THE EQUITY IN CORPORATE LAW

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It is no secret that equity is a central part of corporate law. Yet a fuller appreciation of what equity means for corporate law is still lacking. This Article offers a new account of corporate law's equity, showing that it is a kind of meta-law—or law about law—that operates ex post to address polycentric problems, conflicting rights, and opportunism. As we argue, much of the structure of corporate law—its architecture—is explained by the need for a robust equity that can intervene where needed, while also avoiding the dangers of unconstrained judicial discretion. Corporate law maintains a careful balance, one that constantly updates, to avoid both pitfalls. Efforts to strike that balance explain various features of corporate law, including fiduciary duties, the business judgment rule, derivative litigation, the doctrine of independent legal significance, different standards of review, and even the way corporate law has changed. As we will show, this account also offers something importantly different from conventional theories of corporate law, such as the nexus of contracts approach. Focusing on the equity in corporate law gives us a distinctive picture of both corporate law and its evolution.

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INTRODUCTION

In corporate law, the relation between law and equity is in a constant state of flux. New extensions of equity are commonplace, and new exceptions to its scope are just as frequent. For example, in 2023, the Delaware Court of Chancery held that under the right circumstances, sophisticated shareholders can contract away their right to sue another investor for a fiduciary breach.[1] That decision is striking, as the Delaware corporation is known for its mandatory fiduciary duties. Yet the cases also tell another story. The outcome looks very different when directors vote on their own compensation. Then, advance shareholder approval isn't enough to insulate the directors' decisionmaking from equitable review.[2] Shareholders can approve a specific director compensation package, but they can't give the board a "blank check" to set its own income.[3] Delaware thus jealously guards equity's place for some purposes and not for others.

Understanding why the law-equity divide in corporate law should be so fraught is vital to understanding the field, especially in recent years. Corporate law is a hybrid between law and equity, but it is not an ad hoc mixture of these two components. Nor is their relation something that can be fully explained in contractarian terms. There is, however, a pattern: the law-equity divide in corporate law is highly structured—as the above examples suggest—with repeated doctrinal offshoots of equity that are then carefully (and incompletely) hedged in by law. We need to make sense of equity's role to make sense of these phenomena—indeed, we need a theory of equity itself—and this Article seeks to provide one.

Corporate law has an identity crisis, and its name is "equity." Most lawyers know that corporate law is associated with "historic" equity.[4] They know that fiduciary law is a large part of corporate law and that the Delaware Court of Chancery plays an outsized role in corporate cases, because many corporations are chartered in Delaware. (Indeed, this Article will focus on Delaware law for that reason. Variations on equity's role exist for each jurisdiction, but if Delaware is idiosyncratic in some ways, it is also illustrative.) Those more in the know realize that Delaware law in the hands of the Delaware Court of Chancery is characterized by a large degree of discretion, which in the optimistic

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1 New Enter. Assocs. 14, L.P. v. Rich, 295 A.3d 520, 574–76 (Del. Ch. 2023).

2 *See In re* Invs. Bancorp, Inc. S'holder Litig., 177 A.3d 1208, 1211 (Del. 2017).

3 See *id.* at 1220, 1220–21 (quoting Sample v. Morgan, 914 A.2d 647, 663 (Del. Ch. 2007)) for the proposition that a "blank check" is impermissible.

4 *See* Henry E. Smith, *Why Fiduciary Law Is Equitable*, *in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 261, 272 (Andrew S. Gold & Paul B. Miller eds., 2014) [hereinafter FIDUCIARY LAW].

version enhances the advantages of its expertise—the pessimistic version being that the court is pandering to management in a race to the bottom.[5] None of these views do more than scratch the surface of corporate law's equitable nature.

On one level, that should be no surprise. In the century and a half since the merger of courts of law and equity began, lawyers, academics, and judges have been busy effacing the law-equity distinction. Their success was bound not to be complete: the Seventh Amendment distinguishes between law and equity for purposes of jury trial, and the inertia of the different considerations in granting remedies like damages (law) and injunctions (equity) is remarkable.[6] At the same time, discretion has had its attractions, especially since the legal realist era, and equity can be a storehouse of historical justifications for increasing judicial discretion.[7] Recently, even the U.S. Supreme Court has revived interest in equity, which is after all mentioned in the U.S. Constitution as a source of federal courts' power, and the Court has tried to tether equity to its late eighteenth-century manifestations.[8] To say that all of this amounts to a muddle would be to insult muddles.

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5 For some classic treatments relevant to the question of equity on corporate law, compare Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977), and Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985), with William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 701 (1974), and Lucian Arye Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395 (1989). *See also, e.g.*, Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908 (1998); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987); Sarath Sanga, *Network Effects in Corporate Governance*, 63 J.L. & ECON. 1 (2020).

6 *See* U.S. CONST. amend. VII ("In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."); *see also* Samuel L. Bray, *Equity, Law, and the Seventh Amendment*, 100 TEX. L. REV. 467, 516 (2022).

7 For example, purposivists in statutory interpretation invoked the equity of the statute. *See, e.g.*, James McCauley Landis, *Statutes and the Sources of Law*, *in* HARVARD LEGAL ESSAYS 213, 215 (1934), *reprinted in* 2 HARV. J. ON LEGIS. 7, 9 (1965). *But see* S.E. Thorne, *The Equity of a Statute and* Heydon's Case, 31 ILL. L. REV. 202, 210 (1936); *see also* John F. Manning, *Textualism and the Equity of the Statute*, 101 COLUM. L. REV. 1, 22–27 (2001).

8 On the constitutional source for equity, see U.S. CONST. art. III, § 2 ("The judicial Power shall extend to all Cases, in Law and Equity . . . ."), and Owen W. Gallogly, *Equity's Constitutional Source*, 132 YALE L.J. 1213 (2023). On the Supreme Court's "New Equity," see, for example, *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 318 (1999); *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391–93 (2006); Samuel L. Bray, *The Supreme Court and the New Equity*, 68 VAND. L. REV. 997, 1008–36 (2015); and Mark P. Gergen, John M. Golden & Henry E. Smith, *The Supreme Court's Accidental Revolution? The Test for Permanent Injunctions*, 112 COLUM. L. REV. 203, 206–14 (2012).

These problems of equitable confusion come to a boil in corporate law. While equity and its receptiveness to judicial intervention in the name of fairness is an undeniable part of the received fabric of corporate law, recent trends in law and scholarship are hostile to these features of corporate law. In law and economics, corporations are seen as a nexus of contracts, and the idea of facilitating what transactors want to do becomes the raison d'être for organizational law.[9] And out there in the real world, there are those who are willing to push the boundaries of whatever the law affords. Organizational law has been increasingly accommodating, by affording an expanded menu of forms, including LLCs and even more tailored variants that can appeal to those who want less, not more, judicial equity. Most recently, new environmental, social, and governance (ESG) metrics built into various mechanisms of corporate law and institutions unwittingly raise some very old issues that have bedeviled equity and equity courts since their inception.

Thus, the time might not seem propitious for a revisiting of corporate law's equitable DNA. This Article will, however, do exactly that. It will adopt a theory of equity that is substantive rather than historical or purely jurisdictional and will show that from a functional point of view corporate law is as equitable as ever.

The starting point for equity in corporate law is equity itself. Equity is loosely associated with an important component of the legal system: meta-law, or law about law.[10] Take the (historically controversial) antisuit injunction. *A* might sue *B* on a debt. In times past, a law court would enforce the debt unless it had been cancelled, even if the debtor had paid (and failed to obtain documentation). A court of equity would not change the legal right, but it could order *A* not to sue *B* (and to cancel the debt) on pain of contempt: if *A* did sue at law, *A* could get a judgment at law, but the equity court could fine *A* or throw *A* in jail until *A* complied.[11] Even as the law became less rigid, equity would aid the law where the law produced incongruous or unfair results. Equity would withhold remedies (like specific performance) if the plaintiff had engaged in fraud or other bad acts in the course of the

9 *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 12–15 (1991).

10 *See* Henry E. Smith, *Equity as Meta-Law*, 130 YALE L.J. 1050, 1054 (2021).

11 J.R. v. M.P., YB 37 Hen. 6, fol. 13a, Hil., pl. 3 (1459) (Eng.).

transaction (unclean hands).[12] Equity could also reform an instrument when it did not reflect the parties' intent.[13]

Although equity did many disparate things over the course of its history and left us with a mélange of rules and standards, equity was associated with a suite of functions performed in a constrained way. Equity in its second-order function solves problems presented by the law that a second-order system is suited to: when the law goes off the rails in a complex and uncertain fashion, equity intervenes to achieve a result more in line with the law's purpose.[14] This is not a roving commission to fix all problems. Instead, equity relies on triggers—proxies for the most serious problems—that allow us to toggle into a more open-ended and morally inflected mode of analysis familiar as "equitable discretion."[15] Indeed, once we are in equity, courts are free to use more context, take a harder look at litigants' behavior for unfairness, and seek flexible solutions to align law with its purpose.[16] The role of the triggers is to prevent equity from engaging all the time, and the context that equity, once engaged, can look to is constrained by judicial norms of self-restraint, including some role for stare decisis.

Corporate law deals with classic equitable problems in characteristically equitable fashion. While second-order components of systems tend to be favored when complexity and uncertainty at the primary level become extreme, the device of meta-law finds its home there.[17] More specifically, like equity generally, equitable meta-law deals with situations of conflicting rights, polycentric problems, and

12 *See, e.g.*, Henry E. Smith, *Equitable Defences as Meta-Law*, *in* DEFENCES IN EQUITY 17, 33–36 (Paul S. Davies et al. eds., 2018); T. LEIGH ANENSON, JUDGING EQUITY: THE FUSION OF UNCLEAN HANDS IN U.S. LAW 116–17 (2019).

13 *See, e.g.*, CIGNA Corp. v. Amara, 563 U.S. 421, 440 (2011); 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE AS ADMINISTERED IN ENGLAND AND AMERICA § 313 (W. H. Lyon, Jr. ed., Little, Brown & Co. 14th ed. 1918) (1836).

14 *See CIGNA*, 563 U.S. at 440–41; *see also* Smith, *supra* note 12, at 17; Henry E. Smith, *The Equitable Dimension of Contract*, 45 SUFFOLK U. L. REV. 897, 906 (2012); KENNETH AYOTTE, EZRA FRIEDMAN & HENRY E. SMITH, A SAFETY VALVE MODEL OF EQUITY AS ANTI-OPPORTUNISM 1 (2023); Yuval Feldman & Henry E. Smith, *Behavioral Equity*, 170 J. INSTITUTIONAL & THEORETICAL ECON. 137, 138–44 (2014) (describing equity as a safety valve against legal loopholes); Andrew S. Gold & Henry E. Smith, *Sizing Up Private Law*, 70 U. TORONTO L.J. 489, 514 (2020).

15 *See* Smith, *supra* note 10, at 1084–89. For equity generally, classic examples of such triggers are bad faith or disproportionate hardship. *Id.* at 1081, 1084. Corporate law emphasizes conflicts of interest, and it too is sensitive to bad faith.

16 Interestingly, equity does not prevent all unfairness; it covers certain categories of unfairness. The result is that people can be sticklers for their rights even if their actions are morally wrongful, but only up to a point. *See* ANDREW S. GOLD, THE RIGHT OF REDRESS 198–202 (2020). The problem of handling such sticklers was identified by Aristotle. On that topic, see Dennis Klimchuk, *Equity and the Rule of Law*, *in* PRIVATE LAW AND THE RULE OF LAW 247, 254 (Lisa M. Austin & Dennis Klimchuk eds., 2014).

17 *See* Smith, *supra* note 10, at 1054–55.

opportunism.[18] All three involve complexity and associated uncertainty. Conflicting rights involve the entire set of considerations supporting two or more sets of rights. Think of two adjacent landowners engaged in land uses that are presumptively legitimate but that conflict and need to be reconciled through the law of nuisance. Polycentric problems are those in which many elements are densely connected (almost the definition of a complex system). An example would be dividing paintings from a collection under a will to two museums, because the value of any one painting to a museum will depend on which others it gets.[19] Finally, the advantage that human actors may take of the law, including compliant noncompliance, or "opportunism," looms large as a danger in corporate contexts (as it does perhaps even more starkly in tax law).[20] And, as we will see, much of corporate law's equitable meta-intervention is aimed at countering opportunism in a targeted and constrained fashion.

While opportunism will also loom large in the discussion to come, we emphasize at the outset that this Article is not just about equity as anti-opportunism. The anti-opportunism role for corporate law is well known to corporate scholarship (although equity's second-order approach to that role merits further attention). But corporate law is also filled with cases where equity is used to address conflicting presumptive rights. In different ways, examples include the doctrine in cases like *Schnell v. Chris-Craft Industries, Inc.*,[21] hostile takeover cases like *Unocal Corp. v. Mesa Petroleum Co.*,[22] corporate opportunity cases,[23] and various doctrines that govern control over derivative litigation.[24] And it would be understatement to say that the equity in corporate law responds to polycentricity. The public corporation is itself a complex system, and so are the markets in which such corporations operate.[25] Every example throughout this Article involves equity as a way of managing a

18 *Id.* at 1071–81.

19 Lon L. Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 394–404 (1978) (introducing the concept of polycentric tasks).

20 *See* Smith, *supra* note 10, at 1076.

21 Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971); *see infra* subsection II.C.1.

22 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); *see infra* subsection II.A.3.

23 *See infra* Section I.C. Such cases may also implicate a fourth reason for equity's role (beyond conflicting rights, polycentricity, and opportunism); the nature of loyalty duties and the contexts in which they apply are sometimes extraordinarily difficult to assess from an ex ante perspective. This may, however, be another way of getting at polycentricity.

24 *See infra* Section II.B.

25 Importantly, not all corporations are public corporations, and not all closely held corporations are complex systems. Note, however, that many closely held corporations are situated within complex systems.

complex system—more accurately, complex systems—implicated by corporate law. The always-evolving balance between law and equity in corporate law is an inevitable consequence of that complexity. With that said, we turn briefly to equity's history.

Historically, a particularly important use of meta-law was the trust, out of which developed the corporation. The system of separated courts of law and equity is often caricatured as conflicting, but most of the time this was not so. Especially with trusts, the law courts found it convenient to deal with the trustee's title only as an ordinary legal title.[26] Equity courts would then layer the duties to the beneficiary on that.[27] As a result, the trust presents a simple and clean interface to the outside world: no duties beyond those to the trustee, and only to the beneficiary if one is a transferee who either did not give value or had notice of the trust.[28] Put differently, the "meta" nature of the beneficiary's interest—not directly in the trust res but mediated by the trustee's title—allows an almost in rem property effect to be created out of in personam tools.[29]

At a more granular level, corporations grew out of trusts by extending a similar and more complicated version of the beneficiary's treatment to the shareholders of the corporation.[30] Unlike the trust, the corporation has legal personality and interposes itself between the shareholders and the assets owned and the other relations entered into by the corporation.[31] This is the source of corporate law's location within equity jurisdiction and the reason the Delaware Court of Chancery can play the major role it does.

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26 *See* Joshua Getzler, *"As If." Accountability and Counterfactual Trust*, 91 B.U. L. REV. 973, 979–80 (2011); JE Penner, *An Untheory of the Law of Trusts, or Some Notes Towards Understanding the Structure of Trusts Law Doctrine*, 63 CURRENT LEGAL PROBS. 653, 665–66 (2010); David J. Seipp, *Trust and Fiduciary Duty in the Early Common Law*, 91 B.U. L. REV. 1011, 1014–22 (2011).

27 *See* Getzler, *supra* note 26, at 980. If, as McFarlane and Stevens argue, the beneficiary has a right against the trustee's right, equitable property is inherently meta. *See* Ben McFarlane & Robert Stevens, *The Nature of Equitable Property*, 4 J. EQUITY 1, 2–7 (2010) (Austl.); Ben McFarlane, *Equity and the Justification of Private Rights*, *in* JUSTIFYING PRIVATE RIGHTS 221, 224, 235–38 (Simone Degeling et al. eds., 2020).

28 Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773, 847–49 (2001).

29 *See* Jessica Hudson & Charles Mitchell, *Justificanda*, *in* PHILOSOPHICAL FOUNDATIONS OF THE LAW OF EXPRESS TRUSTS 12, 28–29 (Simone Degeling et al. eds., 2023); Henry E. Smith, *Equitable Meta-Law: The Spectrum of Property*, *in* EQUITY TODAY: 150 YEARS AFTER THE JUDICATURE REFORMS 319, 326 (Ben McFarlane & Steven Elliott eds., 2023).

30 *See* John Morley, *The Common Law Corporation: The Power of the Trust in Anglo-American Business History*, 116 COLUM. L. REV. 2145, 2166–74 (2016).

31 For a suggestive comparison of legal thinghood and legal personhood, see F.H. Lawson, *The Creative Use of Legal Concepts*, 32 N.Y.U. L. REV. 909 (1957).

These equitable origins of corporate law are intertwined with what we argue is a central functional role that equity continues to play in corporate law: equity is what lends corporations their fundamental structure and their characteristic challenge. The whole "separation of ownership and control" is a result of the split between the controller—a role corresponding to that of a legal title holder in a trust—and the beneficiaries or shareholders to which such a person bears fiduciary duties.[32] This split is central to the specialization of function in corporations and gives rise to the agency problem that rightly preoccupies much of the law and economics literature.[33] It also motivates much of the doctrine in corporate law, and that doctrine is, as we will see, largely equitable.

If that were the end of the equitable story, it would be mildly interesting. But it is just the beginning. The corporation sits at the center of multiple stakeholders with many interactions among them of varying intensity. It is itself a complex system. In such situations, conflicting rights, multipolar or polycentric problems, and especially opportunism are common dangers. The corporate form itself is a powerful private law device and can be misused, calling forth a range of equitable responses from courts, most starkly in piercing the corporate veil.[34] A court of equity can counter opportunism by disregarding the corporate form altogether.

Within the corporation itself, equity plays an even more important role. Again, this is a matter both of jurisdictional pedigree and, functionally speaking, the heart of corporate law, namely fiduciary law. Fiduciary law itself is, like the corporate form, an outgrowth of trust law, in which the trustee, the prototypical fiduciary, owes duties of care and loyalty to the beneficiary or beneficiaries. As discussed below, fiduciary rules are couched, like equity itself, in terms of morality and fairness, and, like equity, fiduciary law interposes itself between opportunists and their objectives. Fiduciary law deals with extreme problems of complexity and uncertainty with accompanying dangers of opportunism, and accordingly it takes on a more proactive role: where general

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32 *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4, 4–5 (1933). Berle and Means took the separation of ownership and control as a challenge for the whole notion of private ownership, whereas in a sense the separation of ownership and control is made possible—and workable—by a new kind of property created by equitable meta-law.

33 *See, e.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 309 (1976); *see also* Robert H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning*, *in* THE WORLDS OF THE TRUST 428, 430–31 (Lionel Smith ed., 2013).

34 *See* Robert B. Thompson, *Agency Law and Asset Partitioning*, 71 U. CIN. L. REV. 1321, 1326 (2003) (noting the linkage between veil piercing and equitable concerns); *see also infra* Section III.B.

equity ordinarily intervenes via tailored, ex post remedies, fiduciary law often adopts prophylactic, ex ante rules.[35] These features are responsive to the scope of discretion reposed in fiduciaries and to the corresponding vulnerability of their beneficiaries. The fiduciary setting poses an especially high risk of opportunistic behavior.

Corporate law draws on these features of fiduciary law, yet it also must respond to the particular concerns raised by corporate transactions and actors. While directors and officers share many of the characteristics of other fiduciaries, the corporate setting implicates a variety of highly sophisticated parties, as well as significant risks that not only law, but also equity, will be opportunistically misused. In several respects, corporate law thus adapts equity to more effectively guarantee that directors and officers will not opportunistically take advantage of their discretion. Derivative litigation is a classic example of a corporate law innovation designed to address such opportunism. Yet corporate law also adopts a variety of cabining mechanisms designed to constrain equity, ensuring it remains a safety valve in most circumstances. In effect, corporate law is carefully structured to maintain a balance between law and equity, so that, on the one hand, law is not overly susceptible to opportunism and to breakdown in the face of complexity and uncertainty, and on the other hand, equity does not overwhelm the conventional legal decision-making mode. Once we recognize this hybrid decision-making structure, we can better understand core structural features of corporate law.

Part I of this Article will elaborate on the anti-opportunism account of equity and its relation to fiduciary law. Part II will indicate how equity can contribute to the law of corporate governance. As this Introduction suggests, corporate law adopts a variety of mechanisms designed to maintain equity's role as an anti-opportunism device and a mechanism for managing polycentricity and conflicting rights, while still cabining the scope of equity so that it operates as a safety valve in most settings. These include a subject area strategy, a gatekeeping strategy, a jurisdictional strategy, and a menu strategy. As we will see, the business judgment rule, the process of derivative litigation, the *Schnell* doctrine, and variations across business entities each modulate equity's effects in important ways. That is, the Delaware courts, sometimes more, sometimes less self-consciously, are crafting a regime of corporate meta-law, continuously retooling the law-equity interface, and in a sense are thereby doing "meta-meta-law." Part III will show how equity shapes the nature of corporate law by mandatory boundary doctrines—property versus contract, piercing the corporate veil, and the corporate opportunity doctrine. Part IV will compare the

35 *See* Smith, *supra* note 4, at 262.

equitable meta-law account to alternative accounts. As this Introduction argues, the equitable meta-law account is often a better fit than other accounts, and in many cases, it is able to explain a broader variety of doctrinal phenomena. It also helps overcome the schizophrenia of corporate law—the apparent gulf between certain aspects of doctrine and private law generally on the one hand, and the economic analysis that dominates the field of corporate law in the United States today on the other. Simply put, equity is the thread that holds corporate doctrine, interparty fairness, and economic efficiency together. The Article then concludes.

I. EQUITABLE META-LAW AS A RESPONSE TO OPPORTUNISM

We will argue that corporate law partakes of equitable meta-law across the range of its functions: it deals with multipolar problems, conflicting rights, and opportunism—all of which present challenges of complexity and uncertainty that are difficult to deal with directly on the level on which they occur. The last of these, opportunism, is worth setting forth in more detail both because it is highly characteristic of equity and because it is a particular theme in corporate law. It also often arises in contexts of complexity and uncertainty, which the opportunist takes advantage of. Legal scholars and economists have defined opportunism variously, leading some to question its value as a concept at all. This is a well-taken criticism if opportunism simply means bad behavior.[36] However, if we attend to the kinds of problems that because of their complexity and uncertainty cannot be handled well ex ante, opportunism becomes a notion that is useful and operational enough to employ in explaining and justifying second-order equitable intervention.

Opportunism is somewhat hard to define, and theorists have offered several accounts.[37] In one of the more famous formulations, it is "self-interest seeking with guile."[38] In many cases, this conduct cannot be precisely delineated by legal rules. Instead, courts must seek visible

36 *Compare* Yoram Barzel, *Transaction Costs: Are They Just Costs?*, 141 J. INSTITUTIONAL & THEORETICAL ECON. 4, 10–11 (1985) (arguing against usefulness of notion of opportunism), *and* Peter Klein, *Does Transaction Cost Economics Need Opportunism?*, ORGS. AND MKTS. (Oct. 6, 2006, 1:14 AM), http://organizationsandmarkets.com/2006/10/06/does-transaction-cost-economics-need-opportunism/ [https://perma.cc/U7UT-FTKF], *with* Oliver E. Williamson, *Opportunism and Its Critics*, 14 MANAGERIAL & DECISION ECON. 97 (1993) (defending use of opportunism in economics).

37 *See, e.g.*, Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 522–26 (1981).

38 OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 47 (1985).

proxies that are closely associated with opportunism.[39] Ex ante recognition of opportunism is often difficult, and opportunists frequently find innovative ways to take advantage of legal content. For present purposes, opportunism will be understood with this challenge in mind. Opportunism will be defined as "undesirable behavior that cannot be cost-effectively defined, detected, and deterred by explicit ex ante rule-making."[40] To take an extreme example, tax law would have a difficult time keeping up with loopholes by relying solely on new and better ex ante rules to plug them.[41] The choice is usually draconian simplicity or a combination of ex ante rules and ex post anti-avoidance doctrines. Equitable meta-law is, among other things, an anti-avoidance device.

