

2015

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Citation Information

Mark J. Loewenstein, *Equity and Corporate Law*, 68 SMU L. REV. 783 (2015), available at <http://scholar.law.colorado.edu/articles/408>.

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Citation: 68 S.M.U. L. Rev. 783 2015

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EQUITY AND CORPORATE LAW

Mark J. Loewenstein*

I. INTRODUCTION

IN 1971, the Delaware Supreme Court decided *Schnell v. Chris-Craft Industries, Inc.*,¹ a case that stands for the simple proposition that “inequitable action does not become permissible simply because it is legally possible.”² The inequitable action at issue was the decision of the directors of Chris-Craft to advance the date of the corporation’s annual meeting to derail the plan of the plaintiff-stockholders to wage a proxy contest to unseat incumbent management. The Court acknowledged that the directors had the right under Delaware Corporation Law to advance the date of the annual meeting but, of course, that did not preclude testing that right against equitable principles. This short opinion—just a few pages in the Atlantic Reporter—has been frequently cited by the courts³ and has become a staple in corporate law casebooks.

The contours of the case have been defined over the years. In *Lerman v. Diagnostic Data, Inc.*,⁴ a 1980 case, the Chancery Court considered a challenge to bylaw amendments that allowed the directors to fix the date of the annual meeting (replacing a bylaw that fixed the date) and required stockholders planning to nominate directors to provide seventy days advance notice of the names of such nominees. Some time after adopting these bylaws, the board fixed the annual meeting date for sixty-three days after the board meeting. This foreclosed the ability of the plaintiff to mount a proxy contest, but the board defended on the basis that the plaintiff had plenty of time before the board fixed the annual meeting date to provide the corporation with the required information. The court rejected this defense, reasoning that “it cannot serve to excuse the conduct of management if that conduct was both inequitable (in the sense of being unnecessary under the circumstances) and had the accompanying dual effect of thwarting shareholder opposition and perpetuating management in office.”⁵ *Lerman* may be viewed as an extension of

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1. 285 A.2d 437 (Del. 1971).

2. *Id.* at 439.

3. A search on Westlaw done on May 30, 2015, generated a total of 942 citing references, of which 170 were in judicial opinions.

4. 421 A.2d 906, 907 (Del. Ch. 1980).

5. *Id.* at 914.

Schnell because the court provided relief to a party that could have protected itself, but failed to do so. More importantly, the court defined “inequitable” in the broadest possible terms—an action undertaken by the board of directors that was “unnecessary” under the circumstances.

Schnell was pushed a bit further some ten years later in *Hubbard v. Hollywood Park Realty Enterprises, Inc.*,⁶ a case that also involved an advance notice bylaw. In this instance, however, there was an important twist. Stockholders who sought judicial relief from the bylaw provision had decided to nominate a slate well after the date of the annual meeting was announced, arguing that actions taken by the board subsequent to setting the annual meeting date led them to conclude that the corporation was moving in the wrong direction and needed new leadership. The issue was thus whether *Schnell* compelled the board to affirmatively take action to accommodate the plaintiffs. The Chancery Court held that it did:

[C]onsiderations of fairness and the fundamental importance of the shareholder franchise dictated that the shareholders be afforded a fair opportunity to nominate an opposing slate, thus imposing upon the board the duty to waive the advance notice requirement of the bylaw. And that duty exists, even though concededly the [corporation's] board has acted in good faith and took no steps overtly to change the electoral rules themselves.⁷

Hubbard, therefore, characterizes *Schnell* as a rather broad fairness opinion.

A further expansion of *Schnell* was reflected in *Aprahamian v. HBO & Co.*⁸ and *Berger v. Intelident Solutions, Inc.*,⁹ two other Chancery Court opinions. In *Aprahamian*, insurgents waging a proxy contest challenged the decision of the board of directors to postpone an annual meeting just before it was to occur, presumably because the incumbent board feared it would lose the proxy contest. The court announced a rather low threshold for applying *Schnell*: the action of the board “does not show that any significant interests of the stockholders will be served by the postponement.”¹⁰ In *Berger*, the court applied equitable principles in the context of an appraisal.¹¹ The plaintiff complained that there was not enough time for him to review the materials he received in connection with a freeze-out merger to decide whether to seek appraisal. The court agreed, ruling that defendant's conduct was inequitable under *Schnell*.

