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A Theory of Corporate Fiduciary Duties

Benjamin B. Johnson[*]

Corporate law lacks a general theory of a board's power as fiduciary, and consequently, the law governing corporate fiduciary duties is notably unstable. This Article offers a novel theory that grounds corporate fiduciary duties in stronger microeconomic and legal foundations. The theory, coined the Judicial Monitoring Model (JMM), shows that even imperfect judicial monitoring makes shareholders and boards better off, even when there is no claim of a breach of the duties of loyalty or care as currently understood. The JMM synthesizes the law governing corporate fiduciary duties and other doctrines that protect principals, beneficiaries, and creditors from the risk of agent misconduct due to moral hazard. And it explains why courts evaluate corporate fiduciary conduct in some situations and defer to the board's business judgment in others.

The JMM also generates surprising empirical predictions. It predicts that, in some cases, courts can and do provide substantive review of corporate transactions even if boards are informed, disinterested, and appear to be acting in good faith. The Article finds evidence of such review in old and recent cases, including a startling number of overlooked cases involving corporate waste.

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INTRODUCTION

Founded in 1907, the Blue Bell Ice Cream company nearly dissolved in 2015 due to a liquidity crunch after authorities tied the company to a listeria outbreak in Kansas.[1] Thanks to a quick and substantial investment brokered by a board member and his brother-in-law, Blue Bell was able to renovate its production facilities and restart production.[2] The Governor of Texas issued a press release welcoming Blue Bell back to the market, including a photo of the Governor at his desk, holding two spoons of ice cream behind seven half-gallon containers of Blue Bell.[3] While Blue Bell's return was cause for celebration, its near demise led to significant litigation. The company was forced to pay criminal fines, and federal prosecutors indicted the former CEO for wire fraud and

1. *See* Marchand v. Barnhill, 212 A.3d 805, 809, 814–15 (Del. 2019).

2. *See id.* at 815.

3. *See* Press Release, Off. of Tex. Governor, Governor Abbott Celebrates Return of Blue Bell at Texas Capital (Aug. 31, 2015), https://gov.texas.gov/news/post/governor_abbott_celebrates_return_of_blue_bell_at_texas_capitol.

conspiracy.[4] Shareholders also took the Blue Bell board to court, claiming the directors violated their fiduciary duties.[5]

Traditionally, investors pursue two primary types of corporate fiduciary claims: duty of loyalty claims and duty of care claims.[6] The duty of loyalty requires directors to put the company's interests ahead of their own.[7] The duty of care "requires that fiduciaries inform themselves of material information before making a business decision and act prudently in carrying out their duties."[8] In practice, the duty of loyalty says, "Don't steal," and the duty of care says, "Pay attention."

The shareholder plaintiffs in *Marchand* (the caption of the Blue Bell case) alleged that directors failed to monitor food safety, a failure that led to significant losses for shareholders.[9] This seems like a clear duty of care case: there was no claim the directors put their own interests ahead of the shareholders'; rather, the claim was that the board lacked prudence in overseeing the ice cream's production: it didn't pay attention.

This "failure to monitor" is a classic *Caremark* claim, familiar to any lawyer who has studied corporate law. *Caremark* was a duty of care case that set out the analysis Delaware courts use to determine if a board's failure to pay attention is sufficiently grave to warrant judicial sanction.[10] Nonetheless, while the *Marchand* court agreed with plaintiffs that the Blue Bell directors showed a lack of good faith in their failure to monitor food safety, the court held the board breached its duty of *loyalty*.[11] When discussing the Blue Bell case,

4. *See* Jenna Greene, *Ex-Blue Bell CEO Faces Charges of Cover-Up in Tainted Ice Cream Trial*, REUTERS (July 29, 2022, 6:18 PM), https://reut.rs/3R2janT.

5. *See Marchand*, 212 A.3d at 816. Blue Bell is a Delaware Corporation. Texas forgives it for this because the ice cream is so good.

6. *See, e.g.*, Firefighters' Pension Sys. of City of Kan. City, Mo. Tr. v. Presidio, Inc., 251 A.3d 212, 274 (Del. Ch. 2021) ("[D]irectors owe fiduciary duties of care and loyalty to the corporation and its shareholders." (quoting Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d at 1280) (alternation in original)).

7. *See, e.g.*, CertiSign Holding, Inc. v. Kulikovsky, No. 12055-VCS, 2018 WL 2938311, at *16 (Del. Ch. June 7, 2018) (noting that a former director's decision to "advance his personal interests" over those of the company "is the quintessential breach of the duty of loyalty"). *See also In re* Pattern Energy Grp. Inc. S'holders Litig., No. CV 2020-0357-MTZ, 2021 WL 1812674, at *47 (Del. Ch. May 6, 2021).

8. United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1049–50 (Del. 2021) (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). *See also* PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 (AM. L. INST. 1994).

9. *See Marchand*, 212 A.3d at 807.

10. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

11. *See Marchand*, 212 A.3d at 824.

the *Marchand* court constantly spoke of *Caremark* as a loyalty case[12]—this despite the uncomfortable truth that the word "loyalty" appears just once in *Caremark*, and only to say that "[t]he complaint . . . does not charge . . . loyalty-type problems . . . ."[13]

This odd switch—from care to loyalty in the context of *Caremark* claims—is part of a rather convoluted history of corporate fiduciary doctrine in the twenty-first century. Near the turn of the century, Delaware courts seemingly raised the duty of good faith (which the American Law Institute (ALI) definition clearly placed under the duty of care) to a coequal status with loyalty and care as one third of a "triad" of fiduciary duties. This invited scholars to study good faith as a standalone concept for the first time.[14] But the elevated status of good faith was short-lived. In *Stone v. Ritter*, another case dealing with director inaction, the Delaware Supreme Court demoted good faith. And with this rearrangement, good faith fell under the duty of loyalty.[15] This meant that the lack of care signaling bad faith in *Caremark* came to be understood as a lack of care that signals bad faith and is therefore disloyal. Thus, by the time the Blue Bell case arose, the boundaries between the duties were blurry.

The migration of *Caremark* claims specifically (and good faith claims generally) from the duty of care to the duty of loyalty is significant for several reasons. On the ground, the obvious difference is that loyalty claims open a suite of remedial possibilities that were unavailable in the duty of care context.[16] But theoretically, the recent history of corporate fiduciary duties reveals that the shift has shaken the larger doctrine of fiduciary duties. As such, it seems clear that *Stone* will not be the final word on the matter. It has left fiduciary duties—especially in cases alleging a failure to monitor—on rather unstable ground. Where there was once a clear—albeit artificial—distinction between care and loyalty, *Marchand* shows that any meaningful differences in theory or practice have largely collapsed. Hence, we get statements

12. *See, e.g.*, *id.* at 820 ("Failing to make [a] good faith effort [to oversee a company's operations] breaches the duty of loyalty and can expose a director to liability.").

13. *Caremark*, 698 A.2d at 967.

14. *See, e.g.*, 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, 1417 n.53 (2005) ("Whether good faith is a stand-alone fiduciary duty—along with the duties of care and loyalty—is a point of some debate.").

15. *See* Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006).

16. *See* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004).

in *Marchand* that blend all three potentially distinct duties.[17] Delaware courts and corporate scholars could benefit from a more robust theory of fiduciary duties.[18]

This Article develops and validates just such a theory. The centerpiece is the Judicial Monitoring Model (JMM).[19] The intuition of the model is straightforward. For there to be corporations, there must be investment. For there to be investment, boards must be able to make believable promises to investors. For these promises to be believable, courts must be willing to enforce the promises. But courts are imperfect, so corporate law must develop rules that consider judicial errors.

From a technical perspective, the model embeds substantive understandings of loyalty and care within a standard game theory framework to describe and evaluate the choices of investors, boards, and courts. In the model, investors decide whether to invest; boards must decide whether to pursue some opportunity; and courts must decide whether to block the board when it pursues a deal or to let it go through. The court serves as a monitor to relieve the traditional moral hazard problem that plagues principal-agent arrangements. By fulfilling this role, the court makes potential shareholders more willing to invest than they would be absent an effective monitor. To accomplish this, courts can and should enforce the duty of good faith even if they cannot observe evidence of a breach of either loyalty or care.

The model's key insight is that courts can vary substantive standards of review to optimize policy trade-offs by balancing costs associated with two different types of errors: wrongly blocking or unwinding transactions and failing to block or unwind

17. *See Marchand*, 212 A. 2d at 824 ("If *Caremark* means anything, it is that a corporate board must make a good faith effort to exercise its duty of care. A failure to make that effort constitutes a breach of the duty of loyalty.").

18. Cf. Robert J. Rhee, *A Liberal Theory of Fiduciary Law*, 25 U. PENN. J. BUS. L. 451, 451–52 (2023).

19. The model presented is not the first attempt to formalize fiduciary duties. *See generally* Eric Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 YALE L.J. 277 (1998) (examining a subspecies of the duty of loyalty); Holger Spamann, *Monetary Liability for Breach of the Duty of Care*, 8 J. LEGAL ANALYSIS 337 (2016) (duty of care). In Spamann's model, courts enforce a contract between investors and boards that is keyed to the stock price or a similar clear signal. In my model, courts get a noisy signal and balance public policy concerns to develop their own enforcement strategies.

unprofitable transactions.[20] Wrongly blocking or unwinding transactions will chill the market. If parties are worried that courts will make them undo a deal, they will be less likely to undertake transactions in the first place. On the other hand, failing to block or unwind deals that are expected to lose money will chill future investments since such enforcement is a necessary precondition to the implicit contract between shareholders and the board. Different transactions present different risks, and courts can adapt their standards of review to reflect those differences, thus implementing a rich variety of doctrinal responses to different types of cases.

This argument—that there should be a range of judicial approaches to fiduciary claims—is surprising given the constrained approach corporate law currently takes in fiduciary cases. Right now, the Delaware Supreme Court and most corporate law scholars seem to agree that the only real fiduciary claims—apart from an increasingly narrow set of appraisal matters—are for breaches of loyalty or care.[21] If the prevailing account is correct, then fiduciary claims outside these traditional parameters of care and loyalty should not exist and should certainly not succeed. But they do exist, and they do succeed.

A second contribution of this Article is to show empirically that the JMM bears out in real life. Courts have vindicated and still do vindicate fiduciary claims even when there is no evidence of self-dealing or when the activity would ordinarily fall under the protections of the business judgment rule. This empirical account highlights two overlooked but vital corporate doctrines: corporate waste and the business judgment doctrine. The Article documents dozens of recent waste claims in New York and Delaware that survived motions to dismiss, reached discovery, or won outright. Further, it traces more than a century of cases where courts used equitable powers to block or revoke good faith business decisions

20. The focus on the court's incentive structure is the major innovation from game theory. Previous formal theory has considered how principals (shareholders) and agents (boards) can write more efficient contracts when principals do not have perfect information about the agents' efforts. *See, e.g.*, Milton Harris & Artur Raviv, *Optimal Incentive Contracts with Imperfect Information*, 20 J. ECON. THEORY 231, 232–33 (1979); Bengt Holmström, *Moral Hazard and Observability*, 10 BELL J. ECON. 74, 75 (1979); *see also* Spamann, *supra* note 19, at 341 (applying these insights to the duty of care). These models assume courts act as enforcers, but they do not consider the incentives of the courts themselves.

21. *See, e.g.*, *Stone*, 911 A.2d at 369 ("[A] failure to act in good faith is not conduct that results, *ipso facto*, in the direct imposition of fiduciary liability."); Jack B. Jacobs, *Fifty Years of Corporate Law Evolution: A Delaware Judge's Retrospective*, 5 HARV. BUS. L. REV. 141, 149 (2015) (arguing that "*Stone v. Ritter* put [the duty of] good faith back into its original doctrinal box" as an element of the duty of loyalty).

made by disinterested, informed directors: where one would expect the business judgment rule to apply. Although current scholarship has almost entirely ignored or forgotten these cases, they exist, as predicted by the model outlined in this Article.

The model and cases explored here offer several important payoffs. First, at the level of theory, the model provides a novel and coherent account of corporate fiduciary duties, especially the relationship between good faith, care, and loyalty. Properly understood, good faith is not a component of care or loyalty; neither is it a coequal but separate duty. Instead, good faith is an overarching duty that includes both care and loyalty.[22] Good faith requires directors to use care and to act loyally.

