

ASPEN PUBLISHERS

THE
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JUDGMENT
RULE

Fiduciary Duties
of Corporate Directors

Sixth Edition
STEPHEN A. RADIN

Authors of Prior Editions

DENNIS J. BLOCK
NANCY E. BARTON
STEPHEN A. RADIN

Volume I



Wolters Kluwer
Law & Business

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AUSTIN BOSTON CHICAGO NEW YORK THE NETHERLANDS

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Printed in the United States of America

ISBN 978-0-7355-8936-0 (Vol. 1)

ISBN 978-0-7355-6089-5 (Set)

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To Leona,
Jason and Jeffrey

ABOUT THE AUTHOR



Stephen A. Radin is a member of the law firm Weil, Gotshal & Manges LLP. He has litigated, counseled, written and lectured for more than 25 years on corporate governance subjects, including the business judgment rule, fiduciary duties of corporate directors, controlling shareholder and going private transactions, special committee investigations, contests for corporate control and proxy contests, disclosure requirements, and indemnification and insurance of corporate directors. Much of Mr. Radin's practice focuses on shareholder derivative and class action litigation.

Mr. Radin is a graduate of Cornell University and Columbia Law School, where he was named a Harlan Fiske Stone Scholar. Mr. Radin is an adjunct professor at Cardozo Law School, and the chairperson of the American Bar Association Section of Litigation Committee on Corporate Counsel Subcommittee on Corporate Governance. Mr. Radin was profiled in the November 2004 edition of the *Metropolitan Corporate Counsel* and honored at a June 2005 ceremony in

the Great Hall of the Library of Congress in Washington DC with a Burton Award for Legal Achievement, given to lawyers who exhibit excellence in legal writing.

Mr. Radin has served since 2002 as a member of the Board of Directors of the New York Legal Assistance Group, a privately funded not-for-profit organization that provides civil legal assistance to low income individuals in more than 18,000 cases a year benefiting over 35,000 individuals, and tens of thousands more through successful impact litigation.

ACKNOWLEDGMENT

Legal texts, like other books, often begin with acknowledgments of assistance provided by colleagues, researchers, assistants and cite-checkers. One must write a book, however, to understand fully how much assistance is required to complete such a task and how grateful an author is for that assistance. The more than doubling of this text – from 2 to 4 volumes, 2,175 to 5,593 pages (not including tables), and 12,443 to 31,445 footnotes – in the ten years since the fifth edition of this text was completed in 1998 likewise more than doubled the need for assistance and my appreciation for everyone who provided so much help.

I am grateful to Weil Gotshal & Manges for supporting and encouraging this project, and to the many Weil Gotshal partners, associates, counsel and clients with whom I have spent 25 years counseling, litigating and gaining insights into the issues discussed in these pages. Many of you will recognize your input. I am particularly grateful to Ira M. Millstein and E. Norman Veasey for preparing forewords for this text. It is a rare privilege to work with (or even just watch) two such luminaries in the corporate governance field, and I have been privileged to do that on a daily basis. I am honored that they have attached their names to this text. I also gratefully acknowledge my former partners and mentors, Dennis J. Block and Nancy E.

Barton, with whom I collaborated on previous editions of this text before we moved on our own separate paths a decade ago.

I acknowledge with special thanks the assistance I received from Weil, Gotshal & Manges associate Christine Di Guglielmo. Christie provided invaluable research assistance, and read every page (and every footnote) of this text with the unusual care that characterizes all of her work. Weil Gotshal associates Evert J. Christensen, Jr., Kathy Le, Josh Margolin and Robert V. Spake Jr. and staff attorneys Kamran Khan and Lidija Hubana also provided valuable assistance. Weil Gotshal paralegals William Gordon (who led the paralegal team), Angela Chiarelli, Herbert Chan, Jeffrey Hausman and Leslie Phillips also helped with many of the tedious chores required to complete this project. I cannot give enough thanks to Elio Bettini, Marie Carmant, Luis Cruz, Max Greco, Brenda Pan-cham, Daniela Pugh, Yesenia Santiago and the rest of the Weil, Gotshal & Manges Library Staff.

Last, and far from least, I owe special thanks for the invaluable assistance I received from Weil Gotshal & Manges' document production center, from Jenette Pena during the years 2005 through 2007, and, since January 2008, from Kathie Cedillo. Jenette and Kathie's word processing and desktop publishing skills are second to none. They both assisted me with diligence and good cheer far beyond the call of ordinary duty. Without their assistance, I would still be writing.