This difficulty in ex ante definition, detection, and cost-effective treatment is a fundamental concern for equity. Standard responses to undesirable behavior will not always function well in the face of opportunism, as has been noted in the context of equity:

> Opportunism is not the same thing as fraud. Fraud can be defined ex ante, and a high penalty can make up for the low probability of detection. Opportunism is different. It often consists of behavior that is technically legal but is done to secure unintended benefits that are usually smaller than the costs they impose on others.[42]

Opportunism involves a misuse of the law by parties who, in a sense, have too much information.[43] As a consequence, opportunism commonly involves undesirable behavior that is technically permitted by existing law. Sometimes this is known under the heading of "compliant non-compliance," which is a problem for regulators in complex environments.[44] This problem, which has been studied in depth in particular industries like senior homes, is true more or less of all regulatory environments, in which many of the actors are corporations. In a sense, "compliant noncompliance" can be a problem in corporate law itself. And, as we will see, as corporate law is asked to do more through increasingly elaborate and pervasive ESG metrics, corporate

39 *See* Smith, *supra* note 10, at 1079–81. As Smith notes, the problem is related to the problem raised by "near fraud." *Id.* at 1089 (citing Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 293–301 (1975)); *see also id.* at 1078–79.

40 *Id.* at 1080.

41 *See* David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 861 (1999).

42 Smith, *supra* note 10, at 1080 (footnote omitted).

43 *See id.* at 1080–81 ("[A]nnouncing a clear list of ex ante rules enables evaders to exploit their knowledge of where the bright line is. Plugging nine out of ten holes is sometimes no better than plugging none. . . . [E]quity as meta-law enables a more targeted and ex post intervention against opportunism that leaves less room for sophisticated actors to take advantage of the rules or the legal system overall.").

44 *See, e.g.*, John Braithwaite, *Rules and Principles: A Theory of Legal Certainty*, 27 AUSTRALIAN J. LEGAL PHIL. 47, 56, 55–56 (2002); DOREEN MCBARNET & CHRISTOPHER WHELAN, CREATIVE ACCOUNTING AND THE CROSS-EYED JAVELIN THROWER 103 (1999).

law will need to deal with more compliant noncompliance on the part of corporate actors.

Equity is a powerful mechanism for addressing opportunism ex post. The difficulty is that while equity is a very effective device for preventing and remedying opportunism, equity may be misapplied or misused. Equity could readily swallow up the law if all conduct were reassessed ex post for its desirability.[45] This would eliminate many of the information-cost benefits that result from the modular structures of private law. Moreover, equity is itself a potential source of opportunism, and not merely a remedy for opportunistic behavior.[46] The anti-opportunism account of equity thus focuses not only on equity as a response to sophisticated actors who manipulate legal rules, but also on the manner in which equity interacts with law. From this perspective, law and equity provide two distinct decision-making modes, and the key step is to recognize the way in which both decision-making modes are used in combination.[47]

On the proposed view, general equity as meta-law often operates as a safety valve. Law is a default, with equity intervening in exceptional cases.[48] While a formalist, thoroughly rule-based approach to law would have significant costs, so too would a highly contextualist, standard-based approach. An equitable safety valve offers a different possibility. Were equity too easily avoided, legal rules would readily be manipulated by sophisticated actors. Were equity applied all the time, on a case-by-case basis, it would impose significant information costs on both judges and regulated parties. Equity on the anti-opportunism view has a narrower ambit. Equity as a safety valve is cabined in various respects—notably, through the mechanisms of meta-law: equity's purpose may be to address "fraud, accident, [and] mistake," but it is a set

45 *See* Smith, *supra* note 10, at 1105 (arguing that with equity as a specialized module, "we can predict the effects of equity better than if it were a ubiquitous wild card or *deus ex machina*").

46 *See id.* at 1110, 1126, 1128–29 (indicating how equitable maxims "help[] prevent equitable remedies from themselves becoming tools of opportunism," *id.* at 1126); *see also* Colleen V. Chien, *Holding Up and Holding Out*, 21 MICH. TELECOMMS. & TECH. L. REV. 1, 5–6, 34 (2014) (discussing the opportunistic behaviors apparent in patent hold-up and hold-out issues); Joseph Scott Miller, *Standard Setting, Patents, and Access Lock-In: RAND Licensing and the Theory of the Firm*, 40 IND. L. REV. 351, 380–89 (2007); Henry E. Smith, *Putting the Equity Back into Intellectual Property Remedies*, 96 NOTRE DAME L. REV. 1603, 1618 (2021) (discussing potential two-sided opportunism in intellectual property injunctions).

47 *See* Smith, *supra* note 10, at 1112.

48 *See* Henry E. Smith, An Economic Analysis of Law Versus Equity 40 (Oct. 22, 2010) (unpublished manuscript), https://law.yale.edu/sites/default/files/area/workshop/leo/document/HSmith_LawVersusEquity7.pdf [https://perma.cc/6PKZ-VTJQ] (suggesting that "[l]aw is the default and equity is the safety valve"); *id.* at 43 (noting that "[e]quity's in personam operation and its employment only where the legal remedy is inadequate, are two methods of creating an exceptional safety valve").

of triggers or proxies based on some combination of bad faith and disproportionate hardship that toggle decisionmaking into equity.[49] For example, in building encroachments, the presumption for an injunction can be overcome by showing that the encroachment was unknowing and that it would visit far more harm on the encroacher than it would benefit the encroachee.[50] In unconscionability, various combinations of disproportionate hardship and questionable practices can lead to closer scrutiny for fairness.

Fiduciary law implicates equity, but in a different way from other settings. Many of the characteristic features of equity are prominent in fiduciary law. Courts commonly invoke moral standards, fiduciary law is often vague and open ended, there is an emphasis on substance over form, and its application is in personam.[51] Moreover, the proxies and presumptions in fiduciary law resemble their counterparts in equity generally.[52] That said, there are differences as well: the proxies in fiduciary law are more prophylactic, and the ex post safety valve features of general equity become untailored and ex ante.

In a number of ways, fiduciary law takes on a more expansive role than general equity. For example, in fiduciary law,

> [o]ne need not show there is an actual injury, and so fiduciary law declares that gains belong to the beneficiary because it was the beneficiary's means that were used. In the core area of trusts, self-dealing or conflict of interest on the part of the fiduciary makes the transaction in question voidable and makes available disgorgement remedies; no showing of fraud or even harm in a narrow sense to the beneficiary is required. If equity seeks to ensure that one not profit from one's own wrong, traditional fiduciary law goes a step further in not allowing one to profit from a situation in which it is hard to tell whether one profited from one's own wrong.[53]

The presumptions associated with the duty of loyalty are categorical, and the resulting remedies are especially stringent. These doctrines reflect the heightened potential for opportunism within fiduciary relationships.[54]

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49 Smith, *supra* note 10, at 1082 (alteration in original) (quoting 47 AM. JUR. 2D *Judgments* § 680 (2020)). For analysis of these cabining maxims, see *id.* at 1081–90.

50 *Id.* at 1089.

51 For discussion of these features, see Smith, *supra* note 4, at 272–73.

52 *See id.*

53 *Id.* at 273.

54 *See id.* at 278 (suggesting that "sometimes the problem of opportunism as reflected in the most important proxies like disproportionate hardship, hidden action, vulnerability, and the like, point toward a broad shift in the presumption against the one in the informationally advantaged position—the trustee-like actor"). For additional analysis of fiduciary law as a response to opportunism concerns, see D. Gordon Smith, *The Critical Resource*

Thus, although fiduciary law closely resembles general equity, as a practical matter the equity of fiduciary law is more than just a safety valve. And this raises a challenge for corporate law doctrine. Corporate law builds on the protective proxies adopted in fiduciary law, and with good reason. Directors and officers possess the characteristic discretion we see in other fiduciary settings, and shareholders are vulnerable in a manner comparable to other beneficiaries. Corporate law, however, is applied in a quintessentially commercial setting, frequently involving quite sophisticated parties. Predictability and low transaction costs are significant concerns here.[55] Risks that equitable remedies will be opportunistically misused are also high.[56] Accordingly, successfully cabining the operation of equity is a fundamental challenge.

Corporate law reflects these concerns. It retains many of the classic fiduciary law responses to opportunism—and it adds several new responses—but it also adopts powerful cabining mechanisms. To a large degree, then, corporate law cordons off the more expansive attributes of fiduciary law. Where directors or officers engage in certain categories of transactions, they will trigger the broad proxies and presumptions that are so prominent in traditional fiduciary law. But in various ways, corporate law builds walls around equity, reshapes its contours, and otherwise modifies its application so that the equitable decision-making mode will not overwhelm the legal decision-making mode. Outside of self-dealing and conflict-of-interest contexts, the equity in corporate law is typically applied in exceptional cases, with law operating as a default. The equity in corporate law thus functions as an anti-opportunism device—for that kind of opportunism that arises out of contexts of complexity and uncertainty—as implemented through a structure of proxies and presumptions, and courts have carefully limited it to that function.

II. EQUITABLE GOVERNANCE IN CORPORATE LAW

In corporate law, as elsewhere, general equity serves to manage problems of great complexity and uncertainty that cause law to go off

Theory of Fiduciary Duty, 55 VAND. L. REV. 1399, 1404–06 (2002) (discussing how fiduciary law combats opportunism by means of a restitution remedy).

55 Corporate law is concerned with enabling profit maximization—and consequently is concerned with predictability and transaction costs—in a different way from many other fiduciary relationships. For an argument that specific categories of fiduciary relationship will have their own distinctive animating principles, see Hanoch Dagan & Sharon Hannes, *Managing Our Money: The Law of Financial Fiduciaries as a Private Law Institution*, *in* FIDUCIARY LAW, *supra* note 4, at 91, 104–07.

56 *Cf.* Smith, *supra* note 4, at 274 (noting that, "as in equity generally, the problem [with respect to the fiduciary duty of care] is sometimes potential opportunism on both sides").

the rails, especially when such contexts provide an opening for opportunism. From this perspective, we can understand judicial decisionmaking as a hybrid between law and equity, with law applying as a default and equity applying as a second-order supplement.[57] Yet given the frequent sophistication of corporate parties, and the many occasions for opportunism, corporate law must strike an especially careful balance between these two modes of decisionmaking. There are high risks of opportunism by boards, shareholders, other constituents, and their attorneys, and both law and equity are subject to misuse. Corporate law, like other legal fields, makes use of standard equitable maxims to help constrain this conduct.[58] Corporate law, however, is also notable for the sheer variety of mechanisms employed to make sure that law and equity are kept in balance. On one account, Delaware courts have tried to wrap law around equity.[59] To the extent courts attempt this, it is not an easy task, and the versatility of corporate jurisprudence in maintaining the law-equity balance is one of its defining features.

In some instances, the courts address that balance in a relatively narrow category of cases, often as a response to something novel that has developed through private ordering. The *New Enterprise Associates* case, described at the outset of this Article,[60] is a good example. That case involved an investor who was granted a contractual right by other stockholders; these stockholders had promised that they would not sue the investor (who became a controlling shareholder) for breach of fiduciary duty in exercising that contractual right.[61] In a case like this, a central concern is to strike a balance that does not upset the relation between two important features of Delaware law: its emphasis on

57 *See* Smith, *supra* note 10, at 1100–12 (arguing that law and equity form a hybrid decision-making process, which benefits from the specialization of each component).

58 On the role of these equitable maxims in preventing opportunism, see *id.* at 1119–35. On the role of these maxims in Delaware corporate law, see William T. Quillen, *Constitutional Equity and the Innovative Tradition*, 56 L. & CONTEMP. PROBS. 29, 41 (1993) (noting that in Delaware "the creative and innovative function of equity can operate through historically recognized general equitable maxims"). The traditional maxims often constrain equity as well. A good example is the subordination of equity to law in cases where law provides an adequate remedy—a doctrine well recognized by the Delaware courts. *See, e.g.*, CML V, LLC v. Bax, 28 A.3d 1037, 1046 (Del. 2011) ("Even if the Court of Chancery did have the jurisdiction to extend LLC derivative standing—which, again, it does not—it should exercise that jurisdiction only absent an adequate remedy at law." (citing Chavin v. H.H. Rosin & Co., 246 A.2d 921, 922 (Del. 1968))).

59 *See* Jack B. Jacobs, *The Uneasy Truce Between Law and Equity in Modern Business Enterprise Jurisprudence*, 8 DEL. L. REV. 1, 15 (2005) ("In my view, the concept of wrapping law around equity is a great idea, if it can be carried off. The question is whether the Supreme Court has done that.").

60 *See supra* text accompanying note 1.

61 *See* New Enter. Assocs. 14, L.P. v. Rich, 295 A.3d 520, 528 (Del. Ch. 2023).

contractual freedoms and its emphasis on fiduciary obligations. The careful tailoring of the court's decision—concluding that the covenant not to sue was not facially invalid—shows one way that law can be given a predictable sphere of operation while leaving equity intact.[62] Notably, the court recognized the narrow circumstances at issue and limited its analysis to such circumstances.[63] As the court indicated, "[s]ophisticated repeat players consented explicitly to a clear provision in a stockholder-level agreement that applies only to a specific transaction."[64] That, at a small scale, is a mechanism for delineating the law-equity divide. Other examples are more wide-ranging, as we will see.

This Part will discuss several key mechanisms for striking a balance between law and equity in corporate jurisprudence.[65] The first mechanism is the business judgment rule, in combination with its several exceptions. This legal doctrine both delimits the role for equitable remedies and provides for equity in those cases where the risk of an opportunistic use of legal rules is especially high. Under the business judgment rule, courts refuse to second-guess the substantive business judgments of corporate directors. Yet the rule can be overcome in cases where there is self-dealing, gross negligence in the process of board decisionmaking, a no-win decision, or, in rare circumstances, an irrational decision that wastes corporate assets. The combination of these features creates a strong presumption against judicial review of board decisions, but it is a presumption that will flip in egregious cases. That is, the presumption draws on the notion of disproportionate hardship that is a theme of equity.[66]

The second mechanism is the derivative lawsuit. Director opportunism often raises questions as to whether a corporation should sue its own directors. A litigation decision, however, is itself a type of business decision, and as noted above, courts generally defer to substantive board decisions. Equity's solution is to permit shareholders to initiate litigation on behalf of the corporation, while at the same time strictly limiting access to that option. The derivative suit means that on occasion shareholders can take over a core business decision to address opportunistic director conduct. Where the risks of director opportunism

62 *See id.* at 593.

63 *See id.* at 531–32.

64 *See id.* at 593. Note also that the court still left open tort liability for intentional harm. *See id.*

65 This is not intended to be an exhaustive list of important contexts in which corporate law makes use of equitable remedies. In this Article, we focus particularly on how corporate law employs equitable principles in the settling of internal governance questions. There are, however, also important equitable doctrines in corporate law that concern the protection of third parties (for example, the doctrine of corporate veil piercing). *See infra* Section III.B.

66 *See* Smith, *supra* note 10, at 1081, 1087–89, 1118–19.

are especially high, the derivative plaintiff is enabled to force a suit against the directors on behalf of the corporation. On the other hand, given the risk of strike suits—an opportunistic use of equity—derivative suits are subject to a variety of constraints, ranging from a heightened pleading standard to various substantive limits on the parties given standing to bring suit.

The third mechanism is exemplified by cases like *Schnell v. Chris-Craft Industries, Inc.*[67] This mechanism carves up the proper spheres of equitable and legal reasoning, differentiating their application while also guaranteeing that equity will play a role. Prior to assessing whether a director's or officer's conduct is equitable, courts first determine if the conduct at issue was within the actor's legal authority. This initial analysis is often highly formalist, and courts generally do not apply equitable reasoning at this stage. On the other hand, as the *Schnell* court famously emphasized, "inequitable action does not become permissible simply because it is legally possible."[68] Although equity is initially bracketed when courts determine what is legally possible, equity is then given a prominent role in policing such conduct. The effect is to create a sphere in which law is supreme, while simultaneously retaining a place for equity to protect against misuse of the legal rights at issue.

Finally, the fourth mechanism is to provide a menu of business entities with distinctive relationships to equity. Corporate law mandates fiduciary duties. Yet sophisticated parties are not limited to the corporate form when they start their business. The Delaware limited liability company (LLC) and limited partnership offer a very different legal template, in that they not only permit the restriction of fiduciary duties, but also allow parties to remove fiduciary duties completely. Furthermore, with careful contracting, an LLC may closely resemble a corporation in its governance features and general attributes. Delaware law thus offers a corporation-like business entity without the equity doctrine characteristic of corporate law. Even in a Delaware LLC or limited partnership, the parties must still respect the contractual covenant of good faith and fair dealing; this covenant may not be eliminated.[69] As a consequence, there is still a safety valve against opportunism (albeit a circumscribed one), and the parties have the ability to limit the contexts in which this safety valve will be applicable. In effect,

67 Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971). This case could also be read as a conflicting rights case, thus implicating an additional function of equity.

68 *See id.* at 439.

69 We recognize that the covenant of good faith and fair dealing is contractual (rather than traditionally equitable). However, we adopt a functional account of equity, and the covenant operates in an equity-like fashion. For further discussion of the covenant of good faith and of linkages between contract law and equity, see Smith, *supra* note 14, at 905.

equity's role may be customized. This menu of entities provides a long-term constraint on the opportunistic use of equity, as a sufficient risk of opportunism may result in migration from the corporate form to comparable unincorporated entities.

Equity—both as a response to opportunism and as a potential source of opportunism—is thus carefully shaped by corporate law doctrine. Equitable review is one of the few mandatory features of corporate jurisprudence,[70] and it is designed to play a flexible, context-sensitive role. Common law doctrines are also designed to ensure that equity will continue to play a substantial role in governing the conduct of corporate actors. Yet these features that provide for a powerful form of equity are themselves subject to opportunism. Thus, the availability of equity is also cabined through a series of distinct strategies, including subject area boundaries (e.g., the business judgment rule), standing limitations (e.g., the limitations on parties capable of initiating a derivative suit), pleading requirements (e.g., the particularity requirement for derivative suits), restrictions on equitable authority (e.g., the limits on equity's ability to bring about results that exceed statutory constraints), and opportunities for a different choice of business entity (e.g., the option of selecting a Delaware LLC without fiduciary duties). We will discuss each of these features in turn and will conclude this Part with some thoughts on the relation of recent developments under the heading of "ESG" and the policing role of courts through equity.

A. *The Business Judgment Rule and Its Exceptions*

One of the most striking features of corporate law is the business judgment rule. According to this rule, courts will not second-guess the substance of a board's decision. As the Delaware Supreme Court describes the rule, "[i]t is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[71] Where this presumption applies, courts won't intervene "unless the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose or reach their decision by a grossly negligent process."[72] Whether or not a court

70 *See* Sample v. Morgan, 914 A.2d 647, 664 (Del. Ch. 2007) (noting that the balance between law and equity is an "essential aspect" of Delaware corporate law). On the degree to which the rules in corporate law are changeable, see Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542 (1990).

71 Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

72 *Brehm*, 746 A.2d at 264 n.66.

would have reached a different conclusion if it were in the board's place, the board's business judgment is left alone.

The business judgment rule is a central component of corporate law, and its content has been explained in a variety of ways.[73] In fact, there are multiple overlapping justifications for the business judgment rule. Commentators suggest it is a way of avoiding overly risk-averse director behavior.[74] The business judgment rule is seen as a means to encourage talented directors to serve.[75] It is explained in terms of portfolio theory, given the likely preferences of diversified shareholders.[76] It is also a means to avoid hindsight bias, given that courts will be assessing judgments that often appear foolish in retrospect even if they were reasonable when made.[77] The business judgment rule is sometimes justified in light of doubts about judicial competence in the business sphere.[78] And the rule may be a response to problems of severe judicial uncertainty, and, relatedly, of complexity.[79] Each of these accounts is plausible, and it appears that courts recognize the doctrine for multiple reasons.

This Article will offer an additional justification. The business judgment rule can be understood as a mechanism for maintaining a hybrid law-equity decision-making process. Corporate law maintains a careful balance between law and equity, and the business judgment

73 Examples in the academic literature include William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of* Van Gorkom *and Its Progeny as a Standard of Review Problem*, 96 NW. U. L. REV. 449 (2002); Stephen M. Bainbridge, *The Business Judgment Rule as Ahstention* [sic] *Doctrine*, 57 VAND. L. REV. 83 (2004); Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, 2000 WIS. L. REV. 573; Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 440–45 (1993); Franklin A. Gevurtz, *The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?*, 67 S. CAL. L. REV. 287 (1994); Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on* Disney*, Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398 (2007); Lyman Johnson, *The Modest Business Judgment Rule*, 55 BUS. LAW. 625 (2000).

74 *See* Allen et al., *supra* note 73, at 455 ("A standard of review that imposes liability on a board of directors for making an 'unreasonable' . . . decision could result in discouraging riskier yet socially desirable economic decisions, because an ordinary negligence standard of care will tend to make directors unduly risk averse.").

75 *See id.* at 452 (noting the concern that "the risk of liability under the applicable standard of conduct for assuming a given corporate role may dwarf the incentives for assuming the role").

76 *See* Joy v. North, 692 F.2d 880, 886 (2d Cir. 1982).

77 *See* Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 621 (1998) (suggesting that the business judgment rule arises from an apprehension that hindsight bias can influence judicial decisions).

78 *See* EASTERBROOK & FISCHEL, *supra* note 9, at 100 (noting that "[j]udges are neither chosen for business acumen nor fired or subject to reductions in salary if they err in assessing business situations").

79 *See* Gold, *supra* note 73, at 460–70.

rule is a means to preserve this balance. From this perspective, the business judgment rule serves as a limit on the opportunistic use of equity, but it also still allows equity to function where risks of director opportunism are sufficiently high. As a consequence of the business judgment rule, there is a strong presumption in favor of board conduct—in its strong form, the rule has even been described as an abstention doctrine.[80] Perhaps even more accurately, the business judgment rule is a standard of review, rather than pure underenforcement as many have assumed.[81] Standards of review are second order, and like equity, they are engaged by triggers and, once engaged, range over context in their application. Courts will not intervene so long as the rule applies, and the business judgment rule will often result in the dismissal of a case at an early stage of litigation. This doctrine creates a strict limit on judicial exercise of equitable powers.[82] Yet as we will see, the business judgment rule does not always govern a legal claim.

1. When Presumptions Flip

From an anti-opportunism perspective, the exceptions to the business judgment rule are as significant as the rule's protections. In the ordinary case, the business judgment rule precludes judicial involvement in disputes over the board's decisions. Where the likelihood of director opportunism is particularly high, however, this doctrine does not apply. In cases of director self-dealing, gross negligence in the decision-making process, or irrationality, the business judgment rule can be overcome.[83]

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80 *See* Bainbridge, *supra* note 73, at 87.

81 Julian Velasco, *Fiduciary Judgment Rules*, 62 WM. & MARY L. REV. 1397, 1415 (2021).

82 Following the enactment of DEL. CODE ANN. tit. 8, § 102(b)(7) (2024), Delaware corporations may also exculpate directors from monetary liability for breaches of the fiduciary duty of care by adopting an appropriate provision in their corporate charter. These are now quite common provisions in the charters of public corporations, and such provisions can prove significant in the early stages of litigation. *See In re* Cornerstone Therapeutics Inc., S'holder Litig., 115 A.3d 1173, 1177, 1187 (Del. 2015).