Doctrinally, the model demonstrates the need to recognize the business judgment *doctrine* as distinct from the business judgment *rule*.[23] The key difference is remedies.[24] While the rule protects directors from personal liability and money damages,[25] the doctrine protects the finality of the transaction itself from equitable relief. Without the rule, directors could face personal financial ruin if the corporation loses money and shareholders look to the directors' own pockets to make the corporation whole. Even if people were willing to serve, the risk of potentially ruinous litigation would make the directors excessively risk averse.[26] The doctrine, on the other hand, protects third parties who, in good faith, enter a contract with the corporation. Shareholders may want the deal blocked or undone to benefit the corporation at the expense of the

22. Obviously, this overarching view of good faith covers more ground than other accounts. *Cf.* Melvin A. Eisenberg, *The Duty of Good Faith in Corporate Law*, 31 DEL. J. CORP. L. 1 (2006) (suggesting good faith "consists of four elements: subjective honesty, or sincerity; nonviolation of generally accepted standards of decency applicable to the conduct of business; nonviolation of generally accepted basic corporate norms; and fidelity to office").

23. *See* Joseph Hinsey IV, *Business Judgment and the American Law Institute's Corporate Governance Project: The Rule, the Doctrine and the Reality*, 52 GEO. WASH. L. REV. 609, 611–13 (1984). *See also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 n.10 (Del. 1986) *and In re* Columbia Pipeline Grp., 2021 WL 772562, at *49 (Del. Ch. Mar. 1, 2021) ("When applying enhanced scrutiny, Delaware law distinguishes between 'the transactional justification' setting and the 'personal liability' setting."). Unhelpfully, as the Delaware Supreme Court noted in *Revlon*, Delaware opinions "have not observed the distinction in such terminology." *Revlon*, 506 A.2d at 180 n.10.

24. For a helpful explanation of the range of equitable remedies available to remedy breaches of fiduciary duties, see Samuel L. Bray, *Fiduciary Remedies*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 449 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019).

25. *See* Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1051–53 (Del. Ch. 1996).

26. For these reasons, the business judgment rule is incredibly protective. *See, e.g.*, Bainbridge, *supra* note 16.

third party. The doctrine stands in the way and defends the finality of the deal.

This Article proceeds as follows. Part I builds the theory. Part II shows how the theory fits within existing business law doctrines.

I. THE JUDICIAL MONITORING MODEL (JMM)

The JMM is a spin on familiar principle-agent models. Shareholders take on the role of the principal and the board takes on the role of the agent.[27] The court acts as a third party to possibly enforce any agreement between the shareholders and the board. Shareholders choose whether to give money to the board. Boards choose whether to pursue a business opportunity and, if pursued, to administer it. A court then reviews the board's action and rules either for or against the board, and then payoffs are made. The Article will discuss payoffs for each of these players along the way.

In the model, courts and the board each receive "signals" from "nature."[28] The board receives signals containing information about the quality of an investment, and courts receive signals with information about the probability that the board did something wrong. Importantly, the court's signal is a function of board decisions. When boards pick better opportunities and take more care in administering the business, the signal the court receives will be more likely to lead the court to rule in favor of the board.

This Part builds out the JMM piece by piece to better highlight each individual piece's unique implications. The goal is that, in the end, the JMM will explain the law of corporate fiduciaries, an important component of corporate law.

Generally, the role of corporate law is to provide rules that "if uniformly applied, will maximize the value" of the corporation.[29] Put differently, corporate law should replicate the contract that boards and investors would make if they were required to start from scratch. It is worth thinking about what such an agreement would look like.

27. Importantly, in this context principal and agent take their meaning from game theory literature rather than implying the full suite of duties implied under agency law.

28. Signals are a common device in such games. The idea is that after some process (possibly influenced by players' decisions) the universe sends a signal to somebody. Think about a juror at the end of a trial. After all the evidence comes in, the juror has a sense of the probability that the defendant should win. You might think of that probability as the "signal" the juror received from nature. All of the jurors saw the same information, but they processed it differently in a way we might think of as random.

29. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 35 (1991).

A. The First-Best Contract

To identify the ideal board-investor contract, consider a hypothetical. Assume that a board is seeking investors for a potential opportunity. If the board pursues the opportunity, it receives a salary of $20 to manage the investment. However, there will be no investment to manage unless the board can convince investors to fund the project. Suppose further that the board is not yet sure about the quality of the opportunity, because it must first do due diligence. Based on current information, there is a 60% chance that the opportunity will lose $1,000 and a 40% chance that it will earn $2,000, both after accounting for the board's management fee (let us assume this is $20) and the cost of due diligence (suppose it is $100).

Begin by assuming that everything the board knows and does is observable and verifiable. This would allow boards and investors to write a contract to achieve the most efficient outcome. As it stands, the expected value of the deal is $200.[30] However, if the board pursued the deal only if due diligence revealed it had a positive expected value,[31] the expected return would be significantly higher. In that case, investors would have to sink $100 for due diligence no matter the outcome, so 60% of the time they would face a $100 loss. The other 40% of the time, they would still get $2,000. So, refusing to pursue bad deals after due diligence increases the expected value of the investment to $740.[32] The problem is that the board will still want to pursue the bad deal. It gets paid $20 to manage the investment whether it is a good one or a bad one. From the board's perspective, taking a bad deal gets the directors $20, while passing on it yields nothing.[33]

This is where the contract comes in. The expected value of a bad deal to the board is $12, which is 60% of the $20 management fee. Suppose the investors offered to pay the board $15 in exchange for the promise that the board will not pursue a bad deal. If that happens, the board gets $15 for sure and a $20 management fee when due diligence reveals a profitable opportunity and the board pursues it. That works out to a $23 expected payoff for the board. The shareholders still expect to get $725 after paying the board the extra $15. Clearly, this is a better deal for everyone. If the quality of

30. $0.6 * (-1{,}000) + 0.4 * (2{,}000) = 200$.

31. Assume due diligence reveals the quality of the opportunity perfectly.

32. $0.6 * (-100) + 0.4 * (2.000) = 740$.

33. C.f. *In re* Multiplan Corp. S'holders Litig., 268 A. 3d 784 (involving special purpose acquisition companies).

the opportunity after due diligence is easily verifiable, then the optimal contract happens easily.

Further, it is worth considering what type of relief the contract would countenance. One possibility would be to impose damages on the board. If the board pursues a negative value deal, then expectation damages would require it to pay back $900.[34] But this is suboptimal for a couple of reasons. First, the board might not have $900. It only has the $15 from the contract payment and the $20 management fee it collects for pursuing a deal. If it lacks the assets to make the investors whole, then the investors are much worse off. Secondly, damages are only paid if they are suffered, which means that the loss must have occurred. It would be much better—from a public policy perspective—to find a way to avoid damages in the first place.

Damages can be avoided by allowing investors to block, or possibly even to unwind, the deal. If the board attempts to pursue a bad deal and the investors can see that, they could turn to the court to enjoin the board's efforts. That prevents the loss from happening in the first place. This is far more efficient than damages, which only come into play after losses are incurred.

To be sure, in equilibrium, the board would not violate the contract if either damages or injunctive relief is in play—assuming the injunction imposes some harm (possibly only reputational) on the board. Still, the law must consider how to operate when players operate "off path" and do things that are unexpected. If the board did act irrationally and try to execute a bad deal, it would be better to enjoin the action rather than to apply damages.

One important feature of this example is that the agreement removes any board authority to pursue business opportunities with negative expected values. In this way, corporate law can be seen to follow traditional agency law principles. As a default rule in agency law, an agent lacks authority to sell the principal's asset for less than the market price (if there is such a price) or for less than a reasonable price (if there is no market price).[35] This default rule recognizes that principals would not willingly empower an agent to intentionally lose the principal's money. The same is true of shareholders who are willing to run the risk of *actual* losses, but only if they can *expect* returns.

This simple example highlights two points. First, boards and investors would both be better off if boards could effectively

34. The investors agreed to pay $100 for the due diligence, and the $1,000 loss includes due diligence, so the court should remove $100 from the final award.

35. *See* RESTATEMENT (SECOND) OF AGENCY § 61 (AM. L. INST. 1958).

bargain away any authority to invest in negative value deals and courts could stop boards from trying to go back on their word. Second, the agreement would hold only if courts can credibly enforce it. So far, we have assumed that the expected return of the project was verifiable, but that is unlikely to be true in practice. At least, courts cannot be certain about the expected value. They might, perhaps, be able to get a useful signal.

B. Enforcing the Deal Under Uncertainty

The example just described assumes that all uncertainty can be cleared up with due diligence and that the necessary information can be verified to the court. Neither is likely true in practice. Business opportunities are risky, so even deals with a positive expected value might not work out and end up costing money. Likewise, courts are not usually able to perfectly verify what boards knew, or at least reasonably believed. With so much left uncertain, the earlier example needs further development.

It is important to recognize that well-diversified investors want boards to be risk neutral. That is, they want boards to pursue a deal if it is expected to be profitable, even if there is a good chance that the deal will fail and money will be lost. If the rewards of success are high enough, the strong possibility of loss can be overcome.[36] This means courts cannot automatically find breach in a deal that loses or was likely to lose money. Investors recognize that deals are risky; the mere fact that a deal *actually* loses money or even that it would lose money most of the time is not usually sufficient to conclude a board pursued a project it *expected* to lose money. Further, since it is hard (indeed, likely impossible) to verify what a board believed about the expected outcome of the opportunity, the court will always be uncertain about whether the board did or did not break its promise. Thus, there are two levels of uncertainty. The board is uncertain about the opportunity and the court is uncertain about the board's knowledge.

The JMM addresses this uncertainty by using a signaling structure. The board will get a signal as to the expected value of the deal. The signal is randomly drawn from a distribution that is centered on the true expected value of the opportunity, but the variance of that distribution shrinks as the board exerts effort to learn about the opportunity. Thus, if the board works hard to figure

36. For instance, suppose a board has an opportunity to pay \$10 for a 10% chance of getting \$150. The company would lose the \$10 nine out of ten times, but the expected value of the opportunity is positive: $0.1 * \$150 - 0.9 * \$10 = \$6$.

out the value of a deal, the signal it gets will be close to the true expected value. If the board does not work hard, the signal it draws may be very far away from the true expected value.

This framework accounts for the two types of uncertainty: uncertainty in the actual outcome of an investment and uncertainty in the expected value of an investment. Boards are uncertain about the actual outcome of a chancy investment: it may pan out or it may fail. Since investors are presumably diversified, they want the board to be risk-neutral, so all that matters is the expected value.[37] This means the board can essentially ignore the first type of uncertainty and focus on expectations. But the true expected value is also hidden. This second level of uncertainty is modeled with the signaling structure. The board receives a signal about the expected value, but the signal will be more or less accurate based on the board's effort to inform itself of that value.

While the board will almost certainly be wrong about an opportunity's true expected value, it can work hard enough to ensure its estimate is not far off. This is effectively part of the duty of care. The board must pay attention and be sufficiently sure that it is reasonably stewarding corporate resources. It will then accept opportunities that have positive expected values and reject those expected to lose money.

A straightforward extension of this model is first to allow the signal to contain two pieces of information: the expected value to be returned to shareholders and an expected value to the board.[38] Then, allow the board to draw two signals that represent two (likely related) opportunities. In effect, this extension of the model allows the board to compare two different versions of a deal based on the returns to shareholders and directors. Once again, if the board puts in the work, it will reduce the variance of the signals.

Obviously, shareholders want the board to choose the version of the deal that maximizes the expected returns to shareholders. The board, on the other hand, left unconstrained, would choose the version that maximizes payoff to the board. Importantly, this latter

37. The key idea is that what matters is the expected outcome, not the actual outcome. Boards should be free to take large risks, so long as those risks are expected to pay off in expectation. There is no such thing as excessive risk in this model, which preserves a core component of the business judgment rule. *See* Robert T. Miller, *Oversight Liability for Risk-Management Failures at Financial Firms*, 84 S. CAL. L. REV. 47, 109–20 (2010). *Cf.* Melvin Aron Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437, 461–67 (1993) (reasoning from a probability distribution of actual outcomes instead of expected outcomes).

38. That is, the board learns (imperfectly) two different pieces of information about an opportunity.

path is constrained by the initial agreement: the board lacks authority to pursue a deal that is expected to lose money. Still, if boards can pursue any deal so long as the expected value to shareholders is weakly positive, directors could arrange to expropriate all the surplus for themselves.

If boards can take the surplus for themselves, investors will rationally anticipate zero return and will therefore not invest. To get the shareholders to invest, the board must find a way to convince them that insiders will not steal the money. If the board can make a credible promise that it will not misappropriate corporate funds or opportunities, it benefits both parties. Without that credible promise, there is no investment, and so the board does not get the initial payment nor do the investors get an expected return.