Stephen A. Radin

May 2009

NOTE TO THE READER

This text includes developments in the law as of December 31, 2008. The intent is to describe the state of the law as it has developed in the courts, state legislatures, and most recently, Congress. The intent is not to describe what commentators have labeled “good” and “bad” corporate governance practices or to describe the strategies that have evolved or are evolving that have not yet been litigated in the courts or become the subject of legislation.

Throughout the text, federal court decisions are cited to the Federal Reporter, Federal Appendix, Federal Supplement or Federal Rules Decisions, and state court decisions are cited to regional reporters such as the Atlantic Reporter or Northeastern Reporter. California and New York state court decisions also are cited to the official and unofficial reporters in those jurisdictions. Any decision that cannot be cited in any of the above forms is cited to LEXIS and WESTLAW if the decision is contained in one or both of these data bases, and otherwise is cited in slip opinion or transcript form.

The views expressed in this text are the author’s views except where otherwise specifically noted. These views do not necessarily reflect the views of the author’s law firm, or the author’s or his law firm’s clients.

FOREWORD

BY IRA M. MILLSTEIN

This treatise is about the governance of the core organization of our economic system – the corporation. Understanding the elements which make the corporation the principal mechanism for organizing capital to do the work of the world, and understanding how it functions and is governed, is a critical necessity for all those responsible for the corporation carrying out its many obligations to all those dependent on it.

The corporation is man made, it didn't exist in nature. It is a creature of the law, legislative and court made, as well as the practices which have grown up around it. That "law" constitutes the bones, or structure, of the corporation. And that body of law, and the practices which surround it, weren't invented at one time and in one place; their modern form started in the United Kingdom in the 1860s and evolved in Darwinian fashion, with the needs of the times, in many legislatures and courts, both state and federal. That process will continue as our economy goes forward and backward, in bumps and starts, planned and unplanned.

Lawyers who litigate, counsel, and write about that law, scholars who teach, develop and critique that law, and courts that rule on the conduct and practices of the laymen who manage, direct, and own shares in the corporation, all look to that "law" to deal with

any issue involving the corporation. For better or worse, that law is a moving target.

My business school students are always surprised to learn that there is no statute describing and defining the business judgment rule, nor the basics of the duty of care, duty of loyalty, and the growing concept of good faith. Nor will they find the fiduciary duty of directors spelled out in legislation. Nor will a search produce one set of best practices in corporate governance, based on elaborations of the business judgment rule. Rather, as we lawyers know, our common law tradition gives us the comfort of appreciating that the case by case approach to rock solid principles is the best method of allowing for the growth and adaptability of those principles. The case by case approach has served us well in permitting the courts to evolve the ever growing contours of the Rule.

That is the story this book tells. Much of this story takes place in Delaware, because the Delaware courts have made it their business to deal with the business judgment rule and its application in a fair, impartial and sophisticated manner. The Judges who comprise the Delaware judiciary have made it clear that the business judgment rule is the foundation of Delaware corporate law, allowing for risk, and protecting disinterested, independent and informed directors who make good faith decisions. But unlike many Delaware law texts, these pages go on to discuss the many decisions outside of Delaware, where courts frequently cite and follow – but sometimes reject or alter, sometimes saying so, and sometimes not saying so – the principles announced in Delaware decisions.

The success of this treatise over the past two decades is demonstrated by its having been cited in close to 50 court decisions. It is, in fact, demand created in the best free market sense. Beyond the courts, lawyers and scholars also all need and use it. The reason is simple enough. The wisdom it provides is not static, nor is it in any form dogmatic or based on some ideology. Its strength lies in its dynamic approach to the rapidly developing law, staying current to the extent humanly possible, tracking developments as they occur, and doing this in an even handed non judgmental fashion. Just telling us all how it is.

Beginning with one volume including 344 pages of text in 1987, and virtually doubling in size every few years through successive editions, this treatise tracks the explosion of developments in the law of corporate governance, mostly in lawsuits, each involving its own specific facts, in countless factual contexts: ordinary decisions about the corporation's business (what product should we build, and in what plant?), contests for corporate control, proxy contests, transactions involving controlling shareholders, class and derivative litigation, special board committees created for general and special purposes, indemnification, D & O insurance, and more. These decisions have accepted and rejected practice "guidance" provided, assertedly based on the law, by a host of diverse cottage industry organizations, profit and not for profit. This treatise is the necessary comprehensive effort to provide us with what we need to be current and educated in this very dynamic context. It chronicles the evolution of the concepts which provide the foundation for where the law is and may go in the next "new" factual setting, and there always is one.