83 There is also a notable additional context in which fiduciary claims are successfully brought. This is not, strictly speaking, an exception to the business judgment rule; rather, it is a case in which the rule is inapplicable because the conduct at issue falls outside its coverage. In certain cases, no business judgment is at issue, and accordingly the business judgment rule is inapt. The classic example arises when the board has failed in its duty to monitor the corporation. The hurdle for bringing a claim of this type is relatively high—courts look for a sustained and systematic failure of oversight. But in appropriate cases, plaintiffs may bring claims for fiduciary breach based on such failures to monitor. *See, e.g.*, *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971–72 (Del. Ch. 1996); Stone v. Ritter, 911 A.2d 362, 365 (Del. 2006). This setting also matches another equitable theme in Delaware corporate law, which is its dynamism. For a more recent expansion of *Caremark*'s implications, see *Marchand v. Barnhill*, 212 A.3d 805, 808 (Del. 2019).

In effect, "these categories are versions of the equitable proxies," and, like those proxies, they can be somewhat open ended.[84] In cases of irrationality or gross negligence in the decision-making process, these categories parallel the unexplained extreme imbalances that shift presumptions in the law of equity.[85] Consider a case of corporate waste, for example. Here, the substance of a business decision simply can't be explained in terms that make sense from a business perspective. We may not know of any particular fraud or self-dealing in a case of wasteful conduct, but the irrationality of the business decision at issue is likely to correspond to an underlying opportunistic decision.[86] That said, merely undesirable or foolish business decisions are not enough to support liability. Bad director choices may sometimes coincide with opportunism, but if it were enough to show a business decision's foolishness in order to avoid business judgment rule protections, the business judgment rule would rapidly be swallowed up by its exceptions. A safety valve applies in the extreme cases, and that is how this exception to the business judgment rule works. The cases that implicate corporate waste are highly unusual.

Another context in which a claim can move forward involves the process of board decisionmaking. In rare instances, courts will find that plaintiffs have rebutted the business judgment rule by alleging gross negligence.[87] This is not gross negligence with respect to the substance of the board's decision; that type of claim would have to meet the very high hurdle required for a showing of corporate waste. Rather, plaintiffs argue that the board was not adequately informed when it made its decision. This was the basis for liability in the famed *Van Gorkom* case.[88] Per *Van Gorkom*, the test for gross negligence is met in those cases where directors were not informed of all material information reasonably available to them.[89] Mere negligence, however, will

84 *See* Smith, *supra* note 4, at 274 n.61.

85 *See id.*

86 For a suggestion that such irrational board conduct may amount to bad faith, see Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule.").

87 Moreover, the courts have made it clear that in practice the test for gross negligence is difficult to meet. *See, e.g.*, Guttman v. Huang, 823 A.2d 492, 507 n.39 (Del. Ch. 2003) (indicating that a successful pleading of a breach of care calls for "facts that suggest a *wide* disparity between the process the directors used . . . and that which would have been rational").

88 Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

89 *See id.* at 872 ("The determination of whether a business judgment is an informed one turns on whether the directors have informed themselves 'prior to making a business decision, of all material information reasonably available to them.'" (quoting Aronson v.

not suffice. As a practical matter this standard is also hard to meet, applying only in the more extreme cases.[90]

In cases of self-dealing, the anti-opportunism account is also a good fit. The transaction at issue in a self-dealing case will often be the product of opportunistic director or officer behavior, and the likelihood of such opportunism is sufficiently great in such cases to justify a shift in presumption. Note also that conflict-of-interest transactions raise concerns even where a director's or officer's intent to deceive or otherwise take advantage of a beneficiary is absent. Many conflict-of-interest transactions implicate self-deception. This exception thus addresses the human capacity for rationalization.[91] Self-serving rationalization can lead to evasion, even in those instances where fiduciary parties are not consciously aware that they are misusing their discretion.[92]

There is a pattern to each of these exceptions to the business judgment rule. These exceptions are not entirely open ended, consistent with a desire to prevent the exceptions from supplanting directors' lawful scope of discretion.[93] Moreover, the boundaries of these exceptions are set such that they are narrow in scope. Not everything that statistically corresponds to opportunism will permit plaintiffs to overcome the business judgment rule. Facts that might suggest some limited risk of bias on the part of a director—such as an ordinary friendship between a director and a counterparty to a corporate transaction—are not generally sufficient on their own to rebut the business judgment

Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000))).

90 Moreover, following the *Van Gorkom* case, the Delaware legislature enacted a provision allowing for exculpatory provisions in a corporate charter. *See supra* note 82. It is still possible for plaintiffs to get past such provisions if they can demonstrate a breach of the fiduciary duty of good faith, but the test for a breach of good faith calls for a conscious disregard of the directors' duties or other types of deliberate misfeasance. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006). For further analysis of the *Disney* opinion's standard for fiduciary good faith, see Gold, *supra* note 73, at 421–26.

91 *See* Smith, *supra* note 4, at 277–78; *see also* Irit Samet, *Guarding the Fiduciary's Conscience—A Justification of a Stringent Profit-Stripping Rule*, 28 OXFORD J. LEGAL STUD. 763 (2008); Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 498–99 (2009). For an exploration of self-deception and rationalization in legal contexts through the lens of behavioral ethics, see YUVAL FELDMAN, THE LAW OF GOOD PEOPLE: CHALLENGING STATES' ABILITY TO REGULATE HUMAN BEHAVIOR 1–4 (2018).

92 *See* Smith, *supra* note 4, at 278 (citing Feldman & Smith, *supra* note 14).

93 There are some who would endorse greater flexibility in applying the exceptions to the business judgment rule. For example, courts might adopt a "sliding scale" approach, whereby a combination of gross negligence and structural factors suggesting director bias would support a showing of director bad faith. *See* Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 855–56 (2007). The fact that courts have not yet adopted such an approach is consistent with a concern that if equity is too open ended, it will itself be subject to opportunism.

rule.[94] Instead, the exceptions to the business judgment rule are difficult to trigger outside of the more extreme cases or, alternatively, outside of the more obvious conflict-of-interest scenarios.[95] In this way, corporate law is able to limit the potential for an opportunistic use of equity by sophisticated plaintiffs.

That said, in those cases where a case does fall outside of the business judgment rule, the burden of proof flips. The defendant now has to demonstrate the entire fairness of the transaction at issue.[96] Entire fairness is an exacting standard, and requires the defendant to show both fair price and fair dealing (in those fact patterns where both concerns are applicable).[97] In addition, neither price nor fair dealing is independently determinative.[98] As a consequence, entire fairness is a fact-intensive test, and one that will often be difficult to assess at an early stage of litigation. Where the entire fairness test applies, the burden on the corporate fiduciary is a difficult one to meet, and the proper outcome is hard to resolve through a simple motion to dismiss.[99]

2. When Presumptions Flip Back

In the business judgment rule context, the exceptions to the exceptions are also significant. In certain fact patterns, the presumption flips back yet again. For example, sometimes directors may be required to seek a shareholder vote before a transaction goes through. This is often true with merger transactions. In other cases, directors may voluntarily seek shareholder ratification of a deal. Likewise, the board may delegate its authority to a committee of independent

94 *See* Beam v. Stewart, 845 A.2d 1040, 1051 (Del. 2004) (rejecting the idea that mere friendship is enough to raise a reasonable doubt about independence in the demand excusal context).

95 On the other hand, in the more extreme cases, the courts have been careful to preserve their discretion to recognize new ways in which fiduciary responsibilities have been violated. In recognizing that bad faith conduct can be a type of disloyalty, the courts have described several examples of conduct that implicates bad faith, but have also indicated that these examples are not an exclusive list. *See, e.g.*, Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006) (quoting *In re Walt Disney Litig.*, 906 A.2d at 67). In effect, this list appears to work like a catalog. *See* Gideon Parchomovsky & Alex Stein, *Catalogs*, 115 COLUM. L. REV. 165, 170 (2015) (describing distinctions between catalogs, rules, and standards).

96 For the classic statement of the entire fairness test, see *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

97 *Id.*

98 *See id.* (noting that the entire fairness test "is not a bifurcated one as between fair dealing and price").

99 A point that the Delaware courts have emphasized. *See, e.g.*, Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 459 (Del. Ch. 2011) ("Entire fairness is Delaware's most onerous standard.").

directors. Each of these votes can be important when courts assess the appropriate standard of review. With appropriate disclosure of material facts, these votes can "cleanse" a transaction that would otherwise trigger the entire fairness test.[100]

Suppose that a corporation's board of directors presents a conflicting-interest transaction to the shareholders for a ratifying vote. Ordinarily, such transactions fall under an exception to the business judgment rule. But assuming the shareholders are informed of all material facts, shareholder ratification can often restore the business judgment rule presumption.[101] This outcome makes sense from an anti-opportunism perspective on equity, as the risks of opportunistic conduct are substantially lower in a case where a majority of fully informed shareholders supports the transaction. For similar reasons, a vote by a committee of disinterested directors can also flip the burden back to shareholders, and, again, potentially restore business judgment rule deference. In these cases, the reasons justifying closer judicial scrutiny are no longer applicable, or at least not applicable to such a degree that the benefits of equitable review will outweigh the risks that equity is being used opportunistically.[102]

In addition, Delaware law includes a further subtlety. As we might expect under an anti-opportunism account of equity, directors and officers are not the only parties subject to fiduciary duties. In some cases, risks of opportunism call for fiduciary doctrine to be extended to additional corporate actors. Ordinarily, shareholders do not owe fiduciary duties to other shareholders. But if a shareholder is found to dominate the board of directors, that shareholder will acquire a fiduciary duty to the minority shareholders.[103] In these cases, the controlling shareholder will effectively be in charge of the corporation, and the directors can no longer be relied upon to consistently act as neutral decisionmakers. It is thus understandable that the true party governing the corporation's decisionmaking, the dominant shareholder, should owe a fiduciary duty. Yet here too, the business judgment rule may apply to protect the board's decisions.

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100 For further analysis of this doctrine, which can be quite context specific, see Claire Hill & Brett McDonnell, *Sanitizing Interested Transactions*, 36 DEL. J. CORP. L. 903, 910 (2011).

101 *See* Gantler v. Stephens, 965 A.2d 695, 713 (Del. 2009). For prior analysis of ratification in loyalty contexts, see *In re Wheelabrator Technologies, Inc. Shareholders Litigation*, 663 A.2d 1194, 1202–05 (Del. Ch. 1995).

102 Because such efforts are themselves a potential source of opportunism, we also see limits on how far cleansing transactions can go. *See In re* Invs. Bancorp, Inc. S'holder Litig., 177 A.3d 1208, 1211 (Del. 2017) (limiting effectiveness of a shareholder approval in light of discretion it gave the board).

103 Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719–20 (Del. 1971).

In the non-controlling shareholder case, the Delaware courts have announced that disinterested, uncoerced shareholder approval presumptively provides business judgment rule protection.[104] But what if we have a case of self-dealing by a controlling shareholder? As with other fiduciary settings, the directors will often seek to cleanse the transaction of any conflicting interest concerns by means of a vote by a disinterested party. For example, the board of directors might send the transaction to the shareholders for a vote, and only go forward if there is approval of the transaction by a majority of the minority shareholders. Yet the Delaware courts do not follow their standard precedents in these controlling shareholder cases. Consistent with the anti-opportunism account, ratification doctrines are adjusted: the cleansing vote does not restore the business judgment rule. Instead, the entire fairness test will apply, but the burden will shift to the plaintiff to show that the transaction was not fair.[105] The policy basis for this shift—one in which an entire fairness test still applies—is the likelihood that minority shareholders will vote in favor of the transaction out of fear that the controlling shareholder would retaliate against them following a negative vote.[106] Opportunism would still be a significant risk even where minority shareholders formally support the deal, and the law is responsive to this risk.[107]

Note, however, that in a controlling shareholder merger transaction, the Delaware Supreme Court has more recently recognized business judgment rule protections where both a vote by a committee of disinterested directors and also a vote by a majority of the minority shareholders supported the transaction.[108] The Delaware Supreme Court has since extended the idea further to other controlling shareholder settings.[109] Even where there is a controlling shareholder, there

104 *See* Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304, 306 (Del. 2015).

105 *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1116, 1121–22 (Del. 1994).

106 *See id.* at 1116–17 (quoting Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990)).

107 In addition, there are further contexts where legal doctrines are customized to address risks of opportunism. Where the substance of a transaction is so egregious that it is hard to imagine a legitimate business reason for the board's decision, the courts take this into account through the doctrine of corporate waste. *See* Brehm v. Eisner, 746 A.2d 244, 263–64 (Del. 2000). When waste is implicated, even a vote by a majority of shareholders will not suffice to restore the business judgment rule. *See* Michelson v. Duncan, 407 A.2d 211, 219 (Del. 1979) ("It is only where a claim of gift or waste of assets, fraud or *ultra vires* is asserted that a less than unanimous shareholder ratification is not a full defense.").

108 *See* Kahn v. M & F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014), *overruled by* Flood v. Synutra Int'l, Inc., 195 A.3d 754 (Del. 2018); *In re* MFW S'holders Litig., 67 A.3d 496, 502 (Del. Ch. 2013).

109 *See In re* Match Grp., Inc. Derivative Litig., 315 A.3d 446, 470–71 (Del. 2024) (recognizing application of *MFW* doctrine to controlling shareholder settings outside freezeout merger contexts). We bracket the more specific question as to whether *MFW* is best

is thus a limit to equity's ambit if sufficient legal safeguards are in place and, if the law operates as intended, sufficient limits on the risk of opportunistic behavior. Controlling shareholder transactions are a special case, but they are not immune to the courts' continued fine-tuning of the law-equity divide.

3. Heightened Standards of Review

Over time, corporate law has also recognized new categories in which opportunism is of particular concern. Corporate jurisprudence shows flexibility in response to changed circumstances, and this flexibility is particularly important given that sophisticated parties and counsel regularly develop new transactional types. For example, in the 1980s, hostile takeovers presented the Delaware courts with both novel fact patterns and an increasingly high profile set of corporate disputes. These ultimately produced an adjustment to Delaware's business judgment rule jurisprudence. Confronted with corporate disputes that did not fit into the classic business judgment rule exceptions, but that did raise significant concerns about opportunism, the court adopted intermediate standards of review.

A classic category arises in the context of takeover defenses. In these situations, corporate directors often lack conflicting interests sufficient to trigger the standard exceptions to the business judgment rule. Commonly, the directors will not be on both sides of the transaction. In addition, in many cases there are legitimate business reasons for thinking that a particular takeover would be harmful both to the corporation and to its shareholders. This possibility suggests that a takeover defense could be both well motivated and, in some cases, desirable. On the other hand, the directors could plausibly expect to lose their jobs if a hostile acquirer takes over their corporation. An incumbent board's entrenchment interest is hard to ignore when considering the likelihood of a biased decision-making process.[110]

In the leading case, *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court announced a new legal test.[111] In that case, Mesa (controlled by T. Boone Pickens, Jr.), had initiated a two-tier tender

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confined to limited settings; our aim here is to recognize the general pattern of corporate law's divide between law and equity and its mode of evolution. On the concerns raised, see Lawrence A. Hamermesh, Jack B. Jacobs & Leo E. Strine, Jr., *Optimizing the World's Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321, 336–44 (2022).

110 Note that there is also a conflicting rights problem here: the corporate board has certain rights with respect to directing the corporation; the shareholders have certain rights with respect to disposal of their shares. These two categories are in significant tension when a hostile takeover is in the works. Equity can be seen as responding to this concern in a contextual, ex post manner.

111 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

offer for stock in Unocal Corporation. The tender offer sought thirty-seven percent of the shares, at a price of fifty-four dollars per share.[112] Mesa already owned thirteen percent of Unocal's stock, and presented a takeover threat. After Unocal's board met to discuss this tender offer, and with advice from Goldman Sachs, Unocal's board concluded that the Mesa offer was inadequate. Unocal ultimately responded with an exchange offer of its own, at seventy-two dollars per share.[113] Mesa, however, was excluded from Unocal's offer.[114] Mesa sued, arguing that this discriminatory offer violated Delaware law.

The Delaware Supreme Court concluded that it is legally permissible for a corporation to use exclusionary tactics in its dealings with shareholders.[115] But the mere fact that conduct is legally authorized does not mean that it is equitable. In this context, the risk of opportunism is increased, since the directors and officers may seek to protect their own jobs rather than look out for corporate and shareholder best interests. This, in turn, justified a different standard of review.

As the *Unocal* court explained:

> When a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders. In that respect a board's duty is no different from any other responsibility it shoulders, and its decisions should be no less entitled to the respect they otherwise would be accorded in the realm of business judgment. There are, however, certain caveats to a proper exercise of this function. Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.[116]

Consequently, the court adopted a new, two-part test for judicial review of board decisions in this setting. Under the first part of the *Unocal* test, the board must show it had reasonable grounds for believing a threat to corporate policy existed.[117] Under the second part, the board must show that the response taken was reasonable in relation to the

112 *See id.* at 949.

113 *See id.* at 951.

114 *Id.*

115 *See id.* at 953–54.

116 *Id.* at 954 (footnote omitted) (citing Johnson v. Trueblood, 629 F.2d 287, 292–93 (3d Cir. 1980)).

117 *Id.* at 955 ("In the face of this inherent conflict directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership.").

threat posed.[118] Only if the directors are able to get past these two hurdles will they then fall under the protections of the business judgment rule. *Unocal* thus turns the business judgment rule into a contingent defense in this setting, rather than a default starting point.

Intermediate scrutiny also applies where a corporation is up for sale or faces an inevitable breakup. The key decision is *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[119] In that case, the Delaware Supreme Court addressed a dispute in which the Revlon board had used defensive measures to prevent Pantry Pride from acquiring Revlon. In addition to seeking to prevent a takeover by Pantry Pride through various defensive measures, the Revlon board entered into an agreement designed to lock up a deal with Forstmann Little in return for Forstmann supporting the value of certain Revlon notes.[120] Pantry Pride brought suit.

While the initial defensive measures were subject to a standard *Unocal* analysis, the lock-up agreement with Forstmann was problematic. On the facts in this case, the board had effectively recognized the company was for sale.[121] And, as the court explained in *Revlon*:

> The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. This significantly altered the board's responsibilities under the *Unocal* standards. It no longer faced threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures became moot.[122]

Accordingly, the business judgment rule did not apply.[123] In fact, the Revlon board was now required to maximize the corporation's value, closely tying board decisionmaking to shareholder interests.[124]

Revlon is thus another case in which the Delaware courts have employed heightened scrutiny of director decisions given an increased risk of opportunism. Subsequent decisions, however, have made clear that board action under this standard is subjected to a relatively deferential reasonableness test.[125] And, more recently, in the *C & J Energy*

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118 *See id.* ("If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed.").

119 Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

120 *See id.* at 178–79.

121 *See id.* at 182.

122 *Id.*

123 *Id.* at 185.

124 *See id.* at 182.

125 *See* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994). Subsequent cases have also made clear that *Revlon* is actually a specific application of the *Unocal* doctrine. On this elaboration of *Revlon*, see Stephen M. Bainbridge, *The Geography of* Revlon-*Land*, 81 FORDHAM L. REV. 3277, 3314–15 (2013).

case the Delaware Supreme Court indicated that *Revlon* does not necessarily require an auction whenever the board has approved a change of control transaction.[126] Again, the pattern in corporate jurisprudence is to recognize those situations where conflicts of interest are or are likely to be present, while tailoring the standards of judicial review so that equitable intervention remains constrained.[127] How constrained varies with the transaction type and the context.

As these examples suggest, judicial review of board action both establishes a role for equity and places boundaries around that role. The business judgment rule means that a broad variety of director decisions are not open to equitable intervention, even in those instances where a board has failed to do what is best for the corporation and its shareholders. A series of exceptions to the business judgment rule, however, allow courts to step in where the risk of opportunism is particularly high. These exceptions are nevertheless triggered in cases of extreme behavior or in cases of clear-cut conflicting interests, rather than on a sliding scale. Consequently, the potential that equity will gradually absorb the business judgment rule is reduced. Furthermore, the courts have recognized mechanisms for restoring business judgment rule protections where appropriate measures are taken to "cleanse" a transaction. To this extent, corporations may structure transactions to limit equitable review. Finally, the courts have shown a readiness to develop additional standards of review where categories of director behavior raise unique concerns. Corporate law regularly adjusts to address areas where traditional equitable doctrines may not adequately police an opportunism risk. The resulting approach provides a carefully calibrated form of equity, closely governed by the type of conduct under review.

The role of presumptions and standards of review points to the meta aspect of equity in corporate law. These doctrines do not set a standard directly and enforce it as such. Instead, these doctrines aim at setting rough boundaries for primary behavior not to get too far off track. And these boundaries are couched in terms of where the parties' interaction is headed as a whole, not by evaluating some specific activity they might or might not engage in. As with bankruptcy law, it

126 *See* C & J Energy Servs., Inc. v. City of Mia. Gen. Emps.' & Sanitation Emps.' Ret. Tr., 107 A.3d 1049, 1067 (Del. 2014).

127 Some have suggested that the test in *Zapata Corp. v. Maldonado*, 430 A.2d 779, 787–88 (Del. 1981), also offers an intermediate standard of review. *See* Hill & McDonnell, *supra* note 93, at 839–40. We discuss that case and its significance below, in our analysis of derivative litigation. Another case that alters the standard of review in a setting of increased opportunism risk is *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). Under *Blasius*, courts apply a heightened standard where a board interferes with the shareholder voting franchise. *Id.* at 659.

is easy to mistake such a higher-level guidance function for a very messy set of primary directives.[128] Courts might be much better at keeping parties away from misuse of the law and preventing the occasion for certain kinds of opportunism—shaping the ex post bargaining—than they would be at engaging in a direct inquisition about bad behavior in general.

B. Derivative Litigation and Demand Futility Doctrines

The derivative lawsuit is a crucial equitable innovation. If directors were not subject to derivative suits brought on behalf of the corporation, opportunistic behavior could run rampant.[129] The derivative suit is also one of the more distinctive institutions for policing misconduct in corporate settings. As Judge Winter describes derivative litigation,

> [t]he derivative action is the common law's inventive solution to the problem of actions to protect shareholder interests. In its classic form, a derivative suit involves two actions brought by an individual shareholder: (i) an action against the corporation for failing to bring a specified suit and (ii) an action on behalf of the corporation for harm to it identical to the one which the corporation failed to bring. The technical structure of the derivative suit is thus quite unusual.[130]

In this way, the derivative suit enables claims by the corporation against parties who are, effectively, directing the corporation's own conduct.

Yet while the derivative suit is a crucial feature of corporate law, it is nonetheless subject to opportunistic misuse. There is a substantial risk that directors will not cause their corporation to bring meritorious actions against the directors themselves, but there is also a countervailing risk that the benefits of centralized board decisionmaking could be jeopardized by shareholder second-guessing. Moreover, there is a serious possibility that shareholders will bring derivative suits for improper reasons—ranging from questionable strike suits to litigation designed to benefit rival corporations, labor unions, or other third-party interests. In addition, there is a structural consideration. The board

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128 *See generally* Anthony J. Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, 120 COLUM. L. REV. 1709 (2020).

129 *See generally* Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747 (2004) (providing empirical data on the significance of derivative suits). For further analysis of the costs and benefits associated with derivative suits, see Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55 (1991), and Reinier Kraakman, Hyun Park & Steven Shavell, *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733 (1994).

130 Joy v. North, 692 F.2d 880, 887 (2d Cir. 1982) (citing Ross v. Bernhard, 396 U.S. 531 (1970)).

has been allocated managerial authority to make business decisions, and, ultimately, the question whether a corporation should litigate is itself a business decision.[131] Once again, concerns about conflicting rights arise, intertwined with those about opportunism.

In response to these concerns, equity strikes a balance. Shareholders must ordinarily make a demand on the board requesting that the board consider the appropriateness of a suit. In the absence of such a demand, shareholders lack standing to initiate derivative litigation. And shareholders are not permitted to recharacterize their suit as a direct suit—one made on behalf of shareholders—if the harm suffered is truly a harm to the corporation.[132] The decision to sue on behalf of the corporation is left to the board, at least as a default. In order to get past these challenges, a shareholder plaintiff typically must argue that making a demand would have been futile. Demand futility, however, can only be shown in very limited cases. Corporate law thus employs a gatekeeping strategy to limit an opportunistic use of derivative litigation. Courts limit which parties may initiate derivative litigation, and they limit which types of claims those parties may bring.

