RULES, STANDARDS, AND THE MODEL BUSINESS CORPORATION ACT

MICHAEL P. DOOLEY*

I

INTRODUCTION

Although legal rules and standards are used to achieve the same social goal, they differ significantly in approach. Ex ante, rules and standards are intended to inform actors of the legal consequences of their planned actions; in the event of a subsequent legal challenge, the applicable rule or standard is compared to the action taken to determine compliance. A rule defines the specific conduct or facts that trigger legal consequences, thus focusing attention—both before and after the fact—on the specified conduct or facts stated in the rule. In contrast, a standard describes the general goal to be achieved, but allows the decisionmaker to determine whether planned or actual conduct meets the relevant standard. For example, a posted speed limit of fifty-five miles per hour is a rule, whereas a statute that simply commands drivers not to exceed a "reasonable" speed is a standard.

The relative merits of rules versus standards in lawmaking has been extensively debated both generally and with regard to specific areas of the law, but largely ignored with reference to corporation law.[1] The reason is that corporation statutes have traditionally either been silent or relied almost exclusively on general standards in expressing substantive legal rights and obligations. The result has been that the legislature has ceded to the courts virtually all responsibility for many basic aspects of corporate governance to be developed on a case-by-case basis based upon general standards borrowed from agency law and equity or, less often, found to be implicit in the corporation statute.

This article is also available at http://www.law.duke.edu/journals/lcp.

* William S. Potter Professor of Law, University of Virginia. Professor Dooley is the reporter for the Model Business Corporation Act and a member of the Committee on Corporate Laws. The views expressed herein are his own.

1. *See, e.g.*, Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992); Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); Douglas G. Baird & Robert Weisberg, *Rules, Standards and the Battle of the Forms: A Reassessment of § 2-207*, 68 VA. L. REV. 1217 (1982). A classic example from torts is the dispute between Justices Holmes and Cardozo in defining due care of a driver approaching an unguarded railroad crossing. *Compare* Baltimore & Ohio R.R. Co. v. Goodman, 275 U.S. 66, 70 (1927) (Holmes, J.) (driver should stop and look), *with* Pokora v. Wabash Ry., 292 U.S. 98, 102–03 (1934) (Cardozo, J.) (driver should act with reasonable caution).

II

THE MODEL BUSINESS CORPORATION ACT APPROACH

The Model Business Corporation Act (MBCA) broke this mold in 1988 by adopting chapter 8, subchapter F ("subchapter F") dealing with the validity of contracts or transactions between directors and the corporation.[2] Although other state statutes, including the immediate predecessor to subchapter F,[3] purported to provide a mechanism for sanitizing the contract or transaction,[4] the effect of following the prescribed procedures was not entirely clear. In part, this was because the statutes invariably undercut themselves by providing that the transaction or contract would not be void or voidable "solely" because of the director's conflict if it were approved after full disclosure by disinterested directors or shareholders or was found to be "fair." But what issues were left open by the use of "solely"? Presumably, when a court was satisfied the contract or transaction was "fair" by its standards, the only remaining justiciable issues would have been other challenges to enforceability that were unrelated to the conflicted interest, such as the statute of frauds or statute of limitations. But when the disinterested directors or shareholders approved, was the "fairness" of the contract or transaction still open for judicial review? The statutes did not foreclose that possibility and were phrased in the same broad terms courts had used to review conflict transactions before the statues were enacted.[5] Breadth of expression is characteristic of a standard, rather than a rule, and invites similarly broad judicial discretion in deciding which facts and circumstances are relevant. Accordingly, some courts decided that disinterested director approval merely shifted the burden of proving fairness from the defendant to the plaintiff,[6] and at least one court required the director to prove fairness notwithstanding disinterested director approval precisely because the statute was so close to the common law.[7] And it was not until recently that the Delaware Supreme Court clearly held that approval of a conflict by informed, disinterested directors is entitled to business judgment protection.[8]

Section 8.61 of the MBCA leaves no doubt regarding the effect of following the prescribed procedures: The conflicted-interest transaction "may not be the

---

2. MODEL BUS. CORP. ACT §§ 8.60–8.63 (2008).

3. MODEL BUS. CORP. ACT § 8.31 (1984).

4. DEL. CODE ANN. tit. 8, § 144(a) (2010).

5. Harold Marsh, *Are Directors Trustees?*, 22 BUS. LAW. 35, 39–43, 46–48 (1966).

6. *E.g.*, Rivercity v. Am. Can Co., 600 F. Supp. 908, 922 (E.D. La. 1984), *aff'd*, 753 F.2d 1300 (5th Cir. 1985); Cohen v. Ayers, 596 F.2d 733, 740 (7th Cir. 1979).