Schnell has thus proven to be a useful tool for courts policing inequitable conduct by corporate actors and, incidentally, by those who control

6. Civ. A. No. 11779, 1991 WL 3151, at *243 (Del. Ch. Jan 14, 1991).

7. *Id.* at *260.

8. 531 A.2d 1204 (Del. Ch. 1987).

9. 911 A.2d 1164 (Del. Ch. 2006).

10. *Aprahamian*, 531 A.2d at 1208.

11. *Berger*, 911 A.2d at 1174; *see also*, *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1029 (Del. Ch. 2004) (*Schnell* applied to set aside bylaw amendment requiring unanimous board approval for significant decisions).

alternative entities as well.¹² In the nearly forty-five years since *Schnell* was decided, however, the Delaware courts have developed other, more nuanced, tools to address inequitable conduct, principally the duty of good faith, the implied covenant of good faith and fair dealing, *Unocal v. Mesa Petroleum Co.*¹³ (director action in the context of a potential change of control), and *Blasius Industries, Inc. v. Atlas*¹⁴ (director action interfering with stockholder voting). This evolving jurisprudence raises the questions of whether these “new” tools are superior to *Schnell* and whether *Schnell* can co-exist with them. This essay explores those related questions.

II. GOOD FAITH: FIDUCIARY RESTRAINT OR CONTRACTUAL DUTY?

A. THE DUTY OF GOOD FAITH

Although the mandate that directors of a corporation must act in “good faith” is long-standing and reflected in many corporation statutes, including the Model Business Corporation Act, the contours of this duty were largely unexplored until relatively recently.¹⁵ In the extensive Disney derivative litigation (1998–2006),¹⁶ the Delaware courts began the development of the modern law of the duty of good faith, at least insofar as Delaware law is concerned. In its 2006 opinion, the Delaware Supreme Court cited with approval the definition of good faith articulated in the Chancery Court’s opinion:

The good faith required of a corporate fiduciary includes not simply the duties of care and loyalty, in the narrow sense that I have discussed them above, but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders. A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, dem-

12. See, e.g., *Auriga Capital Corp. v. Gatz Props.*, 40 A.3d 839, 849 (Del. Ch. 2012) (citing *Schnell* with approval in relation to a limited liability company); *Twin Bridges Ltd. P’ship v. Draper*, No. Civ.A. 2351-VCP, 2007 WL 2744609, at *21 (Del. Ch. Sept. 14, 2007) (applying *Schnell* to a limited partnership).

13. 493 A.2d 946 (Del. 1985).

14. 564 A.2d 651 (Del. Ch. 1988).

15. See Mark J. Loewenstein, *The Diverging Meaning of Good Faith*, 34 DEL. J. CORP. L. 433, 438–40 (2009) (describing the case law preceding the *Disney* litigation); Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, 3 (2006) (“An important development in corporate law is the explicit recognition in recent cases that corporate managers—directors and officers—owe a duty of good faith in addition to their duties of care and loyalty.”)

16. *In re Walt Disney Co. Derivative Litig. (Disney I)*, 731 A.2d 342 (Del. Ch. 1998), *aff’d in part, rev’d in part, remanded sub. nom. Brehm v. Eisner (Disney II)*, 746 A.2d 244, 261–64 (Del. 2000); *In re Walt Disney Co. Derivative Litig. (Disney III)*, 825 A.2d 275, 753–56 (Del. Ch. 2003); *In re Walt Disney Co. Derivative Litig. (Disney IV)*, 907 A.2d 693, 753–56 (Del. Ch. 2005), *aff’d*, 906 A.2d 27 (Del. 2006) (Disney V).

