If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft

By Leo E. Strine, Jr.*

I. THE DELAWARE WAY: INVEST BROAD LEGAL AUTHORITY IN DIRECTORS, BUT SUBJECT THEIR USE OF THAT AUTHORITY TO EQUITABLE OVERSIGHT

Judges are lawmakers. Judges do not simply apply settled principles of constitutional and statutory law to particular disputes. Rather, in important ways, judges themselves determine what the law is. For example, there are many cases in which even the most principled of judges, adhering as loyally as possible to traditional methods of finding the law—such as giving effect to plain statutory language and looking at legislative history only when the statute’s own words do not answer the question—will still be left with a great deal of policy freedom to decide what practical meaning a statute has. In this essay, however, I will not focus on situations when judges arguably bring their own policy views to bear in interpreting constitutions or statutes. Instead, I will address that aspect of judging which explicitly and unavoidably involves lawmaking—the articulation and application of judge-made common law.

That judges act as policymakers in making common law is obviously true. But that truth is discomfiting to many jurists. A candid acknowledgement of that truth opens the judiciary, the least politically influential branch, to criticism, as acting as lawmakers without the legitimacy to do so. Relatedly, to admit that the making of common law necessarily involves the judge’s application of his own normative beliefs, rather than the divining of discoverable, pre-existing principles of natural law, demystifies the judicial process in a way that makes many judges nervous.1

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1. In contending that judges making common law unavoidably bring their own normative beliefs to bear, I do not wish to exaggerate the extent to which that is true or to elide the important distinctions between the common law method of lawmaking and the legislative method. The judicial making of
They feel unrobed by this reality, as it makes their decisions less like unquestionable liturgy, and more like debatable stump speeches. The prevalence of the annoying "we" voice by trial judges in their opinions reflects this judicial fear. Just who are the we? Somehow I doubt it is an admission by the trial judge that his law clerk did most of the drafting. Far more likely is that this voice is believed to convey more authority and dignity, to signal that the decision reflects the objective application by a neutral jurist of law made by others, rather than the subjective, discretionary decision of a particular, often unelected judge.

1, of course, do not set forth these thoughts because I am a professor of jurisprudence but because I am a judge on this nation's arguably most important business court, the Delaware Court of Chancery. But I begin this essay by surfacing the lawmaking role of the judiciary for an important reason: many of the important principles of American-style corporate law come in the form of judge-made common law. What, if any, duty of fairness is owed to the minority by a controlling stockholder in effecting a squeeze-out merger? What are the duties of a board of directors that has received a premium, all-shares, all-cash tender offer? What information must directors disclose in asking their stockholders to vote for a

common law is, by tradition and by (in my view) prevailing current practice, bounded by conventions that help curb the leeway that individual judges have to shape the law in a manner that is heavily influenced by their idiosyncratic policy views. And, of course, the judiciary's own appreciation of its political vulnerability also naturally promotes caution about free-wheeling translation of judicial norms into positive law. The common law's caution about innovation, as reflected in its respect for prior precedent, and the judiciary's search for evidence that animating principles are rooted in a deeper societal consensus are illustrative of these realities. Most judges, including me, believe our role to be a markedly different one than that of the legislative and executive branches and endeavor to respect our more constrained role in the process. See, e.g., William T. Allen, Leo E. Strine, Jr. & Leonard P. Stark, Judge "The Game By The Rules": An Appreciation of the Judicial Philosophy and Method of Walter K. Stapleton, 6 DEL. L. REV. 223 (2003) (describing the jurisprudence of a distinguished federal judge committed in an exemplary way to a restrained approach to judging that respects the authority of the political branches at the federal and state levels).

That said, the idea that the normative perspectives of judges do not matter in making common law strikes me as naive or obfuscatory. In determining whether a manufacturer should be held strictly liable in tort or only if it acted negligently, a host of normative considerations are arguably relevant. So, too, when judges determine, as a matter of public policy, to recognize exceptions to an employer's right, in an employment-at-will state, to terminate an employee. Little in life is value free and certainly not the making of common law. Frederick Schauer, Is the Common Law Law?, 77 CALIF. L. REV. 455, 456 (1989) ("the values that guide a common law court in modifying or discarding what had previously been thought of as a rule of law are moral, economic, social and political"). That is also true in making the common law of corporations. Lyman P.Q. Johnson, The Delaware Judiciary and the Meaning Of Corporate Life and Corporate Law, 68 TEX. L. REV. 865 (1990) (arguing that Delaware judges must necessarily seek guidance from, interpret, and apply their understanding of social norms in addressing the important questions for corporate law raised by the emergence of hostile takeover bids). Cf. Leo E. Strine, Jr., The Inescapably Empirical Foundations Of the Common Law of Corporations, 27 DEL. J. CORP. L. 499 (2002) (discussing the extent to which the common law of corporations depends on judicial assumptions about how the world works and businesspersons behave).

Perhaps not coincidentally, one of the finest articulations of the common law process and its differences from the legislative process was crafted by a leading corporate law scholar, Melvin Eisenberg. See M. EISENBERG, THE NATURE OF THE COMMON LAW PROCESS (1988). For a consideration of how normative propositions influence the making of Delaware's common law of corporations, the interested reader could usefully consult, Johnson, supra, 68 TEX. L. REV. 865.

merger? What obligation do directors have to exercise oversight over corporate management? For the most part, the state law answers to all these questions will be supplied by judges, performing their traditional roles of making and applying common law.

In Delaware, whose corporation law governs a solid majority of the largest public companies in the United States, the continued importance of the common law of corporations is not the result of happenstance, but reflects a policy choice made by the Delaware General Assembly. That choice deliberately deploys Delaware's judiciary to guarantee the integrity of our corporate law through the articulation of common law principles of equitable behavior for corporate fiduciaries.

Let me be more concrete about why that is so. The Delaware General Corporation Law is an enabling statute that provides corporate directors with capacious authority to pursue business advantage by a wide variety of means. In general, the statute itself limits the involvement of stockholders in corporate governance to a few discrete, albeit very important, areas such as electing directors, amending by-laws, and voting to approve certain fundamental transactions like mergers. Often, the statute is flexible enough to permit directors to pursue certain ends by more than one means, thereby enabling them to, for example, implement a transaction through a technique that does not require a stockholder vote, while eschewing another statutory method that would have given the stockholders a say.

Of course, investing directors and officers with such extensive authority carries with it certain risks, not the least of which is that these fiduciaries will be less than faithful agents (in the economic sense), placing their own personal interests above those of other stockholders. Even with the annual right to elect directors, disaggregated stockholders, left only with the protections of the Delaware General Corporation Law itself, might be thought too exposed to exploitation by managers.

The method that Delaware has used to address this danger is the principal focus of my address today. That method involves the use of a court of equity—
the Delaware Court of Chancery—to ensure that corporate directors do not use the wide authority granted to them by statute for ends that are inimical to the best interests of the corporations they serve. The key equitable question, at bottom, is whether the directors complied with their fundamental fiduciary duties of loyalty and care. If, upon review, the court concludes that otherwise lawful action was tainted by a fiduciary breach, then the court will act to remedy that misconduct. By this technique, a broad, enabling statute can be used with integrity. The technique's essence is characterized by the maxim that simply because action is statutorily or contractually lawful, does not mean that it is equitable.

Thus, Delaware's system of corporate law still rests fundamentally on a division between law and equity. In my address today, I will take you through a bit of the history of that division during the last quarter century. I do so in order to surface an implicit, but to my mind, fundamental principle necessary to the effective implementation of the division between law and equity by Delaware's judiciary. It is, of course, common for there to be doubt about whether the Delaware judiciary adequately polices managers' compliance with their fiduciary duties. And there is no question that the Delaware system of corporate law cannot function with credibility or efficiency if the judiciary does not use its equitable powers when fiduciaries have failed to act with fidelity or care. If we blanche at finding misconduct when that is warranted, then we, as judges, do not fulfill the promise of our law. Although it is sexier to criticize Delaware courts as lax on managerial misconduct, my own view is that such critiques are usually exaggerated and ignore the too-vast-to-cite body of cases in which Delaware courts have used the equitable form of review to hold directors accountable for serious misconduct.

For today's purposes, I do not dwell on the oft-discussed duty of judges to constrain inequity when they find it. Rather, I focus on a related danger that exists in our corporate law, which is that the courts will forget to respect the law side of the law-equity divide in exercising their equitable powers. The breadth and importance of equitable review in our law can distract judges from the fundamental difference between law and equity. When judges in equity confront corporate action that they perceive to be dangerous to stockholders, they must ask two questions: (1) is that action authorized by statute and by the corporation's governing instruments? and (2) if so, is it equitable in the circumstances? These are separate inquiries.

In this lecture, I will discuss with you the importance of separating these inquiries and in not confusing the two forms of review. Although, as I have said, judges are lawmakers of a particular sort, respecting the separateness of these questions is important to the effective functioning of our law. By doing so, judges preserve the flexibility statutorily provided to faithful managers by the Delaware General Corporation Law. As importantly, by focusing their decision making in this manner, judges reduce the risk that they will overstep the proper bounds of their common law making authority, and thereby inhibit the wealth-creating freedom of action that our corporate law is designed to facilitate.

To demonstrate these points, I am going to take you on a brisk walk through several key Delaware cases, beginning with a landmark decision that is approach-
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ing its 35th birthday, Schnell v. Chris-Craft,\textsuperscript{11} and culminating in a controversial opinion issued in 2003, Omnicare, Inc. v. NCS Healthcare, Inc.\textsuperscript{12} Let me commence our tour.