Indeed, this new edition is more than double the length of its most recent predecessor, and more than 10 times the length of the book's first edition in 1987. Over 1000 decisions in the last decade alone mention the business judgment rule. The tectonic events of the last decade – and that we read about in our newspapers every morning – such as Enron, WorldCom, Disney, Sarbanes-Oxley, Long Term Capital, the subprime mortgage crisis, and the implosion of some of the seemingly solid financial giants of our world – all have spawned and continue to spawn litigation and legislation. All this makes the growth of and the need for a treatise such as this one, obvious.

Why the title "The Business Judgment Rule"? Simply because it is the standard of judicial review of many facets of director conduct, and the point of comparison for those facets of director conduct which due to their nature, receive one form or another of what the courts sometimes call "enhanced scrutiny." The rule permeates every aspect of director decision making, and every aspect, therefore, of corporate governance. And since, it is my belief, as I wrote with my co-author Professor Paul MacAvoy in 2003, that there will always be a "Recurrent Crisis in Corporate

Governance,” there will always be new contours of the business judgment rule to be developed by the courts in cases yet to come.

These volumes bring all this together. Looking at the table of contents explains how the author goes about it, first describing the elements of the business judgment rule as it has developed to date, and then describing its application in the great variety of instances where director action and the governance of the corporation have been called into question. This bringing together and recitation of the law as it has developed in the cases does much to explain the steps prudent directors and their counselors will take to deal with the significantly expanded burdens directors face in today’s world.

Finally, a personal note about the author. Steve and I have worked together on corporate governance matters for more than a quarter century, beginning with the GM/Ross Perot litigations that produced the Delaware Supreme Court’s landmark decisions in *Grobow v. Perot* and *Levine v. Smith*. He has been my partner for many years, and he is someone Weil Gotshal partners and clients turn to for his scholarship and acuity. I congratulate him on a job well done.

Ira M. Millstein

Senior Partner

Weil, Gotshal & Manges LLP

Senior Associate Dean for

Corporate Governance,

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FOREWORD

BY E. NORMAN VEASEY

It is a cliché to say that a particular writing is a “must read.” Nevertheless, careful corporate practitioners—transactional lawyers, advisors, litigators, judges, and law professors—should own or have easy access to this magnificent, comprehensive, and learned treatise. I agree with the observations in Ira Millstein’s Foreword, including the fact that the law relating to corporate law and governance “is a moving target,” and that this invaluable treatise brings together and explains “the steps prudent directors and their counselors will take to deal with [their] significantly expanded burdens . . . in today’s world.”

One should understand precisely why the approach taken by Steve Radin in this monumental treatise distinguishes it favorably from the other fine works in this complex area of the law. In short, the approach is a “deep dive” into the law, its rationale, and its policy, coupled with a marvelous user-friendliness that will be a great asset for the practitioner’s research.

One begins with the proposition that the corporation law is – by its nature – a judge-made body of law. Corporate statutes are enabling only. That is, they are skeletal. It is the judges (primarily the expert Delaware judiciary) who have put flesh on the bones by applying, over the years, established legal principles to the case-by-

case mosaic of varying facts. Having served as Chief Justice of the Delaware Supreme Court for 12 years, I can confidently say that our judiciary strives in every case for clarity, predictability, appreciation of precedent, and the avoidance of unintended consequences.

Of necessity, the law is dynamic, in that new transactions and the creative ideas of practitioners are continuously evolving to challenge judges to apply settled precedent to differing (and often novel) fact situations. This latest iteration of *The Business Judgment Rule* has extraordinary depth in its treatment of the law and is organized so expertly that the reader should have no trouble zeroing in on the abundant material available to analyze the precise issue confronted by the reader.

I must eschew the temptation to go through this rich treatise and methodically point out its many virtues of depth, clarity, and organization because that is not the function of a foreword. Instead, I shall do just a bit of sampling by arbitrarily hop-scotching through a few examples.

Disinterestedness/Independence. The analysis of the fundamentals of the business judgment rule is splendid and sophisticated, particularly in Chapter I, Section D 2, which probes “disinterestedness” and “independence.” Helpfully, the author’s analysis rests cogently on Chancellor Chandler’s observation that disinterestedness and independence are “two separate and distinct issues” that are “sometimes confused.” (Pp. 103-107). With this grounding, the reader can conceptualize the specific factors impacting the determination of disinterestedness and independence. As to the independence inquiry, the treatise leads one to analyze the issue in the context of the Delaware Supreme Court’s central inquiry: “independent from whom and independent for what purpose?” (P. 102).

Delegation/Abdication. Practitioners may find an increasing number of occasions when the board’s authority to delegate is questioned and when the board may have crossed the line from delegation to abdication of its responsibility. In the context of the tensions created by the “realities of modern corporate life,” as highlighted by the Delaware Supreme