The elaboration of derivative suit doctrine is a good example of how equity's tools evolve to more precisely address legal circumstances (ultimately culminating with the decision in *Zuckerberg*). The key starting point was the seminal decision on demand futility in *Aronson v. Lewis*.[133] In that case, the Delaware Supreme Court set forth a two-pronged test. According to *Aronson*, a demand is futile when "under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[134]

Aronson contains several key requirements. One of them is particularity—by requiring particularized facts, the *Aronson* decision limits the likelihood of strike suits. Another is the "reasonable doubt"

131 *See* Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (citing the statutory authority of the board, and noting that "[b]y its very nature the derivative action impinges on the managerial freedom of directors"), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

132 *See* Tooley v. Donaldson, Lufkin, & Jenrette, Inc., 845 A.2d 1031, 1033 (Del. 2004) (announcing rule that whether a claim is direct or derivative "must turn *solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)").

133 *Aronson*, 473 A.2d 805.

134 *Id.* at 814. Note that the "and" in this test has been interpreted to mean "or." Success under either prong of *Aronson* is sufficient for a claim to survive. For an early example of this understanding, see *Pogostin v. Rice*, 480 A.2d 619, 624–25 (Del. 1984), *overruled on other grounds by Brehm*, 746 A.2d 244.

component, a constraint designed to guarantee that claims are comparatively strong. Likewise, the substantive requirements of the *Aronson* test are also significant (for example, the test for independence).

In many respects, the *Aronson* test parallels the business judgment rule in its concerns.[135] This should not be surprising. The court in *Aronson* emphasized that the business judgment rule comes into play repeatedly in derivative litigation: with respect to a board's response to "a demand, in the determination of demand futility," in efforts to dismiss a suit made by independent directors, and "as a defense to the merits of [a] suit."[136] The first prong of the *Aronson* test, with its focus on whether directors are disinterested and independent, clearly reflects the same considerations of director bias that are evidenced in the exceptions to the business judgment rule. And the second prong of the *Aronson* test expressly addresses the validity of business judgments. In each case, the showing required of plaintiffs tracks circumstances in which biased decisionmaking by the board of directors is likely. And in each case, the triggers and proxies embedded in the doctrine allow the law to operate at one remove.

The approach, however, is also nuanced, and it has evolved in subsequent years. Under *Rales v. Blasband*, an exception arose where the board of directors at the time of an allegedly wrongful transaction had been replaced, or where the alleged wrongdoing did not involve a business decision (as occurs when there is a failure to monitor).[137] In such cases, a different analysis was applied. The Delaware courts then effectively combined the *Aronson* and *Rales* tests in the *Zuckerberg* case, addressing the concerns that underpin both approaches.[138] As with other equitable doctrines, the law here adjusts over time to better handle the specific opportunism risks that characterize one context or another. It may also reflect shifts in the underlying legal doctrine that derivative suits implicate, as, for example, when duty-to-monitor cases have grown in importance; as noted, opportunism is not the only concern that equity addresses.

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135 Indeed, the Delaware courts have recognized that the demand futility doctrine and the business judgment rule are closely tied together. *See Aronson*, 473 A.2d at 812 ("In our view the entire question of demand futility is inextricably bound to issues of business judgment and the standards of that doctrine's applicability.").

136 *Id.*

137 *See* Rales v. Blasband, 634 A.2d 927, 933–34 (Del. 1993). For a helpful analysis of the *Aronson* test and its relationship to the *Rales* test, see Andrew C.W. Lund, *Rethinking* Aronson*: Board Authority and Overdelegation*, 11 U. PA. J. BUS. L. 703, 712–23 (2009).

138 *See* United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1048 (Del. 2021).

1. Standing to Initiate Derivative Litigation

The anti-opportunism account is especially illuminating in those cases where courts are called upon to make more significant adjustments to the existing corporate law structure. Standing requirements offer a good illustration. As indicated above, one of the most basic mechanisms for governance of the derivative suit is a limitation on standing. Ordinarily, the only parties who may initiate a suit are current shareholders who owned their shares at the time of the alleged wrongdoing and who have owned their shares continuously since then.[139] Where the risk of opportunism is sufficiently high, the Delaware courts have relaxed this requirement.[140] Yet in most cases, restrictions on standing are strictly enforced, and the Delaware courts have been quite reluctant to extend standing to parties beyond current shareholders.

In exceptional cases, the courts have allowed for a broader group of potential plaintiffs. Consider the treatment of fiduciary protections for creditors. Lower court precedents had once raised the possibility that directors of an insolvent (or nearly insolvent) corporation might owe fiduciary duties to creditors.[141] In *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, the Delaware Supreme Court confronted the question whether creditors could bring a direct claim for a fiduciary breach.[142] The court answered in the negative.[143] The court emphasized the panoply of other remedies already available to creditors.[144] This analysis is consistent with the anti-opportunism view: the availability of a variety of other remedies—some of them quite powerful—suggests that the risk of unchecked opportunism against creditors is limited. The court also expressed concern that the law might become unpredictable if fiduciary duties applied directly; fiduciary duties owed to both shareholders and creditors could have indeterminate content.[145]

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139 Ark. Tchr. Ret. Sys. v. Countrywide Fin. Corp., 75 A.3d 888, 894 (Del. 2013) (quoting Lewis v. Anderson, 477 A.2d 1040, 1046 (Del. 1984)).

140 Where a shareholder loses ownership of his or her shares as the result of a merger perpetrated to deprive shareholders of standing to bring a derivative suit, the ordinary rule does not apply. For discussion, see *id.*

141 *See, e.g.*, Credit Lyonnais Bank Nederland v. Pathe Commc'ns Corp., No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30,1991).

142 N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 94–95 (Del. 2007).

143 *Id.* at 94.

144 *See id.* at 100–01.

145 As the court reasoned, "[T]he need for providing directors with definitive guidance compels us to hold that no direct claim for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency." *See id.* at 101. But the court also rejected a direct claim in those cases where the corporation actually

On the other hand, the *Gheewalla* court also announced that creditors may initiate derivative suits on behalf of an insolvent corporation.[146] As the court argued, "The corporation's insolvency 'makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value.' Therefore, equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation."[147]

And, as the court continued, individual creditors "have the same incentive to pursue valid derivative claims on its behalf that shareholders have when the corporation is solvent."[148] Given the incentives of shareholders in insolvency cases, creditors are not as well protected against opportunism as they ordinarily would be. The interests of shareholders and creditors commonly diverge if the corporation is in trouble. When a corporation is insolvent, shareholders may even prefer a bet-the-corporation strategy at the expense of creditor interests. A grant of derivative standing to creditors provides a remedy for opportunism in this context.[149]

2. Special Litigation Committees

Where necessary, however, the courts have shown a readiness to further customize derivative suits for special circumstances. In the early 1980s, the carefully balanced structure of derivative litigation was called into doubt by a new defense strategy. Corporate codes permit boards of directors to create committees of directors with the authority to decide on transactions in place of the full board. Following a derivative complaint, boards of directors began creating special litigation committees. These committees would be comprised of independent directors with no involvement in the allegedly wrongful transactions that were the subject of the complaint. This raised a new question. If a special litigation committee finds that a derivative lawsuit lacks merit, should courts defer to that decision?

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is insolvent, given the difficulties this would pose for directors attempting to comply with their fiduciary duties to multiple beneficiaries. *See id.* at 103.

146 *See id.* at 101.

147 *Id.* at 101–02 (quoting Prod. Res. Grp., L.L.C. v. NCT Grp., Inc., 863 A.2d 772, 792 (Del. Ch. 2004)).

148 *Id.* at 102.

149 There are, however, also cabining mechanisms. One mechanism for cabining the application of the *Aronson* test and its progeny is to circumscribe the relationships that implicate director independence. For example, the Delaware Supreme Court has rejected the idea that friendships between directors were adequate to call into question a director's independence, absent additional facts. *See* Beam v. Stewart, 845 A.2d 1040, 1050–52 (Del. 2004). The more extreme fact patterns will support a demand futility claim, but generalized claims of structural bias or friendly social relations are inadequate.

In *Zapata Corp. v. Maldonado*, the Delaware Supreme Court squarely confronted this issue.[150] The court began with the question of statutory authority. In the court's view, the authority to create a board committee with the power of the full board was clearly provided for by Delaware statute.[151] In addition, this committee's powers would include the same authority to move for dismissal or summary judgment that is possessed by the entire board. The remaining question concerned the application of equitable principles. The court quickly concluded that the interest of a board majority is not a per se bar to delegation of the board's power to an independent committee. But how should courts then review exercises of such power? Arguably, deferential review would mean that the derivative lawsuit would cease to be a relevant constraint on director misconduct. Yet intrusive judicial review in such cases could mean that the committee's authority would be meaningless in practice.

The *Zapata* court recognized the risk of opportunism by both directors and plaintiff shareholders. As the court explained:

> If, on the one hand, corporations can consistently wrest bona fide derivative actions away from well-meaning derivative plaintiffs through the use of the committee mechanism, the derivative suit will lose much, if not all, of its generally-recognized effectiveness as an intra-corporate means of policing boards of directors. If, on the other hand, corporations are unable to rid themselves of meritless or harmful litigation and strike suits, the derivative action, created to benefit the corporation, will produce the opposite, unintended result.[152]

In other words, the court recognized that opportunistic conduct is a concern with respect to legal rules and with respect to equitable remedies. Equity may respond to opportunism, but equity may itself be used opportunistically.

The problem was to figure out how to address both concerns. One might give special litigation committees no deference at all. This, however, would mean that some legitimate committee decisions to dismiss litigation would be precluded. Or, one might apply the business judgment rule to decisions by a litigation committee. The *Zapata* court also rejected this approach.[153] As the court noted, "[W]e must be mindful that directors are passing judgment on fellow directors in the same corporation and fellow directors, in this instance, who designated

150 Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981).

151 *See id.* at 785 (citing DEL. CODE ANN. tit. 8, § 141(c)).

152 *Id.* at 786–87 (citing George W. Dent, Jr., *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U. L. REV. 96, 96 & n.3, 144 & n. 241 (1980)).

153 *See id.* at 787.

them to serve both as directors and committee members."[154] The risk of director bias is particularly high in this setting. On the one hand, the possibility of reviewing committee action for entire fairness would effectively disregard the independence of a committee's members. On the other hand, overly deferential review would erode the effectiveness of derivative suits as a remedy for fiduciary breaches.

The court's answer was innovative. *Zapata* announced a new standard of review for derivative actions in the special litigation committee setting. Following a thorough investigation, an independent special litigation committee may seek to have a derivative suit dismissed. The court should then follow a two-step test. First, it should inquire into the independence and good faith of the committee.[155] If the court is satisfied that this first step is met, it then has discretion to determine—based on its own business judgment—whether dismissal should be granted.[156] In such cases, the burden will be on the party moving for dismissal.[157] In other words, this is another intermediate form of review. Following *Zapata*, the court does not defer to the board committee, but instead considers a variety of factors in deciding whether a case should be dismissed. *Zapata* offers a means to avoid opportunistic use of the board committee mechanism while still providing a method for weeding out undesirable litigation where appropriate.[158]

Derivative litigation thus offers an important means for equity to prevent opportunistic misuse of board discretion. Yet courts have also limited the settings in which this mechanism is made available to shareholder plaintiffs. In this context, the key strategy for maintaining a balance between law and equity is a gatekeeping strategy. By recognizing the ability to expand derivative standing (as in the *Gheewalla* case), the derivative suit remains a safety valve for new cases in which an inability to initiate litigation would risk a serious injustice. And, once again, the doctrine is sensitive to categories of dispute that pose distinctive risks (as in *Zapata*). That said, in the ordinary circumstance, derivative standing is limited solely to shareholders, and the types of allegations required to show demand futility are quite restricted. The overall approach, then, is to make sure that equity remains an important constraint on fiduciary breaches, but with its protections triggered only by certain parties in certain fact patterns.

154 *Id.*

155 *See id.* at 788.

156 *See id.* at 789.

157 *Id.*

158 This increased level of scrutiny can be understood as a response to greater levels of structural bias within the board. For an analysis of *Zapata* in terms of structural bias, see Hill & McDonnell, *supra* note 93, at 839–40.

C. *The* Schnell *Doctrine*

A particularly notable example of the interaction between law and equity involves the subject matter to which equitable reasoning applies. In corporate law, there is a sphere in which courts use law-type reasoning and another sphere in which they use equity-type reasoning. Moreover, the decision-making process is sequentially ordered: courts first assess whether particular fiduciary conduct is legally permitted, and then, if it is, they assess whether that conduct is equitable. The two inquiries do not overlap. Legal reasoning is thus carefully divided between law and equity, with certain questions allocated to law and certain other questions allocated to equity. In effect, the courts have adopted a jurisdictional strategy to address the balance between law and equity.

1. *Schnell v. Chris-Craft Industries, Inc.*

This approach is closely associated with the 1971 Delaware Supreme Court decision in *Schnell v. Chris-Craft Industries, Inc.*[159] The chancery court's factual findings in that case provide a good example of inequitable behavior by a corporate board. There, an incumbent board faced a challenge from a group of dissident shareholders. The shareholders had indicated that they would use a proxy contest against management.[160] In response, the board amended the bylaws of the corporation in order to move the previously set annual shareholder meeting date to a time five weeks earlier.[161] This shortened time period before the meeting would have precluded a successful proxy contest by the dissidents.[162]

The Court of Chancery effectively found that the board manipulated the machinery of the corporate election process in order to keep itself in power.[163] Even so, the statutory requirements for a change to

159 Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971). It should be noted that the basic division between law and equity elaborated in *Schnell* predated that decision. For an early discussion, see A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (arguing that "in every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a *cestui que trust* to the trustee's exercise of wide powers granted to him in the instrument making him a fiduciary").

160 *Schnell*, 285 A.2d at 438–39.

161 *See id.* at 438.

162 *See id.* at 439.

163 *Id.* ("In our view, [the chancery court's] conclusions amount to a finding that management has attempted to utilize the corporate machinery and the Delaware Law for the purpose of perpetuating itself in office; and, to that end, for the purpose of obstructing the

the bylaws had been complied with, and the new date for the shareholder meeting conformed to the bylaws. This raised the question whether the conduct should stand, despite its motivation. On appeal, the Delaware Supreme Court determined that this date-moving conduct was unacceptable. As the *Schnell* court famously put it, "inequitable action does not become permissible simply because it is legally possible."[164] This language has since been quoted numerous times in the Delaware courts, and the underlying doctrine has proven highly influential.

Former Delaware Supreme Court Justice Jack Jacobs has suggested that *Schnell* ushered in an "equity model."[165] In Justice Jacobs's words, the equity model "describe[s] a system that favors courts intervening in cases whenever it becomes necessary to prevent or mitigate harsh results caused by the application of bright-line rules to particular individuals."[166] Following *Schnell*, courts turned to this equity model in a broad range of corporate law settings. Indeed, Justice Jacobs contends that the equitable principle "became enlarged to include the power to create, through the common law process, entirely new standards for reviewing board conduct in areas where no bright-line legal rule had ever existed."[167] *Schnell* can thus be seen as a crucial pivot point in the development of Delaware corporate law.

As noted, however, the courts' legal analysis under the *Schnell* approach is bifurcated. This feature is arguably just as important as the overlay of equitable review that the *Schnell* case is famous for. Characteristically, courts will begin first with an analysis of challenged conduct to see whether it is authorized under the relevant statutory provisions. This initial analysis is not based on an application of equitable principles. Where statutory interpretation is required, it is often highly textualist, and equity does not play a role at this stage.[168] After a decision

legitimate efforts of dissident stockholders in the exercise of their rights to undertake a proxy contest against management.").

164 *Id.* ("Management contends that it has complied strictly with the provisions of the new Delaware Corporation Law in changing the by-law date. The answer to that contention, of course, is that inequitable action does not become permissible simply because it is legally possible."). As the court's language suggests, the concern here involved what was a precise compliance with the letter of a statute, but was nevertheless an opportunistic use of that statutory text.

165 *See* Jacobs, *supra* note 59, at 6.

166 *Id.* at 4. The law model, in contrast, is "a shorthand to describe a system that elevates the importance of clear rules above all else." *Id.*

167 *Id.* at 8.

168 This is in contrast to a potential alternative model, in which equitable reasoning is applied at the level of statutory interpretation as well. *Cf.* Manning, *supra* note 7, at 8; William N. Eskridge, Jr., *All About Words: Early Understandings of the "Judicial Power" in Statutory Interpretation, 1776–1806*, 101 COLUM. L. REV. 990, 993 (2001).

that particular conduct is within a board's powers, the court will then proceed to determine if the conduct is equitable. There is thus a two-stage decision-making process, with equity entering the scene after a legal analysis of what the relevant corporate actors are authorized to do.

Indeed, one of the notable features of *Schnell* and its progeny is that equitable doctrine is applied against a backdrop of highly formalistic jurisprudence.[169] Equity in general permits the regular law to specialize in being formal, and without equity formalism is more difficult (or at least costly) to maintain.[170] This also makes a great deal of sense if equity is understood in anti-opportunism terms. Courts can more confidently apply rules to the letter for purposes of determining the authority granted by a rule—thus ensuring a type of predictability with respect to those rules—when they have the ability to police guileful exploitation of those rules by sophisticated parties.[171] Directors and officers, in turn, may rely on the courts' decisions when planning transactions, secure in the knowledge that (a) the corporate statute will be read precisely as written, and (b) a careful compliance with their fiduciary mandate should generally insulate a transaction from later challenge.

2. The Doctrine of Independent Legal Significance

A striking instance of the corporate law formalism that coexists with equity is the doctrine of independent legal significance, also known as the equal dignity rule. Under this doctrine, "[t]he mere fact that the result of actions taken under one section [of the statute] may be the same as the result of action taken under another section does not require that the legality of the result must be tested by the

169 In a sense, the *Schnell* doctrine can be understood to create a continued separation between law and equity, even though the Delaware courts hear both legal and equitable claims. *See* Leo E. Strine, Jr., *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, 60 BUS. LAW. 877, 880 (2005) (suggesting that "Delaware's system of corporate law still rests fundamentally on a division between law and equity"). A potential benefit to a second-order equitable safety valve is that it may allow formalism (in the sense of invariance to context) to operate in a more general fashion. *See* Smith, *supra* note 10, at 1100–08.

170 Smith, *supra* note 10, at 1100–08.

171 This is not the only type of predictability that may result from applications of equity as a safety valve. Rules whose meaning coincides with common moral intuitions, for example, may be more predictable in their application than rules whose content is subject to opportunistic but hard to predict behavior by sophisticated parties. *Cf.* Henry E. Smith, *Property, Equity, and the Rule of Law*, *in* PRIVATE LAW AND THE RULE OF LAW, *supra* note 16, at 224, 224–26 (assessing links between equity and the rule of law in light of widely shared moral norms).

requirements of the second section."[172] In other words, courts will treat each provision of the corporate code independently for purposes of determining the legal authority for a particular transactional choice. If the substance of a transaction is such that it could be accomplished under either of two statutory provisions, the courts will look to the form of the transaction; technical compliance with the requirements of one statutory provision will suffice even if the transaction at issue does not comply with the requirements of the other statutory provision.[173]

To make this concrete, consider the example of a stock split. Depending upon whether the stock split is achieved by means of an amendment to the corporation's charter or instead is effectively achieved by means of a dividend, a stockholder vote may or may not be required. Amendments to the articles require a stockholder vote; dividends do not.[174] It is legally acceptable for the board to act without a stockholder vote by opting for a dividend. This type of choice arises in a number of contexts. The classic context for the doctrine of independent legal significance is in response to claims of a de facto merger. While some states have insisted that transactions that are substantively equivalent to mergers (de facto mergers) must comply with the requirements for a merger, Delaware has rejected this doctrine. Each provision of the Delaware code is treated independently, and thus if a transaction can be structured under one of these provisions so as to have the effect of a merger—without complying with the technical requirements for a merger—it is permissible.[175]

It might seem odd to have a doctrine as formalist as the doctrine of independent legal significance, while simultaneously embracing the powerful role for equity developed in *Schnell*.[176] Yet there is nothing

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172 Orzeck v. Englehart, 195 A.2d 375, 377 (Del. 1963).

173 Although this type of reasoning may sound somewhat unusual outside of corporate law, it has analogies in other fields. *Cf.* Mark Tushnet, *Constitutional Workarounds*, 87 TEX. L. REV. 1499, 1503 (2009) (describing how, in the constitutional setting, "[f]inding some constitutional text obstructing our ability to reach a desired goal, we work around that text using *other* texts—and do so without (obviously) distorting the tools we use").

174 This example is helpfully developed in C. Stephen Bigler & Blake Rohrbacher, *Form or Substance? The Past, Present, and Future of the Doctrine of Independent Legal Significance*, 63 BUS. LAW. 1, 1–2 (2007).

175 This approach is sufficiently robust in Delaware jurisprudence that it has (albeit more controversially) been extended to the interpretation of contractual provisions. *See* D. Gordon Smith, *Independent Legal Significance, Good Faith, and the Interpretation of Venture Capital Contracts*, 40 WILLAMETTE L. REV. 825, 827–28 (2004).

176 *Cf.* Bigler & Rohrbacher, *supra* note 174, at 15 ("There has always been a tension between ILS [independent legal significance] and equitable principles. It is a maxim that 'equity regards substance rather than form.' ILS, on the other hand, exalts formalism: if something can be done one way, it can be done, even if the end result is something else in substance. The Court of Chancery deals with the tension in part by keeping the two analyses separate." (quoting Monroe Park v. Metro. Life Ins. Co., 457 A.2d 734, 737 (Del. 1983))).

schizophrenic in this combination of the formal and the contextual.[177] The doctrine of independent legal significance is simply one of the more extreme examples of a more general phenomenon in Delaware corporate law. Delaware's law-equity divide enables formalist and contextualist doctrines to coexist within the same field. While the doctrine of independent legal significance enables transactions at the level of formal statutory authorization, the resulting transactions are still subject to equitable review to determine, in specific cases, whether the conduct at issue was permissible.[178]

The equitable overlay may also be what enables formalist legal doctrines to function as well as they do in corporate law. Formalism can be particularly helpful for sophisticated parties in commercial settings.[179] A cabined resort to equity provides room for formalism to benefit such parties (for example, it allows for a greater degree of predictability, and it enables transactional innovation) while constraining opportunistic use of the underlying legal rules.[180] Without equity, a formalistic reading of the corporate code could result in disproportionate hardships for less sophisticated parties, in the process discouraging investment by these parties.[181] Because equitable remedies provide a substantial limit on such opportunism, courts can more comfortably adopt doctrines like the doctrine of independent legal significance.[182]

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177 *Cf.* Smith, *supra* note 4, at 281–82 (describing how fiduciary law has a mix of formalism and contextualism).

178 *See* Bigler & Rohrbacher, *supra* note 174, at 22 (indicating that while the doctrine of independent legal significance "provides a buffer for judicial review of a transaction," it cannot "defeat a court's authority to look beyond the form of a transaction to its substance").

179 *Cf.* Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 544 (2003) (assessing contract interpretation from this perspective).

180 The effect of this equitable approach may also be appreciated at the legislative level. *See* Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1784 (2006) ("Thus, the legislative preference for flexibility and private ordering is ultimately dependent on what we believe to be a well-founded view that the courts will police overly opportunistic behavior on the part of those in control.").

181 More generally, to the extent equity addresses unforeseen applications of legal rules, equitable remedies will at times bring the application of a legal or contractual mandate closer to its anticipated meaning. *Cf.* Feldman & Smith, *supra* note 14, at 152 ("[T]he good-faith people regard the law from a less detailed perspective and want to know merely that the law accords with their sense of what is right. They do not need or want to know much detail, and in some circumstances can be expected to fill it in with their own sense of morality. For these actors it is important for the law not to intrude with too much specificity, especially specific information that may seem to conflict with basic extralegal morality.").