II. SCHNELL V. CHRIS-CRAFT: THE TRADITIONAL LAW-EQUITY DIVIDE SURVIVES AN IMPORTANT CHALLENGE

In 1967, Delaware completed a process that revised the DGCL comprehensively.\textsuperscript{13} That extensive enactment revived an old debate about the respective roles of the "law" (i.e., the corporate code itself) and equity (i.e., the judge-made common law of corporations as reflected in judicial articulations of the fiduciary duties of directors and officers). Some elements of the Delaware bar believed that the then-new DGCL should be viewed as more or less occupying the entire field of corporate law, relegating the common law of corporations\textsuperscript{14} to the dust heap, or at the very least, to playing a very narrow, marginal role against nakedly fraudulent behavior.

Nearly thirty-five years ago, the Delaware Supreme Court emphatically rejected the proposition that compliance with the DGCL was all that was required of directors to satisfy their obligations to the corporation and its stockholders. That decision came in the famous case of Schnell v. Chris-Craft.\textsuperscript{15}

In Schnell, the incumbent board of Chris-Craft Industries faced a proxy fight over issues of managerial underperformance. Staring at the prospects of an electoral fight, the incumbent board took action, within their legal power, to accelerate the date of the annual meeting from its usual date in January to December, and to move the meeting from its usual location in New York City to a remote upstate location. By saying that the board had the legal power, I mean that everything the board did was permitted by the DGCL and authorized by the corporation's own governing instruments.

In the Court of Chancery, the dissidents argued that the board's actions, while legally authorized, were intended to prevent them from effectively waging a proxy contest. Having accelerated the process and having acted to dampen turnout, the board left the dissidents with too little time (less than a month from receiving the stockholders' list) to solicit proxies effectively.

\textsuperscript{12} Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003).
\textsuperscript{13} See supra note 6.
\textsuperscript{14} In referring to the common law in this article, I am primarily referring to the common law method of adjudication by which the Delaware courts determine the principles of equity that govern the actions of corporate fiduciaries. In the case of Delaware corporate law, much of the law is set forth in statute but is supplemented and tempered by judge-made equitable principles. This system is therefore importantly, if not entirely, distinct from areas of law like tort, in which the "law" is often primarily common, not statutory, law. In Delaware corporation law, judges make the "equity" component that operates in what is hoped to be fair and efficient tandem, with legislatively made statutory law. This interaction, however, is naturally and usefully fraught with creative friction, as the traditional role of equity in tempering the harshness of the law endures, fueling continuing evolution in jurisprudential principles.
\textsuperscript{15} Schnell, 285 A.2d 437.
The Court of Chancery, however, did not warm to this argument and concluded that the board's compliance with legal technicalities was sufficient to insulate its actions from attack. On appeal, however, the Delaware Supreme Court took exactly the opposite view. It concluded that the dissidents were essentially correct: the incumbent board's actions were intended to prevent the dissidents from being able to wage an effective campaign and constituted a purposeful manipulation of the electoral machinery motivated by the board members' desire to entrench themselves. To the board's argument that they were within their legal right to act as they did, Justice Herrmann's opinion had a simple, but resounding response:

The answer to that contention, of course, is that inequitable action does not become permissible simply because it is legally possible.

Although Schnell might have caused a few hard-line defense lawyers to grumble, its articulation of the dual roles of law and equity met with general acceptance within Delaware, as it was entirely consistent with the evolutionary development of our corporate law. That equitable principles of fiduciary duty would be an overlay to and a constraint on the statutory powers of directors was not innovative, it was part of the longstanding operation of our law. Moreover, Delaware's judiciary was not known for adventures in corporate law, but for its careful and sparing, some might say too reticent, use of equity to restrain otherwise lawful conduct.

In other words, the judiciary could be empowered because it recognized that its authority to declare otherwise lawful action inequitable was a sort of sacred public trust, to be prudently exercised only when the court was confident that directors were exploiting their legal powers for improper ends. In this process,

18. Another important determination of this era involved whether DEL. CODE ANN. tit. 8, § 144 was intended to specify complete safe harbors for the consummation of interested transactions. The key part of § 144 provides that an interested transaction shall not be per se void or voidable if it is approved by informed disinterested directors, or informed stockholders, or if the transaction is fair. In Fliegler v. Lawrence, 361 A.2d 218, 222 (Del. 1976), it was held that the only consequence of deploying one of the cleansing techniques in § 144 was to avoid legal invalidity Even with, for example, approval by disinterested directors, an interested transaction would not necessarily be protected by the business judgment rule. Rather, the question of whether the transaction was equitable would be measured by judge-made principles of fiduciary duty.
19. See, e.g., Yasik v. Wachtel, 17 A.2d 309, 313 (Del. Ch. 1941) (suggesting that issuing stock in compliance with the statute but for the improper purpose of depriving a stockholder of control would be impermissible in equity).
20. The classic, if in my view wrong-headed, articulation of the argument that Delaware's judiciary were putty in managers' hands is, of course, William L. Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 YALE L.J. 663 (1974). Cary's view has since been largely supplanted by a more positive view of Delaware's approach to corporate law. See, e.g., ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993).
21. To say that judges on the Delaware Court of Chancery and the Delaware Supreme Court feel a special responsibility to expertly adjudicate corporate cases is an understatement. That responsibility is manifested in, among other ways, a regard for the preeminence of the General Assembly in making corporate law and a respect for the precedent handed down by previous generations of corporate law judges in Delaware. The strong emphasis of both the DGCL and previous judicial decisions on respect for disinterested business judgments provides an important source of reference that counsels restraint by Delaware judges.
the particulars were everything and for a good reason. There exists an implicit, but I think unmistakable, corollary to the rule of Schnell. To wit, if the General Assembly has declared certain acts lawful, presumably there must be circumstances in which those acts would be equitable; otherwise, why permit the acts at all? Fidelity to this corollary requires the judiciary to eschew the formulation of per se rules in equity. To declare, for example, that directors may never do X and Y, when X and Y are clearly authorized by the DGCL, is to undermine the genius of the Delaware way, by narrowing the wide freedom of action our statute affords to directors. Only when a court could say that the directors were taking actions X and Y for an improper purpose (such as the desire to enrich themselves at the expense of the corporation) could the court intrude by using its equitable powers.

And, at least until Smith v. Van Gorkom, the equitable overlay to the DGCL almost never involved judicial inquiries into whether legally permissible conduct resulted from a lack of due care. Rather, equity’s role in corporation law was to police disloyalty—acts of any kind that were motivated by an end other than the best interests of the corporation and its stockholders. Because most acts of disloyalty are inspired by personal self-interest, equity did (many would say, appropriately) little to constrain director action outside the realm of self-dealing transactions or election contests. The idea, that a mere mistake in judgment by a director could support the imposition of personal liability, threatened to impede valuable risk-taking and was viewed by some, like Learned Hand in a famous non-Delaware corporate law case, as unfair because it would give stockholders more than they bargained for from the elected director.

25. For a strong academic brief in support of that position and of the idea that the business judgment rule is designed precisely to keep courts from second-guessing directors for being careless, see Bainbridge, supra note 24.
26. To wit, consider these well-known words of Learned Hand:

True, he was not very suited by experience for the job he had undertaken, but I cannot hold him on that account. After all, it is the same corporation that chose him which now seeks to charge him.... Directors are not specialists like lawyers or doctors.... They are the general advisors of the business, and if they faithfully give such ability as they have to their charge, it would not be lawful to hold them liable. Must a director guarantee that his judgment is good? Can shareholders call him to account for deficiencies which their votes assured him did not disqualify him for his office? While he may not have been the Cromwell for that Civil War, Andres did not engage to play any such role.

III. THE EMERGENCE OF AN ACTIVE MERGERS AND ACQUISITIONS MARKET INSPIRES THE CREATION OF NEW FORMS OF EQUITABLE REVIEW, BUT THE BASIC LAW-EQUITY DIVIDE IS PRESERVED

In the late 1970s and early 1980s, Delaware corporate law confronted the birth of an active market for corporate control. The advent of the hostile takeover era put in play, not only many American companies, but also the question of the balance of power between law (i.e., the DGCL and corporate instruments) and equity (i.e., the fiduciary duties of directors) in addressing this new market phenomenon.

At the end of a series of important cases, the basic law-equity divide survived largely intact. That said, from this period of doctrinal development emerged important new standards of equitable review that accompanied expansive judicial interpretations of the DGCL. These interpretations read the statute as giving directors extremely broad authority to resist a takeover. But that breadth of authority was tempered by new forms of equitable review that constrained directors' ability to use this capacious authority for improper purposes or, as we shall see, in a sloppy manner.

I will illustrate this evolution through a discussion of three key cases. The first is the famous case of Smith v. Van Gorkom. As you might recall, the board of Trans Union had agreed to a merger whereby the company's stockholders would receive a price that was a substantial premium over the highest price the company's shares had traded during the preceding five years. If ever there were a relatively low-risk, high benefit transaction, it was that one. But, as we all know, the Trans Union directors, the majority of whom were distinguished, independent directors, eventually suffered a stinging judgment at the hands of the Delaware Supreme Court. Speaking through Justice Horsey, the three-member majority excoriated the directors for their failure to address the proposed merger in a careful manner, labeling their conduct grossly negligent and exposing them to damages liability on the assumption that the company would have sold at an even higher price had the directors acted more carefully and conducted (what the majority considered to be) an effective market check.