7. Cookies Food Prods., Inc. v. Lakes Warehouse Distrib. Inc., 430 N.W.2d 447, 451–53 (Iowa 1988).

8. Benihana of Tokyo, Inc. v. Benihana, Inc., 906 A.2d 114, 120–21 (Del. 2006). Previously, the effect of section 144 was unclear because of the Delaware courts' insistence on a full entire fairness review whenever the conflicted director either was or represented a controlling shareholder. *See generally* Charles Hansen, *"Benehana of Tokyo v. Benehana, Inc.": Does This Represent Final Closure in the Delaware Law of Conflicts?*, 80 Corporation (Aspen) ¶ 2.1 (Jan. 1, 2009). See *infra* part II(B) for the MBCA's solution in the case of a conflicted-interest merger or disposition of assets.

subject of equitable relief, or give rise to an award of damages or other sanctions against [the conflicted] director."[9] Although section 8.61 provides for the usual three alternatives for curing the conflict, the fairness criterion plays a much more limited role than in the more traditional statutes. In the first place, the concept of fairness in subchapter F includes both fair dealing and fair price.[10] Since it would be virtually impossible for a director who intentionally concealed the existence of a conflict to establish "fair dealing," subchapter F attaches a premium to board or shareholder disclosure, and thereby avoids the perverse incentive for a director to withhold information concerning a conflicted interest and take his or her chances at proving fairness if later caught. More important, if director or shareholder action is taken, a plaintiff attacking the transaction has the burden of proving that the specified procedures required to approve the conflict were not followed, since those are the only grounds on which the transaction can be challenged.[11] The indeterminate fairness standard thus becomes an issue only if the conflict was not disclosed to and approved by the directors or the shareholders.

Subchapter F also seeks to increase predictability and limit the number of litigable issues by providing rule-like definitions of relevant terms, including (1) what constitutes a "director's conflicting interest transaction," (2) the familial or economic relations that will cause another's conflict to be attributed to the director, (3) the scope of required disclosure, and (4) the attributes that must be possessed by those directors who approve a conflicted-interest transaction.[12] These attributes are captured in the concept of "qualified director," a defined term that is applicable to a conflicted-interest transaction, as well as to the dismissal of a derivative action, authorization of indemnification or advance of expenses, and waiver by the corporation of a business opportunity presented to the board.[13]

The MBCA also seeks to limit the number of issues involved in derivative proceedings. The most notable feature is the MBCA's elimination of the demand-required or demand-excused inquiry in favor of a universal demand requirement.[14] Once a derivative proceeding is commenced, the corporation may seek to have it dismissed if continuing the proceeding is not in the corporation's interest. This determination may be made by (1) a majority of qualified directors if qualified directors constitute a quorum of the board; (2) a majority of a committee of two or more qualified directors appointed by a majority vote of qualified directors, even if not a quorum; or (3) a panel of one

9. MODEL BUS. CORP. ACT § 8.61(b) (2008).

10. *Id.* § 8.60(6).

11. *Id.* § 8.31(a)(1).

12. *Id.* §§ 8.60, 8.62.

13. *Id.* § 1.43.

14. *Id.* § 7.42. *See generally* Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503 (1989) (discussing limitations to this inquiry).

or more individuals appointed by the court.[15] Section 7.44 retains the underlying policy of the demand-required or demand-excused distinction in focusing on the disinterestedness of the decisionmaking body at the time of the relevant decision—that is, under traditional law, whether the action has been properly commenced or, under the MBCA, whether it should be dismissed. The corporation has the burden of proof only when dismissal is sought by a committee of qualified directors whenever qualified directors do not constitute a majority of the board; the plaintiff has the burden of proof when the board consists of a majority of qualified directors or if dismissal is sought by a court-appointed panel.[16] In either event, the only facts that can be litigated are those relating to the moving party's investigation. The court is not invited to revisit the conclusion reached by the investigating panel so long as that conclusion has some basis in its investigation.[17]