182 *Cf.* Strine, *supra* note 169, at 903 ("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.").

This equitable approach is closely tied to the flexibility of corporate law, discussed above. Corporate law regularly evolves when faced with new types of opportunism.[183] One legal feature that facilitates this evolution is the possibility that a transaction is at least potentially subject to equitable review, even when the courts have previously concluded the conduct at issue is legally permitted. Efforts to make this equitable review effective have often resulted in new doctrinal approaches. For example, as noted, Delaware's takeover jurisprudence provided new standards of review in response to novel fact patterns. In cases like *Unocal*, the courts developed innovative doctrinal structures in order to determine whether director conduct is equitable.[184] The *Unocal* court unsurprisingly cited *Schnell* in the course of its analysis.[185] The specific anti-takeover devices at issue made use of long-recognized corporate powers; the equitable review recognized in cases like *Schnell* provided a way to reassess these director actions in light of the particular risks they posed.

But corporate law is not only flexible when it comes to policing new types of opportunism; the legal doctrine is flexible in another sense. The law-equity divide under *Schnell* permits a substantial amount of transactional innovation. While the *Schnell* line of cases enables courts to limit opportunistic behavior, the formalist component that precedes equitable review allows for director and officer conduct that was unanticipated when the underlying corporate code provisions were enacted. The Delaware corporate code provides very broad authority to boards of directors, and Delaware courts often read the statutory provisions in the corporate code from a textualist perspective. As a consequence, they have read these statutory provisions to enable conduct that could not have been contemplated by the legislative drafters.[186] And this formalistic aspect of corporate jurisprudence is itself facilitated by the boundaries courts place on equitable reasoning.

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183 Another source of flexibility is the comparatively weak stare decisis doctrine observed by the Delaware Supreme Court. *See* Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1078 (2000) (suggesting flexibility due to a weak stare decisis doctrine in Delaware).

184 *See supra* notes 111–18 and accompanying text.

185 For analysis of *Unocal* and its relation to *Schnell*, see Strine, *supra* note 169, at 885–86.

186 A good example is the poison pill rights plan that the Delaware Supreme Court permitted in *Moran v. Household International, Inc.*, 500 A.2d 1346 (Del. 1985). The *Moran* court was entirely unsympathetic to the argument that this use of a rights plan was unintended by the legislature, refusing to view legislative silence as a prohibition. *See id.* at 1351. The court's interpretation of the statutory grant instead gave the board of directors very broad authority. *See id.* at 1353. That said, if transactional innovations like the poison pill are sufficiently opportunistic, the courts still stand ready to exercise equitable authority on a case-by-case basis. On this aspect of *Moran*, see also Strine, *supra* note 169, at 880.

3. The Limits of Equitable Remedies

There is still a risk that equity can go too far under this approach, and the Delaware courts are aware of this possibility. Significantly, the Delaware Supreme Court has sought to cabin the *Schnell* doctrine so that equity does not swallow up the law side of corporate jurisprudence.[187] A good example is found in an appraisal case, *Alabama By-Products Corp. v. Neal.*[188] Here, the case concerned a question of valuation in a post-merger statutory appraisal proceeding.[189] The court concluded that it was acceptable for the chancery court to assess claims of unfair dealing for purposes of credibility determinations.[190] On the other hand, the court rejected the view that equitable remedies could be provided as part of a statutory appraisal proceeding.[191]

As the *Alabama By-Products* court made clear, *Schnell* is not to be automatically applied whenever a court is confronted with an opportunity to do equity. As the court explained:

> While the doctrine of *Schnell v. Chris-Craft Industries, Inc.* is an important part of our jurisprudence, its application, or that of similar concepts, should be reserved for those instances that threaten the fabric of the law, or which by an improper manipulation of the law, would deprive a person of a clear right.[192]

This is almost a statement of equity as meta-law in this context. Equity is addressed to the threats to the fabric of the law and improper manipulation of the law. Consistent with an equitable meta-law approach to opportunism, this suggests that equity will intervene in only limited situations rife with the danger of opportunistic behavior. As Justice Jacobs notes, in cases like *Alabama By-Products*, "the Supreme Court was

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187 For helpful discussion of this move, see Jacobs, *supra* note 59, at 10–12.

188 Ala. By-Products Corp. v. Neal, 588 A.2d 255 (Del. 1991).

189 *See id.* at 256.

190 *See id.* at 258.

191 *See id.* at 258 n.1.

192 *Id.* (citing Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971)). The court reaffirmed this perspective in *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1137 n.2 (Del. 1991), *superseded by statute on other grounds*, 79 Del. Laws ch. 72, sec. 4, § 204 (2014) (codified as amended at DEL. CODE ANN. tit. 8, § 204 (2024)). Furthermore, there are additional precedents designed to cabin the scope of equity in its relation to law. A good example is *Nixon v. Blackwell*, a case in which the Delaware Supreme Court pointedly critiqued a trial court's use of a "smell test," and warned against "equity jurisprudence which takes on a random or ad hoc quality." Nixon v. Blackwell, 626 A.2d 1366, 1378 & n.17 (Del. 1993). The *Nixon* court went so far as to quote the famous Selden discussion of the "Chancellor's foot." *See id.* at 1378 n.17 (quoting DAVID S. SHRAGER & ELIZABETH FROST, THE QUOTABLE LAWYER 97 (1986) (quoting JOHN SELDEN, *Equity*, *in* TABLE-TALK (London, E. Smith 1689))). Another example is *Stroud v. Grace*, 606 A.2d 75, 87 (Del. 1992) (rejecting an application of equity to expand a statutory disclosure duty beyond the terms of the statute).

sending a clear message that if there is a conflict between equitable principles and clear, bright line rules of corporate law, law trumps equity."[193]

This, too, is a match. Under the anti-opportunism account of equity, it is a fundamental precept of equity that "equity follows the law."[194] Indeed, this is a basic backdrop for equitable remedies. When there were separate equity courts, the maxim "equity follows the law" was partly jurisdiction and theoretically a limitation on equity. It was a self-imposed restraint, and seeing equity as meta-law allows us to see the idea as expressing the overall relation of equity to law.[195] Importantly, equity would not intervene if a statute directly addressed an issue, removing it from the realm of the unexpected and unforeseeable.[196]

Cases like *Alabama By-Products* reflect this same principle, with courts refusing to employ equitable remedies where a statutory text has dictated the applicable legal analysis.

For related reasons, the equity component of Delaware jurisprudence also tends to avoid per se rules. Indeed, this avoidance of per se rules has been described as an implication of the reasoning behind *Schnell*. As former Delaware Chief Justice Leo Strine has argued:

> 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.[197]

On this view, the equitable review permitted by *Schnell* is premised on respect for the statutory law, and, by extension, the broad authority granted to boards of directors.

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193 Jacobs, *supra* note 59, at 12. For further analysis of these limits, see Kurt M. Heyman & Christal Lint, *Recent Developments in Corporate Law: Recent Supreme Court Reversals and the Role of Equity in Corporate Jurisprudence*, 6 DEL. L. REV. 451, 484–87 (2003).

194 1 STORY, *supra* note 13, §§ 64, 26–27 (setting out various interpretations of equity "follow[ing] the law," *id.* § 64).

195 *See* Smith, *supra* note 10, at 1115–16.

196 *Id.* at 1115; *see* Roger Young & Stephen Spitz, *SUEM—Spitz's Ultimate Equitable Maxim: In Equity, Good Guys Should Win and Bad Guys Should Lose*, 55 S.C. L. REV. 175, 178–79 (2003) (discussing Indigo Realty Co. v. City of Charleston, 314 S.E.2d 601, 602–03 (S.C. 1984)).

197 Strine, *supra* note 169, at 883. In Strine's view, this corollary is also a key to the continued flexibility of Delaware law. *See id.* at 905–06 (suggesting that bright-line equitable rules would affect transactional planning in a way that would be unlikely to be revisited in future cases). In addition, Strine suggests that fact-specific equitable doctrines will cabin equity by requiring courts to articulate reasons for their decisions in individual cases. *See id.* at 904.

The outcome of these precedents is a hybrid decision-making structure, with law and equity both operating in tandem. The analysis exemplified by *Schnell* guarantees that any usage of corporate powers set forth in the Delaware code will remain subject to equitable review. Equity's role cannot be evaded. At the same time, the courts' decision-making process is subdivided such that the application of law is set apart from the application of equity. In conjunction with traditional equitable maxims, this functional law-equity divide prevents equity from overtaking law as a mode of decisionmaking. Equity is thus kept within legal bounds through a jurisdictional strategy. Indeed, the resulting balance is sufficiently robust that a highly contextual equitable reasoning is able to coexist with the strictest formalism.

D. The Menu of Business Entities

A key feature of fiduciary law—and an implication of equity as a safety valve—is that equity has a mandatory core.[198] Corporate law shares this feature, and notably directors' fiduciary duties may not be eliminated.[199] In addition, courts are quick to interpret existing doctrines to ensure that equity will retain its traditional role. For example, consider the ratification doctrine described earlier. Suppose that instead of seeking a shareholder vote approving a specific conflicting interest transaction, a board of directors instead sought shareholder permission to exercise broad discretion with respect to the entire category of such transactions. Delaware courts have concluded that this type of ex ante shareholder approval is not sufficient to avoid equitable review.[200] Likewise, courts have found that the board's authority to enter into contracts on behalf of the corporation does not extend to

198 *See* Smith, *supra* note 4, at 281–82.

199 A limited exception covers renunciation of specific business opportunities or classes of business opportunities. *See* DEL. CODE ANN. tit. 8, § 122(17) (2024). It is also true that directors may be exculpated from monetary liability for breaches of the duty of care, but this is not the same as elimination of the duty of care itself. *See supra* note 82 and accompanying text.

200 *See* Sample v. Morgan, 914 A.2d 647, 663–64 (Del. Ch. 2007) (noting that "the mere approval by stockholders of a request by directors for the authority to take action within broad parameters does not insulate all future action by the directors within those parameters from attack"). As the court continued:

> An essential aspect of our form of corporate law is the balance between law (in the form of statute and contract, including the contracts governing the internal affairs of corporations, such as charters and bylaws) and equity (in the form of concepts of fiduciary duty). Stockholders can entrust directors with broad legal authority precisely because they know that that authority must be exercised consistently with equitable principles of fiduciary duty.

Id. at 664.

contracts that interfere with directors' fiduciary responsibilities.[201] Moreover, a blanket waiver of liability for breaches of loyalty is precluded, even if the waiver is contained in the articles of incorporation.[202] The result is that corporate law retains fiduciary duties even in the face of contractual and governance mechanisms designed to avoid their strictures.

There is still an important respect in which equity is subject to opt-out. This possibility is a product of the larger setting in which corporate law is located. The Delaware code provides for a menu of business entities, some of which allow for greater modifications of equity's role.[203] Not all business entities mandate the fiduciary duties that are central to corporate law. In effect, this menu of choices makes it possible for parties starting a firm to opt into a regime in which equity will have significant mandatory features—corporate law—or to opt into a regime in which equity will lack many of those mandatory features—LLC law.[204] The mandatory fiduciary duties that apply in corporate settings are thus effectively defaults, to the extent parties may avoid the corporate form in favor of another comparable business entity.[205]

The Delaware LLC is characterized by a contractual structure.[206] In fact, the Delaware LLC statute indicates that it is the policy of this

201 *See* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 51 (Del. 1994) ("To the extent that a contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable.").

202 *See* Sutherland v. Sutherland, No. 2399, 2009 WL 857468, at *4 (Del. Ch. Mar. 23, 2009) (indicating that a provision that treated interested directors as disinterested for purposes of approving a corporate transaction would be void as against public policy).

203 On the use of legal menus in corporate law, see Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States, and the European Union*, 63 STAN. L. REV. 475, 524 (2011) (describing a menu approach with respect to liability regimes for violations of the duty of care). *See also* Ian Ayres, *Menus Matter*, 73 U. CHI. L. REV. 3, 4–6 (2006) (discussing the significance of menus with respect to corporate law default rules).

204 While we will focus on LLCs, a similar point holds true for Delaware limited partnerships, another setting in which fiduciary duties may be eliminated.

205 It should also be noted that the Delaware LLC has become a popular option for those selecting the LLC form. *Cf.* Jens Dammann & Matthias Schündeln, *Where Are Limited Liability Companies Formed? An Empirical Analysis*, 55 J.L. & ECON. 741, 743 (2012) (finding that for LLCs with over 5,000 employees, sixty-two percent are formed outside their home state, and more than ninety-five percent of these are formed in Delaware).

206 While the analysis of LLC terms is generally contractual, there was an apparent difference of opinion within the Delaware courts as to whether fiduciary duties are at least present by default. *Compare* Gatz Props., LLC v. Auriga Cap. Corp., 59 A.3d 1206, 1218 (Del. 2012) (critiquing chancery court opinion for reaching out to decide that LLCs have default fiduciary duties), *with* Auriga Cap. Corp. v. Gatz Props., LLC, 40 A.3d 839, 856 (Del. Ch. 2012) (finding default fiduciary duties). Subsequent legislation resolved this issue. *See* DEL. CODE ANN. tit. 6, § 18-1104 (2024) ("In any case not provided for in this chapter, the rules

law to give maximum effect to the principle of freedom of contract.[207] And, pursuant to this statute, fiduciary duties may be entirely eliminated by the LLC agreement.[208] In combination, these provisions make it possible for sophisticated investors to customize the application of equitable remedies to their relationship. A successful elimination of fiduciary duties will still require careful drafting, as Delaware courts construe ambiguities so as to preserve traditional fiduciary doctrines.[209] But it is possible to nonetheless have access to an entity that is strikingly corporation-like (if that is so chosen), often with the availability of corporate law precedents.[210] So long as an LLC agreement is sufficiently clear, this law enables substantial contractual freedom.

Even here, there is a mandatory gap-filler. As the LLC statute makes clear, it is not possible to opt out of the contractual covenant of good faith and fair dealing.[211] Yet it is important to note that this is not the fiduciary duty of good faith.[212] It is a contractual doctrine.[213] In addition, the covenant of good faith is less expansive in Delaware than it is in some other jurisdictions. In Delaware, the courts have emphasized that application of the covenant is "a cautious enterprise,"[214] and

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of law and equity, including the rules of law and equity relating to fiduciary duties and the law merchant, shall govern.").

207 *See* DEL. CODE ANN. tit. 6, § 18-1101(b) (2024) (providing that it is the policy of this chapter "to give the maximum effect to the principle of freedom of contract and to the enforceability of . . . agreements").

208 *See id.* § 18-1101(c) (permitting elimination of fiduciary duties for LLCs).

209 *See, e.g.*, Bay Ctr. Apartments Owner, LLC v. Emery Bay PKI, LLC, No. 3658, 2009 WL 1124451, at *9 (Del. Ch. Apr. 20, 2009) ("[T]he interpretive scales also tip in favor of preserving fiduciary duties under the rule that the drafters of chartering documents must make their intent to eliminate fiduciary duties plain and unambiguous.").

210 On the applicability of corporate law precedents to LLCs that adopt a corporate structure, see, for example, *Obeid v. Hogan*, No. 11900, 2016 WL 3356851, at *1, *5–8 (Del. Ch. June 10, 2016).

211 § 18-1101(c) (allowing for the elimination of fiduciary duties "provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing").

212 The fiduciary duty of good faith covers intentional disregard of a fiduciary's duties, as well as a failure to act with an affirmative devotion to the beneficiary. For analysis of this doctrine in the corporate setting, see generally Gold, *supra* note 91; Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131 (2006); and Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004).

213 *See* Gerber v. Enter. Prods. Holdings, LLC, 67 A.3d 400, 418–19 (Del. 2013). For further discussion of the distinction in content between contractual duties and fiduciary duties, see Daniel Markovits, *Sharing* Ex Ante *and Sharing* Ex Post*: The Non-Contractual Basis of Fiduciary Relations*, *in* FIDUCIARY LAW, *supra* note 4, at 209.

214 Nemec v. Shrader, 991 A.2d 1120, 1128 n.24 (Del. 2010) (quoting Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co., No. 1668, 2006 WL 2521426, at *6 (Del. Ch. Aug. 25, 2006)).

cases in which implied terms are found under the covenant "should be rare and fact-intensive, turning on issues of compelling fairness."[215] In settings where fiduciary duties have been eliminated, the covenant will often be read narrowly. The covenant of good faith and fair dealing is nonetheless a requirement that cannot be waived, and in appropriate cases it allows for significant judicial intervention.

Some features of contract law can be understood in equitable terms, and we might view the covenant of good faith and fair dealing in this light.[216] In theory, a covenant of good faith and fair dealing could even replicate fiduciary law. The Delaware Supreme Court, however, has emphasized that the covenant is a legal remedy, not an equitable remedy.[217] More to the point, applications of the covenant of good faith and fair dealing are substantially more constrained than what we see in conventional fiduciary law settings. As a consequence, the role for equity is at least partially a product of the parties' decisions; for LLCs, equity's role can be customized to a degree. This, in turn, means that parties considering incorporation of their business may opt into a different balance of law and equity should the corporate law balance prove undesirable.

Although LLC law is distinct from corporate law, it has great importance for parties who might choose to incorporate in Delaware. The effect of Delaware's LLC law is to provide a menu of options with respect to the modification of equity's role. This suggests another mechanism to address the balance between law and equity in the corporate setting. Private parties may choose their business entity, and in doing so they may choose the degree to which equity is subordinate to law (or contract). While the ability to opt out of fiduciary principles in a corporate setting is constrained, this is not so for the LLC setting.[218] LLC law amounts to a safety valve to address the possibility that, for some firms, the standard equitable overlay is a poor fit. Equity will still provide a safety valve even in the LLC setting, but with careful drafting it may do so in a more constrained fashion.

E. ESG as Super Equity

ESG is in a sense equity without the historic restraints. This is not just about the business judgment rule. Law and equity were kept

215 Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co., 708 A.2d 989, 992 (Del. 1998).

216 *See* Smith, *supra* note 14, at 905.

217 *Nemec*, 991 A.2d at 1128.

218 *See* DEL. CODE ANN., tit. 6, § 18-1101(e) (2024) ("A limited liability company agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) . . . .").

separate so that each could specialize: the law could be simpler and more general on its terms and equity could be more intense. ESG potentially suffuses the entire system with its own moral standards.[219] Second, the content of that morality is contingent. Whereas traditional equity would use received commercial morality as a trigger to get into equity and a richer version of it as the standard of fairness once in equity, ESG refers to an evolving and somewhat undefined set of norms that has many sources.[220] For example, norms may emerge as soft law and then be incorporated into corporate law. Third, ESG is more ex post than the combination of law and equity has been traditionally. It is more difficult at any given time to know how to comply.[221]

If ESG operates as a kind of super equity, the effects on the policies behind ESG and corporate law more generally are ambiguous—and in the absence of major adjustment or revision of corporate law's goals, likely to be problematic.[222] As has been often pointed out, on some level management's performance will be harder to monitor if shareholder wealth maximization is mixed in with metrics reflecting other stakeholder interests.[223] On the other hand, ESG may cause the business judgment rule to become less important.[224] This may lead to chilling of beneficial management behavior and invite difficult and error-prone second-guessing by courts.

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219 Yuval Feldman, Yotam Kaplan & Henry E. Smith, Motivating Equity: A Behavioral Perspective on Legal Dualism (Aug. 9, 2024) (unpublished manuscript) (on file with authors).

220 On the evolving and flexible meaning of ESG, see Elizabeth Pollman, *The Making and Meaning of ESG*, 14 HARV. BUS. L. REV. 403 (2024).

221 This latter concern is closely related to the concerns noted by the Court in *Gheewalla*. *See supra* note 145 and accompanying text.

222 We are already seeing controversy over whether or how *Caremark* claims should be linked to ESG concerns. On that topic, compare Stephen M. Bainbridge, *Don't Compound the* Caremark *Mistake by Extending It to ESG Oversight*, 77 BUS. LAW. 651 (2022), with Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 IOWA L. REV. 1885 (2021). *See also* Matthew Jennejohn & D. Gordon Smith, *Delaware's Frontier*, 24 U. PA. J. BUS. L. 791, 800 (2022) (noting in this context that "[a] court experiencing model uncertainty is relatively unmoored and decision-making becomes, by necessity, more experimental"). One might also wonder how ESG concerns will play out for the entire fairness doctrine.

223 *See, e.g.*, Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 164–68 (2020); *see also* Lucian A. Bebchuk & Roberto Tallarita, *The Perils and Questionable Promise of ESG-Based Compensation*, 48 J. CORP. L. 37, 63–73 (2022) (arguing that the inclusion of ESG metrics will make it more difficult to hold directors and officers responsible and make them act in the best interests of the shareholders).

224 *See* Thilo Kuntz, *How ESG Is Weakening the Business Judgment Rule*, *in* RESEARCH HANDBOOK ON ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE 67 (Thilo Kuntz ed., 2024).

Chilling may be the point for some ESG supporters. Nevertheless, the idea that ESG is like equity without the constraints should be part of the debate because it sets out the stakes more clearly. Lack of clarity in what ESG means coupled with mixing it pervasively through corporate law at one level—as opposed to being a safeguard at a meta level—means that this super equity will be hard to contain. And in terms of the policies of ESG itself in the long run, the expectations are ambiguous. Large corporate players are generally better at navigating a world of unconstrained standards, and are best positioned even in such an environment to engage in compliant noncompliance.[225] It is sometimes hard to know when ESG is window dressing or chilling, or a little of both. This is especially true if major corporate actors can trade one kind of ESG compliance against another. Thus, if a corporation supports progressive causes domestically, will it get a pass on its labor practices internationally? The danger is for ESG to become like indulgences acquired cynically.

And if ESG becomes suffused through all of corporate law, it may do so in a uniform but thin way, rather than being very stringent where it is needed most.[226] That kind of focus is more characteristic of traditional equity. Overall, the design questions involved in traditional equity carry over in some respects to ESG. As Justice Jacobs has remarked, some argue Delaware has attempted to wrap law around equity.[227] If so, that has been an ongoing struggle, and not one that has an evident endpoint. It is not at all clear how well one can wrap law around applications of ESG. As with equity, these questions will have to be addressed—or left unaddressed to the possible detriment of efficiency, fairness, and the policies behind ESG norms themselves.

F. Summary

The equity in corporate law builds on the same principles that characterize equity in fiduciary law. In corporate law, however, not only do we see a concern with the misuse of discretionary power, we also see highly sophisticated actors, regularly evolving transactional types, and novel means by which both law and equity are subject to risks of opportunism. Note also that predictability is a core value in

225 This possibility also raises another question. Some perceive Delaware corporate law to have a legal primacy norm. *See* Asaf Raz, *The Legal Primacy Norm*, 74 FLA. L. REV. 933 (2022). There is, at any rate, an important linkage between director fiduciary duties and legal compliance with noncorporate law. *See id.* at 966. It is an interesting question whether a more pronounced ESG shift will also implicate different notions of what it means for directors as fiduciaries to engage in legal compliance.

226 *Cf.* Feldman et al., *supra* note 219, at 33; Philip Hamburger, *More Is Less*, 90 VA. L. REV. 835, 836–37 (2004).

227 *See* Jacobs, *supra* note 59, at 15.

this setting: it is extremely significant for the businesspeople who choose to incorporate a firm, for those directors and managers who must then run the firm, and also for the investors. Equity remains a central feature of corporate law, and we see a mandatory core much like in other fiduciary contexts. That said, the balance between law and equity is crucial, since the predictability of the law is vital for many businesses. The response to these concerns is a series of doctrines designed to protect equity's role and a series of related doctrines designed to cabin that role.