There are at least two ways to try to enforce this promise. One is to strictly forbid any self-dealing transactions, as is done in trust law. Doing so would be relatively easy. The policy could once again be treated as a limitation on the board's authority, and all that is necessary to enforce it is evidence that an insider was involved in the transaction. The well-known problem with this approach is that there are times that the best investment for investors also benefits an insider. For example, it might be good for the company to borrow money or purchase needed assets from a board member. So, making a strong prohibition that sounds in the register of board authority is likely inefficient. The second way to enforce the promise is to frame it as a fiduciary duty to choose the best deal for the shareholders even if it is not the best deal for the board. This is the duty of loyalty.

The argument up to this point establishes three key points. First, an agreement that gives the board complete authority to pursue opportunities is Pareto-dominated by a different agreement that limits the board's authority.[39] Second, the board's duty of care can be modeled, in part, as an obligation to invest enough to receive a sufficiently accurate signal. Finally, the fiduciary duty of loyalty constrains the exercise of board authority to choose a deal.

39. Pareto improvements occur when something changes, leaving at least one party better off than before and no other party worse off. A situation that could be Pareto improved upon is Pareto-dominated by that alternative. Here, both parties are better off if they agree to exchange money for the denial of authority, so that arrangement Pareto-dominates one where the board retains the authority to enter into deals expected to lose money.

C. Pursuing the Opportunity

Once the board announces the opportunity, two things may happen. First, if shareholders believe the board pursued a deal that loses money in expectation, they can ask the court to block the deal. Second, the board pursues the deal. Obviously, both things can happen simultaneously since, barring an injunction, the board could pursue the deal while litigation is ongoing. Discussion of the litigation path is deferred for the moment to focus on the board.

When a board considers an opportunity, it implicitly assumes that the opportunity will be supervised and managed. If the board does not strive to ensure the corporation makes the most of the opportunity, the initial investment will be wasted. For example, suppose the board purchases a factory that, when operated efficiently, is expected to yield a 12% return. If the board buys the factory but then does not operate it, there will be no return. The initial purchase will simply be lost.

The key implication is that the signals received by the board earlier are implicitly contingent on the amount of effort the board expects to put into the project. But the anticipated effort might not be the effort the board eventually exerts. That effort will affect the profitability—and importantly, the *expected* profitability—of the project. The model captures this by allowing the project's final return to be randomly drawn by nature from a distribution that depends on the board's effort. The greater the effort, the greater the expected value and the lower the variance of the distribution from which nature will draw the actual result of the opportunity.

Tying the return to the board's engagement links the JMM to the broader duty of care. When the board chooses whether to take an opportunity, it exerts effort to learn about the option. Once the board decides to pursue the deal, the board exerts effort to increase the expected final return of the deal. The first of these efforts comports naturally with the part of the business judgment rule that requires the board to be informed. The second effort approaches something like *Caremark* liability. If the board does not take the necessary steps to pursue the opportunity prudently, it fails in its duty. Consider the Blue Bell ice cream case from the introduction. Making ice cream that people love is a profitable business and worth pursuing. But by not investing in minimal safeguards to ensure the safety of the firm's sole product, the board reduced the expected value of the business and the variance of likely outcomes.

D. Introducing the Courts

The model introduced above describes the promises and payments between boards and investors that would lead to efficient investments. The problem, however, is that there is not yet any way to enforce those promises. Absent some enforcement mechanism, the board could pursue a deal that is expected to lose money despite having given up that authority, and it could appropriate surplus for itself despite promises not to do so. If boards could get away with such behavior, they would, but investors would recognize the opportunity for insiders' strategic behavior and refuse to invest in the first place. So, ex ante, both boards and investors want to empower a third party to enforce the bargain. This is the role of courts.

In a perfect world, courts could cheaply verify everything necessary to enforce agreements between parties. But since verification may be impossible (or at least incredibly costly), courts must operate with a great deal of uncertainty. The presence of uncertainty creates the possibility of two distinct errors. The court might punish the board when it should not, or, alternatively, it might not punish the board when it should. These different mistakes will be more or less costly in different situations. To illustrate, consider different claims investors could make against the board.

First, when the board announces that it will undertake an opportunity, the shareholders might claim that the project is expected to lose money and thus the board lacks authority to pursue the deal. Second, shareholders might argue that the board chose an opportunity that is better for insiders over one that is better for shareholders in violation of the duty of loyalty. Third, after the board has pursued a project, the shareholders may claim that the board did not invest enough to limit the opportunity's risks. In leaving too much variance, the board violated the duty of care. Finally, shareholders might say that the board did not invest enough in the project to make it profitable in expectation. In essence, shareholders claim that either new information changing the expected project value arose after the decision to pursue the deal and the implementation phase, or that the board's anticipated effort level was significantly higher than what the board finally provided. This would amount to the board pursuing a negative value transaction, which it lacks the authority to do.

This last type of claim is subtle, so an example may be useful. Suppose in the first stage, the board considers a project that 50% of the time will return \$10 and the rest of the time will lose \$8, but only if the board undertakes "high effort."[40] In contrast, if the board uses "low effort," the project will return $10 only 10% of the time, 80% of the time it will lose $8, and in the remaining 10% of cases, it will lose $10. This project is expected to be profitable if the board uses high effort, but it expects to lose money if the board uses low effort. If the board anticipates using high effort, then the deal is within its authority. Suppose that the board so anticipates and announces it will pursue the deal; however, when the board implements the deal, it actually uses low effort. In that case, it is pursuing a project with a negative expected value, which is beyond its authority.

On the other hand, suppose the low-effort case leaves the chance of a $10 gain at 50%, losses of $8 occur 40% of the time, and the remaining 10% see losses of $15. The deal still has a positive expected value, but the low effort increases the variance by adding weight to especially bad outcomes. Pursuing the project with low effort does not violate the board's authority, and assuming the board does not get any side benefits, there is no loyalty problem. Instead, the low effort here may, if anything, violate the duty of care.

Observe also that these different claims occur at different points in the life cycle of a project and the types of remedies available will differ. When the shareholders sue to prevent a deal that has been announced, they seek an injunction to prevent the board from exercising authority it does not have. Alternatively, suppose the project is expected to be profitable if the board exercises "high effort," but the directors actually only give low effort. Perhaps the deal is still profitable (in expectation), but it is now far riskier than it would have been. Shareholders might sue for damages for a breach of the duty of care. If the low effort makes the deal an expected loser, then the deal falls outside the board's authority. If the board pursues it anyway, shareholders have two options: pursue damages or seek an injunction to unwind the deal.

These options yield a significant range of possible remedies that may emerge under different circumstances. Each remedy has its own effects on public policy. To see this, compare three different possible injunctions. First, suppose a court issues a preliminary injunction that prevents the board from pursuing a deal with a third party. Second, suppose the board pursues a deal with an insider, and the court subsequently voids the transaction. Third, suppose

40. For example, the board spends a lot of time and resources identifying the best possible managers, keeps a close eye on the project via regular reports, etc.

the court unwinds a transaction between the corporation and a third party after it has been concluded.

The stakes are quite different across the three injunctions. Blocking a deal from happening is far less costly than unwinding it after it happens. Unwinding deals with third parties creates significant negative externalities. Parties will fear that deals are never really final, since a court may always be waiting in the wings to reverse them. Third parties may worry about collusion between shareholders and the board: undertake a risky deal, and if it does not work out, the board admits that it exceeded its authority, and the court returns the property, leaving the third party without the benefit of its bargain. So, unwinding deals that are already done may chill the market broadly. On the other hand, unwinding deals with insiders produces much smaller externalities. The broader market is not worried since the only parties involved are inside the company.

The court has conflicting responsibilities. On the one hand, it needs to enforce the bargains made by the parties. On the other, it knows that its decisions will have significant consequences for the larger market. If it simply refuses to block deals, then shareholders will not be able to enforce deals and limit the board's authority to make deals expected to lose money. This will make shareholders less willing to invest and make both them and boards worse off. On the other hand, if courts always block deals, few transactions will happen. Similarly, if courts never unwind deals or punish boards for failing to exercise sufficient effort in implementing deals or for misappropriating deal surplus, shareholders will be wary of investing. Yet, if courts are too quick to punish directors or unwind deals, people will be unwilling to serve on corporate boards and counterparties will be less likely to transact.

To manage these challenges, courts must trade off the costs of different errors. If the costs of wrongly ruling against the board are greater than the costs of wrongly ruling for it, then the court will give the benefit of the doubt to the board in an increasing range of cases. For example, suppose the court receives a (policy) payoff of zero if it gets the case correct, a payoff of $-3/4$ if it wrongly rules against the board, and a payoff of $-1/4$ if it wrongly rules for the board.[41] Assume the court receives a (probably noisy) signal, s, between 0 and 1 that tells the court the probability that the board

41. These payoffs are discussed further in Part II, *infra*.

did violate a duty.[42] Then, if the court blocks the deal, the probability it is wrong is $(1 - s)$ and thus its expected payoff is $-3/4(1 - s)$. Similarly, if the court permits the deal to go through, the probability it is wrong is s and its expected payoff is $-1/4\ s$. Thus, the court will block the deal if and only if $-3/4(1 - s) > -1/4\ s$. We can solve for s to discover that the court will block any deal where it gets a signal $s > 3/4$. That is, in this example, the court will only block a deal if there is a greater than 75% chance that the board is in the wrong.

E. Fitting the Pieces Together

An important assumption is that losing in court is bad for the board. In some cases, for instance if insiders are forced to pay damages, the loss is easy to observe. But there must be some consequence—for instance the harmed reputation of directors or the likely loss of future opportunities to serve on boards—if the board loses in court.

To see why this is true, consider a world in which losing in court is costless to the board. If the board pursues a negative value deal, or appropriates corporate assets or opportunities for itself, then the worst that happens to the board is that the court blocks the deal or returns the assets. The board gets a payoff of zero. If the court's signal is noisy,[43] then there is a chance the board will get away with their bad behavior and benefit, so there is a real chance that the board will get a positive return for violating its duties or exceeding its authority. In this scenario, the board has nothing to lose by pursuing bad deals or misappropriating corporate assets. Investors would rationally anticipate the board's misappropriation and not invest. So, for there to be investment, there must be a chance that courts can meaningfully punish boards.

A second assumption is that the court's policy payoffs are public knowledge. Since courts must trade off different error costs, there is a required level of certainty needed for a court to rule against a board. Below that threshold, the court will not punish directors. The model assumes that the threshold is common knowledge. This allows boards and investors to make decisions based on the court's expected decisions.

42. A "noisy" signal is one that is imperfect because it is muddied by noise. Suppose the real probability the board violated a duty is 0.5. That would be the true signal. A noisy signal would be a random number drawn from a distribution centered around 0.5.

43. Just as the board gets a signal about the expected value of an opportunity, the court also gets a signal about the board's performance; for example, the signal s just described.

A third assumption is that boards know that the court's signal will depend on the board's decisions. When boards pick good projects and pay attention to make sure they are executed well, the probability the court receives a low value of s (signaling the board should win) is higher than when the board picks bad projects or does not pay attention. Given these assumptions, the board will make investment and implementation decisions (both of which are costly to the board) so long as those costs sufficiently reduce the risk the court will get a high (anti-board) signal.

To see this, focus only on the initial choice of whether to pursue an opportunity—a choice that will, if the board pursues the opportunity, then be reviewed by the court. Consider an example where the board gets a payment of $A = 4$ if the court decides in favor of the board and allows the deal, while the board suffers a loss of $B = -2$ if the court rules against the board. To decide the case, the court gets a noisy signal about the board's culpability. When the board chooses higher-value opportunities, the court is more likely to receive a pro-board signal, and likewise, the lower the expected return of the opportunity, the more likely the court is to receive an anti-board signal. Understood this way, it is straightforward for the board to match any opportunity to a probability the court will receive an anti-board signal rule against it: the better the deal, the lower the probability. The board will choose opportunities that give it a positive payout in expectation. Thus, the board will pursue any opportunity where the probability it will lose in court is less than or equal to 2/3.[44]

Finally, consider the investors. For simplicity, assume that investors are deciding whether to make an investment of $10 in the company. If the board makes a bad deal and the court allows it, the investors lose the $10. If the investors do not invest, if the board does not accept the opportunity, or if the court blocks the deal, the investors get their money back yielding a payoff of $0. If the deal goes through and is successful, the investors get a payoff of $20 (so, their initial investment plus another $20 in returns). Suppose that there are more bad ideas in the world than good ones, so the chance that the board draws a good opportunity is only 20%.