onstrating a conscious disregard for his duties. There may be other examples of bad faith yet to be proven or alleged, but these three are the most salient.¹⁷

Tellingly, both the Chancery Court and Supreme Court opinions stated that this definition was not exclusive, leaving the doctrine open for future expansion, presumably as necessary.¹⁸

Another key development in the duty of good faith occurred seven years later, when the Delaware Supreme Court decided *Stone v. Ritter*.¹⁹ In this case, the Court clarified the taxonomy of fiduciary duties, determining that the duty to act in good faith is not an independent fiduciary duty, but is an element of the duty of loyalty.²⁰ Thus, a breach of the duty of good faith can only indirectly give rise to liability.²¹ As the Supreme Court agreed with the lower court that the directors had not breached their duty to act in good faith, court watchers were denied the opportunity to see how a breach might “indirectly” give rise to damages. Subsequent cases do not add clarity.

In any event, this jurisprudence is not unrelated to *Schnell*. It appears that the directors’ decision in *Schnell* to advance the date of the annual meeting was not undertaken to advance the best interests of Chris-Craft. Indeed, it was undertaken to allow the directors to retain their positions.²² Under the test articulated in *Disney*, then, directors in *Schnell* may have violated the duty to act in good faith. Moreover, this version of good faith dovetails nicely with the notion of loyalty: the directors of Chris-Craft acted in their self-interest.

The non-exclusivity of the definition suggests that the concept of equity that animates *Schnell* might easily be replaced with the duty of good faith. The overarching concept—true faithfulness and devotion to the interests of the corporation and its shareholders—can easily accommodate actions that thwart the ability of shareholders to exercise their voting franchise.

Despite this nice tool to address “inequitable conduct,” the Delaware courts have been somewhat reluctant to rely on it. A stark example of this is *Gerber v. Enterprise Products Holdings, LLC*.²³ *Gerber* is best known for its discussion of the implied covenant of good faith and fair dealing, which is discussed in great detail in the next section. More interesting, for present purposes, is that the duty of good faith, whether characterized as an element of the duty of loyalty or not, made a brief and inconsequential appearance in the Supreme Court’s opinion.

17. *Disney V*, 906 A.2d at 67 (quoting *Disney IV*, 907 A.2d at 755–56).

18. *Disney IV*, 907 A.2d at 756; *Disney V*, 906 A.2d at 67.

19. 911 A.2d 362 (Del. 2006).

20. *Id.* at 369–70.

21. *Id.*

22. Motive is a key element in determining whether an actor has breached the duty of good faith. *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1208 (Del. 1993).

23. 67 A.3d 400 (Del. 2013), *overruled on other grounds*, *Winshall v. Viacom Int’l, Inc.*, 76 A.3d 808 (Del. 2013).

Gerber arose out of a challenge by a limited partner to certain related party transactions implemented by the general partner and its affiliates. Like corporate directors, the general partner of a limited partnership owes fiduciary duties to the entity and, indirectly, to the limited partners. While there is a good deal more freedom for an alternative entity to contract around fiduciary duties, the Delaware courts have insisted that the drafter meet a rather high standard to achieve a waiver of fiduciary duties. Moreover, when such duties have been effectively waived, the courts have generously employed the implied covenant of good faith and fair dealing to afford some measure of relief to the disadvantaged parties.

In *Gerber*, the Supreme Court ultimately reversed a lower court decision that dismissed the action and held that the plaintiff had stated a claim under the implied covenant of good faith and fair dealing. In the course of reaching that conclusion, however, the Court characterized the limited partnership agreement as creating a “contractual fiduciary duty of good faith,”²⁴ because it required the general partner to act in the best interests of the partnership when it made a business decision for the partnership. On the facts of this case, the Court apparently could have concluded that the general partner breached this duty, but, instead, chose to rely on the implied covenant.