A. Use of Standards in the MBCA

The director's fiduciary duties of care and loyalty are classic examples of standards: They are open-ended and given content only by a court's assessment of the facts of a specific case. Many corporation statutes, including an earlier version of section 8.30 of the MBCA, appear to define the duty of care in terms of ordinary negligence.[18] Given the relatively few reported decisions wherein directors have actually been held liable for negligence, it is apparent that a disconnect exists between the duty of care as articulated and as actually applied. Delaware courts have implicitly recognized this by erecting the business judgment rule to screen complaints of care violations; violations are limited to those complaints alleging facts sufficient to raise a reasonable doubt that the board's decision was affected by its self-interest or grossly negligent processes. Other courts have referred to the statutory duty of care as their state's version of the business judgment rule.[19] Although there are too few cases to support any firm conclusion, decisions of courts in these states do not appear to depart radically from Delaware law. Nevertheless, the failure to recognize the difference between articulation and application of the duty of care is bound to diminish predictability and perhaps encourage the bringing of lawsuits of doubtful or marginal merit.

Innovative amendments to the MBCA in 1998 eliminate any possible confusion and enhance predictability by explicitly distinguishing between standards of director conduct in section 8.30 and standards of director liability

15. MODEL BUS. CORP. ACT § 7.44(a)–(b), (e) (2008).

16. *Id.* § 7.44(d).

17. *Id.* § 7.44(a) & cmt. 2.

18. MODEL BUS. CORP. ACT § 8.30 (1984). Forty-one states have similar statutory provisions. 2 MODEL BUS. CORP. ACT ANN. § 8.30 at 8-209 (4th ed. & 2009 Supp.); *see also* Michael P. Dooley, *Two Models of Corporate Governance*, 47 BUS. LAW. 461, 482 (1992).

19. *See, e.g.*, Gaillard v. Natomas Co., 256 Cal. Rptr. 702, 710–11 (Cal. Ct. App. 1989); Lindner Fund, Inc. v. Waldbaum, Inc., 624 N.E.2d 160, 161 (N.Y. 1993).

in section 8.31. The standards of conduct set forth in section 8.30 are intended as guides for behavior and as points of reference for evaluating a director's conduct, but violations of these standards do not carry direct liability consequences.[20] Section 8.31 lists the grounds for imposing liability on directors, which, although denominated as standards, more closely resemble rules. Thus, liability may be imposed for a decision if the director "was not informed to an extent that the director reasonably believed appropriate in the circumstances," or if the decision was improperly motivated by outside influences, and the director is unable to establish that he or she reasonably believed the decision was also in the best interests of the corporation.[21] Losses resulting from an alleged failure of the director's oversight will result in liability only when there was a "sustained failure" to devote attention to oversight, or when the director was on inquiry notice and failed to take appropriate action.[22] Liability may also result if the director's actions were "not in good faith" or were not reasonably believed by the director to be in the best interests of the corporation.[23] While these two grounds are expressed as standards, they describe fairly extreme behavior that is not often likely to occur.[24] Section 8.31 also clarifies that the plaintiff has the burden of proof of establishing a breach of the duty of care, damages, and causation; however, the section preserves existing state allocations of the burden of proof when fairness is an issue.[25] By more clearly identifying the issues that are relevant in liability claims against directors, section 8.31 significantly narrows the scope of judicial discretion and provides both greater assurance and more guidance to directors in discharging their duties.

20. MODEL BUS. CORP. ACT § 8.30 cmt. at 8-34 (2008).

21. MODEL BUS. CORP. ACT § 8.31(a)(2)(ii)(B), (iii)(B) (2008).

22. *Id.* § 8.31(a)(2)(iv).

23. *Id.* § 8.31(a)(2)(i)–(ii)(A).