Under these assumptions, imagine that the court never provides meaningful substantive review, so every deal goes through as if approved. In that case, the board never has to worry

44. When the probability the board will lose is equal to 2/3, the expected return to the board is $2/3 * (-2) + 1/3 * (4) = 0$. So long as the probability the board loses is at most 2/3, the board expects to benefit.

about a deal being blocked. It therefore faces no risk of a negative payoff and will therefore approve any opportunity. Since 80% of the deals lose money, the expected return to shareholders is $-10 * 0.8 + 0.2 * 20 = -4$. Since the investors can get a payoff of $0 by not investing, and zero is better than losing money, they will not invest.

But suppose the court chooses to enforce, and as before, the board will only accept an opportunity if there is at least a 1/3 chance the court will allow the deal to go through. For simplicity, suppose there are three types of investments. The first type, comprising 50% of possible deals, would be overturned every time they are reviewed. Another 30% of the deals are not profitable, but the probability they are blocked on review is 2/3. Finally, as before, we assume 20% of deals are profitable and, to keep the arithmetic simple, that the court never blocks a deal that is profitable. This means that the board will take 50% of the opportunities. Of the ones the board takes, 40% will be profitable and 60% will not be.

Now calculate the investors' expected payoff. Investors get nothing 50% of the time when the board declines to engage in the first type of deal. Another 20% of the time, the board approves a profitable deal, and investors get $20. In the remining 30% of cases, the court blocks 2/3 of the deals (20% of the total possible deals), giving the investors a payoff of $0. In 1/3 of the bad deals the board pursues, the court allows the transaction to go ahead. Thus, in 10% of the total possible deals, investors get −$10. So, the expected payoff is $0.2 * 20 - 0.1 * 10 = 3$. Therefore, the court's supervision makes the investors better off.

Not only are the investors better off, the board is too. Recall that absent court enforcement, the investors face a negative payoff, so they don't invest at all. That means the board gets nothing. But now, consider the payoffs to the board. The board rejects half of the deals for zero payout. In 20% of deals, the court blocks the board's decision to pursue a deal. In the remaining 30% of opportunities, the court approves the decision. Thus, the payoff to the board is $4 * 0.3 - 2 * .02 = 0.8$. So having the court as a third-party monitor also makes both the board and the investors better off.

F. Allowing for Market Monitoring

The model can account for market monitoring with a simple extension.[45] First, one must admit the obvious: if the market is a perfect monitor of the board's decisions and can punish the board

45. Readers should feel free to take an expansive view of the market (creditors, shareholder voting, the market for corporate control, etc.).

sufficiently whenever it pursues a transaction expected to lose money, there is no need for a court. Faced with a perfect monitor in the market, the board would never pursue a bad deal, and the court would be superfluous. Yet there is no reason to believe the market is a perfect monitor that can police and punish bad behavior flawlessly. If it could, there would be no need for traditional loyalty suits, *Revlon* cases challenging the board's decision to sell the company to a lower bidder, etc. This is not to suggest that markets cannot monitor at all. It is merely an acknowledgement that markets are imperfect monitors, which opens a role for courts.

Return to the previous example, but instead of the court being the primary monitor, suppose the market is. To keep things simple, substitute the market for the court, so that the market will punish boards in 2/3 of the nonprofitable deals the board pursues. To do this, say the probability that the market punishes the board with a payment of $-\$2$ is $m = 2/3$. If there is no court, then we have the same numbers as before, swapping the letter *m* for the letter *b*, but we have helpfully assumed they have the same value. The market monitor—assuming it is just as accurate as the court—will give similar results.

From the board's perspective, if the market monitors and there is no court, the outcome is the same. The board will still invest in half of the opportunities and decline the other half. Among the deals the board pursues, two in five will be profitable and go through; the same fraction will fail and the board will be punished; and one in five will be unprofitable, but the market will not punish the board, which means the board will still get paid.

Things are different from the perspective of investors, however. The market may be able to punish the board, but the market lacks the equitable powers to block a deal. So, even though the board will be punished in 2/3 of the bad deals it pursues, the deals will still happen, and the investors will still lose their investments. Thus, for the investors, their payoff from a market monitor is $0.2 * 20 - 0.3 * 10 = 1$. The investors still make money, but less than when the court monitors. It is easy to see that one could slightly change the payoffs to find examples where investors make money if the court monitors and lose money if the market is the primary enforcer.

Employing the court as monitor does at least two things. First, it reintroduces the court's equitable powers to block deals that cost investors money. Second, if the court is willing to operate somewhat independently of the market, the probability that the board will be punished increases. In the hypothetical world where 30% of deals lead to the market punishing the board 2/3 of the time—which is exactly the threshold at which the board will approve a merger—adding the court increases the probability the board will be punished. Once the probability of punishment exceeds 2/3, the board will not pursue those deals at all. At that point, the only deals the board will pursue are the most reliably profitable ones, maximizing the investors' payoffs.

In effect, court-monitoring is additive to market-monitoring in two ways. First, it has power not only to punish boards for bad decisions but also to enjoin (and even avoid ex post) these bad deals. Second, thanks to its independence, court-monitoring increases the probability that the board's bad behavior will be caught and punished. This monitoring diminishes the board's incentive to pursue negative value projects.

II. THE JMM AND CORPORATE LAW DOCTRINE

The model presented above and more formally detailed in the appendix captures many of the essential economic features of corporate law. It also accounts for much of corporate law doctrine, especially related to fiduciary duties. The previous Part observed several points of intersection between the economic model and corporate doctrine. This Part revisits these touchpoints in greater detail.

A. The Limits of Board Authority

The first takeaway from the JMM is that both boards and investors are better off if they can create a binding limit on the board's *authority* to pursue certain opportunities. The invocation of authority keeps any dispute on this point outside the realm of traditional fiduciary duties. Roughly speaking, fiduciary duties constrain how one undertakes an authorized action. Authorization is the first-order concern. This is not to say that the board is not, in some relevant sense, a fiduciary; rather, for legal purposes, exceeding authority is different from abusing authority. This understanding has important and overlooked consequences. A board that acts outside of its authority is not violating a duty of loyalty or care, it is acting *ultra vires*.

The ultra vires doctrine in corporate law has traditionally been limited to activities that fall outside the corporate purpose as stated in the charter. While this was an important doctrine and subject to frequent litigation in the past, the modern practice of allowing corporations to state as their purpose "any lawful business" has, in the eyes of most, killed or invalidated the doctrine.[46]

Kent Greenfield has taken issue with this broad claim of the doctrine's demise by pointing out that "lawful" can still do some work.[47] Illegal activities are still "beyond the power" of corporations. He notes that this limitation is efficient because "all stakeholders would either want a term in the corporate contract requiring corporate managers to obey the law or would be willing to accept such a clause at a low price. This explains why illegal acts would be considered ultra vires."

The same point could be made in the context of boards pursuing opportunities expected to have negative returns. One could imagine a rhetorical framing similar to Greenfield's but placing the emphasis on "business" rather than "lawful." A board that pursues money-losing opportunities is not really engaged in business activities, just as a board that pursues illegal opportunities is not engaged in lawful activities. Removing both from the board's capacity ex ante increases the value of the firm.[48]

This is clearly the case in traditional agency law. Absent explicit authority to do so, an agent lacks authority to sell a principal's assets for less than market or reasonable value.[49] The principal could ratify such a sale later if desired, but if not, it would be wrong to bind the principal to the contract.[50]

This doctrinal difference is easily defended on efficiency grounds. If agents could freely sell a principal's assets for less than a reasonable price, that possibility would reduce the use of agents. Since both principals and agents benefit from such relationships, it is in the interest of both parties to enforce a rule denying agents the authority to sell for less than a reasonable value. Thus, from the perspective of principals and agents, it is easy to defend the limit

46. *See* Harwell Wells, *The Life (and Death?) of Corporate Waste*, 74 WASH. & LEE L. REV. 1239, 1241 (2017) (observing that ultra vires has been considered dead for a century).

47. Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce International Law Norms)*, 87 VA. L. REV. 1279, 1323 (2001). *See also id.* at 1284. ("From an ex ante perspective, the principal stakeholders in the corporate contract—the shareholders, the state, the creditors, and, indeed, even the managers themselves—want the corporation and its management to forego illegalities as a way to increase the value of the firm.").

48. This understanding opens the potential for a new interpretation of DEL. CODE ANN. tit. 8, § 124(1), which allows "a stockholder" to go to court to "enjoin the doing of any act or acts or the transfer of real or personal property by or to the corporation" when the company lacks capacity or power to act or transfer.

49. *See* RESTATEMENT (SECOND) OF AGENCY § 61 (AM. L. INST. 1958).

50. *See id.* § 82.

on authority. The economic rationale is identical for boards and investors.

B. Different in Thresholds for Different Remedies

In the JMM, courts provide substantive review of corporate transactions. In effect, the court reviews the board's performance in selecting and administering business opportunities. It does this by asking how reasonable the board was at different points along the way. If it determines the board's action was unreasonable (e.g., exceeded its authority or violated a fiduciary duty), courts have a range of remedial options available.[51] For instance, they could award damages from directors, block a transaction from occurring, or possibly unwind one that has already happened. Just as there are different remedies available, the court will also apply different standards of substantive review. In the mergers and acquisitions context, for example, deals may be reviewed under a more exacting *Revlon* analysis, a more forgiving enhanced scrutiny analysis, or a very lenient review under business judgment.

These remedial options may be helpfully classified along different dimensions for analysis. For instance, some are only available before a transaction is completed, while others only apply ex post. More relevant for this section, remedies might also be categorized based on who bears the cost of remuneration or whether they target the assets involved in the deal or the pockets of various actors. For instance, claims seeking money damages from directors for a breach of the duty of care impose costs on directors. The policy concern is that if directors are personally liable, qualified individuals will be unwilling to serve on boards. Transaction-based equitable remedies impose costs on the corporation's counterparty. So, if a company enters into an agreement with a third party and the court blocks or unwinds the deal, the third party loses the benefit of the bargain.

The JMM allows—indeed, explains—this heterogeneity in remedies and review. The key is that courts will be more likely to find a breach when the costs of providing a remedy are lower. For instance, and as already mentioned, it is certainly less costly to block a merger than to unwind one after closing. This observation does not imply that ex-ante remedies are always lower cost than ex-post remedies; it may be cheaper, from the court's perspective, to

51. *See generally* Dan L. Burk, *Means and Meanings in Patent Remedies*, 92 TEX. L. REV. 13, 18 (2014) ("[C]ourts sitting in equity may have . . . inherent authority to invoke a wider range of remedies.").

allow a merger to close and then to use appraisal to make dissenters whole. This observation would similarly not support a general conclusion that money-based damages are cheaper than transaction-targeting measures. It is quite likely far more costly to the public to hold board members liable for a bad merger decision (and thereby make qualified directors less willing to serve) than to block the deal in the first place.

Since different remedies have different costs in different contexts, the challenge arises: how unreasonable does something have to be to provide notice? On the margin, this creates something of an obvious trade-off between the shareholders and the corporation's counterparty. When the court closely examines the deal and applies a strict standard, it is more likely to block or unwind transactions. This benefits the shareholders at the expense of directors. Conversely, if courts apply a more lenient standard, the transferee benefits at the expense of the principal.

This policy decision has larger repercussions. All market participants are potential principals or counterparties in future transactions. If third parties face high litigation risk and worry that sales might not be final, this expectation raises the costs of future transactions. If transaction costs increase, wealth-maximizing deals will decrease. So, it is imperative that courts do not police transactions too closely or too eagerly block or unwind deals. Doing so chills the market. On the other hand, failing to provide effective monitoring makes it harder to enforce the promises boards make to investors. If those promises cannot be enforced, they will not be believed. In that case, there will be fewer investors and thus lower investment.

Navigating this trade-off across different factual situations is a central job for the judiciary, and the JMM shows how these policy concerns play out in the larger economic environment. The court's determination of what counts as "reasonable" will enforce an implicit contractual limit on an agent's authority to dispose of the principal's assets. When the price is unreasonable, authority is exceeded, and the principal cannot be held to the bargain.[52] This violation opens the door to transaction-based remedies.