Arguably, the Court opted for the least restrictive doctrine when addressing what might be characterized as inequitable conduct on the part of the general partner. Were the Court to have relied on a fiduciary concept, it would have marked an expansion of the definition, as applied, that it had endorsed in *Disney*. Both *Disney* and *Stone*, the two most prominent Delaware Supreme Court cases discussing the duty of good faith, involved fact patterns alleging, essentially, that the boards of directors failed in their duty of oversight. In *Disney*, the board approved an employment agreement and, later, a settlement, that the plaintiff alleged was disastrous for Disney. In *Stone*, the plaintiff alleged that the board’s failure to properly oversee the company’s operations resulted in a violation of federal law and large penalties. In neither case could the plaintiffs sustain their burden of proof that the defendants’ conduct amounted to a conscious disregard of their responsibilities, a rather high bar for plaintiffs to overcome. Were the Court to apply the abstract definition of good faith that it articulated in *Disney* and *Stone*—true faithfulness and devotion to the interests of the corporation and its shareholders—it could set aside any action (or, perhaps, relief for inaction) that results in inequity. Wisely, the Court has chosen not to go in that direction and, instead, has developed the implied covenant of good faith and fair dealing as a tool to police overreaching, especially in the context of alternative entities and most commonly in cases involving related party transactions. Despite the apparent narrowness of this doctrine—at least insofar as corporate governance disputes are concerned—it may have salience in resolving such disputes.

24. *Id.* at 412.

B. THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

Gerber provides an instructive case in how the Delaware Supreme Court views the implied covenant of good faith and fair dealing, which a recent Chancery Court described as follows:

The implied covenant is a limited gap-filling tool to infer contractual terms to which the parties would have agreed had they anticipated a situation they failed to address; it is not a “free-floating duty” or “a substitute for fiduciary duty analysis.” Put differently,

“[f]air dealing” is not akin to the fair process component of entire fairness, *i.e.*, whether the fiduciary acted fairly when engaging in the challenged transaction as measured by duties of loyalty and care It is rather a commitment to deal “fairly” in the sense of consistently with the terms of the parties’ agreement and its purpose. Likewise “good faith” does not envision loyalty to the contractual counterparty, but rather faithfulness to the scope, purpose, and terms of the parties’ contract. Both necessarily turn on the contract itself and what the parties would have agreed upon had the issue arisen when they were bargaining originally.

Additionally, when a contract confers discretionary rights on a party, the implied covenant requires that party to exercise its discretion reasonably. And “what is ‘arbitrary’ or ‘unreasonable’—or conversely ‘reasonable’—depends on the parties’ original contractual obligations” and “reasonable expectations at the time of contracting.” Fundamentally, therefore, “[t]he implied covenant cannot be invoked to override the express terms of the contract.”²⁵

This definition, which is representative of the way the Delaware courts have described the concept, is narrow compared to the *Schnell* concept of inequitable conduct and the *Disney* concept of the duty of good faith. Yet it is not without force, and it is useful as a tool to police misconduct, as *Gerber* itself demonstrates. Its salience for corporate law, however, depends on how one characterizes the fundamental corporate documents—the certificate of incorporation and bylaws. To apply the implied covenant doctrine in the corporate context, then, a court would have to conceive of the certificate of incorporation and bylaws as contracts and, while there is much literature that characterizes them as such,²⁶ the courts have not. I return to the wisdom of such an approach in Part IV below, after considering the shortcomings of the *Schnell* doctrine and its relationship to the iconic corporate law cases of *Unocal* and *Blasius*.

25. *In re Encore Energy Partners LP Unitholder Litig.*, C.A. No. 6347-VCP, 2012 WL 3792997, at *12 (Del. Ch. Aug. 31, 2012) (footnotes omitted).

26. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 1–39 (1991); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1261–62 (1982); William A. Klein, *The Modern Business Organization: Bargaining Under Constraints*, 91 YALE L.J. 1521, 1522–24 (1982); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310–11 (1976); Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 783 (1972).

III. THE PROBLEMS WITH *SCHNELL*

There are several problems with the *Schnell* doctrine: it is indeterminate, it is inconsistent with the notion of private ordering, it overlaps with other legal doctrines, and it increases litigation without a corresponding benefit. I will discuss each in turn.