24. *See infra* note 29 and accompanying text (describing the Delaware courts' struggle with and eventual rejection of the concept of "good faith" as a separate fiduciary duty). Initially, Delaware's creation of a separate "good faith" duty was an empty vessel into which plaintiffs sought to fit various forms of negligent behavior in order to avoid an exculpatory-charter provision authorized by DEL. CODE ANN. tit. 8, § 102(b)(7) (2010). By describing more precisely specific grounds for liability, MBCA section 8.31 appears to cabin the concept of "good faith." That is, a director's receipt of an improper financial benefit might logically be described as an act not in good faith, or one that was not in the best interests of the corporation, but the assertion of those grounds adds nothing to the director's liability specified in section 8.31(a)(2)(v) for receipt of an improper financial benefit.

25. MODEL BUS. CORP. ACT § 8.31(a)–(c) (2008). This preserves the traditional distinction between care and loyalty violations regarding placement of the burden of proof, and rejects the current Delaware rule in care cases that imposes the burden of proving entire fairness on the defendant if the plaintiff overcomes the business judgment rule in the complaint. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361, 371 (Del. 1993).

B. Use of Rules in the MBCA

1. Director Liability-Limiting Provisions

The director liability-limiting provisions of Delaware law and the MBCA illustrate the difference between rules- and standards-based approaches to director liability. Both statutes authorize the adoption of a charter amendment limiting, or eliminating, the liability of directors in suits brought by or on behalf of the corporation. The provisions differ, however, in defining the types of director liability that cannot be limited or eliminated. The MBCA's exceptions are limited to (1) the amount of a financial benefit to which the director was not entitled, (2) an intentional infliction of harm on the corporation, (3) liabilities in connection with an unlawful dividend, and (4) an intentional violation of criminal law.[26] The factual findings necessary to determine whether challenged conduct falls within one of these exceptions are both limited in number and fairly easily established. The Delaware provision also permits liability for an excessive dividend, receipt of a financial benefit, and intentional misconduct or violation of law (apparently civil or criminal), but would further allow liability for breach of the duty of loyalty and acts or omissions not in good faith.[27] Breach of loyalty is not defined, but is obviously meant to extend beyond self-dealing since receipt of an improper financial benefit is listed as a separate ground. The exception for "good faith" also invites exploration of its outer boundaries. That is just what happened in Delaware: After the Delaware Supreme Court declared in 1993 that "good faith" was a separate fiduciary duty of equal rank with care and loyalty,[28] plaintiffs tried to escape charter exculpatory provisions by characterizing claimed oversight failures as violations of the duty of good faith.[29] It was not until thirteen years later that the Delaware Supreme Court put an end to this maneuver by demoting good faith to a component of the duty of loyalty and limiting its application in oversight cases to instances in which the board of directors intentionally fails to discharge its duties.[30]

The MBCA chose a rule-based approach in recognition of the importance of clarifying the permissible scope of liability-limiting charter provisions:

> As important as validating the shareholders' right to determine for themselves the extent of the directors' liability is stating the limits of this right in terms of promoting a

---

26. MODEL BUS. CORP. ACT § 2.02(b)(4) (2008).

27. DEL. CODE ANN. tit. 8, § 102(b)(7) (2010).

28. *Cede*, 634 A.2d at 361.

29. These were generally known as "*Caremark* claims" and based upon dicta by Chancellor Allen in approving a settlement in *In re Caremark International Litigation*, 698 A.2d 959, 967, 969–70 (Del. Ch. 1996). Earlier, Chancellor Allen had foreclosed characterizations of negligent behavior as a lack of good faith. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1141–42 (Del. Ch. 1994).

30. Stone v. Ritter, 911 A.2d 362, 369–70 (2006). *Stone* may not be the last word, however, as plaintiffs have continued to try (albeit unsuccessfully) to characterize other forms of behavior as good-faith violations. *See, e.g.*, Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242–44 (Del. 2008) (rejecting a claim that the alleged failure to discharge adequately *Revlon* duties constituted bad faith).

> clear understanding of the conduct which is and which is not included in the limitation of liability. Terms such as "duty of loyalty," "good faith," "bad faith," and "recklessness" seem no more precise than (and potentially as expansive as) "gross negligence." All of these formulations are characterizations of conduct rather than definitions of it. Characterizations by nature tend to be more elastic than definitions.[31]

2. Sales of Assets

Standards seem an especially inappropriate way to provide the statutory procedures necessary for corporate combinations. Accordingly, statutes straightforwardly describe the types of combinations that are possible under the statute (mergers—straight or triangular, long or short form—and, under the MBCA, share exchanges) and then list the necessary steps, including who is entitled to vote on the combination, what percentage of votes is required, what documents must be filed, and the like. One would not expect a statute to declare that a plan of merger must receive a "reasonable" number of votes to be approved.