Van Gorkom has been the subject of an immense legal literature and my intent is not to retread that ground. Rather, my focus is on the effect Van Gorkom had on directors' freedom of action as fiduciaries. By putting real teeth in the duty of care, the Delaware Supreme Court necessarily expanded equity's relative importance in our corporate law. Because the Court was prepared not only to enjoin lawful acts that resulted from gross negligence, but to award damages against the directors for acts of fiduciary sloppiness, the Court increased, by judicial mandate, the procedural steps directors must take in the M & A context to avoid personal

27. Van Gorkom, 488 A.2d 858.
28. Id. at 866 n.5.
liability and to perform certain legally-authorized acts competently. Although this heightened form of review expanded the scope of equity's reach, as well as the consequences for equitable violations through inattention, nonetheless, it remained clear that otherwise lawful action would not be enjoined unless the Court found a breach of duty in the particular circumstances of a case. However controversial Van Gorkom was, it did not draw bright-line rules in the name of equity.

Equally important in delimiting the respective domains of equity and law were the landmark rulings in Unocal Corp. v. Mesa Petroleum Co.30 and Moran v. Household Int'l., Inc.31 These cases are closely related.

In Unocal, the first of these two cases to be decided by the Delaware Supreme Court, the issue was whether Unocal's board could proceed with a two-tiered, front end loaded tender offer for its own securities—a tender offer that was available to all Unocal stockholders except Mesa, which was controlled by one T. Boone Pickens. The motivation for the self-tender was to fend off Pickens' hostile and coercive two-tiered tender offer by giving stockholders a higher-priced (if still structurally coercive) alternative.

The Court of Chancery viewed Unocal's offer as discriminatory against Mesa, and as requiring justification under the entire fairness standard. Because the Unocal directors and all other stockholders than Mesa were allowed to benefit, the Court of Chancery concluded that Unocal's board was pursuing a self-interested transaction and had to prove that the transaction was entirely fair to Mesa.32 Although the Court of Chancery did not conclude that the discriminatory nature of the offer made it per se illegal, the Court arguably came close. The reason is relatively simple: if Mesa had to be treated fairly in the transaction, how could Unocal do so while excluding Mesa from the self-tender?33

On appeal, the Supreme Court took a starkly different approach. It brushed aside any argument that the provisions of the DGCL authorizing boards to manage the corporation’s “business and affairs”34 and to deal in the company's own stock35 were not intended to empower boards to make defensively motivated, discriminatory tender offers, stating:

[O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs. Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited.36

33. Perhaps for this reason, Unocal did not even attempt to prove that it was acting fairly towards Mesa, hanging its hat on its argument that protecting the corporation and the other stockholders from Mesa was a sufficient justification for its actions. See 1985 WL 44691, at *7 (noting that Unocal put in no evidence of the fairness of the transaction).
36. Unocal, 493 A.2d at 957.
Through this ringing language, the Court signaled that it would not use statutory interpretation to constrain directors' ability to respond to takeover bids even though that capacious statutory language was likely never originally intended to add to the arsenal of entrenching tools available to corporate directors.

Instead of law—in the guise of statutory interpretation—it was equity that would act when necessary to guarantee that boards reacted to takeover bids in a responsible manner. Crafting an innovative new middle ground and specifically citing the maxim of *Schnell*, the Court subjected defensive measures to a form of reasonableness review, which required boards to demonstrate that their defensive actions addressed a legitimate threat to corporate interests and were proportional to that threat. The Supreme Court therefore tightened the screws on corporate boards, by ratcheting up the judicial standard of review from the lax test of bare rationality, to the stricter form of reasonableness review used to review actions by other fiduciaries, such as trustees. Importantly, the Court also created a powerful incentive for vesting power in the independent, non-management directors, by indicating that boards with a majority of such directors (or by implication, which entrusted the full power of the board to a special committee of such directors) would be given extra credit towards meeting their burden to demonstrate the reasonableness of their defensive response. In this manner, the Court sought to minimize the "omnipresent specter" that self-interest would pollute board responses to takeovers.

The timing of the decision in *Unocal* is important to understanding the case that followed it, *Moran v. Household Int'l, Inc.* *Moran*, of course, involved the question of whether a board of directors could issue so-called shareholder rights, the only business purpose of which was to make it prohibitively expensive for a bidder to proceed with a tender offer. Stated very simply, the so-called rights had the practical effect of diluting the acquirer if it triggered the rights plan, causing it to waste its money massively in a fruitless effort to get all the shares. The bonanza to the other stockholders, however, was unlikely to ever result, because, if well-designed, the rights plan would inhibit any acquirer from consummating its tender offer unless the target board agreed to redeem the rights. The drastically toxic effect of a well-deployed rights plan on any bidder who dared trigger it, earned it a more colorful moniker in the M&A lexicon—the poison pill.

In *Moran*, the two greatest corporate lawyers of the post-war era, Joseph Flom and Martin Lipton, squared off. Lipton, the inventor of the poison pill—a name he despised, but that seems entirely apt to me—defended the legality of his invention. Flom's team attacked it.

For present purposes, the key is to understand the central basis of the statutory challenge to the pill. In essence, Flom's squad argued that the variety of statutory

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37. *Id.* at 955 (citing *Schnell*, 288 A.2d at 439).
38. *Id.* at 954–56.
39. *Id.* at 958.
40. *Id.* at 954.
provisions\textsuperscript{42} that Lipton pointed to as authoring the issuance of a rights plan were being subverted.\textsuperscript{43} These statutes were intended, they asserted, for legitimate business purposes such as raising capital to fund new projects. They were never intended to permit a board to issue illusory "rights" (which did not actually serve a business purpose or provide stockholders with valuable economic benefits) simply to invest the board with the ability to preclude, and therefore effectively veto, a hostile tender offer. By improperly exploiting these statutes, the Household board obtained a role in tender offers that was nowhere articulated in the DGCL, which was—and remains—entirely silent about tender offers. Relatedly, Flom's side contended that the discriminatory nature of the pill, which singled out the bidder for invidious treatment, undermined the device's viability on both statutory and equitable grounds.

The Court of Chancery rejected all of these arguments, in a well-reasoned, if debatable decision.\textsuperscript{44} I am not going to dilate on the Court of Chancery's approach, however, because what is more important is what the Supreme Court did when this important case came to it on appeal. Moran was argued on May 21, 1985. Unocal was decided less than a month later. Once Unocal came out, doubtless both Flom and Lipton sensed what would happen to the Moran appeal—which is that the poison pill would be upheld. And so it was. When Moran came out in November 1985, it predictably cited Unocal heavily. Unocal's authorization of discriminatory defensive responses defanged one of Flom's main attacks on the pill. And Unocal's broad approach to statutory interpretation doomed his argument from statutory intent. Citing specifically to Unocal, the Moran court reiterated that:

\begin{quote}
[O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs. Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited.\textsuperscript{45}
\end{quote}

Instead of law, it would be equity in the form of the new reasonableness review set forth in Unocal that would check boards if they misused their broad statutory power.\textsuperscript{46}

These cases set the stage for takeover disputes to come, in which very little of the action centered on the legal authority of boards. Rather, the key disputes were about whether legally permissible actions were, in the particular circumstances, equitable in the sense that they were not tainted by a breach of fiduciary duty, not only in the traditional sense that their action did not involve any breach of the duty of loyalty, but in the more novel senses of not involving unreasonable

\textsuperscript{42} E.g., Del. Code Ann. tit. 8, § 151 (authorizing issuance of preferred stock); Del. Code Ann. tit. 8, § 157 (authorizing issuance of rights or options in company stock).

\textsuperscript{43} Moran, 500 A.2d at 1351.

\textsuperscript{44} See Moran v. Household Int'l Inc., 490 A.2d 1059 (Del. Ch.), aff'd, 500 A.2d 1346 (Del. 1985).

\textsuperscript{45} Moran v. Household Int'l Inc., 500 A.2d 1346, 1351 (Del. 1985) (quoting Unocal, 493 A.2d at 957).

\textsuperscript{46} Id. at 1357.
defensive tactics barred by *Unocal* (or the related case of *Revlon v. MacAndrews & Forbes Holdings, Inc.*47), or grotesque sloth as illustrated by Van Gorkom. Importantly, even when a court was deploying the tightened reasonableness standard, its ability to strike down lawful action required it to identify expressly why the directors had acted unreasonably in the circumstances and therefore breached their fiduciary duties.

The more familiar concern arising out of this era's cases goes as follows. By reading the DGCL so broadly, the Delaware courts left stockholders more dependent than ever on the strength of equitable review. If the new focus of review became, in fact, just a gussied-up version of hands-off business judgment rule review, then stockholders would lose out on valuable opportunities at the instance of boards wielding the pill and other defensive devices.48 That aspect of the overall story is, however, not my focus.49

Here, I instead focus on a different danger of the particular law-equity divide that exists in Delaware Corporate law, one that is less a topic of obsession among corporate law scholars. That danger is that judges, being vigilant to act as a bulwark against inequity, will confuse their authority to make case-specific equitable rulings, with a more generalized power to declare, in equity, that legally authorized conduct is nevertheless in all circumstances forbidden. I will now look to three important cases to illustrate this less talked-about danger.

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47. *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (setting forth duty of reasonableness owed by boards when they decide to sell or break up the company).