Powerful fiduciary duties, limits on fiduciary opt-outs, the derivative lawsuit, and the *Schnell* doctrine are all examples of legal doctrines designed to ensure that equity is available to prevent and remedy opportunistic applications of law. In each case, the features that make these strategies successful also pose their own risks. In response, corporate law has been quite versatile in developing techniques to maintain a balance between law and equity. Broadly speaking, the cabining strategies fall into four categories: a subject area strategy (the business judgment rule), a gatekeeping strategy (the procedural and standing hurdles for derivative litigation), a jurisdictional strategy (the division between judicial analysis of what is legally permitted and what is equitable), and a menu strategy (providing parties with the ability to select different equitable treatment by opting for different business entities). Each is a customized response to the risk that equity may overtake law. The result is that corporate law retains a hybrid decision-making structure, one in which equity does more to shape the environment by tweaking the primary rules than by taking on a primary role itself. The equitable meta approach to anti-opportunism is thus able to explain a broad range of the law of corporate governance in functional terms.

III. EQUITY AND THE NATURE OF CORPORATE LAW

In the previous Part, we showed that equity pervades governance devices that corporate law affords. Corporate law is in large part fiduciary law, and fiduciary law is equitable. Like fiduciary law generally, corporate law solves problems of uncertainty and complexity, especially those involving potential opportunism, using ex post standards. Because of the special problems and greater dangers of opportunism in this area, it employs ex ante prophylactic rules as well. The need for dealing with such problems without upsetting an equilibrium involving hard-to-review business decisions made for often diversified shareholders makes calibration especially necessary.

Equity pervades corporate law in other ways, such that we might say that it is in corporate law's DNA. In this Part, we show how equity as meta-law tames the complexity and uncertainty that are caused by fundamental features of the corporate form itself.

There is a sense in which equity is at the heart of the corporate structure. Corporations grew out of trusts and as such were developed originally in equity courts.[228] That is why the Delaware Court of Chancery has jurisdiction over corporate law. In a trust, legal title is qualified by equitable title. Some would go so far as to say that the beneficiary has a right to the trustee's right.[229] Either way there is a sense in which equitable rights are meta. In keeping with its origins, this is true of corporate law as well. Here the corporation is interposed between shareholders and the assets the corporation owns and the contracts it enters into. Unlike a trust, the corporation is an entity. Like the trust, the corporation provides a more articulated structure in order to promote specialization of function. Suppliers of capital can be different from those who direct and manage the entity. This separation of function creates polycentric problems, situations of conflicting rights, and a great potential for opportunism. Indeed, much of the law we discussed in the previous Part is directed at this problem of opportunism. In this Part, we focus on the problems of maintaining the structure itself and deciding what is inside and outside the corporation. Here too equity as meta-law plays a major role.

A. *Corporations as Property and Contract*

The special nature of the corporation as a kind of property institution creates problems that call for equitable meta-law. Adolf Berle and Gardiner Means considered the separation of ownership and control to be the central problem in corporate law, launching a research program in corporate law that still has yet to run its course.[230] Less well known is that they saw this separation as undermining the notion of property itself.[231]

The corporation does serve a property function, with its own challenges. Very basically, the corporation (and in other ways other organizational forms) allows for asset partitioning. The law allows those setting up a corporation to designate a pool of assets that will be available to the creditors of the business but not to the creditors of the business owners—which Hansmann and Kraakman originally called "affirmative asset partitioning."[232] To this most basic function, corporations

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228 *See* Morley, *supra* note 30, at 2166.

229 *See* McFarlane & Stevens, *supra* note 27; Ben McFarlane & Robert Stevens, *What's Special About Equity? Rights About Rights*, *in* PHILOSOPHICAL FOUNDATIONS OF THE LAW OF EQUITY 191, 191 (Dennis Klimchuk et al. eds., 2020).

230 *See* BERLE & MEANS, *supra* note 32, at 4–6; Jensen & Meckling, *supra* note 33, at 306, 327.

231 *See* BERLE & MEANS, *supra* note 32, at 4–5.

232 Henry Hansmann & Reinier Kraakman, *Property, Contract, and Verification: The* Numerus Clausus *Problem and the Divisibility of Rights*, 31 J. LEGAL STUD. S373, S406 (2002).

add the more familiar limited liability of shareholders: the creditors of the business cannot reach the personal assets of the corporation's shareholders—which is termed "defensive asset partitioning."[233] What this asset partitioning accomplishes is the modularization of the interactions of the actors surrounding the corporation—the shareholders, creditors, contracting partners, employees, and so on. The partitioning makes some information relevant to some actors and not to others. Creditors don't have to investigate the credit worthiness of the firms' owners, etc.

Even at this stage, complexity and opportunism need to be contained. The basic structure manages complexity (suppressing some interactions) but not completely. As we have seen, the boundaries of the corporation are subject to misuse, and equity can look beyond them in a targeted way. Moreover, there is a panoply of assets surrounding the corporation that bear a looser or more distant relation to the corporation. In the next Section, we assess corporate veil piercing with this in mind. In the following Section, we analyze the corporate opportunity doctrine from this perspective. More generally, the asset partitioning is a kind of exclusion regime—a rough cut at managing complexity—that leaves the kind of problems we explored in the previous Part in need of a governance regime.[234] Equity as meta-law contributes to such a governance regime.

Where asset partitioning intersects with the separation of ownership and control, special problems of uncertainty and complexity arise. Various actors have a relation to only a part of a complex corporate ecosystem and may be tempted to maximize only those aspects that redound to their advantage. The problem is that because the set of interconnections between actors and sources of value is not exhaustively and definitively defined by the corporate structure, unanticipated mismatches can lead to trouble.

B. Piercing the Corporate Veil

Equity is not just concerned with internal corporate governance as it relates to shareholders. Corporate law also employs equitable remedies to address opportunism against third parties. This is evident in a case like *Gheewalla*, where the Delaware Supreme Court extended derivative standing to creditors in cases of corporate insolvency.[235] But equity's protection of third parties is especially prominent in cases of corporate veil piercing. This is in keeping with equity's role in

233 *See id.* at S406 n.67.

234 *Cf.* Henry E. Smith, *Exclusion Versus Governance: Two Strategies for Delineating Property Rights*, 31 J. LEGAL STUD. S453 (2002).

235 *See supra* text accompanying notes 146–49.

preventing the misuse of forms provided by the law (or even equity itself). Equity will look to substance over form in such situations.[236]

One of the most basic features of the corporate form is that it provides limited liability to its shareholder investors. For a variety of reasons, the asset partitioning that limited liability provides is a beneficial feature of the corporate form.[237] Yet while limited liability offers significant benefits in general, it is a corporate feature that lends itself to opportunistic behavior, vis-à-vis both contract creditors and tort creditors.[238] Equity's response, at least in sufficiently egregious cases, is to pierce the corporate veil: courts will disregard the corporation's existence and impose joint and several liability on shareholders who have opportunistically used the corporate form.[239]

The doctrine of corporate veil piercing is notoriously imprecise.[240] Courts apply a broad variety of factors, and generally speaking no one factor is dispositive. Considerations include a shareholder's dominance of the corporation, the presence of fraud, a failure to keep corporate formalities, undercapitalization, siphoning of assets, and intertwining of corporate and shareholder activities. In some cases, courts look to see if the corporation is a mere instrumentality or alter ego of a defendant shareholder. Commonly, courts will adopt a three-part analysis, assessing whether (a) the shareholder(s) controlled the corporation, (b) the control was used to perpetrate a fraud or wrong, and (c) the fraud or wrong was the cause of the plaintiff's loss.[241]

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236 *Cf. supra* note 51 and accompanying text. From another angle, one of us has argued that equity is also policing the boundary between conventional applications of tort law principles and the characteristic principles and structure of corporate law. *See* Andrew S. Gold, *Private Law's Choice of Private Law*, *in* INTERSTITIAL PRIVATE LAW 111, 114–18 (Samuel L. Bray et al. eds., 2024). This is a different respect in which equity manages complexity.

237 *See* Hansmann & Kraakman, *supra* note 232, at S406; Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 93–97 (1985).

238 *See* Hansmann & Kraakman, *supra* note 232, at S407. While limited liability is an established feature in both contract and tort settings, its availability in tort settings is somewhat more controversial. *See* Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991).

239 *See* Gold, *supra* note 236, at 117. This is not the only mechanism that equity employs in such cases, although it is likely the most prominent. Equitable subordination is also a significant remedy in cases where shareholders act opportunistically with respect to creditors. *See, e.g.*, Pepper v. Litton, 308 U.S. 295, 311–12 (1939); Costello v. Fazio, 256 F.2d 903, 909–10 (9th Cir. 1958).

240 *See* Easterbrook & Fischel, *supra* note 237, at 89 ("'Piercing' seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled."); *see also* Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926) (describing law in this area as "enveloped in the mists of metaphor").

241 *See* Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41, 45–46 (2000) (suggesting that Frederick Powell's three-part test "is the one now most frequently used as the touchstone for veil-piercing analysis," *id.* at 46).

Just as equity generally needs to retain a degree of uncertainty in order to limit opportunism by sophisticated actors, the veil piercing remedy also requires scope for judicial discretion. As Robert Thompson suggests, "As with insider trading and much of the law of directors' fiduciary duties, additional specification may not be possible without inviting greater abuse, as investors and their lawyers plan transactions to avoid specific terms of the law."[242] As noted, veil piercing doctrine makes use of a variety of factors, with no single dispositive factor. This fits the broader pattern of fact-intensive analysis in contexts where equity serves as an ex post counter to opportunistic conduct.

Once again, we also see a pattern of judicial decisions that limit the application of equity so that it doesn't overwhelm the legal doctrines to which it applies. Limited liability would lose many of its benefits if entrepreneurs and investors could not broadly predict the likelihood of limited liability during the course of their business. While no particular factor guarantees veil piercing, the absence of certain factors may suggest that the corporate veil will stay intact (thus, it matters if the parties have at least maintained corporate formalities). Moreover, certain factors are defined in such a way that veil piercing is not likely to swallow up the limited liability rule. In particular, the control factor is often applied such that only the egregious cases—cases involving corporate dominance—will implicate control.

A good example is *Craig v. Lake Asbestos*.[243] In that case, plaintiffs sought to pierce the veil to get to a subsidiary's parent corporation. The district court had concluded that veil piercing was appropriate, in light of its conclusion that the parent corporation had regular involvement in its subsidiary's financial and management affairs, that the parent corporation had three directors on its subsidiary's board of directors, and that the parent corporation also owned a majority of its subsidiary's stock and could exercise control if it wished to.[244] On appeal, the Third Circuit concluded that under New Jersey law, this was not sufficient to meet the level of control required for veil piercing.[245] Indeed, as the Court noted, the applicable New Jersey precedent had found no control in circumstances where a parent corporation was constantly involved in its subsidiary's day-to-day business.[246] As cases

242 Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1043 (1991).

243 Craig v. Lake Asbestos of Que., Ltd., 843 F.2d 145 (3d Cir. 1988).

244 *See id.* at 151.

245 *See id.* at 152.

246 *See id.* at 152 (citing State of N.J., Dept. of Envt'l Prot. v. Ventron Corp., 468 A.2d 150, 165 (N.J. 1983)).

like *Lake Asbestos* suggest, the required showing of control can be a difficult task.[247]

The strategy in this case reflects the approach we see elsewhere in equitable reasoning: courts limit equity's role to the more extreme cases. Then equity polices the boundary of the corporation for misuse.

C. *Corporate Opportunity Doctrine*

If corporations are to achieve asset partitioning, we need to know what is in and what is out. This extends to new opportunities that present themselves to corporate actors. This turns out to be the kind of complex problem rife with dangers of opportunism that lends itself not to detailed rules but to equitable meta-law.

The corporate opportunity doctrine is notorious for failing to clarify when a corporate opportunity exists.[248] We think this is no coincidence. There are features of corporate opportunities as a category that make it extraordinarily difficult to use a clear rule for identifying them ex ante, and vague standards like "fairness" tend to be unhelpful in this context, where directors and officers need predictability.[249] In-between hybrids are closer to the mark, but still less helpful than one would hope. As we will see, what makes things challenging also makes corporate opportunities a good fit for equity. And this is a match for the judicial approach in Delaware, which adopts a multifactor approach, grounded on a general requirement of loyalty from corporate fiduciaries. This approach allows for ex post, case-by-case interventions that are sensitive to the facts of each opportunity as they come before the court.

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247 In commercial settings, doctrines of waiver and estoppel may also limit claims for corporate veil piercing. *See, e.g.*, Consumer's Co-op of Walworth Cnty. v. Olsen, 419 N.W.2d 211, 220–23 (Wis. 1988).

248 *See* Eric Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 YALE L.J. 277, 279 (1998) ("Repeated endeavors by litigants, judges, and legal scholars to clarify the doctrine have generated a panoply of tests, variations, and hybrids. But the end product of this collective effort appears—by virtually all accounts—more tautologous than diagnostic, replete with exceptions and indecipherable distinctions that provide little guidance either to theorists or to practitioners.").

249 It is true that some rules can incorporate very nuanced exceptions, but the cases in which that holds true are not easily expanded to include legal disputes. *Cf.* LORRAINE DASTON, RULES: A SHORT HISTORY OF WHAT WE LIVE BY 265 (2022) ("The art of making rules consisted in building in enough give to accommodate every circumstance that could be foreseen and quite a few that couldn't. Rules for governing monastic communities or teaching musical composition or perfecting the mechanical arts anticipated their own incompleteness. These thick, expansive rules included their exceptions, not the other way around.").

A good example is Delaware's leading modern case, *Broz v. Cellular Information Systems, Inc.*[250] The complexity of the fact pattern is indicative of the puzzles that are commonplace in corporate opportunity cases. In *Broz*, the defendant Dr. Broz was a director of Cellular Information Systems (CIS), as well as the president and sole stockholder of RFBC, a corporation that competed with CIS (CIS was aware of this conflict of interest).[251] Broz was presented with an opportunity to purchase a cellular telephone service license (Michigan-2) in his capacity as president of RFBC, and the offeror had no intention that CIS would be a purchaser.[252] Broz did not share the opportunity, although he mentioned it to several directors and officers of CIS.[253] They indicated that CIS would not be interested; there was also reason to doubt whether CIS could afford the opportunity.[254]

In an added twist, another corporation, PriCellular, was also interested in purchasing the Michigan-2 license.[255] Broz and PriCellular ended up in a bidding war for the license, which Broz ultimately won.[256] While all of this was happening, PriCellular was also attempting to purchase CIS, which it ultimately did by means of a tender offer.[257] PriCellular's tender offer was delayed for financing reasons, however, and so it did not close the deal on CIS until a few days after Broz had won the battle for the Michigan-2 license. Once PriCellular took over CIS, a new board was put in place and suit was then brought by CIS alleging that Broz had taken a corporate opportunity—the Michigan-2 license—from CIS.

The case was heard by Chancellor Allen, who concluded that Broz had breached his fiduciary duty of loyalty by taking the opportunity.[258] Chancellor Allen emphasized the import of disclosure to the full board, and he also concluded that Broz needed to take into account the interests of PriCellular in figuring out whether the opportunity should be shared with CIS.[259] On appeal, the Delaware Supreme Court disagreed.

250 Broz v. Cellular Info. Sys., Inc., 673 A.2d 148 (Del. 1996). The classic Delaware decision prior to that is *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939).

251 *Broz*, 673 A.2d at 151.

252 *See id.*

253 *See id.* at 152.

254 *See id.* Note that the financial capabilities of CIS were a topic on which the Chancery Court and Delaware Supreme Court disagreed. *Cf. Cellular Info. Sys., Inc. v. Broz*, 663 A.2d 1180, 1186 (Del. Ch. 1995), *rev'd*, *Broz*, 673 A.2d 148.

255 *Broz*, 673 A.2d at 152.

256 *See id.* at 153.

257 *See id.*

258 *See Cellular Info. Sys.*, 663 A.2d at 1181–82.

259 *See id.* at 1186–87.

Elaborating on its prior legal doctrine, the Delaware Supreme Court offered an eight-factor test. The first four factors indicate that an opportunity cannot be taken by a director or officer if

> (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation.[260]

The second four factors indicate that an opportunity can be taken if

> (1) the opportunity is presented to the director or officer in his individual and not his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity.[261]

None of these eight factors, moreover, is dispositive.[262]

While the above approach is equitable in its features and function, the court also offered a more predictable rule for directors and officers who are uncomfortable taking their chances with a relatively fact-specific, multifactor ex post test. The *Broz* court held that disclosure to the full board for a formal decision is a safe harbor that can allow such parties to avoid risk of liability.[263] What is striking about Delaware's approach, especially when compared to the more rule-like disclosure mandate of the ALI *Principles of Corporate Governance*,[264] is that it was acceptable for Broz to tell individual CIS directors about the opportunity and forgo presenting the opportunity to the full board (and by implication, he might not have told any directors at all).

Interestingly, the court also added bad faith as a consideration when assessing if presentation to the board is required.[265] Although bad faith is not one of the eight factors described above, it is evident from the court's analysis that bad faith is another determinant of whether liability will result. The court distinguished a prior case in which it was held necessary to present an opportunity to the full board—unlike what happened in *Broz*, which involved merely telling individual directors about the opportunity—on the basis that this prior

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260 *Broz*, 673 A.2d at 155.

261 *Id.* (citing Guth v. Loft, Inc., 5 A.2d 503, 509 (Del. 1939)).

262 *See id.*

263 *See id.* at 157.

264 *See* Ne. Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1150–52 (Me. 1995) (quoting PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.05 (AM. L. INST., Proposed Final Draft 1992), and discussing its significance).

265 *Broz*, 673 A.2d at 157.

case involved bad faith.[266] In addition, the *Broz* court concluded that an opportunity should be assessed as of the time it was presented to the director, which meant that PriCellular's interests should not be taken into account.[267] The end result was that Broz avoided liability.

The result is also a corporate opportunity doctrine that is equitable in its approach. The potential uncertainty posed by equity's fact-specific, ex post nature is also limited by a safe harbor and, in light of subsequent legislation, by carve outs in the Articles of Incorporation.[268] Why use equity in cases like this? There are multiple reasons why equity is a good fit for the corporate opportunity setting. They encompass the fact-specific nature of legal loyalty, the problem of conflicting rights, anti-opportunism concerns, and polycentric challenges. We will discuss each in turn.

First, the use of loyalty as fiduciary law's central standard of conduct is itself a reason for turning to equity, at least some of the time. Delaware has good reason for selecting loyalty as the guiding standard for corporate fiduciaries (as opposed to, say, reasonableness or fairness), and on multiple bases. Loyalty norms are highly accessible, sufficiently stringent to preclude various forms of opportunism, and also, in many cases, internalized and taken very seriously by corporate actors. Loyalty norms are also well suited to context-specific elaboration, as evidenced not only in the law but also in our daily lives through our friendships and other close relations.[269] This context-specificity, however, can mean that loyalty's requirements for specific fact patterns are hard to fully spell out ex ante. The reality that loyalty norms are somewhat open ended—inside and outside the law—adds a further layer of uncertainty, as does the possibility that what loyalty requires will update with changes in the relationship at issue and with past practices that set expectations among the parties.[270]

266 *See id.* at 158 (distinguishing Yiannatsis v. Stephanis, 653 A.2d 275 (Del. 1995)).

267 *See id.* at 158–59.

268 *See* DEL. CODE ANN. tit. 8, § 122(17) (2024) (permitting such carve outs).

269 *See* Andrew S. Gold, *The Reasonably Loyal Person*, *in* PRIVATE LAW AND PRACTICAL REASON: ESSAYS ON JOHN GARDNER'S PRIVATE LAW THEORY 330, 344 (Haris Psarras & Sandy Steel eds., 2023) ("Loyalty can mold itself to the particularities of new fact patterns, subtly addressing opportunism while also providing predictability and accessibility to those familiar with loyalty practices." (footnote omitted)).

270 A good extralegal illustration of indeterminacy involves the loyalty obligations that friends owe each other. For example, it is often unclear whether loyalty requires advancing a friend's goals or her best interests. *See* JOSEPH RAZ, THE ROOTS OF NORMATIVITY 235 (Ulrike Heuer ed., 2022) ("Friends are caught in a dilemma that strangers are spared, the dilemma of whether to engage with us as we want them to do, or whether to protect us from ourselves. Different friendships often define themselves by the way they negotiate this tension."). The law likewise imposes loyalty obligations that are defeasible, with fuzzy boundaries that may evolve. *See* Gold, *supra* note 269, at 346 (noting that fiduciary loyalty is open ended and "evolves with regularity, especially in heavily litigated fields like corporate law").

As applied to specific legal disputes, what this means is that loyalty often requires a degree of specification, or re-specification, in order to resolve a case. Legally enforced loyalty is indefinite with respect to many of its rights and duties, at least until the right case arises and a precedent is set.[271] That isn't to say that loyalty norms don't provide guidance; it is to say that they do not provide that guidance in detail (loyalty does, at least, mean that the fiduciary must abjure self-interested motivations, and in corporate settings it calls for acting in the best interests of the corporation and its shareholders). The requirements of loyalty nonetheless tend to be decided after a court has reviewed the specifics of a fact pattern, analogous judicial precedent, and any other considerations relevant to its decision. Notwithstanding the accessibility of loyalty norms and the gradual accretion of caselaw, it is optimistic to think that each loyalty case that comes before a court—and especially each corporate opportunity case—can be resolved by a deductive application of a loyalty rule's ex ante requirements. Giving loyalty more ex ante precision in order to do so would produce frequent mismatches for loyalty as it is known both inside and outside the law. It would also produce an incredibly lengthy, exception-riddled legal rule.

A second reason for turning to equity is that the corporate opportunity doctrine raises the challenge of conflicting rights. As one of us has noted:

> Equity as meta-law is also well suited to resolving situations of conflicting rights. Where two or more parties hold presumptive but conflicting rights, one solution is to define rights better ex ante. An even better alternative is often to leave the presumptive rights in place and to reconcile them ex post based on an equitable, context-sensitive style of reasoning.[272]

Classic contexts where such rights conflicts arise are nuisance cases where each party may have a prima facie "right" to use their property in a certain way.[273]

Where are the conflicting rights located in the corporate setting? As the Maine Supreme Judicial Court emphasized in *Northeast Harbor Golf Club, Inc. v. Harris*, notwithstanding the duty of loyalty's import,

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Note that what is required by a loyalty obligation may also involve updating where the beneficiary's circumstances change over time. *See* Markovits, *supra* note 213, at 221–22.

271 In this respect, there is a parallel to the way rights in property allow for indefiniteness and re-specification. *See* Andrew S. Gold & Henry E. Smith, *Scaling Up Legal Relations*, *in* WESLEY HOHFELD A CENTURY LATER: EDITED WORK, SELECT PERSONAL PAPERS, AND ORIGINAL COMMENTARIES 419, 425, 435–37 (Shyamkrishna Balganesh et al. eds., 2022).

272 Smith, *supra* note 10, at 1073.

273 *See* John C.P. Goldberg & Henry E. Smith, *Wrongful Fusion: Equity and Tort*, *in* EQUITY AND LAW: FUSION AND FISSION 309, 315–18 (John C.P. Goldberg et al. eds., 2019).

"[i]t is important to preserve some ability for corporate fiduciaries to pursue personal business interests that present no real threat to their duty of loyalty."[274] This can be reformulated in terms of rights. The right to pursue personal business interests that present no real threat to the corporation shares an uneasy boundary with the corporation's right to opportunities that, in light of the corporation's claim to loyal director conduct, should belong to the corporation. Both rights are recognized at a high level of generality, and in the abstract that works well. The precise boundary between these rights need not be drawn with precision ex ante—a task that is extraordinarily hard to do in a reliable way—if it can be demarcated ex post through equity. The corporate opportunity doctrine is a way of doing so.

A third reason emerges if we recall that fiduciary loyalty offers a response to opportunism; indeed, its breach is a legal proxy for opportunism.[275] One of the core functions of equity is to address opportunism by parties who know the law well and manipulate it to serve their purposes.[276] Fiduciary loyalty is, as one of us has noted, "broader than the general equitable safety valve,"[277] but it also consistently captures opportunism cases within its scope, given the evident difficulties in acting opportunistically and loyally at the same time.[278] Opportunism is difficult to adequately address ex ante, as the legal rules and standards that regulate conduct ex ante are always potentially subject to opportunistic conduct by savvy legal actors. An equitable approach to corporate opportunities, like the one Delaware has adopted, offers a way to address subtle machinations by directors and officers, taking into account their degree of control regarding both transactional structures and governance of the corporation itself.