Yet something uncomfortably close to establishment of such a standard has occurred with respect to the sale of assets: Whether shareholder approval is required and, at least in some states, whether appraisal is available turn on whether the proposed sale amounts to "substantially" all of the corporation's assets.[32] Clearly, a statute providing for shareholder approval only if all of the assets were sold would invite game playing, such as withholding a trivial amount of assets to avoid a shareholder vote; but it is not obvious why the legislature could not have provided that the sale of some specified percentage of the assets would require shareholder approval. Even so, one can imagine courts would have eventually distinguished between transactions requiring shareholder approval and those requiring only board action by developing at least rough guidelines based on the value of the assets sold. One could imagine such a development, that is, if the Delaware courts had not added a "qualitative" standard to the quantitative test implied by the statute. According to the test established in *Gimbel v. Signal Cos.*,[33] shareholder approval is required if the sale "is out of the ordinary and substantially affects the existence and purpose of the corporation."[34] The word "existence" seems related to quantity, but "purpose" invites the court to make its own assessment of the sale's effect on the corporation's future business plans, and perhaps to substitute its own judgment for that of the corporation's board of directors.[35] The statutory purpose is to distinguish sales of assets that represent a fundamental change in

31. MODEL BUS. CORP. ACT § 2.02 cmt. 3.I (2008).

32. *E.g.*, DEL. CODE ANN. tit. 8, § 271(a) (2010).

33. Gimbel v. Signal Cos., 316 A.2d 599 (Del Ch. 1974), *aff'd*, 316 A.2d 619 (Del 1974).

34. *Id.* at 606.

35. For example, in *Katz v. Bregman*, 431 A.2d 1274, 1276 (Del. Ch. 1981), the court considered relevant to the qualitative test the fact that the manufacture of a company's principal product, industrial drums, would be switched from steel to plastic after disposition of the assets in question. Normally, the choice of products to be manufactured by a corporation is clearly a decision for the board.

the nature of the shareholders' investment, which require shareholder approval, from sales that are in the ordinary course of business, which the board may approve.[36] The "qualitative" test can thus be seen as directed to the magnitude of the resulting change in the shareholders' investment, but it is too open-ended to limit the types of facts that might be deemed relevant ex post, thereby decreasing predictability and encouraging challenges to sales transactions.[37]

This is an instance in which a rule seems inarguably superior, and section 12.02 of the MBCA adopts that approach. A sale, lease, or other disposition of assets requires shareholder approval if it would leave the corporation "without a significant continuing business." The determination whether the corporation retains a "significant continuing business" requires a minimum amount of fact finding, especially since the section also provides an arithmetical safe harbor: If the retained business activity accounts for at least (1) twenty-five percent of total assets and (2) twenty-five percent of either income before taxes or revenue from continuing operations,[38] the corporation will be conclusively deemed to have retained a significant continuing business and shareholder approval will not be required.

3. Appraisal Remedies

Ironically, the most innovative and potentially most significant change is likely to result from the MBCA's adoption of a rule-based approach to one of the least economically important provisions in corporation law: the appraisal remedy as applied to publicly traded corporations. Although relatively few shares are presented for appraisal in mergers or similar transactions, there is no obvious reason why it should be available at all in the case of publicly traded shares.[39] Certainly courts have not been able to agree on a rationale. Historically, appraisal was a substitute for the common-law right of a single share to veto a merger transaction,[40] and this notion, now long abandoned,

---

36. *See* MODEL BUS. CORP. ACT § 12.01 (2008) (listing dispositions of assets that do not require shareholder approval).