49. By not focusing upon that aspect of the history, I do not mean to slight the importance of that topic. Thoughtful commentators sincerely believe that the Delaware courts have been unfaithful to both law and equity in addressing the poison pill. In this conception, the Delaware courts stretched the fabric of the DGCL (i.e., of the law) in *Moran* to hold the pill valid and then reneged in later case law on their promise to hold boards accountable for their proper use of the pill through the *Unocal* form of review (i.e., through equity). An incisive example of a critique of this kind is Ronald J. Gilson, *Unocal Fifteen Years Later (And What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 497, 510, and passim (2001) (describing the Supreme Court's validation of the pill in *Moran* as "quite activist" and as involving a judicial "stretching" of § 157 of the DGCL, and contrasting that with what the author perceives to be the abandonment of any genuine, heightened scrutiny of the pill's use, in favor of funneling all takeover battles into the election context). In particular, Gilson and others remain dissatisfied with the Delaware courts' refusal to set stricter limits on boards' ability to deploy a pill indefinitely to block an unconditional premium, all cash, all shares, tender offer. Id.; see also Lucian A. Bebchuk, John C. Coates IV, & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002) (arguing that once a board has lost one takeover-offer centered election, even for a minority of the board, Delaware courts should require the board to redeem the pill for a non-coercive bid).
IV. STOPPING JUST SHORT OF CROSSING THE LINE: BLASIUS AS AN EXAMPLE OF THE JUDICIAL TEMPTATION TO USE EQUITY TO INTRUDE ON LAW’S DOMAIN

The temptation to blur the line between law and equity re-emerged prominently in the important case of Blasius Indus. Inc. v. Atlas Corp. Now, this is a decision written by a jurist for whom I have the utmost respect, my friend, former Chancellor and now Professor, William T. Allen. Bill is open-minded and thick-skinned enough not to be offended by a provocative critique of the decision’s outcome. I say provocative because the opinion’s stirring rhetoric about the sanctity of the corporate election process has the tendency to distract the reader from certain key facts that arguably open the judgment to question on doctrinal grounds.

To refresh you, in Blasius, the Atlas board was comprised of seven directors. By charter—that is, by the corporation’s constitution—its board was to be staggered. Through inattention, however, the effectiveness of the classified board structure had not been competently protected. The charter of the company provided for up to fifteen directors. With only seven directors in office, however, the company was left vulnerable to a proxy solicitation to (1) amend the company’s bylaws, (2) increase the size of the board to fifteen, and (3) elect eight new board members—a new majority. If, before a raider came along, the Atlas board had exercised its authority to increase the size of the board and to fill the new vacancies, it could have, without controversy, fixed this defensive weakness that undermined the intended protection provided in the corporate charter.

Instead, the raider emerged before the board fixed the problem. And not just any raider arrived: it was not Warren Buffett making an all-cash, all-shares offer. Rather, Blasius Industries showed up, touting a highly speculative plan to pay the Atlas stockholders immediate cash upfront with the promise of additional reward later, in the form of a pay-off on debentures, if a highly risky, leveraged business strategy panned out.

The Atlas board was in the midst of executing its own well-planned corporate restructuring strategy, premised on focusing the company’s operations on its gold mining business. As Chancellor Allen held, the board was legitimately troubled by Blasius’s bid, believing it to be a reckless and imprudent strategy that was not in the best interest of the company’s stockholders, and that could render the company insolvent and leave its common stock worthless. In his understated way, Chancellor Allen expressly found that the board’s perspective, that the Blasius plan would cause “great injury,” was reasonable, stating that he was personally “inclined to think it was not a sound proposal.”

Recognizing that the earlier failure to attend to the classified board structure gave Blasius an opportunity to select a new board majority and implement its
plan through a consent solicitation, the Atlas board acted to, as my colleague Steve Lamb would put it, fix the "wounded bird."55 They filled two vacancies on the board with persons who Chancellor Allen concluded were well-qualified and independent.

But, of course, the effect of the board’s action was to stymie Blasius’s opportunity to elect a new board majority, except by fighting through the classified board structure and winning not one, but two elections, over a more extended time frame. Blasius challenged this action. Its challenge provided Chancellor Allen with a doctrinal dilemma. As he understood the rule of Schnell, he could not invoke that case’s maxim to enjoin the board’s appointment of two new members. Why? Because Chancellor Allen was convinced that the Atlas board was acting, not selfishly to entrench themselves for their own benefit, but in the good faith belief that Blasius’s plans were injurious to Atlas and its stockholders.56

Chancellor Allen extracted himself from this quandary by positing that the question before him was more one of power allocation than of situational equity. To wit, his ringing words:

The real question the case presents, to my mind, is whether, in these circumstances, the board, even if it is acting with subjective good faith (which will typically, if not always, be a contestable or debatable judicial conclusion), may validly act for the principal purpose of preventing the shareholders from electing a majority of new directors. The question thus posed is not one of intentional wrong (or even negligence), but one of authority as between the fiduciary and the beneficiary (not simply legal authority, i.e., as between the fiduciary and the world at large).

* * *

The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.

* * *

A board’s decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of the corporation’s power over its property, or with respect to its rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation.

* * *

Judicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal. This is not, in my

55. Under the "wounded bird" theory Vice Chancellor Stephen P. Lamb coined and the two of us have often discussed, corporate law cases often involve situations when directors, by failing to heal the wounded bird before hunting season, must stand before the hunter defenseless, because once hunting season starts, healing action that would otherwise be permitted is often deemed improper.

opinion, a question that a court may leave to the agent finally to decide so long as he does so honestly and competently; that is, it may not be left to the agent's business judgment.

* * *

The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters.57

Now, for the provocative critique, not of the sentiment behind these words, but of their relevance to the case Chancellor Allen was actually deciding. In the republic of Atlas, in what genuine sense can the Atlas board be said to have offended the fundamental electoral scheme of the polity? After all, the constitution of Atlas called for a staggered board, thereby envisioning that anyone who wished to change the policy of the company through replacing a majority of the board, would have to win, not one, but two elections. Likewise, the governing instruments of Atlas expressly permitted the Atlas board to fill vacancies and for directors they appointed to serve unexpired terms in accord with the classified board structure.

The question therefore, is whether this was really an apt case to premise a ruling on power allocation or the vindication of a system of corporate democracy. For one thing, it was clear to Chancellor Allen that the Atlas board's primary purpose was not to prevent the election of a new majority so as to keep their jobs—it's primary purpose was to prevent Blasius' dangerous plan. Fixing the "wounded bird" was the instrument to that primary end. The Atlas board deprived Blasius of no legal right; it merely closed off an opportunity that had dropped in Blasius's lap because of the Atlas board's prior inattention. Moreover, Blasius knew that by Atlas's charter and bylaws, the Atlas board was empowered to do just what it did.

To illustrate why this contrarian reading should not be seen as un-American, consider this political analogy. Imagine that a state—let's say California—has two Democratic senators and a Republican governor. The United States Senate has two more Democratic than Republican members and there is a Republican President and Vice President. One of the California's senators dies with three years left on his term. By the state's constitution, the vacancy can be filled, at the governor's option, in one of two ways. She can declare a special election to fill the seat for the remainder of the unexpired term or she can fill the seat herself, by appointment, for the same period. The governor chooses the second option and appoints a Republican to fill the seat eliminating the Democrats' numerical advantage in the U.S. Senate. A lawsuit is filed and alleges that the governor's appointment should be set aside because, by using her legal power, she disenfranchised the electorate that could have voted to elect a Democrat if it wished. Do any of us think this lawsuit would stand any chance of succeeding? And, if

57. Id. at 658–663 (emphasis in original).
we do not, why is it that courts should look behind the law in the context of corporate elections but not those in actual politics?58

For present purposes, the key point is not whether one might reasonably contend that Chancellor Allen should have upheld the Atlas board's action.59 More pertinent here is how he instinctively respected the law-equity divide. Although dubious about whether a board could ever, in his words, act for the primary purpose of disenfranchising the electorate, Chancellor Allen refused to give into the impulse to say the word "never" about conduct that was legally permissible. He therefore specifically declined to "invalidat[e], in equity every board action taken for the sole or primary purpose of thwarting a shareholder vote . . . ."60 Instead, he crafted a stringent test that permitted a board to purposely impinge on the stockholders' ability to elect a new board if the board could show a compelling justification for its decision.61 This admittedly onerous standard, redolent of the constitutional tests used to evaluate governmental restrictions on free speech or racial classifications,62 was nonetheless theoretically passable.

As a result of Chancellor Allen's principled refusal to craft a per se rule prohibiting certain legally permissible conduct in all situations, he enabled the common law process of adjudication to shape the rule he announced into a more

58. The actual experience in New Jersey involving Governor James E. McGreevey is a real world example. In that situation, McGreevey announced on August 12, 2004, his intention to resign, effective November 15, 2004. McGreevey timed the effective date of his resignation from office precisely in order to ensure that under the New Jersey Constitution, his successor, the President Pro Tempore of the New Jersey Senate, who was also a Democrat like McGreevey, would serve in office until the next regularly scheduled gubernatorial election. Had McGreevey actually departed from office at the time of his announced decision to resign or up until sixty days before the upcoming 2004 legislative elections, a special election for governor would have been held on November 2, 2004, to fill the gubernatorial vacancy. A challenge to McGreevey's conduct was filed in the United States District Court for the District of New Jersey and rejected. Afran v. McGreevey, 336 F. Supp. 2d 404 (D. NJ.) (holding, at the pleading stage, that because McGreevey's decision to announce his resignation but to delay his actual departure from office complied with New Jersey statutory and constitutional law, and did not create a vacancy until he actually left office, there was no unconstitutional disenfranchisement of the electorate in violation of the fourteenth amendment's due process clause), aff'd, 2004 WL 2309897 (3d Cir. 2004).