A. *SCHNELL* IS INDETERMINATE

The Delaware courts have expressed the importance of certainty: to facilitate private ordering, the law should be clear to corporate actors. The Delaware Supreme Court expressed this in no uncertain terms in a footnote to *Williams v. Geier*:

In addition to the specter of impermissible judicial legislation, the relief requested by Williams [setting aside an amendment to the certificate of incorporation and a recapitalization], if granted, would introduce an undesirable degree of uncertainty into the corporation law. . . . Directors and investors must be able to rely on the stability and absence of judicial interference with the State's statutory prescriptions.²⁷

Somewhat paradoxically, the Court ended this footnote citing *Schnell* approval, the very case that creates uncertainty.

Perhaps the best, but not the only, example of *Schnell*'s uncertainty can be found in *Singer v. Magnavox Co.*²⁸ and its progeny.²⁹ Relying partially on *Schnell*, *Singer* established the principle that a freeze-out merger may be set aside as inequitable and a breach of the fiduciary duty that the majority owes to the minority if the merger is undertaken merely to eliminate the minority stockholders. The case is commonly characterized as one that requires the majority to demonstrate there was a corporate business purpose for the merger.³⁰ The precedent was short-lived. In 1983, just six years after it decided *Singer*, the Court reversed course and held, in *Weinberger v. UOP, Inc.*,³¹ that no such purpose need be shown. Instead, the Court held that the majority stockholder bears the burden of proving that the merger was entirely fair to the minority stockholders, but that the purpose of the merger was not an element of fairness. The Court said that in light of this fairness test, together with an expanded appraisal remedy announced in the case and an affirmation of the broad discretion of the Chancellor to provide relief "as the facts of a given case may dictate,"³² the business purpose test was no longer needed. The Court provided no additional explanation, but the overruling of *Singer* speaks

27. 671 A.2d 1368, 1384 & n.36 (Del. 1996).

28. 380 A.2d 969, 980 (Del. 1977), *overruled in* *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

29. *Principally* *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979); *Tanzer v. Int'l Gen. Indus.*, 379 A.2d 1121 (Del. 1977).

30. *See, e.g.*, R. FRANKLIN BALOTTI AND JESSE A. FINKELSTEIN, *DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS*, § 9.37 (2015).

31. 457 A.2d 701, 704 (Del. 1983).

32. *Id.* at 715.

strongly to the indeterminacy of *Schnell*: that which is inequitable one day, ceases to be such a few years later.

A flip-flop like the shift from *Singer* to *Weinberger* seems inevitable with a doctrine as fuzzy as *Schnell*. Consider the observation of former Chief Justice E. Norman Veasey³³ reflecting on the doctrine in a 2004 law review article: “The tension between deference to director flexibility in decision making and the need for judicial oversight is often a defining tension. The complexity of the issues and the variety of highly textured fact situations require a delicate balance in fiduciary duty jurisprudence.”³⁴ This statement foreshadows the difficult task that any court faces and cannot help but lead to inconsistent results. For instance, in *Applebaum v. Avaya, Inc.*,³⁵ plaintiff appealed a decision by the Chancery Court holding that under Delaware law, a corporation could “initiate a reverse stock split and selectively dispose of the fractional interests held by stockholders who no longer hold whole shares.”³⁶ The Court refused to apply *Schnell* and noted that applicable Delaware law did not forbid such disparate treatment. The Court wrote that “[w]hile principles of equity permit this Court to intervene when technical compliance with a statute produces an unfair result, equity and equality are not synonymous concepts in Delaware General Corporation Law. Moreover, this Court should not create a safeguard against stockholder inequality that does not appear in the statute.”³⁷ In contrast to *Applebaum*, the Minnesota Supreme Court did provide relief under the *Schnell* doctrine to a minority shareholder complaining of the unfairness of a reverse stock split.³⁸