When considering these remedies, courts can benefit from something of a rule of thumb that ex-ante injunctions are lower cost than ex-post avoidance. There will, of course, be exceptions; but in general, injunctions do not threaten deal finality in the same way that revoked deals do. Injunctions thus do less to chill the market—

52. *See* RESTATEMENT (SECOND) OF AGENCY § 61 (AM. L. INST. 1958).

lowering the relative cost of finding that an agent has exceeded their authority—and they do not threaten the directors with personal liability.

C. Fraudulent Conveyance

The trade-offs described above are quite analogous to the traditional account of fraudulent conveyance, which targets transactions *intended* to hinder, delay, or defraud creditors, regardless of the success of the effort.[53] Intent was key to the original Statute of 13 Elizabeth—the statute that established the foundation of fraudulent conveyance law. Importantly, it was not only the debtor's intent that mattered. The Statute protected purchasers who gave "good consideration and bona fide" and did not "at the time of such conveyance . . . [have] any manner of notice or knowledge of such covin, fraud or collusion."[54] In other words, the Statute only applied if the debtor and the transferee were conspiring to harm creditors. And if only the debtor had ill intent, the Statute did not apply.

Since the state of mind of any one party is difficult enough to establish, and the Statute seemed to require creditors prove improper state of mind for two parties, the centrality of intent caused obvious problems. Courts eventually dealt with this problem by not requiring direct evidence of fraudulent intent. *Twyne's Case* is widely recognized as the first such instance, and it set out a list of "badges of fraud" that could indirectly establish the necessary state of mind.[55] The number and description of the badges changed over time,[56] but they can be helpfully classified into four sets: instances where 1) there is a family or agency relationship between the debtor and purchaser, 2) there is concealment, 3) the debtor gave more to than they received from the transferee, and 4) the debtor was insolvent (or was in an otherwise challenging financial position) at the time of the transfer.[57]

Modern fraudulent transfer law has continued this movement away from state of mind. Traditional fraudulent transfer required at least an indirect showing of fraud. However, for more than a

53. *See* Frank R. Kennedy, *Involuntary Fraudulent Transfers*, 9 CARDOZO L. REV. 531, 536–37 (1987).

54. Fraudulent Conveyances Act 1571, 13 Eliz. c. 5 (Eng.).

55. Twyne's Case (1601) 76 Eng. Rep. 809; 3 Co. Rep. 80.

56. *See, e.g.*, UNIFORM FRAUDULENT TRANSFER ACT § 4(b) (UNIF. L. COMM'N 1984) (listing eleven badges of fraud to determine actual intent).

57. *See* Marie T. Reilly, *The Latent Efficiency of Fraudulent Transfer Law*, 57 LA. L. REV. 1213, 1218 (1997).

century, fraudulent conveyance law has also allowed creditors to proceed on a theory of "constructive" or "presumptive" fraud.[58] This alternative pathway draws on the third and fourth sets of badges above. To show constructive fraud, creditors must demonstrate that:

1. the transfer was made "without fair consideration"; and
2. at the time of the transaction, the debtor:
    a. was insolvent (or became insolvent as a result of the transaction);
    b. was thinly capitalized; or
    c. intended to not repay his debts.[59]

A key point of fraudulent transfer law—equally true when creditors assert actual fraud or constructive fraud—is that the remedy is not aimed at the debtor. The point of fraudulent transfer law is to recover assets that once belonged to the debtor from third-party transferees. The party on the hook is thus the original transferee, who may have innocently thought they had simply made a good deal. If fraudulent transfer law applies, the transferee will likely have to return the property or at least make up the difference between what they paid and what the asset was worth.[60] This risks unfairness to innocent third parties, and it increases the risk to lenders, making them less likely to lend. If lenders become too reticent, that could lead to a less efficient economy.[61]

The leading fraudulent transfer efficiency account is by Professors Baird and Jackson.[62] Their analysis proceeds from the recognition that the creditor's ability to avoid debtors' transactions through fraudulent transfer law limits the ability of debtors to enter

58. *See id.*

59. *Id.*

60. *See* Judd M. Treeman, *Blessed Be the Name of the Code: How to Protect Churches from Tithe Avoidance Under the Bankruptcy Code's Fraudulent Transfer Law*, 25 EMORY BANKR. DEV. J. 599, 602 (2009).

61. The fairness point is more easily dealt with since these creditors are treated like other creditors who are owed money that the debtor does not have.

62. Just as Clark does not ignore the possibility of economic analysis, Baird and Jackson recognize the importance of morality, at least to the drafters of the UFCA. *See* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 831–32 (1985) (noting that the drafters found gifts by insolvents "inherently objectionable" because they harmed creditors).

certain transactions in the first place.[63] The greater the restrictions creditors place on borrowers and the greater the power they have to unwind transactions, the harder it will be for debtors to utilize the borrowed assets to earn a return.[64] Either the covenants will restrict the borrower's ability to deploy the capital, or the risk that creditors would unwind the deal will scare off counterparties. Creditors, therefore, must allow for some risk that borrowers will make bad decisions that cost-deplete wealth.[65]

This risk calls for a sort of line-drawing exercise. Plainly, some deals must be protected, or else the borrower will have nobody to do business with. On the other hand, some deals must be avoidable, or else borrowers will be able to defraud lenders with ease. Fraudulent transfer law, per Baird and Jackson, solves this problem through a gap-filling program akin to contract law.[66] This program suggests that a law should provide terms that creditors would want to impose and that borrowers would accept.[67] While this is an effective argument for some dividing line between the extremes of "creditors can avoid all transactions" and "creditors can avoid no transactions," it does not provide much guidance as to where to draw the line. The best solution turns out to be the reasonably equivalent value standard.[68]

Fraudulent transfer law can be productively evaluated using the cheapest cost avoider principle.[69] In many, if not most, instances, creditors have superior information relative to third-party transferees.[70] Creditors have at their disposal tremendous contractual powers to monitor and intervene in the affairs of borrowers. Third parties on the other side of arms-length transactions do not. Thus, creditors should not ordinarily be able to avoid transactions.[71]

There is an exception, however, when the third-party exchanges with the debtor for less than reasonably equivalent

63. *See id.* at 834.

64. *See id.*

65. *See id.*

66. *See id.* at 836.

67. *See id.*

68. *See, e.g.*, Reilly, *supra* note 57 at 1236 (arguing that when the transfer is for less than reasonably equivalent value, the third party "transferee is on notice that the transferor is not trading normally [and is] either acting altruistically [which would be waste] or opportunistically.").

69. *See id.* at 1215.

70. *See id.*

71. *See id.*

value.[72] It is important that the standard does not require perfectly equivalent value, only *reasonably* equivalent value. The third party is only at risk when they received an unreasonably good deal in the transaction. Such a transferee is therefore "on notice that the transferor is not trading normally."[73] Specifically, this aberration sends strong signals that the transferor may be suffering from a problem of moral hazard. If, for instance, the transferee also knows—perhaps from industry sources or the news—that the transferor is in desperate financial straits, there is a real risk that the transaction is an effort to externalize losses to the creditors.[74]

In such a situation, it is easy to see the parallels to the traditional "actual fraud" framework within fraudulent conveyance where two collaborators work together to benefit themselves at the expense of the creditors. The transferee knows enough to recognize the fraudulent transfer and can therefore avoid the cost more cheaply than the lenders. It is the transferee's knowledge that is the key. Absent such knowledge, the law protects transferees who acquired property in good faith for value.[75]

This discussion demonstrates the synergies between fraudulent conveyance doctrine and the predictions of the JMM. Recall that the court is concerned with relative costs. It follows that the court would be more likely to engage its equitable powers when it could do so relatively cheaply and when the effects on the larger market can be contained. In particular, if the court can be relatively more confident that there has been a breach, it can save on the overall judicial costs looking for the "fires" of improper deals by focusing on cases where there is more evidentiary "smoke." Further, when the third party has notice that the court is likely to intervene—and the market can observe that the court is only engaging after the third-party accepted the risk implied by that notice—the market-chilling effects are lessened. Indeed, since fraudulent transfer doctrine functions to protect creditors, the doctrine likely increases willingness to invest.

72. *See id.* at 1236.

73. *Id.* One could make a similar point in agency law, where the rule is that an agent's apparent authority runs out when the third party can no longer reasonably believe that the agent has actual authority. *See* Deborah A. DeMott, *Fiduciary Principles in Agency Law*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 23, 32 n.54 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019).

74. *See* Reilly, *supra* note 57, at 1236.

75. This is true, at least relatively, if the purchase is for less than reasonably equivalent value. *See id.* at 1240.

The badges of fraud are an important part of the fraudulent conveyance story. Their creation marks the point at which the doctrine shifted from the hard-to-prove actual fraud to the more achievable constructive fraud account.[76] This facilitates greater creditor protection and prevents courts from having to assert actual bad faith and dishonesty to debtors.

Functionally, the badges of fraud are also rather similar to traditional fiduciary duty concerns. Consider the first badge: a family or agency relationship between debtor and purchaser. This is effectively a concern about self-dealing transactions. When there is such a relationship between counterparties, there is a greater chance that there will be malfeasance. The court knows this, and so it can concentrate attention on such transactions. This reduces the court's overall costs since it can limit its involvement to such cases.

A second type of case where the court may see smoke is where there is concealment. If a court determines there was concealment—a finding that does not require the court to check the substance or fairness of the deal itself—that again signals to the court that something may be amiss. The obvious way to avoid a finding of concealment is to disclose, which explains corporate law's insistence that insiders disclose self-interested transactions.

The fourth badge, insolvency, leads directly to constructive fraud under modern fraudulent conveyance law, as we have already seen. When the debtor is insolvent, the court is more willing to step in both because insolvency affects the debtor's incentives and because it changes the relative costs of judicial intervention. This leaves the third badge: an uneven exchange. Here, too, we find a clear example in the law: corporate waste.

A. Corporate Waste as Constructive Bad Faith

Waste is generally analyzed apart from ordinary fiduciary duties.[77] This different treatment follows from its origins in the ultra vires doctrine,[78] which prohibited corporate actions "outside the corporation's authority."[79] The doctrine was particularly important in a world where corporate charters included narrowly defined statements of purpose. But as charters have come to permit

76. *See* Amanda Barkey, *The Application of Constructive Fraud to Divorce Property Settlements: What's Fraud Got to Do With It?*, 52 WAYNE L. REV. 221, 224–25 (2006).

77. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 35 (Del. 2006); Wells, *supra* note 46, at 1241.

78. On waste's ultra vires origin, see Wells, *supra* note 46, at 1243–48.

79. *Id.* at 1244 (quoting ERNST FREUND, THE LEGAL NATURE OF CORPORATIONS § 36 (1897)).

corporations to conduct "any lawful business purpose," its importance has declined.

Ultra vires litigation differs from fights over fiduciary duties. The latter consider whether the directors act in good faith, loyally, with due care, etc., while the former asks whether the directors have the power to act at all. An ultra vires act is punishable regardless of intent or good faith, and directors can be held personally liable. The distinction is helpfully set out in a leading commentary from the early twentieth century: Directors who use corporate money "for purposes so outside [the board's] power that the company could not sanction such application . . . may be made personally liable as for a breach of trust," but if the use is not ultra vires, "then a strong and clear case of misfeasance must be made out to render them liable for a loss."[80]

The classic example of ultra vires acts by insiders is the gift. Gifts were considered ultra vires early on, but waste as a category was slow to emerge.[81] As one leading treatise from the late nineteenth century put it, "[n]o agent of a corporation has implied authority to give away any portion of the corporate property . . . gratuitously."[82] But in the nineteenth century, "waste" was as likely to involve a violation of fiduciary duties as it was an ultra vires act. For instance, *Robinson v. Smith* said directors could be held liable for "funds or property . . . lost or wasted by gross negligence and inattention to the duties of their trust."[83] Similarly, *Smith v. Hurd* dealt with an instance where the entirety of a bank's capital was "wasted and lost" as a result of "negligence and malfeasance."[84] Still, waste was a distinct conceptual category, even absent negligence; *Gilbert v. Finch* concluded the use of one company's funds to purchase another "was ultra vires, and constituted a waste of the funds."[85]

By the turn of the century, the ultra vires doctrine was in retreat, but the prohibition on gifts remained and was eventually

80. 3 SEYMOUR D. THOMPSON, COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS § 4009, at 2923 (1895); *see also* 6 WILLIAM MEADE FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 4062, at 6904 (1919) ([T]o enjoin ultra vires acts . . . it is not necessary that there shall be any intentional wrong or actual fraud on the part of the officers . . . . It is enough that the act be ultra vires.").

81. *See* Wells, *supra* note 46, at 1247.

