louisiana's permissive language is contained in its Code of Civil Procedure Article 3224, providing that "[w]hen it appears to the best interest of the succession . . . the court may authorize a succession representative to continue any business of the deceased for the benefit of the succession . . . ."[206] New Jersey and Pennsylvania are eastern states also adopting this approach.[207]

There is very little, and virtually no contemporary, expository jurisprudence treating the applicability and impact of these provisions in corporate (as well as other entity) contexts.[208] This dearth of contextual entity analysis leaves open the question as to what these states considered adequate justification for this broadly permissive allowance.[209]

---

[203] *See infra* notes 204, 206–07 and accompanying text.

[204] WIS. STAT. ANN. § 857.25(1) (West 2022).

[205] WIS. STAT. ANN. § 857.25(1)(a) (West 2022) ("For the conduct of the business solely by the personal representative or jointly with one or more of the decedent's surviving partners or as a corporation or limited liability company to be formed by the personal representative. . . .").

[206] LA. CODE CIV. PROC. ANN. art. 3224 (2022).

[207] N.J. STAT. ANN. § 3B:14-23(v) (West 2022) ("In the absence of contrary or limiting provisions in the judgment or order appointing a fiduciary, in the will, deed, or other instrument or in a subsequent court judgment or order, every fiduciary shall, in the exercise of good faith and reasonable discretion, have the power . . . . [t]o continue any business constituting the whole or any part of the estate for so long a period of time as the fiduciary may deem advisable and advantageous for the estate and persons interested therein . . . ."); 20 PA. STAT. AND CONS. STAT. ANN. § 3314 (West 2022) ("Giving due regard to the provisions of the governing instrument and any other factor that the court deems relevant, and aided by the report of a master if necessary, the court may authorize the personal representative to continue any business of the estate for the benefit of the estate.").

[208] *See generally* Roger W. Andersen, *The Influence of the Uniform Probate Code in Nonadopting States*, 8 U. PUGET SOUND L. REV. 599, 609–11, 616 (1985) (illustrating the lack of focus on the corporate applications of the permissive language of state probate code statutes).

[209] *See supra* notes 204, 206–07 and accompanying text.

B. Clearer Corporate Code Coordination

Interestingly, the vast majority of states adopting the Uniform Probate Act have also adopted the Act's approach to articulating the permissions granted an estate representative in managing the affairs of the decedent.[210] In doing so, this approach makes it clear that the business continuation powers are limited to unincorporated entities, a very important qualification.[211] Similarly, New York and California, two of the nation's most populous states, have also adopted this approach.[212] New York law goes further in restricting the applicability of granted permissions to estate representatives where the decedent was a sole business owner.[213] The New York Code notably also withholds this power from estate representatives when the business is professionally licensed.[214] Further still, New York courts have interpreted powers granted under the statute as temporary, articulating a requirement that the estate representative employs the powers granted to "wind up" the business.[215] The California Probate Code likewise now

---

[210] *See, e.g.*, FLA. STAT. ANN. § 733.612(22) (West 2022); ARIZ. REV. STAT. ANN. § 14-3715 (2022) (adopting the Uniform Probate Code's language).

[211] UNIF. PROBATE CODE § 3-715(24) (amended 2010) ("Except as restricted or otherwise provided by the will or by an order in a formal proceeding and subject to the priorities stated in Section 3-902, a personal representative, acting reasonably for the benefit of the interested persons, may properly . . . continue any unincorporated business or venture in which the decedent was engaged at the time of death (i) in the same business form for a period of not more than 4 months from the date of appointment of a general personal representative if continuation is a reasonable means of preserving the value of the business including good will, (ii) in the same business form for any additional period of time that may be approved by order of the court in a formal proceeding to which the persons interested in the estate are parties; or (iii) throughout the period of administration if the business is incorporated by the personal representative and if none of the probable distributees of the business who are competent adults object to its incorporation and retention in the estate . . . .").

[212] *Most Populous*, U.S. CENSUS BUREAU, https://www.census.gov/popclock/embed.php?component=populous [https://perma.cc/9LEN-52RF].

[213] N.Y. SURR. CT. PROC. ACT § 2108 (McKinney 2022) ("A fiduciary may petition for the continuation of a business other than a profession, of which decedent or the person whose estate is being administered was *sole owner* and it is desired to continue it for the best interests of the estate. . . .") (emphasis added).

[214] *Id.* ("A fiduciary may petition for the continuation of a business *other than a profession*. . . .") (emphasis added).

[215] *See* Philco Radio & Tel. Corp. v. Damsky, 294 N.Y.S. 776, 779 (N.Y. App. Div. 1937) (Only if a will authorizes the executor to continue a business

restricts the powers granted to an estate representative, reserving that authority to contexts involving unincorporated businesses.[216] California also provides a default restriction on the power to continue the business to six months, absent special judicial dispensation.[217] These approaches seem to embody a more appropriate recognition of the fundamental differences between corporations and unincorporated entities.[218] Delaware, acknowledged as the longstanding preferred domicile for American corporations, has not adopted the Uniform Probate Code.[219] Further, Delaware Code Title 12. Decedents' Estates and Fiduciary Relations, governing *inter alia* estate representative[220] is largely silent concerning

---

may she do so, except for the limited purpose of converting the business assets to cash for the benefit of the estate. However, if the estate beneficiaries consent to or acquiesce in an executor's continuing a business without authorization, some courts consider it the equivalent of authorization in the will); *see also In re* Hammond, 997 N.Y.S.2d 761, 762–63 (N.Y. App. Div. 2014) (in which the Surrogate granted a summary judgment motion to hold the executors responsible for losses sustained by the business they had continued without authorization, the Appellate Division sent it back to the Surrogate for a hearing on that point.).