Finally, a fourth reason is implicit in all of the above. The corporate opportunity doctrine, like other loyalty settings, raises polycentric challenges. The *Broz* case is a striking example of how many moving parts are potentially involved in contemporary corporate opportunity cases. In addition to the many factors the court considered—taken singly or in aggregate—note also that those factors have unclear

274 Ne. Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1150 (Me. 1995).

275 *See* Smith, *supra* note 4, at 261.

276 In this setting, self-serving rationalizations by directors and officers are also a concern, with roughly parallel concerns to the opportunism risk. *See id.* at 278.

277 *Id.*

278 *See id.* This does not mean that someone who acts loyally in their personal life will act in the same way as someone who acts equitably. The two standards are not coextensive. *See* Gold, *supra* note 269, at 344 (noting that "it is possible for individuals to be equitable toward someone while still falling short of what loyalty requires"). Likewise, it is notable that the law's version of a loyalty obligation is more sweeping than the standard equitable proxies and presumptions. *See* Smith, *supra* note 4, at 274 ("The duty of loyalty is closely tied to the danger of opportunism, while at the same time sweeping broadly.").

boundaries (defining a line of business is difficult) and that the facts at issue may not obviously cut in one direction. What should we make of a case in which a corporation's line of business is in flux? That was apparently the case for CIS in the *Broz* case, and it is not hard to imagine cases in which the defendant director plays a role in the way a corporation's business changes. What if we confront a case in which the alleged corporate opportunity is not in a corporation's line of business, but the opportunity might be advantageous to the corporation's line of business indirectly because of its potential effects? What if the corporation can't afford an opportunity, but the director who took the opportunity is partly responsible for that state of affairs? What if we have clear conflicts among the factors—for example, if the corporation can't afford an opportunity but has a strong interest in it?

From a legal policy perspective, this problem gets much more complex. For then we need also to consider whether legal doctrine might deter directors and officers from serving; whether that doctrine would be likely to alter their incentives with respect to the financing of the corporation or with respect to how it defines its line of business; whether it might lead to subtle cases of opportunism in the future that are hard to detect ex post; whether it might signal a devaluation of loyalty norms within the courts, with consequent effects on compliance in other types of loyalty-related case; whether the doctrine is so amorphous that directors inevitably overdisclose to the board; whether an ex ante approach will require constant add-ons and revisions over time; and various other considerations with respect to future incentives. Case-by-case, ex post equitable interventions do not make these policy questions dissolve, but they do mitigate some of the concerns by largely limiting the significance of a loyalty decision to its facts. At the same time, they hold promise for keeping directors and officers accountable when bad faith, fraud, or other forms of opportunistic conduct are especially likely to have occurred. And they may also help counter good faith but self-serving deliberations by corporate directors who are blinded by an opportunity's value.

The above discussion shows why the corporate opportunity doctrine is a natural home for an equitable approach. If the corporate opportunity doctrine is more visibly a case for equity, however, it is by no means exceptional. As the Delaware Supreme Court announced in *Malone v. Brincat*, "Although the fiduciary duty of a Delaware director is unremitting, the exact course of conduct that must be charted to properly discharge that responsibility will change in the specific context of the action the director is taking with regard to either the corporation or its shareholders."[279] The variety of fact patterns that implicate

279 Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998).

this principle—from controlling shareholder cases, to hostile takeovers, to claims that the board failed to monitor corporate employees, to directors' lack of candor with their shareholders, among others—and the context-sensitivity of these fact patterns mean that settings for an equitable approach to director and officer loyalty are scattered throughout the corporate landscape.

Finally, taken together these problems are not merely additive in their effect. A solution to the corporate opportunity doctrine that swept in the kind of opportunity relevant to a bidder in a takeover—like that of the Michigan-2 license in *Broz*—invites another kind of opportunism from complex interaction: a competitor could launch a takeover bid in order to stymie a competitor if the owner of the competitor is on the board of the target.

More generally, it is this kind of open-ended set of interactions that—sometimes compounded—makes ex ante solutions or even permanent structures impossible to maintain. A main alternative is meta-law. We start with the need for stability—for the "law" that meta-law presupposes. In particular, the divide in corporate law needs to have enough fixity so that we are not in a world where equity swallows up the law (or, likewise, where law is fully wrapped around equity). Consequently, we should expect the structured, and varied, strategies that we see for making sure that equity has a role, but a delimited one.

That said, the reality is that new occasions for the use of equity constantly arise in corporate settings that call for equitable meta-law. As seen with veil piercing and the corporate opportunity doctrine, in addition to the activities governed by equity (e.g., in the *Schnell* doctrine), new strategies for contractually or otherwise hedging in equity regularly arise. Further, market and other external conditions shift in ways that change the stakes. All told, it is unwise or even infeasible to fill in all details of the law-equity divide ex ante and even to give it an unchanging boundary line. In effect, the law-equity divide itself is regularly in need of revision or re-specification and, in some cases, ex post, equity-style intervention to fine tune it. In a sense, equity needs to reinvent itself. This equity involves a kind of meta-meta-law, which is not a problem as long as we recognize that equity's open-endedness is compatible with some self-reference.[280] Instead of having an official articulated meta-meta-level, equity uses its discretionary aspect to go to a higher level when it is under extreme pressure. This is true of the cases in which courts announce that equity cannot be used to do inequity.[281]

280 *See* Smith, *supra* note 10, at 1128–29; Nicholas A. Tiverios, *Preventing the Infinite Regress: Discretion, Bars to Relief and the Structure of Equity*, 82 CAMBRIDGE L.J. 350, 350 (2023).

281 *See, e.g.*, Patsourakos v. Kolioutos, 26 A.2d 882, 885 (N.J. Ch. 1942) ("A court of equity should not lend itself to the accomplishment of any . . . inequitable purpose."), *aff'd*, 30 A.2d 27 (N.J. 1943); Ogden v. Straus Bldg. Corp., 202 N.W. 34, 48 (Wis. 1925) ("A court

IV. COMPARISON TO OTHER THEORIES OF EQUITY

Equity as meta-law with a major focus on preventing opportunism within primary structures is one among several accounts that might explain equity's role in corporate law. Other accounts seek to reduce equity to something else. Equity could instead be a means for courts to exercise discretion, deciding cases according to their individual preferences or policy predilections. Or equity could be a mechanism for courts to impose moral outcomes on legal disputes. Some may understand equity in terms of a balance between crystalline rules and muddy standards. And equity might fall within the broader nexus of contracts theory of corporate law. We will discuss each of these possibilities below. While these alternative accounts have merit in some cases, the anti-opportunism account—and more broadly, the view of equity as meta-law—better fits equity's treatment in corporate law doctrine, and it is better able to explain the structural features of corporate law.

A. *The Pure Judicial Discretion Theory*

Equity often provides substantial discretion to legal decisionmakers, at least as a practical matter. An alternative view of equity would suggest that equitable authority gives courts judicial discretion to decide cases as they wish.[282] Where the anti-opportunism account views equity as a constrained doctrine, applicable in limited cases, the pure judicial discretion theory views equity as a tool available to courts should they wish to obtain particular outcomes. This discretion-based theory, moreover, finds support in the literature on indeterminacy in corporate law. A number of scholars have drawn attention to areas of vagueness and uncertainty in corporate doctrine.

For example, Douglas Branson argues that Delaware precedents give Delaware courts the "tools of indeterminacy."[283] On this account, the courts have a very large scope of discretion in choosing outcomes.

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of equity in its effort to do substantial justice between the parties, will not endeavor to commit a wrong, even to a wrongdoer.").

282 The contractarian approach to corporate law tends in this direction and is consistent with law and economics analysis that sees equity as unbounded ex post discretion. *See* Jody P. Kraus & Robert E. Scott, *The Case Against Equity in American Contract Law*, 93 S. CAL. L. REV. 1323, 1323–24 (2020); Robert E. Scott, *Contract Design and the Shading Problem*, 99 MARQ. L. REV. 1, 1 (2015). *But see* Smith, *supra* note 14, at 906 (suggesting that the current view of equity makes of equity "a naked appeal to judicial discretion implemented in (ex post) standards couched in terms of amorphous fairness"); *see also* Smith, *supra* note 10, at 1111–12.

283 Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 108 (1990).

Branson emphasizes the availability of the *Schnell* doctrine as a counterbalance to rules like the doctrine of independent legal significance (the "equal dignity rule"). As Branson puts it, "*Schnell* has become a kind of universal solvent for courts and plaintiffs. Just as courts and defendants can use the 'non-rule' equal dignity rule to facilitate transactions, courts and plaintiffs can use the *Schnell* doctrine to derail them."[284] While Branson recognizes that institutional factors may constrain the exercise of such judicial discretion, his account suggests substantial indeterminacy in light of equitable doctrine.[285]

Ehud Kamar has emphasized the fact-intensive standards that apply in various specific litigation contexts.[286] For example, courts apply a proportionality test to review defensive measures under the *Unocal* doctrine.[287] Likewise, we see a multifactor analysis adopted under the corporate opportunity doctrine.[288] Or, there is the discretion-centered test for review of a special litigation committee's findings under *Zapata*.[289] Each of these legal standards involves highly fact-intensive inquiries, with significant room for courts to adopt an outcome of their choosing. As Kamar concludes, "One can never be confident that a certain corporate action will be upheld in court, given that a litany of factors, which are neither conclusive, nor cumulative, nor prioritized, can come into play."[290]

Jill Fisch offers several additional arguments. She suggests that, as courts of equity, the Delaware chancery courts contribute a significant amount of flexibility to corporate law.[291] Furthermore, this flexibility is buttressed by the manner in which the courts apply their prior holdings. Fisch contends that the Delaware Supreme Court "appears ready to distinguish or overrule a precedent without regard to considerations of stare decisis."[292] This approach is also facilitated by the fact-intensive nature of many corporate law doctrines. In addition, the Delaware

284 *Id.* at 100. For a critique of *Schnell* on indeterminacy grounds, see Mary Siegel, *The Dangers of Equitable Remedies*, 15 STAN. J.L., BUS. & FIN. 86 (2009).

285 *See* Branson, *supra* note 283, at 108 (suggesting Delaware judges "certainly have some ability to decide cases in whatever way they wish," while also questioning whether they have unfettered discretion).

286 *See* Kamar, *supra* note 5, at 1915.

287 *See id.* (contending that "[t]he law does not define what constitutes a cognizable threat in this regard, nor does it clarify what defensive measures are reasonable").

288 *See id.* at 1916 (describing a multifactor test that only provides guidelines and under which no one factor is dispositive).

289 *See id.* at 1916–17 (suggesting that "the court is entrusted not only with applying open-ended standards to the case at bar, but also with determining which standards it will apply," *id.* at 1917).

290 *Id.* at 1917.

291 *See* Fisch, *supra* note 183, at 1077; *cf.* Smith, *supra* note 4, at 264–65 (noting that equity needs to be open ended in order to capture hard-to-foresee opportunism).

292 Fisch, *supra* note 183, at 1078.

courts have significant control over their lawmaking agenda. The Delaware courts make frequent use of dicta, and, as Fisch suggests, "[t]hey have repeatedly announced legal principles solely to guide future business decisionmaking."[293] On this view, the Delaware courts act more like a legislature than the typical state court.

Finally, William Carney and George Shepherd have suggested a further basis for indeterminacy.[294] They focus on the elaborations of corporate law in the mergers and acquisitions context. While Carney and Shepherd concede that Delaware court decisions can be clear, they focus on the rate of change in legal rules as a source of indeterminacy. As they argue, "The important observation here is not that the rules are difficult to discern once announced, but that new rules have been announced with remarkable regularity."[295] Even law that is precise with respect to a given precedent may be indeterminate in practice if parties cannot readily figure out if that law will apply to their case.

Not everyone agrees on the scope of this indeterminacy. For example, Robert Thompson has questioned whether Delaware law is as indeterminate as its critics suggest.[296] On his account, there is a continuum from deference to entire fairness review in corporate law. He suggests that there are five key decision points that determine where a case will lie on this continuum.[297] Directors have a significant ability to move review towards deference based on how they structure a transaction, or how they respond to a derivative suit. Furthermore, Thompson emphasizes that certain core Delaware precedents have been clarified over time.[298] If Thompson is right, the points on this continuum are fairly predictable ex ante, as long as we keep in mind the key factors

293 *See id.* at 1079.

294 *See* William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 16.

295 *Id.* at 16–17.

296 *See* Robert B. Thompson, *Delaware's Disclosure: Moving the Line of Federal-State Corporate Regulation*, 2009 U. ILL. L. REV. 167, 169–76.

297 *See id.* at 170–74.

298 In particular, Thompson suggests that *Unocal* and *Revlon* do not "have the breadth that they appeared to have at their initial announcement." *See id.* at 174. On the link between litigation and the clarification of fiduciary standards, see Ehud Kamar, *Shareholder Litigation Under Indeterminate Corporate Law*, 66 U. CHI. L. REV. 887, 897 (1999). Note also that corporate law arguably shifts at particular moments, for example in response to economic crises or financial scandals. *See* Sean J. Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 8 (2005) (arguing that "the purpose and effect of such [good faith] rhetoric is to loosen the doctrinal constraints on the Delaware judiciary and to enable its judges to shift the authority/accountability balance in response to a change in the set of pressures and constraints then operating upon them"). To the extent corporate law is indeterminate during moments of transition, it need not follow that it is indeterminate during ordinary times.

that push a legal dispute along this continuum from one standard of review to another.

But there is a more fundamental reason to doubt the pure discretion theory: the operation of these purportedly indeterminate legal doctrines is more consistent with a meta-law account of equity than with equity as an untethered source of judicial discretion. The courts' discretion is delimited by legal structures in a variety of ways, some of which circumscribe equity's role quite effectively. The business judgment rule is a powerful constraint on judicial exercise of equitable discretion; the demand refusal doctrines raise a variety of challenges before a derivative suit can even be heard; the *Schnell* doctrine does not generally intrude on questions of power allocation within the corporation; and, in some cases, parties may opt out of fiduciary duties altogether by selecting a noncorporate business entity, such as an LLC. Although in individual cases a court may have significant freedom to attain its preferred outcome, the overall effect of these various mechanisms is to provide a type of equity that intervenes in exceptional cases.

It is worth asking why these various mechanisms exist, if the equity in corporate law is designed to be a source of pure judicial discretion. These doctrines would represent a substantial amount of wasted judicial effort if they were ineffective. Even if courts have a noteworthy level of discretion, it is hard to explain the laborious detail of these doctrines if they are not operating to constrain judicial discretion in practice (or if courts do not at least believe they will have that effect). If equity is acting as meta-law, the creation of these structures makes sense. The indeterminacy accounts are on to something if equity takes its broader form—an unchecked equity looks like an invitation for unfettered judicial discretion. But the broader understanding of equity is best seen as a risk to be avoided rather than a presently realized state of affairs. As noted above, opportunism is a concern both with respect to legal rules and also with respect to equity. It is precisely because corporate law can slide into indeterminacy that equity needs to be cabined, and that it often is.

B. *The Moralizing Theory*

One might instead read equity as a means for courts to bring about conduct that is fair or morally desirable, all things considered. On this reading, the equity in corporate law has a very wide ambit—it is designed to bring about moral results, or at the least to bring about those results that the community takes to be moral. This is another way of developing a broad theory of equity. As noted, equity as a whole is subject to a broad interpretation under which courts intervene to make sure of moral outcomes and a more narrow, anti-opportunism interpretation.[299] Like the pure discretion theory, this account faces challenges in explaining the various structural features of corporate law. The more profound difficulty with the moralizing theory is that it runs contrary to Delaware cases in which courts have expressly eschewed a morality or social norm–based understanding of corporate law. The Delaware courts have distanced their jurisprudence from the view that equity is an invitation to ensure morally appropriate behavior, or even to ensure corporate best practices.

Even in those areas where corporate law appears most clearly linked to morality, the courts have indicated the legal doctrine is not concerned with enforcing morality as such. A good example is the opinion in *Desimone v. Barrows*.[300] In that case, the court concluded that intentional lying to shareholders or intentional violations of law are forms of disloyalty.[301] Policing lies and unlawful behavior by means of fiduciary duties certainly sounds like legal doctrine designed to address moral failings. But the *Desimone* opinion does not endorse the broad approach to equity, despite legal conclusions that would seem a perfect fit for that theory.[302] As then–Vice Chancellor Strine noted in *Desimone*, there is a "justified concern that concepts of fiduciary duty not be used in an unprincipled and wholly-elastic way to reach any and all behavior that, upon first blush, strikes judges as inappropriate."[303] The court went out of its way to reject the idea that this is what fiduciary law is supposed to do.

Likewise, the courts have rejected the view that fiduciary law should enshrine judicial views on "best practices." A good example is the chancery court opinion after trial in the *Disney* litigation.[304] That case involved, among other things, a claim that the Disney board had breached its duty of care in the hiring and ultimate termination without cause of Michael Ovitz.[305] Chancellor Chandler concluded that the

299 The broad interpretation has a long pedigree, as is evident in the work of proto-realists like Roscoe Pound. *See* Roscoe Pound, *The End of Law as Developed in Legal Rules and Doctrines*, 27 HARV. L. REV. 195, 226 (1914). For a Kantian theory of equity based on conscience, see IRIT SAMET, EQUITY: CONSCIENCE GOES TO MARKET (2018). On the other hand, it should be noted that the broad interpretation is far from universally accepted. *See* Douglas Laycock, *The Triumph of Equity*, 56 L. & CONTEMP. PROBS., Summer 1993, at 53, 73 (rejecting the view that "a court of equity has a roving commission to do good once it identifies a threshold violation of law that justifies its intervention").

300 Desimone v. Barrows, 924 A.2d 908 (Del. Ch. 2007).

301 On lying to shareholders as a form of disloyalty, see *id.* at 933; on knowing violations of law as a form of disloyalty, see *id.* at 934.

302 For an argument that loyalty doctrine can coherently extend to lying and to knowingly unlawful conduct, see Gold, *supra* note 91, at 472–96.

303 *Desimone*, 924 A.2d at 932.

304 *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693 (Del. Ch. 2005).

305 *Id.* at 745.

Disney board of directors "fell significantly short of the best practices of ideal corporate governance."[306] Yet the court found no breach of the duty of care.[307] In reaching this conclusion, the Chancellor was quite explicit that fiduciary responsibilities are not co-extensive with best practices. As the Court noted, "All good corporate governance practices include compliance with statutory law and case law establishing fiduciary duties. But the law of corporate fiduciary duties and remedies for violation of those duties are distinct from the aspirational goals of ideal corporate governance practices."[308]

Granted, social norms are relevant to the application of corporate equity. Former Delaware Supreme Court Justice Norman Veasey and Christine Di Guglielmo have argued that equity "is the means by which social and business norms and mores can affect the outcomes of cases."[309] This claim is accurate, if interpreted narrowly. Yet there are different ways in which social norms and mores can affect outcomes of cases. For example, courts might interpret reasonable expectations in light of such norms and mores,[310] or they might instead directly enforce those social norms and mores. The former type of reasoning is common: social and business norms influence fiduciary caselaw in Delaware given their relation to reasonable expectations.[311] There is less evidence that the Delaware courts are conflating the requirements of equity with social and business norms as such.

It should also be noted that Delaware judges make frequent use of moral concepts and rhetoric in their published opinions. Edward Rock has rightly emphasized the morally inflected narrative structure of these corporate law opinions.[312] As he suggests, "Taken as a whole, the Delaware opinions can be understood as providing a set of parables—instructive tales—of good managers and bad managers, of good lawyers and bad lawyers, that, in combination, fill out the normative

306 *Id.* at 697.

307 *See id.* at 760, 772.

308 *Id.* at 745 n.399.

309 E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1497 (2005).

310 *See* D. Gordon Smith & Jordan C. Lee, *Fiduciary Discretion*, 75 OHIO ST. L.J. 609 (2014) (arguing that courts define the boundaries of fiduciary discretion by means of industry custom and social norms).

311 *Cf.* Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1, 30–31 (2006).

312 *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997). Rock dismisses accounts of the equity style of Delaware corporate law. *Id.* at 1101 ("The problem with this sort of account is that it does not tell us very much about why the equity style survived in corporate law, or what functions that style serves."). However, his account based on morality tales is not incompatible with equity as meta-law.

job description of these critical players."[313] Much of this language nonetheless takes the form of dicta. We should be careful to distinguish the moral language that runs throughout corporate law jurisprudence from a court's legal reasoning in deciding a case. As Rock notes, "These richly detailed and judgmental factual recitations, combined with explicitly judgmental conclusions, sometimes impose legal sanctions but surprisingly often do not."[314]

Rock and others have demonstrated that the use of moral tales in corporate law is an important phenomenon. For example, the morality that infuses corporate law opinions may serve a shaming function, as several scholars have noted.[315] In addition, it may serve a guidance function, with directors and their counsel looking to corporate law decisions for indications of appropriate behavior.[316] Judicial opinions may likewise have an impact on social norms—social norms that can impact corporate conduct through internalization or through external incentives.[317] It is also possible that the use of moral concepts in judicial opinions has an impact on how fiduciary cases are decided, given features of judicial cognition.[318] But the significance of the courts' moral language should not be confused with adoption of a broader moral theory of equitable authority.

There are plainly cases in which moral reasoning is decisive for the resolution of corporate law disputes. In these contexts, morality is doing more than expressing judicial points of view or developing legal

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313 *Id.* at 1016. It would be worthwhile investigating to what extent such parables are good at defeating the kinds of self-deception and rationalizations discussed in Feldman et al., *supra* note 219. They might also serve to simultaneously reassure garden-variety actors and threaten potential opportunists. *See* Feldman & Smith, *supra* note 14, at 142.

314 *See* Rock, *supra* note 312, at 1016.

315 *See id.* at 1104 ("A system that relies on public shaming is perfectly suited to such contexts: The cost to the actor—the disdain in the eyes of one's acquaintances, the loss of directorships, the harm to one's reputation—may often be sufficiently great to deter behavior . . . ."); David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1829–35 (2001) (assessing shaming mechanisms in the corporate context).

316 *See* Rock, *supra* note 312, at 1102 (suggesting that the "particular sort of guidance demanded seems to be better provided by narrative than by rule"). For discussion of law's guidance function more generally, see Dale A. Nance, *Guidance Rules and Enforcement Rules: A Better View of the Cathedral*, 83 VA. L. REV. 837, 858–61 (1997).

317 For further analysis of this relation between corporate law and social norms, see Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1796 (2001) (suggesting how corporate caselaw can encourage corporate participants to internalize norms); Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1696 (2001) (describing the insider/outsider position occupied by Delaware judges). Those cases in which corporate doctrine affects social norms are distinct, however, from cases in which social norms determine the outcomes of cases.

318 *See generally* Gregory S. Alexander, *A Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767 (2000).

narratives, and this is particularly so where fiduciary principles are at stake. Such cases are important, but they should not be taken to mean that the meta-law account focusing on opportunism is inaccurate; the parts of morality that equity is sensitive to are relatively narrow. For the most part, the courts' moral reasoning in these contexts is understandable in anti-opportunism terms.[319] Significantly, it is not the case that any and all moral failings by corporate directors and officers will result in liability or equitable remedies—the classic cases involve an opportunistic misuse of board discretion, or conduct that at the least serves as a strong proxy for such opportunistic behavior. The subset of moral breaches that drive corporate law outcomes is typically the subset that involves opportunism.[320]

One may thus recognize that moral concepts are embedded in equitable reasoning without adopting the broad view of equity's function.[321] The morality in equity classically comes into its own where sharp discontinuities occur (e.g., forfeitures or disproportionate hardships).[322] This means that courts do not intervene whenever morality might favor one litigant over another; rather, the application of equity is ordinarily in a safety valve capacity. Indeed, morality sometimes cabins equity, rather than expanding it.[323] Widely recognized moral concepts thus serve as benchmarks for appropriate behavior, yet the morality of equity still dovetails with an anti-opportunism perspective.[324] Corporate law shares these features with equity more generally.