82. 1 VICTOR MORAWETZ, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS § 423 (2d ed. 1886).

83. Robinson v. Smith, 3 Paige Ch. 222, 231 (N.Y. Ch. 1832).

84. Smith v. Hurd, 53 Mass. (12 Met.) 371, 383 (Mass. 1847).

85. Gilbert v. Finch, 66 N.E. 133, 134 (N.Y. 1903).

refashioned by courts into the doctrine of waste.[86] This revised waste doctrine primarily developed in executive compensation cases.[87] The United States Supreme Court fired the starting pistol in *Rogers v. Hill*, a case dealing with a bonus plan at American Tobacco.[88] There was no evidence of self-dealing, but the Court developed a new rule: A payment that bore "no relation to the value . . . for which it is given . . . is in reality a gift in part" and thus ultra vires.[89] In applying this new understanding in the context of compensation, courts had to integrate the new doctrine into the longstanding concern with not getting too involved in corporate decision-making. The result was an effort to "distinguish between compensation that is actually wasteful and that which is merely excessive. The former is unlawful, the latter is not."[90]

Early judicial willingness to find waste in executive pay agreements tended to track the emergence of stock options as a means of compensation.[91] When they first emerged, these new instruments were difficult, if not impossible, to value.[92] Soon, however, markets and academic finance came to better understand the valuation puzzle posed by these options.[93] As the valuation of these options became more certain, judges became more comfortable with them. This led to a return to a more deferential standard.[94]

In practice, waste seems directly analogous to fraudulent conveyance. Since the business judgment rule largely protects directors from personal liability, the only way for investors to prevent boards from wasting their equity investment—if the board is inclined to do so—or to recover their investment is to challenge the transaction itself. However, absent some clear showing of requisite intent or self-dealing, there is no way to prove fraud or a

86. *See* Wells, *supra* note 46, at 1249–50.

87. *See id.* at 1250–61.

88. Rogers v. Hill, 289 U.S. 582 (1933); *see* Victor Brudney, *Revisiting the Import of Shareholder Consent for Corporate Fiduciary Loyalty Obligations*, 25 J. CORP. L. 209, 210 n.7 (2000).

89. *Rogers*, 289 U.S. at 591.

90. McQuillen v. Nat'l Cash Reg. Co., 27 F. Supp. 639, 653 (D. Md. 1939).

91. *See* Wells, *supra* note 46, at 1256.

92. *See id.*

93. The Black-Scholes model is the great achievement here. It dates to 1968, though it was not published until 1973.

94. Indeed, courts became so deferential that Judge Friendly said that to find waste, it would not be enough for executive pay agreements to be unreasonable; they would need to be "unreasonably unreasonable." *Mutual Fund Legislation of 1967: Hearing on S. 1659 Before the S. Comm. on Banking and Currency*, 90th Cong. 1015 (1967) (statement of J. Henry J. Friendly, U.S. Court of Appeals for the Second Circuit).

breach of loyalty. What is needed is a workaround that would protect investors without targeting directors personally or imposing liability on bona fide purchasers. Waste tracks fraudulent conveyance law in imposing third-party liability only when the price is so obviously insufficient that it provides effective notice to purchasers.[95] More importantly, it tracks fraudulent conveyance as it too relies on one of the badges of fraud: inadequate compensation.[96]

Finally, the corporate waste doctrine's relationship with fraudulent conveyance provides the doctrine with a straightforward justification. When compensation is sufficiently inadequate, it places third parties on notice that the corporation is either acting "fraudulently" (giving away someone else's assets and externalizing the costs) or altruistically, effectively just making a charitable donation. If the board's intent is fraudulent, it seems evident that the transferor is acting in bad faith. If the intent is altruistic, it is waste. Thus, just as fraudulent conveyance allows courts to find constructive fraud, corporate waste is effectively a finding of constructive bad faith.

E. The Business Judgment Doctrine

An important feature of the discussion so far deals with the possibility of transaction-based remedies. When applied ex ante, these remedies have the benefit of preventing waste. Ex post, they are useful because they compensate shareholders and provide a relatively mild penalty to directors. This penalty is important because it provides a necessary incentive to improve board performance without making board service too risky for potential directors. The JMM, therefore, suggests a need to understand how courts should approach providing equitable, transaction-based relief when shareholders sue claiming that the board's business decision breached its fiduciary duties or perhaps exceeded its authority. How courts address this problem is the province of the business judgment *doctrine*, which can perhaps be best introduced via comparison with the more familiar business judgment *rule*.

95. *See* Sample v. Morgan, 914 A.2d 647, 669–70 (Del. Ch. 2007) (noting that waste is "a transaction that is on terms so disparate that no reasonable person acting in good faith could conclude the transaction was in the corporation's best interest").

96. *See* Jeffrey Sagalewicz, *The Martha Duty: Protecting Shareholders from the Criminal Behavior of Celebrity Corporate Figures*, 83 OR. L. REV. 331, 343 (2004) (noting that waste may apply when there are "excessively low sales prices for corporate assets").

1. The Rule vs. the Doctrine

The business judgment rule protects disinterested directors from personal liability for their informed, good faith decisions.[97] The rule is largely justified as necessary to get people to serve on boards at all or to keep directors from becoming too risk-averse in their decision-making once they agree to sit on boards.[98] Transaction-based remedies, however, do not target the disinterested directors personally. Thus, requests for such remedies should not trigger the rule's protections.[99]

One implication of the JMM is that unless boards are punished in some way for making bad decisions, they will approve any proffered deal in which directors get a larger payoff from attempting the deal than from passing on an opportunity. In the model, we normalized the payoff from skipping the deal to zero, so there needs to be an actual penalty that reduces directors' wealth. Strictly speaking, however, what matters is that directors are worse off having a deal blocked than they would be if they had passed on the deal. For instance, if directors received \$3 for a deal that goes through, \$2 for passing on a deal, and \$1 for accepting a deal that is blocked, then court monitoring will give boards an incentive to skip some bad deals.

What matters to the board is the relative returns from a successful deal, a blocked deal, and a declined deal. If courts' concern is to incentivize boards to make the efficient decisions (that is, the decisions designed to maximally benefit shareholders), damages are not the solution. Traditional damages link the remedial payment to the loss suffered. But since losses can be large,[100] especially for large corporations, director pay would have to be comparably massive to ensure proper incentives. This is very inefficient when the same incentives could be achieved for significantly less money.

Of course, if directors are not on the hook for significant money damages for making bad decisions, it becomes less likely that

97. *See, e.g.*, Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052–53 (Del. Ch. 1996).

98. *See id.* at 1052.

99. *See* Eisenberg, *supra* note 37 at 459–60 (arguing for different standards of review in injunction and liability settings).

100. For example, in the wake of the financial crisis, Citigroup paid \$590 million to settle shareholder claims, Bank of America settled for more than \$600 million, and Wells Fargo settled a case for \$590 million. *See* Jonathan Stempel, *Citigroup Settles Shareholder CDO Lawsuit for \$590 Million*, REUTERS (Aug. 30, 2012, 4:31 AM) https://www.reuters.com/article/us-citigroup-settlement/citigroup-settles-shareholder-cdo-lawsuit-for-590-million-idUSBRE87S0UA20120830.

anybody would pay the costs to enforce any penalties that do exist since there would be no financial incentive to do so. Since the board knows nobody will enforce the penalty, they will not respond to it. But making the penalty large enough to justify enforcement means that companies will have to pay more to directors (and more for insurance) to offset the increased risk.

Since there is almost no economically rational way to impose penalties on directors through courts, a robust business judgment rule makes a lot of sense. However, penalties are necessary; otherwise, boards will just rubberstamp deals regardless of quality. Knowing boards will not carefully monitor whether a deal is good or bad, investors will not fund the company. Everyone is worse off.

Markets offer a partial resolution to this problem because they are likely able to impose costs on directors. If directors make terrible decisions, those directors may be less likely to be asked to sit on boards in the future. The threat of future scrutiny may encourage boards to decline a set of dubious transactions. The more likely the market is to enforce this punishment and the larger the expected loss to the board, the more conservative the board will be.

From the perspective of investors, this cautionary influence is certainly better than nothing. However, boards will almost certainly still accept some bad deals, thinking the expected cost of market discipline is acceptably low to have a shot at larger compensation from completing a deal. The market may punish boards for these decisions, but investors will still suffer losses. Thus, investors often want judicial avenues available to provide transaction-based relief. Such a possibility would lower investors' risk and thus increase investment.

This type of remedy is very different from an effort to recoup damages from directors personally. As a result, we need to better understand the analysis the court must undertake when considering transaction-based remedies. That is, we need to consider the business judgment doctrine, rather than the business judgment rule.

2. Substantive Review of Transactions and Equitable Relief

While the business judgment rule protects directors from personal liability, the business judgment doctrine protects deals from equitable remedies.[101] For reasons covered extensively in the literature and alluded to above, there are good reasons for an

101. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 n.10 (Del. 1986); Hinsey IV, *supra* note 23, at 611–12.

expansive and protective business judgment rule. The business judgment doctrine, however, requires a more nuanced analysis. For one thing, though the rule generates exceptionally broad latitude for managers, it is not absolute. The rule only protects directors from personal liability for losses resulting from informed business judgments, and even then, it does not protect against waste.[102] It is not an absolute immunity. Consistent with the JMM, the doctrine will be protective in relation to the court's relative error costs. The more expensive it is—to courts, to parties, and to the economy—to wrongly block a profitable deal, the more protective the doctrine will be.

Consider the following hypothetical: a corporation transfers $10 million in government securities for $4 million in cash. If the transferee is an insider, the duty of loyalty is implicated, which entails entire fairness review.[103] Alternatively, suppose the transfer is to a third party, but the transaction leaves the corporation insolvent, bringing fraudulent conveyance law's reasonably equivalent value standard into play.[104] The situations involve identical transactions and requested remedies: both the shareholders and creditors want the court to unwind the deal. But the court applies a different standard.[105]

The JMM explains the difference by recognizing the relative costs of getting these cases wrong. If the court blocks or unwinds a transaction with an insider, the consequences are likely contained to the company and the insider. Viewing the two as a single entity for a moment, all that is required is an internal transfer of assets that does nothing to harm the company's standing in the market or its ability to do deals going forward. Courts do not simply use recission in duty of loyalty because it aptly targets the bad actor (though it does that, too); they are willing to do so because the costs of making a mistake are relatively low.

102. *See* United Food and Workers Union v. Zuckerberg, 250 A.3d 862, 879 n. 4 (2020).

103. *E.g.*, E. Norman Veasey, *Duty of Loyalty: The Criticality of Counselor's Role*, 45 BUS. LAW. 2065, 2067 (1990).

104. *E.g.*, John E. Barnes, *Don't Sound the Death Knell for Nonrecourse Lending Yet: A Proposal for Determining a Nonrecourse Lender's Standing Under the Uniform Fraudulent Conveyance Act*, 49 BUS. LAW. 669, 681 n.57 (1994).

105. We should immediately set aside any tempting moral explanation for the different treatment. There is no reason to believe that an insider has any greater moral obligation to shareholders than to creditors. Indeed, Robert Clark long ago admonished us that, in the case of insolvent companies, one must be just before being generous. Robert Charles Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 510 (1977). Transferring creditors' assets away to friends is no more just that siphoning off shareholders' assets to one's own accounts.

Contrast that with the fraudulent transfer situation. The remedy in that case is to unwind transactions between the debtor and a third party. The higher the risk that the court will void a transaction, the lower the likelihood a deal will happen in the first place. Especially since many companies work hard to emerge from insolvency, it is important to protect their reputations and ability to make deals in the marketplace. It makes sense, then, that courts apply a more relaxed standard here than in loyalty cases. It is not that there is a lower obligation; rather, it is that the cost of wrongly blocking a fraudulent transfer is likely higher than that of wrongly blocking a self-dealing transaction with an insider.

The point is sharpened when we consider waste. In the case of an insolvent company, there is a fair chance that the company will fail, and it will not pursue many deals in the future. That is, while in many cases it is very important to avoid reputational effects, in many others, it will not matter much if the company ceases to exist. In contrast, when solvent companies make deals, the finality of these deals is more important. If there is a significant risk that a court will come and unwind the transaction, parties will not be confident that their deals are final. This will chill the market. Parties will worry that a "losing" company's shareholders will sue in hopes of unwinding the transaction.[106] Accordingly, courts apply a far more forgiving standard (from the perspective of boards) to waste claims. Again, this is not because boards have any different duties or because remedies are more or less efficacious. It is because the costs of wrongly unwinding a transaction between solvent, going concerns is significantly higher than unwinding a deal involving an insolvent company.