[216] CAL. PROB. CODE § 9760(a) (West 2022) ("As used in this section, 'decedent's business' means an unincorporated business or venture in which the decedent was engaged or which was wholly or partly owned by the decedent at the time of the decedent's death, but does not include a business operated by a partnership in which the decedent was a partner.").

[217] CAL. PROB. CODE § 9760(b) (West 2022) ("If it is to the advantage of the estate and in the best interest of the interested persons, the personal representative, with or without court authorization, may continue the operation of the decedent's business; but the personal representative may not continue the operation of the decedent's business for a period of more than six months from the date letters are first issued to a personal representative unless a court order has been obtained under this section authorizing the personal representative to continue the operation of the business.").

[218] *See supra* notes 211–17 and accompanying text.

[219] Rachel Cautero, *Delaware Inheritance Laws: What You Should Know*, SMARTASSET (Feb. 25, 2020), https://smartasset.com/financial-advisor/Delaware-inheritance-laws [https://perma.cc/96XY-6VYM].

[220] DEL. CODE ANN. tit. 12, § 3301(d) (West 2022) ("The term 'fiduciary' shall mean trustees, personal representatives, guardians, custodians under the Uniform Transfers to Minors Act (Chapter 45 of this title), advisers or protectors acting in a fiduciary capacity under § 3313(a) of this title, designated representatives acting in a fiduciary capacity under § 3339 of this title, agents to the extent delegated duties by another fiduciary and other fiduciaries; while the term 'nonfiduciary' shall mean advisers or protectors acting in a nonfiduciary

that representative's capacity to continue the deceased's business.[221] *Chapter V. Fiduciary Relations, governing trustees*, does give relevant insight into how the aforementioned silence concerning estate representative business powers should be interpreted.[222] Trustees are permitted the power to continue participating in an ongoing business but are clearly instructed to do so in alignment with traditional corporate business principles.[223] This standard seems more prophylactic against the potential conflation of ownership and management roles and can prove instructive in determining how the rights and duties of estate representatives should be viewed.[224]

CONCLUSION

A seemingly innocuous provision in the probate codes of various states throughout the nation threatens to undermine the very premise on which the corporate form and corresponding protections are based.[225] The allowance of an estate representative to directly manage a corporation as "continuing *any* business" of

---

capacity under § 3313(a) of this title or designated representatives acting in a nonfiduciary capacity under § 3339 of this title."); DEL. CODE ANN. tit. 12, § 101(6) (West 2022) ("'Personal representative' includes executor, administrator, successor administrator and administrator with will annexed, and persons who perform substantially the same function under the law governing their status.").

[221] *See* DEL. CODE ANN. tit. 12, § 3325 (West 2022).

[222] *See id.*

[223] *Id.* ("Without limiting the authority conferred by § 3324 of this title, a trustee may . . . . (7) With respect to an interest in a proprietorship, partnership, limited liability company, statutory trust, business trust, corporation or other form of business or enterprise, continue the business or other enterprise and take any action that may be taken by shareholders, members or property owners, including merging, dissolving or otherwise changing the form of business organization or contributing additional capital; (8) With respect to stocks or other securities, to exercise the rights of an absolute owner, including the right to: a. Vote, or give proxies to vote, with or without power of substitution, or enter into or continue a voting trust agreement; b. Hold a security in the name of a nominee or in other form without disclosure of the trust so that title may pass by delivery; c. Pay calls, assessments and other sums chargeable or accruing against the securities, and sell or exercise stock subscription or conversion rights; and d. Deposit the securities with a securities depository or other regulated financial services institution;").

[224] *See id.*

[225] *See supra* notes 206–07 and accompanying text.

the deceased without adhering to longstanding statutory corporate governance requirements has significant and dangerous potential.[226] This conflation of governance authority would compromise the very notion of corporate personhood and associated separateness that provides liability protections for both the corporation and the shareholders who ultimately benefit from corporate business activities.[227] However, this dilemma can be easily remediated and avoided through the inclusion of clarifying language in the probate code that would leave no doubt that all corporate shareholders, including estate representatives, must adhere to the fundamental tenets of corporate governance.[228] Helpful language can be adopted and adapted from the Delaware Trust Code and the probate codes of New York, California, and other prominent states.[229] This solution should be adopted to avoid an inadvertently dangerous predicament.

---

[226] *See supra* notes 204, 206–07 and accompanying text.
[227] *See supra* text accompanying note 182.
[228] *See* UNIF. PROBATE CODE § 3-715(24) (amended 2010).
[229] *See* discussion *supra* Section III.B.