37. In *Hollinger Inc. v. Hollinger International, Inc.*, 858 A.2d 342 (Del. Ch. 2004), the plaintiff challenged a sale of one of several newspaper groups on the grounds that the group to be sold included the London *Daily Telegraph.* Even though the sale would leave the corporation with sizable assets representing other newspapers, the plaintiff argued that great weight should be placed "on the greater journalistic reputation of the *Telegraph* when compared to the [Chicago] *Sun Times,* and the social importance of that newspaper in British life. . . . [A]fter the *Telegraph* sale, International's name will even ring hollow, as it will own . . . only one paper of topflight journalistic reputation, the *Jerusalem Post* . . . ." *Id.* at 349, 384. Although the argument did not succeed, it was not completely preposterous to claim it was relevant to the qualitative test.

38. Income and revenue include all assets of the corporation and its subsidiaries, on a consolidated basis, for the most recent fiscal year for the purposes of this analysis.

39. Appraisal may be justified for fundamental changes in the case of smaller firms without a public market because there is no independent, market-determined benchmark of value, and because the shareholder seeking appraisal may have been an active participant in the business and thus in possession of information relevant to firm value.

40. *See, e.g.*, Elliott J. Weiss, *The Law of Takeout Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 626–29 (1981).

continues to influence the view of appraisal as a compensatory remedy. According to this view, the purpose of appraisal is to compensate the dissenting shareholder from the loss of the shareholder's proportional share of the corporation's "going concern value."[41] But what does this mean? The only way to monetize a business's going-concern value is to sell it, which, of course, is the very transaction to which the dissenter is objecting. A literally-minded person might conclude that the dissenting shareholder is essentially claiming the merged corporation was sold for less than its fair value, which makes sense but is not what the courts mean. Indeed, although some Delaware decisions have urged that a merger price produced by arm's-length negotiation be given great weight in appraising fair value,[42] the courts insist that a fair merger price is not necessarily the same thing as appraised fair value,[43] which must therefore take into account other factors. Those "other factors" have sometimes produced appraisal awards of two to three times the merger consideration, thereby turning appraisal into something of a lottery.[44]

In fairness to the courts, they have been saddled with trying to give content to a statutory standard that is almost completely devoid of any hint of what the statute is intended to achieve. Thus, courts have been left to their own devices to explain what is to be appraised and why. But compensatory explanations unravel when the Delaware "market out" is taken into account.[45] In Delaware, the market-out exemption from appraisal is available only when shareholders of the merged firm receive publicly traded shares rather than cash. This distinction is not explainable on any rational economic ground. Obviously, cash is easier to value than stock, and stock consideration is neither more nor less likely than cash to compensate shareholders fairly. Nor can the distinction be explained on some imagined shareholder preference for one form of consideration over another. Since the market-out is available only if both parties are publicly traded, any shareholder who wants to retain an interest in the merged entity can easily do so by using the cash received for her shares to buy shares in the survivor, just as a shareholder who is paid in shares but does not want to continue as a shareholder can easily convert his shares to cash.

---

41. *E.g.*, Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1142, 1145 (Del. 1989); Tri-Continental Corp. v. Battye, 74 A.2d 71, 76 (Del. 1950).

42. *E.g.*, Highfields Capital, Ltd. v. AXA Fin., Inc., 939 A.2d 34, 52–59 (Del. Ch. 2007).

43. *See, e.g.*, M.P.M. Enters., Inc. v. Gilbert, 731 A.2d. 790, 797 (Del. 1999) ("A fair merger price in the context of a breach of fiduciary duty claim will not always be a fair value in the context of determining going concern value.").

44. *See, e.g.*, *id.* at 792–94; Rapid-American Corp. v. Harris, 603 A.2d 796, 798, 800, 805, 809 (Del. 1992). *See generally* William J. Carney & Mark Heimendinger, *Appraising the Non-Existent: The Delaware Courts' Struggle with Control Premiums*, 152 U. PA. L. REV. 845, 846–47 (2003). In a collection of short essays published in the *Delaware Lawyer* to commemorate the fortieth anniversary of the 1967 revision of the Delaware General Corporation Law, all three essays on Delaware appraisal were highly critical. Michael P. Dooley, *Rethinking Appraisal*, 26 DEL. LAW. 28, 28 (2008); Stuart M. Grant & Michael J. Barry, *Delaware's Appraisal Statute: A Relic in Need of Reform*, 26 DEL. LAW. 29, 29 (2008); James C. Morphy, *Doing Away with Appraisal in Public Deals*, 26 DEL. LAW. 30, 30 (2008).