59. Blasius also must be read in the context of the jurisprudential environment in which it was issued. At that time, it seemed possible, if not probable, that Chancellor Allen's decision in City Capital Assocs. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988), which articulated limits on a board's ability to use a poison pill to block an all cash, all shares bid beyond the time necessary to find or negotiate a better deal, or to inform the stockholders of the board's views about the bid's inadequacy, might not find favor with the Delaware Supreme Court. Blasius might therefore be viewed as sending a strong message that boards could not, in addition to blocking tender offers directly through the pill, also close off the other viable, but indirect, route to an acquisition, through the ballot box. The fear that Interco would not be endorsed by the Supreme Court, of course, came true, through the emphatic, if factually inaccurate, dictum criticizing Interco in Paramount Communications, Inc. v. Time Inc. 571 A.2d 1140, 1152–53 (Del. 1990) (inaccurately indicating that Interco hinged on Chancery striking down defenses when it thought a pill-stymied tender offer was the better option for stockholders, as opposed to holding that stockholders eventually have to be permitted to decide for themselves whether it was better to accept or reject a structurally, non-coercive tender offer).

60. Blasius, 564 A.2d at 662.

61. Id. at 661–62.

workable and livable one. Most important, because Chancellor Allen did not say "never," he did not erect an ethical barrier for boards or practitioners that prevented them from taking legally authorized actions affecting the election process, if they viewed that as necessary to protect the corporation and its stockholders. Although Blasius obviously taught boards and their advisors that they must be very careful in the election context, if left open to them to act so long as they were prepared to justify, in a situationally specific way, their behavior. In other words, whether or not it can be argued that the Atlas board's actions were wrongly set aside by the Blasius decision, that decision did not totally inhibit future conduct, as the subsequent cases applying Blasius demonstrate. In this manner, Blasius remained fundamentally faithful to the law-equity divide by refusing to enact, in equity, a per se rule equivalent to a statutory ban.

In the period following this takeover boom of the 1980s, the Delaware Supreme Court became, if anything, more careful to police the law-equity divide and limit equity's intrusion on law's domain. As Justice Jack Jacobs recently described in an excellent address at the UCLA School of Law, on several occasions the Delaware Supreme Court emphasized to the Court of Chancery in the early 1990s the importance of using its equitable powers with great care. When a board acted in compliance with law—that is, in compliance with the DGCL and the corporation's governing instruments—the Supreme Court said that equity should only intrude in "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." "The invocation of equitable principles to override established principles of Delaware Corporate Law must be exercised with great caution and restraint . . . ." “Otherwise, the stability of Delaware law is imperiled.” As Justice Jacobs aptly summarized, by these words, the “Supreme Court was sending a clear message that if there is a conflict between equitable principles and clear, bright line rules of corporate law, law trumps equity.”

Less explicitly, the Supreme Court also cabined equity's role during this era by tempering its decision in Van Gorkom through later case law and by emphasizing


66. Id.

67. Id.

68. Jacobs, supra note 64, at 23 (citing to, among other things, Waggoner v. Laster, 581 A.2d 1127, 1131 n.2 (Del. 1990) to illustrate this point). These broad statements in the strand of cases that Justice Jacobs cites, if read literally, illustrate the flip-side of the danger I focus upon in this article. If the equitable concepts of fiduciary duty really only preclude the grossest kind of fraud, when directors undertake transactions that are in compliance with statutory law, then the integrity-enforcing role of equity that permits the responsible deployment of a broad, enabling statute will be undercut. Schnell's tradition cautions against a literal reading of the quoted language, which is better read as manifesting a recognition that equity should not lightly impede actions authorized by law. The relationship between law and equity is never fully settled, as their synergistic operation is an important manifestation of our polity's continued struggle to define and do justice.
that the heightened reasonableness standards of Revlon and Unocal did not permit the judiciary to overturn a board's decision, so long as that decision was among the reasoned courses of action available under the circumstances.\textsuperscript{69} No mere quibble about the reasonableness of a board's conduct would suffice to displace its legally authorized acts.

V. WHEN PRACTITIONERS PUSH THE ENVELOPE, THEY CREATE THE CONDITIONS MOST CONDUCIVE TO JUDICIAL EROSION OF THE LAW-EQUITY DIVIDE

Because the Delaware judiciary sustained the use of the poison pill and other defensive devices permitting directors to block shareholder access to tender offers, it is natural to think that our judges, in good faith, will be particularly offended when they see practitioners go even further, and devise even more far-out anti-takeover measures. When confronted with what appears to be outrageous abuses of statutory freedom, the judiciary is most vulnerable to declaring, in equity, bans that the General Assembly did not enact via statute.\textsuperscript{70}

As the new century approached, the Delaware Supreme Court issued a decision, which although uncontroversial in its outcome, well illustrates the temptations created by these circumstances. In Mentor Graphics v. Quickturn,\textsuperscript{71} a bidder chal-

\textsuperscript{69}. In this regard, see, e.g., Barkan v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989) (stressing the different ways that boards could meet their Revlon duties); Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994) (emphasizing that so long as the board took one of the reasonable approaches available, the court should not overturn its action under Unocal or Revlon); Unitrin, Inc. v. American General Corp., 651 A.2d 1361, 1388 (Del. 1995) (same, under Unocal). Notably, the General Assembly also put limits on the application of Van Gorkom through the adoption in 1986 of the well-known provision, DEL. CODE. ANN. tit. 8, § 102(b)(7), 65 Del. Laws ch. 289 (1986), allowing a corporation to limit directors' personal liability for negligent and grossly negligent fiduciary breaches.

\textsuperscript{70}. It would be hypocritical for me not to acknowledge that these temptations do not afflict me, too. In ACE Ltd. v. Capital Re Corp., 747 A.2d 95, 107 (Del. Ch. 1999), I expressed suspicion about the circumstances in which it would be equitable for a board to sign up a merger with a "force the vote" provision knowing that a sufficient number of the votes were locked up by a voting agreement such that, even if the board, changed its recommendation, the merger would almost certainly be approved. Under the facts of Ace itself, however, I concluded that one could not read a merger agreement to lack a fiduciary out in favor of a more favorable deal, when it specifically included reference to an out and when the stockholders' voting agreement was not enforceable if the board exercised the out in the merger agreement. In the course of ruling on the specific issue in the case, some have said that I used some language in my rapidly crafted decision that was perhaps overbroad. That is a fair, if arguable, perspective and it is incontestable that in Ace I signaled a concern about the use of this potent combination of statutorily-authorized techniques when there was not an important business justification. The decision, however, expressly refrained from saying never, and even articulated circumstances in which one could imagine that the combination of a force the vote merger provision and a voting agreement irrevocably binding a controlling block of shares would be equitable and therefore protected from judicial censure. \textit{id.} at 107 n.36.

In the same vein, Chancellor Chandler issued a strong warning signal about the upward creep of termination fees in his important bench ruling in Phelps Dodge Corp. v. Cyprus Amex Minerals Co., 1999 WL 1054255 (Del. Ch. Sept. 27, 1999). In that ruling, he indicated that a termination fee of 6.3% "seems to stretch the definition of range of reasonableness and probably stretches the definition beyond its breaking point." \textit{id.} at *2. But he stopped short of saying that a fee of that size could never be justified.

lenged the sustainability of a delayed redemption or slow-hand (Eric Clapton) poison pill. The specific slow-hand in question prevented any Quickturn directors other than so-called continuing directors—that is, the incumbent board or their hand-picked successors—from redeeming the pill during their first six months in office. The slow-hand was combined with a bylaw amendment delaying any stockholder-called special meeting for 100 days. Therefore, the combined effect of the dual devices was such that it would take Mentor Graphics, which sought to purchase Quickturn by winning a proxy fight and electing a new board, at least nine months to do so, regardless of how attractive the electorate found its offer.

In the Court of Chancery proceedings, then-Vice Chancellor Jacobs enjoined the slow-hand pill, finding that its use, in combination with the bylaw delaying the meeting, was an unreasonable response to Mentor Graphics' bid and failed the Unocal test. Vice Chancellor Jacobs consciously decided not to decide whether a slow-hand of some duration (say 30 days) might be equitable in some circumstances. Nor did Vice Chancellor Jacobs analyze whether the slow-hand was proscribed by statute, although he was asked to do so. Instead, he declined to issue a broad pronouncement, concluding that it was both unnecessary and, given the state of the record, imprudent.72

When the case went to the Supreme Court on appeal, the Supreme Court affirmed but on distinctly broader grounds. In a sweeping opinion, the Court concluded that the slow-hand pill was per se invalid. The reasoning rested primarily on the Court's reading of §141(a) of the DGCL, which states that:

The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.73

Because the slow-hand had the effect of disabling a newly elected board from redeeming the pill during their first six months in office, the Court held that:

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. The Quickturn certificate of incorporation contains no provision purporting to limit the authority of the board in any way. The Delayed Redemption Provision, however, would prevent a newly elected board of directors from completely discharging its fundamental management duties to the corporation and its stockholders for six months. While the Delayed Redemption Provision limits the board of directors' authority in only one respect, the suspension of the Rights Plan, it nonetheless restricts the board's power in an area of fundamental importance to the shareholders—negotiating a possible sale of the corporation. Therefore, we hold that the Delayed Redemption Provision is invalid under Section

72. Id., 728 A.2d at 52 n.105.
141(a), which confers upon any newly elected board of directors full power to manage and direct the business and affairs of a Delaware corporation.\footnote{Quickturn, 721 A.2d at 1291-92 (citations omitted) (emphasis in original).}