The indeterminacy of *Schnell* is further demonstrated by the terms that the Delaware courts use to describe the test. For instance, *Alabama By-Products Corp. v. Neal*,³⁹ a 1991 Delaware Supreme Court opinion, indicates the Court’s unease with the potential broadness of the *Schnell* precedent. The Court was faced with an argument that *Schnell* ought to provide some relief in the context of what the plaintiffs characterized as unfair dealing in an appraisal proceeding. The Court declined the invitation, writing that *Schnell* “should be reserved for those instances that threaten the *fabric of the law*, or which by an improper manipulation of the law, would deprive a person of a *clear right*.”⁴⁰ This stringent test stands in stark contrast to the actual application of *Schnell*, some examples of which are noted in the Introduction to this article. Consider just one example—*Hubbard*—where the Chancery Court held that *Schnell* imposed a duty on the board of directors to waive an advanced notice

33. Chief Justice of Delaware Supreme Court from 1992–2004.

34. E. Norman Veasey and Christine T. DiGuglielmo, *What Happened in Delaware Corporate Law and Governance From 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1416 (2005) (footnotes omitted).

35. 812 A.2d 880 (Del. 2002).

36. *Id.* at 882.

37. *Id.* at 886.

38. *U.S. Bank N.A. v. Cold Spring Granite Co.*, 802 N.W.2d 363 (Minn. 2011).

39. 588 A.2d 255 (Del. 1991).

40. *Id.* at 258 n.1 (emphasis added).

bylaw so that the plaintiffs could mount a proxy contest, even though there was no finding that the board set the date of the annual meeting to adversely affect the plaintiffs. Indeed, at the time the date of the annual meeting was set, the plaintiffs had no plan to challenge the incumbent board. Can it fairly be said that the board's inaction threatened the fabric of the law and deprived the plaintiffs of a clear right?⁴¹

The fluid definition of inequitable conduct has given rise to other uncertainties in its application, primarily, the question of whether the plaintiff bears the burden of proving that the defendant acted with *scienter*. Perhaps unsurprisingly, the case law does not provide clear guidance. In *Accipiter Life Sciences Fund, L.P. v. Helfer*,⁴² for instance, plaintiff claimed that the corporation buried the announcement of an annual meeting in a press release primarily devoted to financial result and, consequently, plaintiff missed the opportunity to mount a proxy contest. The Chancery Court denied relief under *Schnell* because no one at the corporation "had reason to know" that the plaintiff intended to nominate directors when the decision was made to announce the annual meeting.⁴³ Thus, plaintiff lost because it failed to demonstrate that defendant acted to interfere with plaintiff's plans. Other cases suggest a similar requirement of intent.⁴⁴ In contrast to *Accipiter*, a 1997 Chancery Court decision flatly held that "[t]o set aside the election results on the basis of inequitable manipulation of the corporate machinery, it is not required that *scienter*, i.e., actual subjective intent to impede the voting process, be shown."⁴⁵

B. *SCHNELL* IS INCONSISTENT WITH PRIVATE ORDERING

Delaware courts frequently distinguish corporations from alternative entities by characterizing the latter as "contractual entities," while the former are subject to numerous statutory mandates.⁴⁶ Indeed, Delaware's alternative entities statutes direct the courts to "give the maximum effect

41. Among other cases in which the Delaware courts suggested that *Schnell* may apply yet one may doubt that the "fabric of the law" was threatened are *Klaassen v. Allegro Dev. Corp.*, 106 A.3d 1035 (Del. 2014) (deceptive conduct); *ATP Tour Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014) (fee shifting bylaw); *City of Providence v. First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014) (forum selection bylaw); *Esopus Creek Value LP v. Hauf*, 913 A.2d 593 (Del. Ch. 2006) (filing of a bankruptcy petition).

42. 905 A.2d 115 (Del. Ch. 2006).

43. *Id.* at 126.