This discussion of waste suggests an interesting test of the JMM. If the model is correct, courts will look upon claims of corporate waste differently depending upon the type of remedy sought. Corporate waste, as a doctrinal matter, is not protected by the business judgment rule.[107] That means that if a court finds waste, the directors could face personal liability. Indeed, given that recent courts have suggested waste is equivalent to bad faith,[108] the

106. Indeed, third parties may worry that boards would effectively treat a more stringent standard as an option. If courts are willing to unwind deals when the compensation is more or less reasonable, the board may think that if the deal works out, the corporation will keep the benefit of the bargain, and if the deal doesn't work, the corporation can simply fall on its sword and get the court to unwind the deal.

107. *See In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 73–74 (Del. 2006).

108. *See, e.g.*, Feuer *ex rel.* CBS Corp. v. Redstone, No. 12575-CB, 2018 WL 1870074, at *10 (Del. Ch. Apr. 19, 2018).

directors' liability might not be waived, indemnified, or insured.[109] If waste is easily proven, directors have a lot to worry about, and now the traditional defenses of the business judgment rule return with extra force. Individuals will be unwilling to serve on boards if they face the risk of financial ruin; or, if they do serve, they will be excessively cautious.

Plaintiffs seeking money damages from the directors should expect to face the full force of the business judgment rule. But for plaintiffs seeking equitable relief, things might be different. Equitable relief that targets the transaction would not pose the same threats to directors personally. Such relief would be more likely to chill the market than an analogous action in a fraudulent conveyance context, however. The JMM suggests, then, that waste-type claims seeking equitable remedies should face a standard more lenient than the business judgment rule but more stringent than the reasonably equivalent value standard. Moreover, even within this class of claims, courts could apply stricter or more tolerant standards based on the relative costs.

Consider that under *Revlon*, courts will provide substantive review of the good faith decision of an informed and disinterested board when there are competing bids for the company.[110] Yet *Revlon* does not apply the business judgment rule.[111] If the court determines that an alternative bidder provides better value, it will enjoin the board's preferred deal.[112] In such a case, the costs of blocking the deal are relatively low: the directors are not personally liable, and since the company is going to be sold, its ability to do transactions in the ordinary product market is not impaired by judicial intervention.

On the other hand, if shareholders sue ex post, the court is exceedingly unlikely to even attempt unwinding a merger. Instead, shareholders sometimes have the option of pursuing appraisals.[113] And though appraisals also involve substantive review, they require neither unwinding the deal nor holding directors

109. *See* Sandra K. Miller, Ph.D. & Yvonne L. Antonucci, Ph.D., *Default Rules and Fiduciary Duty Waivers in Alternative Entities: Policy Issues and Empirical Insights*, 42 J. CORP. L. 147, 153–56 (2016).

110. *See* Revlon, Inc v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

111. *See id.* at 185.

112. *See id.*

113. *See* DEL. CODE ANN. tit. 8, § 262 (2024).

personally liable.[114] Once again, the court only engages if the cost of getting it wrong is not too high.

Revlon is a continuation of a line of cases—some involving the potential sale of a company and others not—where even though disinterested and informed boards were operating in good faith, the court provided a substantive review of the transaction. Consider *Allied Chemical & Dye Corp. v. Steel & Tube Co. of America* in 1923.[115] In *Allied Chemical*, a minority shareholder sought a preliminary injunction against the sale of the company, alleging both fraud and that the price was too low.[116] Importantly, there was no evidence of meaningful self-dealing by any directors.[117] Chancellor Wolcott granted the preliminary injunction.[118] In his opinion, he noted that "inadequacy of price will not suffice to condemn the transaction as fraudulent, unless the inadequacy is so gross as to display itself as a badge of fraud."[119] *Allied Chemical* thus provides a clear conceptual link between directors' fiduciary duties to shareholders and the older doctrine of fraudulent conveyance, which relied on "badges of fraud." Thus, at the roots of Delaware's duty of care jurisprudence, we find the very synthesis suggested in the formal and legal theories above.

Shortly after *Allied Chemical*, Chancellor Wolcott decided *Bodell v. General Gas & Electric Corp*.[120] The plaintiffs in *Bodell* sought a preliminary injunction to prevent the issuance of new stock.[121] In that case, Chancellor Wolcott turned to a trust analogy, asserting that neither personal profit nor advantage were necessary antecedents to a successful challenge to the directors' "actions in performance of their quasi trust . . . [because t]rustees owe not alone the duty to refrain from profiting themselves at the expense of their beneficiaries. They owe the duty of saving their beneficiaries from loss."[122]

114. *See In re* Stillwater Mining Co., No. 2017-0385-JTL, 2019 WL 3943851, at *24 (Del. Ch. Aug. 21, 2019).

115. Allied Chem. & Dye Corp. v. Steel & Tube Co. of Am., 120 A. 486 (Del. Ch. 1923).

116. *See id.* at 489.

117. *See id.* at 493–94.

118. *Id.* at 497.

119. *Id.* at 494. Chancellor Wolcott goes on to say that an inadequate price will not be fraudulent if one could reasonably consider it an "honest exercise of sound judgment . . . ." *See id.*

120. Bodell v. Gen. Gas & Elec. Corp., 132 A. 442 (Del. Ch. 1926).

121. *Id.* at 444.

122. *Id.* at 447 (citations omitted); *see also* Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971, 982 n.45 (1994) (collecting additional cases on this point).

Chancellor Wolcott returned to these themes once again in *Cole v. National Cash Credit Association*.[123] *Cole*, which also dealt with a preliminary injunction, is likely the first Delaware case where gross negligence of disinterested directors was satisfactory grounds to avoid the business judgment rule. In this case, shareholders complained of the relative valuations of the two companies involved in a merger.[124] While ruling against the plaintiffs, Wolcott observed, "mere inadequacy of price will not reveal fraud. The inadequacy must be so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested."[125]

This logic carried forward into the 1970s. Consider *Gimbel v. Signal Companies, Inc.*[126] In an opinion explaining an injunction against a board-approved transaction, Chancellor Quillen observed, "[a]ctual fraud . . . is not necessary to challenge a sale of assets . . . . There are limits on the business judgment rule which fall short of intentional or inferred fraudulent misconduct and which are based simply on gross inadequacy of price."[127] Similarly, Ernest Folk observed in his famous treatise that "directors' actions are outside of the protection of the business judgment rule on finding 'fraud, actual or constructive' . . . or if the transaction is 'so manifestly unfair as to indicate fraud . . . .'"[128]

In more recent years, however, the inadequate price grounds for surmounting business judgment rule protections have been largely ignored, though there have been notable exceptions.[129] Still, the logic lurks, as do the citations. For example, consider the Delaware Supreme Court's explanation of the business judgment rule in *Cede & Co. v. Technicolor, Inc.*,[130] in which the Court said the rule "operates as both a procedural guide for litigants and a substantive rule of law."[131] In particular, the rule "creates a 'presumption that . . . the directors . . . acted . . . [with due care], in

123. Cole v. Nat'l Cash Credit Ass'n, 156 A. 183 (Del. Ch. 1931).

124. *See id.* at 187.

125. *Id.* at 188.

126. Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch. 1974).

127. *Id.* at 610.

128. ERNEST L. FOLK, III, THE DELAWARE GENERAL CORPORATION LAW: A COMMENTARY AND ANALYSIS 76 (1972) (citations omitted).

129. *See, e.g.*, *In re* Abbott Lab'ys Derivative S'holders Litig., 325 F.3d 795, 808–09 (7th Cir. 2003); *In re* Walt Disney Co. Derivative Litig., 825 A.2d 275, 286–87 (Del. Ch. 2003).

130. Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).

131. *Id.* at 360 (quoting Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (1989)).

good faith and in the honest belief that the action taken was in the best interest of the company.'"[132] Directors get the benefit of this presumption so long as there is no "evidence of 'fraud, bad faith, or self-dealing in the usual sense of personal profit or betterment.'"[133] For authority, the opinion cites to *Allaun v. Consolidated Oil Co.*[134] But in *Allaun*, the court noted that it had an obligation

> to inquire whether or not the price which the majority have decided to accept is a fair and adequate one. The answer to this question invites a study of the value which the assets may be fairly said to possess, and, having ascertained the value, a determination of the question of whether or not there is such a disparity between the price to be received and the value found as would indicate legal fraud upon the rights of the dissenting minority. It is not every disparity between price and value that will be allowed to upset a proposed sale. The disparity must be sufficiently great to indicate that it arises not so much from an honest mistake in judgment concerning the value of the assets, as from either improper motives underlying the judgment of those in whom the right to judge is vested or a reckless indifference to or a deliberate disregard of the interests of the whole body of stockholders including of course the minority.[135]

Insufficient consideration, then, has always been a plausible ground to challenge a transaction, even when directors otherwise satisfy the conditions of the business judgment rule. The threshold the court will apply, however, depends on the relative costs of judicial error. Ex-ante injunctions are far less costly in the global sense than having to unwind a deal ex post.

As expressed above, this explanation opens a possible test for the JMM. A key driver of the difference in costs between fraudulent conveyance and waste involves remedies. Unlike analogous fraudulent transfer claims, waste exposes the directors to personal liability. Putting directors' personal assets in jeopardy is significantly more dangerous from a public policy standpoint than unwinding a deal in insolvency proceedings.

But suppose that plaintiffs sought transaction-based relief instead of targeting the directors personally. The JMM would suggest that courts apply a different standard. Which standard is applied likely depends on the remedy sought. The court would be

132. *Id.* (quoting *Citron*, 569 A.2d at 64) (citations omitted).
133. *Id.* (quoting *Citron*, 569 A.2d at 64) (citations omitted).
134. Allaun v. Consol. Oil Co., 147 A. 257, 261 (Del. Ch. 1929).
135. *Id.*

far more likely to block a deal ex ante via an injunction rather than work ex post. If courts develop the practice of unwinding arms-length deals between going concerns, they will threaten the finality of all market transactions. On the other hand, if courts block corporate actions before they happen, they prevent deals from closing in the first place. This latter approach is less damaging to the market because it means that final deals are not under threat. Unfortunately, there are relatively few existing cases upon which this theory can be tested. There is, however, at least one clean example.

B. *Explaining* Kamin v. American Express

The facts in *Kamin* are relatively straightforward. American Express made an ill-advised equity investment in Donaldson, Lufken, and Jenrette, Inc. (DLJ).[136] When the price of DLJ stock crashed, the initial $29.9 million investment was worth only $4 million.[137] Under the prevailing accounting rules of the day, American Express had two options. First, it could write down the investment. If it did this, the company would recognize a one-time expense that would lower its quarterly earnings, but the loss would also lower the company's tax bill by about $8 million.[138] Alternatively, it could dividend the DLJ stock to shareholders, simply wiping the stock from the balance sheet without imposing any effects on the income statement.[139] In effect, option one saved investors $8 million in tax expense but made company leadership look bad when reporting earnings.[140] Option two forced investors to pay more in taxes (since they would have to pay them on the dividends) and required the company to give up the tax credit, but it made corporate leadership look less bad.[141] The board went with option two.[142] The court refused to impose liability on directors because there was no evidence of self-dealing and thus no loyalty violation.[143] Additionally, there was evidence that the

136. *See* Kamin v. Am. Express Co., 383 N.Y.S.2d 807, 809 (N.Y. Sup. Ct. 1976).

137. *Id.*

138. *See id.* at 809–11.

139. *See id.* at 811.

140. *See id.* at 809–10.

141. *See id.* at 809–11.

142. *See id.* at 809–10.

143. *See id.* at 810–12.

board had been informed, which gave directors business judgment rule protections.[144]

Students (and at least this professor) have long wondered at the court's decision in *Kamin* since the board's decision seemed so obviously wasteful. The JMM suggests that relative costs may answer the question. In his description of the facts, Judge Greenfield makes a curious observation about the plaintiffs' litigation choices.[145] He first observes that plaintiffs initially asked for three things: 1) a declaration that the dividend was waste; 2) a direction to the board not to distribute the shares; and in the alternative, 3) money damages.[146] However, the plaintiffs did not, as the judge notes, request a preliminary injunction to prevent the distribution or do anything else to block the dividend.[147] Accordingly, distribution went ahead and the request for the direction to not distribute was moot.[148] The court then applied the business judgment rule to deny relief on the further requests.[149]

The JMM suggests that what matters to the court is the relative costs of error. Contrast the relative costs of a preliminary injunction against post-hoc relief. A preliminary injunction is relatively simple to enforce. The company simply holds onto the shares until the court resolves the case or sells them on the market.[150] No third party has a deal in place for these shares that will be upended. The market consequences are minimal, and because directors are not personally liable for anything, concerns about chilling directors' willingness to serve on boards are largely absent.