Although the Court was rightly suspect of this type of obvious entrenchment device, its broad reasoning raised eyebrows by implying that no past board could take action that would bind a future board.\footnote{In an interesting article, Professor Stephen Bainbridge has argued, for reasons that are animated by the same general spirit as inspires these remarks, that Quickturn, if read broadly, would restrict boards from taking certain actions, so called pre-commitment strategies, that might benefit stockholders. Stephen M. Bainbridge, Precommitment Strategies in Corporate Law: The Case of Dead Hand and No Hand Pills, 29 J. Corp. L. 1 (2003). Although that article sets forth arguments that I find resonant, it is, in my view, a tad too unsympathetic to the natural concerns that Delaware courts have when boards disable themselves (particularly unilaterally) from accepting a third party acquisition bid. Because directors, through self-created poison pills, have rendered stockholders unable to accept tender offers without board assent or judicial injunction, board action that prevents the board from facilitating acceptance of a bid is rightly subject to heightened scrutiny. The legitimate risk that Bainbridge identifies is that the courts will overreact, and instead of policing unreasonable board behavior, will more broadly restrict the decision-making authority of boards in general.}

Problematically, many third-party contracts that boards enter into raise this same specter. For example, what if a trucking company's board entered into a five year agreement to buy fuel from a single, exclusive supplier at a set price?\footnote{It is possible, of course, to attempt to distinguish Quickturn from this example by reading Quickturn as focusing on a type of pill that limited who could redeem the pill. But that ground for invalidity is arguably much narrower than the opinion's language emphasizing the need for the board—seemingly regardless of however it is composed—to retain managerial freedom, especially when that language is read in concert with the later Omnicare decision. See infra note 79 and accompanying text. Furthermore, if the answer to the long-term contract issue is that the later board can breach the contract, is that different from a newly elected board announcing its efficient breach (by abrogation) of a slow-hand pill? In this regard, would it be possible, under Quickturn, for a board to agree to a merger agreement provision precluding the redemption of a pill by the board (be it comprised of current or successor directors) for six months after the merger agreement terminated?} Would that contract violate § 141(a) because a new board did not have the freedom to choose another strategy to get fuel? Implicitly, the Quickturn opinion seemed to presage that its broad statements were really very narrowly focused on the use of an extraordinarily aggressive form of that still controversial and extraordinary innovation—the poison pill. To wit, the language of the opinion that stressed that "negotiating a possible sale of the corporation" was "an area of fundamental importance to the shareholders,"\footnote{Quickturn, at 1291-92.} suggested that the powerful rhetoric was limited to that specific circumstance. Relatively, the Quickturn Court was mindful that the original decision in Moran sustaining the equity of the household pill was premised on the stockholders' ability to bypass the pill through a proxy contest or by obtaining an injunction against a board's failure to redeem a pill as unreasonable under Unocal.\footnote{Id. at 1291.} If neither option was open, then it was hard to conceive of the slow-hand pill being reasonable.

The uniqueness of the poison pill—a device whose only function is to block a bid and that is unilaterally created by a board—could therefore be thought to explain Quickturn. But even though there were arguably much narrower statutory grounds for invalidating the slow-hand pill—i.e., that the slow-hand pill created...
classes of directors with different powers but not by the required means of a charter amendment—the overbreadth was not very problematic. After all, the equitable justification for a slow-hand of any but the smallest length was hard to perceive, resting solely on the proposition that no new board could be trusted to act with proper care and fidelity. That a current board would, through unilateral action and in exchange for no consideration from a third party to the company, disable successor boards does seem hard to conceive of as ever being equitable.

The problem for the narrower reading of Quickturn arises out of the last case I will discuss—the controversial case of Omnicare, Inc. v. NCS Healthcare, Inc.80

VI. OMNICARE: THE JUDICIARY CRAFTS A PER SE RULE OF EQUITY

The key facts of Omnicare, as found by Vice Chancellor Lamb, go like this. NCS Healthcare, Inc. was a troubled company that provided pharmacy services to healthcare and nursing home facilities. By standard measures, it was insolvent by 2001, being in default on $350 million in debt.81 It had two classes of stock, one of which had 10 votes per share. The company's chairman, John Outcalt, and its CEO, Kevin Shaw, together owned the largest equity stake in the company and controlled a majority of the voting power.

For an extended period, the NCS board, with the help of two different financial advisors, sought a buyer or merger partner to guarantee full repayment to the company's creditors and, it was hoped, some return to the equity. During this process, another industry competitor, Omnicare, was contacted and asked if it had any interest. Omnicare declined, expressly indicating on more than one occasion its desire to acquire NCS in bankruptcy, where it would not have to pay the equity holders at all and would not make full repayment to the creditors.82

By 2002, NCS's performance improved somewhat and it hoped to secure a deal with some value for its equity holders. The company was still in serious default, however, and thus the NCS board felt they owed duties to NCS as an enterprise, not just to the common stockholders. Therefore, they created a special committee of independent directors to consider transactions for NCS. The special committee excluded Outcalt and Shaw.83

79. See Del. Code Ann. tit. 8, 141(d); Carmody v. Toll Brothers, Inc., 723 A.2d 1180, 1190–91 (Del. Ch. 1998) (The decision notes, in discussing a dead hand pill, that § 141(d) only permits voting power distinctions among directors if there is a staggered board and if the distinctions are "expressed in the certificate of incorporation." Further, the right to elect directors with disparate powers is reserved to shareholders and cannot be accomplished by "unilateral board action."); see also, Jeffrey N. Gordon, "Just Say Never?" Poison Pills, Deadhand Pills and Shareholder-Adopted Bylaws: An Essay for Warren Buffett, 19 Cardozo L. Rev. 511, 537 (1997) (arguing that a dead hand pill is inconsistent with § 141(d)).
82. Id., at 245–47. Omnicare was a competitor of NCS and conducted sales "blitzes" to try to lure away NCS's customers. Id. at 246 n.3.
83. Id. at 247.
NCS found one credible bidder, Genesis Health Ventures, Inc. Genesis was not willing to be a mere stalking horse for a later auction, however. But Genesis was willing to buy NCS at a price that guaranteed nearly full repayment to the creditors and $20 million for the stockholders, with the same per share price going to the controllers as the other stockholders. Late in NCS's bargaining process with Genesis, Omnicare reemerged and suggested that, contrary to its earlier refusal to discuss a deal, it might now be a non-bankruptcy bidder. Genesis was not well pleased. It indicated that it would walk unless NCS gave it a locked-up deal whereby the NCS board would put its merger agreement to a vote and the controllers would agree to cast their votes for their deal. This presented the NCS board with a real dilemma because Genesis's threat to depart seemed genuine as it was fueled in part by a prior bad experience when it lost an acquisition bid to Omnicare late in an M&A contest. The NCS board, faced with this difficult situation, explored whether Omnicare would make a firm bid. Omnicare refused, claiming a need to do due diligence—diligence that it could have conducted much earlier when it was initially invited to bid.

Nonetheless, the NCS board used Omnicare's last-second overture to extract important concessions from Genesis. These included an 80% percent increase in the exchange ratio for the NCS equity holders and a commitment to pay off the NCS noteholders in full. But Genesis did not want to lose another deal to Omnicare and still insisted on receiving (1) a voting agreement from Outcalt and Shaw, (2) a provision in the merger agreement requiring that the merger be put to a vote regardless of whether the NCS board changed its recommendation, and (3) the absence of any provision permitting the NCS board to terminate the merger agreement (except if there was a breach of a representation or warranty excusing performance). Genesis told NCS that unless it agreed to a deal within 24 hours, it would walk and NCS could take its chances finding another buyer. The independent committee of NCS met and decided to meet Genesis's demands because it lacked any firm bid from Omnicare and because it faced the loss of a deal that would fully repay its creditors and give its stockholders a healthy return. For the same reasons, the full NCS board agreed to sign the deal with Genesis.

After NCS signed, Omnicare expressed interest in presenting a topping bid but again failed to do so unconditionally. Genesis permitted NCS to provide Omnicare with confidential information and, several months after the NCS-Genesis deal was inked, Omnicare finally put on the table a superior bid that was unconditional. Omnicare and certain shareholder plaintiffs then attacked the NCS-Genesis merger agreement in court.

For today's purposes, the key issue is the attack on the combined effect of the shareholder voting agreements and the so-called "force the vote" provision in the merger agreement. Both the shareholder voting agreements and the force the vote provision were specifically authorized by sections of the Delaware General

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84. Id. at 250.
86. At the time of the case, Del. Code Ann. tit. 8, § 251(c) permitted the force the vote provision. That authorization is now codified at Del. Code Ann. tit. 8, § 146. See 74 Del. Laws ch. 84 (2003)
Corporation Law. In other words, they were clearly kosher under the “law” side of the law-equity divide.