44. *E.g.*, *Brody v. Zaucha*, 697 A.2d 749 (Del. 1997); *Portnoy v. Cryo-Cell Int'l, Inc.*, 940 A.2d 43 (Del. Ch. 2008); *Hubbard v. Hollywood Park Realty Enter., Inc.*, Civ. A. No. 11779, 1991 WL 3151 (Del. Ch. Jan. 14, 1991).

45. *Linton v. Everett*, No. 15219, 1997 WL 441189, at *9 (Del. Ch. 1997).

46. *E.g.*, *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 291 (Del. 1999) ("The basic approach of the Delaware [LLC] Act is to provide members with broad discretion in drafting the Agreement and to furnish default provisions when the members' agreement is silent."); *Miller v. Am. Real Estate Partners, L.P.*, No. Civ. A. 16788, 2001 WL 1045643, at *8 (Del. Ch. 2001) (noting that under the Delaware partnership law, investors should carefully read partnership agreements before investing); MARTIN I. LUBAROFF & PAUL ALTMAN, *DELAWARE LIMITED PARTNERSHIPS* § 1.2 (2015).

to the principle of freedom of contract.”⁴⁷ While there is truth to this characterization, it overstates the difference. In fact, alternative entities are subject to mandatory terms and corporate actors do have considerable freedom to shape their relationship. For instance, as to the former, under Delaware law a member of a limited liability company has the right to certain information about the company⁴⁸ and an operating agreement cannot disclaim the implied covenant of good faith and fair dealing.⁴⁹ While these might seem like rather narrow limitations on the freedom of contract, in fact a robust jurisprudence has developed around the implied covenant, nearly making it a de facto substitute for mandatory fiduciary duties.⁵⁰ On the other hand, amendments to the Delaware corporate code have greatly increased the contractual freedom of corporate actors, including provisions that allow the certificate of incorporation to disclaim the directors’ monetary liability for breach of their duty of care⁵¹ and limit the reach of the duty of loyalty.⁵²

What is important here, whether the entity is a corporation or an alternative entity, is that the law has moved decisively in the direction of private ordering, especially in Delaware and, more generally, around the country. *Schnell* is inconsistent with this trend. It says that private ordering is fine, to a point, but the court will set aside the result of private ordering when it determines that an unfair result would ensue. And, as noted above, the parameters of this intervention are nearly impossible to discern.

C. *SCHNELL* OVERLAPS WITH OTHER DOCTRINES: UNOCAL AND BLASIUS

As discussed above, the *Schnell* doctrine overlaps with the implied covenant of good faith and fair dealing and the duty of good faith. But there are other longstanding doctrines in Delaware law that could be invoked in lieu of *Schnell*. Consider a situation in which directors take some action that influences a vote by stockholders and has the effect of entrenching the directors in office. Say, for instance, that pursuant to an agreement with a potential acquirer, the target board agrees to allow the stockholders to vote on a recapitalization proposal that would, among other things, displace the target board of directors. If the directors engage in some sort of manipulative conduct that affects, or is intended to affect, the outcome, their conduct could be challenged under *Schnell*, *Unocal*, or *Blasius*. *Unocal* would be triggered because the board’s actions arguably thwarted a

47. E.g., Delaware Limited Liability Company Act, DEL. CODE ANN. tit. 6, § 18-1101(b) (West 2015).

48. *Id.* § 18-305.

49. *Id.* § 18-1101(c).

50. See, e.g., Douglas M. Branson, *Alternative Entities in Delaware – Reintroduction of Fiduciary Concepts by the Backdoor?*, in RESEARCH HANDBOOK ON PARTNERSHIPS, LLCs AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS (Robert W. Hillman & Mark J. Loewenstein eds., 2015).

51. DEL. CODE ANN. tit. 6, § 102(b)(7) (West 2015).

52. *Id.* § 122(17).

change of control and, therefore, their actions would be subject to judicial review: the board would bear the burden of proving that their actions were motivated by a reasonable belief that there was a danger to corporate policy and effectiveness, and that their response was reasonable in relation to the threat posed.⁵³ Suppose, however, that the board's actions were challenged, instead, under *Schnell*? The manipulative board action, if it precluded a recapitalization, might well fit within the notion of inequitable conduct. Similarly, under *Blasius*, when a board acts for the primary purpose of preventing the effectiveness of a shareholder vote, it bears the burden of proving that it had a compelling justification for its actions.