Things are very different if, as requested by the plaintiffs, the court acts ex post. Unwinding the dividend is almost logistically impossible. The shares will likely have been sold (more than once) by the time the court could order relief. Since those sales would have been between shareholders and third parties at market prices, returning the shares to the company would require unwinding arms-length transactions undertaken at market prices. Asking the directors to personally make up the difference introduces the traditional policy concerns that animate the business judgment rule.

144. *See id.* at 811–12.

145. *See id.* at 809.

146. *See id.*

147. *See id.* at 810.

148. *See id.*

149. *See id.* at 811–12.

150. There are risks, of course. The shares might continue to fall, and if the company eventually prevailed in the litigation, the shareholders would have to sell the distributed shares for less.

In short, the costs of unwinding the deal are vastly higher than the costs of blocking the deal in the first place.

Accordingly, the JMM predicts that the court would have been more likely to grant an injunction to stop the distribution in the first place; but once the distribution was made, the court had little interest in awarding damages after the fact. Courts do not want to be in the business of disincentivizing dividends when companies are solvent. Further, the court likely had serious concern about setting a precedent where plaintiffs could try out the deal and look to damages after the fact. If the plaintiffs really wanted to stop the dividend, they could and should have asked for an injunction. They did not. Instead, they hoped to get the shares and cash. Understandably, the court was unwilling to go along with that plan.

G. The Surprising Presence of Corporate Waste Cases

While the JMM is thus broadly consistent with existing doctrine and the history of corporate law, and it even explains a difficult case like *Kamin*, the JMM has yet to fully show its predictive power. That is, while the JMM did predict that there should be an overlooked line of cases showing that courts can and should review corporate actions for insufficiency of consideration, one could suggest that those cases are old, and the JMM does not apply today. Yet for the JMM to tell us something about corporate law generally, its predictions cannot be so timebound. Thus, the JMM can be tested by looking at corporate law on the ground in recent times as well.

Recall that the JMM embeds the duties of loyalty and care within a framework that foregrounds the duty of good faith. One innovation of the model is that it shows how courts can and should intervene in instances where there is clearly a fiduciary breach, but it is unclear whether the breach is of either care or loyalty. That is, the JMM shows how courts can determine there is bad faith even if the court cannot fully explain the reasons for the breach. The model thus links bad faith and waste—exactly where Delaware corporate law is moving.[151]

The judicially recognized link between waste and bad faith is a point in favor of the explanatory power of the JMM, but it does not on its own show that the theory is consistent with the facts on the ground. The linkage is at the level of theory and doctrine, but the

151. *See, e.g.*, Bamford v. Penfold, L.P., No. 2019-0005-JTL, 2022 WL 2278867, at *47 (Del. Ch. June 24, 2022) ("Contemporary Delaware decisions have brought waste within the fiduciary framework of the business judgment rule by re-conceiving waste as a means of pleading that a fiduciary acted in bad faith.").

model also suggests that there should be actual cases where the courts have to step in. Though this means there should be a meaningful number of corporate waste cases, it is widely believed that the threshold for waste is so high—at least in Delaware—that it is impossible to imagine a company meeting it.[152] Since a waste claim is nearly impossible to imagine in theory, there is little reason to suspect it holds together in practice. Accordingly, Vice Chancellor Strine spoke of the "waste vestige" twelve times in a single opinion.[153] The late Chancellor Allen compared waste to the Loch Ness Monster (those with an interest in the story often see it, but more disinterested observers do not) and suggested it does not exist.[154] If this view correctly describes reality, it would be evidence against the JMM. But if the model is correct and there are cases predicted by theory that consensus overlooks, that would be evidence for the JMM.

As it turns out, the consensus view needs updating. Consider *Feuer ex rel. CBS Corp. v. Redstone*.[155] In that case, a stockholder sued CBS over $13 million in payments the board authorized to Sumner Redstone, the incapacitated chairman emeritus of the company, in exchange for services to be rendered.[156] Chancellor Bouchard agreed that the particularized facts met the test for waste and denied CBS's motion to dismiss.[157] This case is hardly an outlier; indeed, it is not even the only successful waste claim against CBS.[158]

In addition to the waste claim involving compensation paid to Sumner Redstone, CBS also found itself embroiled in another lawsuit involving a claim of corporate waste.[159] CBS's controlling shareholder, Shari Redstone, made several failed attempts to orchestrate a merger between CBS and Viacom.[160] The CBS board fought off each attempted merger, but Shari Redstone was undeterred.[161] In desperation, the CBS board attempted to distribute

152. *See* Wells, *supra* note 46, at 1240.

153. *See* Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 882, 897–99, 902 (Del. Ch. 1999).

154. *See* Zupnick v. Goizueta, 698 A.2d 384, 387 (Del. Ch. 1997) (citing Steiner v. Meyerson, No. 13139, 1995 WL 441999, at *5 (Del. Ch. July 19, 1995)).

155. Feuer *ex rel.* CBS Corp. v. Redstone, No. 12575-CB, 2018 WL 1870074 (Del. Ch. Apr. 19, 2018).

156. *See id.* at *1.

157. *See id.* at *16.

158. *See In re* CBS Corp. S'holder Class Action & Derivative Litig., No. 2020-0111-JRS, 2021 WL 268779, at *1 (Del. Ch. Jan. 27, 2021).

159. *Id.*

160. *See id.*

161. *See id.* at *1–*2.

a special dividend that would eliminate her control of CBS.[162] These efforts had the full support of CBS's Chief Operating Officer, Joseph Ianniello.[163]

The dividend plan failed. Seven members of the CBS board resigned, and Ms. Redstone brought on six hand-picked candidates.[164] Ianniello was installed as CEO and changed his tune, suddenly discovering the tremendous value of the proposed merger with Viacom.[165] Some CBS shareholders sued, alleging that Ianniello's change of heart may have been purchased by a $125 million compensation package.[166] This alleged quid pro quo arrangement constituted the plaintiff shareholders' case for waste against Shari Redstone and members of the CBS board.[167] While noting the extremely high bar such claims must meet, Vice Chancellor Slights nonetheless denied the defendants' motion to dismiss the waste claims.[168]

Similar examples extend well beyond CBS. In recent years, Delaware plaintiffs alleging waste have been able to beat back motions to dismiss in cases against Yahoo!,[169] Quadrant,[170] and Tesla.[171] This is, in part, because waste claims are so fact-bound;[172] they are difficult to dismiss on the pleadings.[173] Thus, even if waste never happens, it can still be alleged, which can give plaintiffs a path to discovery, judicial examination, and settlement.[174] Indeed, in looking at recent cases that involve claims of waste, more than 10% get through to discovery.[175]

162. *See id.* at *2.

163. *See id.*

164. *See id.*

165. *See id.*

166. *See id.* at *17.

167. *See id.*

168. *See id.* at *48, *54.

169. *See* Amalgamated Bank v. Yahoo! Inc., 132 A.3d 752, 784 (Del. Ch. 2016).

170. *See* Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155, 193 (Del. Ch. 2014).

171. *See In re* Tesla Motors, Inc. S'holder Litig., No. 12711-VCS, 2020 WL 553902, at *12 (Del. Ch. Feb. 4, 2020).

172. *See, e.g.*, Lewis v. Vogelstein, 699 A.2d 327, 339 (Del. Ch. 1997).

173. *See id.*

174. *See* Sample v. Morgan, 914 A.2d 647, 670 (Del. Ch. 2007) ("When pled facts support an inference of waste, judicial nostrils smell something fishy and full discovery into the background of the transaction is permitted. In the end, most transactions that actually involve waste are almost found to have been inspired by some form of conflicting self-interest.").

175. A spreadsheet containing the analysis of cases can be found at https://digitalcommons.law.byu.edu/lawreview/vol49/iss4/7.

If this were the entirety of the empirical story, documenting such a prevalence of waste claims would be compelling. Although waste claims are not extremely common, neither are they rare; they are present in some of the most high-profile corporate litigation in Delaware. Given the general view that waste claims should not exist, their very real presence demands an answer. However, the prevalence of waste litigation becomes even clearer when we look outside Delaware.

For instance, a basic Westlaw search for cases in New York reveals eleven cases in which plaintiffs defeated a motion to dismiss waste claims, two instances where plaintiffs won on summary judgment, and two more where plaintiffs were awarded judgment on waste claims.[176] These are surprisingly large numbers, but perhaps even more surprising is that the search was limited to opinions issued from January of 2020 to March of 2022.[177]

CONCLUSION

Delaware courts provide a steady diet of substantive oversight to corporate decisions. This is perhaps surprising, since courts regularly acknowledge that management has greater business knowledge and skill. As such, second-guessing by a less-informed and less-skilled judge seems like a bad idea. But courts have an important role to play. If they do not have both the power and the willingness to punish management through damages or through transaction-based equitable remedies, the constitutive bargains between shareholders and directors will fail. Thus, courts must not only provide substantive review, but they must also be willing to rattle the corporate cages and make sure management lives up to the bargain.

This Article formalizes those bargains in the Judicial Monitoring Model, which brings needed rigor and clarity to corporate fiduciary duties, a body of law that has been remarkably unstable. It shows how courts can trade off the costs of two different possible errors—wrongly blocking "good" transactions and wrongly allowing "bad" ones—to maximize public welfare.

176. *Id.*

177. The larger number of cases in New York seems to reflect a conceptual difference in waste across the two states. New York courts seem more willing to overlook business judgment rule protections. Further, New York's corporate waste jurisprudence is more closely tied to traditional fiduciary duties, whereas in Delaware, waste exists somewhat apart from the traditional analysis under loyalty or care. Still, these doctrinal differences should not be overstated. In both states, corporate waste claims allow shareholders to attack decisions that deplete corporate assets for too little, or no, return.

Thus, courts find the socially optimal solution to the moral hazard that traditionally plagues principal-agent relationships. In effect, when courts monitor, agents are more willing to invest. The equitable power of courts, and their ability to provide a fresh look at a deal, makes courts useful even if there is a robust market to separately discipline boards and keep them honest.

The JMM clarifies and emphasizes the difference between the business judgment rule and the business judgment doctrine. The former protects directors from liability, while the latter protects the underlying deal.[178] When plaintiffs seek transaction-based remedies to block or unwind deals, directors are not personally liable. This sidesteps the primary arguments for the business judgment rule, which point out that the risk of personal liability would make directors less effective or entirely unwilling to serve.[179] The JMM recognizes these risks as costs that courts incorporate into their decision-making when they act as monitors. When these risks are removed, determining that a particular decision violated fiduciary duties becomes less costly.

In sum, corporate fiduciary duties are necessary to satisfy the efficiency norm. Shareholders will invest much less if boards can steal or be grossly negligent with the shareholders' money. If boards want investors' money, they must be able to make credible commitments to work for the shareholders' good, to not steal, and to pay attention. Shareholders, however, will not simply accept cheap talk. They will need these promises to be enforceable. That is where courts enter the story.

Judges solve the moral hazard problem that would otherwise keep shareholders from investing. If courts were perfect, they could enforce the board's obligations vis-à-vis the shareholders, and this enforcement would lead to efficient investment by directors. The problem is that judges are imperfect, and they will make mistakes.[180] Not all mistakes are equal. There are different consequences for allowing boards to get away with theft or negligence than for intervening when boards did not violate their promises. Further, these different errors will have different costs in different contexts. Courts do the best they can to make sure that their mistakes do not freeze the market or leave investors too

178. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 n.10 (Del. 1986).

179. *See* Gagliardi v. TriFoods Int'l, Inc., 683 A.2d 1049, 1052 (Del. Ch. 1996).

180. *See* JULIAN VELASCO, *Fiduciary Principles in Corporate Law*, *in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 61, 62–63 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2018).

unprotected. Judges must balance the costs of error to find the proper standard of review. This is a difficult balancing act, and perhaps it explains in part why courts seem to struggle to maintain a consistent line in corporate fiduciary cases.

If courts will not enforce fiduciary duties, potential shareholders will be far less willing to invest. Fiduciary duties represent the promises boards make to shareholders to facilitate investment. But such promises are not self-enforcing; we need courts as monitors.