In what I consider to be a model “equity” opinion, Vice Chancellor Lamb therefore painstakingly analyzed the propriety of the NCS board’s decision to agree to a merger with Genesis that was, absent a contractual breach by Genesis, completely locked-up. Importantly, he deployed the Unocal standard of review. 87 This heightened reasonableness standard enabled Vice Chancellor Lamb to take into account the potential conflicts of interest faced by Outcalt and Shaw in a more nuanced manner than either the business judgment rule or entire fairness standards of review permit. In particular, given NCS’s precarious financial condition, it might have been possible that Outcalt and Shaw favored a deal with NCS because NCS would employ them after the transaction. It was, in the circumstances, plausible to conceive that their financial interests were more dependent on their continued employment than in maximizing the value of their equity position in NCS. Vice Chancellor Lamb looked closely at this factor and decided that the controllers’ incentives were not distorted in this manner because they had a huge interest in getting the best price for their equity and, furthermore, because Omnicare had also wished to retain their services, deflating the continued employment argument. 88

He then went on to apply the Unocal standard, concluding that the NCS board had acted reasonably in deciding that the risk of losing a transaction that would guarantee full repayment to its creditors and a healthy return to equity holders was too great to accept in exchange for the highly conditional expression of interest from Omnicare—a party that had previously expressed a desire to pick the company’s bones in a bankruptcy deal. Furthermore, he found that the board’s acquiescence to a force the vote provision, knowing that Outcalt and Shaw’s agreement to vote their shares in favor of the merger would guarantee the merger’s success, was not preclusive. For one thing, he found no evidence that the NCS board, which had been searching for alternatives for a long time, was purposely acting to preclude a higher bid, instead of simply acting on its belief that it had, after long effort, secured a deal too good to risk for empty promises. 89 Moreover, in keeping with the famous decision in Time-Warner, 90 Vice Chancellor Lamb noted that there would be no barrier to Omnicare bidding to buy the combined NCS-Genesis entity. 91

In so ruling, he was explicitly conscious that the deal protections the NCS board had agreed to were statutorily authorized. 92 Therefore, he made a very fact-
specific inquiry to determine whether he could identify any breach of duty by the NCS board—either of care under the heightened reasonableness test of Unocal or of disloyalty in the form of financial conflicts of interest. Perceiving none and thereby finding that the two NCS stockholders with the most to lose by precluding a higher bid had freely chosen, as stockholders, to support the NCS-Genesis merger, Vice Chancellor Lamb declined to enjoin the meeting at which the merger would be voted upon.

All in all, his decision was a classic example of the Delaware corporate law model. After first concluding that all the conduct was legally authorized, Vice Chancellor Lamb then carefully inquired whether the conduct was nonetheless situationally inequitable, using the more intrusive reasonableness standard.

A rapid appeal ensued. In an order, three members of the Supreme Court decided to reverse and enjoin the NCS-Genesis merger. Echoing the Quickturn opinion, the Court majority stated that the NCS board failed the Unocal standard because it had “irrevocably locked up the merger” and the “absence of a fiduciary out . . . precluded the directors from exercising their continuing fiduciary obligation to negotiate a sale of the company in the interests of the shareholders.”

Two members of the Court—then-Chief Justice E. Norman Veasey and now-Chief Justice Myron T. Steele—dissented. The Court’s order indicated that an opinion would follow in due course.

What went on between the date of the Court’s order on December 10, 2002, and the issuance of the final opinion on April 4, 2003, is known only to the Justices, of course. But from the eventual opinions in the case, one surmises that the majority for reversal was anxious to find a way to conclude that the NCS board had been guilty of a breach of duty of care in the sense of having proceeded without adequately informing itself of material facts. But there was no principled way for the majority to overturn Vice Chancellor Lamb’s express findings of fact to the contrary.

Therefore, although the majority opinion is filled with indications that the majority was dubious about the NCS board’s process, and would have reached a different decision about its adequacy than did Vice Chancellor Lamb, the majority assumed for the sake of argument that the NCS board had fulfilled its duty of care. Instead of reversing on due care grounds, the majority premised its reversal on two determinations of law. Initially, the majority concluded that the NCS board’s actions violated the Unocal standard because those actions both precluded the Omnicare offer and coerced NCS’s stockholders. This rationale depended on the majority ignoring that an arguably necessary premise for their
findings was missing—namely, that the questions of preclusion and coercion are designed to frame an inquiry into whether the stockholders have, by inequitable board action, been prevented from accepting a valuable takeover offer or been coerced into accepting a board-approved transaction. Here, of course, stockholders who controlled a majority of the votes and who were receiving the same per share consideration as the minority, had approved the transaction, meaning that free and unconflicted stockholder choice was vindicated.99

97. That is, the idea of *Unocal* and *Revol* is that heightened scrutiny is merited to ensure that boards and managers, with potentially divergent interests from stockholders, do not unreasonably prevent stockholders from receiving valuable bids. Once a court concludes, however, that a controlling stockholder has no interest in conflict from that of the other stockholders, the controlling stockholder's own choice to approve a transaction becomes very strong evidence of the fairness of accepting that deal.

98. In the context of a stock-for-stock merger, one can imagine a situation when the board of a financially healthy target company might approve a termination fee, triggered solely by a no vote on the merger, that was so sizable as to render stockholders unable to do anything other than tender because the financial consequences of a no vote were too onerous. Under the *Unocal* standard, a scenario of this kind might, after a fact-based inquiry, be found unreasonable, as either an unreasonably preclusive barrier to a higher bid or an unreasonably coercive intrusion on the stockholders' right, per DEL. CODE ANN. tit. 8, § 251, to freely vote to approve the merger.

By way of contrasting example, however, one can imagine a scenario in which a financially strapped company, which has not met payroll or other bills for several months, might give a bidder who provided risky, sub-market financing, a much higher-than-typical termination fee as consideration for the tangible benefits provided and risks taken by that bidder. In that circumstance, it would be much harder to conclude that the fee was unreasonably preclusive or coercive, as opposed to being simply a reflection of the company's straitened condition. Equity's strength is in recognizing the importance of and being able to take into account fairly such circumstantial differences in policing the boundaries of the directors' authority under § 141 and the stockholders right to vote under § 251.

99. Moreover, in a conceptual move that borders on the metaphysical, the Court indicated that the reasonableness of the NCS board's actions would be determined, not by what they knew when they acted, but by later events. *Omnicare*, 818 A.2d at 933 ("The latitude a board will have in either maintaining or using the defensive devices it has adopted to protect the merger it approved will vary according to the degree or detriment to the stockholders' interests that is presented by the value or terms of the subsequent competing transaction."). Because a higher unconditional bid was eventually presented, the court concluded that the NCS board's earlier decision (which had been made when no such bid existed and when the board risked losing a valuable and very certain opportunity) was unreasonable. This, of course, implicitly suggests that the NCS board would have acted reasonably if Omnicare had eventually never presented an unconditional, topping bid. In this regard, one wonders how the case would have come out if NCS's charter had permitted action by written consent. See Del. CODE ANN. tit. 8, § 228. If the necessary consents were filed and the merger completed, would have Omnicare still have been able to argue to set aside a fully consummated merger agreement?

Equally interesting is to imagine what exposure the NCS board would have faced had they, in reaction to Omnicare's last-second, conditional expression of interest, refused to accede to Genesis's terms. Assume Genesis walked away and that Omnicare returned to its preferred strategy of a bankruptcy deal and refuses to offer a transaction giving full repayment to NCS's creditors. Eventually, Omnicare gets the company with no payment to the equity and only 80 cents on the dollar to the creditors. The creditors sue the NCS board for turning Genesis away because, they plausibly contend, the company was insolvent at the time the key decision was made. This alternative scenario was not considered in the majority opinion, nor was there consideration of the fact, because NCS was insolvent or nearly so, any risks that the board took to achieve a higher payment for the equity necessarily represented a much lower percentage of the company's total enterprise value than in the scenario of a thriving, profitable public company. Refusing to put at risk a deal guaranteeing full repayment to the creditors in exchange for an increase for the equity is, at the very least, more understandable in this setting, and there are non-frivolous legal arguments available to creditors that directors must consider creditor interests when the company is in the so-called "zone of insolvency" and, more certainly so, when the company is actually insolvent. See Production Resources Group, L.L.C. v. NCT
But for right now, it is the majority's alternative basis for its ruling that is most important. That alternative basis rested on the proposition that the NCS board did what no board could ever validly do—signed a merger agreement with a force the vote clause and no fiduciary right of termination knowing that a majority of the necessary votes were contractually committed to approve the deal. Echoing Quickturn, the majority held that the "NCS board had no authority to execute a merger agreement that subsequently prevented it from effectively discharging its ongoing fiduciary responsibilities."\(^{100}\) The majority then made clear that in their view this meant that the NCS board should have retained the right for itself to pull the plug on the Genesis merger if a higher price came along, irrespective of the facts that the necessary stockholder votes to approve the contract were secured and that there was no allegation that the NCS board had failed to protect the company adequately through contractual representations and warranties, covenants, and closing conditions.

Notably, the majority went out of its way to stress that it was not ruling on the "general validity" of stockholder voting agreements or force the vote provisions.\(^{101}\) Rather, the use of these two statutorily valid techniques in combination to "craft an absolute lock up" was what converted statutorily legal action into "invalid and unenforceable" behavior.\(^{102}\) In the Supreme Court's words, "the NCS board did not have authority to accede to the Genesis demand for an absolute 'lock up.'"\(^{103}\)

This reasoning renders indistinct the line between law and equity by announcing that legally authorized action is, in any conceivable circumstance, somehow invalid. The reasoning is, to borrow a term from the majority, "unremitting"\(^{104}\) and not susceptible to exception. Therefore, by its own terms, the reasoning would forbid conduct that one would imagine would typically be of very little concern to an equity court. For example, imagine a seller that has conducted a full market search for buyers for a year. In the last round, the seller is down to three bidders, who have each completed due diligence and engaged in a few weeks of preliminary competition. To extract the very last nickel from the bidders' pockets, the seller, which has a majority stockholder who has agreed to share the control premium ratably with the minority, indicates that final bids will be due in a week and that the high bidder will get an "absolutely locked up" deal including a force-the-vote provision, a voting agreement from the majority stockholder, and no fiduciary out. Under the strict reasoning of Omnicare, that action would be invalid, yet it is difficult to see why such an agreement would be inequitable.