There are, of course, many instances of what might be characterized as inequitable conduct that do not fit within the implied covenant or under *Unocal* or *Blasius*. The implied covenant can be raised only when someone has exercised a right created under a contract; *Unocal* is triggered only when there is a possible change of control; and *Blasius* applies only when the board's actions have the primary purpose of interfering with the effectiveness of a stockholder vote. Yet under each doctrine, there is an important commonality: a beneficiary of a fiduciary duty challenges the otherwise lawful actions of the fiduciary. This commonality likely prompted then Vice Chancellor Strine (now Chief Justice of the Delaware Supreme Court) to write about the overlap of these principles in *Mercier v. Inter-Tel (Delaware), Inc.*:⁵⁴

It would hardly be indiscreet for me to acknowledge yet again the widely known reality that our law has struggled to define with certainty the standard of review this court should use to evaluate director action affecting the conduct of corporate elections. The results in the cases make sense, as the decisions do a good job of sorting between situations when directors have unfairly manipulated the electoral process to entrench themselves against insurgents and those when directors have properly used their authority over the election process for good faith reasons that do not compromise the integrity of the election process. The problem that remains though is that there is no certain prism through which judges are to view cases like this.⁵⁵

In *Mercier*, Justice Strine noted that *Blasius* has rarely been applied, because its compelling justification standard is so difficult to satisfy.⁵⁶ His opinion in *Mercier* seeks to rationalize *Unocal* and *Schnell*, and, basically, suggests an approach that captures all three cases:

[T]o satisfy the *Unocal* burden, directors must at minimum convince the court that they have not acted for an inequitable purpose. Thus *Unocal* subsumes the question of loyalty that pervades all fiduciary duty cases, which is whether the directors have acted for proper rea-

53. *Unocal Corp. v. Mesa Petrol. Co.*, 493 A.2d 946, 955 (Del. 1985).

54. 929 A.2d 786 (Del. Ch. 2007)

55. *Id.* at 805.

56. *Id.* at 805-06.

sons. This aspect of the test thus addresses issues of good faith such as were at stake in *Schnell*.⁵⁷

In *Mercier* and other cases,⁵⁸ it appears that the Delaware courts are recognizing that they have created an overflowing toolbox to deal with inequitable conduct. Their tools require varying burdens of proof and include varying qualifications, but all ultimately require some demonstration by the fiduciary that it acted fairly with regard to its beneficiary.

IV. CONCLUSION

In the confines of this symposium, one cannot fully parse the rich jurisprudence that has developed to address alleged misconduct by those who control a business entity, be it a corporation, partnership, or limited liability company. What has developed, however, and best demonstrated in Delaware, is a rather haphazard jurisprudence in which the determinative precedent that resolves the case is somewhat unpredictable. More importantly, the standards of proof for these doctrines differ in a way that cannot easily be explained. In the corporate context, this jurisprudence is largely developed from *Schnell*, *Unocal*, *Blasius*, and *Disney*, although the last of these cases is both the least utilized and potentially the most expansive. In the context of alternative entities, the jurisprudence is an evolving one, focusing on the implied covenant of good faith and fair dealing. The last doctrine is one that could also loom large in corporate cases, but as yet has not. Interestingly, however, it could provide yet another tool for the judiciary, to the extent that fundamental corporate documents are viewed as contracts between the stockholders and the board of directors. Given the plethora of extant doctrines to deal with alleged board misconduct, and the looming possibility of yet another doctrine, the time is ripe for the judiciary to reconsider its overflowing tool box, keeping those tools that are most likely to yield consistent, fair outcomes and removing those that have outlived their usefulness.

57. *Id.* at 807.

58. See, e.g., William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW 1287 (2001).