Finally, just as the pure discretion theory has difficulty in explaining the complex structural features of corporate law doctrine—ranging from the business judgment rule, to the demand futility doctrines, to the various burden-flipping fact patterns—a broad moralizing

319 *See* Smith, *supra* note 10, at 1056, 1076–81, 1123–28.

320 While still adopting a safety valve approach, one of us has argued that the moral considerations equity responds to sometimes cover a broader range of misconduct than opportunism. *See* Andrew S. Gold, *Equity and the Right to Do Wrong*, *in* PHILOSOPHICAL FOUNDATIONS OF THE LAW OF EQUITY, *supra* note 229, at 72.

321 *See, e.g.*, Smith, *supra* note 4, at 272 ("As an outgrowth of equity, it is not surprising that fiduciary law is often untailored and morally inflected.").

322 *See* Smith, *supra* note 14, at 911.

323 *See* Smith, *supra* note 4, at 279 (noting that "[c]ommonsense morality goes some way toward cabining equity"); *see also id.* at 281 (noting that "[l]ike equity, fiduciary law is moral but not unboundedly so"); Smith, *supra* note 10, at 1123 ("[N]otions of right and fairness are not totally freeform. Rather, equity receives much of its substance from everyday moral disapproval of deceptive behavior."); *cf.* Smith, *supra* note 14, at 913 (suggesting that "[e]quity benefits from basic morality to the extent that it is based on widely known and shared morals, as we see in property and tort"); Gold, *supra* note 91, at 505 ("[F]iduciary duties can be more accessible if good faith is tethered to a well-known morality or virtue-based concept—such as loyalty—than if courts engage in a more ad hoc approach whenever new good faith cases arise.").

324 *See* Smith, *supra* note 10, at 1077–80.

account of equity is also stymied by these features. One can reason from a broad theory of equity to the duty of loyalty, but it is more difficult to reason from a broad theory of equity to the business judgment rule and similar constraints. Understanding the morality of equitable reasoning in anti-opportunism terms, in contrast, is a good fit with these structural components.

C. A Crystals and Mud Theory

Another approach (or set of approaches) focuses on the distinction between crystalline legal rules and muddy standards. Equity provides fact-specific, comparatively vague standards that allow courts to address the harshness of overinclusive and inflexible rules. Equity, on this view, softens the hard edges of legal doctrine. In doing so, it may provide efficiency benefits, a greater degree of fairness, and a more context-specific set of outcomes in corporate litigation. Corporate law could be understood in these terms, and this account might be posed as an alternative to the meta-law account.

A leading example of this kind of approach can be found in property theory.[325] Carol Rose famously describes property law in terms of crystals and mud.[326] As she suggests:

> A strong element of moral judgment runs through the cases in which mud supersedes crystal. These cases are often rife with human failings—sloth and forgetfulness on the one hand, greed and self-dealing on the other. These vices put pressure on our efforts to elaborate clear and distinct property specifications, and make judges and others second guess the deals that call for a pound of flesh.[327]

Rose's account is not the same as a broad moralistic account of equity, however. For, as Rose adds, there may be another aspect on which we can focus. As she notes, "Perhaps we can get at this human element by thinking not about the moral qualities that are at issue, but rather about the pound of flesh."[328] The law, she suggests, finds "dramatic losses abhorrent."[329] The muddiness of property law seems to arise in settings where such losses are at stake, and it is the fact-intensive, ex

325 This analysis can also be situated within a broader discussion of rules and standards. For a leading example, see Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

326 Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577 (1988).

327 *Id.* at 597.

328 *Id.* Nor does the crystals and mud account simply reduce to a pure discretion theory. The crystals and mud perspective brings out the effects of muddy standards on the regulated parties; it does not merely suggest a place for judicial discretion.

329 *Id.* at 598.

post perspective that offers a way to limit such forfeitures. A similar process may be at work in corporate law.[330]

Ian Ayres has suggested that crystals and mud play another role in the corporate law setting. Ayres raises the possibility that minoritarian defaults will sometimes be superior to majoritarian defaults, given the difficulties in contracting into particular defaults.[331] And, as he argues:

> In simple terms, it may be cheaper for corporations to contract for crystals than mud. If the default rule involves courts in muddy ex post balancing of the activity's costs and benefits, corporations that prefer unconditional rules (that unconditionally either allow or prohibit particular management behavior) can cheaply contract for them.[332]

Corporations could opt in by adding muddy provisions to their corporate charters or bylaws. But, according to Ayres, this would likely be less efficient than starting with a muddy default. In Ayres's view, "[b]ecause the ex ante formulations of reasonableness by individual corporations can take so many different forms, there is a much smaller likelihood of developing a coherent (and therefore valuable) precedential base."[333] The existing use of muddy defaults in corporate law may then be explained by the greater ease in amending these defaults through private contracts. Opting into such defaults may be comparatively difficult.[334]

Jill Fisch suggests additional possibilities. While recognizing the costs of uncertainty, she contends that standards can increase lawmaking efficiency in two respects: "Standards permit the lawmaker to tailor the result in a case and to thereby avoid the hardship or unfairness associated with application of a crystalline rule without destroying the

330 In the fiduciary setting, however, the movement from crystals to mud may be reversed. *See* Robert H. Sitkoff, *An Economic Theory of Fiduciary Law*, *in* FIDUCIARY LAW, *supra* note 4, at 197, 203 n.35 ("The dynamic in fiduciary law thus stands apart from the conventional story in property law. As opportunists find a new trick, the 'mud' of loyalty and care becomes a 'crystal' of a subsidiary rule addressing that trick.").

331 *See* Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391, 1403 (1992) (book review).

332 *Id.* at 1405 (footnote omitted).

333 *Id.* It should be noted, however, that muddy defaults also come with costs. *See* Stephen M. Bainbridge, *Contractarianism in the Business Associations Classroom:* Kovacik v. Reed *and the Allocation of Capital Losses in Service Partnerships*, 34 GA. L. REV. 631, 652 (2000) ("Both tailored and muddy defaults may tend to increase transaction costs. Because such defaults leave the outcome to *ex post* judicial determination, they increase uncertainty, which in turn encourages litigation. In addition, cases governed by a muddy default can be expensive to litigate, because parties must, for example, use the litigation process to educate the decisionmaker as to what is reasonable under the circumstances." (footnote omitted)).

334 The ease of opting out may also raise concerns. Some corporate default rules may be difficult to modify, even if they are still technically defaults. *See generally* Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 SMU L. REV. 383 (2007).

applicable doctrinal structure. Standards also create an affirmative role for the courts as gapfillers."[335]

In addition, Fisch emphasizes that muddy legal doctrine may encourage negotiation. As she argues, "[A] careful examination reveals that many Delaware cases settle early in the litigation process and that Delaware law both encourages and facilitates settlement."[336] Furthermore, she claims that muddy rules "enable courts to engage in ex post tailoring of the legal structure to the particular factual context presented."[337] Courts are well suited to recognize the effects of the legal doctrine they set forth over time. As Fisch explains:

> Corporate law, in particular, because of the essentially unlimited range of structural possibilities, may make ex ante specification difficult. Corporate lawmakers may be unable to determine the appropriate legal standards until they see a range of factual scenarios. Muddy rules provide courts with the flexibility to respond to these scenarios.[338]

While the resulting indeterminacy in corporate law may have costs, Fisch suggests a variety of countervailing benefits.[339]

Each of these arguments thus suggests a role for equity as a source of muddiness in corporate law. We think these arguments are on the right track; the crystals and mud account does offer insights into corporate law given its mixture of rules and standards. Corporate law is a field in which rules and standards frequently overlap, with ex post standards often governing the availability of ex ante rules. Notice, however, that the crystals and mud account (in its several variations) does not suggest any particular balance between crystals and mud within corporate law.[340] The original model of crystals and mud also implied that there would be endless cycling between crystals and mud, typically with legislators and parties creating firm rules that courts with their ex

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335 Fisch, *supra* note 183, at 1082.

336 *Id.* at 1083; *see also* Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027, 1029–30 (1995).

337 Fisch, *supra* note 183, at 1084.

338 *Id.* (footnote omitted).

339 There may also be further benefits beyond the ones Fisch describes. Another potential benefit to muddiness may arise if muddy doctrines induce moral deliberation. *See* Seana Valentine Shiffrin, *Inducing Moral Deliberation: On the Occasional Virtues of Fog*, 123 HARV. L. REV. 1214 (2010); Andrew S. Gold, *The Loyalties of Fiduciary Law*, *in* FIDUCIARY LAW, *supra* note 4, at 176, 193.

340 Notably, the crystals and mud account does not indicate why the equity in corporate jurisprudence would operate in such a constrained fashion, rather than through some other interaction with law. *Cf.* Smith, *supra* note 10, at 1138 ("[W]hile standards bear many similarities to equity, they are not central to equity. Standards can be first- or second-order. . . . Accounts of standards indirectly get at something about equity but cannot capture its meta-law aspect.").

post perspective would fuzz up. The meta-law account of equity contains no such implication: sometimes equity becomes a stable part of the common law, as with the recording acts, and sometimes a hybrid of law and equity might be possible over long stretches of time, as with building encroachments.[341] Nor does it explain the panoply of structural mechanisms that maintain the balance that we currently have. The crystals and mud account offers an accurate picture of the phenomenon it describes, but it also offers an incomplete one.

When we observe the features of corporate law, we see not only crystalline rules and muddy standards, but also the particular way in which they interact. An anti-opportunism account explains the way crystals and mud coexist in corporate law; it covers core features like the business judgment rule as well as gatekeeping rules like the demand futility doctrine. At the same time, Delaware courts ensure that equity will always be available in some form, particularly where opportunism is likely. As *Schnell* reminds us, technical compliance with a corporate statute is not enough to guarantee that conduct is equitable. The mechanisms by which the law-equity balance is struck are themselves crucial features of corporate law. The meta-law account can help explain this structure of presumptions, allocations of authority, and equitable remedies.

D. The Corporation as a Nexus of Contracts

Finally, one of the leading accounts of corporate law sees the corporation as a nexus of contracts.[342] Significantly, the vast majority of terms governing the corporate relationship are subject to contractual modification, and even fiduciary duties can be seen as contractual.[343] On a standard contractarian view, the content of fiduciary duties is determined by figuring out the terms of a hypothetical bargain in a world of zero transaction costs; fiduciary duties represent what the majority of parties would have bargained for if they had addressed their

341 *See* Henry E. Smith, *Rose's Human Nature of Property*, 19 WM. & MARY BILL RTS. J. 1047, 1052–53 (2011); *see also* WILLIAM W. BILLSON, EQUITY IN ITS RELATIONS TO COMMON LAW: A STUDY IN LEGAL DEVELOPMENT 7 (1917) (noting that "[c]onceptions of right which by the equity jurisprudence had been made familiar to the popular and professional mind, and proven practicable and wholesome, had a constant tendency to find their way by degrees into the common law even unavowedly and illicitly").

342 *See, e.g.*, EASTERBROOK & FISCHEL, *supra* note 9, at 15 ("We treat corporate law as a standard-form contract, supplying terms most venturers would have chosen but yielding to explicit terms in all but a few instances.").

343 *See* Black, *supra* note 70 (discussing the extent to which the terms of corporate law are subject to modification).

concerns ex ante.[344] This is a powerful explanation of corporate law doctrine, and the nexus of contracts theory might offer an alternative account of the equity in corporate law. On such a view, equity would be a mechanism for delineating and enforcing the bargains between the various constituents of the corporate firm.

Yet while the nexus-of-contracts theory does provide important insights, it is doubtful that a contractarian account fully explains the equity in corporate law. Corporate law is largely comprised of default rules, and the terms of directors' fiduciary duties are often consistent with the terms of a majoritarian hypothetical bargain (or in some cases with other types of contractual defaults).[345] Yet if we try to understand corporate law entirely from within this template, certain features are harder to explain. For one thing, much of the moral reasoning that is so prominent in equitable decisionmaking may become epiphenomenal. Admittedly, contractarians may not be concerned by this result (although for functional reasons, perhaps they should be).[346] But the nexus-of-contracts approach also faces a more fundamental descriptive challenge: corporate law provides non-waivable terms. For example, fiduciary duties have a mandatory core.[347] And, generally speaking, the

344 *See* Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 (1993) ("Fiduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings.").

345 On the tendency of fiduciary duties to provide an untailored (majoritarian) gap-filler rather than a tailored gap-filler, see Mariana Pargendler, *Modes of Gap Filling: Good Faith and Fiduciary Duties Reconsidered*, 82 TUL. L. REV. 1315 (2008). On occasion, fiduciary law may provide penalty defaults or, in some cases, bargain-mimicking defaults. *See* Andrew S. Gold, *Dynamic Fiduciary Duties*, 34 CARDOZO L. REV. 491, 503–16 (2012) (discussing the possibility of bargain-mimicking defaults in corporate law). On penalty defaults in general, see Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989). On bargain-mimicking defaults, see Omri Ben-Shahar, *A Bargaining Power Theory of Default Rules*, 109 COLUM. L. REV. 396 (2009).

346 *Compare* Easterbrook & Fischel, *supra* note 344, at 429 (arguing that "we seek knowledge of when fiduciary duties arise and what form they take, not a theory of rhetoric—a theory of what judges *do*, not of explanations they give"), *with* Alexander, *supra* note 318, at 777 (arguing in the fiduciary setting that "[r]hetoric matters, too, precisely because it affects behavior"); *see also* Gold & Smith, *supra* note 14, at 489–90 (discussing the functional significance of moral concepts in private law).

347 For arguments that the mandatory features in corporate law are significant, see John C. Coffee, Jr., *The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618 (1989); Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461 (1989); and Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820 (1989). Relatedly, it should be noted that some of the default features of corporate law are particularly hard to opt out of, even though they are technically still defaults. *See* McDonnell, *supra* note 334, at 385.

mandatory core of these fiduciary duties is hard to square with a contractarian account.[348]

This doesn't rule out an economic justification. There are efficiency-based explanations for a mandatory core in fiduciary law, and these can supplement a contractarian account. For example, Robert Sitkoff has argued that the mandatory core of fiduciary duties may serve a protective and cautionary function. On this view, the mandatory core has a paternalistic aim, addressing contexts in which fiduciary relationships commonly involve unsophisticated parties.[349] This core may also serve a categorization function. From this perspective, the mandatory core "addresses the need for clean lines of demarcation across types of legal relationships, among other things to minimize third-party information costs."[350] Both of these accounts are convincing in particular contexts. However, Sitkoff suggests these arguments are weaker as applied to filing entities such as corporations and LLCs.[351]

The equity-as-meta-law account offers an additional way to explain these mandatory features through the problem of opportunism. Corporations frequently involve sophisticated parties, but this is precisely the type of context in which opportunism will be a lingering concern[352]:

> Particularly in the corporate area, we can expect sophisticated parties to be able to deal with opportunism *ex ante*, and Delaware law

348 One way in which the mandatory features of corporate law can still be understood as defaults is to emphasize the possibility of legislative amendments. *See* Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 2 (2006) ("The provisions of corporate law are essentially contract terms that can be repeatedly reformed by a third party—the state—to adapt them to changing circumstances."). Yet this approach would stretch the contractarian account beyond its ordinary meaning. The ability for the parties themselves to modify the terms of their relationship is usually taken as a key signal that the terms of the corporate relationship are contractual.

349 *See* Sitkoff, *supra* note 330, at 205.

350 *Id.* (first citing Hansmann & Kraakman, *supra* note 232; then citing Merrill & Smith, *supra* note 28; then citing Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The* Numerus Clausus *Principle*, 110 YALE L.J. 1 (2000); and then citing Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 643 (2004)).

351 *See id.* at 206 ("The explanation is weaker as regards filing entities, such as corporations and limited liability companies, because the public filing that brings the entity into existence also provides notice of the existence and nature of the entity. For this reason, and because the parties in such contexts are more likely to be fully informed and sophisticated, the mandatory core for filing fiduciary entities is both less robust and more contentious than in agency and trust law."). It bears noting for both LLCs and for corporations that various governing documents are not publicly filed, and that the degree to which investing parties are sophisticated or well-informed can vary significantly.

352 For a discussion of how opportunism is particularly a concern in settings involving sophisticated parties, see Smith, *supra* note 10, at 1076, 1080–81.

> in particular takes a broad opt-out approach. Nevertheless, even in Delaware one cannot contract out of the duty of good faith altogether, just as in contract law. This mandatory kernel protects the domain of contracting from an unscrupulous party who might do something outside that domain that defeats the contract's purpose.[353]

Thus, "[t]o the extent we can characterize this problem as one of true uncertainty (as opposed to risk), the rationale for some small mandatory core of fiduciary law makes sense."[354]

Note also that the mandatory domain of equity extends beyond fiduciary duties. It might be thought that the LLC context, in which such duties can be eliminated, shows that the apparent mandatory core is not genuinely mandatory. The difficulty with this potential argument is that it does not cover the full scope of equity's application. Delaware courts have emphasized that equity is not displaced even in the LLC setting; the courts retain their equitable powers.[355] Thus, to the extent there is an ability to opt out of fiduciary duties, that is not the same thing as an ability to opt out of equity's reach. This does not mean the contractarian account is incorrect in its understanding of many central corporate law features; it does mean that we still need a theory of the equity in corporate law that accounts for its mandatory aspects.[356] An anti-opportunism account is able to supply that theory.

E. Equity and Corporate Law's Place in Private Law

Stepping back, we can see that viewing corporate law as resting on a core of equitable meta-law permits a qualitatively different picture of corporate law—and one that reconciles some apparent opposites in much theorizing. In current theory, much of the equity in corporate law is treated as a mere collection of features. These include a degree of open-endedness, frequent use of moral concepts and rhetoric, and a mixture of rules and standards. Given these features, commentators have proposed accounts of equity in corporate law that emphasize judicial discretion in applying equitable remedies, the moralizing qualities of equitable decisionmaking, and the courts' usage of muddy standards in fiduciary law. In light of the many default rules that run through corporate law, equity can also be understood from a

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353 Smith, *supra* note 4, at 282.

354 *Id.*

355 *See In re* Carlisle Etcetera LLC, 114 A.3d 592, 594 (Del. Ch. 2015). For helpful discussion, see Christopher M. Bruner, *The Fiduciary Enterprise of Corporate Law,* 74 WASH. & LEE L. REV. 791, 808–11 (2017).

356 *See* Smith, *supra* note 4, at 281 (indicating that "equity as anti-opportunism can explain why fiduciary law is mostly but not entirely contractarian").

contractual perspective. While these approaches do offer insights into equity in corporate law, they tend to struggle with the structural features of corporate law, and they do not readily account for the particular mix of rules and standards that characterizes the field.

Meta-law is different. Equity is not a collection of features, and it is not a mere additive appendage to the law. Rather, as in equity more generally, law and equity in corporate law operate in tandem, synergistically, by specializing.[357] Law and equity do different things, which potentially make each other better. Law can be simpler and more general if it is backed up by equity, especially when opportunists seek to exploit and undermine it. Likewise, equity can afford to be discretionary, contextual, and morally inflected precisely because it does not have to apply everywhere. Before equity is engaged we need to toggle into the meta-mode. Otherwise, equity, if it tried to be law, would overwhelm transactors in uncertainty. This would be particularly problematic in corporate law where private planning, while not everything, is of central importance. The specialization of law and equity, if it is successful, provides an answer to contractualists who see it as an ex post moralistic judicial myopia or the self-aggrandizement of Delaware. And it also puts the very real moralizing of equity in perspective, as an aspect of corporate law whose strength is inseparable from its self-restraint—and its structure. This structure is the interface between law and equitable meta-law as implemented in the various doctrines canvassed in Parts IV and V. That structure has been and continues to be reengineered by the equity judges in Delaware, and it is that structure that makes the specialization of law and equity possible. Such ongoing tailoring is needed for the special kind of meta-law that the highly useful separation of ownership and control needs to work in the first place.

The anti-opportunism account based on equitable meta-law can also explain why fiduciary law has a mandatory core, a problem for the standard contractarian account. And it can explain why corporate law has developed a variety of doctrines to enhance equity's role while at the same time cordoning off equity's application. This is not to deny that these other theories can help us to see what corporate equity accomplishes. The muddy standards of fiduciary law do produce many of the results that commentators note, and the default content of fiduciary duties will often reflect a majoritarian hypothetical bargain. But for purposes of understanding why corporate equity is structured as it is, the meta-law account of equity offers significant additional insights.

357 *See* Smith, *supra* note 10, at 1100–12 (offering a theory of specialization of law and equitable meta-law).

CONCLUSION

On the meta-law account of equity, we should expect equity—and fiduciary law—to have different features depending on the risks presented by opportunism and the challenges of polycentricity and conflicting rights in particular contexts. Rather than dealing directly with defined activities that constitute opportunism, equitable meta-law ranges over the law after it is engaged by various proxies and presumptions. Often equity operates as a safety valve, and fiduciary law makes use of broader prophylactic rules. Corporate law confronts many of the same opportunism concerns present in fiduciary law. Indeed, given the high frequency of sophisticated parties and the evolution of transaction types, these risks are enhanced. But corporate law also has a particular need to constrain the role of equity. Making sure that equity is effective as an anti-opportunism device while simultaneously obtaining the benefits of a predictable legal decision-making mode requires a hybrid of law and equity.

The law-equity divide in corporate law is distinctive to the field, and it is highly structured. Corporate law is a hybrid of law and equity, but it is not ad hoc or amorphous. Understanding this law-equity divide—why it looks the way it does, but also why it evolves so frequently—is a central puzzle for corporate law theory, and it is an underappreciated one. Yet it is also a challenge that must be confronted if the cases are to have any semblance of coherence. Indeed, we need to understand why corporate law takes its particular shape if we are to embark on successful reforms. Law and equity are systems within corporate law, and adjustments to either system will not work well unless we see how they operate in tandem.

One reason for the persistent evolution of corporate law is that any efforts to wrap law around equity must always be either incomplete or quixotic. Because equity addresses problems of complexity of a type that are intractable when confronted ex ante, the law-equity divide is always a work in progress. It needs to be at least partly indefinite, in roughly the way that equity handles the problem of conflicting rights, but on a larger scale. Specification of the boundary must often be done as the need arises. Moreover, when the law-equity divide is specified in detail, it must often be re-specified ex post. That this occurs with reasonable frequency in corporate law is a product of party sophistication, evolving transaction types and market conditions, and litigation incentives, among other factors. But it is ultimately an unavoidable consequence of equity's roles in corporate law.

The meta-law account of equity also explains why corporate law adopts many of the standard features of fiduciary law, including its broad proxies and presumptions. It also indicates why corporate law adopts some additional features designed to ensure the effectiveness of equitable remedies. These include a mandatory core of fiduciary duties, derivative litigation, and the *Schnell* doctrine. Such doctrines are in turn balanced by a series of constraints, many of which are corporate law innovations. Among these are the business judgment rule, the series of rules governing shareholder approval and ratification votes, the limiting features of the *Schnell* doctrine, the doctrine of independent legal significance, and the option of forming a Delaware LLC and waiving fiduciary duties altogether.

The equity in corporate law is thus designed to address the infinite variety of opportunistic schemes that sophisticated parties may devise while still supporting transactional innovation and contractual choice. Equity is not simply a device for courts to reach morally desirable ends on a case-by-case basis, nor is it simply a source of indeterminacy producing strong judicial discretion. As an effective—and structured—device for reconciling conflicting rights, solving complex problems, and providing guardrails against potential opportunism by parties, the equity in corporate law is designed to be both powerful and limited. The resulting doctrine exhibits a mixture of rules and standards, but these rules and standards are not haphazardly grouped together—they show a pattern. They are one of the most important and consequential manifestations of equitable meta-law in our legal system. At its very heart, corporate law is equitable meta-law.