45. DEL. CODE ANN. tit. 8, § 262(b)(2) (2010).

Perhaps influenced by the appraisal statute, Delaware courts have carried over the cash–share distinction to the duties of the board of directors when selling the corporation. According to what has become known as the *Revlon* rule, if a transaction will result in a change of control of the selling corporation, its board of directors must devote themselves to obtaining for the shareholders the highest value reasonably available.[46] Since a sale of the corporation for cash will necessarily result in a change of control, the board cannot be content with negotiating a "good" or a "reasonable" price, but it must seek to obtain the "highest value" reasonably available, and its efforts in selecting and negotiating with a merger partner will be subject to special and more intrusive judicial scrutiny.[47] One explanation offered for the special concern for change-of-control transactions is that this is the last chance for sellers to receive a "control premium" for their shares.[48] Of course, that is true of anyone who sells anything: Not even Max Bialystock could succeed in trying to sell the same thing over and over again. Moreover, this justification does not explain the special concern for the seller's shareholders. If the seller's board has a duty to sell at the highest price, the buyer's board has a duty to pay the lowest price. That, of course, is true of all negotiations between buyers and sellers. In all other instances, the price reached by the bargainers in an arm's-length negotiation is the best evidence of a fair price, and the bargain will not be disturbed or second-guessed by courts, in the absence of fraud, conflicted interest, or other factors infecting the bargaining process. Some change-of-control transactions may present conflicts of interest,[49] but the existence of the conflict should prompt concern, not the change of control—and certainly not the type of consideration used. A sale of the corporation for cash, negotiated at arm's length, is not the same as an endgame where the buyer stands on both sides of the transaction and has the power to influence the seller's board in its favor.[50] Nor is it the same as a sale, whether for shares or cash, where the loyalty of the seller's directors may have been compromised by side payments from the buyer.

Although it may be too much to attribute the courts' struggles with these issues to a lack of clarity in the appraisal statute, a rule-based approach to appraisal can sort these issues more logically. In sharp contrast to Delaware, the MBCA specifies what is to be valued and how: the "fair value" of the corporation is determined with reference to similar businesses in similar transactions.[51] The MBCA directly confronts the conflicted-interest problem by

46. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182, 184 n.16 (Del. 1986).

47. *E.g.*, Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1264 (Del. 1989); Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 277–78, 280–81 (2d Cir. 1986).

48. Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 42–43 (Del. 1994).

49. This is true of *Revlon* itself, but later decisions do not remark upon the rule's conflicted-interest origins.

50. *E.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

51. MODEL BUS. CORP. ACT § 13.01(4) (2008). In contrast to the traditional view of appraisal identifying a *single* fair value, the MBCA recognizes that "[m]odern valuation methods will normally

making both the availability of the market-out exemption and the scope of remedies turn on whether the transaction is a "conflicted interest transaction" as defined in the MBCA.[52] Even so, the conflict can be cured by subjecting the transaction to approval by qualified directors and by shareholders in the same manner as provided in subchapter F for a director's conflicted-interest transaction.[53] The latter procedures would do much to limit what has become one of the most productive sources of shareholder suits.[54]

III

CONCLUSION

Bayless Manning once famously described corporation statutes as "towering skyscrapers of rusted girders, internally welded together and containing nothing but wind."[55] While that is more than a bit harsh, it does recognize a central truth that has been largely ignored: The great bulk of corporation law in the United States has been created by courts, not legislatures. While courts must always play an important role in shaping the law on a case-by-case basis in many instances, it does not follow that all issues must be decided by litigation. There is much to be gained—in predictability, efficiency, and conservation of judicial resources—from stating at least some important rules upfront. In that regard, the Model Business Corporation Act presents an important new model for corporate legislation.

---

result in a range of values, not a particular single value. When a transaction falls within that range, 'fair value' has been established." *Id.* § 13.01(4) cmt. 2.

52. MODEL BUS. CORP. ACT §§ 13.01(5.1), 13.02(b)(4), 13.40(b)(3) (2008).

53. *Id.*

54. Indeed, three distinguished Delaware jurists have urged the adoption of an approach similar to the MBCA provisions. William T. Allen, Jack B. Jacobs & Leo F. Strine Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1307 & n.81 (2001).

55. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 & n.37 (1962).