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\(^{100}\) Omnicare, 818 A.2d at 938.

\(^{101}\) Omnicare, 818 A.2d at 939.

\(^{102}\) Id.

\(^{103}\) Id. at 938.

\(^{104}\) Id.
Imagine, by way of another example, that a board signs up a merger agreement subject to certain regulatory conditions. The stockholders vote and approve the merger, fully aware of the regulatory condition. Must the board include a blanket fiduciary out permitting termination if a higher bid comes along or—even more broadly—any other business circumstance arises that leads the board to conclude, in its fiduciary judgment, that the transaction is no longer advisable? That is, does the board have to retain a blanket out, even after the stockholders have actually approved the deal and it is therefore like any other contract?

In vigorous dissents, Chief Justice Veasey and Justice Steele, strongly protested the Court's decision. Each, in his own way, surfaced the tension between the majority's reasoning and the distinction between law and equity in the application of Delaware's corporation law. For his part, Chief Justice Veasey believed that the majority had besmirched the "beauty of the Delaware corporation law, and the reason it has worked so well for stockholders, directors, and officers . . . ." Our law's elegance was a "framework . . . based on an enabling statute with the Court of Chancery and the Supreme Court applying principles of fiduciary duty in a common law mode on a case-by-case basis." The "bright-line, per se" ban that the Court had enacted was, in his words, a "judicially-created 'third rail' that . . . [became] one of the given 'rules of the game' . . . ." Like Chief Justice Veasey, Justice Steele found that use of equitable powers to declare legally authorized action invalid in all circumstances jarring, noting that the Court had declared the NCS board's actions invalid without finding any "breach of loyalty or care."

VII. RESPECTING BOUNDARIES: THE CONTINUED UTILITY OF HONORING THE LAW-EQUITY DIVIDE

This aspect of the jurisprudential debate in the *Omnicare* opinions raises, to my mind, an issue of no less importance than the argument in *Schnell v. Chris-Craft* itself. Without the rule of *Schnell* that permits the invalidation of legally permitted acts that result from a breach of an equitable duty, Delaware law could not responsibly invest directors with the capacious authority set forth in the DGCL. But forgetting the dangers of *Schnell* creates an equally troubling policy problem.

As I mentioned at the beginning of this talk, there has always been an implicit corollary to *Schnell*, which is that if the General Assembly has decided that certain acts are legal, then presumably there must be circumstances when a board's decision to take those acts must be equitable. For the judiciary to decide that in all possible circumstances, particular legally authorized acts are forbidden, is for the judiciary to place itself clearly on the law side of the law-equity divide. But our legitimacy to place ourselves on this side of the divide, not as interpreters of statutes passed by our General Assembly, but as makers of common law supplements to the DGCL is highly questionable.

106. Id.
107. Id.
108. *Omnicare*, 818 A.2d at 948 (Steele, J. dissenting).
The utility of our doing so is also doubtful. Unlike a legislature or regulatory agency, a court's ability to expand its window on the world is ethically and practically constrained. If, instead of dealing with the case at hand and at most providing warnings to transactional planners about the concerns raised by certain techniques, courts fashion absolute bans on legally permitted behavior, they risk stifling useful innovation and disabling fiduciaries from using their best business judgment in the widely disparate circumstances that their companies face.

As important, there is a valuable self-disciplinary aspect to a more traditional use of equity's power. If the corollary is respected, then a determination that legally permitted action should be enjoined requires the court to find that there was a specific breach of an equitable duty. That does not necessarily mean that the judge must conclude that the directors acted for a disloyal purpose. But, at minimum, it requires the court to articulate why the directors did not fulfill their fiduciary duties in the circumstances they confronted. If, for example, the court concludes that the directors, despite acting in good faith, acted unreasonably, then the court must articulate why that is so, with reference to the particular business choice they confronted. The very requirement to explain how actual businesspersons violated the equitable standard of conduct required of them tempers judicial overreaching and encourages modesty. In equity, one cannot avoid the uncomfortable task of addressing specifically why a specific group of persons violated their equitable duties in a specific business context. The corollary to Schnell forbids end-running that job by declaring that what the directors did is, instead of being circumstantially inappropriate, in fact altogether forbidden because the judge believes that is the correct policy, rather than because the legislature has actually adopted that policy. In essence, the corollary to Schnell helps the judiciary remember the difference between the more limited scope of action it has to make common law and the more legitimate, plenary authority the General Assembly has to write the DGCL.

In emphasizing this point, I do not wish to obscure just how blurry the line between law and equity sometimes is in our corporate law. Because of the

109. An illustration of the tendency of the law and equity boundaries to blur are the equitable rules that govern transactions in which controlling stockholders seek to acquire the rest of a company's shares. By the process of common law, the courts have imposed procedural pre-conditions to effecting either squeeze-out mergers, see, e.g., Kahn v. Lynch Communication Sys., 638 A.2d 1110 (Del. 1994), or tender offers, In re Pure Resources, Inc., Shareholders Litig., 808 A.2d 421 (Del. Ch. 2002), that do not exist within the DGCL. The failure to use these procedures, however, does not invalidate the transaction entirely or even subject the controller to damages liability. Rather, it results in the controller bearing the burden to show, in equity, that the transaction was fair to the departing stockholders. Lynch, 638 A.2d at 1115-17; Pure Resources, 808 A.2d at 445. That is, even in this area in which Delaware law has traditionally demonstrated a particular keen interest in protecting stockholders from fiduciary overreaching, Delaware courts have not erected a complete ban on consummating transactions without using the recommended procedural protections.

A recent case illustrates another aspect of the tendency of law and equity to intertwine. In interpreting the DGCL, the Delaware courts are, not infrequently, required to determine whether an aspect of corporate law codified in the DGCL was intended to incorporate a pre-existing common law principle addressing the same subject. This year, for example, Vice Chancellor Lamb concluded, in keeping with prior precedent, that Del. Code Ann. tit. 8, § 202, which deals with the validity of transfer restrictions on stock and was first enacted in 1967, incorporated the common law requirement
importance of fiduciary duty review to our system of corporate law, the judiciary will often issue decisions that have more than case-specific influence. When a court declares, as did the court in Guth v. Loft,\textsuperscript{110} that a director may not usurp a corporate opportunity, that sensible rule will influence future behavior. But much of the reason why our model of corporate law works well is that it permits the evolution of good practices without inhibition by an enormous set of prescriptive rules. The common law method of adjudication permits that evolution, by providing practitioners with guidance, but in a low-cost way. When judicial decisions premised on case-specific determinations of breach of duty are unwise or overbroad or suffer from some fault, the judiciary may correct or limit them later in future cases raising the same or similar problems. In the wake of Van Gorkom, for example, there ensued a number of decisions that tempered some of the more questionable aspects of Justice Horsey's decision.

When the judiciary departs from case-specific determinations, however, and announces bright-line prohibitions on otherwise legal conduct, it risks imposing costs that outweigh the corresponding benefits, in the same way that some aspects of the new Sarbanes-Oxley Act and stock exchange rules arguably do.\textsuperscript{111} This is not surprising because the announcement of an across-the-board ban on legally permitted conduct has a similar effect to a statutorily or regulatory ban. If the Delaware Supreme Court has announced that in no circumstances may the board of a Delaware corporation do X or Y even though the DGCL says they are acceptable acts, then the lawyers who counsel boards face an ethical decision. Even if the circumstances seem to cry out for the use of X or Y to meet a danger to the company, can a lawyer in good faith counsel his client to choose X or Y? Can a director choose that course of action even thought it has been, by judicial pronouncement, declared per se invalid? For obvious reasons, the very act of declaring by judicial ruling that legally permissible behavior is never appropriate renders it far less likely that the ruling, if less than socially optimal, will be revisited in future cases. This is particularly so when the judicial declaration rests, not on a debatable interpretation of a statute that might be corrected by a
statutory amendment, but on the articulation of a bright-line rule of equity, the legislative overruling of which would involve an intricate and awkward statutory intrusion into an area of corporate law that is, otherwise, judge-made.\footnote{112}

For all these reasons, the judiciary's constant appreciation of the separate roles that law and equity play in the evolution of corporate law making is vital to the continued development of our system of corporate law. The self-discipline of separating the inquiry into whether the challenged conduct is lawful, in the sense of being prohibited by a statute or governing instrument, from the inquiry into whether the challenged conduct is equitable in the particular circumstances before the court, promotes better decision making and makes more credible the judiciary's exercise of its common law making powers. No doubt, this separation makes plainer the reality that judges—particularly Delaware judges who decide corporate cases—do make law more than occasionally. But it simultaneously forces judges to admit when they are making a debatable policy choice and to be mindful of the difference between the judiciary's role in making limited case-specific determinations of appropriate fiduciary behavior and the legislature's role in establishing broad, across-the-board limits on permissible managerial conduct.

This does not mean that Delaware judges should hesitate to hold directors to high standards of fiduciary conduct or to provide, in an appropriate way, guidance that might be useful in more than the case at hand. But it does mean that we should appreciate the special nature of our lawmaking authority, be careful in its use, and, most importantly, be willing to change direction if, upon reflection, we have made a suboptimal choice in a prior decision. Remembering and honoring the unwritten corollary to Schnell will help us do that.

\footnote{112. In other words, if the General Assembly is required to perform micro-surgery to restore the range of freedom taken away by an overbroad use of equity's power, it risks undermining our very system of corporate law. If a delicate operation of this kind goes wrong by being more widely invasive than necessary, there is risk that equity's utility in policing actual inequity will inadvertently be undermined.}